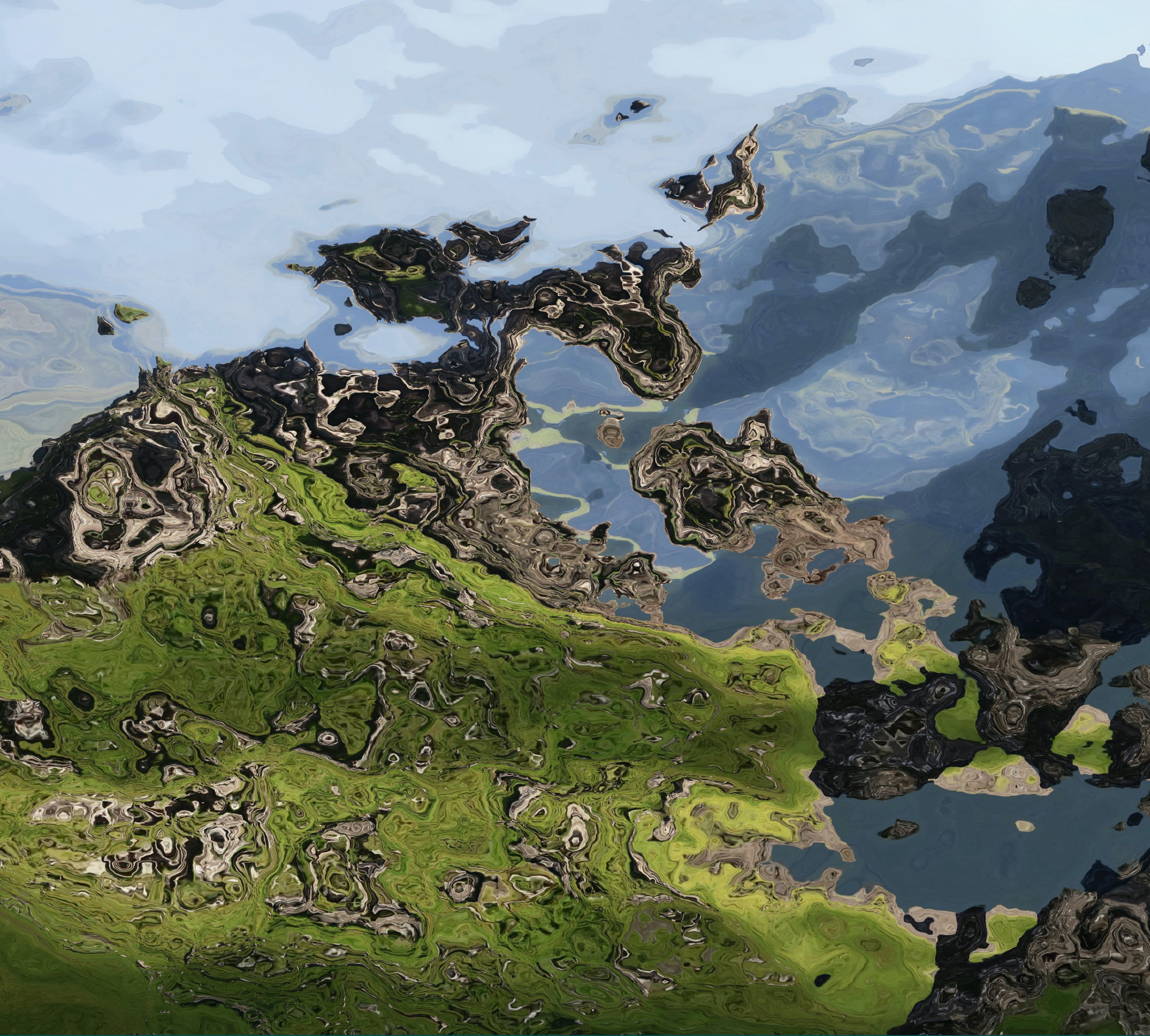

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Munro Partners

The Annual

June 2022

It's a bear market!

