FIRETRAIL ABSOLUTE RETURN FUND

MONTHLY REPORT | DECEMBER 2022

PERFORMANCE (AFTER FEES)[1]

	Month	Quarter	1 Year	3 Years p.a.	Fund inception p.a.[3]	5 Years p.a.	7 Years p.a.	Strategy inception p.a.[5]
Fund[2]	2.44%	0.88%	(14.32%)	2.03%	1.53%	-	-	-
Strategy composite[4]	2.44%	0.88%	(14.32%)	2.03%	-	1.11%	7.50%	7.83%
Benchmark	0.26%	0.70%	1.27%	0.56%	0.84%	0.86%	1.09%	1.12%
Excess Return	**+2.18%**	**+0.17%**	**-15.59%**	**+1.46%**	**+0.69%**	**+0.26%**	**+6.41%**	**+6.70%**

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 DECEMBER 2022

Top 3 Overweight Holdings (Alphabetical)
Newcrest Mining Ltd
QBE Insurance Group Ltd
Santos Ltd

FUND DETAILS

Unit Prices	31 December 2022
Application Price	$1.0584
Redemption Price	$1.0510
NAV Price	$1.0547
Fund Details	
APIR Code	WHT5134AU
Benchmark	RBA Cash Rate
Inception Date	14 March 2018
Risk/Return Profile	High
Fund Size	$315mil
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 DECEMBER 2022

	Portfolio Exposure
Long Equity	188.0%
Short Equity	-187.9%
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 2.44% (after fees) for the month ending 31 December 2022, outperforming the RBA Cash Rate by 2.18%. The ASX 200 Accumulation Index declined -3.21% during the month.

For the quarter ending 31 December 2022, the Fund returned 0.88% (after fees), outperforming the RBA Cash Rate by 0.17%.

CONTRIBUTORS TO RETURNS

Positive contributors to monthly returns included long positions in Newcrest Mining and Virgin Money UK, and a short position in Downer EDI. Detractors included long positions in ResMed, Atlas Arteria and PEXA. We discuss each further in our commentary below.

POSITIVE CONTRIBUTORS

Newcrest Mining

Newcrest Mining outperformed in December following a 7% increase in the gold price. The outlook for gold remains positive through 2023, driven by the prospect of moderating interest rate rises and a weaker US dollar. During the month, Newcrest announced the retirement of long-serving CEO, Sandeep Biswas. Sherry Duhe, the current CFO, has assumed the role of interim CEO while the search for a replacement is completed. We believe there remains considerable bench strength within Newcrest to carry forward key growth projects in 2023 and beyond.

Virgin Money UK

Virgin Money UK shares outperformed the ASX 200 and UK bank peers following a strong FY22 result. The macro environment remains supportive of net interest margins, with hawkish central bank commentary driving a 50 basis point rise in UK 10-year bond yields during December. Virgin Money UK has now outperformed the ASX 200 by 50% from its October lows.

Downer EDI (short)

Downer EDI shares declined over 28% in December following a major downgrade to FY23 net profit guidance. Downer revised FY23 net profit guidance from expectations for 10-20% growth to a decline of 15% at the mid-point. Downer also announced it had identified accounting irregularities involving the misreporting of one of its maintenance contracts, resulting in historical overstatement of pre-tax earnings by $30-40 million. The Fund held a short position in Downer EDI.

NEGATIVE CONTRIBUTORS

ResMed

ResMed shares underperformed as the healthcare sector trailed the ASX 200 modestly. During the month, ResMed's main competitor, Philips, provided positive results from the testing it has carried out on recalled CPAP devices. However, Philips is yet to receive feedback from the FDA on the data.

Atlas Arteria

Atlas Arteria underperformed the ASX 200 by 3% during December, which was broadly in line with the relative performance of REITs and bond proxies. Atlas completed the purchase of a 67% stake in the Chicago Skyway in December. We believe the Skyway deserves a valuation premium to Atlas' existing assets given its long-dated concession (c.80 years remaining), favourable pricing terms and tax position.

PEXA Group

PEXA Group underperformed in December following a weak trading update from real estate listings portal Domain. Domain's listing volumes declined -16% in October and -22% in November, with the trend continuing into December. Real estate listing volumes are a leading indicator for PEXA Exchange's revenue, as the company earns a fee for each property that settles using the platform. PEXA currently has ~88% market penetration of Australian property transfers. Ongoing market share gains provide some offset to the weak listings environment.

