# Global Evolution Capital

## August 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 dislocations 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

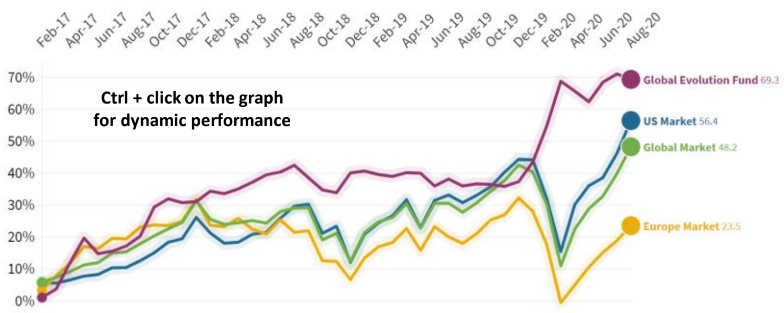
- Global absolute return fund
- Gross exposure range = 100% to 220%
- Net exposure range = -30% to +60%
- Long position range = 10 to 30
- Managed fx exposure
- Fees = 1.25% base fee and 20% performance fee above 5% hurdle rate subject to high water mark

### Current Metrics

| | |
|---|---|
| Gross Exposure | 218% |
| Long Exposure | 95% |
| Short Exposure | -123% |
| Net Exposure | -28% |
| | |
| Total Positions | 33 |
| Long Positions | 16 |
| Short Positions | 17 |

### Performance (gross, cumulative)

| | US Market | European Market | Global Market | FUND |
|---|---|---|---|---|
| **1M** | 7.0% | 3.9% | 6.0% | -1.0% |
| **YTD** | 8.3% | -6.6% | 4.0% | 23.3% |
| **1Yr** | 19.6% | 4.7% | 16.0% | 24.5% |
| **3Yr** | 42.4% | 4.2% | 29.3% | 44.6% |
| **Inception** | 56.3% | 23.5% | 48.2% | 69.3% |




***Performance Comparison***

- *US Market = SPX (S&P 500 Stock Index)*
- *European Market = IEV (iShares S&P Europe 350 Index ETF)*
- *Global Market = VT (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 (since inception)

| | US Market | Euro Market | Global Market | FUND |
|---|---|---|---|---|
| **Ending VAMI** | 1563.5 | 1234.6 | 1481.6 | 1692.7 |
| **Max Drawdown** | 20.0% | 24.8% | 22.2% | 6.0% |
| **Sharpe Ratio** | 0.85 | 0.45 | 0.78 | 1.43 |
| **Sortino Ratio** | 1.24 | 0.59 | 1.07 | 3.88 |
| **Standard Dev.** | 4.5% | 4.4% | 4.4% | 3.0% |
| **Downside Dev.** | 3.1% | 3.7% | 3.2% | 1.1% |

### Key Positions

| Long Positions | Short Positions |
|---|---|
| Alphabet (GOOGL-US) | Fedex Corp (FDX-US) |
| Amazon (AMZN-US) | Uber (UBER-US) |
| Tencent (700-HK) | Nissan (7201-JP) |
| Xinyi Solar (968-HK) | CVS Health (CVS-US) |
| Thermo Fisher Scientific (TMO-US) | Marks and Spencer (MKS-GB) |

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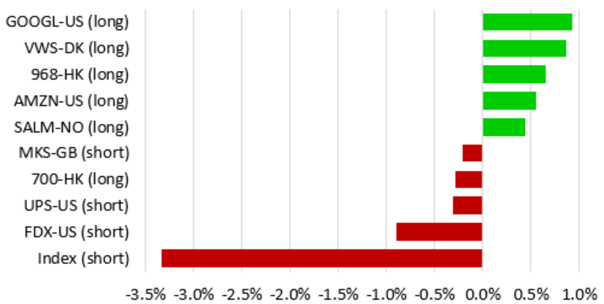
## What happened last month

Market Commentary

If the recovery to date has been extraordinary, then what happened in August was amazing. US markets lifted 7% and made gains in all but 5 trading days while Global markets rose 6%. Big tech names led the way with Apple rising 21%, Facebook 16% and Microsoft 10%. The enthusiasm for Tesla continued, posting a gain of 74% for the month. Global markets are now in positive territory on a YTD basis at +4% and are +16% on a 12month view. Given what we see as deepening scars from Covid as short term unemployment morphs into long term job losses we continue to find the current trading levels surprising. Stimulus continues to swamp reality for the time being.

