SOLARIS
investment management

Solaris Core Australian Equity Fund

(APIR: WHT0012AU)

Quarterly Investment Report

as at 31 December 2021

Market and Fund Performance

The S&P/ASX 200 Accumulation Index rallied +2.7% in December and +2.1% over the quarter, a positive end to a strong year with the market finishing up +17.2%. The fund underperformed its benchmark for the quarter by 0.67%. The economy roared back to life following the COVID-19 'Delta' lockdowns in September, as high rates of vaccination combined with substantial policy support underpinned the recovery. Retail sales bounced +4.9% in October, driven by fashion and spending at cafes and restaurants which jumped significantly. Job creation has been stronger than expected with almost all of the jobs lost during the Delta lockdown already being replaced. The Australian unemployment rate is at 4.6% and back down to pre-lockdown levels. As we enter 2022 many sectors of the domestic economy are in good health. The emergence of the new Omicron COVID-19 variant added a new element of uncertainty in late November, spreading quickly across the nation. Given the advances in vaccine and treatment technology over the past 18 months, we believe the world is in a strong position to detect, assess and respond to the new variant and do not expect it to derail the recovery. The strong economic activity and heightened demand for goods has led to ongoing capacity constraints in the shipping and logistics industry. These capacity constraints combined with rising energy costs and labour shortages have driven a spike in inflation, which the Reserve Bank of Australia is closely monitoring. The Reserve Bank has signalled less accommodative policy conditions ahead with the end of the asset purchase program expected in May 2022. Commodity markets remained volatile over the quarter with Iron Ore falling materially mid quarter and rallying back to finish up +3.4%. Oil markets experienced a similarly volatile quarter – up +11.4% in October as travel resumed, down -20.8% in November due to the onset of Omicron and then up +13.6% in December as the variant is appearing to be less severe than feared.

The top three index moves over the quarter were Pilbara Minerals (+56.1%) which appreciated on the back of increasing Lithium prices due to continued strong demand, Nickel Mines (+52.1%) which advised first production from its 80% owned Angel Nickel asset is expected well ahead of schedule and Lynas Rare Earths (+51.6%) which was supported by strength in price and demand for rare earths. The bottom three moves were Magellan Financial (-39.9%) after losing a major mandate, St James's Place, and encountered the departure of their CEO, Zip Co Limited (-38.7%) which underperformed in line with the 'buy now pay later' due to regulatory concerns in the United States and the high growth sector derating on inflationary concerns more broadly and Clinuvel (-36.5%) underperformed the market, in part due to a research note from a bank analyst downgrading the stock from 'Buy' to 'Hold'.

A portfolio holding that contributed to active return over the quarter is Altium, which provides market leading software for the design of electronic products globally across a wide array of industries. The number of internet connected devices is forecasted to surpass 25.4 billion in 2030 and every second 127 devices hook up to the internet for the first time, which provides large industry tailwinds for Altium's specialised design tools and platforms. Altium is pivoting from one off licence sales to cloud based subscriptions which generate attractive recurring revenue. 'Altium 365' is Altium's cloud-based platform which is sold on a subscription basis and has over 17,300 active users. It is growing quickly based on the success of Altium's 'Designer' desktop software which is currently the world's most widespread professional Printed Circuit Board (PCB) design tool and used by over 100,000 engineers worldwide. Albeit at a smaller scale, this reminds us of Microsoft's pivot away from one off licence sales to cloud based subscriptions, which has generated significant wealth for shareholders over the past decade. In the recent past Altium has been subject to a takeover offer from offshore peer Autodesk, which validates Altium's high quality products, user base and business model. We are attracted to Altium's strong track record of profitability, its high-quality cash backed earnings, the experienced and aligned management team, the strong balance sheet and the potential to continue to disrupt and transform the global electronics industry in the years ahead.

