FIRETRAIL AUSTRALIAN HIGH CONVICTION FUND

MONTHLY REPORT | DECEMBER 2021

PERFORMANCE (AFTER FEES)

	Month	Quarter	6 Months	1 Year	2 Years p.a.	3 Years p.a.	Fund inception p.a.[2]	5 Years p.a.	7 Years p.a.	10 Years p.a.	Strategy inception p.a.[4]
Fund[1]	1.96%	2.56%	5.86%	18.67%	10.80%	13.86%	7.91%	-	-	-	-
Strategy composite[3]	1.96%	2.56%	5.86%	18.67%	10.80%	13.86%	-	10.70%	12.62%	12.91%	10.08%
Benchmark	2.75%	2.09%	3.84%	17.23%	9.03%	13.62%	10.05%	10.76%	9.38%	10.97%	7.53%
Excess Return	**-0.79%**	**+0.46%**	**+2.02%**	**+1.44%**	**+1.77%**	**+0.24%**	**-2.13%**	**-0.06%**	**+3.24%**	**+1.94%**	**+2.55%**

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.

AUSTRALIAN HIGH CONVICTION FUND

The Australian High Conviction Fund ("Fund") is a concentrated portfolio (approx. 25 companies) of our most compelling equity ideas. 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 ASX200 Accumulation Index over the medium to long term.

PORTFOLIO POSITIONING 31 DECEMBER 2021

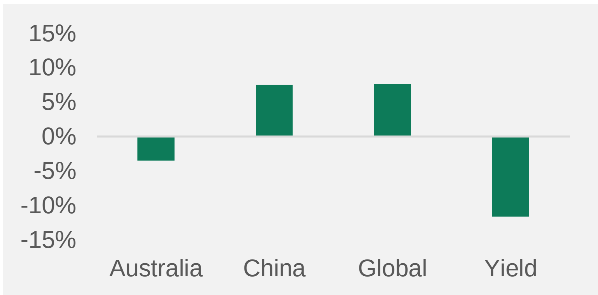
Top 3 Overweight Holdings (Alphabetical)
Newcrest Mining
Oz Minerals
Santos Ltd

FUND DETAILS

Unit Prices	31 December 2021
Application price	$ 1.2685
Redemption Price	$ 1.2647
NAV Price	$ 1.2666
Fund Details	
APIR Code	WHT3810AU
Benchmark	S&P/ASX 200 Accumulation Index
Inception date	14 March 2018
Number of Holdings	26
Fund size	$655mil
Management fee*	0.90% p.a.
Performance fee*	15% of outperformance above an annual Hurdle
*Please read the Product Disclosure Statement for more details	

THEMATIC POSITIONING 31 DECEMBER 2021

Relative to the Benchmark



Past performance is not a reliable indicator of future performance.

The Product Disclosure Statement ('PDS') and the Target Market Determination ('TMD') of the Fund is available at www.firetrail.com. Any potential investor should consider the PDS and TMD before deciding whether to acquire, or continue to hold units in, the Fund.

1. Firetrail Australian High Conviction 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 Australian High Conviction Strategy Composite ('Strategy') which has been operating since 29 November 2005. 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 High Conviction Fund (after fees) between 29 November 2005 to 23 November 2017. The Fund employs the same strategy as was used by the same investment team that managed the Macquarie High Conviction Fund as at 23 November 2017. Firetrail has records that document and support the performance achieved as the Macquarie High Conviction Fund. The composite returns for the Strategy and the S&P/ASX 200 Accumulation Index (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 29 November 2005.

PORTFOLIO COMMENTARY

The Fund returned 2.56% for the quarter ending 31 December 2021, outperforming the ASX200 Accumulation index by 0.46%. For the month of December, the Fund returned 1.96%, underperforming the ASX200 Accumulation index by 0.79%.

CONTRIBUTORS TO RETURNS

Positive contributors included Lynas, Oz Minerals, and a nil holding in CSL. Negative contributors included Megaport, Seek and Santos. We discuss each further in our commentary below.

CONTRIBUTORS

Lynas

Lynas outperformed on the back of higher prices for its major rare earth metal, NdPr, which moved up to ~US$130/kg. There was significant industry consolidation during the month in the Chinese rare earth sector that supplies over 80% of the global market. This highlights the strategic importance of Lynas' non-Chinese supply chain.

Oz Minerals

A higher copper price supported Oz Minerals performance. Early in the month Oz Minerals also confirmed that the Carrapateena Block Cave Expansion is on track.

CSL (no holding)

CSL announced a $6.3bn equity placement to fund the acquisition of Vifor Pharmaceuticals, a Swiss manufacturer of treatments for kidney diseases and iron deficiency. The stock underperformed due to some question marks around the strategic rationale of the acquisition and the sheer size of the placement, the largest ever primary equity raise in Australia.

