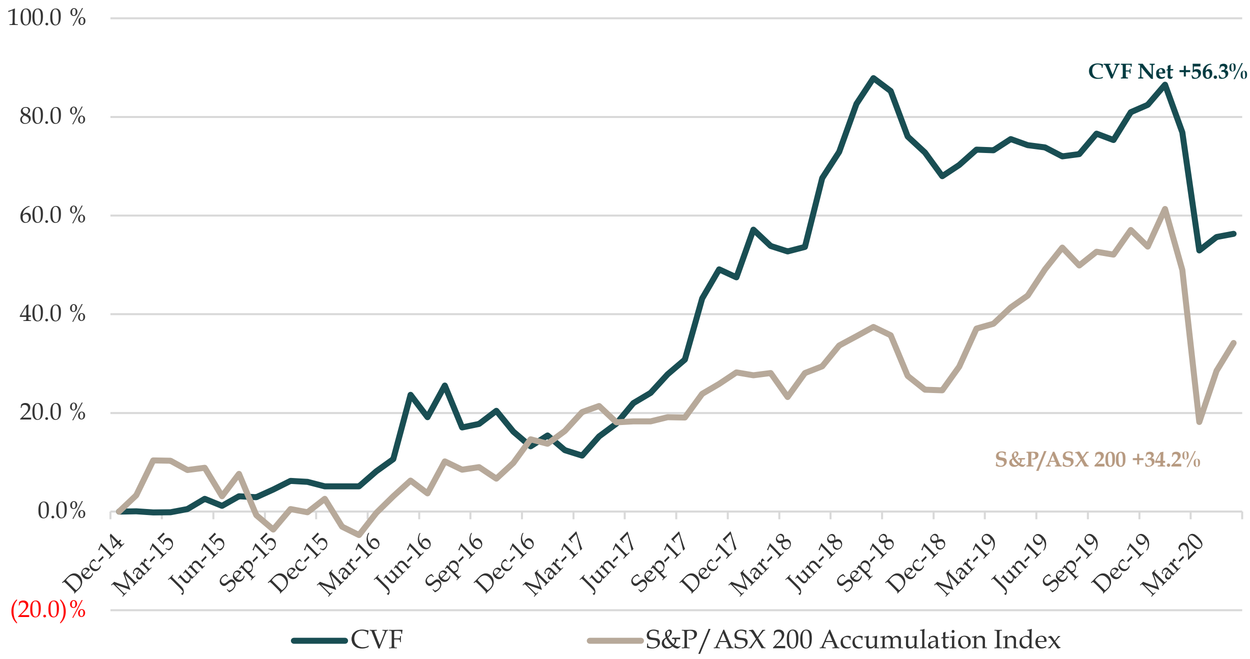
AROWANA
CONTRARIAN VALUE FUND

# Monthly Update | May 2020

## Fund Performance

### CVF Cumulative Net Performance vs Index - Since Inception




| At 31 May 2020 | 1 mth | 6 mths | 1 yr p.a | 2 yr p.a | 3 yr p.a | Since IPO (5 Jan 2015) Annualised | Cumulative |
|---|---|---|---|---|---|---|---|
| **Arowana CVF Gross performance** | 0.6 % | (12.2)% | (8.1)% | (1.2)% | 14.0 % | 12.0 % | 84.5 % |
| S&P/ASX200 Accumulation Index | 4.4 % | (14.6)% | (6.7)% | 1.8 % | 4.3 % | 5.6 % | 34.2 % |
| Gross outperformance | (3.8)% | 2.4 % | (1.4)% | (3.0)% | 9.7 % | 6.4 % | 50.3 % |
| | | | | | | | |
| **Arowana CVF Net performance*** | 0.4 % | (13.6)% | (10.3)% | (3.4)% | 9.9 % | 8.6 % | 56.3 % |
| S&P/ASX200 Accumulation Index | 4.4 % | (14.6)% | (6.7)% | 1.8 % | 4.3 % | 5.6 % | 34.2 % |
| Net outperformance | (4.0)% | 1.0 % | (3.6)% | (5.2)% | 5.6 % | 3.0 % | 22.1 % |

