Geometrica Fund

Investor Newsletter – March 2020

We seek asymmetric investment opportunities informed by the coalescence of rigorous fundamental analysis and alternative data discovery.

The Geometrica Fund aims to deliver outstanding returns to unitholders via highly targeted investments in the global mid-cap equity universe.

Overview

Net of costs, the Geometrica Fund closed the month of March down 5.17%. In relative terms we did significantly better than major indices, reflecting our strong process bias to capital preservation in difficult markets. The S&P/ASX200 Index was down 25.9% and the S&P500 Index was down 12.5% in USD terms.

March was a month of extreme volatility and correlation across equities. Pretty much everything went down. In such brief episodes, stock picking is unlikely to be rewarded. And so, as we discussed last month, we move to protect capital, knowing that the better we do that, the more capital we'll have to deploy when markets once again richly reward stock pickers.

With the goal of protecting capital, we ran with a net short position through most of March, which had seen us in positive territory month to date, reflecting a view that the virus might morph into a full-blown credit crisis given the profound output and employment reductions in motion.

Then on the 23rd of March the US Federal Reserve commenced unconventional monetary accommodation and essentially said they would do whatever it took to ensure a properly functioning financial system. This was a swiftly articulated and aggressively interventionalist regulatory position, far speedier than what we saw in 2008. And so, the market, inculcated in the mantra of "don't fight the Fed", took the bit in its mouth and started to run hard.

We were a little slow to reverse course and shift to a net long position. Initially we questioned the capacity of a financial regulator to change the course of a physical event such as a pandemic, but that perspective missed the point. In hindsight on the 23rd of March markets were already partially pricing in a financial crisis. And more troublingly, perhaps markets were then, and remain now, too sanguine about the exit trajectory from this pandemic or the capacity of the US Federal Reserve to influence credit flow in the real economy.

We have learned over the years to be flexible in our outlook. Changes in expectations can change the direction of markets as much as fundamentals. John Maynard Keynes, famed economist and successful investor said it best: "markets can stay irrational longer than you can stay solvent."

Framework

Our whole process is driven by asymmetry. We seek to only take risk when we believe the upside from doing so greatly outweighs the downside.

In that context we have been using the R0, or real time basic reproduction rate of the virus, to guide us to date. A basic understanding of the exponential compounding capacity of cases was invaluable in allowing us to aggressively cut our longs in February and March, knowing that globally, lock downs to control the virus were on the horizon. Because risk far outweighed the potential rewards of equity ownership, we flattened off our risk and went net short during March.

As for the exit from our net short position, we had a simplistic view that when respective state and / or country level R0 dropped below c.2.0, it would mean the back of the virus had been broken and that the attention of markets and regulators alike would shift to plans for opening up. Such a sanguine shift from lock down to opening up seemed an opportune time to tilt once again towards being exposed to equities where our efforts at stock picking were far more likely to be rewarded.

Thus far that framework has worked reasonably well, if a little belatedly given the decisive action of the US Federal Reserve on 23 March 2020. Globally, R0's are indeed falling and in most places are at 2.0 or below.

But this might altogether be too simplistic for the exit, or rather, elongated exit from this pandemic.

Part of navigating a crisis is finding analogues or frameworks than can help you conceptualise the path events might take. We stress might because these events are path dependent.

We have been asked repeatedly: is the Great Recession of 2008 and 2009 the correct analogue and so, shouldn't we be buying?

It is natural to compare the current crisis with the most recent crisis. But in reaching for the most recent crisis as analogue we betray our tendency to bias; in this case anchoring bias or our vulnerability to influence from recent events simply because we remember them most clearly.

The Great Recession was an endogenous credit shock emanating from the exceptionally high leverage that drove the US housing bubble. It initially moved at glacial pace. US house prices peaked in 2006, wobbles in some credit markets started in 2007 and trade financing and other parts of the credit market started entering gridlock in 2008, with the US Federal Reserve only reaching for their unconventional policy toolkit in early 2009 when the world was on the cusp of systemic financial failure.

This time is different to the Great Recession and that play book may serve poorly as a guide, because this shock is not yet a financial crisis.

This is an exogenous, not endogenous, shock. The suddenness of the onset is similar to a natural disaster and a recent NY Fed blog compared the sudden spike in US unemployment claims to Hurricane Katrina's impact on local unemployment claims. But natural disasters are no analogue for the exit path here because natural disasters lift GDP in their wake due to the construction activity they spur, as was the case with the New Zealand earthquakes of 2011.

