Geometrica Fund

Investor Newsletter – December 2020

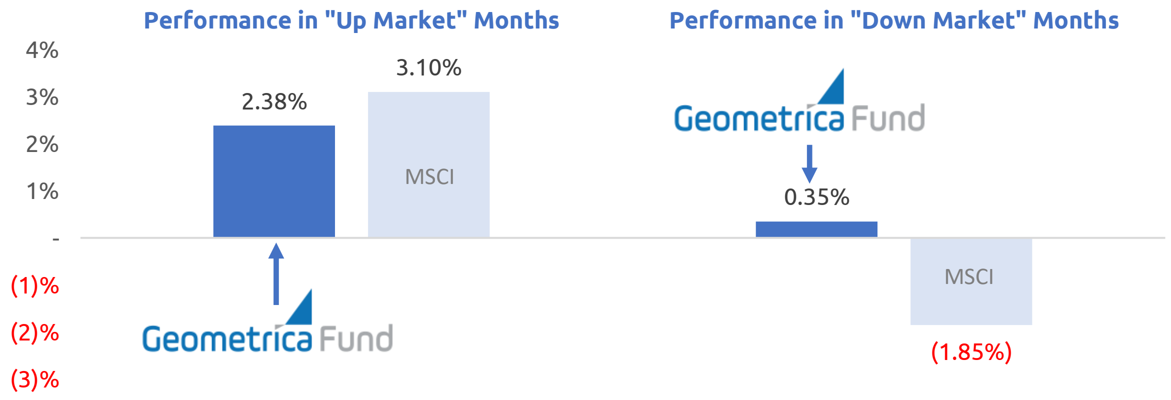
We seek asymmetric investment opportunities informed by the coalescence of rigorous fundamental analysis and alternative data discovery.

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

Investment performance (net)

As at 31 December 2020	Inception p.a.	CYTD	12 months	6 months	1 month
Founder Lead Series*	+18.81%	+25.24%	+25.24%	+17.94%	+2.01%

Performance Asymmetry: Uncorrelated Outperformance



Source: Mainstream, ASX Announcements, Geometrica and Bloomberg. Performance is after all fees, from Jan 2015 – Dec 2020 (excluding the period of Sep 2018 – Aug 2019; Manager left CVF in Aug 2018 and began Geometrica in Sept 2019). MSCI = MSCI ACWI (AUD).

Overview

Net of costs, the Geometrica Fund returned **+25.24*%** for calendar year 2020, with December contributing a net return of **+2.01*%.**

2020 was a great first full calendar year for the Fund.

We thank our co-investors for entrusting us with their precious capital.

Now, our attention shifts to 2021. As ever, the focus is on how we can improve our investment process and thus our investment returns.

Fourth year of over 20% p.a. returns by our team - *See page 5.*

Founders Class units – Approaching Hard Close - *See page 6.*

* *Founders Class units – Lead Series. Small variations will occur between unit classes and series based on differences in timing and terms. Source: Mainstream Fund Services, the Fund's external administrator and calculation agent.*

December 2020

Our largest performance contributor in December was a short position in well-known New Zealand consumer products company **A2 Milk Company Limited** (A2M.AU, market cap A$7.9bn).

A systematic screening tool we use highlighted A2 Milk as a potential opportunity.

Our initial bias was to consider A2 Milk from the long side. Some years back we made outsized gains from Bellamy's, a competitor of A2 Milk's and this no doubt coloured our initial inclination.

But our investment process is deeply rooted in data and dispassionate logic. Once we had studied the situation and examined two highly relevant data sources, it became apparent A2 Milk was an earnings expectations train wreck.

The data we studied in November 2020 surprisingly indicated that the company would need to aggressively revise downwards fiscal 2021 earnings guidance.

In essence, because A2 Milk's fiscal 2021 earnings guidance was predicated upon a recovery in a key distribution channel, yet the data showed deterioration, there was a large expectation gap that was only growing with the passage of time.