Fund Performance

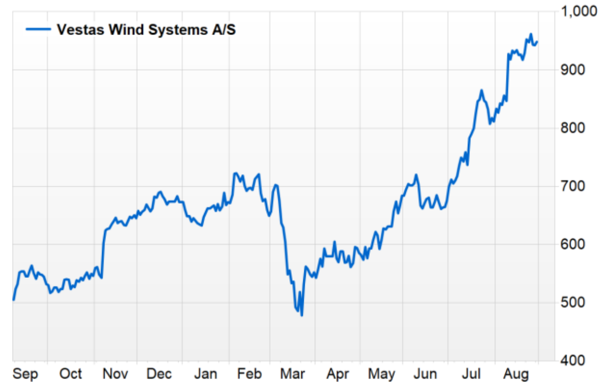
The exuberant market backdrop combined with a maximum net short positioning saw the fund fall -1.0% in August. The bulk of the losses incurred due to the defensive portfolio positioning were recouped by strong stock specific performance. The fund remains +23.3% YTD and +44.6% cumulative over 3yrs. Key contributors to August performance are below:




In terms of positive contributors in August, key drivers were:

- **GOOGL-US** (long): Alphabet continues to advance its hardware offerings through a partnership with ADT to improve their home device capabilities, as well as building the health position through a partnership with Amwell to deliver telehealth solutions. Scrutiny of the Alphabet acquisition of Fitbit by the European Commission is ongoing.


- **VWS-DK** (long): Vestas Wind Systems rose 17% over the month post 2Q results that showed strong revenue growth and a record high backlog of EUR35bn. Vestas also reintroduced full year guidance for revenue of EUR14-15bn which is +20% on 2019 at the midpoint. Headline earnings were weaker than expectations due to an extraordinary warranty provision that the market looked through.




In terms of negative contributors in August, key stock specific drivers were:

- **FDX-US (short)**: as per July, the short logistics positions again detracted in August. As per our comments in July we have been re-testing our thesis and have concluded that the current benefits of additional online volumes for Fedex and UPS are transitory, while the short term threat of Amazon, medium term threat of drones, and longer term threat of autonomy are not factored into current valuations.

  In terms of Amazon, their self-fulfilment capabilities continue to grow with data from ShipMatrix indicating 66% self-fulfilment in July, up from 61% for April to June. Amazon continue to build out their capabilities with the announcement in June of the leasing of 12 Boeing cargo aircraft taking their total fleet to more than 80. As per Amazon Web Services, we do not see this capability build ending at self-fulfilment but see it as a substantial external business line taking volumes away from incumbent players. As such we maintain short positions in FDX and UPS.


## What is on our mind - Markets

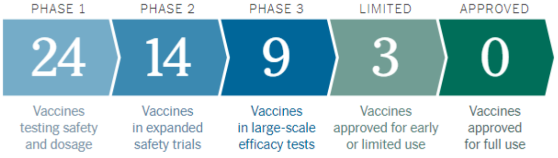
Has the extraordinary become normality? That is what it feels like in 2020 as each month throws up increasingly intriguing situations. August was no different in that regard with the remarkable market lift containing impacts spanning TikTok bans, Covid vaccine speculation, Fed stimulus signalling, "value creating" stock splits and economic recovery conjecture.

Tik Tok ban / forced sale

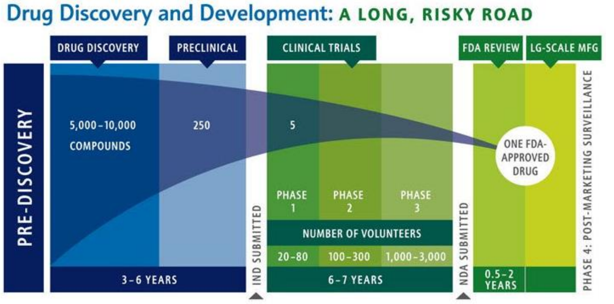
On 6th August President Trump signed an executive order banning any transactions with TikTok parent company ByteDance after 45 days (subsequently extended to 90) on the grounds that data collection by the app was creating national security concerns. Such an action effectively bans TikTok in the US unless the US business is divested to a local company. This triggered a wave of "TikTok take-over" speculation, driving up the share price of any entity rumoured to be in contention for the US$30bn business. To date this list has spanned Microsoft, Twitter, Google, Oracle and even Walmart.

Covid vaccine speculation

Covid vaccine optimism continued to wash through markets, with positive announcements driving associated share price moves and spurring broader "re-opening" trades. A summary of current vaccine status is below:




Of the leading candidates currently in Phase 3 trails, Moderna, AstraZeneca / Oxford University and Pfizer / BioNTech are leading the field with speculation that a vaccine may be available by year end. However, we remain cautious on the potential for a widespread vaccine solution in the short term. Drug development is complex, and extensive trial protocols exist to ensure safety. While a significant compression in the usual drug development cycle of 10yrs can be expected, to anticipate this to compress to <1yr is optimistic in our view. While Phase 2 results (immune response) have been promising, Phase 1 (safety) and Phase 3 (protection) generally require a higher threshold of proof for approval to occur.



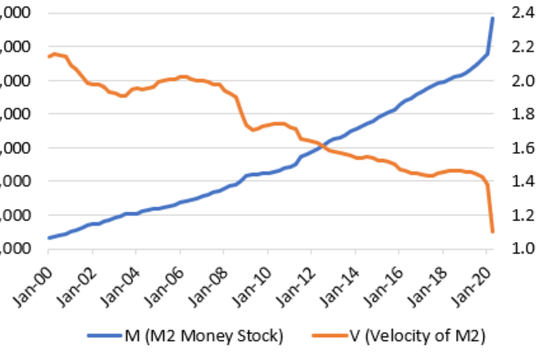

US Federal Reserve Stimulus

The most recent salvo from the US Federal Reserve in terms of indicating support for the market came in the form of a speech from US Federal Reserve Chairman Jerome Powell on 27th August where comments around targeting average inflation implied policy remaining "looser for longer". These comments drove an end of month rally in markets.

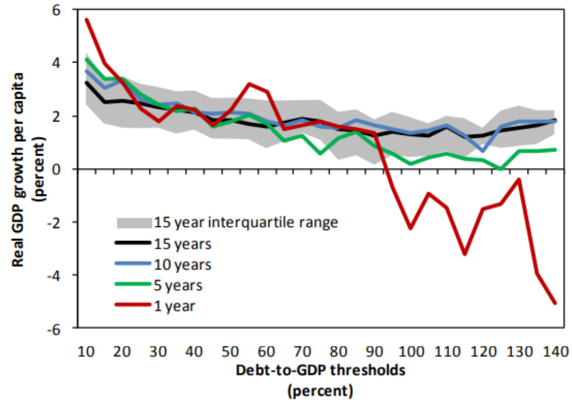
We continue to question whether the current US Fed settings will create the desired economic response above the current observable impact of driving up asset prices, and as such consider whether the current approach by the Fed will be challenged at some point in the future. First we look at attempts to lift GDP by expansion of the money supply. The prevailing view is that an expansion in the money supply (M) will lead to higher GDP as characterised by the equation below:

$$GDP = M \times V$$

However to date this has not occurred. Instead what has transpired is a commensurate fall in the velocity of money (V). It appears that while you can flood the system with liquidity it is harder to make it move as shown below:




Secondly we look at debt levels and their potential medium term drag on growth. Work by the IMF in 2014 studying the relationship between debt levels and GDP growth indicates a significant growth drag as debt levels rise. Given the current trajectory for US debt we view this as a concern, and remain unconvinced that Japan is the ideal benchmark to measure to.



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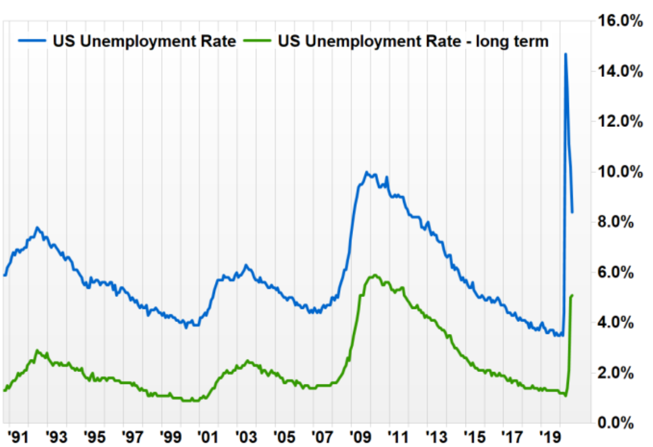
Stock splits

Another event that we found confounding in August was "value creating stock-splits". Apple and Tesla both announced stock splits during August and despite stock splits creating no additional value, both stocks lifted appreciably on the news with commentary around "greater accessibility for retail investors". Apple rose 34% and Tesla 81% in the weeks between the announced split and the split taking place. We find this financial alchemy indicative of periods of market exuberance which reinforces our wariness of current market trading levels.

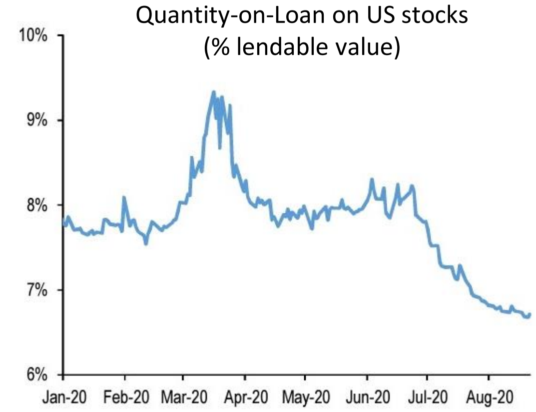

US economic recovery

Post the end of August the latest US employment figures were released, with the headline unemployment rate coming in better than expectations at 8.4%. While these headline numbers looked favourable, we remain focused on the long term unemployment number as we feel it is this metric that best represents the residual scarring from permanent job losses post the Covid impact. This measure showed a continued deterioration in August and is now approaching GFC levels giving cause for concern in relation to the trajectory and timing of the subsequent recovery.



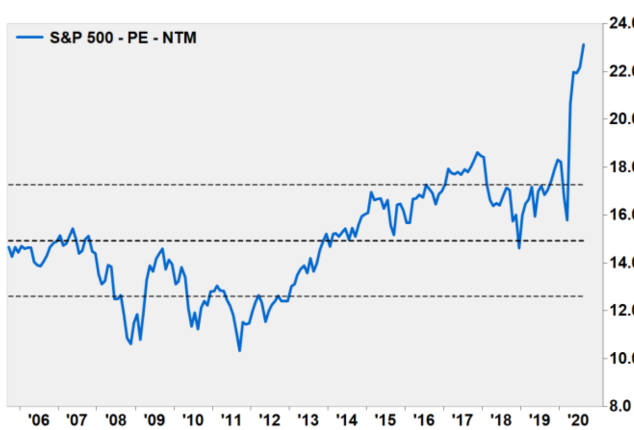

Market positioning

The final piece of data that caught our attention in August relates to market positioning. Hedge fund data indicates a movement back towards the top end of gross and net exposure ranges. This corresponds with data from Datalend that indicates that short positions on US stocks had fallen appreciably as the market has run. We find this surprising given that long term market valuation levels have been becoming increasingly stretched, even allowing for a normalisation of earnings post Covid. As such the fund has been moving in the opposite direction and has been increasing the net short position as markets rise.




**Implications for fund positioning**

Despite the myriad pieces of noise and cross-currents in markets we remain firmly focused on long term market valuation when setting overall portfolio positioning. While disconnects will occur for periods of time we believe that eventually a sanity anchored in valuation reality will re-emerge. On this front we remain surprised at the stretched levels of market valuation, with PE NTM trading >3.5x standard deviations above long term average, and PE2Yr >2 SD's above. Given these valuation metrics combined with what in our view will be an elongated economic recovery the portfolio remains positioned near the maximum net short boundary of -30%.



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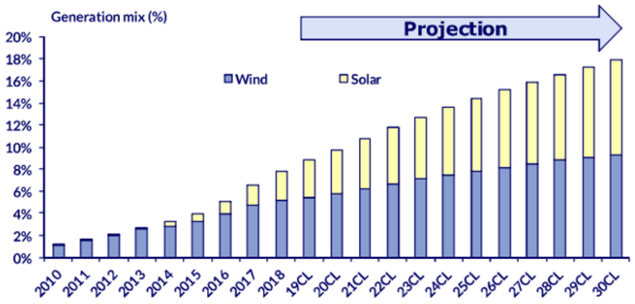
## What is on our mind - Stocks

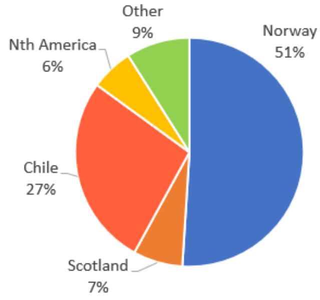
Reporting season continued to work its way through August, with the general theme being one of companies exceeding what were very low expectations. In terms of the portfolio there were a number of results of particular interest:

- **968-HK** (long): The Chinese solar producer Xinyi Solar posted results for 1H20 that were ahead of expectations, with revenue +16% and core net profit +51%. As the dominant solar glass manufacturer in China, and with China accounting for 35-40% of new global solar capacity, Xinyi is well placed to continue to benefit from the Chinese energy transition towards renewable sources as demonstrated below. The business generates operating margins of 35-40%, ROIC of 15-20%, maintains a strong balance sheet with net debt / EBITA of 1.2x and currently trades on PE1 of 22x.

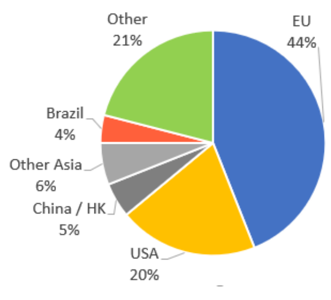



- **SALM-NO** (long): The Norwegian salmon producer Salmar was added to the fund in July and posted results for 2Q20 that were in line with expectations given the impacts of Covid. Revenue was flat on pcp at $3.3bn NOK while operating EBIT fell 11% to $882m NOK. Salmar is well placed to benefit from increased demand for aquaculture with salmon demand in particular increasing at >4% pa in volume and 12%pa in value in since 2010. The business generates operating margins of 25%, ROIC of 20% and maintains a strong balance sheet with net debt / EBITA of 0.6x. Key supply and demand origins for the salmon industry are below:

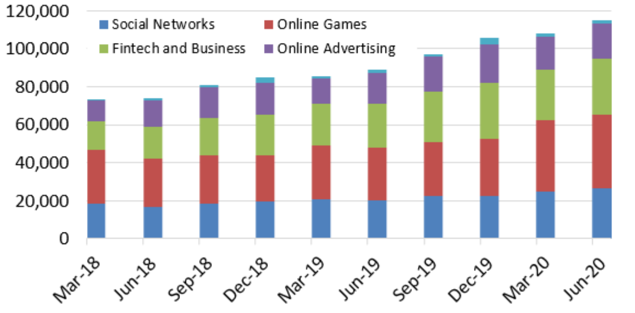
**Supply by Origin**




**Demand by Origin**




- **700-HK** (long): The Chinese internet giant Tencent posted results for 2Q20 that were exceptional. Revenue grew 29% to 115bn RMB (US$17bn) while EBIT grew 33% to 29bn RMS (US$4.4bn). Performance in games was particularly strong, with revenue lifting 40% and representing 34% of total revenues. A breakdown of revenue is below:




The main focus for Tencent through August however was being caught in the crossfire of two broader battles; a geopolitical one between the US and China and another between Apple and disgruntled app developers.

In terms of the US / China battle, the Tencent owned messaging app "WeChat" was also subject to an Executive Order from President Trump. While Tencent discloses revenue of 2% from the US there was some confusion as to how the order applied to the Tencent gaming business which is diverse. However it appears the gaming business is unaffected by the order.

The second battle between Apple and app developers involved pushback from Fortnite owner Epic Games on the 30% revenue cut that Apple takes from revenue generated through the app store. Given that Tencent owns 40% of Epic Games and Fortnite is estimated to generate US$2bn of revenue a year, at risk is just over 1% of revenue until a solution is found.

While the headlines from the US and Apple battles sound negative, in quantum they are small given the vast majority of Tencent earnings are generated domestically. We remain comfortable with the holding given the business has incredible breadth and opportunities for additional penetration of services, generates 25% operating margins, 15-20% ROIC, holds almost no net debt and is growing at 30%pa.

In terms of the broader portfolio, we are looking to trim the tech exposure post the end of August given the run in valuations. We are currently exploring the Industrials theme with a focus on automation to satisfy this minor repositioning. The European based engineering business ABB appears a likely candidate given the busines focus on electrification, automation and robotics paired with robust operating metrics, and we will look to complete the evaluation of the business in the coming week.

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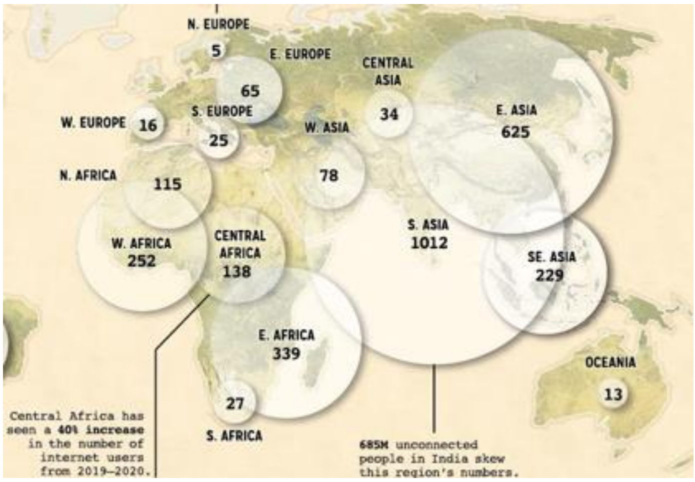
### Item of Interest: The Next Billion Internet Users

In recent years big tech companies have turned their attention to India as they seek the next leg of growth. Key initiatives have included:

- Facebook: Announced a $5.7bn investment in the top telecom operator in India, Reliance Jio Platforms, in April for a 10% stake in the business
- Alphabet: Announced in July that it plans to invest $10bn in India over the next 5 to 7 years through the India Digitization Fund, and followed Facebook into Jio Platforms with a $4.5bn investment for a 7.7% stake
- Amazon: Announced an additional $1bn investment in April taking total commitments to date to $6.5bn after Jeff Bezos stated in January that "the 21st century is going to be the Indian century".

This makes sense when you examine where the greatest number of people currently not connected to the internet and therefore the greatest future opportunity lies. South Asia (dominated by India), East Asia (dominated by China) and Africa represent the key regions for future internet penetration.




On a country specific basis, the greatest opportunity lies in India, as shown below:

| Country | Unconnected people (m) | % of Population |
|---|---|---|
| India | 685.6 | 50% |
| China | 582.1 | 41% |
| Pakistan | 142.3 | 65% |
| Nigeria | 118.1 | 58% |
| Bangladesh | 97.4 | 59% |
| Indonesia | 96.7 | 36% |
| Ethiopia | 92.4 | 81% |

Given the closed internet ecosystem of China, the targeting of India as a key strategic growth leg makes logical sense.

The other region of interest for tech players is Africa given the penetration story overlayed with strong population growth. In terms of the fastest growing regions for internet use, Africa is currently dominant. Growth in internet use from 2019 to 2020 by key region is below:

| Region | Change in use % (2019 - 20) |
|---|---|
| Central Africa | 40% |
| Southern Asia | 20% |
| Northern Africa | 14% |
| Western Africa | 11% |

Such factors prompted Twitter CEO Jack Dorsey to announce an intention to live in Africa for 3-6 months in 2020. However these plans were curtailed when the Board of Twitter thought it best that their CEO who also moonlights as CEO of payments business Square Inc (which incidentally is twice the size of Twitter) may be better served operating a little closer to home.


What we find interesting from this data is a misconception that the internet penetration story is largely a mature one. But to conclude this is to look at current penetration rates through developed market eyes. While European and North American penetration rates approach 90%, this represents only 15% of the global population. India and Africa both represents approximately 17% of the global population each, and with penetration rates of <50% they represent substantial opportunities for growth in the coming decade.

The fund will open to new investors in 2H20.
To indicate your interest or discuss the fund in more detail, please contact us on:

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***10th September 2020***

*Sources: Factset Data Solutions, NYT coronavirus vaccine tracker, FT.com, Datalend, JPMorgan, Pharma Research and Manufacturers of America, Federal Reserve Bank of St Louis, IMF: Debt and Growth is there a magic threshold, Visual Capitalist, Datareportal*