MONTHLY REPORT MAY 2022

FUND PERFORMANCE TO 31 MAY 2022

	1M	3M	6M	1yr	2yr p.a.	3yr p.a.	SI³p.a.
Net Fund Performance[1]	-5.9%	-1.8%	-4.0%	0.5%	13.3%		7.3%
Benchmark Performance[2]	-7.0%	-3.6%	-11.0%	-4.6%	10.0%		5.0%
Excess Return	1.1%	1.8%	7.0%	5.0%	3.3%		2.3%

1. Return net of 0.89% p.a. management fee. **2.** S&P/ASX Small Ordinaries Accumulation Index. **3.** Inception date: 31 Oct, 2019. Past performance is not a reliable indicator of future performance, p.a performance is annualised.

The Longwave Australian Small Companies Fund decreased by 5.9% during May 2022, outperforming the 7.0% decrease in the S&P/ASX Small Ordinaries Accumulation Index benchmark by 1.1% over the month.

EVERYTHING EVERYWHERE ALL AT ONCE

"I very frequently get the question: 'What's going to change in the next 10 years?' And that is a very interesting question; it's a very common one. I almost never get the question: 'What's not going to change in the next 10 years?' And I submit to you that that second question is the more important of the two -- because you can build a business strategy around the things that are stable in time. ... In our retail business, we know that customers want low prices, and I know that's going to be true 10 years from now. They want fast delivery; they want vast selection. It's impossible to imagine a future 10 years from now where a customer comes up and says, 'Jeff I love Amazon; I just wish the prices were a little higher,' or 'I love Amazon; I just wish you'd deliver a little more slowly.' Impossible." – Jeff Bezos, Amazon founder, July 2016

Investors frequently focus on the constant change in markets. Investors spend less time considering what is not going to change in markets. Like Jeff Bezos, we would submit this is the more important question and building an investment approach around things that are stable in time is more likely to work.

WHAT CHANGES IN THE INVESTMENT WORLD?

During most months it feels like Everything Everywhere All at Once.

Business Cycles (GDP, interest rates, inflation, exchange rates), Politics and geopolitics, Technology, Market players (politicians, executives, fund managers, bankers), Demographics, Themes (Dot Com, BRICs, Commodity Super Cycle, SaaS, Digital Disruption, Crypto), Investment structures (public, private, venture, ETF, LIC, LIT). The list goes on and on. On any day you can pick up a newspaper or a broker report and read thousands of words on the fleeting and ultimately long-term inconsequential changes in the investment world.

WHAT IS LIKELY TO REMAIN STABLE OVER TIME?

We think there are three constants for investors to consider: 1) human behaviour, 2) investment arithmetic and probability, and 3) costs.

Human behaviour: Having invested through a few bubbles and crashes now (tech bubble in the late 1990s, the US housing bubble in 2005-08, the commodity bubble in 2010 and the latest post-COVID bubble) and studied some of the more prominent examples of history, it never ceases to amaze how consistently humans behave. The cycles of fear and greed and the response to market events governed by instincts formed thousands of years ago continue to repeat. Each cycle is updated for modernity, but people are constant and respond to the same stimuli. Humans are adapted to focus on change and susceptible to act in ways unproductive to long term investment outcomes. There are hundreds of books, papers, and studies on behavioural bias in investing, but reading about them is not enough. Investors should consider deliberate actions and processes to reflect and control these biases. We have many embedded in our investment process from complex systematic models to pre-trade checklists to help us make more objective, unbiased and consistent investment decisions.

Investment arithmetic and probability: Investing is grounded in some pretty solid foundations around discounting future cash flows. Wild share price swings come not from an argument about the math, rather the uncertainty (hence probabilities) about the key variables – future company cash flows and the appropriate discount rate.

CONTINUED

TOP 10 HOLDINGS

Name (Alphabetical)
Beach Energy Ltd
Brickworks Ltd
Corporate Travel Management Ltd
Fletcher Building Ltd
Janus Henderson Group PLC
Mainfreight Ltd
Sims Ltd
Spark New Zealand Ltd
Viva Energy Group Ltd
Whitehaven Coal Ltd

FUND AND BENCHMARK SECTOR WEIGHT (%)

	Fund	BM²
Communication Services	8.0	6.1
Consumer Discretionary	12.5	12.5
Consumer Staples	3.1	5.2
Energy	11.8	6.5
Financials	10.7	10.2
Health Care	4.0	5.1
Industrials	11.3	6.9
Information Technology	5.1	8.3
Materials	22.2	24.6
Real Estate	6.4	14.5
Utilities	0	0
Cash	4.9	0.0

STOCK ATTRIBUTION (ALPHABETICAL)

Top 5 - Contributors
AUB Group Ltd
AVZ Minerals Ltd
Eagers Automotive Ltd
Lake Resources NL
Sayona Mining Ltd

Bottom 5 - Detractors
Brickworks Ltd
Corporate Travel Management Ltd
CSR Ltd
News Corp
PEXA Group Ltd

Occasionally – usually in the middle of a bubble – the very idea of discounting future cash flows at a discount rate becomes questioned and "new math" attempts to justify the unjustifiable.