The Munro funds delivered the first year of negative returns since inception in the financial year 2021-2022. While it is frustrating for returns to reverse over a 12 month period, we probably shouldn't be surprised.

Bear markets are an unfortunate reality of investing. In my career, I have seen five if measured by a 20% fall in the S&P 500, and two big ones 2000-2003 and 2008-2009. They are a necessary part of the market cycle, a time to cleanse the financial markets of excessive risk-taking and a time to normalise economic policy towards a more sustainable long run trajectory.

Looking at this current bear market, it shows all the hallmarks of its predecessors.

Central banks globally have spent years trying to create inflation; they now have it in spades and have been caught behind the curve trying to subdue it. Consequently, interest rates are rising aggressively and will cause, at best, an economic slowdown, at worst, a deep recession. Elsewhere rampant speculation has seen large parts of the financial system get aggressively overvalued. The resulting adjustment is, in turn, having its own effect on the economy but also leading to redemptions across most asset classes. Lastly, like all previous bear markets, despite seeing the warning signs, investors are still remarkably unprepared for the size and scale of the impending adjustment. Or put differently, thought they were immune only to discover they were not!

There's five bears in there

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Source: Bloomberg Finance L.P and Munro Partners 30 June 2022

Portfolio changes

At Munro Partners, we spent much of the first half of 2021/22 moving down the growth risk curve: exiting our exposure to higher growth but higher valuation companies (i.e. Spotify, Twillio, Atlassian and Freee), and consolidating our holdings in the large market capitalisation growth names (Microsoft, Danaher, Mastercard). The goal was to maintain a portfolio of large-cap structurally growing companies that could withstand the volatility coming from a rising interest rate environment. This strategy initially worked well with the funds delivering solid returns in the first half of the financial year despite weakness in growth equities generally.

Come January 2022; it became clear that we were 'not as immune as we thought', which meant more needed to be done. The Covid crisis subsided rapidly with the Omicron variant, and it was evident that central banks were horribly behind the curve. Our stop loss risk management guidelines were flagging problems and we chose to adhere to our disciplines with PayPal, Netflix, HelloFresh, Lululemon, Snowflake and Cellnex all exciting the fund in January. This combined with a reduction in some of our core holdings we chose not to trigger saw the absolute return fund, Munro Global Growth Fund, raise over 40% in cash, while our long only funds (Munro Concentrated Global Growth Fund and Munro Climate Change Leaders Fund), mandated to remain fully invested (no more than 10% cash), pivoted to larger more defensive growth names.

The following chart illustrates our portfolio changes over the past 18 months. The "greyed out" companies represent some of the higher growth but higher valuation companies that have been exited while the "coloured" is where we consolidated into the large market capitalisation growth names.

How to protect against rising rates and inflation

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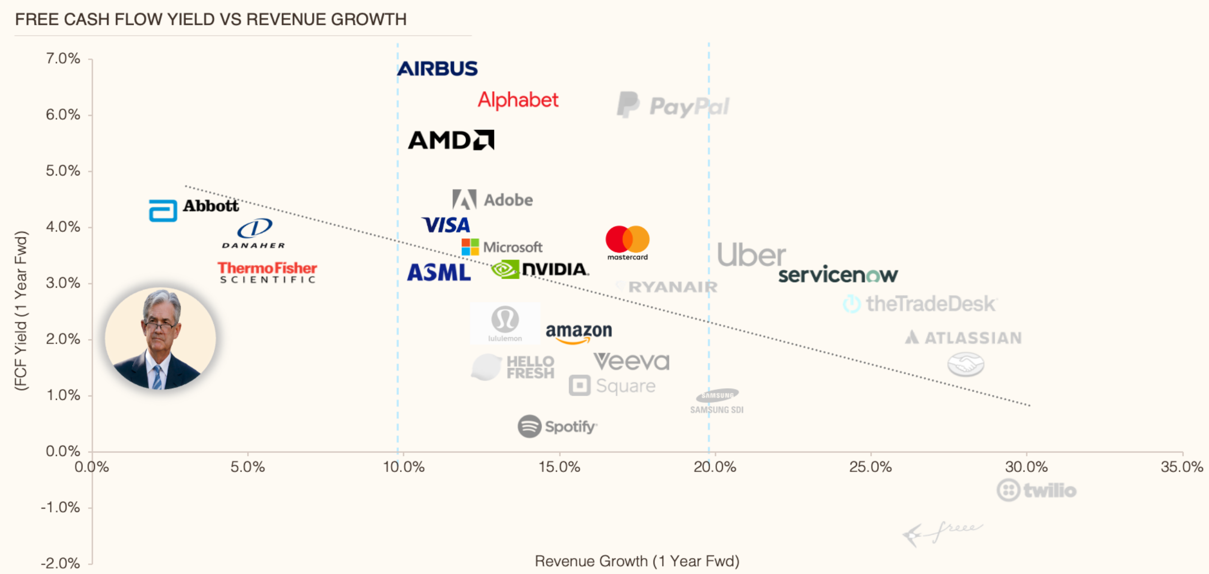