Given the highly favourable asymmetry in the situation and our data insights, we scaled the short to around 3% of capital; a large short position for us (noting under our mandate we are only able to size a single short to 5% of capital).

The truth surfaced on the 18th of December when the company cut earnings guidance and the stock fell 24%.

We took the vast bulk of the profit on the short position in the immediate wake of the earnings downgrade.

We continue to monitor the underlying data. At this juncture it is important to note that we have no dogmatic view on whether A2 Milk is a "buy" or a "short", simply because the company's earnings trajectory is path dependent. We simply continue to monitor management activity, market conditions and most importantly the data.

Boohoo Group Plc (BOO.LN, mkt cap £4.6bn) was another significant positive performance contributor during the month, advancing 9.6% in local currency terms.

Boohoo is an online apparel retailer, in a similar albeit more innovative vein than Zara.

Years ago, Zara's owner Inditex (ITX.SM, mkt cap. €81.7bn) pioneered a disruptive take on fashion retailing.

Recognising that the largest invisible cost in apparel retailing was "mark down", the discounts given to clear merchandise, Zara upended the business model.

Rather than have centrally planned and seasonally driven product ranges which would span six or more months from design to sourcing, shipment and delivery to store for ranging, Zara simply watched what was hot on the catwalk.

Then they shamelessly copied with some incremental innovation and dropped very small batches of product into their stores quickly.

Because Zara's small batches were the latest thing, they sold well, meaning lower mark down and lower inventory losses. And because Zara only ran small ranges and never replenished precisely the same products, they trained their customers to buy as soon as the saw what they wanted, rather than wait for the end of season discounts.

This was a self-reinforcing situation. Lower losses meant lower prices, which meant more market share, more sales, more profit for Zara as they ate their legacy competitors' lunch. This "fast fashion" business model was the widow-maker of many incumbent apparel wholesalers and retailers.

Boohoo has gone one better, leapfrogging Zara's innovations and driving exceptionally strong sales and earnings growth over a number of years as an outcome of their business model innovation.

Boohoo's business had its roots in garment manufacturing. Historically the forebears of the business made apparel for large brand owners; one in particular. Recognising the shortcomings in their largest customers business model, they innovated.

Boohoo uses social media to drive customer engagement and understand what is popular and selling with its targeted consumer cohorts. Boohoo, in particular, is exceptionally adept at amplifying target customer engagement around particular hot products.

Because Boohoo has no stores, physical store space is no constraint to the business model in either cost or ranging. This frees Boohoo to spend on sourcing and freight and reinvest back into price, which drives market share, sales and earnings growth.

This highly efficient model is well placed to give consumers what they want, when they want it, at a highly competitive price.

Our opportunity to own the stock was a result of a misstep we've frequently seen before.

Fast growing businesses often have issues around their supply chains.

In Boohoo's case, the apparel industry is notorious for using suppliers who then sub-contract to other suppliers, mostly unbeknownst to the end customer and consumer. The issue is that some of Boohoo's suppliers have used sub-contractors that underpaid and mistreated workers.

This was revealed in an explosive newspaper exposé released in July 2020 which caused Boohoo's stock price to tank around 40%. Once it became clear that Boohoo had been aware of some of the issues but were moving only slowly to rectify them, there was a sharp and probably justified investor backlash which drove Boohoo's share price down sharply.

You might ask, why are we investing in a stock with a history of involvement, even if indirect, in the mistreatment of workers in its supply chain.

The answer, in the timeless words of ice hockey great Wayne Gretsky, is that we "skate to where the puck is going, not to where it has been".

It appears exceedingly clear to us after spending some time on the situation that Boohoo is actively working to rectify its supply chain issues. Which presents us with an opportunity, especially as evidence indicates customer engagement has not deteriorated.

Is it better to buy the stock that scores 10 on the ESG meter today, or buy one that scores 3 today but is going to 10 in a reasonable period of time?

Change is the opportunity; we'd argue there's a lot more investment return available in the latter than the former.

IDP Education (IEL.AU, mkt cap A$5.6bn) was the largest single performance detractor during December. You may remember it from our last newsletter when it was the largest positive contributor.

