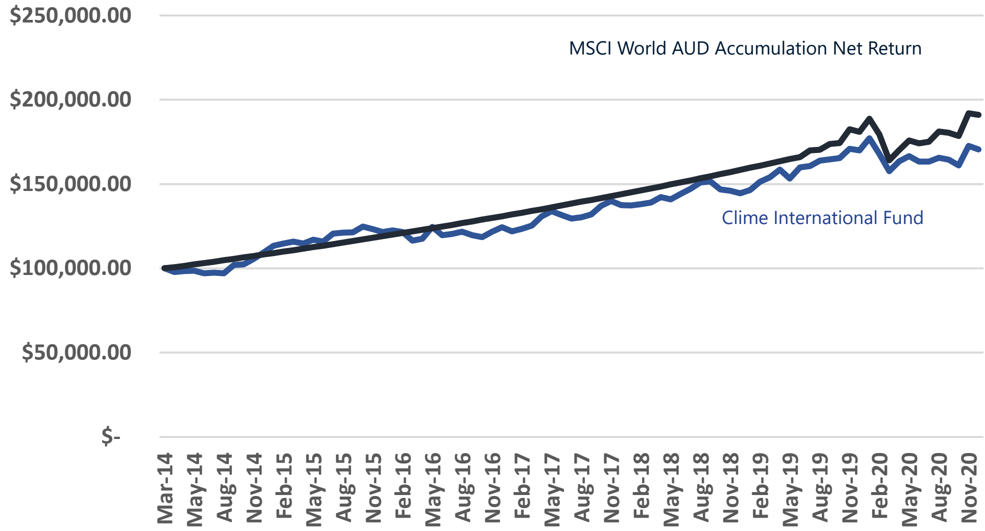
Clime International Fund

Quarterly Report December 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.

Quarter Net Return (Wholesale)*	1 - Year Net Return (Wholesale)*	Inception p.a. Net Return (Wholesale)*	Total Fund Size
3.7%	0.3%	8.1%	$96.9m



	1 month	3 months	6 months	1 year	3 years*	5 years*	Inception*
Fund Net Return (Wholesale)*	-1.2%	3.7%	4.4%	0.3%	7.4%	7.0%	8.1%
Benchmark^	-0.5%	5.9%	9.7%	5.6%	9.9%	9.9%	9.9%

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.

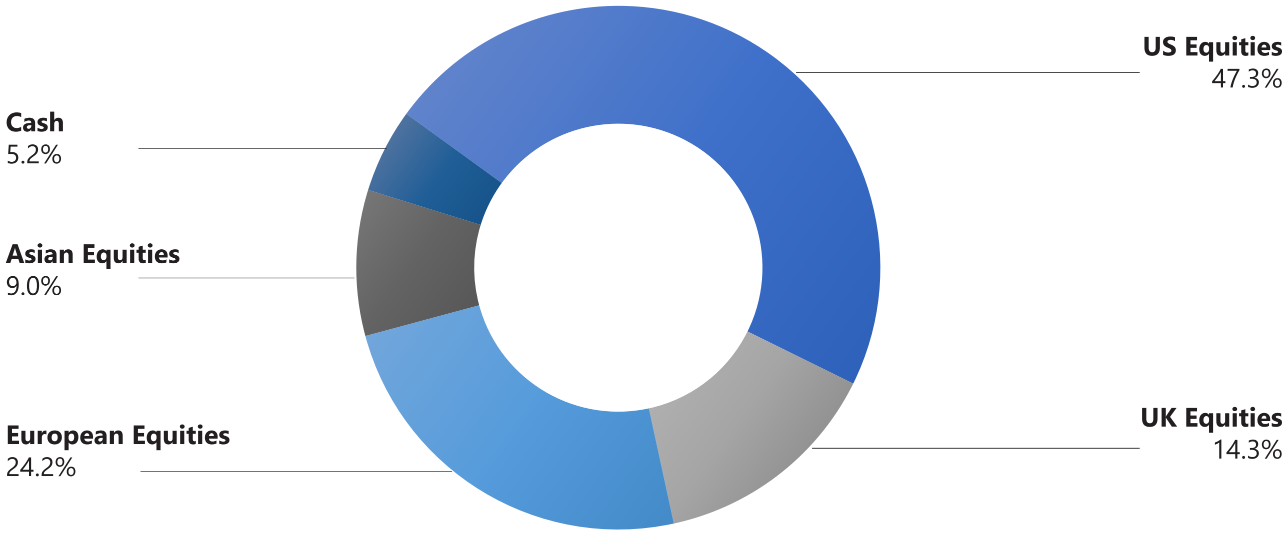
Fund Facts

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

Top 5 Holdings

Company	Weight %
Booking Holdings	4.8%
Alphabet	4.7%
Samsung	4.7%
Heineken	4.5%
Intercontinental Hotels Group	4.2%

