Global Evolution Capital

March 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

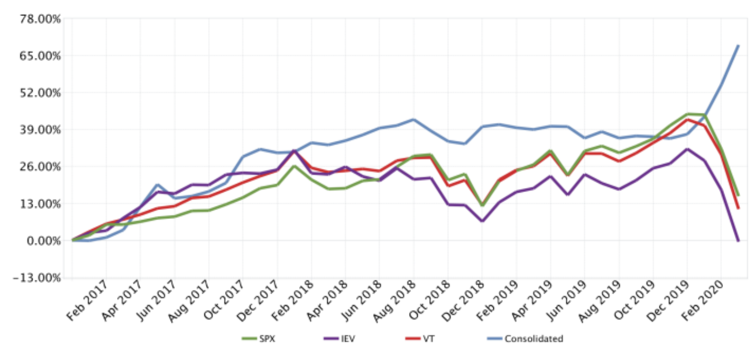
- Global absolute return fund
- Gross exposure range = 100% to 220%
- Net exposure range = -30% to +60%
- Long position range = 10 to 30
- Managed fx exposure
- Fees = 1.25% base fee and 20% performance fee above 5% hurdle rate subject to high water mark

Current Metrics

Gross Exposure	157%
Long Exposure	71%
Short Exposure	-85%
Net Exposure	-14%
Total Positions	30
Long Positions	14
Short Positions	16

Performance (gross, cumulative)

	US	Europe	Global	FUND
1M	-12.5%	-15.4%	-14.8%	9.1%
YTD	-20.0%	-24.8%	-22.2%	22.8%
1Yr	-8.8%	-15.9%	-12.0%	21.4%
3Yr	9.1%	-7.6%	3.1%	62.4%
Inception	15.4%	-0.6%	10.9%	68.7%



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:	1,154.44	994.19	1,109.13	1,686.68
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:	0.28	-0.03	0.19	1.44
Sortino Ratio:	0.34	-0.04	0.23	3.89
Calmar Ratio:	0.23	-0.01	0.15	2.90
Standard Deviation:	4.20%	4.44%	4.20%	3.06%
Downside Deviation:	3.37%	3.63%	3.44%	1.13%

Key Positions

Long Positions	Short Positions
Alphabet (GOOGL-US)	Fedex Corp (FDX-US)
Amazon (AMZN-US)	Uber (UBER-US)
Tencent (700-HK)	Hewlett Packard (HPE-US)
Xinyi Solar (968-HK)	CVS Health (CVS-US)
Biogen (BIIB-US)	Kohl’s (KSS-US)

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What happened last month

Market Commentary

If February was described as a wild ride, we are at a loss for an appropriate word to describe March. Not since the GFC have markets swung with such ferocity as the health impacts of the coronavirus, and the financial implications of the actions required to contain it, crashed their way into market valuations. Accentuating the volatility were the myriad of responses from Central Banks and Govs while also thrown into the mix was an oil price war between Saudi Arabia and Russia.

Fund Performance

Against this backdrop, the Fund performed strongly in March recording its best month on record. The Fund gained 9.1% in the face of market falls of -12% to -15%. On a YTD basis, Fund performance was +22.8% vs Global Markets at -22.2%.

Key positive contributors to performance in March were:

- Amazon (long): the resilience of the Amazon cloud business combined with the shutdown of physical retail creating an advantage for online players saw Amazon materially outperform the market (+3.5% vs -15%).

- Physical retail (short): store shutdowns and questions around the sustainability of capital structures led to large falls in the share prices of Dillards (-34%), Marks and Spencer (-37%) and Kohl's (-63%).

Key negative contributors to performance in March were:

- Xinyi Solar (long): While results for 2019 were strong (+30%yoy), solar glass products are likely to experience softer demand and pricing in the current environment.

- UPS (short): Post significant falls in February post Q4 results, UPS recovered marginally in March as delivery services experience localised demand. However we expect underperformance to recommence in coming months.

General Observations

The impacts of Covid-19 on share prices generally differed depending on two key characteristics for companies; exposure to the physical economy and the strength of balance sheets.