There are a few cardinal sins in the world of equity investing: excessive leverage (=>100% net exposure), excessive diversification, excessive concentration, and the "round trip".

The round trip is when you buy a stock at say $1, watch it go to $3, celebrate, and then look on, mortified, as it retreats to $1. Which is why you never celebrate; better to stay paranoid and profitable than suffer a round trip.

IDP is $20.09 as we write; it had run to $25.76 a share but fears of Chinese retribution upon Australia hosting Chinese students and the malingering impact of Covid-19 tempered the market's enthusiasm somewhat. Having run up +26.9% in November the stock fell back 18.9% in December.

The consolation in IDP's case is our average entry price is $15.99 (we bought the initial position at $13 and change, but as the fund has grown, we've increased exposure to the stocks we think offer the best return asymmetry).

Our response was to see what the negative or bearish view was, in order to understand if our thesis was "busted" or no longer valid. We think not. So, we bought a tad more, on the logic that if we liked it well enough to own it at $25, we should like it even more at $20.

2020 Review / 2021.

We'll skip the temptation to write a large retrospective on 2020. It is a year best left in the rear-view mirror.

Rather than dwelling on what stocks made how much P&L in 2020, we've been spending some time looking at how we can improve our investment process.

We're pleased to report that our investment screening is becoming far more systematic, freeing up time to concentrate on investment research which we'd contend is the key driver ultimately of our investment returns.

2021 has started well.

In the opening days of January 2021, one of our larger holdings attracted a takeover offer.

Fourth year of over 20% p.a. returns

Calendar 2020 saw a +25.24% net return, most pleasingly with low downside participation, meaning that we didn't drop as sharply as major indices did in February and March 2020.

In the three years prior[†] to Geometrica we compounded capital at a prior fund at an average annual rate of 28.1% per annum (gross). During those three years we likewise had very low downside participation (see charts on page 1).

2020 marks the fourth full year of 20%+ returns and very low downside participation.

Risk management in March 2020

In the depths of late March 2020, when the S&P500 was down -24%, the S&P/ASX200 was down -29% and even the NASDAQ Index was down -20%, our portfolio was showing a +5% return for the same period.

In the end, the US Federal Reserve arrived and jammed so much liquidity into financial markets that prices recovered, a fiscal response followed and prices kept on recovering.

The Fed's actions in late March caused a sharp short squeeze for us; we ended March down -5% (the S&P500 ended March down -12%, Nasdaq -10% and the ASX/S&P200 down -21%).

As it turned out, we all should have held on and just doubled down at the bottom on 23 March. But you didn't *know* that at the time.

And doubling down blindly was after all the strategy of Storm Financial, which didn't work out so well.

[†] Ending 31 August 2018.

So, the counterfactual of what would have happened had the US Fed been slower to react bears consideration in the context of risk management.

We'd do the same again, with some improvements of course. We manage the portfolio with the goal of eliminating large drawdown risks.

Large drawdowns are incredibly damaging to any investor's capacity to compound capital and should be avoided at all costs.

Founders Class units – Approaching Close

Founders Class units have lower fees than our standard Alpha Class units.

The Geometrica Information Memorandum stated that no more than 50 million Founders Class units would be on issue at any one point in time.

We have issued just under 30 million Founders Class units to date. Based on the pattern of recent investor inflows, we project that we will cease issuing Founders Class units at some point in the next six months.

Meaning if you want any, you should let us know.