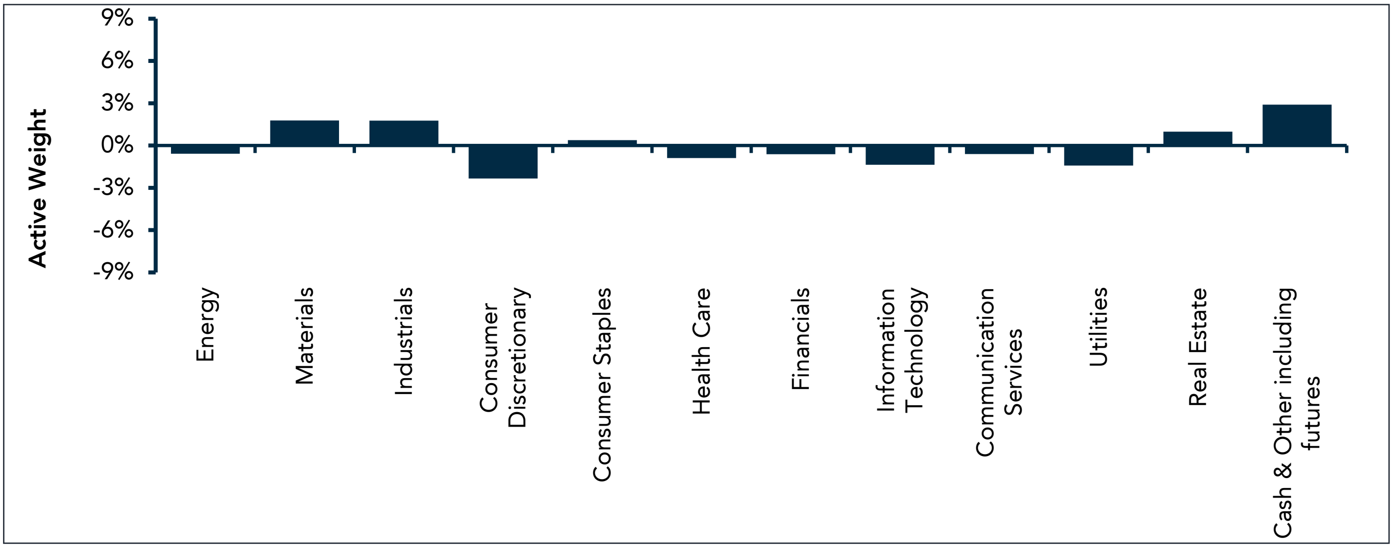
Returns	Month	Rolling Quarter	FYTD	1 Year	3 Years p.a.	5 Years p.a.	7 Years p.a.	10 Years p.a.	Inception p.a. (17/09/2008)
Fund Gross Return^	2.49%	1.67%	5.09%	16.92%	11.82%	9.66%	9.55%	11.95%	8.97%
Benchmark Return*	2.75%	2.09%	3.84%	17.23%	13.62%	9.76%	8.99%	10.80%	7.96%
Active Return	**-0.26%**	**-0.42%**	**1.25%**	**-0.31%**	**-1.80%**	**-0.10%**	**0.56%**	**1.15%**	**1.01%**
Fund Net Return^	2.40%	1.42%	4.58%	15.80%	10.74%	8.60%	8.50%	10.87%	7.94%
Benchmark Return*	2.75%	2.09%	3.84%	17.23%	13.62%	9.76%	8.99%	10.80%	7.96%
Active Return (After fees)	**-0.35%**	**-0.67%**	**0.74%**	**-1.43%**	**-2.88%**	**-1.16%**	**-0.49%**	**0.07%**	**-0.02%**

^ Performance is for the Solaris Core Australian Equity Fund (APIR: WHT0012AU), also referred to as Class B units, and is based on month end prices before tax. Net performance is calculated after management fees and operating costs, excluding taxation. Gross performance is stated excluding all fees, costs and taxation. This is historical performance data. It should be noted the value of an investment can rise and fall and past performance is not indicative of future performance. All p.a. returns are annualised. * Benchmark refers to the S&P/ASX 200 Accumulation Index.

Top 10 Stocks (Alphabetical Order)

Name	Sector
Australia and New Zealand Banking Group Limited	Financials
BHP Group Limited	Materials
Commonwealth Bank of Australia	Financials
CSL Limited	Health Care
Goodman Group	Real Estate
James Hardie Industries PLC	Materials
Macquarie Group Limited	Financials
National Australia Bank Limited	Financials
Westpac Banking Corporation	Financials
Woolworths Group Limited	Consumer Staples

Sector Allocation



Market Valuation & Earnings Estimates:

	Market & Sector EPS Growth			Market & Sector PEs			Market & Sector Dividend Yield		
Pro-rated to June	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
All Companies	31.5%	9.9%	2.5%	19.8x	18.1x	17.7x	3.6%	3.7%	3.7%
Banks	26.0%	8.9%	5.5%	16.6x	15.2x	14.4x	3.9%	4.6%	4.8%
Listed Property Trusts	-3.9%	9.7%	9.0%	20.0x	18.3x	16.8x	3.4%	3.6%	4.1%
Resources	81.5%	7.2%	-17.1%	10.2x	9.6x	11.6x	7.2%	6.0%	5.0%
Industrials ex-Banks	8.6%	13.0%	16.8%	30.1x	26.8x	22.9x	2.4%	2.7%	3.0%

Estimate only

The securities presented on this slide are for illustrative purposes only and are not the complete holdings of the fund.

