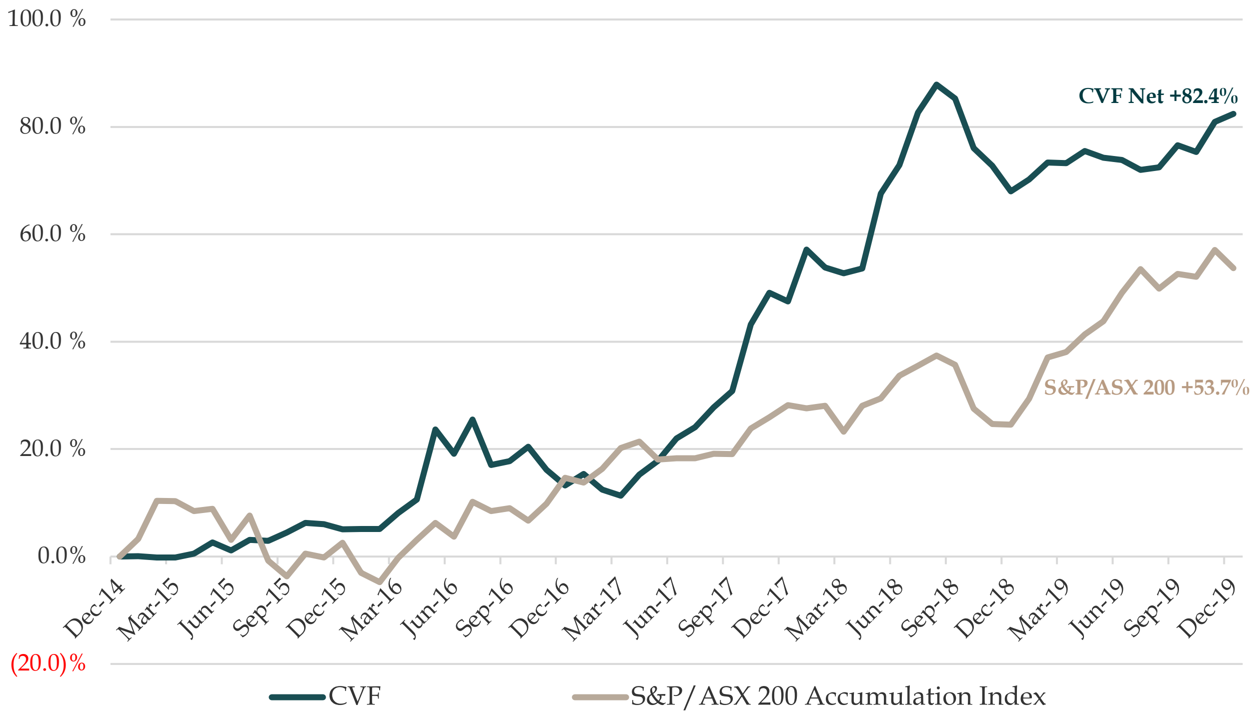
AROWANA
CONTRARIAN VALUE FUND

Monthly Update | December 2019

Fund Performance

CVF Cumulative Net Performance vs Index (since IPO)



At 31 December 2019	1 mth	1 yr p.a	2 yr p.a	3 yr p.a	Since IPO (5 Jan 2015) Annualised	Since IPO (5 Jan 2015) Cumulative
Arowana CVF Gross performance	1.3 %	10.5 %	15.1 %	21.3 %	16.3 %	112.8 %
S&P/ASX200 Accumulation Index	(2.2)%	23.4 %	9.5 %	10.3 %	9.0 %	53.7 %
Gross outperformance	3.5 %	(12.9)%	5.6 %	11.0 %	7.3 %	59.1 %
Arowana CVF Net performance*	0.8 %	8.6 %	11.2 %	17.2 %	12.8 %	82.4 %
S&P/ASX200 Accumulation Index	(2.2)%	23.4 %	9.5 %	10.3 %	9.0 %	53.7 %
Net outperformance	3.0 %	(14.8)%	1.7 %	6.9 %	3.8 %	28.7 %

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

Net Tangible Assets (NTA) per Share

At 31 December 2019	$
NTA pre-tax on unrealised gains	**1.20**
NTA after tax on unrealised gains[1]	**1.18**

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. Any such tax would generate franking credits, whose value would not be lost but rather transferred to shareholders on payment of franked dividends.