15 January 2021.

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Fund overview (Alpha Units)

Fund	Geometrica Fund	Investor Eligibility	Wholesale only
Structure	Wholesale unit trust	Platforms	Ausmaq, Hub24
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	Administration & custody	Mainstream Fund Services
Buy / Sell Spread	Nil / 0.25%		

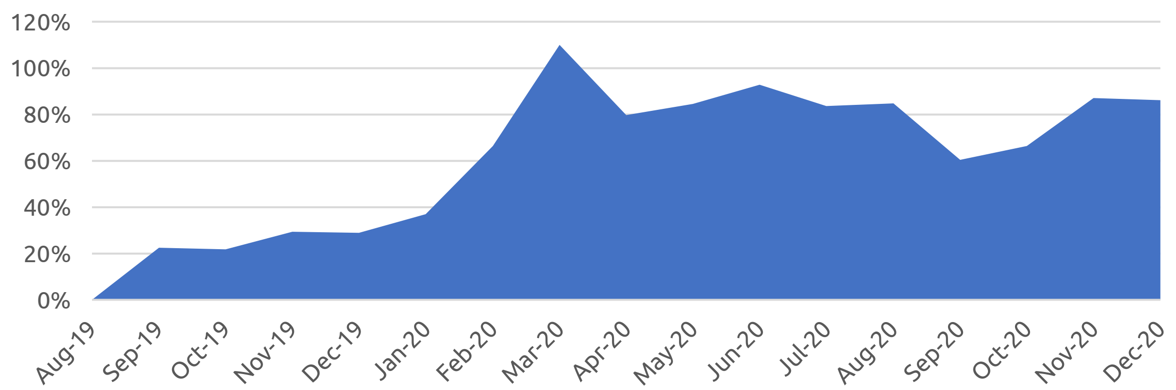
Investment performance (net)

	Founder Lead Series 2019	Founder Lead Series 2020
Jan	-	-1.3%
Feb	-	-0.3%
Mar	-	-5.2%
Apr	-	2.4%
May	-	7.9%
Jun	-	3.0%
Jul	-	9.5%
Aug	-	3.5%
Sep	1.1%	-1.4%
Oct	0.8%	-1.4%
Nov	0.1%	4.8%
Dec	-1.6%	2.0%
Total	0.5%	25.2%

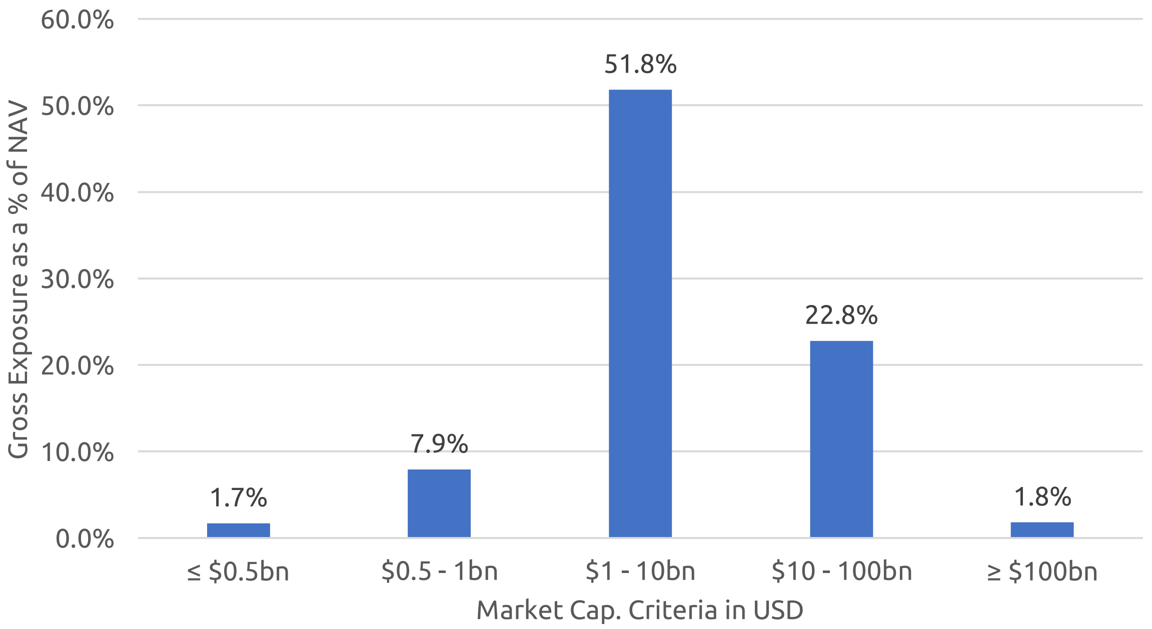
Asset allocation

Country	Long	Short	Gross	Net
Australia	28.9%	(2.0)%	30.9%	27.0%
Americas	33.4%	(3.4)%	36.8%	30.0%
Asia	2.7%	0.0%	2.7%	2.7%
Europe	15.7%	0.0%	15.7%	15.7%
Total	80.7%	(5.4)%	86.1%	75.3%

