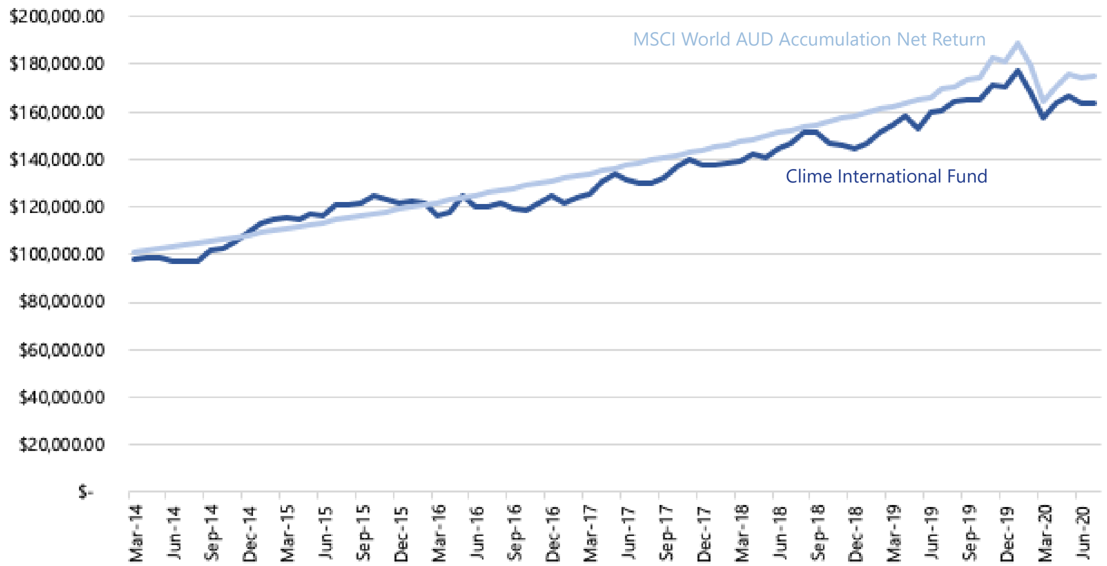
Clime International Fund

Monthly Report July 2020

The Clime International Fund (CIF) aims to provide consistent capital growth and income over the long term (5-7 years) by investing in international securities. The Fund is intended to be a medium to high-risk fund, however the ability of the Fund to hold a significant cash position allows for capital preservation and the delivery of a smoother return profile. The Fund seeks to deliver a return in excess of the MSCI World Index.

1 - Month Net Return (Wholesale)*	1 - Year Net Return (Wholesale)*	Inception p.a. Net Return (Wholesale)*	Total Fund Size
0.0%	1.7%	8.0%	$96.9m



	1 month	3 months	6 months	1 year	3 years*	5 years*	Inception*
Fund Net Return (Wholesale)*	0.0%	-0.1%	-7.8%	1.7%	8.1%	6.3%	8.0%
Benchmark^	0.6%	2.9%	-7.3%	3.1%	8.2%	8.9%	9.1%
Excess Return	-0.6%	-3.0%	-0.5%	-1.3%	-0.1%	-2.6%	-1.1%

Inception: Wholesale Units: 4 March 2014. Retail Units: 11 March 2015.
*Performance figures for more than 1 year are annualised, calculated after all applicable fees and taxes. Performance figures compare unit price to unit price for the given period.
^10%p.a. from 4 March 2014 and then MSCI World Net Total Return Index in AUD from 1 July 2019.

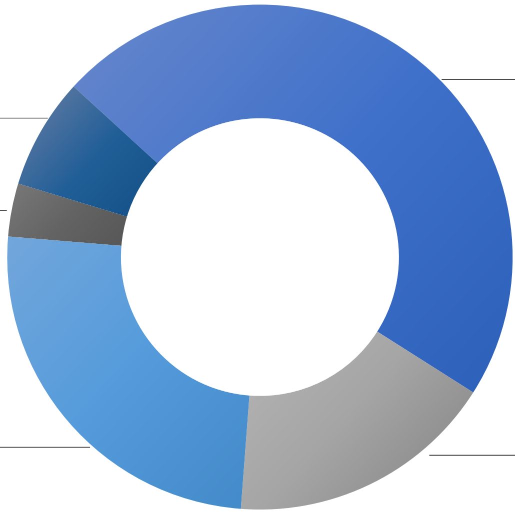
Fund Facts

Portfolio Managers	Pieter Fourie
Fund Inception	March 2014
Fund Size	$96.9m
Cash Distributions	Annually
Eligibility	Wholesale & Retail

Top 5 Holdings

Company	Sector	Weight %
Alphabet	Communications	4.9%
Facebook	Technology	4.8%
Booking Holdings	Tourism	4.5%
Johnson & Johnson	Healthcare	4.2%
Unilever PLC	Consumer Goods	4.1%

Asset Allocation



Portfolio Commentary

As the world emerges from lockdown, the full extent of the damage done to economic output and company balance sheets is yet to be fully understood. How, and when, economic growth can recover will be of extreme importance to investors. But for now, they are trusting that governments will continue to do “whatever it takes” to keep companies afloat.

The financial assistance from governments has led to equity market resilience, despite the global economy facing one of the worst recessions it has ever experienced. As investors struggle to find returns from less risky assets, such as bonds, they feel compelled to take more risk, which has resulted in equities recovering to pre-Covid levels.

Despite this optimism, the reality is that we can expect to see slower economic growth, higher unemployment, and lower profits for some time to come. Ultimately, company earnings drive returns and finding companies with a good growth outlook will become harder, which makes careful stock picking so important. Today’s high valuations rely on businesses generating good results, which makes the rise to such confident levels somewhat surprising.

