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

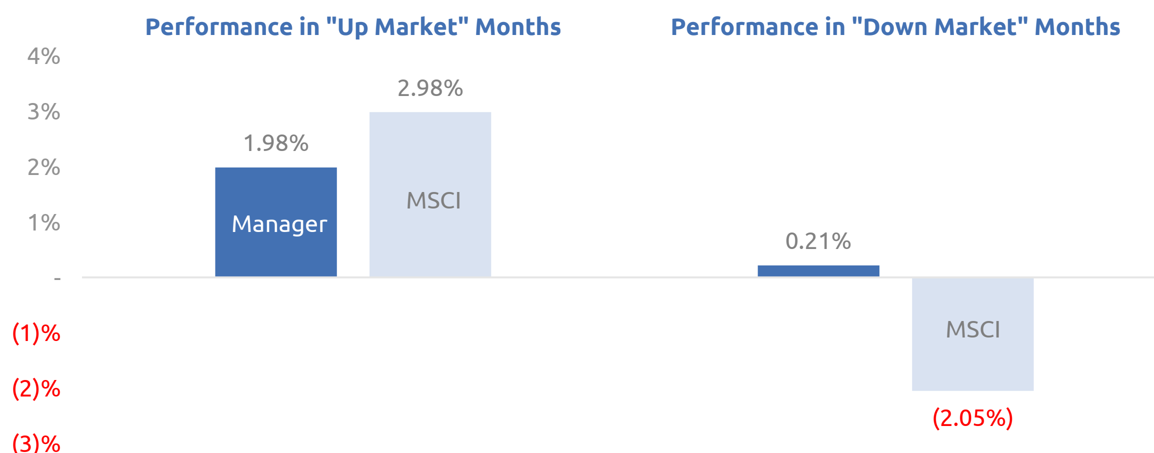
The Geometrica Fund aims to deliver outstanding returns to unitholders via highly targeted investments in the global mid-cap equity universe.

INVESTMENT PERFORMANCE (NET)[1]

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Fund	Index
2019	--	--	--	--	--	--	--	--	+1.1	+0.8	+0.1	-1.6	+0.5	+6.6
2020	-1.3	-0.3	-5.2	+2.4	+7.9	+3.0	+9.5	+3.5	-1.4	-1.4	+4.8	+2.0	+25.2	+5.9
2021	+4.5	+6.9	+1.2	+3.0	-1.5	-0.7	-1.4	+2.6	+3.1	-0.6	-4.6	-0.4	+12.2	+25.8
2022	-4.1	-1.7	+1.5	+0.5	-2.0	-3.5	+1.4	+4.4					-3.8	-12.8
										Since Inception			+35.7	+23.9

31 Aug 2022	Inception pa	2 year pa	CYTD	1 year	6 months	3 months	1 month
Founder[1]	+10.76%	+5.99%	-3.77%	-6.36%	+2.05%	+2.12%	+4.35%

PERFORMANCE ASYMMETRY



Source: Mainstream, ASX Announcements, Geometrica and Bloomberg. Performance is after all fees, from Jan 2015 (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

The Geometrica Fund returned +4.35% in the month of August, against a backdrop of generally declining global equity indices.

The MSCI All Countries World Index (AUD) fell -1.8% during August.

[1] *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.*

PORTFOLIO

Major equity indices remain under pressure as we write, continuing their path of decline afresh since the latter half of August.

August's US CPI data shattered market hopes for an easing in price pressures or a "Fed Pivot." Any moderation in traded goods and energy prices is being swamped by excess US domestic demand.

For the US (and Australia) a red hot domestic economy has driven a white hot employment market. In both the US and Australia, job openings now outnumber workers looking for a job – a first for Australia. If you think there is a real chance of a wage price spiral, then this is like dry kindling waiting for a spark.

Source: U.S. Bureau of Labor Statistics. Data is seasonally adjusted

Perhaps this is why in the wake of the August US CPI numbers Jerome Powell, Chairman of the US Federal Reserve, was so visibly downbeat, actively backpedaling the notion that higher interest rates and a US recession could be mutually exclusive events. To put this dilemma in context, there were 11.2m job vacancies in July 2022, or ~2x the amount of people unemployed. To put the market back into balance there would need to be nearly 6m jobs destroyed or >2x the amount caused in 2008 by the Global Financial Crisis.

Sometimes as a fiduciary, you have no paths which will be popular, just a path which ultimately will lead to less regret and a better long term outcome.

The history of US interest rate cycles seems to show that the faster the Federal Reserve hikes, the shallower the resulting recession. This is part of the reason why Paul Volcker is

so revered as the former Fed Chairman, who conclusively broke the runaway inflation of the 1970s by rapidly hiking interest rates.

The corollary is delay causes damage, as Arthur F. Burns, the former Chairman of the Federal Reserve demonstrated in the 1970s. Burns refused to include items he saw as outside his control, like energy prices, in his inflation policy setting calculus and was consequently a laggard when it came to hiking interest rates. His behaviour was later described as "policy neglect" by economic historians, because his prevarication led to a latter and higher peak policy rate.

