



Dear investors and well-wishers,

In its first month, our new fund returned 2.0% for July.

Top contributors		Top detractors	
Afterpay	1.9%	Hedges	-0.5%
Equity shorts	1.2%	Fiat	-0.5%
Cooper Energy	0.9%	Weibo	-0.5%
HCA Healthcare	0.7%	Facebook	-0.4%
Brazil	0.6%	Adaptimmune	-0.3%

Including our prior fund, we have returned, 32% net over the past 12 months, vs 17% from both the ASX 200 and S&P 500. Since June 2016, we’ve outperformed the ASX 200 by 13% net.

Net Performance vs the ASX 200



Note: Period from June 2016 to June 2018 was recorded in a separate fund with different terms and conditions. This is displayed for information purposes only.

It was pleasing to see that our hedges and shorts combined generated positive returns.

Our Macro View

This is a curious time to launch a fund, more than nine years after the 2009 market lows.



Seven decades of US employment data

US unemployment is now below 4%, and we are currently at a low in the chart above.

Previous lows marked times when economic fundamentals looked excellent, but subsequent returns for investors were poor.

Similarly, it's the highs, when vast numbers of people were unemployed, that marked excellent buying opportunities.

It's strange how often you read of bullish commentary that takes the opposite position, seeing strong, broad economic fundamentals as a reason to buy stocks.

By far, the most striking part of the chart above is that it is hardly ever flat. Unemployment is always rising or falling.

There's a good reason for this. Those hundreds of thousands of monthly new jobs lead invariably to more spending by the newly employed, higher corporate profits, which leads to further hiring, and a lower unemployment number the next month.

The reverse effect results in those sharp, straight rises. The best bet of whether there are job losses or gains next quarter, is whether there were job losses and gains the previous quarter.

Every month that passes, we are closer to the first surprise set of job losses that will mark the new unemployment low, and perhaps, the beginning of the end of the cycle.

The trigger could be anything, but we expect it to be inflation-driven rate hikes.

Even with US unemployment at 3.9%, wage inflation has been fairly muted. But the prospect of hundreds of billions of tariffs imposed globally may change things.

Whether or not these should be considered taxes is open for debate, but irrespective of the politics, these are price increases by definition.



We are positioning the fund carefully for this environment. Fortunately our strategy doesn't require us to precisely time the market.

We are 100% invested in our favourite thematics, while hedging in three ways:

1) Direct shorts

Late cycle exuberance means there are plenty of opportunities on the short side.

We're focusing on IPOs of unprofitable companies with fragile business models and little prospect of long-term success. Late-cycle megadeals tend to be value-destructive, so we are keeping a close eye on all deal announcements.

There are many companies with markets caps over \$100 billion that have shrinking revenues and shrinking profits, while trading at valuations in excess of an already stretched market. This has allowed us to enter short positions in highly liquid stocks. The median market cap of our investments is ~A\$20 billion, but the median market capitalization of our shorts is about twice that.

Highly leveraged companies with negative free cash flow are more than usually exposed right now. If fundamentals improve, these companies face higher interest bills, whereas if fundamentals deteriorate, the growth required to carry high debt burdens may not materialize.

We are also taking a thematic approach, identifying structurally declining industries, to balance our investment portfolio.

2) VIX upside

As usual, we are investing heavily in optionality on the VIX. This is a tough trade to get right, however we managed to maintain this trade over the past two years and two months, which included one of the longest periods of low volatility on record.

And VIX optionality offers the prospect of outsize returns if things really do go wrong. This gives us the confidence to maintain our 100% investment in our investment portfolio. Any sudden nasty surprises will pay off quickly here, with the proceeds reinvested in our high-conviction portfolio.

3) Index hedges

We are also building index hedge positions, which is somewhat unusual for us.

As seen in 2016, and indeed, earlier this year, it's very possible for markets to fall ~10% in two days. We are balancing this expensive protection with upside optionality on emerging markets and the Nasdaq, which we will come in handy if our bearish view proves wrong, and markets rip higher.

Anyone can buy insurance on an index - a poor way to invest and a poor way to live. Buying puts is a proven loss-making strategy over most time horizons, perhaps as the consistent demand for insurance ensures they are systematically over-priced.

Our point of difference is that we pair these otherwise-expensive hedges with our thematic, high-growth, innovation-focused investments strategies, and can justify the expense.