DETRACTORS

Megaport

There was no company specific news from Megaport in December. The stock underperformed on the back of broader tech sector weakness, reversing its strong outperformance in November.

Seek

Similar to Megaport, Seek was impacted by tech sector weakness. Data on new job ads highlighted a 1.1% improvement from October to November, uncharacteristically strong given businesses typically start winding down recruitment ahead of Christmas.

Santos

The substantial disconnect between the oil price and the Santos share price continued in December. Brent Crude Oil rose 10% whereas Santos underperformed the ASX200 by 4%. The merger with Oil Search was confirmed with over 95% of votes cast in favour of the deal. While we are always cautious of M&A, we believe the merger has all the building blocks needed to create material value for shareholders.

2021 IN REVIEW

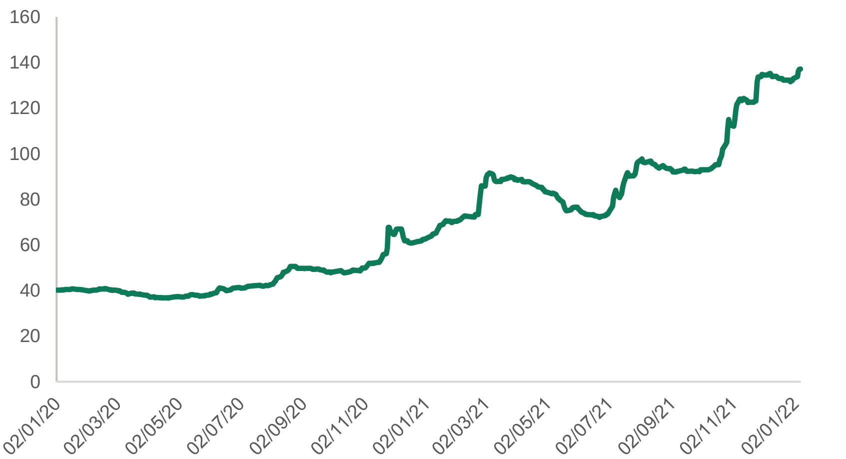
We entered 2021 positioned for a cyclical recovery as the global economy moved beyond the worst days of COVID. This delivered strong absolute and relative returns for our investors notwithstanding speed bumps from the spread of the Delta and Omicron variants. The Fund returned 18.67% for the year, outperforming the ASX200 Accumulation index by 1.44%.

By the end of 2021, key considerations for the equity market were not only how COVID would continue to impact company fundamentals, but also how inflation could impact earnings and valuation. Inflation trends have already driven central banks in Norway, New Zealand and the UK to lift rates, and the RBA's message has transitioned from "no rises until 2024" to "no rises until inflation is sustainably in the range of 2-3%". We believe we remain well positioned for most inflation scenarios if the global demand recovery is not substantially derailed.

WINNERS AND LOSERS

Our top performer during the year was Lynas, rising more than 150%. The price of Lynas' main rare earth metal, NdPr, rose more than 100% as demand for magnets used in electric vehicles and wind turbines accelerated. Lynas remains a core portfolio holding due to favourable supply/demand dynamics and its strong execution track record in mining a complex resource.

Figure 1. NdPr Price (USD/kg)



Source: Bloomberg, Firetrail Research, December 2021

The portfolio benefitted from holding two M&A targets, Oil Search and Crown. Oil Search was the best performing energy stock because of its merger with Santos. Crown received four separate takeover bids from two different suitors. With a clear path now established to restore its suitability to operate casinos in Victoria and NSW, we believe more offers for Crown may emerge in 2022.

ResMed was another of our top contributors. A strong underlying growth recovery was amplified by a competitor product recall initiated in June 2021. ResMed also released its new AirSense11 device which enhanced its market leadership position. We believe the equity market continues to underestimate how much share ResMed can take and retain in the coming years.

Other strong outperformers included Oz Minerals, Virgin Money UK and James Hardie.

On the negative side, overweight positions in Newcrest, Lendlease and Santos all detracted. Our investment theses remain unchanged for all these positions. Newcrest is one of our largest holdings and we added to our investments in Santos and Lendlease as they underperformed.

Consistent adherence to our investment process enabled us to identify a handful of new opportunities that were oversold on short-term concerns but offer substantial medium-term upside. In 2021 we added Ampol and Megaport to the portfolio. Adding both value and growth stocks demonstrates our flexibility to find opportunities in both the value AND growth corners of the market.

In contrast to 2020, the market was fairly calm throughout 2021. We saw nothing like the dislocation of February/March 2020, and portfolio turnover was correspondingly lower.

A large proportion of our selling activity in 2021 was trimming outperforming positions. We also made some mistakes. We exited positions in Challenger and IAG due to underwhelming progress from management in improving underlying business performance. The silver lining was that we generally identified issues before they were fully reflected in share prices, shielding our investors from material losses on these investments.

2022 OUTLOOK AND POSITIONING

As we look into 2022, we are excited about the opportunities presented by a continually evolving and dynamic environment. Our philosophy of 'every company has a price' and consideration of the future on a three-year horizon has served our investors well over the past 15 years. The flexible process of the High Conviction Fund allows us to allocate your capital to the best opportunities without being constrained to the benchmark.

As our investors would know, our investments are all driven by detailed analysis of stock-specific factors. In recent times, our stock specific work has resulted in a portfolio tilt towards companies that will perform well if the global economic recovery continues. While some of these holdings have rallied substantially off their lows, we still believe there is substantial upside when the market starts to price in more normalised conditions.

Qantas is a prime example. More relaxed state and international borders, combined with pent up demand and a rational competitive environment creates a potent cocktail of profitability drivers over 2022/23 in our view. Qantas is likely to generate its highest profitability ever in the coming years. An increasing contribution from its Loyalty division makes the current single-digit PE far too low. We believe major upside is on offer for investors.

Outside of the debates around COVID, we believe there will be five big themes this year:

1. MANAGING COSTS AND MARGIN PRESSURE

The widespread impacts of global supply chain disruption will likely persist well into 2022. Even COVID winners like supermarkets are hurting, as described in more detail below. Inflation is bad for all companies. You can't avoid it.

To date, most companies have passed on higher costs due to strong demand. The ease of cost pass-through has led investors to become complacent about future pass-through challenges. In our view, cost pass-through will prove much harder in a growth slowdown.

We focus on the ability of companies to pass these costs on. The overwhelming majority of the companies we hold with reliance on global supply chains have reasonably strong pricing power in their markets. For example, companies like Amcor and James Hardie.

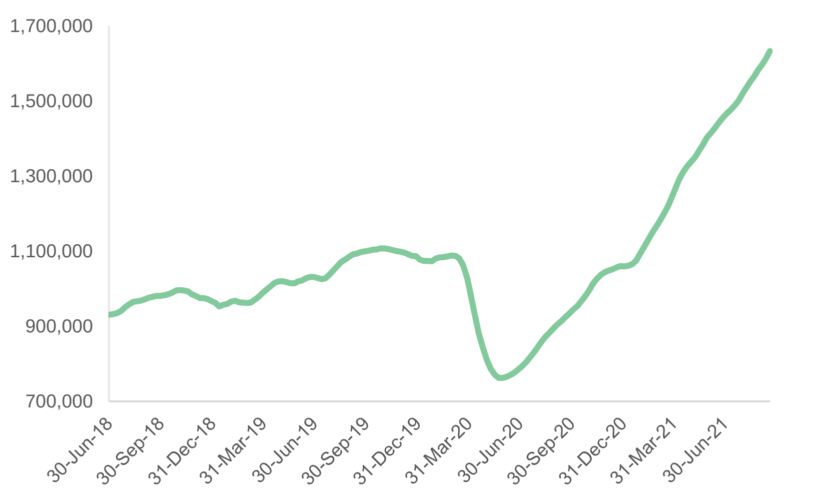
2. LABOUR MARKET TIGHTNESS

In our view, the tight conditions in global employment markets over the second half of 2021 will intensify in 2022. The US is leading the world out of COVID, and in December active job listings were more than 50% above pre-COVID levels. Australia appears to be on a similar trajectory.

A broad range of companies have publicly stated how difficult it is to find staff, and anecdotal feedback suggests some entry-level positions are seeing 20%+ wage increases. Portfolio holding Seek should benefit from higher volumes and higher spend per advertisement as employers seek to attract workers.

Even looking beyond current Omicron-driven disruption, we believe the jobs market in Australia will remain very tight for the duration of 2022. The translation into widespread wage inflation appears to be inevitable. But it will take time. Approximately 40% of the Australian workforce, or 4 million workers, are on Enterprise Bargaining Agreements.