Today, it seems like the Fed's invidious dilemma from the perspective of asset markets is thus:

- If the Federal Reserve hikes interest rates faster, it will result in a lower peak Fed Funds rate and this peak will occur faster. Long duration asset prices get hurt in the process.

- If the Fed hikes interest rates slower, the peak in the Fed Funds rate is later and higher. Long duration asset prices get hurt in the process.

With the first choice, the Federal Reserve will at least retain its credibility and any economic contraction and asset price impact will be shallower than it might otherwise be.

That there is no popular policy choice presently open to the Federal Reserve has been demonstrated by Liz Truss, Great Britain's neophyte prime minister.

Truss' government attempted economic populism very recently with large tax cuts. UK sovereign yields spiked alarmingly higher on the news. The market saw that tax cuts would simply increase domestic demand and by implication require the Bank of England to tighten more than would otherwise be the case.

This is a pernicious environment for all long duration assets. As the market adjusts to this reality, we would expect the valuation of all long duration assets to continue to be pressured: everything from private equity to real property will adjust downwards as interest rates rise.

Listed equities tend to discount information far faster than less liquid asset classes; the consequence of trading on liquid exchanges. But where listed equities go, other less liquid assets will follow. Just because an asset isn't being marked to market regularly doesn't mean it has escaped the downshift visible in listed equities. All long duration assets are ultimately hostage to interest rates.

Depending on how your personal portfolio is positioned, what is unfolding now is either going to be a painful reset or a phenomenal opportunity.

If you step back, what is unfolding in financial markets is a very large downward valuation reset across all long duration assets. There is (almost) nowhere to hide on the long side.

But once the process is done and the Federal Reserve stops hiking interest rates, valuation multiples should stop compressing and the coiled springs we are collecting (as noted in prior letters) should kick into gear.

We are well placed to navigate this environment.

The capacity to short sell and a flexible investment mandate are crucial to our ability to protect capital and profit from dislocation, and most importantly, to compound capital through market cycles.

For now, we are being amply rewarded for our short selling endeavours and selective long side exposures.

European Energy Crisis

We have spent a considerable amount of time studying the European energy situation and are presently benefiting from a series of related investments on both the long and short sides.

Russia's decision to reduce gas supply through key European pipelines coupled with trade sanctions against imports of Russian energy have exposed an underlying vulnerability in some parts of the energy complex.

Structurally, the last decade has seen a massive influx of solar photovoltaic (PV) electricity generation capacity globally. Whilst generally laudable, as intermittent renewable generation capacity increases, a reduction in traditional base load generation capacity (coal and nuclear) has resulted.

Now, when the sun doesn't shine and solar PV cannot generate electricity, the ability to call upon base load capacity is much diminished and gas peaking capacity is required to fill the gap - at a much higher price.

Europe imports around 85% of its gas and around 60% of this used to come from Russia.

Sanctions on Russian energy and in turn Russia's rapid reduction in gas exports to Europe have vividly exposed Europe's excessive reliance not only on Russian gas, but also the tightness of global liquid natural gas markets in part due to structural shifts in electricity generation markets.

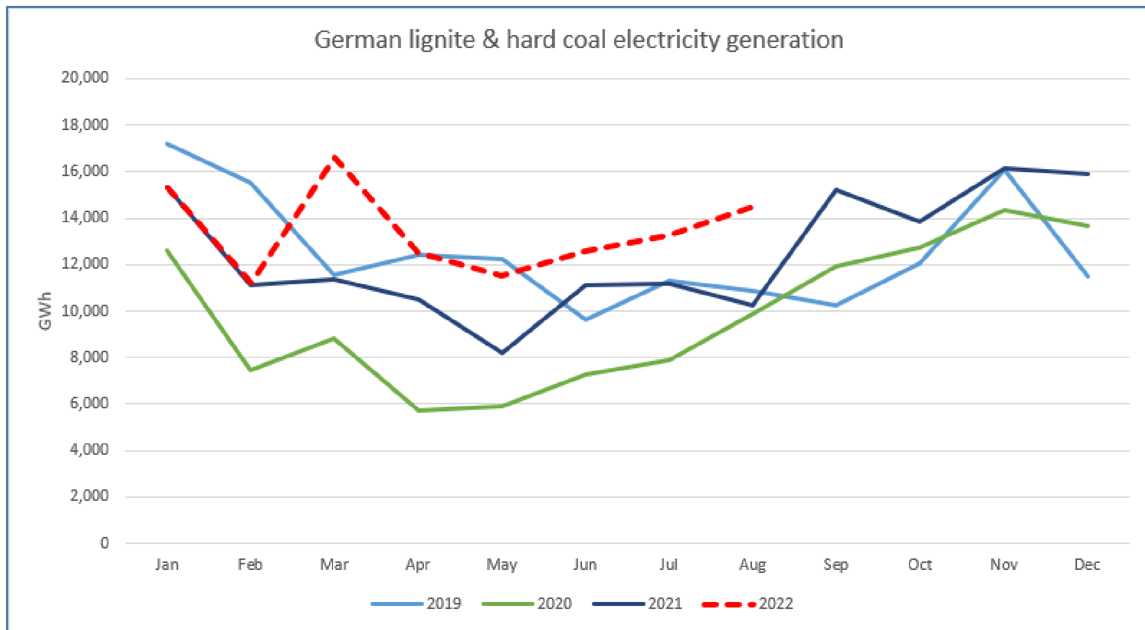
Germany and Italy, of Europe's major economies, appear to be most exposed to the risk of having insufficient electricity during the coming winter. Germany in particular is a useful market to analyse due to its size and capacity to be a significant net exporter of electricity within Europe.

