Global Evolution Capital

April 2020

About the Fund

The world is evolving more rapidly than it has in any time in human history, and these shifts are creating opportunities for select companies to position for multi-year growth while impairing the economics of others as the world shifts from under them.

Our focus is on identifying these companies, and constructing a portfolio that protects as well as grows the wealth of our investors irrespective of the market environment.

Our global focus allows our investors access to the best companies in the world. Our absolute return philosophy means that our investors have the right to expect positive returns regardless of what the world throws our way.

Fund Features

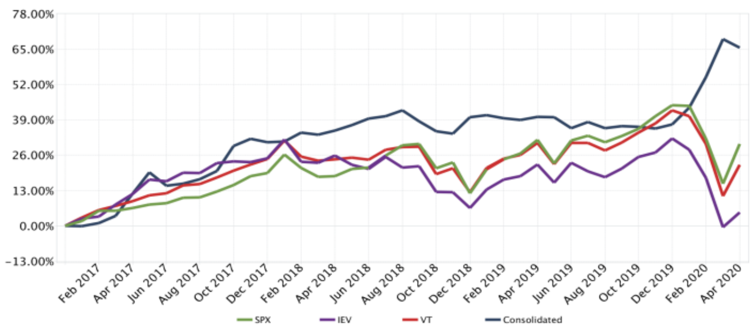
- Global absolute return fund
- Gross exposure range = 100% to 220%
- Net exposure range = -30% to +60%
- Long position range = 10 to 30
- Managed fx exposure
- Fees = 1.25% base fee and 20% performance fee above 5% hurdle rate subject to high water mark

Current Metrics

Gross Exposure	186%
Long Exposure	80%
Short Exposure	-106%
Net Exposure	-26%
Total Positions	32
Long Positions	14
Short Positions	18

Performance (gross, cumulative)

	US	Europe	Global	FUND
1M	12.8%	5.8%	10.4%	-1.8%
YTD	-9.3%	-18.5%	-14.1%	20.6%
1Yr	1.0%	-12.4%	-6.1%	15.6%
3Yr	29.7%	-3.0%	12.2%	48.0%
Inception	30.1%	4.9%	22.4%	65.6%



Performance Comparison

- *Consolidated = Global Evolution Fund*
- *SPX = US market (S&P 500 Stock Index),*
- *IEV = Euro market (iShares S&P Europe 350 Index ETF)*
- *VT = Global Market (Vanguard Total World Stock Index ETF)*

Inception date is 1st January 2017. Past performance is provided for illustrative purposes only and is not a guide to future performance

Risk Metrics

	SPX	IEV	VT	Consolidated
Ending VAMI:	1,300.87	1,049.06	1,224.11	1,655.65
Max Drawdown:	20.00%	24.77%	22.15%	6.01%
Peak-To-Valley:	Dec 19 - Mar 20	Dec 19 - Mar 20	Dec 19 - Mar 20	Aug 18 - Nov 18
Recovery:	Ongoing	Ongoing	Ongoing	14 Months
Sharpe Ratio:	0.49	0.08	0.38	1.34
Sortino Ratio:	0.67	0.09	0.49	3.55
Calmar Ratio:	0.41	0.06	0.28	2.71
Standard Deviation:	4.57%	4.47%	4.44%	3.06%
Downside Deviation:	3.32%	3.58%	3.39%	1.16%

Key Positions

Long Positions	Short Positions
Alphabet (GOOGL-US)	Fedex Corp (FDX-US)
Amazon (AMZN-US)	Uber (UBER-US)
Tencent (700-HK)	Cognizant Technoolgy (CTSH-US)
Xinyi Solar (968-HK)	CVS Health (CVS-US)
Thermo Fisher Scientific (TMO-US)	Kohl's (KSS-US)

Global Evolution Capital

April 2020

What happened last month

Market Commentary

Markets recovered somewhat in April, with global markets lifting circa 10%, leaving them -14% YTD. The scale and breadth of Central Bank and Government interventions created a significant disconnect between economic conditions (which continue to deteriorate) and asset pricing. The ructions in oil continued, with an oil futures contract trading negative and oil pricing remaining circa -65% over the last 12months.