** Net of all fees and expenses, pre-tax*

## Net Tangible Assets (NTA) per Share

| At 31 May 2020 | $ |
|---|---|
| **NTA pre-tax on unrealised gains** | **$1.02** |
| **NTA after tax on unrealised gains[1]** | **$1.04** |

*1.The Company is required to estimate the tax that may arise should the entire portfolio be disposed of on the above date and show the result per share after deducting this theoretical provision. Generally, any such tax would generate franking credits, whose value would not be lost but rather transferred to shareholders on payment of franked dividends. At the current time, this would not be the case as the fund has unrealised net losses on its holdings and these would offset tax liabilities.*

## Top 5 Holdings (% of Gross Portfolio Value)

| Ticker | | % |
|---|---|---|
| PSH.NA | PERSHING SQUARE HOLDINGS | 9% |
| AENA.SA | AENA SME SA | 6% |
| CCL.LN | CARNIVAL PLC | 5% |
| VRL | VILLAGE ROADSHOW LIMITED | 4% |
| DSCK.US | DISCOVERY COMMUNICATIONS | 4% |
| **Top 5 as % of Gross Portfolio** | | **28%** |


**Contrarian Value Fund Limited** (ACN 602 250 644)
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Date of announcement: 12 June 2020

## Newsletter

During the month of May CVF recorded a return of 0.4% net of all costs and fees while the S&P/ASX200 Accumulation Index posted an increase of 4.4%. Pre-tax NTA per share stood at $1.02 as of 29 May 2020. In addition, the current franked dividend yield stands at 13.6% based on a share price of $0.82.

Global markets continued their dramatic recovery during the month as massive government stimulus programs manifest in significant liquidity calming bond markets and fueling a sharp rebound in risk assets including equities. As for the drivers behind one of the speediest market recoveries on record (if it is sustained) we posit that the rapid response of governments around the world to 'do whatever it takes' to support their economies and markets have likely led investors to believe the worst is behind us. According to the IMF, $9 trillion of fiscal stimulus has been announced globally in response to the pandemic (weforum.org). To put this in perspective, the G20 countries, where the bulk of the spending lies, have so far committed 4.5% of GDP in fiscal support compared to 2.5% of GDP during the GFC. Germany, Italy and the UK have announced fiscal support measures equivalent to greater than 20% of their respective GDPs. While much of the support in the largest Eurozone countries and the UK is in the form of guarantees which may not be fully taken up, these measures have been combined with massive monetary stimulus. The ECB has pledged to buy corporate and sovereign assets equal to over 7% of Eurozone GDP while the UK has announced an asset purchase program totaling 9% of GDP. Meanwhile, the US has announced an enormous stimulus package with direct fiscal support equal to over 11% of GDP. In addition, the US Federal Reserve has announced an 'unlimited' QE program which initially covered US Treasuries and mortgage backed securities but was later amended to include Corporate bond ETFs to ensure liquidity in the High Yield bond markets. Some have estimated that this will likely amount to $4 trillion which would equate to almost 20% of GDP. But it appears that estimate may be conservative. As of 2 March, the Fed's Balance Sheet stood at $4.2 trillion and as of 27 May it had expanded to an astounding $7.1 trillion. This is almost 3x the increase witnessed during the GFC. Finally, Australia's own fiscal measures announced to date total just under 9% of GDP and for the first time the RBA has launched its own QE program which has thus far amounted to $50 billion or 3.5% of GDP (Fitchratings.com, RBA.gov.au). It remains to be seen whether these measures will be enough to stimulate a sustained recovery and bring millions of jobs back into the global economy. While they seem to have calmed investors frayed nerves and inspired an optimistic view on a global recovery one wonders what price will be paid for this massive stimulus response? As global debt to GDP has already risen to unprecedented levels before the crisis, can inflation be far behind as governments look to inflate away this massive increase in debt?