Given the nature of the virus response in shutting down cities and restricting movement, companies that require physical interaction such as entertainment venues and retail stores were particularly hard hit. Travel related companies were also heavily impacted. Given the focus of the Fund on transformational shifts the Fund holdings are more skewed towards "new economy" businesses in IT and health which helped drive out-performance.

In terms of balance sheets, given the speed and severity of the revenue impact, exposed companies with elevated gearing experienced out-sized falls due to doubts as to whether they could survive a prolonged downturn. Again given the Fund has a strong balance sheet as a pre-condition for investment, the Fund holdings in general suffered less of an impact.

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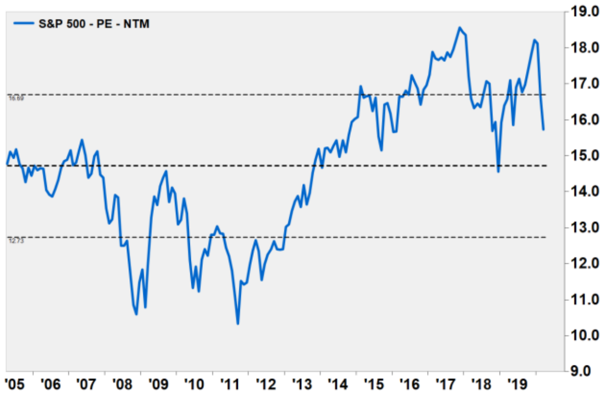
What is on our mind

At a portfolio level, as markets fell during March the Fund naturally de-risked as the stock specific short positions contracted and the index short position generated cash. This led to the net short position of the Fund contracting from -27% towards -10%. However, despite these price falls markets do not yet look “cheap”. Especially in light of the fact that earnings expectations still factor in a relatively aggressive recovery from current circumstances. As such we retain a net short position heading into April.



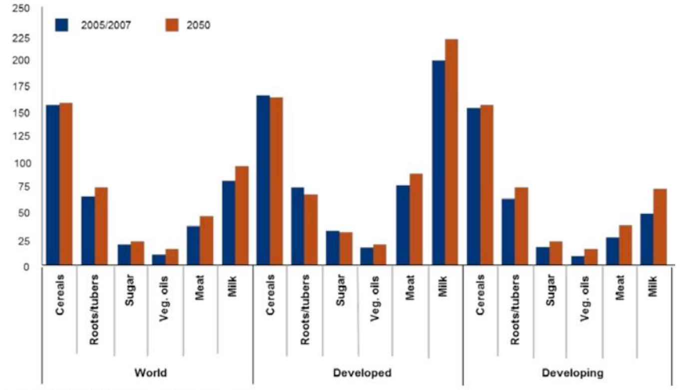
What has been a challenge this month is the extreme volatility in markets, combined with difficulties in factoring in the potential shape of the myriad stimulus packages that Central banks and Governments are pushing into the system. This is especially challenging when it comes to the short side of the book. The nature of some of these stimulus packages leave Governments with the ability to “pick winners” making conviction shorts of distressed businesses more fraught than usual. As an example, price moves for the **week** of 23rd March for select travel and finance companies in the S&P500 are below. To stand in front of these movements can be a dangerous place to be.

- +70.5% **BA** (Boeing Company): -49.6% YTD
- +61.0% **LNC** (Lincoln National Corporation): -52.8% YTD
- +52.1% **DFS** (Discover Financial Services): -54.2% YTD
- +51.2% **UNM** (Unum Group): -44.3% YTD
- +44.9% **RCL** (Royal Caribbean Cruises Ltd.): -73.6% YTD

As such we have been selective in terms of rebuilding short positions, and have increased the reliance on index shorts to manage net exposure where comfort cannot be reached. This also extends to some energy short positions where given that we can claim no insight into the machinations or likely outcome of the supply war between Russia and Saudi Arabia, once these positions closed we decided to remain on the sidelines and re-focus our attention elsewhere.

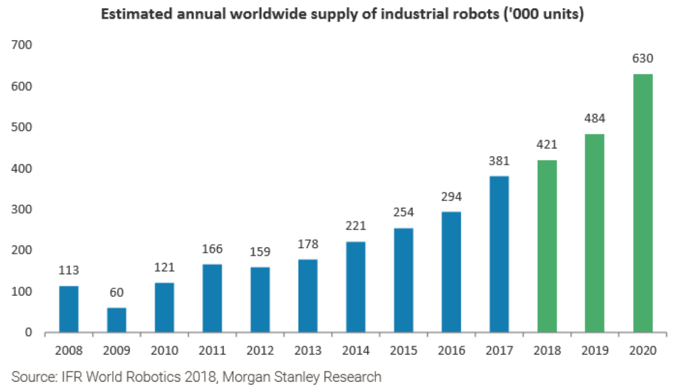
At a stock specific level, from mid-April the quarterly reporting season kicks into gear. It is at this point that we will gain greater clarity from companies in terms of quantifying the impact on earnings from the current situation. Of particular interest will be commentary around the impact on advertising spend given this is a key leg of value for Alphabet. Further details around the push of Amazon and Uber into delivery, continued cloud computing migration, and developments in health will also be a key focus.

At a thematic level we are turning our attention towards resource shortages and connected industrials. On the resource shortages side, we continue to explore the collision between population growth, an emerging middle class and available resources. The shift in diets as the middle class emerges (more meat and dairy) led us to an initial investment in China Mengniu Dairy. We will broaden this work in the coming months.



Source: UN FAO, BofA Merrill Lynch Global Research

And given the pressure in the industrial space, we will take the opportunity to explore potential investments in the connected industrials space, with an initial focus on robotics.



Source: IFR World Robotics 2018, Morgan Stanley Research

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Item of Interest – Current downturn vs GFC

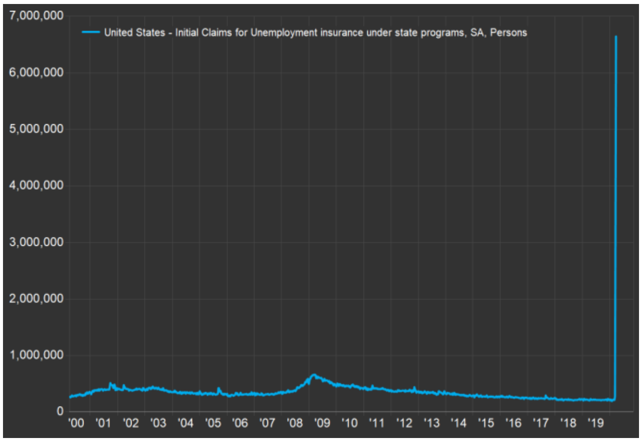
History doesn't always repeat. But there are episodes that can be illustrative in terms of the shape of what to expect. As such we look to the GFC for a recent and broad ranging economic dislocation to put the current situation in context.

As can be seen in the S&P 500 chart at the bottom of the page, as the economic system shuddered post the Lehmans collapse, a myriad of policy responses were wheeled out covering rescue packages, funding lines, rate cuts and even Government equity stakes in distressed financial businesses in an effort to find some form of stability. Within the 6 month period of broader equity market falls were some significant rallies as markets hoped that what was announced was enough to cushion the blow. The scale and duration of the moves between the periods highlighted below were:

Points	Move	Cumulative	Duration
1 to 2	-32%	-32%	5 weeks
2 to 3	+18%	-20%	1 week
3 to 4	-25%	-40%	2 weeks
4 to 5	+24%	-26%	7 weeks
5 to 6	-27%	-46%	9 weeks

Major policy announcements that drove these intra-period rallies were progressively mugged by an economic reality that a deep recession was unavoidable, and with it rising unemployment and deep cuts to company earnings. The market only found a bottom in March 09 once earnings expectations had properly reflected the economic damage the GFC episode had caused.