Top 5 Holdings (% of Gross Portfolio Value)

Ticker		%
ADSK.US	AUTODESK INC	9%
VRL	VILLAGE ROADSHOW LIMITED	7%
PSH.NA	PERSHING SQUARE HOLDINGS	6%
KER.FP	KERING	4%
GSKY.US	GREENSKY INC	4%
Top 5 as % of Gross Portfolio		**30%**

Newsletter

Month in review

The Fund outperformed by 3.0% during the month ended 31 December 2019, recording a net performance gain of 0.8% whilst the index lost (2.2)%.

The top 3 contributors were Village Roadshow (which was subject to a takeover bid from private equity), Greensky and Cooper Energy. The top 3 detractors were Graftech, Autodesk and Vocus. Cash weighting decreased by 6.2% to 45.4% as we established positions in UK home builders, Persimmon and Taylor Wimpey (post a UK election result that we consider to be positive for the sector and a value catalyst) and also Carnival PLC (the world's largest cruise company, which reported better than expected quarterly results, which we believe will be a rerating catalyst).

Calendar year in review

For the calendar year ended 31 December 2019, the Company delivered a gross return of 10.5% and a net return of 8.6%. This represented underperformance against the ASX / S&P 200 Accumulation Index, which finally captured a new all-time record high (the first time since 2007) and also recorded a 23.4% annual return the best annual performance in over a decade.

However, our returns were achieved with no gearing and whilst holding an average cash balance of 63.9% during the year. Adjusting for the average cash balance, the Fund's portfolio delivered a gross return of 28.5% and a net return of 22.5%.

Our performance profile for the year very much reflects that of a classic value manager, which will typically underperform in momentum driven upswings in the market (as the first 6 months of the 2019 calendar year were) as the value manager becomes cautious in such an environment. However, over the latter 6 months, as equity markets became more choppy, the Fund outperformed.

The underperformance was obviously due to our cash holding, which whilst higher than the previous years' average of 46.3%, was a conscious strategy to err on the defensive, given the numerous geopolitical risks and concerns we had about stretched valuations.

Furthermore, over the past 12 months, we had been hearing with increasing frequency and volume, the time-tested warning bell phrase of "this time it is different". As a team that has lived and invested through cycles going back to Australia's last recession in 1991-1993, this very much does remind us of the 1999-2000 and 2006-2007 bull market summits (both of which preceded significant bear markets) where that phrase was widely proclaimed. As keen students of history, we of course do not subscribe to this phrase at all (more on this below) and thankfully were able to profit handsomely in the aftermath of both 1999-2000 and 2006-2007 by sticking to our contrarian value philosophy.

That being said, this does not mean we believe we are about to enter a significant bear market episode; we are pragmatic in understanding (i) the distortive effect of ultra-low and negative interest rate policy in buoying stock prices; and (ii) the weight of money phenomena (with increasing flows into passive index funds and ETFs) coupled with the growing supply demand imbalance dynamic (as more companies borrow to do buybacks that reduce share count and/or with more and more companies being privatised and leaving the listed markets).

We are also not macro strategists but are fortunate to have the sagely data driven advice of our longstanding advisory board member, Simon Ogus, who whilst having bearish tendencies, is not a perma-bear who would continuously call for a recession. Simon has forewarned of events such as the Global Financial Crisis (2008), the Emerging Markets financial crisis (1998) and the Asian financial crisis (1997) but equally he has been positive on the NZD and economy (2010), USD and economy (2012) as well as Japan more recently, when the consensus view was negative.