Asset Allocation



Portfolio Commentary

A new year dawns with a heightened need for a fresh start. With 2020 now firmly behind us, we can approach this year with renewed hope and a desire to seek new and exciting opportunities. Caution will need to be exercised, but there is much to feel positive about. It would be naive to suggest that the effects of the global pandemic are in the past. But with a portfolio of vaccines on the horizon, there is light at the end of the tunnel, and from an investor's perspective that means a return to economic growth and business opportunity.

The strong recovery of global equity markets form the lows in March led to extreme differences between regional and sector performances this year. A strong rally in risk assets benefited the fund during the last two months of the year as global equity markets rallied by 17.6% in US$ from the end of October. The rally was the result of good news on a vaccine for COVID19 in early November.

Global equity markets finished the year up 16% in US$. The US contributed 12% of the 16% returns in 2020 or 75% of global equity market returns. The technology heavy NASDAQ index ended up close to 50% for the year driving global equity markets higher. The UK was the biggest drag on global equity markets as Brexit worries persisted. Continental European equity markets were clear laggards this year (+6%) yet Japan was surprisingly strong returning more than 15% in US$.

We have not owned any Japanese names since fund launch even though the Japanese market represents 1/12th of the world's market capitalisation. Emerging markets finished up 18% in US$ for the year and benefited investments like Samsung and Tencent which were our top performers in 2020.

In Europe we invested in new names like SAP, Heineken and Novartis when valuations became very compelling earlier in the year. We have carefully analysed these businesses and were patient for our chance to invest when markets panicked in March. One should note though that our decision to invest in these names was not based on a view that "Europe is cheap" but purely on bottom up analysis of these multinational businesses.

Without exposure to technology stocks an investor would have struggled to outperform the market over the last 5 years. Our exposure to the technology and communications sectors represents close to 30% of the fund's overall exposure. It is important to be selective though and we did sell Cognizant and Accenture this year as technology stocks became more expensive. We also invested in some new technology related names like Electronic Arts which ended up performing well for us in a short period of time.

The concentration risk in global equity markets has reached new levels as a few names dominate short term returns. 1/6th of global equity market returns since fund launch nearly 7 years ago came from Apple, Microsoft, Amazon, Google and Facebook. We aim to invest in high quality companies but only when the valuations are attractive. It is important for us to invest with a long term objective of holding on to superior businesses. Microsoft, Yum Brands, Johnson & Johnson and Oracle have been in the fund since inception. Over the last 3 years these 5 names contributed almost 30% percent of total equity market returns illustrating how concentration risk keeps increasing.

Investing in new high quality businesses like Anthem, AbbVie, Novartis, Becton Dickinson, Alibaba, SAP and Electronic Arts in 2020 protect the fund against concentration risk whilst maintaining exposure to long term secular growth industries. We view industries like healthcare, ecommerce, cloud computing and online gaming as secular growth opportunities which will outperform other slower growth industries or industries ones in terminal decline.

We have shifted out of stocks with excessively high valuations into stocks with more realistic valuations this year. Investing in Anthem, AbbVie, Novartis, Becton Dickinson, Alibaba, SAP and Electronic Arts are testament to our adherence to:

- Investing in high quality businesses
- Maintaining valuation discipline by not overpaying
- Hold on to these businesses with preferably a multiyear time horizon

As a consequence of our actions our portfolio has become more attractively priced versus a year ago.
Diageo, Heineken and Accenture are excellent businesses but they are expensive hence our decision to sell them. Most "pure growth" portfolios have become more expensive during the pandemic.

This may be unsustainable for investors only focused on growth and not adhering to valuation discipline but only time will tell if valuation still matters.

During December we reduced our position in Samsung, and added to our positions in Roche, Novartis and Alibaba.

