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FRAZIS

• CAPITAL PARTNERS •

May 2020

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Dear investors and well-wishers,

In April the fund advanced +24.9%, taking us to -5.8% for the calendar year-to-date. Over that period the ASX total return was -18%, and the S&P total return was -13%.

Market update

We wrote that the perfect scenario for equities was:

- a temporary shock,
- a 30-40% market decline, with many companies down twice that,
- a complete derisking/move to cash/increase in short interest by investors
- enormous fiscal and monetary easing, with rates cut to zero and cash transfers to citizens and companies around the world.

The recent market rally suggests we weren't so far from the mark.

There is another critical piece of the puzzle: we expect stimulus to remain in place until **employment** recovers, irrespective of how hot certain parts of the market get.

It's important to remember that in March, the future earnings of the human race didn't drop 35%, though many indices certainly did. *It was the sell-off that was irrational, not the rally.* Perhaps it's a good thing that nobody seems to agree.

Fortunately, we have orientated the portfolio towards companies that are accelerating in the current environment. This was a very helpful pivot in April and May.

We are taking a **concentrated diversified** approach to the portfolio: concentrated in thematic areas that are accelerating in the current environment (like digital health, online retail and companies that let you work, study and play from home), but diversified within each theme, holding 30-35 names in total.

The biggest risk

I was recently asked what I saw as the biggest risk to markets. I gave a poor answer, so here's a better one.

I spent most of my 20s in London, where a policy of austerity ushered in a conservative Government, and the country had a shockingly weak decade. I also have family in some of the poorer parts of Greece. There, the European austerity movement resulted in an economic catastrophe materially worse than the Great Depression. Decades of economic development vanished and the statistics hide millions of personal tragedies.

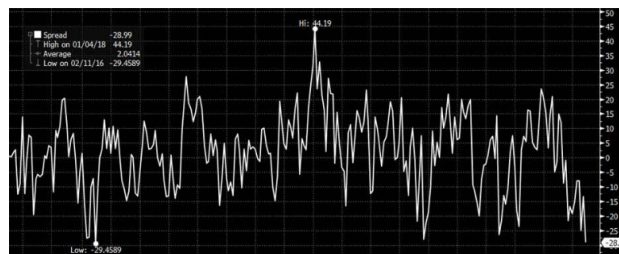
This is what poor public policy looks like.

The Great Depression, the recession of the 1980s, the Lehman collapse, even the Christmas massacre of Q418, (which now seems quaint after the past few months), all involved policy error.

The debates over stimulus, rescues and quantitative easing that raged long and fierce in 2009, have been largely settled. Today, it's hard to imagine the US Government letting a major firm, let alone a bank, go bankrupt.

Given how quickly a degree of stability has returned to economic life after this particularly nasty crisis, this is assuredly a good thing.

Markets have rallied, but cash balances remain at record highs and sentiment remains at record lows. You can be sure that at some point much of this cash will be put back to work.



AAll bull/bear spread. Equities are usually most dangerous when it's high: it is currently low. Note Dec 2018. Even today, after a significant rally, we are below that point.



This has given rise to what is simply the best environment for an active manager I can remember, or really imagine.

Spending is down and unemployment is up, so we are in a very real, very hard recession.

But certain parts of the economy are absolutely booming, stocks are coming off major lows, and the trillions of dollars of liquidity looking for a home really only have a handful of sensible destinations in technology and the life sciences.

There has never been a better time to be nimble and free to allocate entirely to companies that are performing well.

Strategy Update

Our current approach is simple: **we are invested in companies that are thriving in the current environment.**

Fortunately, the sectors thriving most in the current environment align closely to where we were investing before. Specifically, our investments are focused in:

1. Companies that allow you to work, study and play at home
2. E-commerce
3. Digital health and telemedicine
4. Life sciences
5. Software, with a focus away from richly valued and widely known names with large enterprise sales
6. Solar and renewables

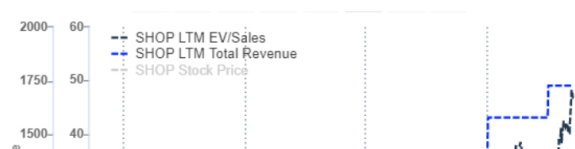
Some of the new firms of behaviour that are taking off in this crisis are so much better for the consumer, and save so much money, that they are likely to stick.

Companies like Shopify are having the equivalent of Black Friday every day single day.



This is not to say we are chasing stocks in the hottest part of the market. In recent weeks we have been doing what we said we would try avoid, and have reduced this position substantially. We are often asked when we would sell a company like Shopify. We now have an answer. ~50x sales is a little too punchy even for us.