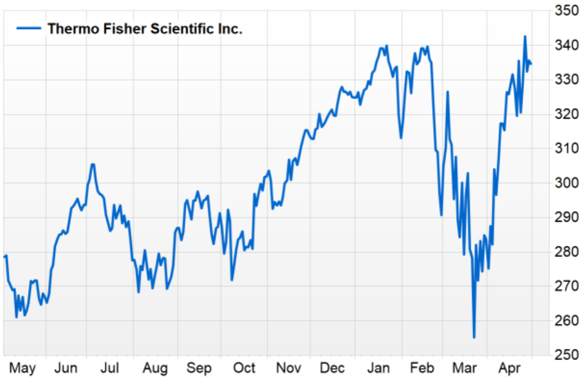
Fund Performance

Against this backdrop, despite retaining a net short position the Fund largely held the YTD gains. The Fund remains +20.6% YTD after giving back 1.8% during April. This compares to Global Market performance YTD of -14.1%.

Key positive contributors to performance in April were:

- Amazon (long): the outperformance in Amazon continued as the post Covid-19 landscape (cloud computing, online retail) continued to shift in their favour. However guidance comments of "if you're a shareowner in Amazon, you may want to take a seat" flagged a challenging June quarter.

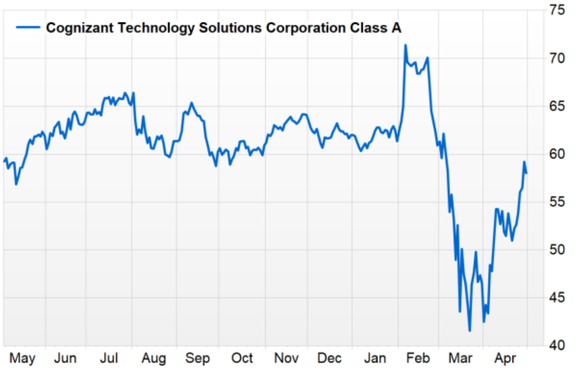
- Thermo Fisher Scientific (long): Thermo Fisher reported solid results for 1Q underpinned by demand for testing equipment. Revenue was +2% and operating income +1% as Covid 19 had a mixed impact across business segments.



Key negative contributors to performance in April were:

- Biogen (long): While the result for 1Q20 was solid, this was a sideshow compared to what appeared to be a significant delay in the FDA filing for Biogen's alzheimers treatment. Given this is a key leg of future growth, the delay is meaningful

- Cognizant Technology (short): Commentary around strong performance pre the Covid-19 impact was well received, and the stock continued to lift despite reports of a ransomware attack impacting some clients towards the end of the month



General Observations

As Microsoft commented with their March qtr results, many companies are seeing 2yrs of transformation occurring in 2 months. These transformations span online work and education along with a fundamental reshaping of the shopping experience.

The key is determining what is temporary and what is permanent. In terms of the Fund, we see gains in cloud computing continuing as companies accelerate the push to reshape IT architecture for a more fragmented operating environment. We also see the increased penetration of online shopping holding as behavioural changes stick.

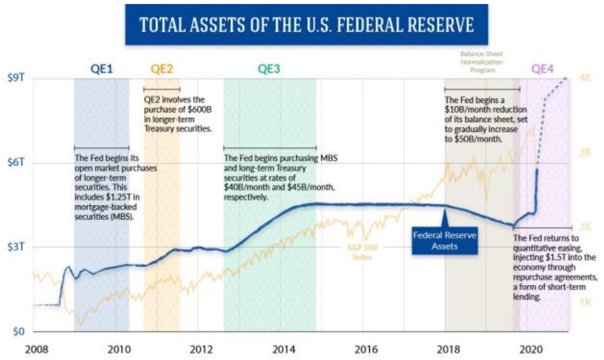
Our aim has been to build a portfolio positioned for how the future would unfold. In our mind the impact of Covid-19 has not changed what that future looks like in terms of key industrial thematic shifts, but is has accelerated the impacts in a number of key areas.