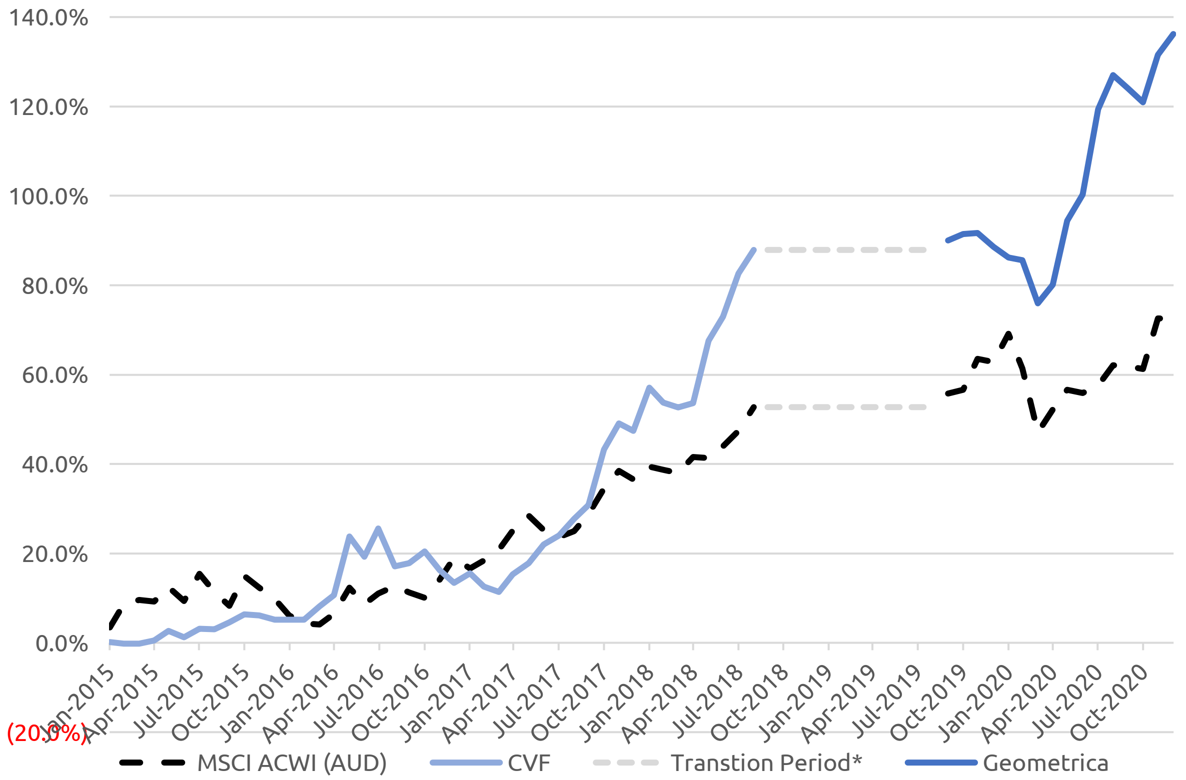
Gross exposure



Gross exposure by market capitalisation



Manager performance history



*** Manager left CVF in Sept 2018 and began Geometrica in Sept 2019 NB: Performance period is from 5 Jan 2015 – 31 December 2020. Performance is net of all fees.**

DISCLAIMER

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The Fund is not suitable for all investors. Investing in any security or fund involves significant risk. The price of any security or fund may decline as well as rise.

Past performance is not predictive of future performance and no guarantee or representation as to expected future returns is or can be made.