Pieter Fourie
Portfolio Manager

Market Commentary

Calendar 2020 was the year everyone wanted to see end. The pandemic has been the defining event that we will remember our entire lives – not just because it supposedly "came out of nowhere", but because it shook our confidence and proved to us that life is full of surprises and that nothing, least of all our prosperity and comfort, should be taken for granted.

The pandemic closed down large segments of the global economy, confined many of us to our homes for weeks or even months on end, saw the disappearance of immigrants, tourists, and overseas students from Australian shores, and caused unemployment to rocket and economic activity and financial markets to collapse.

The pandemic is likely to leave longer term scars with a setback to globalisation, more social tensions, bigger government and public debt, massive money printing (risking higher inflation), faster embrace of technology, and more consumer caution. In Australia, we will see lower population growth (at least for the next year or two), and have already experienced growing tensions with our largest trade partner, China.

While share markets plunged in March in the early stages of the pandemic, they then progressively rebounded over the next three quarters thanks to massive fiscal stimulus and limited economic re-openings, low interest rates and bond yields that made shares look comparatively cheap. In the last two months, good news on vaccines has enabled investors to look forward to recovery in 2021.

For those investors who stayed the course from the beginning of the year, there were double-digit gains from US and global equities and solid returns from bond markets. The US benchmark S&P 500 index gained 16% while the MSCI World index was up 14%. The Australian ASX 200 Index had a flat annual return, held back by greater exposure to cyclical sectors. Japanese and European markets also generally underperformed.

Government bonds had reasonable returns as yields fell in response to central bank rate cuts and bond buying along with safe haven demand. The Bloomberg Barclays Global Bond index showed total returns for the year of 9%. Government bond purchases have anchored long term interest rates at extremely low levels and this will probably continue during 2021, albeit at a reduced pace.

Real estate investment trusts had negative returns as a result of the hit to property space demand and rents. It was a similar story for unlisted commercial property and infrastructure, although industrial property generally did well.

Australian house prices rose 3% over the year, defying forecasts that housing could lose 10-15% of its value because of the pandemic. As the virus spread across Australia in March and April, residential property sales as measured by volumes fell 40%, causing prices to dip. A surge in buying activity in the fourth quarter bolstered by record low mortgage rates caused a rebound in prices, particularly outside the capital cities, with regional home values rising 6.9% in the 12 months to end December.

The strength of Australia's property prices has been mirrored across other developed economies, with UK house prices rising 7% in 2020 and New Zealand enjoying even faster growth. The trajectory of prices is important for Australia's economy, both for the health of the big banks and for sustaining consumer confidence during recovery. It is also of great importance during a time when the rate of household debt to income is above 200%.

Cash and bank term deposit returns were poor as the RBA cut the cash rate to just 0.1%.

After a pandemic-driven plunge to $US0.55 in March, the $A rose reflecting higher commodity prices and a falling $US.

2021 – Time for Recovery

Just as 2020 was dominated by the pandemic and this determined the relative performance of investment markets, 2021 will be dominated by the recovery. There are reasons for optimism. First, massive fiscal and monetary stimulus is feeding through economies with high savings rates indicating pent up demand that can be spent once confidence improves, and which will help offset the winding down of support measures (like JobKeeper in Australia).

Second, the news on vaccines is positive. While uncertainties remain, by end 2021 or early 2022 there is a good chance the developed world will be approaching a degree of herd immunity.

Third, new US president Joe Biden should usher in a period of more stable and expert-based policy making in the world's biggest economy. In particular, it will likely head off a return to trade wars that could have wreaked havoc in 2021. A more diplomatic US approach to resolving differences with China could also help Australia move down a path to resolving its own differences with China.

Fourth, Australia navigated 2020 remarkably well, controlling coronavirus far better than most comparable countries and seeing its politicians and institutions working well together. It also led to limited structural reforms that may help future growth (for example, property tax reform in NSW).

The combination of vaccines, policy stimulus and pent up demand is expected to see a strong cyclical rebound in global GDP of around 5% (and 4.5% in Australia) in 2021. This is likely to see strong double-digit rebounds in corporate profit growth.

Inflation is likely to remain weak, reflecting still high levels of spare capacity which in turn means interest rates will remain low. While this is not good for those relying on bank interest, it benefits the household sector as a whole (with debt exceeding bank deposits), eases the servicing of high public debt levels and makes shares look relatively inexpensive. Thus we remain in the sweet spot of the investment cycle with improving growth but very low interest rates. In Australia, the cash rate is expected to end 2021 at 0.1% but there is still a chance of further quantitative easing.