Global Evolution Capital

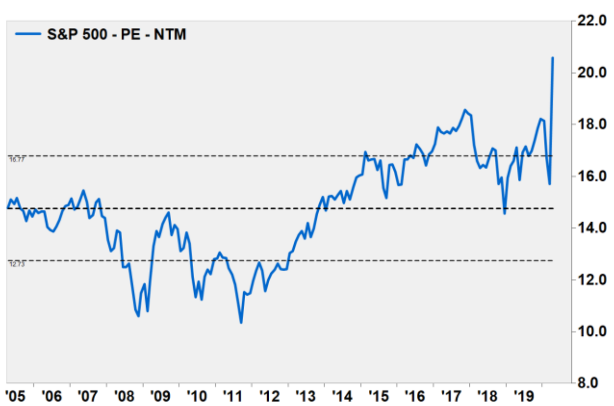
April 2020

What is on our mind - Markets

At a portfolio level, April presented some interesting questions in terms of portfolio positioning. While the economic fundamentals could best be described as “horrendous”, markets rallied significantly on the back of substantial Government and Central Bank interventions. While a degree of intervention is expected during market dislocations, the nature of the interventions this time around were a surprise, including an unprecedented US Fed move into buying junk bond ETF’s and a “Main Street” lending program. After the explosion in the Fed balance sheet from $800bn to $4tr post the GFC, and only a mild reduction in the intervening years, the US Fed balance sheet is now on track to reach $9tr.



What this has led to are what appear to be significant anomalies in market valuations. We now see the PE Next Twelve Months (NTM) for the S&P500 sitting >2.5 standard deviations above the long term average. And this with earnings expectations still to fully adjust to current conditions. As such we view the true PE NTM even higher than stated numbers.

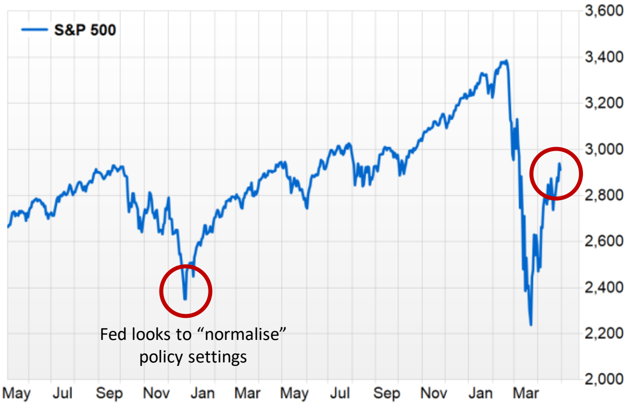


There is an argument that given the nature of the pandemic, that the current year of earnings should be “looked through”. This is an argument that to us holds merit. But as we look out to 2021 the PE 2yr multiple also appears elevated, sitting 1.5 standard deviations above long term average. And this with an aggressive “V” shaped recovery factored into earnings.

	Dec '18	Dec '19	Dec '20E	Dec '21E	Dec '22E
EPS	159.69	162.10	131.41	166.51	188.22
% EPS Growth	21.5%	1.5%	-18.9%	26.7%	13.0%

When we sense check the current market valuation metrics we come to a similar conclusion. Below is a chart of the S&P500 over the past 2yrs. The dip at the end of 2018 was when the Fed had signalled that due to the strength of the US economy it was looking to normalise policy settings by lifting rates towards 3-3.5% and undertaking a moderate reduction in the size of the balance sheet. At that time real GDP was running at 2.5-3% and the unemployment rate was <4%.

Now we have a global pandemic affecting the global economy where current estimates are for a deep recession (2Q20 US GDP estimates of -30%) and for unemployment to head towards 15-20%. Yet we have the S&P 500 trading at +15 to 20% above the Dec 18 levels. That does not feel right.



In terms of what this means for the Fund, in terms of portfolio positioning we had commenced the month mildly net short post the market falls in March. However based on market valuations we have been increasing the net short position as markets have rallied through April, and the Fund now sits towards the top end of the net short range.