Figure 2. US total active job listings (rolling four weeks)



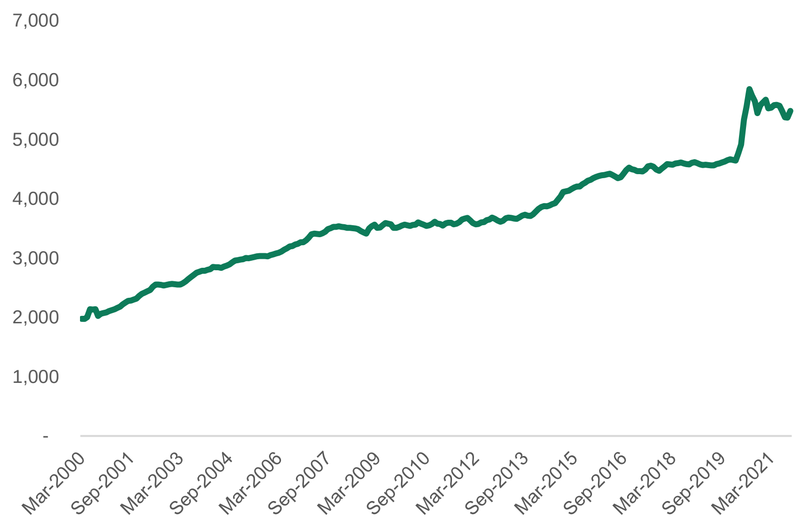
Source: UBS Evidence Lab

3. REVERSION OF SPEND ON SERVICES VS GOODS

Household goods were one of the biggest winners out of COVID. Spend remains well above the long-term trend. We believe it will revert, but does the pull forward of demand mean that sales will be below trend for a period? A period of much softer demand for goods is not priced in to key beneficiaries like Wesfarmers, owner of the Bunnings franchise.

If spend on household goods meaningfully declines, it may mean spend on services remains elevated for a period. Travel would be a clear beneficiary from this dynamic. As stated above we don't think Qantas' current share price captures the potential demand upside over the next 12-24 months.

Figure 3. Australian Household Goods Spend (AUD$ in millions)



Source: ABS

4. HIGHER ENERGY PRICES

At the end of 2021, energy prices were much higher than anyone expected. You can point to many causes for high oil, gas and coal prices. Firstly, a strong rebound in global demand and GDP growth leads to more energy demand. Secondly, there has been lower European renewable production, leading to higher demand for fossil fuels to fill the gap. Finally, cold winters and warm summers globally led to low storage levels.

Europe has borne the brunt of the energy price surge because they are heavily reliant on imported energy. Economic growth in the region continues to be impacted. Gas intensive industries like fertiliser have been forced to curtail production to ensure gas is freed up to provide electricity and heat for citizens.

We see a similar supply demand issue playing out in oil markets. Demand is likely to eclipse pre-COVID levels at a time when supply expansions are at an all-time low. Our view continues to be that oil capex spend remains far too low to meet the projected demand to 2030.

Crucially, to invest in energy companies today, you don't need to believe in higher energy prices. The disconnect between the rising oil price and underperforming energy equities means the stocks are still attractive at lower energy prices. We believe the valuation gap could begin to close as markets come to appreciate the important role these companies will play in the energy transition. We are exposed to this thematic through overweight positions in Santos and Woodside.

5. RBA'S DELICATE BALANCING ACT

While rate rises appear to be a question of 'when' not 'if', we are reluctant to make any strong calls on the path of RBA tightening over the next few years. Australia's central bank faces a unique balancing act given global-high levels of mortgage debt and housing affordability issues.

We hold several positions that provide leverage to higher interest rates but are more skewed to the US and UK, namely QBE and Virgin Money UK. We maintain a nil holding in Australian major banks given continued intense competition and margin pressure.

Current portfolio positioning can be summarised as follows:

- Overweight:
  - Re-opening trades like Qantas and Santos where competitive dynamics will be more attractive than before COVID.
  - Base metal and EV material companies where supply won't be able to keep up with demand in the medium-long term.
  - Market leaders including Resmed, Aristocrat and James Hardie who are benefitting from strong demand while taking market share in their categories.
  - Financials with material leverage to interest rate rises including Virgin Money UK and QBE.
  - Undervalued defensive companies including Newcrest, Telstra and Crown.
- No holding in Australian banks and underweight iron ore where we don't see compelling opportunities.

Portfolio settings are:

- Highly concentrated with an 81% active share
- Beta of 1.05
- Substantially underweight ASX20, overweight 21-100.

ONE INTERESTING THING THAT HAPPENED THIS MONTH

In the Australian supermarket sector, investor focus through COVID has predominantly been on what level sales growth normalises at. Woolworths' December trading update highlighted that the cost line is under substantial pressure. Despite guiding to sales growth of 3% in the Dec-21 half, Woolworths guided to an 8% decline in EBIT for the division.

A reasonable chunk of the additional cost can be expected to decline as COVID subsides, however we believe the conventional wisdom that inflation is good for supermarkets needs to be retested in the current environment. Inflation is really not good for any business.

Figure 4. Woolworths Australian Food sales vs EBIT growth (%)

Source: Company data

MORE INFORMATION

General enquiries 1300 010 311

Existing client enquiries 1300 360 306

www.firetrail.com

Firetrail INVESTMENTS