

FIRETRAIL ABSOLUTE RETURN FUND

MONTHLY REPORT | OCTOBER 2022

PERFORMANCE (AFTER FEES)¹

	Month	Quarter	6 Months	1 Year	2 Years p.a.	3 Years p.a.	Fund inception p.a. ³	5 Years p.a.	7 Years p.a.	Strategy inception p.a. ⁵
Fund ²	(2.36%)	(3.21%)	(12.02%)	(19.81%)	(4.91%)	2.73%	0.88%	-	-	-
Strategy composite ⁴	(2.36%)	(3.21%)	(12.02%)	(19.81%)	(4.91%)	2.73%	-	0.46%	7.83%	7.52%
Benchmark	0.22%	0.55%	0.75%	0.80%	0.45%	0.44%	0.77%	0.81%	1.07%	1.08%
Excess Return	-2.58%	-3.76%	-12.76%	-20.61%	-5.36%	+2.28%	+0.11%	-0.34%	+6.77%	+6.44%

1. Past performance is not a reliable indicator of future performance.

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 (after fees).

PORTFOLIO POSITIONING

31 OCTOBER 2022

Top 3 Overweight Holdings (Alphabetical)
Newcrest Mining Ltd
ResMed Inc
Santos Ltd

FUND DETAILS

Unit Prices	31 October 2022
Application Price	\$ 1.0248
Redemption Price	\$ 1.0176
NAV Price	\$ 1.0212
Fund Details	
APIR Code	WHT5134AU
Benchmark	RBA Cash Rate
Inception Date	14 March 2018
Risk/Return Profile	High
Fund Size	\$317mil
Management Fee*	1.28% p.a.
Performance Fee*	20% of outperformance above an annual Hurdle

*Please read the Product Disclosure Statement for more details

FUND EXPOSURE

31 OCTOBER 2022

	Portfolio Exposure
Long Equity	193.4%
Short Equity	-193.5%
Net Equity Exposure	-0.1%

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/>.

2. 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. 3. Fund inception is 14 March 2018. 4. 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. 5. Strategy inception 30 June 2015.

PORTFOLIO COMMENTARY

The Fund returned negative 2.36% (after fees) for the month ending 31 October 2022, underperforming the RBA Cash Rate benchmark by 2.58%.

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 large cap company positions detracted from portfolio performance through October, which was partly offset by outperformance of our smaller cap company exposures. Key positive contributors included long positions in Telix Pharmaceuticals, Estia Health and Santos. Detractors included long positions in Megaport, ResMed and Reliance Worldwide.

The short portfolio detracted from performance in the month, driven by short positions in consumer discretionary and REIT stocks.

NEGATIVE CONTRIBUTORS

Megaport

Network-as-a-service provider Megaport underperformed in October after reporting a weaker than expected quarterly result. The company also increased capital expenditure guidance by ~25% due to foreign exchange moves and continued supply chain challenges. On a positive note, the company sold a record 22 MVEs (Megaport Virtual Edges) during the quarter and grew recurring revenue by ~36% year on year.

ResMed

ResMed shares underperformed following weaker than expected sales in its Rest of World division during the September quarter. The weaker ROW result was offset by much stronger sales in the US. However, market expectations were elevated leading into the result.

Reliance Worldwide

Reliance Worldwide underperformed after reporting September quarter results that were lower than market expectations. This was due to lower-than-expected operating margins that were impacted by a softening in US volumes and higher input costs. While we expect sequential improvement in margins through the remainder of FY23, consensus profit estimates fell 10% due to the result.

POSITIVE CONTRIBUTORS

Telix Pharmaceuticals

Telix Pharmaceuticals outperformed in October following a strong quarterly update. Sales of its prostate cancer diagnostic Illucix beat analyst expectations by 20%. There was also a material improvement in cash burn from -\$25 million in Q2 to -\$5 million in Q3, reflecting Telix's shift to a commercial stage pharmaceutical company.

Santos

Santos shares outperformed in October on the back of strength in the oil price. OPEC agreed to cut production by two million barrels per day during the month in response to a weakening demand outlook. The company also reported a quarterly result which was in line with expectations, with only minor tweaks to 2022 guidance measures.

Estia Health

Shares in aged care provider Estia Health outperformed in October. The company announced the acquisition of four residential aged care homes from Premier Health Care. The homes add 409 beds to Estia's total of over 6,100 beds. The deal is expected to be earnings accretive and fully funded from cash and debt. The deal reflects the disconnect between the cost to build a bed (\$400k) and the cost to acquire a bed (\$260k). We believe the acquisition was a prudent move by Estia. We anticipate a supply crunch as aged care operators with poor quality assets exit the industry while demand for beds continues to build.