Fortunately, there are plenty of companies growing at higher rates trading at less than one tenth of the multiple, that stand to benefit even more from the current environment.

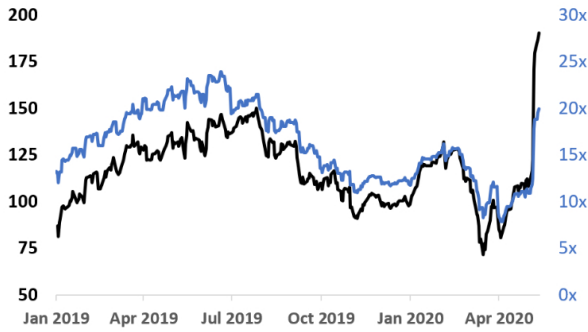




Mind you, an investor in Shopify at 23x sales in mid 2015 would be sitting on a 20x return today. After a few years, growth and fundamental performance generally becomes the dominating factor.

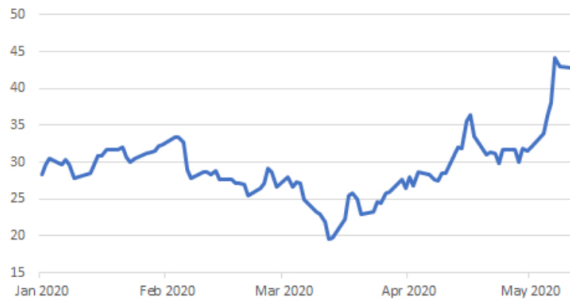
Twilio is a good example of what happens when multiples get too high. We held Twilio through an extraordinary rally to a peak of 24x sales. This was no disaster, in fact, Twilio recently pushed to new highs. However, there have been some wild swings along the way. This is something we want to avoid where possible, even when the long term thesis is correct.

Twilio Stock Price vs Twilio EV/Sales LTM



Fortunately, our new portfolio companies have performed strongly out of the gates, like work-out-from-home company Peloton - only wish I bought home gym equipment when we bought the stock, as it has been sold out for weeks.

Peloton



Carvana is now one of the only ways to buy a car in the United States, as if the existing consumer proposition wasn't already strong enough. *The firm is growing in a market where sales are down over 50%.* The firm has gained years of market share in weeks.

This is what we mean by 'thriving in the current situation'.

Of all the online marketplaces, Pinduoduo remains the most fascinating and original model. It's rare indeed that a company can challenge a firm so entrenched as Alibaba. Anyone looking for an exciting new business idea should bring the concept to the West.

Pinduoduo vs Alibaba



We have had some fun in picking sector winners, whether it's Shopify vs the retail sector, Pinduoduo vs Tencent/Alibaba, Affirm vs any financial company, or Carvana

sector, including Verizon, Alibaba, Airbnb vs any financial company, or Carvana vs the auto sector.

But for the reasons highlighted above, we are working hard to find more opportunities of that calibre so we can reduce our reliance on any one company as much as possible.

So in March, we added Sea Ltd, the leading e-commerce player in South East Asia, with a thriving gaming business. Gaming is an area where we are behind the curve, and are currently spending a lot of time.



We added MercadoLibre, the leading e-commerce player in South America, with a thriving payments business too.

In 2019 MercadoLibre posted ~60% yoy growth. After the March coronavirus quarter, growth **accelerated** to 80%. *The company is thriving in the current environment.*



Salesforce and Trade Desk have continued to perform strongly. In software, we are largely focused on category leaders, and are keen to avoid the hottest parts of the market. There is a wide dispersion between the hottest stocks trading at >20x, and less cool companies with similar growth profiles trading 1/3 of the multiple.



Life Sciences

We've written a lot about Moderna. The firm makes vaccines, with ten programs in the clinic, including a lead candidate for a form of herpes. Moderna did early work on

clinical, including a lead candidate for a form of herpes. Moderna did early work on MERS, the camel coronavirus, which few seem to know is still floating around Saudi Arabia. This helped the firm win the race to test the first coronavirus vaccine candidate in-human.

Moderna



Every second biotech is currently announcing a coronavirus program, reminiscent of the late company pivots to bitcoin in 2017. There is a lot of market danger in most of these situations, as:

1. Most clinical programs fail,
2. If multiple programs succeed, usually only one will be considered standard-of-care, so successful programs might still not make any money, and
3. Epidemics pass quickly, particularly on a drug development timeframe.

Yet the move in Moderna's stock is not irrational. In this case, the US Government is offering over US\$480 million of funding to help research and build out manufacturing capability. Since Moderna has genuine platform technology - their vaccines and treatments are made the same way - they will reap the benefit of this support for years to come.