Source: Bloomberg Finance L.P 30 June 2022

Our stop loss disciplines have been invaluable in helping the Funds avoid some of the signature 'blow-ups' in growth equities over the last 12 months and are designed for this very environment. As discussed above, the environment can change very quickly, and as managers, we need an effective reaction function to help us realise the environment has changed.

Adhering to this discipline has served us well over the journey, with many of the names exited above being sold on a fall-from-peak trigger, but rather than selling at the lows they have since gone on to more than halved since we sold them. PayPal, Netflix, Spotify, Snowflake and Hellofresh are all examples of where our discipline has outweighed our conviction and we have successfully stepped to the sidelines. We still like these companies, just recognised there were short term headwinds that we didn't want to endure, and we may look to return in the future.

Every drawdown is different

While at the stock level, the Funds' disciplines have helped it manage the growth equity sell off better than most, for the absolute return fund, our capital preservation tools were less effective.

As many would know, the absolute return strategy (Munro Global Growth Fund) can use put options, short selling and currency to manage volatility and effectively 'smooth the ride' for clients. The Fund was caught out in early January by the aggressiveness of the sell off and did not have put option hedging in place. Since then, option hedging has added value but not to the extent one would expect due to the whipsaw nature of markets as compared with previous drawdowns. Short selling, while disappointing in the March quarter, has improved in the June quarter. The Fund was better able to target specific earnings downgrades rather than the inherently dangerous pure valuation shorts that dominated the first quarter. Lastly, up until recently, the Australian currency has not sold off like it usually does in equity market drawdowns which limited our ability to use that tool. Looking ahead, we expect a number of earnings downgrades and distressed situations that the fund can exploit on the short side should the economic malaise deepen in the months ahead.

Recapping the market outlook - Are we there yet?

Today we still hold over 40% cash, and every week since mid-January I have been asked 'when are we putting that cash back to work?' We flag a few signposts we are looking out for to signal the end of this current bear market.

Stabilisation of long-term bond yields
In our view, bond yields can only go up so much as there is simply too much debt in the world for long-term interest rates to get much higher than 3%. We suspect that long term interest rates are in the process of peaking. With higher expectations of how many rate hikes the US Federal Reserve will put through, the 2x10 year interest rate curve went negative at the beginning of June. With growth expectations now rolling over, long term rates have probably peaked regardless of how many interest rate hikes the Fed needs to do to combat inflation. Put a different way, the Fed is committed and will win its fight against inflation. The question from here is how much damage the Fed does to the economy, so long-term rates have probably peaked.

Valuation multiples
Valuation multiples have de-rated significantly since the start of the year. At some point, the market multiple will price in an expectation of cuts to earnings. Towards the end of the quarter, the S&P 500 P/E multiple fell to 15.3x forward earnings, the trough multiple in 2015 and 2016 when bond yields were much higher. We believe we are close to the bottom of the de-rating process, provided long term interest rates discussed above have peaked.