Market Outlook

We approach two years since the onset of COVID-19 and have witnessed a remarkable period following the initial precipitous fall – large stay in business capital raisings in 2020, a strong equity bull market through 2021, with near-record levels of M&A and IPO's. Looking forward, the onset of the new COVID-19 'Omicron' variant will bring uncertainty but should not be a surprise to global markets. As developed nations have focused on vaccinating their local populations, access to vaccines in the developing world has been lacklustre leading to the heightened potential for mutations. We remain focused on the link between the infection rate and the mortality rate, which continues to weaken due to the success of global vaccination efforts combined with findings the Omicron is significantly less 'severe' than previous variants. Whilst we are focused on ensuring our portfolio companies have the balance sheet strength to withstand periods of volatility, we believe advances in vaccine and treatment technology put health authorities in a strong position to manage the new variant.

In terms of the Australian equity market, we enter 2022 with valuation levels elevated versus history. On Solaris forecasts the one year forward 'price to earnings' ratio for the 2022 financial year is 18.1, which is above the 10-year average of 15.5. However, this is supported by forecasted elevated earnings per share growth of +9.9% (when compared to the 2021 financial year), driven primarily by the Industrials ex-Banks sector (+13.0%), as industrials continue to recover from COVID-19 impacts. The market is supported by a forecast dividend yield of 3.7% in 2022, amplified by the Resources sector where we forecast a 6.0% yield as a result of the heightened commodity price environment and the strong balance sheet position of the major miners enables the potential return of excess capital through dividends and buybacks.

We are genuinely excited about the outlook for our portfolio holdings. As a reminder – company research is where we dedicate the overwhelming majority of our time. Solaris analysts are focused on deriving an underlying fair value for each company within our investment universe. We have held over 680 company-related meetings this year – with portfolio companies, competitors, and industry experts as we build a deep understanding of each company and industry. It's this analysis that gives us a high conviction in our portfolio as we approach 2022 where we believe several themes will continue to resonate:

1) M&A and Corporate Activity will remain elevated

Capital remains cheap - access to debt markets and equity capital markets is wide open for corporates looking to expand, acquire or list. We expect this to support corporate activity in 2022. In particular, companies with real assets are highly desired by long-term investors and we expect that unlisted investors (superannuation funds, private equity) will continue to pay close attention to listed assets that are trading at a discount to their intrinsic valuation.

2) ESG factors are critical

Climate change and the flow-on effects from COP26 will be a major focus with the consideration of new technologies, capital expenditure, accelerating decarbonisation demands and the potential (likely) impacts on portfolio construction becoming more widespread and mainstream. Solaris expects to see the Taskforce on Nature-Related Financial disclosure (TNFD) increase in importance. Many companies are already considering their impact on biodiversity and nature, but this framework (much like the TCFD) will give structure to their approaches.

3) Income will remain a key focus

With cash rates near zero, term deposits yielding little and inflation increasing, the real interest rate for savers (after adjusting for inflation) is significantly negative. Income will remain a key focus however investors must remain focused on total return (income plus capital movement), . As we have seen over the past quarter simply chasing yield in the Banks and Mining sectors leaves savers facing material capital volatility.

4) Inflation will remain elevated

Given the monetary and fiscal stimulus supporting demand, the constrained movement within the labour force due to closed borders and the ongoing supply chain related impacts, we expect inflationary pressures to remain elevated. The onset of the Omicron COVID-19 variant will do little to alleviate the on-going supply chain impacts. While the Reserve Bank of Australia is holding cash rates at the 0.10% setting, the market is pricing in the potential for cash rate rises earlier than previously anticipated due to heightened inflationary pressures.

5) Stimulus will fade

We expect that direct and indirect monetary and fiscal stimulus will continue to ease into 2022. Already we have seen stricter lending conditions imposed on the banks by the regulator (Australian Prudential Regulatory Authority) and we have seen a significant reduction in Job Keeper related handouts. However, in the short term with an Australian Federal election slated to be held in the coming months we see potential for further tax cuts to be proposed by both major parties.

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While we have outlined several key themes above, our portfolio is driven from bottom-up stock selection as opposed to macroeconomic views. As we approach 2022, we see investment opportunities across a wide range of companies and we are focussed on the following key attributes:

✓ Attracted to stable or improving industry structures

✓ Avoid excessively geared balance sheets

✓ Attracted to competent and trustworthy management

✓ Focus on good cashflow, cash realisation and earnings quality

✓ Favour companies with improving return on equity

✓ Strong belief that ESG factors can drive share price performance

Source: Solaris Investment Management, December 2021

Contact Details

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