Digital Health

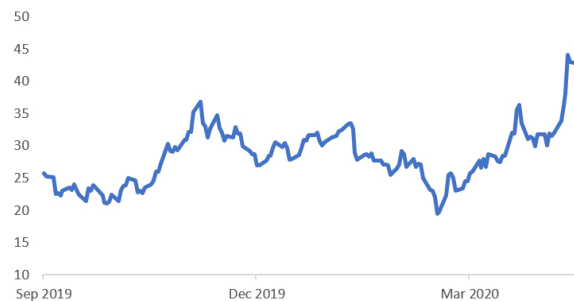
This is one of the more exciting areas in commerce right now.

We invested in three companies using modern technology to tackle chronic conditions. One is focused on fertility, another on diabetes and heart health, and a third on mental health and addiction.

All are growing at over 100% - not to imply we are simply chasing growth. Rather it is intrinsically interesting to us if twice as many people are using a product or service today as they were this time last year.

Livongo, for example, facilitates the digital management of conditions like diabetes, hypertension and weight loss.

Livongo



As with e-commerce, we are taking a **concentrated diversified** approach. Concentrated in the sectors that are thriving in the current environment, but diversified within each theme.

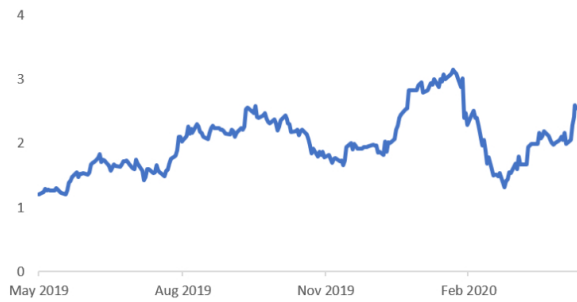
This is an opportunity rich environment, to put it mildly.

Outlook

In March, we were fortunate that in many of our heavily shorted core investments, insiders stepped up to the plate and added capital when the outlook was most uncertain.

Carvana's founders invested \$50 million of their own money into a \$600 million capital raising, and Tencent has popped up onto the share register of Afterpay. Even Polynovo, one of the more polarising companies on the ASX, was a beneficiary, as the Chairman bought shares on the open market in March, more or less at the lows.

For some reason, as with Afterpay, Carvana and Pinduoduo, people keep writing in to tell me Polynovo was a mistake. You could have done better, but you could certainly have done a lot worse:



We actually sold Polynovo down in the recent rally for a tidy bear market profit, so we could take advantage of some earlier stage local life sciences capital raisings.

One of them was Mesoblast. We owned this pre coronacrisis, took profits, and were able to buy back at \$1.3 close to the lows:

Mesoblast



The life science sector was hit hard in March when non-essential medicine was halted and research and regulatory attention diverted to the coronavirus. This added an unwelcome sting to our portfolio in March, but resulted in the extraordinary opportunities of April and May.

In March and April, the correct strategy was to stay long and buy when possible, when everyone else was running to the hills. Now, we believe the correct positioning is to focus entirely on the companies that are accelerating in the current environment.

For many industries, the worst is still to come, as the wealth effect flips into reverse to depress discretionary consumer spending for big ticket items like cars and real estate.

At the same time, there are a large number of companies that are gaining years of growth in weeks. You don't need to have any particular insight to find them: you can see them right there in the data.

We are orientating our entire portfolio in this direction. We are asking the same question of every existing company and every new idea: *will this company thrive in the current environment?*

The true market leaders, those widely loved companies, with novel business models and accelerating customer growth, will continue to attract a bid, even as the broader market is sold. Many of these are advancing even on days when the broader market is selling off.

We don't need to worry about the portfolio under a second wave if it's going to continue the trend towards new and better ways of living and doing business.

A silver lining of this dismal corona cloud is that it seems to have lit a fire under technological progress. At least virus research is finally getting the funding it deserves.

The natural home for all the liquidity sloshing around is technology and life sciences - and that's a good thing for all of us.

We are lucky indeed to be able to focus our investments entirely in these areas.

A sincere thank you for all of your support,

Michael

ps **we'll be hosting a webinar** where we'll go through the current investing landscape and our portfolio in more detail next Wednesday at 10.30am. You can register [here](#).

If you'd like to organize a Zoom catch up, please contact Anna at anna@fraziscapitalpartners.com to arrange a time, and I'd be happy to take you through what we do.

If you'd like to invest with us, you can access our investment portal and fund documentation through the button below, or simply reply to this email and we'll be in touch.

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