5 year anniversary review

The year ended 31 December 2019 also marks the 5 year anniversary of the Company being listed on the ASX. We are pleased that the Fund has delivered outperformance during this time and over the last 3 years is in the top quartile of equity LICs on the ASX[1], despite having no gearing and maintaining an average cash balance of 57.0%.

Adjusting for cash (see table below), the Fund's returns were even stronger, with cumulative net performance since IPO of 156.2% versus the index at 53.7%. These returns were achieved without the use of any gearing.

Cash Adjusted Performance				*Since IPO (5 Jan 2015)*	
At 31 December 2019	**1 mth**	**1 yr p.a**	**3 yr p.a**	**Annualised**	**Cumulative**
Arowana CVF Gross performance	2.3 %	28.5 %	32.1 %	32.1 %	293.2 %
S&P/ASX200 Accumulation Index	(2.2)%	23.4 %	10.3 %	9.0 %	53.7 %
Gross outperformance	4.5 %	5.1 %	21.8 %	23.1 %	239.5 %
Arowana CVF Net performance*	1.5 %	22.5 %	24.1 %	21.1 %	156.2 %
S&P/ASX200 Accumulation Index	(2.2)%	23.4 %	10.3 %	9.0 %	53.7 %
Net outperformance	3.7 %	(0.9)%	13.8 %	12.1 %	102.5 %

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

Since listing, we have also paid out 34 cents in grossed up dividends representing a grossed up yield of 6.8% per annum on the initial issue price of $1.00.

We have also undertaken buybacks that have reduced the share count by 2.9m shares.

Investment style

Globally, over the past 12 months, we have observed an increasing number of value orientated fund managers throw in the towel or succumb to the "this time is different" bandwagon, changing their approach in the process to one of "growth at a reasonable price" or momentum driven investing (albeit justified on the basis that a stock is cheap relative to its forecast earnings in 3 to 5 years time).

In this "growth trumps value" investing environment, we often get asked the question "how do you avoid value traps?". For us the answer lies in two factors, the first being the detailed understanding of the microeconomics surrounding a business and in particular, whether there are "net tailwinds" or "net headwinds". For example, we would consider the financial services industry, especially banking as one contending with significant net headwinds, in the form of ever

[1] *Source: ASX Investment Products. Included are only LICs that report 3 year performance and have a market cap of >$30m. Performance data is 3 years to November 2019.*

increasing regulations as well as threats from fintechs and government mandated challenger banks. Similarly, with power generation and oil companies, we consider there to be net headwinds due to growth of the renewable industry, where the marginal cost of power generation is zero. These microeconomic shifts are playing out and will continue to do so over the next decade, but even now we would not invest in such businesses irrespective of how cheap they might get as we believe the value trap risk is high. Another example would be printing companies – whilst they can be invested in at 4x EBIT or less even, we would never do so. In our minds, these are already value traps. In order to truly understand the micreconomics, it is important to be able to analyse government policy, industry competitive nomenclatures and above all else, technology trends that could disrupt an industry. In other words, technology literacy is paramount and will be increasingly key in investment management. It is for this reason, we as the Manager (and Arowana more broadly) has transformed the composition of its team to be more weighted with data scientists and AI (artificial intelligence) and ML (machine learning) engineers. The second factor we look for is a value catalyst, cognizant that a value stock can remain that way for a long time. The value catalyst could be an earnings result that beats compressed consensus expectations, or it could be a takeover offer. On the latter, we expect the trend of private equity buyers privatising listed stocks to continue, as the shift away from public markets to private markets continues and as the private equity war chest continues to grow. In 2019, buyout activity topped $478 billion, a level not seen since 2007. However, as of year-end 2019, private equity firms, fuelled by low cost debt and large inflows from institutional investors, had amassed almost $1.5 trillion in unspent capital, the highest on record.