Amidst this market rally we continue to judiciously look for opportunities to upgrade the quality of the portfolio as well as enhance the overall margin of safety. As for the existing portfolio, we continue to closely monitor holdings like Carnival whose businesses have been severely impacted by the coronavirus, to determine if the current challenges are temporary in nature or represent a structural shift leading to a permanent impairment of the business. After a recent capital raise, Carnival appears to have sufficient runway from a liquidity perspective to weather a complete shutdown of operations through the end of 2020 to perhaps Q1-21. In addition, they likely have further liquidity options such as debt holidays from export finance agencies and ship liquidations (our research indicates that the Chinese are active buyers of ships as they look to build a domestic cruise industry of their own). As well, there are early indications that demand is registering signs of improvement with pricing for 2021 holding firm. Booking volumes for 2021 are showing sequential improvement with a very small percentage of that demand coming from cancelled cruises being re-booked. CCL's global footprint also presents an opportunity to phase in operations sooner in parts of the world that were not as severely impacted by the virus like Shanghai and Hamburg. However, we are mindful of the risk that a second wave of the virus could cause yet another protracted lockdown in many parts of the world and lead to a material change in the economics of the cruise industry. We continue to monitor the situation closely and weigh potential downside risks.

We also note that there are quite positive signs that our most recent acquisitions should fare well in a sustained recovery. Our cumulative purchases over the last two months have appreciated by over 19% from our original cost. We say this with great trepidation as we are long term investors and firmly believe that investing is a marathon, not a sprint. However, we mention it, as it is in part, a confirmation of our original thesis that these companies would be most levered to rebound in a sustained recovery.

Finally, we would like to leave you with some observations regarding risks we see building as a result of the rise of passive investing. The extraordinary growth in indexation post the GFC has resulted in passively managed assets recently surpassing those of actively managed funds for the first time in the US. In part due to this dramatic rise, two of the most popular ETFs, the SPDR S&P 500 (SPY) and the NASDAQ 100 (QQQ), today are far more concentrated than investors may be aware. As a background, the S&P 500 Index, on which the SPY is based, is the most widely used index globally with USD 3.4 trillion of passive assets tied to it and the SPY is the largest ETF with over $270+bn in assets (S&P Global, etfdb.com). As of May month end, the top 5 holdings in the S&P 500 SPDR ETF were Microsoft, Apple, Amazon, Facebook and Google. These holdings represent 1% of the names in the index and yet comprise a 20.2% weighting by value. As of year-end 2016, these same constituents made up just 9.9% of the index (S&P Capital IQ). That is a doubling in concentration in just 3 years. This increase is due to the dramatic performance of the Fab 5 over that time period which investors are most assuredly quite pleased with. However, as a result there is now a far greater risk that under-performance in these names will negatively impact Index/ETF performance. Upon closer inspection, we see that these 5 companies are trading at an average trailing P/E of 47x (S&P Capital IQ). This does not tell the full story as Amazon is trading at a P/E of 118x. If we were to take the median P/E to account for AMZN as an outlier, then we arrive at 30.9x trailing earnings. Upon examination of the estimated earnings growth rates for these companies, we see that consensus estimates for the group over the next 5 years is approximately 17% per annum. Some might suggest that 30x earnings is a fair price to pay for a collection of businesses of such high quality with, seemingly sustainable barriers to entry and strong growth prospects. However, one could make a strong case that this is quite an expensive multiple to pay for these companies given the headwinds they may be facing e.g. privacy concerns, anti-competitive practices, sustainability of current growth rates given their current market share, etc. One would be hard pressed to make an argument that one is buying these businesses at a discount to fair value. Our experience informs us that during periods of fear, when high growth, momentum fueled companies stumble and even slightly decelerate from expected growth trajectories, their stock prices tend to suffer greatly.