Implications for investors

Shares are at risk of short term correction after having rallied sharply from their March lows and 2021 is likely to see a few rough patches along the way. Looking through the noise, the combination of improving global growth and low interest rates augurs well for growth assets. We are likely to see a continuing shift in performance away from investments that benefited from the pandemic and lockdowns - like US shares, technology and health care stocks and bonds - to investments that will benefit from recovery, such as resources, industrials, financials, and tourism.

In a global context, Australian shares are likely to be relative outperformers because we have: 1) less Covid scarring; 2) more fiscal and monetary "dry powder" than most; 3) faster future population growth (when migrants return in 2022); 4) corporate Australia is in generally good health; 5) commodity prices are rising sharply ; 6) the financial sector is strongly capitalised and well regulated; 7) cyclical global recovery favours our materials and financials-heavy index; 8) a strengthening AUD is usually positive for foreign investor flow; 9) Australia has a well-regarded, stable government with a AAA credit rating; and 10) we are well served by a responsible and supportive RBA.

Investors will likely continue to search for income yield, benefiting the share market as dividends are increased resulting in better-than 4% grossed up dividend yield.

Cash and bank deposits are likely to provide very poor returns, given the ultra-low cash rate of just 0.1%.
Although the $A is vulnerable to bouts of uncertainty about coronavirus and China tensions, a rising trend is helped by rising commodity prices and a cyclical decline in the US dollar.

All prognoses about the future are inherently somewhat speculative and based on assumptions. For example, we expect the various vaccines to be effective in combating the pandemic and a return to relative normality by late 2021. We also expect that some incipient signs of re-emerging inflation will remain sporadic and frail, allowing central banks to maintain monetary support for global reflation. If inflation materialises in a more sustained way than expected, markets will react negatively.
Another factor to consider is whether share prices have already priced-in the recovery. In other words, have markets borrowed heavily from 2021 returns? Global and US share markets have already recorded two consecutive years of double digit gains and history suggests that a string of three straight years of double digit gains is unusual.
The answer probably rests with the scale of an anticipated corporate earnings recovery. Looking at the US market, which remains the global bellwether, the current consensus estimate for bottom-up earnings per share for the S&P 500 for the 2021 calendar year is $169.20, which is an increase of 21.7% from 2020. That would mean a record high EPS for the benchmark and would come after an earnings decline of 13.8% in 2020. Fundamental measures for the Australian market suggest our market is similarly pricey when considered against historical patterns.

China

With the US and Europe facing difficult winters as vaccines roll out, China will continue to lead the global economic recovery in the interim. As the first economy both to succumb to the virus and to bring it under control, China has already completed its recovery phase and entered into a new period of growth.

It has been unfortunate to see the deterioration of China - Australia political relations, with the consequent trade and sanction outcomes. China remains our largest trading partner by a wide margin, notwithstanding recent ructions in the relationship: it represents an extraordinary 48% of Australia's two-way trade with the world and so this relationship is vitally important. Fortunately, China's appetite for Australian iron ore is not capable of being easily replaced, and high prices for that commodity are delivering a vital windfall to our economy at a time we really need it. China has few alternatives as it seeks to stimulate its economy through infrastructure investment, with Australia accounting for more than half of iron ore shipments globally. If Beijing were to try to purchase solely from non-Australian producers, at best it could get around 55% of the volumes it typically imports.

Concluding comments

It looks increasingly promising for vaccines and herd immunity to suppress the virus. The Federal Reserve, the RBA and other central banks are likely to remain accommodative on monetary policy, keeping short-term interest rates low throughout 2021. With gradual economic re-opening and slow return to normality, we anticipate a favourable backdrop for economic recovery. This will prove supportive for the reflation of growth and risk assets in 2021.

A strong recovery in global growth will provide a boost to cyclical assets, including commodities and cyclical goods sectors (examples are discretionary consumer markets, housing, tourism, travel, leisure, etc). However, the path may be volatile as the market balances occasional growth hiccups with a forward outlook that is more supportive. The most concerning issue is probably that starting valuations are already somewhat full. That said, the market is large enough that there remain many excellent companies that offer an attractive mix of high quality, growth optionality and solid fundamental value that we can purchase at favourable prices.

Adrian Ezquerro
Head of Investments