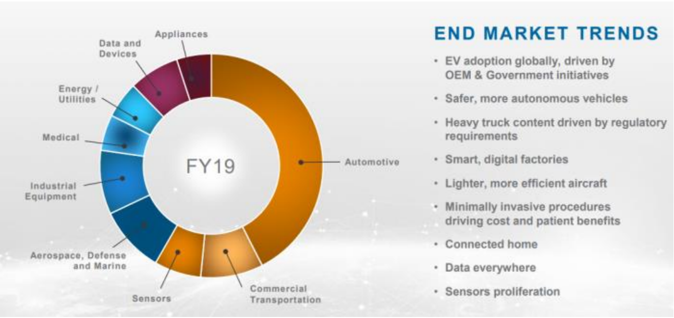
As for what the world faces post the current dislocation, we think the cartoon below from the Economist best encapsulates what is in store. The US Fed can print money but it can’t print earnings. And while access to funding lines will help get companies through the current malaise, it does not ensure profitability or viability on the other side. As such we are comfortable maintaining a cautious stance.

Global Evolution Capital

April 2020

What is on our mind - Stocks

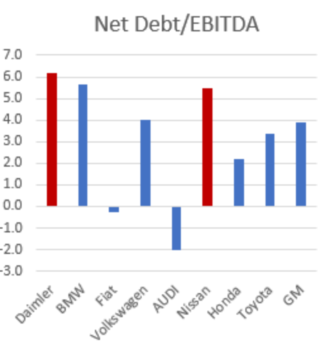
In terms of portfolio changes, our work in Connected Industrials, as foreshadowed in our March update, led us towards TE Connectivity (TEL-US). TE designs and manufactures connectivity solutions spanning Industrial, Transportation and Communication sectors.

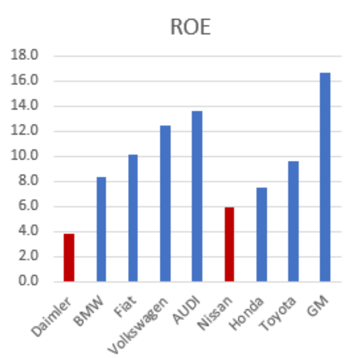


As we model out TE, it demonstrates the attributes that we look for in an investment; a business positioned in markets set for secular growth while generating strong returns (ROE approaching 20% and ROIC >10%) and operating with a solid balance sheet.

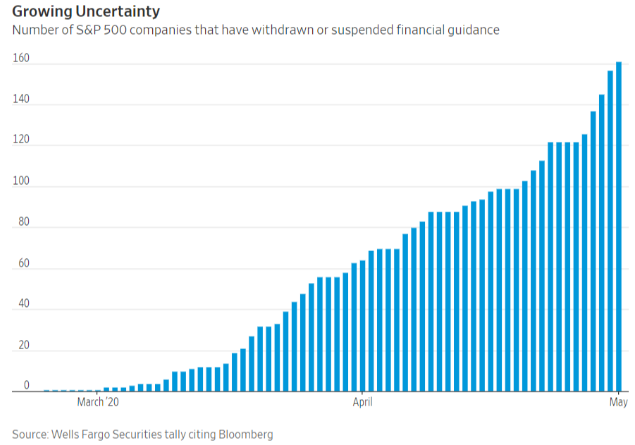
While secular growth is apparent, TE brings with it significant automotive exposure. The auto sector is under significant pressure at present and is already well represented as an exposure in the portfolio through various business lines within SQM (lithium producer), Texas Instruments (semiconductors) and Sensata (sensors). As such, we took the opportunity to remove Sensata from the Fund while adding TE. While both businesses exhibit similar operating metrics, the Sensata balance sheet is of a poorer quality.

Another position added to the Fund was a short position in the auto company Daimler (DAI-DE). The migration to electric and autonomous vehicles requires solid balance sheets to facilitate the investment required to achieve this transformation. As such those companies with constrained balance sheets remain at risk of being left behind. Daimler falls into this category, as does Nissan in which the Fund also retains a short position.





In terms of portfolio news, April saw reporting season kick into high gear. What became evident as the season unfolded was that visibility for earnings post the Covid-19 impacts had become negligible, with more than 160 of the S&P500 withdrawing guidance altogether.