2022: YEAR IN REVIEW

We entered 2022 positioned for the continuation of a post-pandemic global recovery and higher corporate profit margins. Throughout the year, we saw global central banks react to persistent high inflation by winding back the very accommodative financial conditions instituted since the COVID Pandemic. By year end, we were left with a much tighter financial backdrop. Interest rates in most developed markets moved several hundred basis points higher from a near-zero starting base.

Figure 1: Central Banks have moved away from expansionary monetary policy

Country	Central Bank	Cash Rate Jan-22	Cash Rate Dec-22
US	Federal Reserve	0.25%	4.50%
Australia	Reserve Bank	0.10%	3.10%
Great Britain	Bank of England	0.25%	3.50%
Canada	Bank of Canada	0.25%	4.25%
EU	European Central Bank	0.00%	2.50%
New Zealand	Reserve Bank	0.75%	3.50%

Source: Central bank data, Firetrail.

It was a disappointing year for the Firetrail Absolute Return Fund. The Fund returned negative 14.32% (after fees) compared to an RBA Cash Rate return of 1.27%.

The broader Australian equity market fell 1.08% over the year, its worst performance since 2018. The best performing sectors were Energy (+49%), Utilities (+30%) and Materials (+13%). The worst performing sectors included sectors with longer duration cashflows, comprising Tech (-34%), REITs (-21%) and Consumer Discretionary (-20%).

While we were disappointed with performance over the past year, we believe that adherence to our philosophy and process over this tumultuous period has allowed us to set the portfolio up for a strong rebound over coming years.

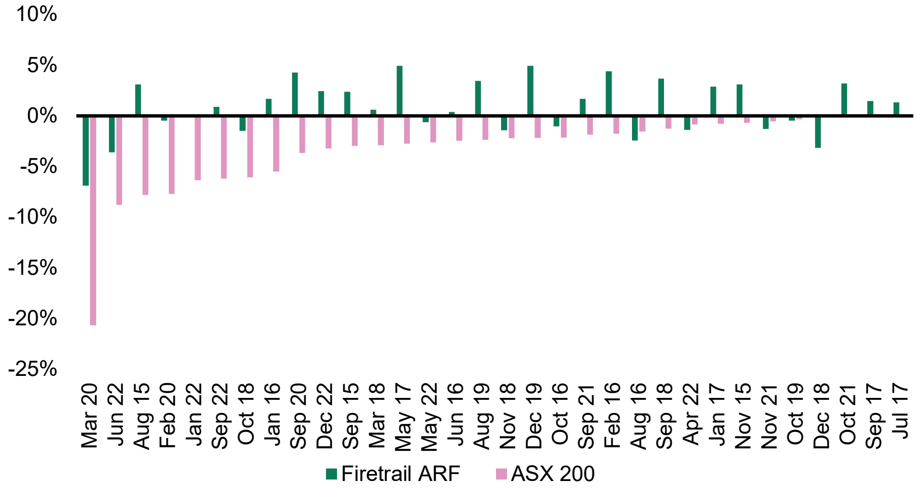
Looking back, the three main contributors to underperformance in 2022 were:

1. We remained overweight small companies for too long. Small companies underperformed significantly in 2022. We were conservative in unwinding some positions due to the impact of lower liquidity on trading outcomes.
2. We were overweight unprofitable technology companies which underperformed as a hangover to the lucrative IPOs and placements in 2021. What we gained in performance in 2021, we gave back through 2022; and
3. We were overweight gold. However, we retain a positive view on the commodity, which we discuss further in our 2023 outlook commentary below. We are overweight gold to supplement our underweight in REITs and bond proxies.

The Fund is designed to provide portfolio protection during equity market drawdowns and major dislocations. Historically, the Fund has provided good diversification from negative monthly equity market returns. Figure 2 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 Fund.

Historically, when the ASX 200 monthly return was negative, the Firetrail Absolute Return Fund has delivered a positive return 63% of the time after fees. On average, the Fund delivered a positive return of +0.83% (after fees) versus the ASX 200 average monthly drawdown of -3.38%, providing good diversification during monthly market drawdowns.

Figure 2: Firetrail Absolute Return Fund performance (after fees) in negative markets since inception (30 June 2015). The Fund delivered a positive return in 63% of negative ASX 200 months



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

WINNERS

Santos

Our top performer for the year was Santos, which rose circa 15% despite a 1% decline in the broader Australian market. Santos benefited from persistently higher global energy prices. Oil rose 5% over the year, while spot natural gas prices were also elevated. Santos sells around 30% of its output at the spot price, therefore benefiting from higher current prices.