Particularly as when the hedges pay off, we are able to incrementally invest the proceeds in our thematics.



We believe this is a materially different strategy and return profile to most fund managers, and as far as we're aware, no one is doing it quite like us.

Active and Index investing

I vividly remember a time when 10 year returns on the S&P 500 were negative. The stock market seemed a poor place to park wealth. Naturally, that was the buying opportunity of a lifetime, certainly mine so far.

Nearly a decade later, capital is pouring indiscriminately into market ETFs, with many indicators at late cycle extremes. Leveraged ETFs are also booming.

We would humbly suggest that, in light of where we are in the rate and unemployment cycle, now is not the best time to be investing long-only.

Naturally, we believe a hedged approach that maintains exposure to the pockets of high innovation and global growth, while preparing for both long bear markets and sudden crashes, is a better way to position for this environment.

Of course, we shall see.

Weibo

Finally, it has been a while since I featured a stock. Here is one of our new positions.

Weibo is a US\$17 billion social media platform in China. It's tempting to call it the Twitter of China, but those kinds of comparisons can be more misleading than helpful. Weibo is growing five times faster, has a net profit margin three times higher, has more users, and is cheaper too.

The key numbers of the Weibo story are:

- 68% annual revenue growth;
- Net profit after tax margin of 32%; and
- if growth continues, Weibo trades on a 2020 multiple of sub 15x, 2021 multiple of sub 10x.

These remind us of Alibaba's numbers when we purchased in 2016, only with all the profitability and defensiveness of a leading social media network.

There are certainly risks. Depreciation of the RMB hurts the position, and social media is under the control of the Chinese Government. The site may be taken down during periods of social unrest.

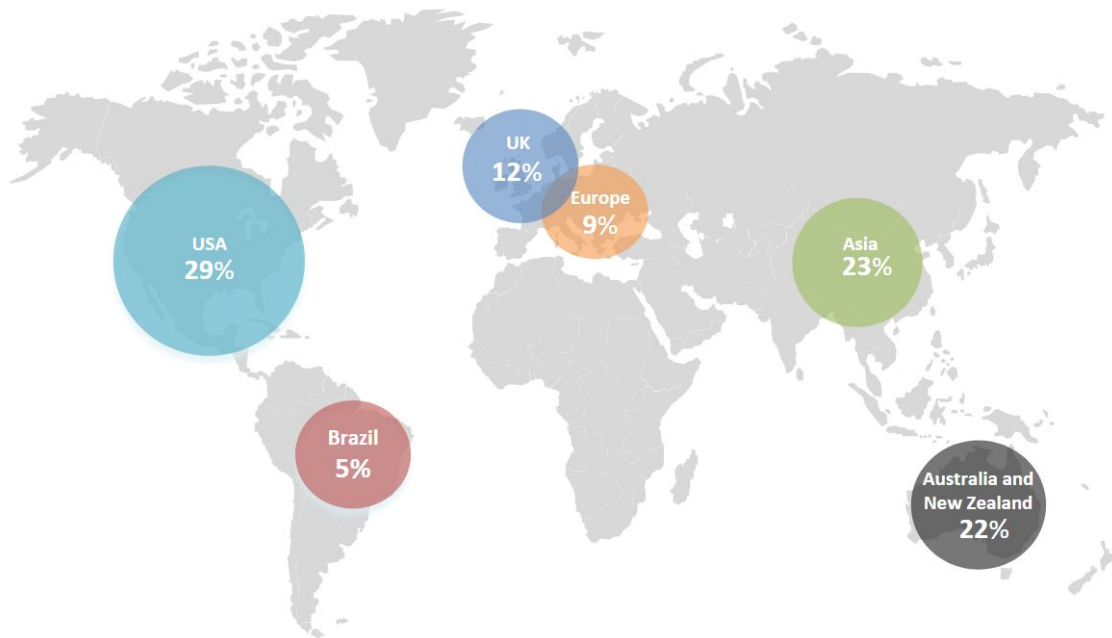
As with Alibaba, there is an indirect ownership link from the US-listed shares to the asset in China, and this could be unwound in a political storm. We judge this extremely unlikely, given the long term consequences to China's access to US capital markets, but the risk is certainly there.

Finally, I'd like to thank all the investors in the old fund who came with us into the new one. And a very warm welcome to our new investors.

Best wishes
Michael



Geographic Exposure



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