Germany has planned on a 15% reduction in electricity demand and heightened use of gas storage to address its coming gas and electricity crises. Yet this burden of voluntary demand reduction is likely to fall unevenly, be affected by weather and may not even be enough depending on how tight gas markets are. The dynamics of gas storage depletion also imply that the crisis will persist into the winter of 2023/24.

Simulating German electricity load from a base year of 2019, inclusive of a 15% voluntary demand reduction and the current run-rate increase in coal generation capacity, suggests the country becomes supply constrained on electricity generation in early January 2023.

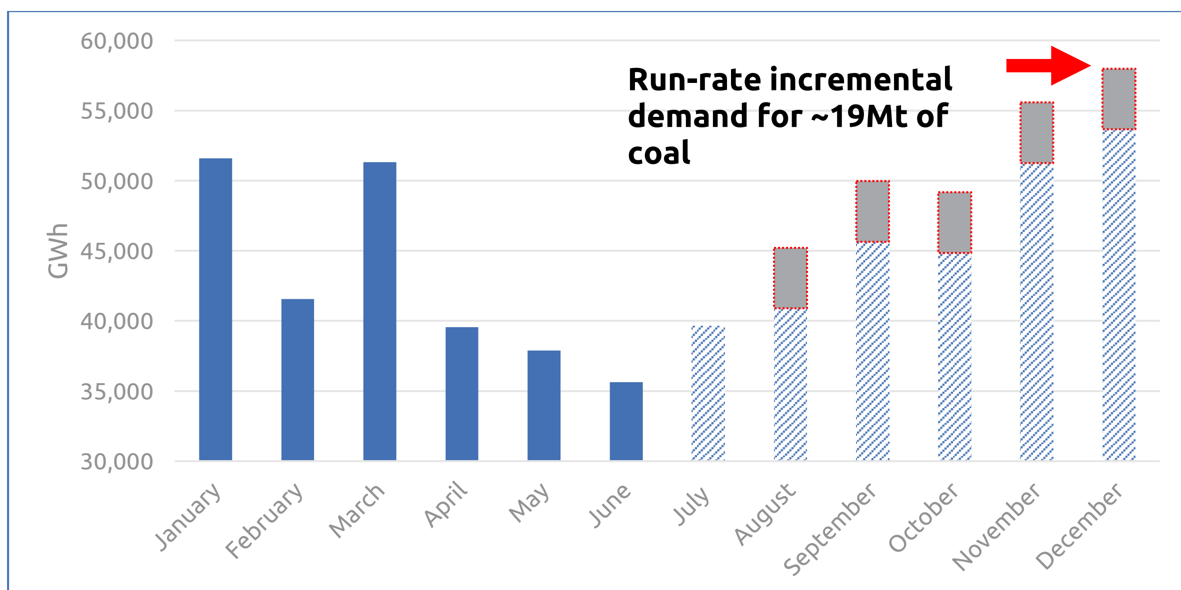
Thermal Coal

There is a large incentive to burn coal to fill this shortfall in generation capacity. The data shows that the German coal burn rate since the war started has increased 33% yoy.



Source: Bundesnetzagentur & Geometrica analysis

Germany also has the largest fleet of mothballed coal fired generators in Europe and these are generally geared to use high quality (called high calorific value / high CV) coal. They are now restarting.