Some areas of the market defined as “growth” have delivered spectacular out performance in earnings over the last three and a half years. One reason technology companies have outperformed over the medium term includes superior earnings streams. For example, the mega-cap growth stocks in the US have delivered three times the earnings of their S&P peers since the financial crisis in 2009.

The result of earnings out performance by the technology sector translated into significant out performance of the broader US index by some technology companies. In the Clime International Fund the likes of Microsoft, Google and Facebook have delivered strong returns and we are still invested, the most recent addition being Facebook which we invested in two years ago. We believe these three companies will continue to deliver superior earnings growth versus the market as a whole even though in the short term the upside is now more limited than mid-March this year.
We have made no new investments in the fund this month.

We added to our positions in Medtronic, Unilever, Novartis and Heineken this month.

We reduced our positions in RB Group, Tencent and Samsung this month.

Pieter Fourie
Portfolio Manager

Market Commentary

It seems crazy, but world sharemarkets in the three months to June completed one of their best quarters ever - for example, the S&P 500 Index was up 20% - and this during the deepest economic contraction since the Second World War. How can financial markets be so complacent while the COVID-19 pandemic continues to rage, and large sections of the global economy remain shut down?

Since late March, markets have surged back to levels that seem expensive, even as the pandemic rolls on and most companies report pretty awful profits. Of course, markets are forward-looking, so share prices have risen in anticipation of recovery.

Superficially, a number of financial markets appear inflated at present, and that includes sharemarkets and bond markets. Indeed, even precious metals like gold and silver are running hard. A number of markets seem quite divorced from economic fundamentals. On some valuation metrics, the US sharemarket is currently more expensive than it has been since the tech bubble period in 1999-2000.

But valuations have always been very sensitive to interest rates, whether the "official" short term cash rate set by central banks, or longer term Government bonds. Simply put, lower rates "across the curve" make shares look more attractive. And many investors prefer stocks because the dividends they yield are higher than either bank term deposits or fixed income securities. The ultra-low rate policies of the US Federal Reserve and other central banks have clearly acted to inflate asset prices.

Fiscal stimulus or support money from governments attempting to prop up the economic devastation of the pandemic is also finding its way into the sharemarket, further inflating prices. Stuck at home and without sport to watch or bet on, retail investors (the "Robinhood brigade") now account for 20-25% of US trades, up from about 15% a year ago.

Australia sees prices going backwards

In traditional economic models, central banks lower rates to stimulate activity when times are tough, and raise rates when inflation threatens to get out of control. The Australian Bureau of Statistics released its latest Consumer Price Index figures, which fell 1.9% in the June 2020 quarter. ABS economist Bruce Hockman said, "This was the largest quarterly fall in the 72 year history of the CPI." The annual inflation rate was -0.3% in the year to end June 2020 quarter. Since 1949, this was only the third time annual inflation has been negative. The previous times were in 1962 and 1997-98.

Returning to our traditional economic model, if there is no inflation in the system, then the central bank (in this case the RBA) can hold rates low for "as long as it takes". Importantly, this gives the Government the opportunity to borrow in the bond markets at very low rates too. And this is precisely what has occurred.

The Government has rather quickly raised the debt required to fund the forecast $167 billion increase in gross debt as outlined by the Treasurer recently. It then offered investors $15 billion in a 30-year bond issue that attracted some $38 billion in investor demand.

The debt manager for the Government, the Australian Office of Financial Management, has now sold more than $130 billion through a combination of auctions and capital markets deals since mid-March, when the pandemic prompted a surge in government spending to support the economy.

The 30-year bonds were priced to yield 1.94%. The deal size marks the third-largest Australian Government debt issue in history, and the longest outstanding Australian sovereign debt obligation. Whereas the long-term bond market was all but closed for issuers at the height of the COVID-19 crisis, long term securities are now highly sought-after.
In March, the Reserve Bank intervened in the bond market to restore its functioning and to lower borrowing costs. But unlike other central banks, it has limited its buying focus at the shorter end of the yield curve, with the aim of pinning the 3-year rate at 0.25%.

Concluding remarks

The market is constantly trying to capture every new piece of information or shift in economic sentiment, so its volatility at times suggest that economic conditions are frequently changing, unpredictable, shifting at the margin - responding to good news or bad news. Markets are forward looking. They incorporate all the known information at any point in time - but they also tend to "overshoot" when either going up or down.

Although the US market looks to have performed very well since the bottom on March 23, in fact it is really the mega-cap Tech companies that have lifted it as the pandemic has accelerated the economy's digitization. That is Apple, Microsoft, Facebook, Google, Amazon, Netflix etc; these stocks make up more than 20% of the market index. Most other sectors are flat or negative.

Traditional valuation methods do look stretched, but the market is looking past the pandemic and anticipating a sharp recovery in 2021. Also, if you adjust for the sub-1% rate of most government bonds, markets do not look as expensive.

There are some obvious risks that deserve mention apart from high valuations: geopolitical risks of worsening tension between US and China; the US election on 3 Nov and possibility of change in administration which creates uncertainty; domestic unrest in the US and the risk that President Trump will not accept an election loss; a second wave of the pandemic that necessitates longer and more strict lockdowns.

We would always emphasize the point that accurately timing markets is well-nigh impossible and attempting it is often counter-productive. Prudence suggests a sensible diversified portfolio held for the long term (5 years or more) is a preferable strategy. At present, it seems like the market is treating the pandemic for what it is, a major natural disaster that hits suddenly and then after a year or 18 months, it recedes or disappears - only it is not clear how long it will take to fully disappear. In the meantime, investors appear ready to look across the valley and try to imagine what 2021 will look like.

Adrian Ezquerro
Head of Investments