July 2022 update

The 2022 financial year was a volatile and challenging year for markets. It was a tale of two halves. The first half featured favourable market conditions, euphoric valuations in some sectors, and record highs set for the US and Australian indices. This was replaced in the second by a rapid devaluation of risk assets and the US market tumbling into a bear market. This has been a significant test for investors conviction and marks the third bear market within just the last four years.

Set out below are the annual results since inception:

Blue Boat Performance vs Indices Total Returns: 3 April 2017 – 30 June 2022:

	Blue Boat Gross Return	Blue Boat Net Return	ASX 200	MSCI All Country
FY17 (3 months only)	+1.3%	+1.1%	-1.7%	+4.6%
FY18	+42.3%	+32.5%	+13.0%	+11.3%
FY19	-11.5%	-11.9%	+11.5%	+6.3%
FY20	-10.3%	-10.8%	-7.7%	+2.6%
FY21	+40.0%	+38.9%	+27.8%	+39.9%
FY22	-17.0%	-17.6%	-6.5%	-15.4%
Since inception	+32.7%	+20.7%	+36.5%	+50.2%
CAGR	+5.5%	+3.6%	+6.1%	+8.1%

Source: Bloomberg. The returns for Blue Boat & ASX are presented in AUD, MSCI in USD. Index returns include net reinvested dividends. CAGR is the compound annual growth rate since fund inception 3 April 2017.

In past letters, we raised concerns about the speculative behaviour occurring around cryptocurrencies, SPACs and the questionable valuation justifications being used in the pre-profit technology sector.

We aim to avoid bubbles and overtly overpriced corners of the market. Any envy we experienced regarding missing out on the dazzling returns generated in these assets has been replaced with relief that we maintained our discipline and avoided them altogether.

As in past market sell-offs, the deflation of the bubble has decimated the valuations in these specific areas, but it has also extended globally into many other sectors. Blue Boat's portfolio has not been immune to this contagion.

The contagion has been acutely felt in the smaller end of the market, where there is less liquidity. We have exposure to this end of the market, where we invest in several founder-led industrial companies. In Australia, the Small Ordinaries Index (representing the 101st-300th largest stocks in the ASX300) is down 24% for 2022 year to date; a more severe bear market than the US S&P

500. In contrast, the ASX 100 (representing the top 100 stocks by market capitalisation) is down by only 8% for the calendar year to date. We don't view this divergence in performance as sustainable. Rather it is more likely to be another short-lived anomaly that occurs during a volatile market.

Signs of market pessimism are now abundant. In mid-June, we noted that over 40% of all companies listed on the ASX were trading at 52-week lows, and the ASX 200 is trading roughly 8% below its pre-Covid levels. In the US, only 47 companies, valued at $4.6bn, have undergone IPOs in 2022, and SPAC listings have ground to a halt. Together these raising are down 74% compared to the same period in 2021.

The market price falls so far in 2022 have been entirely driven by a downgrade in valuations, whereas forward earnings expectations have in fact slightly increased. Taking the US S&P 500 index as an example, since January, analysts have increased their 2023 earnings estimates by 3%, whilst the forward P/E ratio has dropped 23% from 20x to 15x (together these factors combine to drive the -20% year-to-date price drop in the index).

These are all indications of an extreme change in investor sentiment and bearish conditions, which are very painful for investors in the short term but are unsustainably negative.

2022's sell-off has, to date, been mostly driven by macroeconomic fears, chiefly the concern that high inflation will prompt rising interest rates and an impending recession. We have been sceptical of sweeping consensus views regarding such complex and uncertain issues, particularly when they materially alter the valuations of businesses and industries.

The reality is always more nuanced, as economics involves many counteracting forces. For example, we are now seeing indications of inventory build-up leading to some retailer discounting and reduced strain on supply channels. This is likely to ease inflationary pressure, which is already showing through in pronounced declines across commodity markets.

Economic systems are complex with multiple mechanisms which are all interacting at once. We don't know what will happen in the future but take confidence when the market is overwhelmingly pricing in a tightening-led recession when a whole range of scenarios are plausible.

In general, we think it's more constructive to compare current market perceptions with on-the-ground realities. We failed to do this during the bear market of late 2018 but feel we significantly improved our process during 2020, where we bought well, and 2021, where we avoided well. Here are some observations related to the market segments where Blue Boat is exposed and where we hope to capitalise.

Perception versus reality - China

Chinese stocks have been labelled "uninvestable" recently, suffering from sudden and drastic changes in regulation along with disruptions from Covid-19 and slowing economic growth. As a result, from February 2021 to March 2022, the Hang Seng declined 41%, creating what we believed was one of the great buying opportunities in recent times in Alibaba, which fell 78% from high to low. We subsequently made Alibaba our biggest position.

One quarter on, we observe that the Chinese economy is set to be assisted by pro-growth economic policies and stimulus, with regulatory pressures easing. They are not seeing inflationary pressures, have room to reduce interest rates if needed, and share market valuations are at or near all-time lows. Contrast this with Western economies, where inflation is high, central banks are compelled to increase interest rates, stimulus is being withdrawn, and economic policies are shifting away from growth. We see the risk/reward proposition in China to be exceptionally skewed to the upside from current market levels.

Chinese stocks have been the only major global market that has generated a positive return for the last quarter, which we view as encouraging.

Perception versus reality - Housing

Residential housing has been a beneficiary of record-low interest rates, with prices surging in metropolitan and regional centres in Australia and USA throughout 2020 and 2021. As central banks move to a tightening regime, combined with extremely high construction costs, sentiment has become very negative. Media commentators and economists tend to be sensationalist and have predicted catastrophic declines in housing activity and major city house prices.