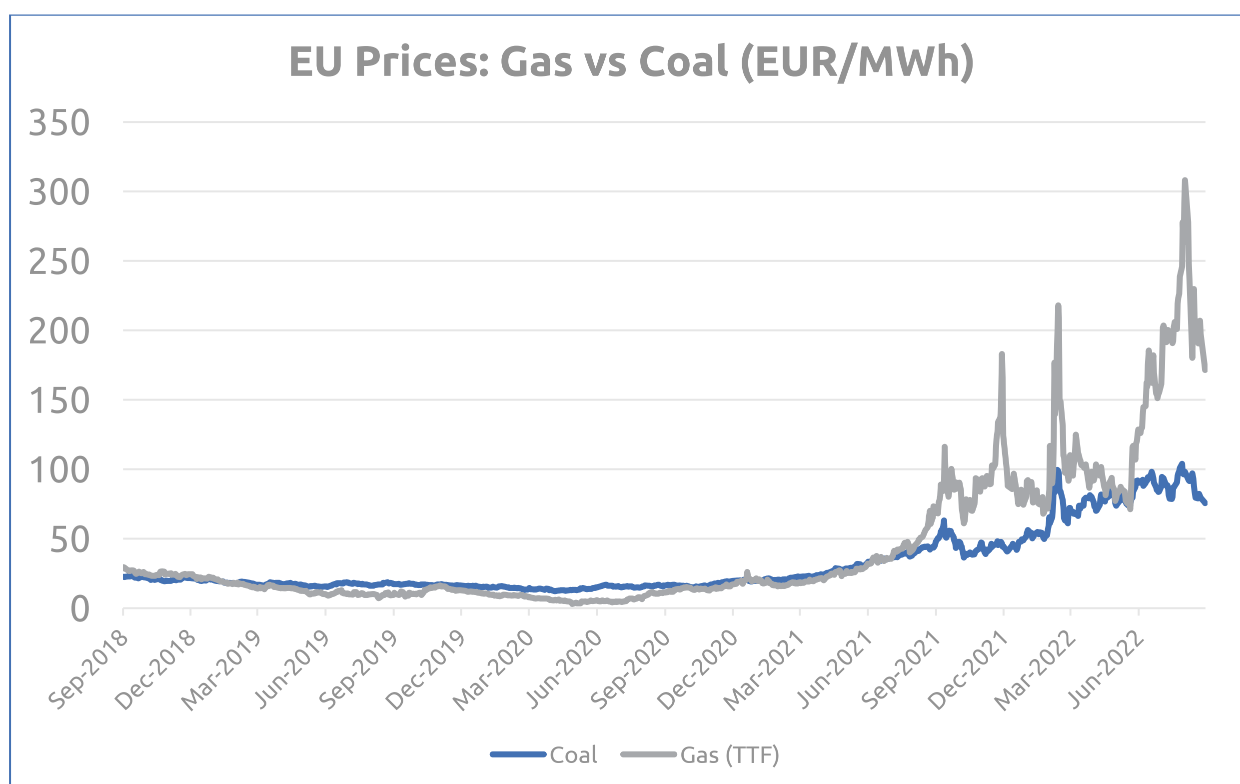
Source: Company announcements & Geometrica analysis

The imperative to pay up for high quality coal is also driven by the fact that a power plant only has so much capacity; using cheaper low-quality coal, aside from increasing pollution, also reduces electricity generation relative to using high quality coal and requires more tonnes of low CV coal to do it.

Asia should also see an accelerating increase in high CV coal demand given Japanese sanctions on Russia coal don't effectively start until 31 December 2022 and thereafter 31 March 2023.

Because Russia was ~30% of the high calorific value thermal coal seaborne market the impact of sanctions on available high CV coal supply has been very large.

Despite this, coal prices on an energy equivalent basis remain significantly below gas prices in Europe, hence the incentive to burn coal.



Source: Datastream & Geometrica analysis

The reason that gas prices remain so elevated is the increasing importance placed on LNG and yet the LNG market available for prompt spot sales is very small. This is why the LNG spot prices are the equivalent of around US$280 per barrel of oil equivalent.

[show column chart: HH gas USA US$/BoE, Brent oil $/bbl, LNG NBP US$boe.

Unsustainable

Make no mistake, in the long run current coal prices are unsustainably high.

In the long run, energy storage becomes economic and will benefit from an increasingly large volume overhang of solar PV curtailment in peak production periods. Storage is coming.

But for the next 5 to 10 years, we think it is not possible to eradicate coal fired capacity completely from OECD generation mix without driving electricity prices so high that the energy transition risks the loss of public support. Such an outcome would be disastrous. A lot depends on how fast storage can become economic.

New coal mines are extremely difficult to develop as most major financiers have ceased lending to new projects and regulatory approvals are extremely difficult, meaning supply is likely to stay significantly below demand. The rationing mechanism in such a situation is price.

In the meantime, companies like Whitehaven (WHC.AU, mkt cap A$8.9bn) are making so much money they can repurchase their entire share count within 2 years.

On our numbers Whitehaven is trading on less than 2x EV/EBITDA. This low multiple is largely driven by the markets unwillingness to capitalise such high coal prices. This is to an extent rational.

Another way to view this is that a very low multiple is simply a high cost of capital. A high degree of market-based uncertainty on future coal prices is what is driving this.

We suspect the market is being overly pessimistic in its forward coal price assessment. But we cannot prove this because we cannot reliably forecast the future.

This is why we have engaged with coal companies like Whitehaven, to ask them to, in effect, "predict" the future of coal prices…with certainty.

With certainty on coal prices, even if they were lower at, say, US$250/tonne for five years, on our numbers Whitehaven would with certainty produce nearly 2x its current enterprise value in cash. We think the market would pay for this certainty.

The Analogues

Thermal coal prices are typically traded on a spot or index basis. Supply contracts exist, but generally they are for fixed volume at variable price.

The history of commodity price structures is for long periods of stability and then with demand pressure you get change.

Iron ore used to be on annual price contract, moved to quarterly index and is now traded largely on spot because demand was greater than supply, allowing suppliers to shape the price construct.