The follow-on question we often then get is "if you exclude such value stocks, where are you finding value opportunities"? Our answer is that we consider our job as value investors to identify stocks with "net tailwinds" (that are not value traps) where the future earnings potential is overly discounted and where there is a sufficient margin of safety in terms of our weighted average entry price. In this environment they are harder to find (than say in 2009 when we launched the initial Fund) but there are still opportunities. For example, we recently bought Carnival PLC, a stock we have been watching and analysing for most of the past year. As most would acknowledge, the cruise ship industry continues to be underpinned by long term "net tailwinds" and Carnival is the largest in the industry globally. Until its December 2019 quarter results, it had not met revenue and earnings expectations for almost a year and the stock had been de-rated to a forward PE multiple of 10x, an EV/EBITDA multiple of 7.7x, with a dividend yield of 4.6%. Our data analytics had suggested that a decline in cruise ship patronage was a blip and would commence rising again, and at a level above expectations that had been revised downwards.

The Manager will continue to steadfastly maintain our contrarian value investment style so as to deliver sustainable investment outperformance over the long term. We acknowledge the perspicacity of history in the pursuit of this objective. As Samuel Clemens (otherwise known as Mark Twain) quoted "history does not repeat, but it sure as hell rhymes". We recently came across a compelling research report called "Value is Dead, Long Live Value" (reference: www.osam.com). The report analyses what it calls Deep History and uncovers an analogous period when growth stocks outperformed value stocks for a long period of time between 1926 to 1941. Back then, the equivalents to the FAANG stocks of today were fast growing mass manufacturers (that were leveraging new industrial technology) like General Motors, General Electric, Eastman Kodak as well as retailers such as Sears and Woolworths. However, what the report goes on to illustrate is that value stocks would proceed to outperform growth stocks for the next 65 years (between 1942 and 2007) before underperforming again since 2007. We would contend that this time it is no different.

Wishing all our co-investors a happy, healthy and prosperous 2020 and decade ahead.

Fund Information

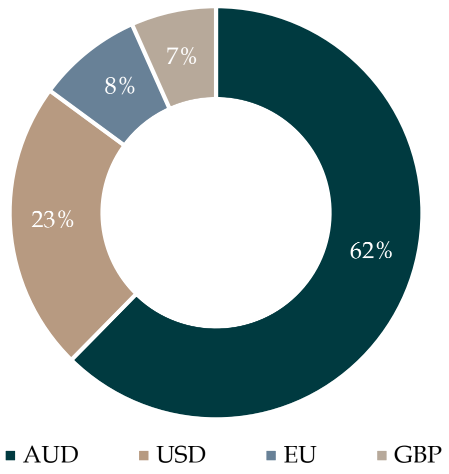
ASX ticker	CVF
Month's net performance	0.8%
Last price (at 31 December 2019)	$1.04
Pre-tax NTA	1.20
Premium/(Discount) to pre-tax NTA	(13.3)%
Fund AUM	$82.9m
Market capitalisation	$71.3m
Shares on issue	68,538,802
Current franked dividend yield	10.2%
Franking account balance	A$5.5m
Gross/Net equities exposure	54.6% / 54.6%
Cash weighting	45.4%
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
Jan	0.1%	0.0%	1.9%	6.5%	1.3%
Feb	(0.3)%	0.0%	(2.6)%	(2.1)%	1.8%
Mar	0.0%	2.9%	(1.0)%	(0.7)%	(0.1)%
Apr	0.7%	2.3%	3.5%	0.6%	1.3%
May	2.1%	11.8%	2.2%	9.1%	(0.7)%
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%**