The best analogue is probably still the 1918-1919 Spanish Flu and there is decent economic and other data on that analogue which might yet prove especially useful to those who study it diligently.

False dichotomy

The current debate on the cure being worse than the disease is gaining volume most especially in the United States.

It is a simple and appealing dichotomy to paint. Keep the economy closed to save lives, or sacrifice lives to save the economy.

We suspect it is a false dichotomy. In part, based on the behaviour of viruses and the epidemiological analogue of the 1918-1919 Spanish Flu.

And in part based on the economic outcomes of "lock down" versus letting the virus run rampant through the population, again using the 1918-1919 Spanish Flu analogue, as observed in economic output and employment outcomes.

US equity markets appear to be embracing the temporal proximity of an end to lock downs with vigour. US equity markets might even be moving to simplistically discount a return to "normal" in 6 to 12 months post lockdown.

Once the lock down does end in the US that simplistic view can be tested, but not before.

Irrelevant debate

There has also been a debate as to whether the current rally in equities is a bear-market rally or a broad-based recovery.

It is *irrelevant*, at least for us because we pick stocks, we don't invest in indices.

If you are an index level investor or run low tracking error, then it is *existentially relevant* and important because if you committed capital at the height of 2007 to, say, the S&P/ASX200 Index, you had to wait *years* to recoup your losses.

But it gets worse! How can you be sure it isn't a bear market rally? How can you be sure you're not missing out? These are impossible questions given the answer is path dependent.

The index level view is a massive over-simplification of underlying diversity, complexity and, most importantly, opportunity!

If it was an artist's palette it would be brown muck obscuring incredible vibrancy and colour beneath.

From another perspective, if you look at almost any period in time, no matter how bad things got, some stocks went up. Our job is simply to find and own them. It gets harder in a falling market, but it doesn't fundamentally change.

So, we view large dislocation events as opportunities that tend to provide potential excess returns for years to come.

The easy opportunities have come and gone. We got some but missed some.

Then there are those stocks that you can imagine Warren Buffett wading in and buying amidst the market carnage. You get to play Warren about once every 10 years. We bought a few of these, but in small size. They were mostly mega caps.

But the real opportunities are still to come. A lot of stocks haven't really recovered at all. There are a lot of busted business models in this detritus, but there are going to be gems in there as well. One example is the "good business / bad balance sheet" analogue that has been particularly good to us over the years. It's a little early we think on balance for these, but equally we don't have long to wait.

You see there is a rich opportunity set still ahead of us at a single stock level. What a wonderful time to be a stock picker!

Gary, James and Ben.

17 April, 2020

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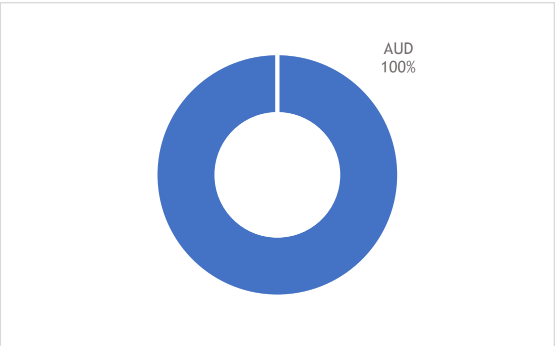
Fund overview (Alpha Units)

Fund	Geometrica Fund	Investor Eligibility	Wholesale only
Structure	Wholesale unit trust	Minimum Investment	A$250,000
Mandate	Global long short Mid-cap focus	Fees	1.5% management (+GST) 20% performance (+GST)
Gross exposure range	0 - 200%	Benchmark	RBA Cash Rate
Net exposure range	up to 100%	High water mark	Yes
Single stock long limit	15% at cost	Liquidity	Monthly
Single stock short limit	5% at cost	Admin & custody	Mainstream Fund Services
Buy / Sell Spread	Nil / 0.25%	Platforms	Ausmaq