In terms of the Fund, some key reporting outcomes were:

- Google
  - Revenue +13%, Operating Income (ex fines) -4%
  - Google saw search revenues fall from +ve double digits to mid teens decline by the end of the quarter. The company is slowing hiring through to year end
- Amazon
  - Revenue +26%, Operating Income -10%
  - AWS represents 77% of Amazon operating income and continues to grow at >30%. However commentary for Jun 20 was for the expected $4bn operating profit for Amazon as a whole to be consumed by Covid-19 costs
- Texas Instruments
  - Revenue -7%, Operating Income -10%
  - TXN guided to a wide revenue range for the coming quarter, with expectations of -4% to -22% on a sequential basis. TXN expect clients to stop spend rapidly and are reverting to their GFC playbook of 2008
- UPS (short)
  - Revenue +5%, Operating Income -23%
  - CEO comments of “over my 46-year career with UPS, I have never seen the level of demand variability in the markets we serve and among our customers that we are now experiencing” indicate the severity of Covid-19

The overarching theme from reporting season to date is that visibility is close to non existent, and that the impacts from Covid-19 just scraped the edges of the March quarter. It will be the June quarter results where the full impacts are felt.

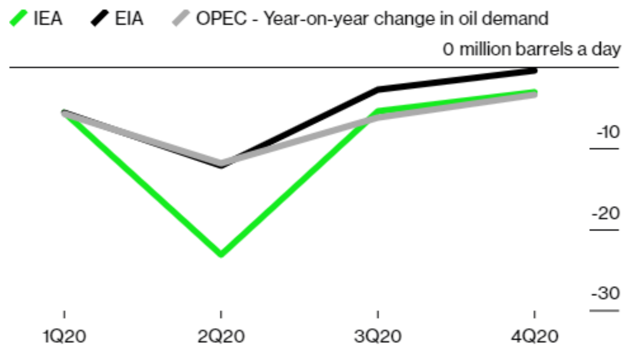
Global Evolution Capital

April 2020

Item of Interest: Oil and the danger of futures

The wildest ride in markets during April occurred in oil. Severe falls in demand combined with a supply war and the vagaries of futures contracts collided to create a situation where some oil contracts fell into negative territory. On 20th April the May futures contract for West Texas Intermediate (WTI) Crude Oil bottomed at -$37.63. That's right – people were paying to have oil taken off their hands. How did this happen?

Starting with demand, the impact of Covid-19 has seen a significant decline in oil demand as people stop flying and driving. On an annual basis, the International Energy Agency (IEA) expects oil demand to be >9m barrels a day lower than 2019, representing a 9% reduction in total demand. The figures on a quarterly basis are even worse with the IEA seeing demand falls of 23m barrels per day over Q2 before improving into year end.



Sources: Bloomberg, IEA, EIA, OPEC

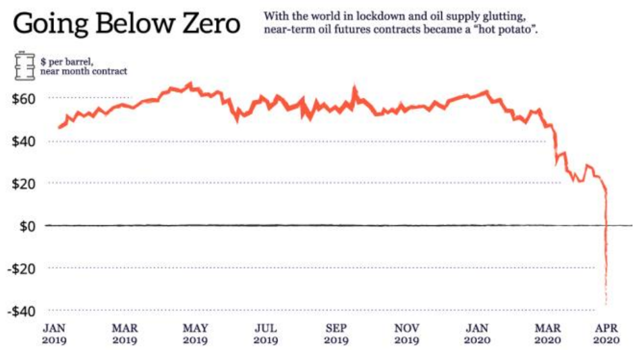
On the supply side, normally a demand shock would be met by co-ordinated cuts to retain some form of market balance. But this time tensions between Russia and Saudi Arabia, inflamed by concerns over increased US production, meant that initial discussions collapsed, and Saudi Arabia actually increased production while offering price discounts. Cuts of circa 10m barrels per day were eventually agreed.