LNG markets came into being with 20+ year contracts typically with price floors to enable financing. Spot price exposure for lenders on essentially low return infrastructure didn't work without floor price certainty.

In 2017 a surge of demand for graphite electrodes allowed the industry's largest player to recut contracts to fixed prices over 3 to 5 years. Analysts were able to value the cash flows with certainty. As a result, the stock in question traded at a dramatic premium to where it previously traded.

On our numbers, Whitehaven and similar companies could double if they did this.

If Whitehaven locked in US$250/t coal for 5 years - which is an ~40% discount to spot prices - they would lock in a 31% p.a. dividend yield for the next 5 years! We think this would provide an immediate catalyst for the company's market valuation.

GrafTech International

The graphite electrode stock was GrafTech International.

Graphite electrodes are used in electric arc furnaces to produce steel.

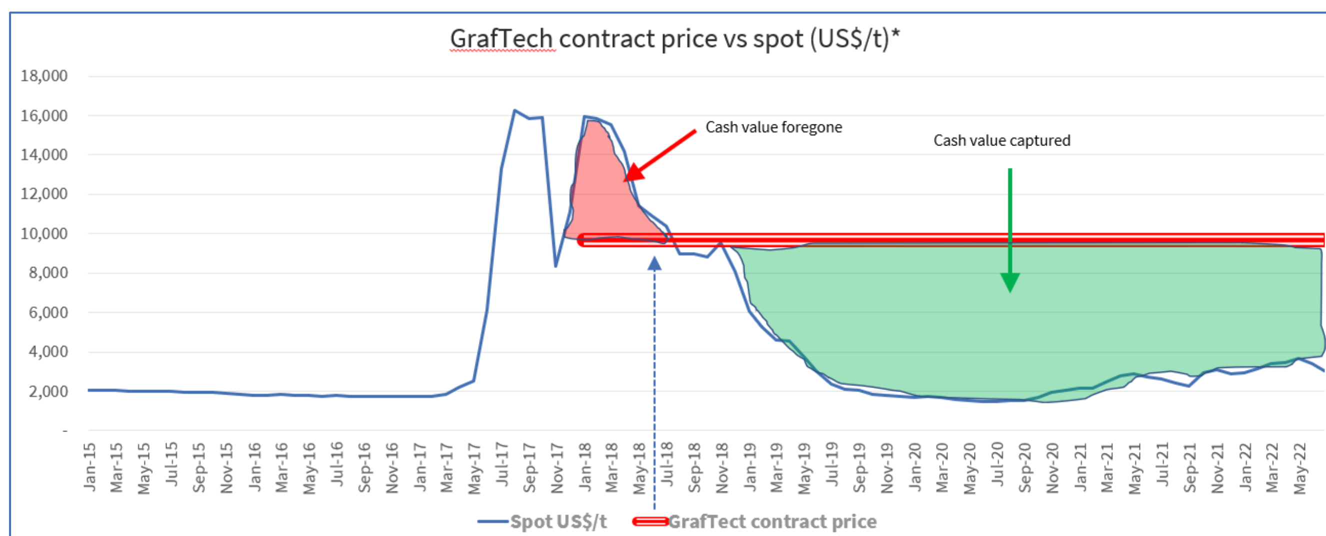
After a long period of very low prices for graphite electrodes, a perfect storm drove prices from ~US$3,000/tonne to ~US$20,000/tonne.

The market had always traded on a type of bilateral spot contract basis. Prices were negotiated based on market conditions and spot pricing.

GrafTech had recently been acquired by Brookfield, who no doubt gleaned that an excessively low valuation multiple was counterpoint to an excessively high cost of capital, driven by material uncertainty about the future prices of graphite electrodes.

GrafTech orchestrated industry change and seized upon the opportunity to drive shareholder value. They dramatically diversified two thirds of their sales volumes and entered into around 100 different contracts for fixed prices over 3 to 5 years.

The contract prices were significantly below prevailing spot prices. Contract prices were around US$10,000 for 3 – 5 years when the spot price was ~$17,000/tonne. Spot prices went as high as US$20,000/t but then gradually declined.



Source: Bloomberg, Company reports & Geometrica analysis

GrafTech initially lost some cash flow relative to spot pricing. More importantly, with strong contracts and counterparties, GrafTech gained cash flow certainty. A dramatically lower cost of capital meant a much higher valuation multiple applied by the market.

When Brookfield sold the business via initial public offer, they made a multiple of their investment as GrafTech traded at a premium multiple relative to where it historically traded.

Before GrafTech fixed prices, lots of people in the industry said “it cannot be done” or “that’s never been done before”.

Can high CV coal producers fix prices for 3 to 5 years?