The NASDAQ Index has received a great deal of press of late as it has not only dramatically recovered from its pandemic lows but proceeded to reach new highs at the time of writing. The QQQ, an ETF that tracks the NASDAQ 100 Index, has become a popular vehicle for investors to gain exposure to large cap growth companies that have fueled this historic bull market. The QQQ is now the 5th largest ETF by assets at $109 billion. (ETFdb.com). In the QQQ, we see the same Fab 5 hold the largest weightings but here they comprise an astounding 45% of assets, more than double that of the SPY. For the QQQ, under-performance in only one or two of these companies would have a dramatic impact on performance. As of 31 May, the QQQ was trading at a lofty 60x P/E on a trailing basis (S&P Capital IQ). Framed another way, an investor is paying $60 for every $1 of earnings being generated for an earnings yield of 1.6%. As nearly half of the index is comprised of businesses that have a prospective 5-year growth rate of 17% per annum, it is hard to argue that one is paying a fair price for this investment. What happens if the projected growth rate slows from here? The future is extraordinarily difficult to predict and during the internet era we have witnessed with increasing frequency, businesses being disrupted by upstart enterprises. I refer you back to our earlier comment that in times of fear when high growth stocks priced to perfection face the prospect of even modest slowdowns in growth the resultant market reaction can be quite dramatic.

Market indices and the trillions of dollars in passive vehicles tied to them were designed to provide investors with low cost, diversified exposure to various markets. Over the years, however, index construction has been modified to allow sufficient capacity for growth in indexation. These changes along with the exponential growth in passive assets have resulted in increased risks from passive investing that investors should be mindful of. With the immense growth in passive investing post the GFC one wonders how much of the performance of companies like the Fab 5 has been the result of a self-fulfilling cycle of ever rising ETF assets increasingly concentrated in a narrow corner of the market. It is unclear. We do know with certainty however that when assets flow out of ETFs these vehicles are forced to sell their holdings indiscriminately and those businesses with the most exposure to these passive vehicles are likely to feel the greatest pain. We saw a prelude of that in the March 2020 bear market crash, the fastest in recorded history.

***"… the farther back you can look, the farther forward you are likely to see."***

**Winston Churchill**

As keen students of financial history, we are acutely aware that there have been similar episodes in the past where growth stocks were bid up to stratospheric levels, justified by the investing herd all becoming "Nostradamus" like in terms of their long-term forecasting capabilities. These include the Dot Com Boom growth stocks of the late 90s, the Japanese growth stocks of the late 1980s, the Nifty Fifty growth stocks in the late 60s/70s and the manufacturing growth stocks of the 1930s. In all of these episodes, the investing herds also formed the consensus view that these equivalent of the Fab 5 growth stocks were invincible franchises that would continue to dominate their markets in perpetuity. For example, in the late 1960s, the Nifty Fifty stocks were the analogs of the Fab 5 of today and by the early 1970s, these stocks were similarly trading at stratospheric valuations. The Nifty Fifty included, amongst others Polaroid (94x PE multiple in 1972), MGIC (68x P/E multiple), Avon (61x P/E), Digital Equipment (56x P/E multiple) and Emery Air Freight (55x P/E). The ensuing years were not kind to many of these high flyers. In the 26 years from December 1972 through August 1998, the S&P 500 returned 12.7% per annum while Avon and Digital Equipment produced an annualized return of circa 5%, Polaroid posted a return of -1% per annum, Emery Air Freight returned -1.9% and MGIC experienced an agonizing decline of 8.6%.

(1) Looking back more recently to the dot-com bubble, it is instructive to examine the performance of the 4 Horsemen (Microsoft, Cisco, Intel and Dell), the dot-com bubble's analog to the Fab 5, post the tech bubble. Of these 4 stocks only Microsoft has recovered and surpassed its dot.com bubble highs (Dell was taken private and re-listed). However, it took Microsoft over 15 years to get back to its tech bubble peak. (2) Looking more broadly at the Nasdaq Index, we see the time to recovery was equally long and painful. From dot-com peak to trough the Nasdaq declined over 78% and it took until November 2014 for it to revisit its March 2000 peak. This is the longest time to recovery in US history and compares to the average US bear market recovery since the Crash of 1929 of just over 3 years. (3) Whilst we may not be witnessing the same degree of over-valuation experienced in the dot-com era, the performance of indices like the S&P 500 and the Nasdaq 100 have become increasingly dependent on a handful of companies. Companies whose very success has made them more susceptible to increasing regulatory scrutiny and competition and whose valuations, in our humble opinion, leave little margin for error.

Notes:

1) https://www.aaii.com/journal/article/valuing-growth-stocks-revisiting-the-nifty-fifty?via=emailsignup-readmore
2) https://www.reuters.com/article/us-usa-stocks-dotcombust-graphic/20-years-after-dot-com-peak-tech-dominance-keeps-investors-on-edge-idUSKBN20C1J7
3) https://www.wsj.com/articles/lessons-from-the-dot-com-bust-11583192099

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# Monthly Update | May 2020

## Fund Information

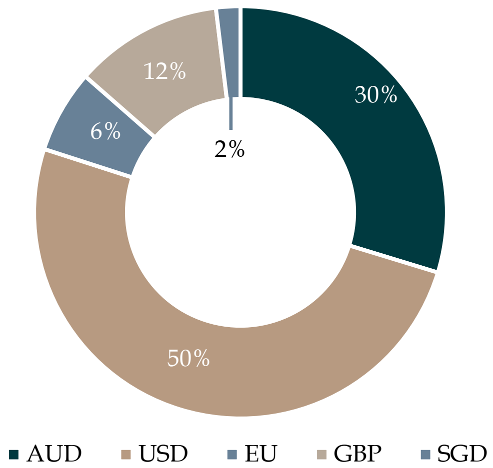
| ASX ticker | CVF |
|---|---|
| Month's net performance | 0.4% |
| Last price (at 30 April 2020) | $0.82 |
| Pre-tax NTA | $1.02 |
| Premium/(Discount) to pre-tax NTA | (19.6)% |
| Fund AUM | A$69.7m |
| Market capitalisation | A$51.6m |
| Shares on issue | 68,865,703 |
| Current franked dividend yield | 13.6% |
| Franking account balance | $4.0m |
| Gross/Net equities exposure | 51.7% / 49.0% |
| Cash weighting | 48.3% |
| Geographic mandate (Equities) | Global (45% ex Aust.) |
| Fund Inception | 5-Jan-15 |

**INVESTMENT PERFORMANCE (Pre-tax, net of all costs)**

| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|
| **Jan** | 0.1% | 0.0% | 1.9% | 6.5% | 1.3% | 2.2% |
| **Feb** | (0.3)% | 0.0% | (2.6)% | (2.1)% | 1.8% | (5.2)% |
| **Mar** | 0.0% | 2.9% | (1.0)% | (0.7)% | (0.1)% | (13.5)% |
| **Apr** | 0.7% | 2.3% | 3.5% | 0.6% | 1.3% | 1.8% |
| **May** | 2.1% | 11.8% | 2.2% | 9.1% | (0.7)% | 0.4% |
| **Jun** | (1.4)% | (3.6)% | 3.5% | 3.2% | (0.2)% | |
| **Jul** | 2.0% | 5.3% | 1.7% | 5.6% | (1.1)% | |
| **Aug** | (0.2)% | (6.8)% | 3.0% | 2.9% | 0.3% | |
| **Sep** | 1.5% | 0.6% | 2.4% | (1.4)% | 2.4% | |
| **Oct** | 1.7% | 2.3% | 9.5% | (5.0)% | (0.7)% | |
| **Nov** | (0.2)% | (3.5)% | 4.1% | (2.0)% | 3.2% | |
| **Dec** | (0.9)% | (2.5)% | (1.1)% | (2.8)% | 0.8% | |
| **Total** | **5.1%** | **7.7%** | **30.3%** | **13.9%** | **8.6%** | **(14.3)%** |