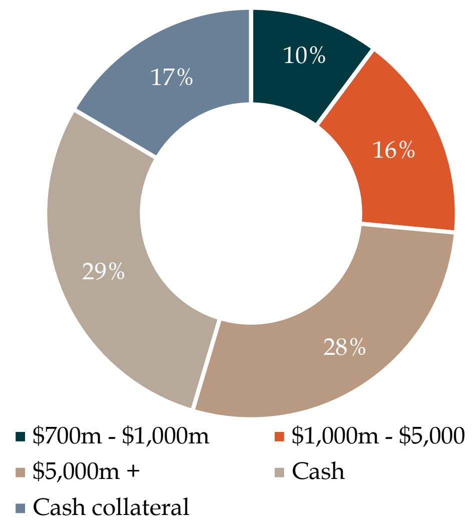
Portfolio Information

Currency Mix*

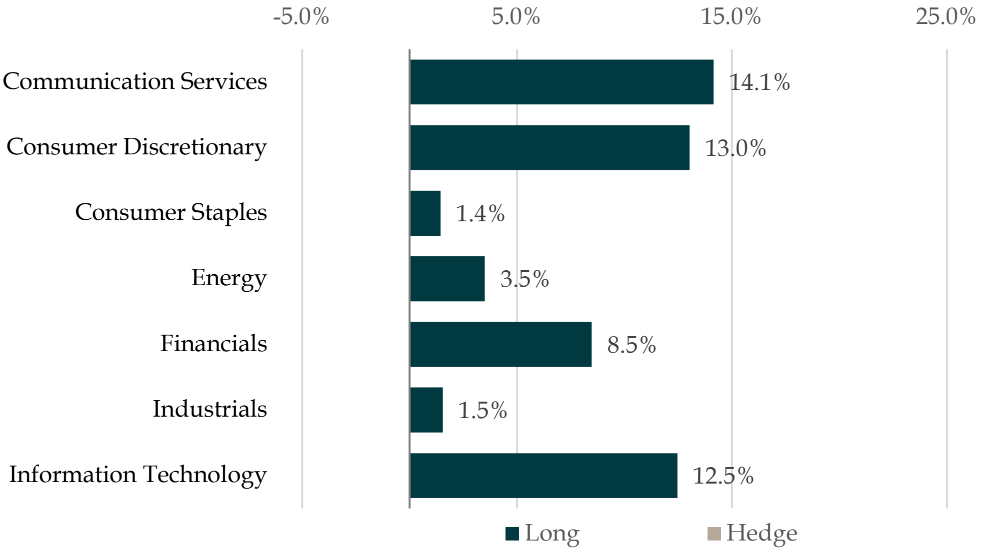


*Currency mix includes cash and equities

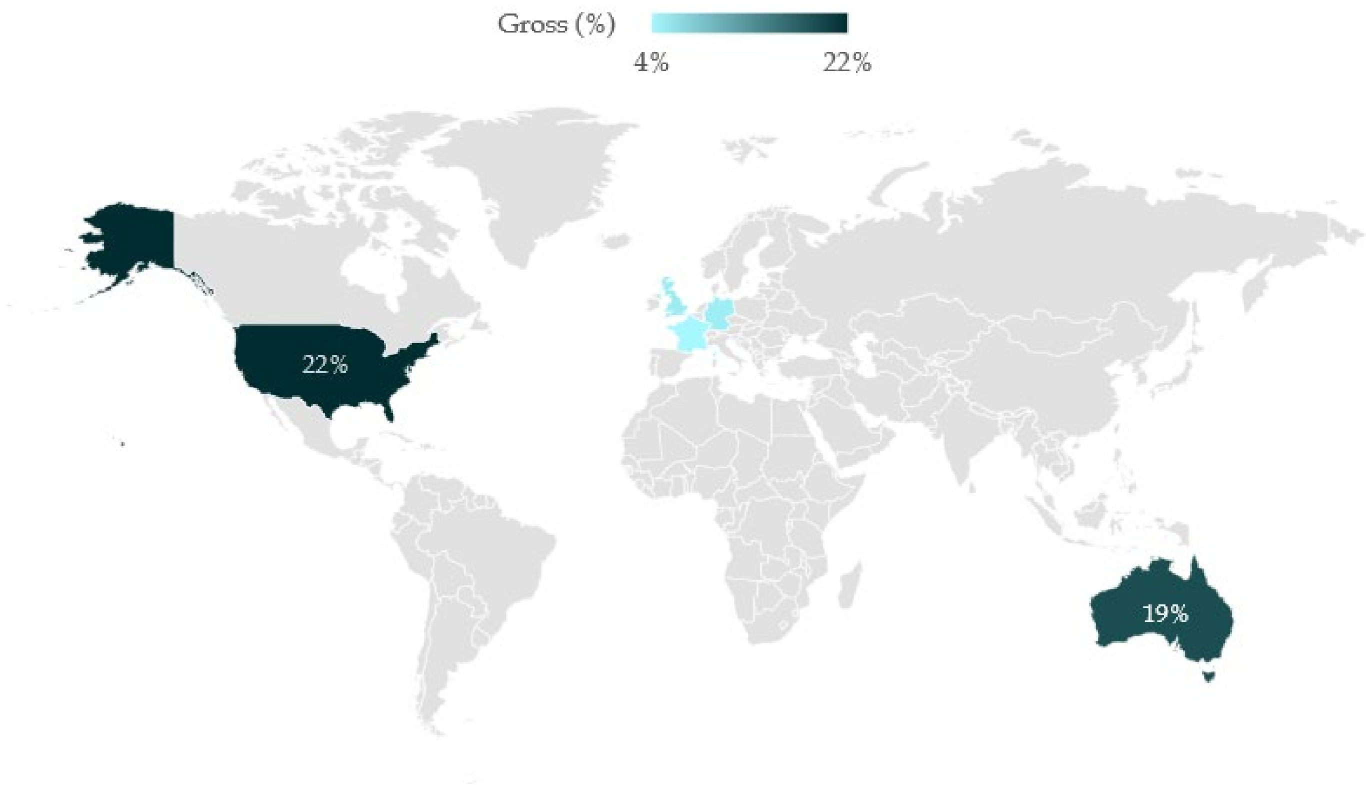
Market Cap Mix



Exposure by Sector

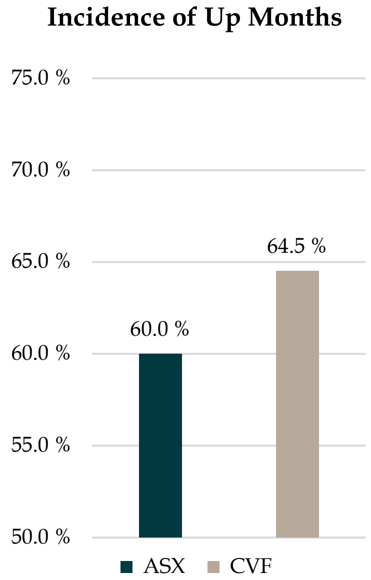