Despite outperforming, the Santos share price remains below pre-COVID levels on a relative basis despite a 50% higher oil price. We retain our large overweight in Santos given the continued positive outlook for energy. We also believe the market is undervaluing the substantial growth optionality of Santos' portfolio of assets.

Tabcorp

Tabcorp was another strong performer through the year following the demerge of its lotteries and wagering operations which has allowed investors to appropriately value the sum of the parts.

Mineral Resources

The Fund also benefited from its exposure to decarbonisation and the energy transition through its position in Mineral Resources. Mineral Resources has made substantial progress in transforming its business from a high-cost, short-life iron ore operation to a low-cost, long-life iron ore and lithium asset owner and operator.

The company's substantial Australian lithium mining operations at its Wodgina and Mount Marion mines make it a top five global producer.

DETRACTORS

Our detractors through the year consisted of 1) long duration growth stocks such as Megaport and Serko, and 2) cyclical small companies with limited pricing power operating in highly competitive markets, such as Pact Group.

In select circumstances we have added to these positions. However, we have reduced or exited our positions in long duration unprofitable technology stocks in most cases. We believe higher interest rates and an increasing cost of capital means business models that enjoyed the era of cheap funding are unlikely to outperform.

PORTFOLIO CHANGES

We have used the volatility of 2022 to increase the quality of the portfolio, adding to best-in-class companies that have been sold off indiscriminately in line with the broader market. Examples include new positions in Mineral Resources, CSL, Domino's Pizza, Reliance Worldwide and Ramsey Health Care. We also increased our positions in existing holdings such as ResMed, SEEK, Virgin Money UK and Ampol.

Companies mentioned are illustrative only and not a recommendation to buy or sell any particular security.

2023: OUTLOOK

Heading into 2023, we believe higher global interest rates and lower liquidity will continue to drag on equity valuation multiples. The new debate taking centre stage revolves around the flow-on effects of tighter financial conditions and the severity of an increasingly likely global recession.

While inflation has probably peaked this cycle, we expect it to remain elevated and above the US Federal Reserve and RBA's targets for some time. This backdrop will present challenges for the overall market, in contrast to the accommodative conditions experienced over the last two years. We are excited by the opportunities current market conditions are presenting for stock picking on both the long and short side.

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.

We see four key themes shaping the economic and market's backdrop through 2023:

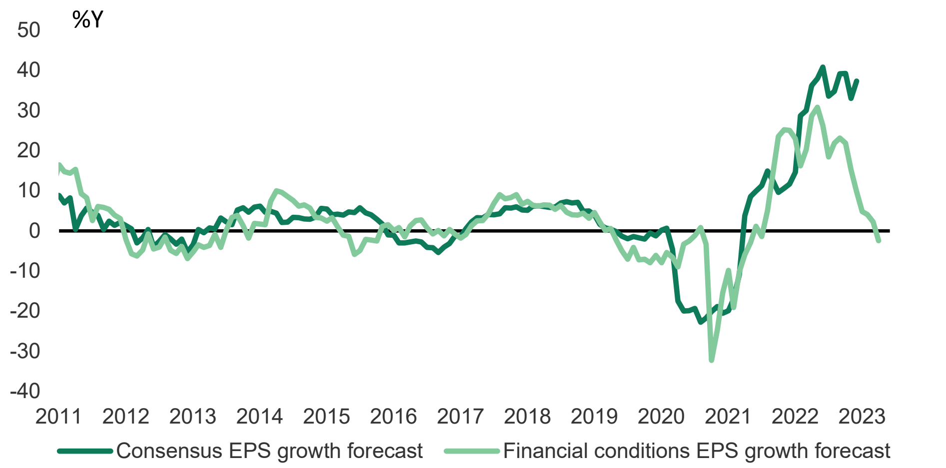
1. Interest rates and liquidity a drag for equity investors

Global central banks cut interest rates and increased liquidity for over a decade after the Global Financial Crisis. This changed last year, as major central banks employed tighter financial conditions to combat inflation.

Excess liquidity is being wound back and still has a long way to go. Global interest rates are no longer accommodative. The US terminal interest rate is expected to settle at >5%. In Australia it is expected to settle around 4%, well above levels seen over the last decade.

Money is no longer cheap, which has major implications for equity markets. The cost of capital is rising, reducing the value ascribed to longer dated cashflows. Investors are likely to allocate capital more rationally, winding back investments in speculative or lower returning business models. Higher risk premiums will continue to compress valuation multiples, which remain high, emphasising the importance of stock picking in delivering above index returns.