Earnings expectations to reset lower
As shown in the chart below "are we there yet?", there have been limited downward earnings revisions to date, despite the headwinds from supply chains to input cost pressures. We believe earnings for the market as a whole need to be revised downwards significantly as economic growth slows. We expect to see the start of this during the upcoming quarterly earnings season and this is the main reason we remain under exposed to equity markets at this point.

Time
The last factor we are waiting for is a simple one: time. The average bear market lasts just under 300 days and falls 37% and if history is any guide, this one may only be halfway done. Experience tells us to be patient in this environment and respect the history of previous down cycles.

Are we there yet?

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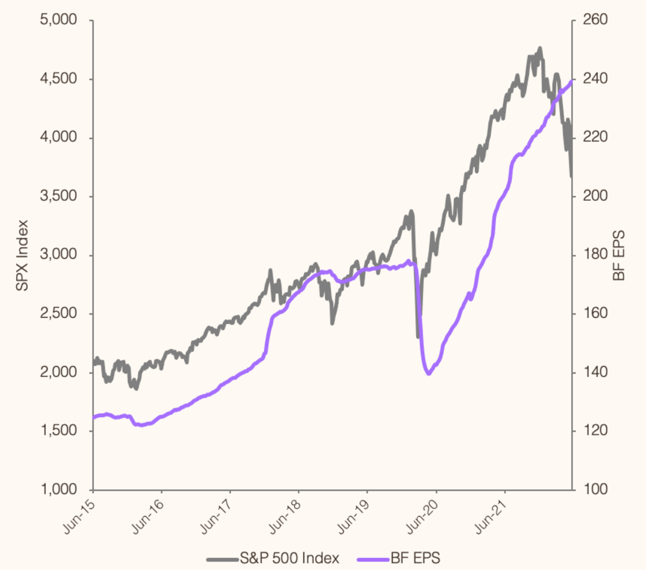
S&P 500 & BLENDED FORWARD EARNINGS



S&P 500 & BLENDED FORWARD P/E RATIO

Source: Bloomberg Finance L.P 30 June 2022

The sun will shine again

Longer term the sun will shine again, it always does. As time passes, the market will eventually start looking over the valley of uncertainty and toward what normalised earnings look like for stocks and note that on a medium to long-term time horizon, stocks are looking attractive. The average bull market lasts 64 months, and you do not need to pick the bottom to enjoy the good times still when they return.

Across all our portfolios, we own large capitalisation stocks with fortress balance sheets. Longer term, we know that these companies are leveraged to some of the most significant structural changes occurring in the world and hence remain confident that these companies can grow through the current uncertainties.

The shift to cloud computing, the need for better healthcare outcomes or the desire to de-carbonise the planet doesn't change just because the economy slows, it merely gets delayed a little. Consequently, despite the short-term hiccups, we expect these companies to continue to produce strong earnings growth in the months and years ahead, and ultimately, we know that their share prices will eventually follow that earnings growth.

We remain excited about the opportunities presenting themselves out of this current bear market and are simply attempting to remain, prudent, disciplined and patient in what is a difficult time for markets.

Nick Griffin
CIO & Founding Partner
Munro Partners

Performance - MGGF

Inception 1 August 2016	1YR	3YRS (P.A.)	5YRS (P.A)	INCEPT (P.A.)	INCEPT CUM.
MUNRO GLOBAL GROWTH FUND (AUD)	-13.9%	9.7%	10.5%	11.1%	86.1%

Performance - MCGGF

Inception 31 October 2019	1 YR	2YRS (P.A)	INCEPT (P.A.)	INCEPT CUM.
MUNRO CONCENTRATED GLOBAL GROWTH FUND (AUD)	-14.2%	4.2%	10.1%	29.2%

Performance - MCCL

Inception 29 October 2021	INCEPT CUM.
MUNRO CLIMATE CHANGE LEADERS FUND (AUD)	-20.7%