Currency allocation



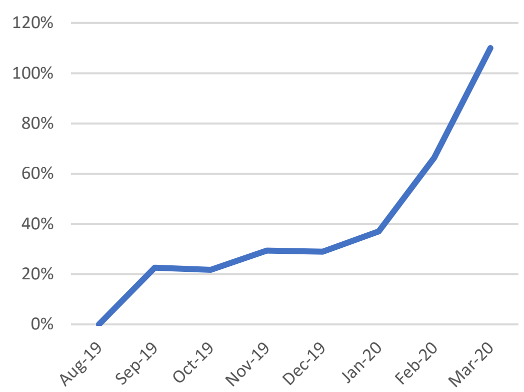
Asset allocation

Country	Long	Short	Gross	Net
Australia	38.2%	(9.6)%	47.8%	28.6%
United States	41.4%	(12.8)%	54.2%	28.6%
Asia	2.4%	0.0%	2.4%	2.4%
Europe	6.1%	0.0%	6.1%	6.1%

Investment performance (net)

	Founder Lead Series - 2019	Founder Lead Series - 2020
Jan	-	-1.3%
Feb	-	-0.3%
Mar	-	-5.2%
Apr	-	
May	-	
Jun	-	
Jul	-	
Aug	-	
Sep	1.1%	
Oct	0.8%	
Nov	0.1%	
Dec	-1.6%	
Total	0.5%	

Gross exposure



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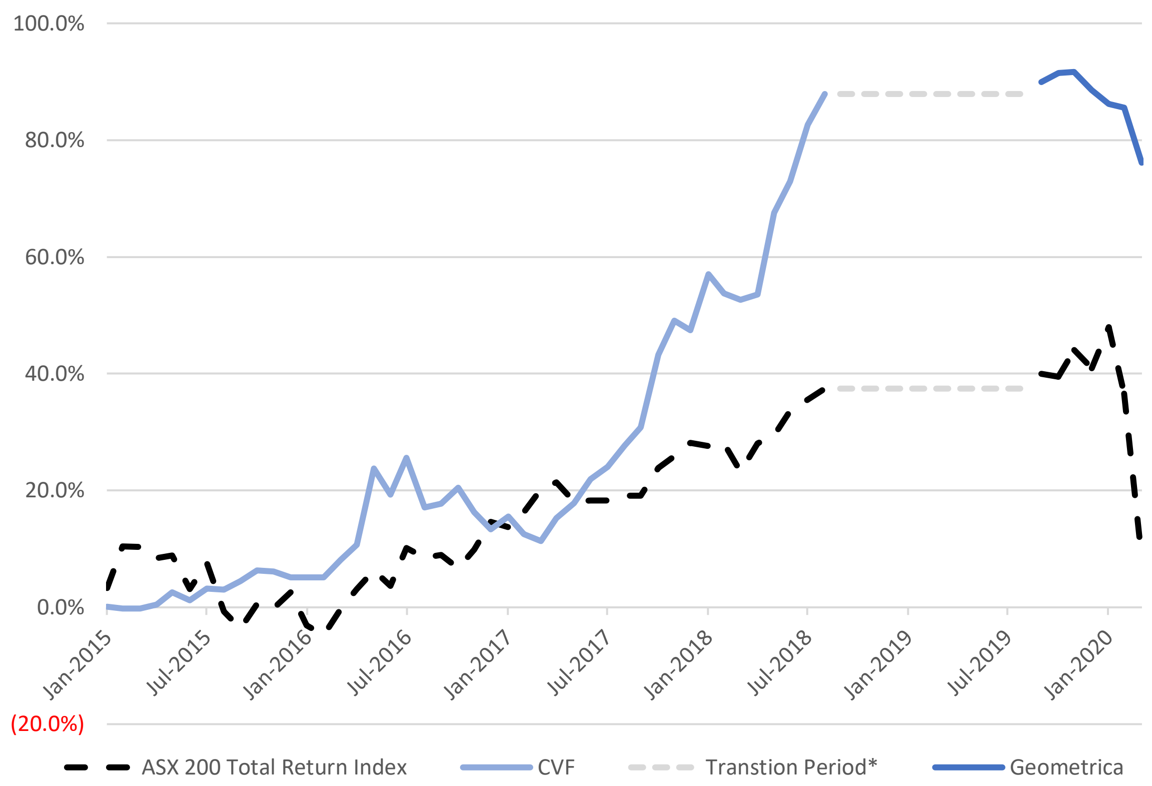
Manager performance history



*** Manager left CVF in Sept 2018 and began GFA in Sept 2019**

NB: Performance period is from 5 Jan 2015 – 31 March 2020. Performance is net of all fees