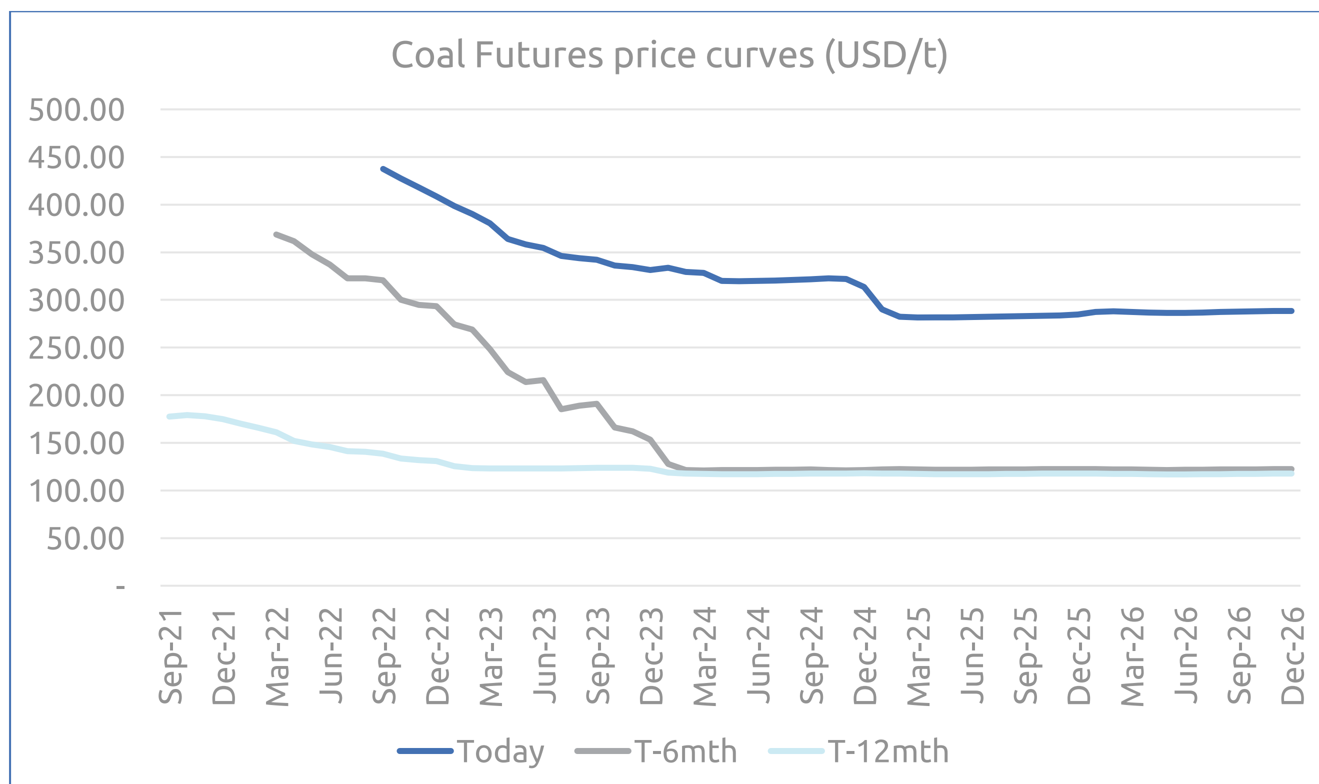
The crux question is would such a change meet a customer need? We think this is indeed possible.

A German utility knowing coal prices will not return to normal for at least 5 years might want to spread the price burden over 5 years at less than spot price for part of its volumes.

A Japanese utility wanting to finance a new mine might similarly agree.

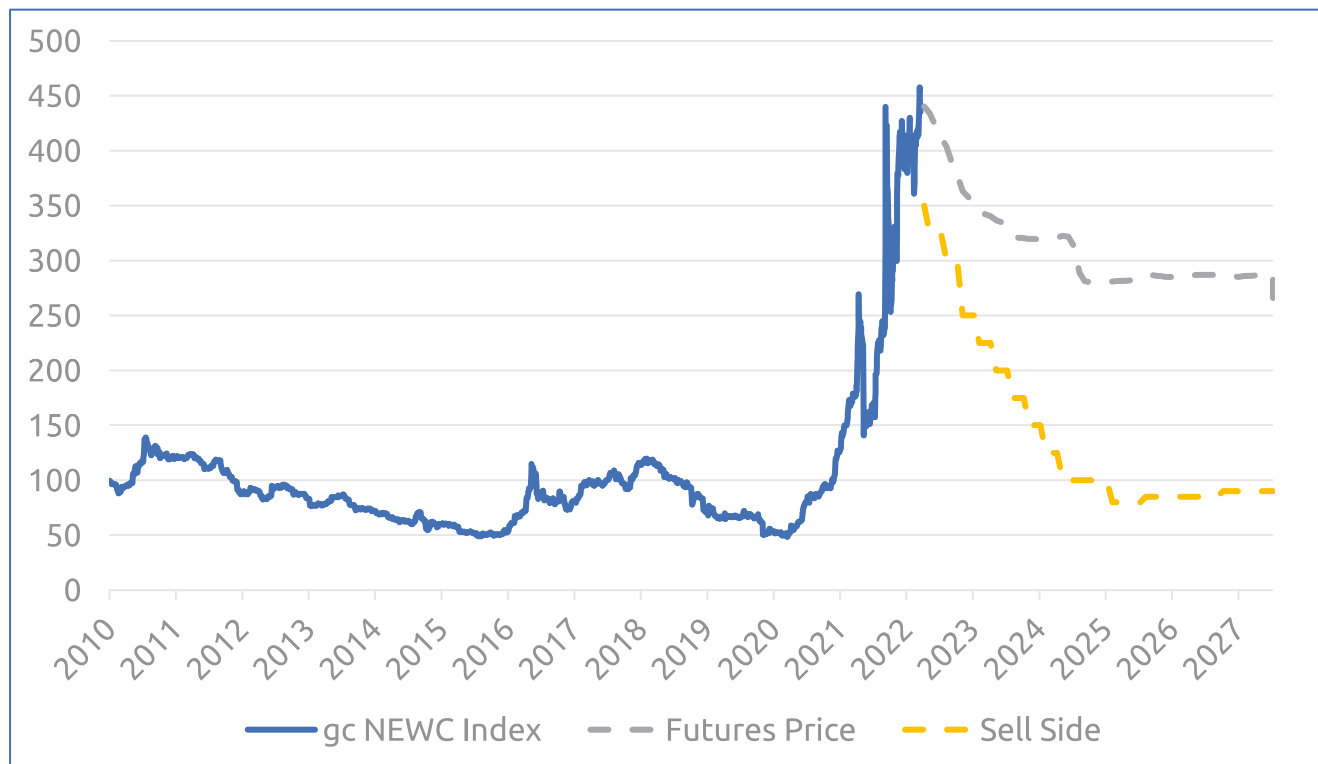
This was the analogous case for GrafTech’s customers.

Coal futures continue to show rising future price levels particularly in longer dated contracts.



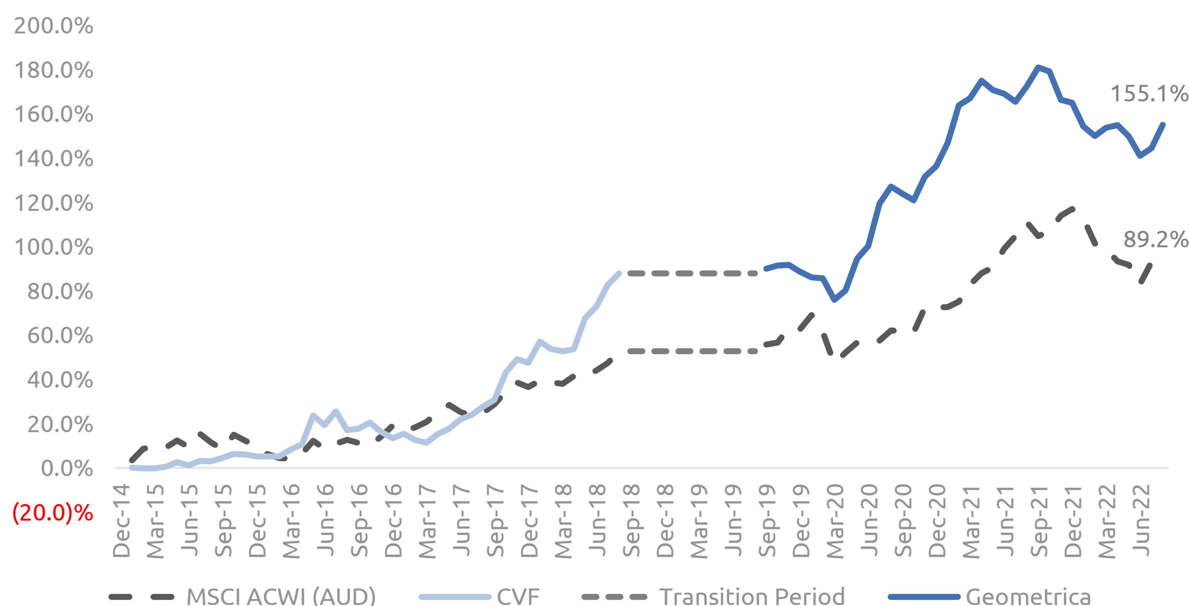
Source: Bloomberg

The below chart shows the disconnect in expectations between energy market participants and sharemarket participants. We think there is a likely share price rerate available should any of the Australian high CV producers be able to lock in fixed pricing over 3 to 5 years, even if it is at lower than current spot market prices.



Source: Bloomberg & Geometrica analysis

MANAGER PERFORMANCE HISTORY

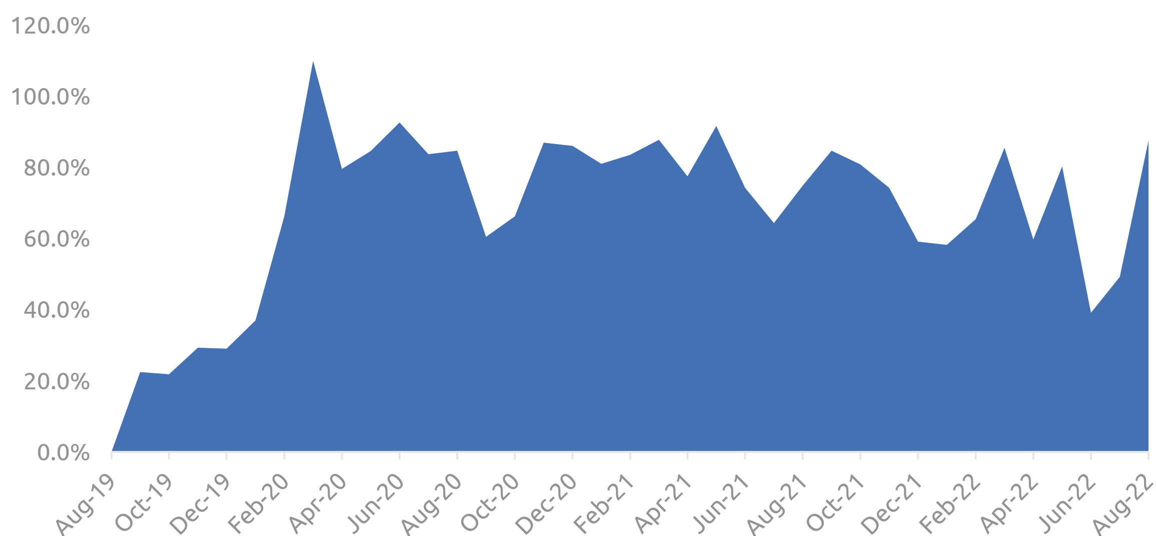


* Manager left CVF in Sept 2018 and began Geometrica in Sept 2019 NB: Performance period is from 5 Jan 2015. Performance is net of all fees.

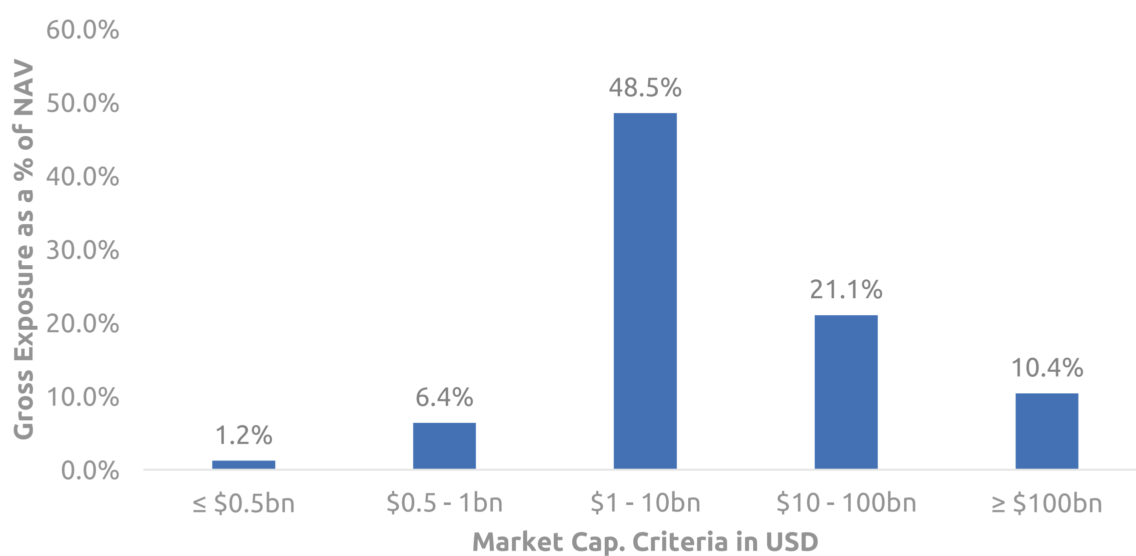
ASSET ALLOCATION

Country	Long	Short	Gross	Net
Australia	43.8%	(4.7)%	48.6%	39.1%
Americas	14.9%	(15.1)%	30.0%	(0.2)%
Asia	0.0%	(1.7)%	1.7%	(1.7)%
Europe	5.9%	(1.5)%	7.4%	4.4%
Total	64.6%	(23.0)%	87.6%	41.7%

GROSS EXPOSURE



GROSS EXPOSURE BY MARKET CAPITALISATION



FUND OVERVIEW (ALPHA UNITS)

Fund	Geometrica Fund
Structure	Wholesale unit trust
Mandate	Global long short Mid-cap focus
Gross exposure range	0 - 200%
Net exposure range	up to 100%
Single stock long limit	15% at cost
Single stock short limit	5% at cost
Buy / Sell Spread	Nil / 0.25%
Investor Eligibility	Wholesale only
Platforms	Ausmaq, Hub24, Netwealth
Fees	1% management (+GST) 20% performance (+GST)
Benchmark	RBA Cash Rate
High water mark	Yes
Liquidity	Monthly
Administration & custody	Mainstream Fund Services

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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.