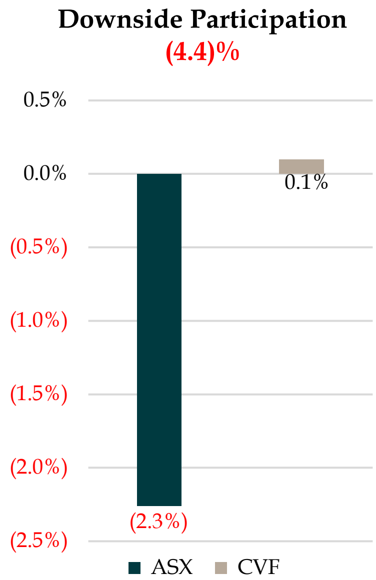
Equities Exposure by Country

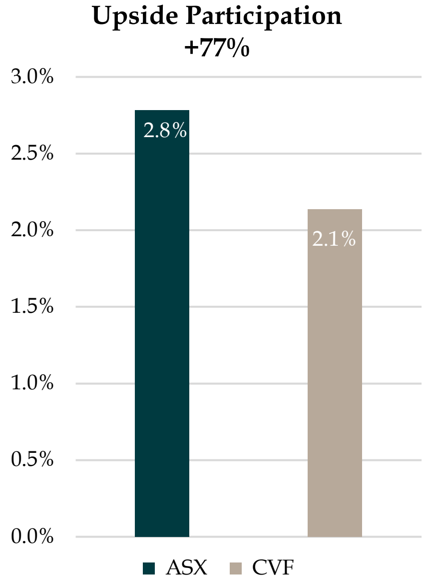


Country	Long	Hedge	Gross	Net
Australia	19.3%	-	19.3%	19.3%
United States of America	22.3%	-	22.3%	22.3%
United Kingdom	4.8%	-	4.8%	4.8%
Germany	4.5%	-	4.5%	4.5%
France	3.7%	-	3.7%	3.7%