Figure 3: Consensus 1-year earnings per share (EPS) expectations are not factoring in weakening leading indicators such as Consumptions, House Prices and Employment



Source: Morgan Stanley, Firetrail

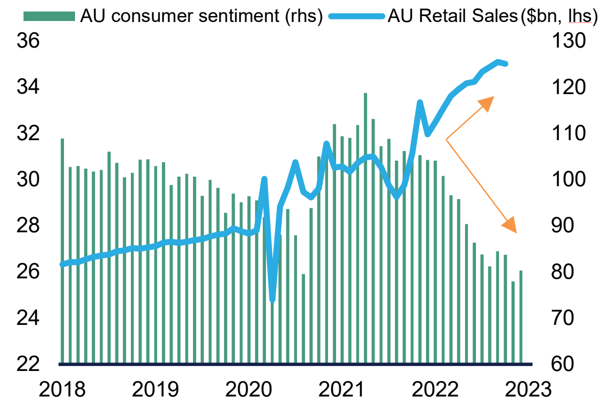
Risk of earnings recession remains high

We are yet to see the full impact of tighter financial conditions on broader economic indicators, the consumer, and corporate profitability. However, leading manufacturing, services and consumer indicators are pointing to a weaker outlook in 2023 as high inflation and rising interest rates start to take effect. In Australia, about 25% of mortgages will be re-priced at significantly higher rates in 2023-24. This is likely to negatively impact consumer confidence, raising the risk of an economic slowdown or recession.

The chance of a corporate earnings recession also remains high. Australian corporate profit margins are well above the long run average following two years of very loose financial conditions and government stimulus. Lower demand coupled with high inflation suggests the possibility of a more meaningful downward reversion in margins than in previous cycles.

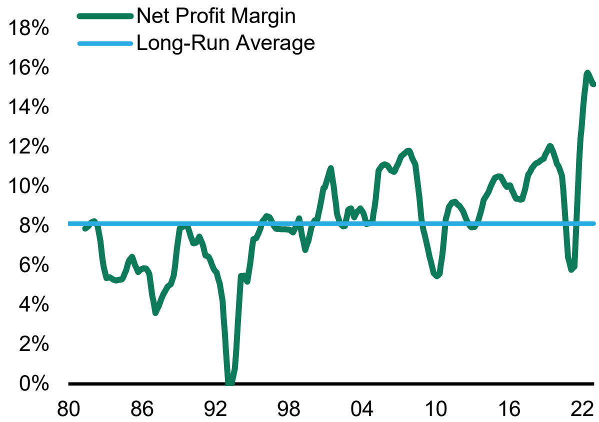
We don't believe earnings estimates for FY23 reflect these risks. Consensus estimates are still forecasting mid-single digit earnings growth. We are particularly cautious around domestic consumer discretionary names with limited pricing power exposed to a softening demand backdrop.

Figure 4: Retail sales numbers are yet to reflect a sharp decline in consumer sentiment



Source: UBS, Firetrail

Figure 5: Net profit margins for the ASX ex-Resources are sitting at all-time highs



Source: UBS, Firetrail

2. Gold to finally shine

Gold finished 2022 broadly flat despite negative pressures such as higher long term real interest rates, poor investor interest and a stronger US dollar. Central bank gold purchases, which generally make up 20% of demand, were stronger and broad based, putting upward pressure on the gold price. A recent World Gold Council survey suggests central bank gold purchases will continue. A quarter of central banks surveyed indicated that they expect to increase exposure to precious metals.

We believe the current backdrop supports an increase in gold demand in 2023, driven by:

a) **Inflation and interest rates** – Peak inflation is likely behind us, but sticky inflation above central bank targets will make gold attractive as an inflation hedge. Investors often assess their level of inflation protection through the lens of real yields (10-year interest rates minus inflation expectations). Real yields moved higher in 2022, creating headwinds for gold. In 2023, we could see this reverse as central banks slow the pace of interest rate hikes and economic activity slows.

b) **Moderating US dollar** – After rising for two years, the US dollar index has started to ease. Forecasting FX moves is difficult. However, indicators suggest further USD moderation will be driven by slowing US growth and falling inflation. Secondly, the European, UK and Japanese central banks are lagging the US on their interest rate trajectory, which could result in flows out of US dollars and into these currencies.

c) **Geopolitical risk** – Heightened geopolitical uncertainty is likely to continue in 2023 with the ongoing conflict in Ukraine and tensions between the West and China. Geopolitical risk enhances gold's attractiveness as a safe haven asset.

We remain exposed to the gold thematic through overweight positions in Newcrest Mining, Genesis Minerals and St Barbara.