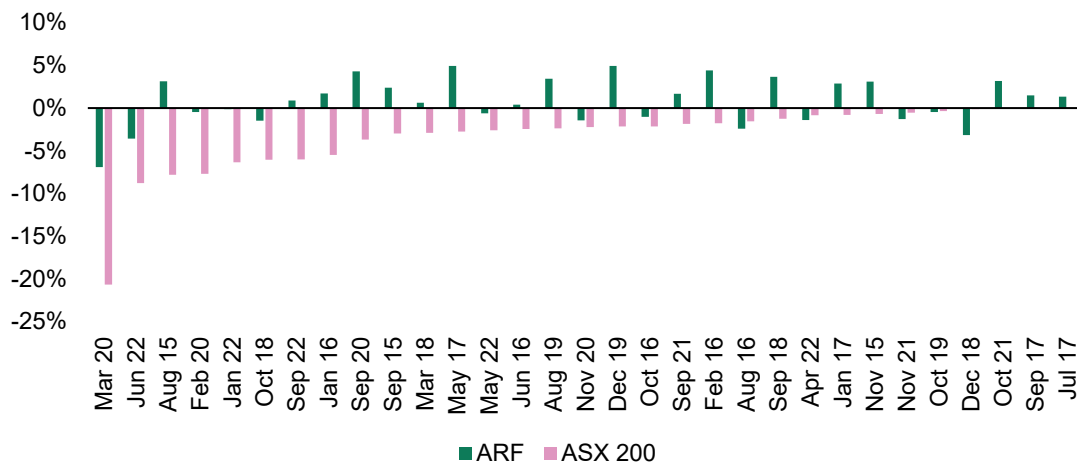
PORTFOLIO POSITIONING

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. Historically, the strategy has provided good diversification from negative monthly equity market returns. Figure 1 below shows every negative ASX 200 market return since Strategy inception in 2015 in pink, from largest to smallest drawdown. The bars in green show the corresponding return of the Firetrail Absolute Return Strategy.

Historically, when the ASX 200 monthly return was negative, the Firetrail Absolute Return Strategy has delivered a positive return 58% of the time. On average, the Strategy delivered a positive return of +0.78% vs the ASX 200 average monthly drawdown of -3.38%, providing good diversification during monthly market drawdowns.

Figure 1: Firetrail Absolute Return Strategy performance (after fees) in negative markets since inception (30 June 2015). The Fund delivered a positive return in 58% of negative ASX 200 months



Source: Firetrail, Morningstar, November 2022
Past performance is not a guarantee of future returns.

Overall, we believe that the Fund remains well balanced in terms of its thematic exposure. We continue to see companies exposed to energy and the decarbonisation complex providing greater opportunities over the medium term, 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.

The long portfolio can be summarised as:

- 193.4% long exposure across 40 to 60 stocks with upside based on our medium-term forecasts.
- Overweight Energy, Gold, Rate-Sensitive Financials, and high-quality Growth companies that we believe have been oversold in recent market volatility
- Overweight value / cyclicals which remain undervalued with underappreciated medium-term earnings.

The short portfolio can be summarised as:

- 193.5% 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 Bond Proxies, Consumer Staples, and Consumer Cyclical where we see material earnings risks and elevated expectations.

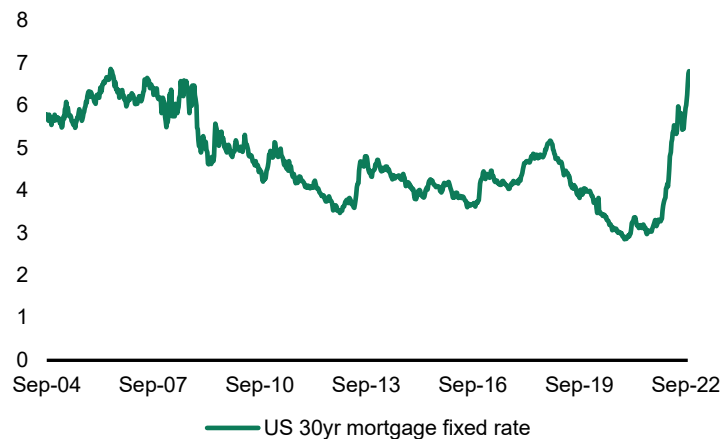
ONE INTERESTING THING THAT HAPPENED THIS MONTH...

Interest rates on new US mortgages have risen rapidly this year with the US Federal Reserve taking serious action to tackle 40-year high inflation.

Fortunately for US homeowners, over 80% of mortgages are on a fixed rate locked in for up to 30 years. Homeowners have benefited from locking in the very low rates on offer during the COVID pandemic. The situation is different in Australia, where over 80% of mortgages are on variable interest rates. Australian homeowners are likely to feel the impact from rising rates much sooner than their counterparts in the US.

Unfortunately for US first home buyers and existing mortgage holders who need to refinance, long-term mortgage rates are now close to 7%, the highest rate we've seen in 20 years!

Figure 2: US 30-year mortgage rates are soaring (%)



Source: Factset

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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

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