Total	**54.6%**	**-**	**54.6%**	**54.6%**

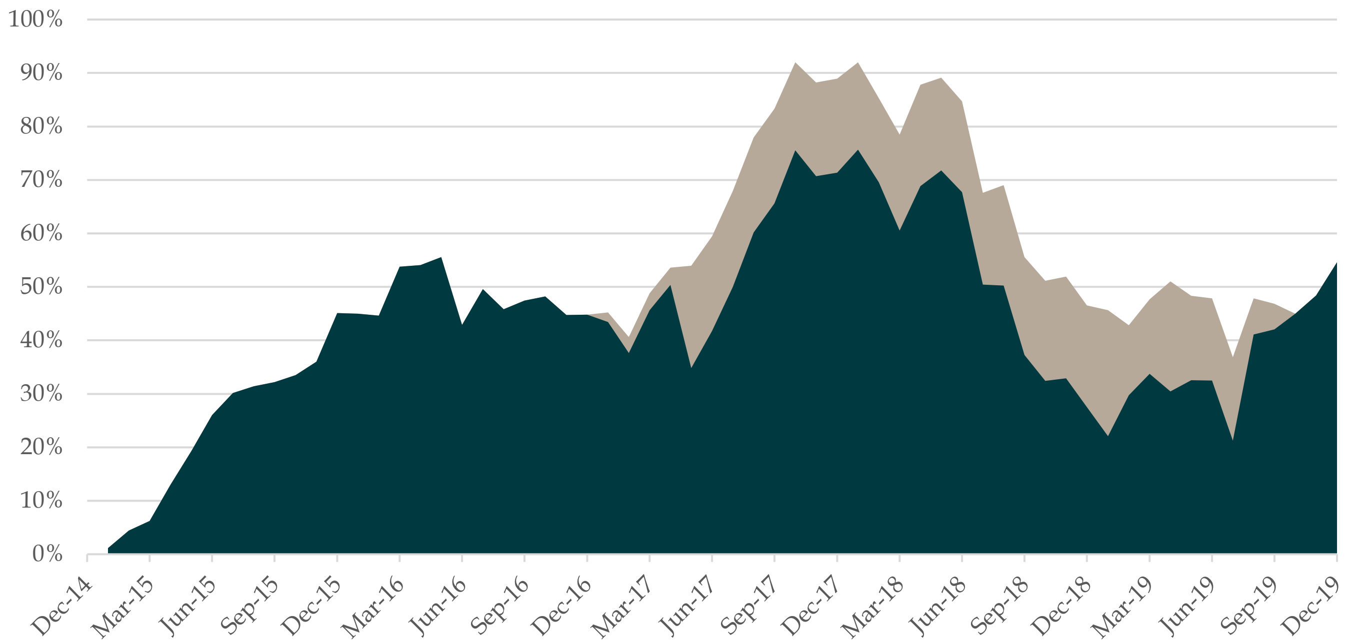
Uncorrelated Returns: More positive months and negative correlation in months when market is down







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



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