3. Energy to remain supported

Energy was the top performing ASX sector in 2022. The year was characterised by volatility in both oil and gas markets following the Russian invasion of Ukraine and western sanctions against Russian energy supplies. Oil prices peaked near US$140/bbl, while spot LNG prices hit almost $100/mmbtu.

Prices for both commodities have since settled lower due to global recession concerns. However, we believe the backdrop for energy remains positive in 2023 driven by the following:

a) **Oil demand concerns overblown** – In past recessions, global oil demand has only fallen 0-1 million barrels per day, just 1% of global demand. A similar magnitude decline in this cycle can be managed by OPEC+.

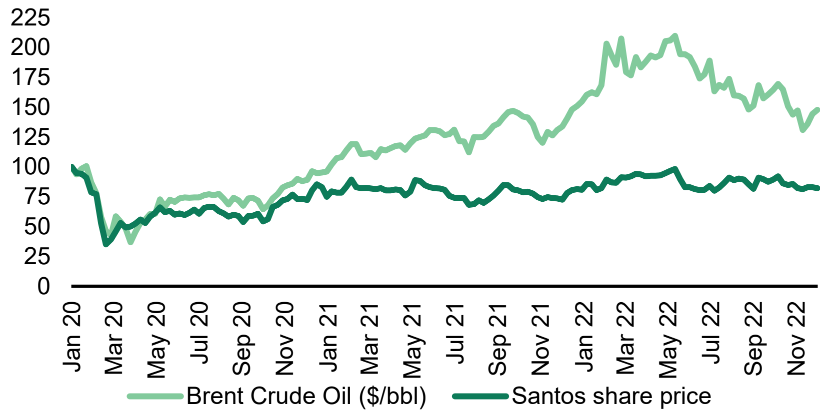
b) **China reopening** – China is the second largest consumer of oil, accounting for 15% of demand. A full reopening is expected to increase demand by 600-800 thousand barrels per day, or 0.6-0.8% of global demand, in 2023.

c) **OPEC+ supportive** – OPEC+ announced a 2 million barrel per day production cut at its October 2022 meeting in response to a softer global economic backdrop. This has yet to be fully implemented. OPEC+ is already producing below its stated quota, adding weight to our view that the bloc will continue to support oil prices in the near term.

d) **Natural gas** – Natural gas prices will remain supported in 2023 as Europe draws on global LNG supplies and moves away from Russian pipeline gas. China LNG imports should also recover, following a 5% fall in 2022. This provides a positive outlook for LNG prices and producers over the next one to two years, particularly given the absence of meaningful supply additions until 2026 at earliest.

Importantly, energy stocks continue to trade on compelling valuations with attractive free cashflow yields, supporting ongoing returns to shareholders. We are exposed to this thematic through positions in Santos, Origin Energy, and Incitec Pivot.

Figure 6: Despite outperforming the ASX 200, the Santos share price still lags the elevated oil price (indexed to 100 at 31 Jan 2020)



Source: Factset, Firetrail

PORTFOLIO POSITIONING

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:

- 188.0% long exposure across 40 to 60 stocks with upside based on our medium-term forecasts.
- Overweight Energy, Gold, 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:

- 187.9% 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 rising costs and slowing demand.
- 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 Cyclicals where we see material earnings risks and elevated expectations.

ONE INTERESTING THING THAT HAPPENED THIS MONTH…

2022 was driven by interest rates and inflation. Macroeconomic issues dominated equities markets, investor time horizons collapsed, and there was low dispersion / high correlation in stock price movements. It was a difficult year for stock pickers. But it has created significant opportunities in 2023.

2023 looks set to be a good year for bottom-up stock pickers. Inflation is bad, but some of the worst impacts have passed. Wages are also looking more robust. Companies are adjusting strategies to offset earnings weakness due to lower demand. Share prices have adjusted to reflect lower expectations. Although some parts of the market still need to adjust earnings down, creating shorting opportunities. And stock correlations appear to have peaked (see Figure 7 below).

Low or falling stock correlations are typically good periods for fundamental stock pickers, e.g., post-GFC, post-COVID. Today, we are seeing highly attractive stock opportunities across the long and short portfolio. We believe market conditions have created elevated opportunities for bottom-up stock pickers like Firetrail to deliver strong outperformance in 2023 and beyond

Figure 7: Have stock correlations peaked in 2022? ASX 200 pairwise correlations (mean, rolling 12 months)

Source: Firetrail

Companies mentioned are illustrative only and not a recommendation to buy or sell any particular security.

MORE INFORMATION

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www.firetrail.com

Firetrail INVESTMENTS