BLUEBOAT

October 2020 update

It has been a productive quarter for the Blue Boat Portfolio, as the results below highlight:

Blue Boat Performance vs Indices Total Returns: 3 April 2017 – 30 September 2020:

	Blue Boat Gross Return	Blue Boat Net Return	ASX 200	MSCI All Country
FY21 YTD (3 mths)	11.5%	11.4%	-0.4%	8.2%
Since inception	27.4%	17.3%	13.8%	37.4%
CAGR	7.2%	4.7%	3.8%	9.5%

Source: Bloomberg. Blue Boat and ASX returns are presented in AUD. MSCI returns are presented in USD. Index returns include net reinvested dividends. CAGR is the compound annual growth rate since fund inception.

The last three months have been choppy for global markets following the sharp bounce back from the crash that occurred in March.

Our concentrated portfolio approach is well suited to these market conditions, which are highly uncertain and volatile. We feel we will have opportunities to be assertive in the year ahead both buying and selling and we are searching far and wide for investment opportunities in overlooked companies.

During this period, we had the first major round of company reporting since the Covid-19 pandemic emerged. This reporting season provided critical insights to distinguish between those companies that are suffering, those who are prevailing, and those who are receiving a major boost from the pandemic.

Judged relatively to expectations, our companies reported strongly in August.

Overall, there was a clear trend of "not as bad as feared", and in many cases management far exceeded our expectations. Not surprisingly it was the companies led by founders or those who have a culture of ownership that performed best, resisting the urge to do dilutive capital raisings when the market fell.

What has emerged is a dichotomy which has popularly been labelled the 'stay at home' and 're-opening' economies.

We have seen that the pandemic has changed people's behaviour and where they allocate their spending. The fact that spending was near-instantly re-allocated, rather than grinding to halt, is what many in the market misjudged. At a consumer level, we have seen a significant shift towards spending on home-related products, whilst for enterprises, there has been a boom in technology spend to enable digital functionality. We noticed this trend emerging in April and moved quickly to position the Fund in stocks that were set to benefit from this enormous shift in consumer activity.

The portfolio has been boosted by owning several companies that are key beneficiaries of this trend. We bought when it was unpopular to do so. The task now is judging how these companies perform when the full range of spending options is once again available to consumers. It is likely to be some time before the world is 'fully open', but once travel, hospitality and entertainment are back on the menu for consumers, we expect to see a reduction in spending on the 'stay at home' categories.

A common theme in the dozens of meetings we have had with company management in recent months is that consumer behaviour is driven by the level of restrictions in that region, rather than some immediate and permanent shift in consumer demand. We are monitoring this situation closely but feel very comfortable with the positions we currently hold exposed to the Australian consumer.

Meanwhile, we have been impressed by some of our other investments which have been negatively impacted by the pandemic. These companies have done an outstanding job to cut costs, reposition online and preserve cash, far exceeding the pessimistic expectations during the depths of the market crash. Some of these companies have experienced a near-total loss of revenue, yet have remained in a net cash position throughout the crisis and will have weaker competition on the other side. This 're-opening' portion of the portfolio has been especially volatile and will likely remain so.

Our view is that it will be three steps forward, two steps back, in regards to the world re-opening but we are firm in our belief that the world will gradually go back to 'normal', or some new form of it.

Typically during this reporting time companies give guidance for the year ahead. However this year, due to the pandemic, companies across the board held back and instead offered to provide an update at the AGM in the coming quarter. Accordingly, we expect the upcoming AGM season to be especially instructive for markets, and likely to act as a kind of third reporting season which will present volatility. We will be ready to pounce if this volatility creates an opportunity.

At a macro level, the consensus expects China to be the only major economy to record GDP growth for 2020. To achieve this, they will need to be growing GDP at 5%+ for the second half of 2020, which is in line with their pre-COVID growth rate.

This growth is being driven by government stimulus in steel production, construction and heavy industry. Blue Boat is not exposed to this part of the Chinese economy.

GDP growth is likely to accelerate further in 2021, but the growth will come from the services sector rather than what is driving the 2020 growth.

We remain very confident in the outlook for our investments in China (Hong Kong listed), which focus on the Chinese consumer and in financial services. An incredibly exciting development is the upcoming IPO of Ant Group, which is expected to be one of the largest IPOs ever. As Ant is 1/3rd owned by Alibaba, a core position in Blue Boat, we look forward to greater market recognition of its value.

Ant is a genuinely extraordinary business with 711 million monthly active users on their Alipay platform. It has become one of the most critical parts of the Chinese financial system. In fact, Alipay's annual transaction value to 30 June reached $17.4tn, 23% greater than China's GDP[1]. We keenly read the Ant prospectus which reveals that iResearch forecast Chinese personal disposable income and expenditure are expected to grow at compound annual growth rates of 7.6% and 9.0% respectively from 2019 to 2025. This is staggering growth for over one billion people living in the second-largest economy in the world and suggests we will have nice tailwinds ahead for the portfolio, which has significant exposure to these growth trends.

Whilst China has now largely recovered, the other major markets continue to be impacted, and the prospect of 2nd & 3rd waves of infection threatens new rounds of lockdown restrictions. Economic forecasts have been revised upward from terrible to bad for most economies, but we expect governments to remain heavily supportive of their economies for some time.

---

[1] Total national transaction value will exceed GDP because GDP only measures the total value of all *finished* goods & services and does not account for payments made back & forth along the supply chain.

To reiterate a key point from our April letter, a short-term hit to earnings does not impact the intrinsic value of an asset that much (provided it is robust enough to weather the storm). With four vaccines in the final phase of development, plus the positive way that businesses have quickly adapted, combined with massive government support, we think markets are more and more willing to look at stocks through this lens.

Investors have rapidly shifted to valuing companies based on a 'post-COVID-19' outlook, but we do not expect this conviction to remain constant in the months ahead. We have no view on the likelihood of a second major fall in markets during this crisis. Still, in the event of one occurring we vow to continue to look at stocks as parts of businesses, valuing them on the cash they'll generate over the long term which we now know can handle tremendous short term disruption to operations.

We expect the path to recovery to be uneven, which likely spells a volatile market. We expect this to increasingly become a stock-pickers market, which we think favours the Blue Boat portfolio.

Tim is adding to his investment in the Fund. If you would also like to top up or refer someone who please don't hesitate to contact either of us.

Yours sincerely,

David Nelson and Tim Evans

blueboatcapital.com.au