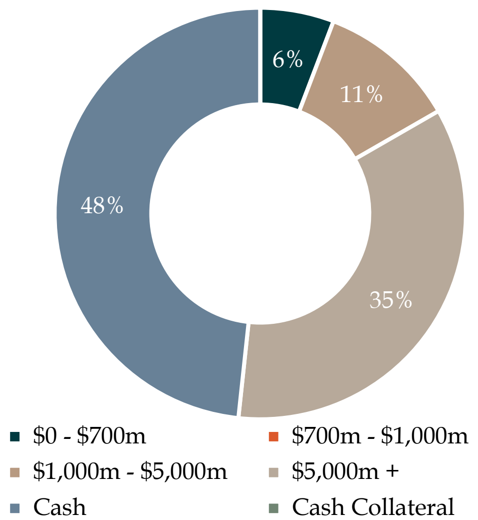
## Portfolio Information

### Currency Mix*

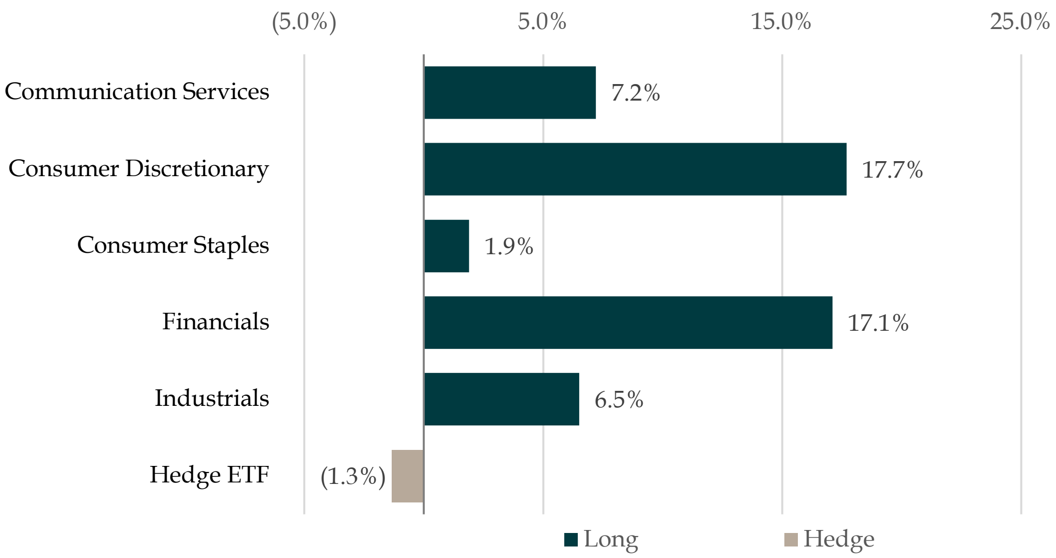



*Currency mix includes cash and equities

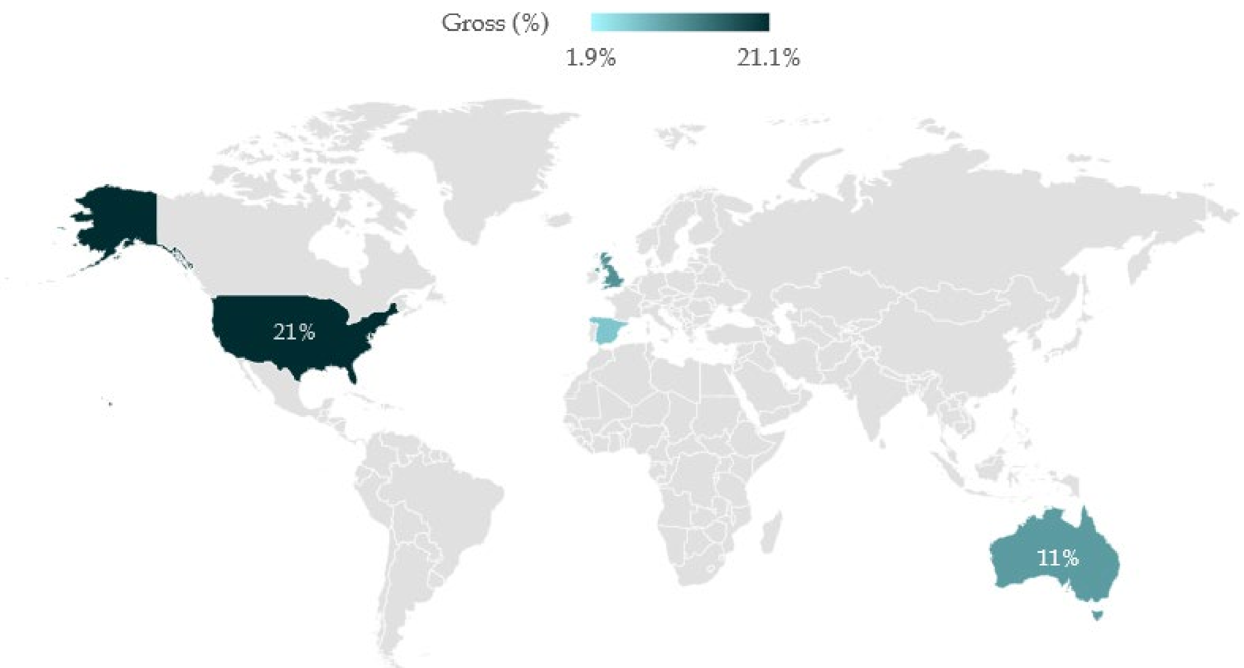
### Market Cap Mix



## Exposure by Sector

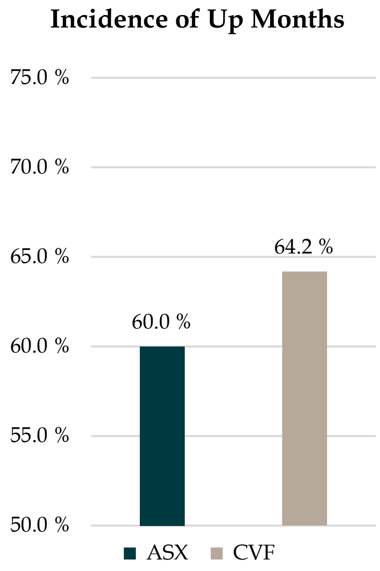


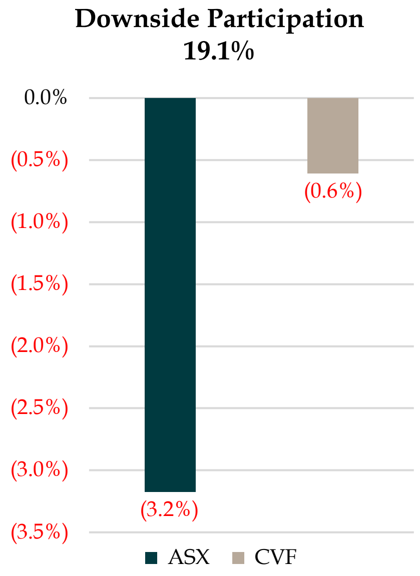

## Equities Exposure by Country

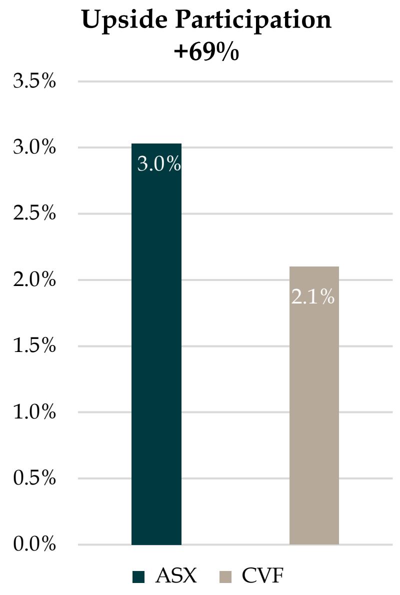



| Country | Long | Hedge | Gross | Net |