Whilst not underestimating the impact rising interest rates will have on consumer confidence, we disagree with this overly simplistic and dramatic view. We observe that:

1. There is a substantial backlog of renovation and remodelling work in Australia and the USA, which we expect will result in heightened activity levels for an extended period.
2. Both markets are facing a shortage of new housing. The USA has a shortage of four million homes, which would take three years to deliver without adding population growth. Australian rental accommodation vacancy rates are running at a ten-year low, leading to strongly rising rents. This is very different to prior cycles where housing has been oversupplied.
3. Homes are being used differently post the pandemic with the growing acceptance of hybrid work and a rising percentage of dual-income families. We do not see this trend reversing.
4. Home equity has risen to a 15-year high due to price increases and elevated savings rate.

Across the board, housing-related stocks are now priced for sustained falls in profitability. Rising interest rates will likely see housing activity cool, which we believe is rational and necessary. Still, we see far more resilience in the industry than the market action is indicating. We think rising rental yields will attract investors into the market, low unemployment will see loan arrears remain low, and the restart of Australia's skilled migration program will support both the rental and owner-occupier markets.

New Zealand, which is further advanced in normalising its interest rates, provides us with an example of this robustness. Recent results have shown that New Zealand housing activity has only decelerated rather than suffered a collapse, as some feared.

Furthermore, there has been little distinction between different housing-related companies. The significant backlog for renovation and remodelling suggests companies providing products in this area, where Blue Boat is invested, have much stronger outlooks than others.

Perception versus reality –Market share gains

Discretionary spending is closely linked to consumer confidence and often negatively correlated with rising interest rates. Consumer spending is currently very strong. For example, Australian retail sales set an all-time monthly record in May, a fourth consecutive monthly record. Forecasters expect sales to drop off a cliff, which is now reflected in consumer discretionary stock prices. We sold some of our investments in the retail sector in the first half of the financial year.

We do remain invested in three unique retailers, each with excellent execution in their respective categories, and we believe they will prove to be long-term compounders.

Whilst we believe the consumer will be more resilient than currently forecast, we also look to the longer-term opportunities created by such a downturn should it occur. Downturns tend to be when the best market share gains are captured by outstanding operators, and each of our consumer discretionary companies have a track record of opportunistically taking advantage during times of difficulty. We have deliberately positioned Blue Boat in retailers where significant market share gains can be achieved and/or expansion into new markets is already underway.

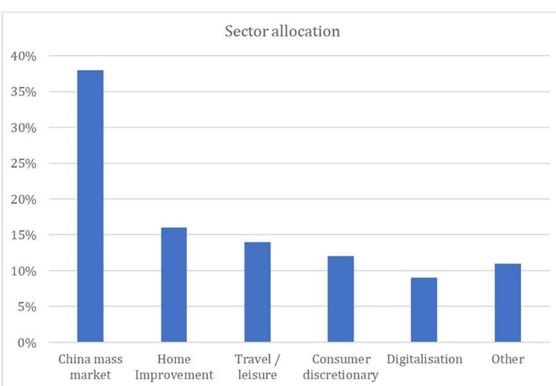
A great example of this is the market share gain achieved by Corporate Travel Management (CTM) during the Covid-19-induced travel downturn. CTM acquired Travel and Transport (FY21) and Helloworld's corporate and entertainment division (FY22) while expanding organically when most of their competitors were focused on survival. They have emerged from the pandemic as the world's fourth-biggest corporate travel company. We anticipate CTM will become more profitable and prosperous than would have been possible without the pandemic's devastating impact on the travel industry.

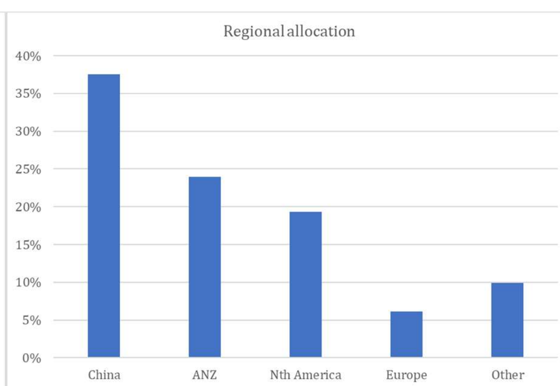
Portfolio positioning

Throughout FY22, we have narrowed our focus and reduced the number of stocks in the portfolio. We exited some retail exposure, reduced our exposure to companies in the battery minerals space at advantageous prices, and sold some disappointing investments in industrial companies that did not fulfil our expectations. We feel we have increased the quality of the portfolio.

We have increased our exposure to China further in the fourth quarter, by adding to our three direct China investments in Alibaba, Ping An and Anta Sports. We are watching the regulatory and economic situation very closely and feel confident the worst is behind us, and that these outstanding companies will justify our patience in the long term.

Currently, the top 10 investments in the Blue Boat portfolio account for 85% of the portfolio. Below is a summary of the portfolio allocations by sector and region:





We do not know how the current macroeconomic malaise will play out, but we retain conviction in our portfolio and our companies' managers. Bill Miller refers to the paper losses experienced in bear markets as "tuition fees" that must be paid to reap the outsized returns available to long-term investors. Blue Boat has paid its fair share of these "fees" in recent times. We thank you for your patience and support and we vow to repay the faith.

Yours sincerely,

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