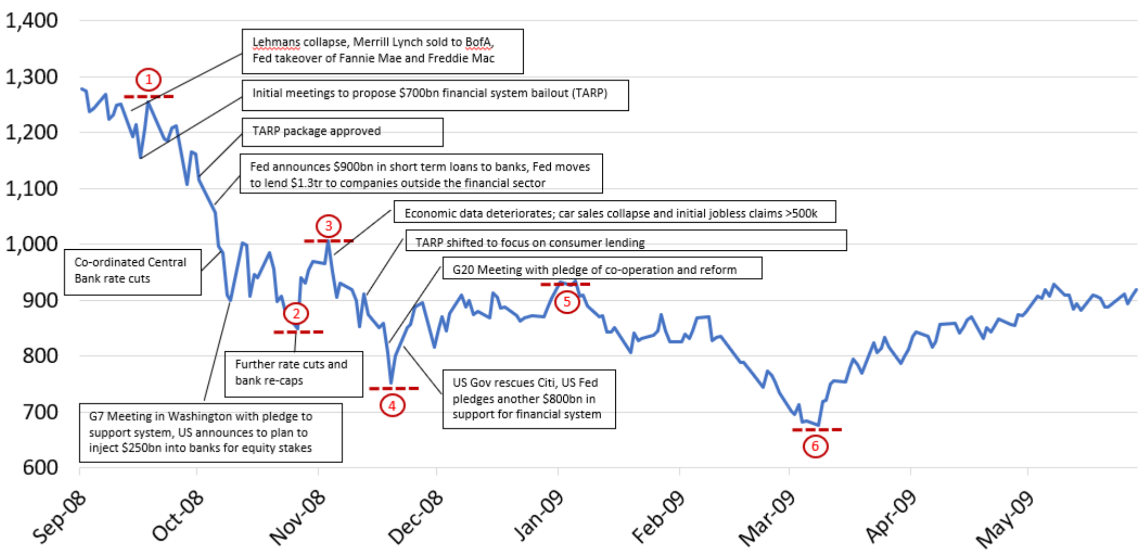
In terms of how the current situation compares, below is a graph of US initial jobless claims. During the GFC the measure peaked at 665,000 in March 09. The most recent reading for 27th March 2020 was 6,650,000. This number is unprecedented in history.



Looking at the GFC period, the unemployment rate peaked at 10.0% and the GDP decline was 5.1%. Given the gravity of the current situation, expectations are for the depths of this period to far exceed these metrics.

Given some continuing expectations for a V-shaped recovery, we do not feel that markets are adequately pricing the impact of this current episode. As such it appears to us when looking at market valuations and expectations that we are currently at point 3 in the chart below, with the full gravity of the economic damage caused by Covid-19 still to be adequately reflected in company earnings.

S&P 500 – GFC Period



On a brighter note, on a stock specific level there have been some companies that have made strong gains in the current environment as the shift in work practices has created elevated demand for their products. Two companies facilitating the current "work from home (WFH)" situation have experienced particularly strong gains.

The first is Zoom Communications (ZM-US). Zoom is a video-conference communications platform that has experienced explosive growth with the advent of a global economy increasingly confined to their homes. The Zoom share price has risen 118% so far in 2020 pushing its PE NTM to >250x.

Another key beneficiary of the WFH trend has been Citrix Systems (CTXS-US). Citrix provides digital workspaces for employees connecting through to the office environment remotely. As such demand for Citrix solutions has risen pushing the share price +28.5% in 2020. While this isn't as lofty as Zoom, for a larger and more mature business a lift of circa +30% in the face of materially lower global markets is significant.

The key question for both of these businesses will be how much of the current activity sticks when the environment returns to normal. While there can be an expectation of some of the decentralised work practices remaining, we believe that a centralised office environment will also retain a meaningful place.

Where we do see a more sustainable shift occurring is in video conferencing replacing corporate travel for an increased proportion of low value meetings given the time and expense associated with business travel.

Given the Fund's focus on industry dislocations, we did evaluate Zoom and Citrix as potential investments. We did not envisage a global pandemic driving such a rapid adoption of their services so this evaluation only occurred once share prices had lifted. At current levels it is difficult to put together a set of assumptions that support current trading levels and as such we will remain passive observers of the WFH investment boom for the time being.

Conclusion

The current environment remains fraught with the full economic impact of the current global shutdown yet to wash its way adequately into company earnings and valuations. Economies just don't "bounce back" after such a material lift in company distress and unemployment. The impact on confidence and spending lingers well after the initial system shock and subsequent announcement of recovery programs.

As such we retain a defensive position in the Fund, with a mildly net short position. We will continue to look for company earnings to be adequately rebased and valuations to reflect a more protracted downturn before looking to move the Fund back towards a positive positioning.

In the meantime we continue to work through a range of industry dislocations to identify new opportunities for our investors.

Trent Masters

Founder and CIO – Global Evolution Capital
3rd April 2020