|---|---|---|---|---|
| Australia | 10.6% | - | 10.6% | 10.6% |
| United States of America | 19.8% | (1.3%) | 21.1% | 18.5% |
| Singapore | 1.9% | - | 1.9% | 1.9% |
| United Kingdom | 11.6% | - | 11.6% | 11.6% |
| Spain | 6.5% | - | 6.5% | 6.5% |
| **Total** | **50.3%** | **(1.3%)** | **51.7%** | **49.0%** |

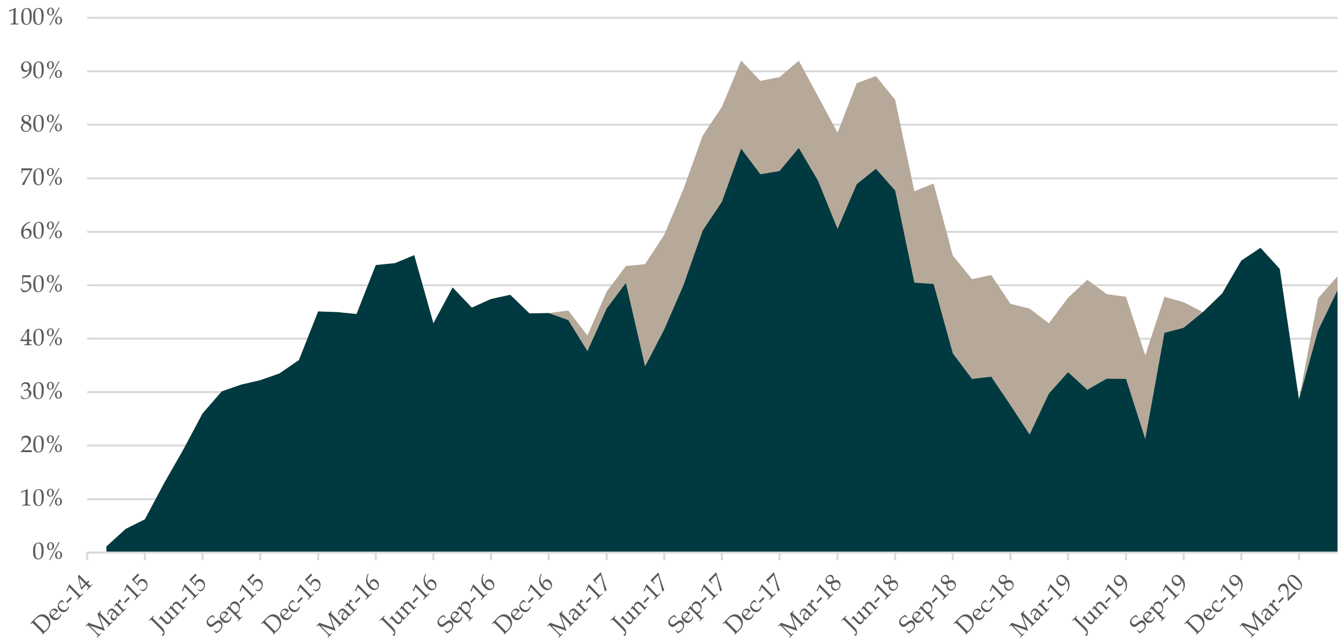
**Uncorrelated Returns: More positive months and negative correlation in months when market is down**




**Gross & Net Portfolio Exposures – Outperformance achieved with no portfolio leverage**




On behalf of the Board of Contrarian Value Fund Limited,

Laura Newell

Company Secretary

**Important Information and Disclaimer**

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Past performance is not indicative of future performance. Returns can be volatile. Potential investors should seek independent advice as to the suitability of a particular investment to their investment need.