We have yet to see an example of when forgetting to consider investment arithmetic and probability resulted in a superior long-term outcome. Eventually valuation always matters. There are high prices where great businesses become lousy investments. There may also be prices where lousy businesses become great investments, but this is a much harder game as the potential to be stopped out (equity goes to zero) means the logic of business quality vs price is not symmetrical. In small caps we believe it is better to focus *only* on the good businesses as the risk of total failure from low quality enterprises is far greater in this part of the market.

Costs: Many finance professionals like to avoid talking about costs because investment costs are their revenue. Longwave included. Costs in all their forms (transaction costs, spreads, stock-based employee compensation, fund management fees, taxes, custody, accounting etc) are constant and unavoidable. Understanding what costs stand between an investment idea and realised net returns and minimising them where appropriate and possible will always improve investment outcomes. As inflation moves through the economy, the friction from costs is going to increase. Pretending they don't exist won't help.

In a world that will continue to change and surprise, an investment approach should consider the consistent behaviour of humans, foundational investment arithmetic and probabilities and the influence of costs on the investment outcome.

WHAT DO LONGWAVE CLIENTS VALUE OVER TIME?

We have built both our investment approach and our fund objectives around things that are likely to be stable through time. Regardless of what else happens, we believe our clients will continue to prefer More Consistent Alpha at Lower Fees and this is the focus of our fund. Today, tomorrow and 10 years from now, we can't imagine a client who asks us to deliver lower alpha. Who asks us to make our performance more volatile. Who asks us to charge them a higher fee.

PORTFOLIO POSITIONING AND PERFORMANCE

Lithium stocks are around 6% of the small ords index and may be the last speculative bubble yet to re-price. Unlike producers recently promoted into the ASX 100 (Allkem, IGO, Mineral Resources, Pilbara Minerals) the remaining small cap names are all non-producing development projects including Liontown (1.05%), AVZ (0.94%), Core Lithium (0.90%), Lake Resources (0.76%), Firefinch / Leo Lithium (0.53%), Sayona (0.51%), Ioneer (0.42%), Vulcan Energy (0.36%) and Novonix (0.53%). Many of these stocks meet all the characteristics of hope stocks we outlined last month. As the market starts to move from pricing the hope, to valuing these mining projects in a more defined way, the gap between market value and economic value is starting to close. The underperformance of many of these lithium names was a key source of relative outperformance for the fund during the month.

A-REIT underperformance in the face of high inflation and interest rates was also a contributor during the month.

Detractors included communications services (Overweight Newscorp), industrials (Fletcher Building and Mainfreight) and consumer discretionary (Corporate Travel). Inflation may result in a consumer spending preference shift towards staples and away from discretionary and the market appears to be starting to consider this impact. In these sectors we view the quality of the companies we own and their valuations to both support strong long-term returns, however near-term uncertainty may be unavoidable as inflation ripples through the economy.

Fund characteristics	
NAV	A$1.1148
Redemption unit price	A$1.1115
Inception Date	31 Oct, 2019
Minimum Investment	A$25,000
Management Fee	0.89% p.a.
Performance Fee	-
Buy / Sell Spread	0.30% / 0.30%
Benchmark	S&P/ASX Small Ordinaries Accumulation Index
Distribution frequency	Half-yearly
Portfolio FUM (A$m)	6.0
No. of Holdings:	119
Portfolio Managers	David Wanis, Jai Beathe & Melinda White
Strategy FUM (A$m):	184.3

INVESTMENT OBJECTIVE

The Fund aims to outperform the S&P/ASX Small Ordinaries Accumulation Index over the long term.

The Fund aims to provide long-term capital growth through investment in a diversified portfolio of high-quality Australasian small companies (outside S&P/ASX 100 Index at time of investment or expected to be within six months).

INVESTMENT STYLE

Longwave's investment philosophy is underpinned by the belief that the stocks of high-quality small companies outperform the benchmark over time, and as such, an active approach to investing in high-quality stocks provides value to investors who might otherwise have invested passively. Longwave believes in the value of a deep and fundamental understanding of the securities in which we invest.

Signatory of: