

# FIRETRAIL ABSOLUTE RETURN FUND

MONTHLY REPORT | AUGUST 2022

## PERFORMANCE (AFTER FEES)

	Month	Quarter	6 Months	1 Year	2 Years p.a.	3 Years p.a.	Fund inception p.a. <sup>2</sup>	5 Years p.a.	Strategy inception p.a. <sup>4</sup>
Fund <sup>1</sup>	(2.01%)	(10.36%)	(16.03%)	(14.84%)	(3.26%)	2.62%	1.19%	-	-
Strategy composite <sup>3</sup>	(2.01%)	(10.36%)	(16.03%)	(14.84%)	(3.26%)	2.62%	-	2.10%	7.90%
Benchmark	0.15%	0.32%	0.37%	0.41%	0.27%	0.36%	0.71%	0.78%	1.05%
Excess Return	<b>-2.16%</b>	<b>-10.68%</b>	<b>-16.40%</b>	<b>-15.25%</b>	<b>-3.53%</b>	<b>+2.26%</b>	<b>+0.48%</b>	<b>+1.32%</b>	<b>+6.85%</b>

## ABOUT FIRETRAIL

Firetrail is an investment management boutique which is majority owned by the Firetrail investment team. Additionally, the investment team is invested alongside clients in the investment strategies.

## ABSOLUTE RETURN FUND

The Absolute Return Fund ("Fund") is a market neutral strategy with minimal correlation to equity market direction. It aims to generate positive returns in all market environments. The strategy is built on fundamental, deep dive research guided by the philosophy that 'every company has a price'.

## INVESTMENT OBJECTIVE

The Fund aims to outperform the RBA Cash Rate over the medium to long term.

## PORTFOLIO POSITIONING

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Top 3 Overweight Holdings (Alphabetical)
Australia & New Zealand Banking Group Ltd
Newcrest Mining Ltd
Santos Ltd

## FUND DETAILS

Unit Prices	31 August 2022
Application price	\$ 1.0374
Redemption Price	\$ 1.0302
NAV Price	\$ 1.0338
Fund Details	
APIR Code	WHT5134AU
Benchmark	RBA Cash Rate
Inception date	14 March 2018
Fund size	\$333mil
Management fee*	1.50% p.a.
Performance fee*	20% of outperformance above an annual Hurdle

\*Please read the Product Disclosure Statement for more details

## FUND EXPOSURE

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	Portfolio Exposure
Long Equity	185.1%
Short Equity	-184.4%
Net Equity Exposure	0.8%

Past performance is not a reliable indicator of future performance.

The Product Disclosure Statement ('PDS') and Target Market Determination ('TMD') of the Fund are available at <https://firetrail.com/firetrail-absolute-return-fund/>.

1. Firetrail Absolute Return Fund ('Fund'). Net Fund returns are calculated based on exit price with distributions reinvested, after ongoing fees and expenses but excluding taxation. 2. Fund inception is 14 March 2018. 3. The Fund has been operating since 14 March 2018. To give a longer-term view of our performance for this asset class, we have also shown returns for the Firetrail Absolute Return Strategy Composite ('Strategy') which has been operating since 30 June 2015. Strategy performance has been calculated using the monthly returns (after fees) of the Fund from 14 March 2018 to current date, as well as the monthly returns of the Macquarie Pure Alpha Fund (after fees) between 30 June 2015 to 23 November 2017. The Fund employs the same strategy as was used by the same investment team that managed the Macquarie Pure Alpha Fund as at 23 November 2017. Firetrail has records that document and support the performance achieved as the Macquarie Pure Alpha Fund. The composite returns for the Strategy and the RBA Cash Rate (Benchmark) exclude returns between 24 November 2017 and 13 March 2018. During this period the investment team did not manage the Strategy. As such, the annualised performance periods stated are inclusive of the combined composite monthly returns, and do not include the period when the team were not managing the Strategy. For example, the annualised return over 3 years for the Strategy and benchmark are inclusive of 36 monthly performance periods available in the composite return period, excluding the period between 23 November 2017 and 13 March 2018. For additional information regarding the performance please contact us through the link on our website. Net Fund returns are in AUD terms. Net Fund returns are calculated based on exit price with distributions reinvested, after ongoing fees and expenses but excluding taxation. Past performance is for illustrative purposes only and is not indicative of future performance. 4. Strategy inception 30 June 2015.

## PORTFOLIO COMMENTARY

The Fund returned negative 2.01% for the month ending 31 August 2022, underperforming the RBA Cash Rate benchmark by 2.16%.

The major driver of negative performance was the portfolio's exposure to small companies. Stock selection continues to play a key role in the performance of the fund.

Our objective is to deliver positive returns over the medium term (rolling 3-years), irrespective of equity market direction. Whilst the underperformance over the past 12-months has been difficult, some of our strongest performance periods have followed challenging performance periods, and we have high conviction in our long and short portfolio positioning to deliver on our medium-term objectives.

## CONTRIBUTORS TO RETURNS

Our small company positions detracted from portfolio performance, which was partly offset by outperformance of our high conviction large cap companies. The short portfolio also detracted from performance in the month, driven by short positions in global technology and lithium names.

Overall, we believe that the Fund remains well balanced in terms of its thematic exposure. We continue to see companies exposed to the energy complex providing greater opportunities overall, particularly given the current inflationary backdrop and medium-term supply constraints. This is reflected in the Fund's value tilt over more yield sensitive bond proxies and growth sectors.

## NEGATIVE CONTRIBUTORS

### Megaport

Megaport underperformed over the month despite reporting FY22 results that were pre-announced in July. We saw incremental earnings downgrades due to wage inflation and higher marketing costs for FY23. Pleasingly, the cash balance is forecasted to trough in 1H24, leaving Megaport with ample headroom to reach cashflow breakeven from 2H24.

### ResMed

ResMed reported June quarter revenues and earnings in line with consensus, however the share price underperformed following a strong run during July. US device revenues grew 11% in the quarter and the CEO continued to guide to further sequential revenue improvement in each quarter of FY23 as supply chain pressures begin to ease.

### Pact Group

Pact Group shares underperformed after reporting FY22 results at the low end of guidance. Guidance for FY23 will be skewed to the second half of the year due to inflationary pressures in the 1H. Pleasingly, net debt was lower than expected at FY22 end. Following a challenging period for Pact, we expect the operating environment to begin to improve from 2H23 driven by better cost recovery and a moderating inflationary backdrop.

## POSITIVE CONTRIBUTORS

### Mineral Resources

Mineral Resources shares outperformed in August. Global lithium names were buoyed by the passing of the US' Inflation Reduction Act (IRA). The IRA will provide a subsidy of up to \$7,500 for every electric vehicle produced in the US. Mineral Resources also delivered a solid FY22 result through August, providing positive details around its Onslow iron ore project that were better than market expectations.

### Incitec Pivot

Incitec Pivot shares outperformed in August following a stronger outlook for fertiliser prices. This was driven by higher gas prices which are a major input into production of fertiliser products. Gas prices increased globally led by a 25% increase in Europe. Incitec stands to benefit from the higher input cost backdrop given its exposure to fixed price gas in Australia and low-priced Henry Hub gas in North America.

### Qantas Airways

Qantas Airways shares outperformed during the month driven by a strong FY22 result and material upgrade to earnings expectations in FY23. We were also pleased by cost performance and how the Qantas balance sheet ended the period. Net debt is back within the target range, with the balance sheet also now fully recovered, as evidenced by the \$400m on-market buyback announced for FY23.

## PORTFOLIO POSITIONING

The Firetrail Absolute Return Fund is a market neutral portfolio (long/short) with zero net market exposure and beta (+/- 0.1) to ensure Fund performance is uncorrelated to equity market direction. The Fund is designed to provide portfolio protection during equity market drawdowns and major dislocations. Although the Fund will not provide positive returns in every equity drawdown, since strategy inception in July 2015, we have observed 30 monthly equity market drawdowns, with the ASX 200 falling 3% on average during these periods. Pleasingly, the Firetrail Absolute Return Fund has delivered an average return of +0.77% (after fees) during these negative monthly periods\*.

The Fund is driven by our best long and short ideas. We continue to remain overweight value over growth, reflected mainly through our exposure to energy and select cyclicals where we see attractive supply and demand dynamics and company fundamentals. Overall, the portfolio is positioned as follows:

### The long portfolio can be summarised as:

- 185.1% long exposure across 40 to 60 stocks with upside based on our medium-term forecasts.
- Overweight energy, gold and select global growth with attractive supply and demand dynamics and company fundamentals.
- Overweight value / cyclicals which remain undervalued with underappreciated medium-term earnings.

### The short portfolio can be summarised as:

- 184.4% short exposure across a diversified portfolio of earnings shorts and risk-reducing shorts.
- Earnings shorts aim to profit from falling share prices because of earnings downgrades. The current market environment is creating heightened shorting opportunities as companies deal with supply chain issues, rising costs, and changing consumer preferences.
- Risk-reducing shorts offset equity exposure risks and control portfolio risks such as style (value/growth), size, sector, and thematic biases to ensure returns are driven by stock specific risk (not macro risk).
- The short portfolio is currently overweight expensive consumer staples and bond proxies.

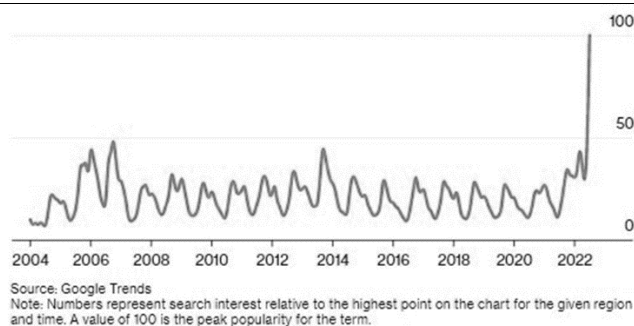
## ONE INTERESTING THING THAT HAPPENED THIS MONTH...

With a cold winter approaching, Germans are understandably anxious about securing enough natural gas to keep them warm through the season. Russia, who have historically provided over half of Germany's natural gas, did not cool any nerves in early September after announcing another shutdown of the critical Nord Stream 1 gas pipeline. As highlighted in Figure 1 below, Germans are now turning to a familiar alternative as a result. Firewood.

Supply issues resulting from the Russia/Ukraine crisis have caused EU natural gas prices to soar in 2022. In August, prices reached an eye-watering €334 per megawatt hour, over 7 times August 2021 prices of around €45/mWh.

The Absolute Return Fund is overweight beneficiaries of higher gas prices, such as Santos (Australia's largest supplier of natural gas) and Incitec Pivot (a fertiliser producer who benefits from fixed price gas contracts).

**Figure 1:** Google searches for 'firewood' in Germany have exploded in 2022 as the country braces for natural gas shortages



\* Past performance is for illustrative purposes only and is not indicative of future performance.

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Links to the Product Disclosure Statement: [WHT5134AU](#)

Links to the Target Market Determination: [WHT5134AU](#)

For historic TMD's please contact Pinnacle client service Phone 1300 010 311 or Email [service@pinnacleinvestment.com](mailto:service@pinnacleinvestment.com)

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