The 10 largest oil[1] producers and share of total world oil production[2] in 2019[3]

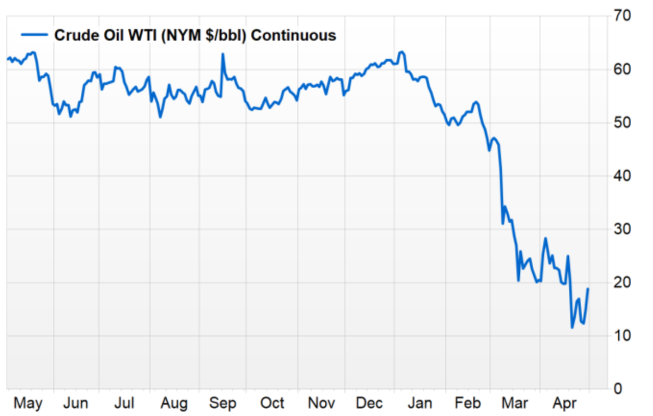
Country	Million barrels per day	Share of world total
United States	19.51	19%
Saudi Arabia	11.81	12%
Russia	11.49	11%
Canada	5.50	5%
China	4.89	5%
Iraq	4.74	5%
United Arab Emirates	4.01	4%
Brazil	3.67	4%
Iran	3.19	3%
Kuwait	2.94	3%
Total top 10	71.76	71%
World total	100.63	

Despite the agreement to cut oil production, these cuts did not commence until May. As such a significant supply glut was to persist for the coming months. Enter the West Texas Intermediate (WTI) Crude Oil Futures contract for May. This contract expired on 21st April, and if you held that contract at expiry you were obliged to take physical delivery of 1,000 barrels of oil at Cushing, Oklahoma on that date.

The problem? Given the huge demand and supply imbalance, storage at Cushing, Oklahoma was approaching capacity. So there was market panic to avoid obligations of physical delivery given there was an absence of locations to store the oil, driving the price into negative territory.



While the spot price of WTI has fallen heavily based on the demand and supply dynamics described previously, it has not traded negative. Prices bottomed at $6.50 intra-day on 21st April, and now sit at circa $22. This is +240% from trough intra-day levels but still -65% over the past 12 months).



The Fund does not currently have exposure to oil stocks. While we did briefly hold some short positions (established due to a long term view of the world turning away from oil within the global energy mix) these were stopped out during the extreme volatility in March. Given the severity of the falls and the fact that we cannot claim insights into a 3 sided geopolitical battle between Russia, Saudi Arabia and the US, we were unwilling to place capital at risk and reinstitute the positions.

Global Evolution Capital

April 2020

This turned out to be a prudent move given the degree of share price moves in the Energy sector during April. The Energy sector rebounded 30%, and some key players saw share price gains of 100-200% over the month.

- Energy: +29.66% vs (34.97%)
  - Top performers
    - APA (Apache Corporation) 225.4%
    - MRO (Marathon Oil Corporation) 96.2%
    - DVN (Devon Energy Corporation) 83.7%

So while the April moves in oil and associated volatility in oil exposed stocks did not impact on the Fund, the shifts were an invaluable lesson in general on the risks in trading futures and the inherent risk in positioning in commodity markets. Especially commodity markets such as oil where end pricing is largely disconnected from the cost of production.

Conclusion

While the world is beginning to come to terms with the trajectory of Covid-19, markets are only just beginning to see the economic impacts wash through numbers. The current reporting season is a case in point as results are only reflecting the front edge of the financial impacts; commentary accompanying results indicates that the June quarter will give a more accurate depiction of the economic damage currently cascading through economies.

While a valid argument exists to look through short term earnings impacts, even when casting towards a “normalised” situation current market valuations appear excessive. The scale and breadth of Government and Central Bank interventions have driven valuations to levels that exceed historical norms and while these interventions can provide a path to short term company survival, they cannot provide a path to a viable business capable of sustaining excessive debt loads once the stimulus begins to dissipate. For a consumer led economy like the US, given expectations for elevated unemployment levels and stressed household balance sheets the outlook makes justifying current market trading levels difficult to achieve.

As such we retain a defensive position in the Fund, and while we remain acutely aware of Central Bank interventions, our primary focus remains on analysing company financials to find the best long term investment propositions for our clients.

Trent Masters

Founder and CIO – Global Evolution Capital
6th April 2020

Sources:
- Factset Data Solutions
- The Visual Capitalist
- The Economist
- Bloomberg, IEA, EIA, OPEC