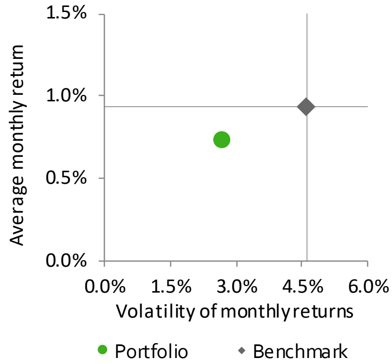
Emerging Companies Portfolio Service
Fact Sheet – December 2020

Investment Report

In the December quarter the Reference Portfolio returned **2.85%** compared with **12.16%** for the S&P/ASX Small Industrials (TR) Index, underperformance of **9.31%.** Elevated cash holdings again led to meaningful underperformance against a market which tore higher on positive vaccine news. The reduction in downside risk fuelled a palpable recovery in sentiment although it will presumably also have implications for fiscal and monetary policy, which remain on extremely expansive settings that are highly supportive of asset values. We note that the vaccine news coincided with the largest single day rotation from growth to value stocks in many years. Asset price appreciation, improved investor sentiment and significant excess liquidity has fuelled a resurgence in speculation in some markets.

Returns and Volatility



Micro-X (+51.1%) continued to recover during the quarter, announcing several positive developments in the commercialisation of its imaging technology. **Maca** (+47.3%) was a very strong contributor after announcing the acquisition of Downer's West Australian surface mining operation. This acquisition will diversify Maca's operations into high volume, large scale, contract iron ore mining. Another mining services business **Perenti** (+24.2%) also recovered some of its recent decline and we expect the value of this business to become increasingly obvious as management successfully deleverages its balance sheet. **Fleetwood** (+19.5%) again outperformed; announcing some meaningful contract wins, management renewal and confirming its strategic commitment to the growing east coast modular construction industry.

McPhersons (-50.8%) was the worst performing position for the quarter. We had begun reducing this position in recent periods on concerns around its China strategy and some managerial missteps. These concerns were accentuated when the company announced an unexpected acquisition and associated discounted capital raise during the quarter, and subsequently compounded by an earnings downgrade attributable to poor sales in China.

At 30 December 2020 45.0% of the Reference Portfolio was held as cash.

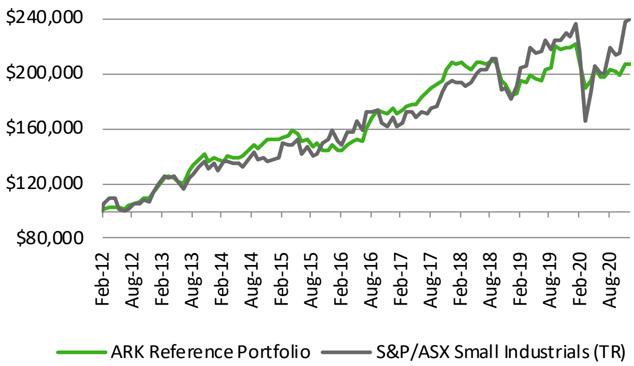
Investment Returns as at 31 December 2020

	1 Month	3 Months	1 Year	3 Years	5 Years	Since Inception
Portfolio performance	**0.11%**	**2.85%**	**-5.67%**	**-0.26%**	**6.92%**	**8.55%**
Portfolio outperformance	*-1.14%*	*-9.31%*	*-11.60%*	*-7.49%*	*-1.74%*	*-1.84%*
S&P/ASX Small Industrials (TR)	**1.25%**	**12.16%**	**5.93%**	**7.23%**	**8.66%**	**10.39%**

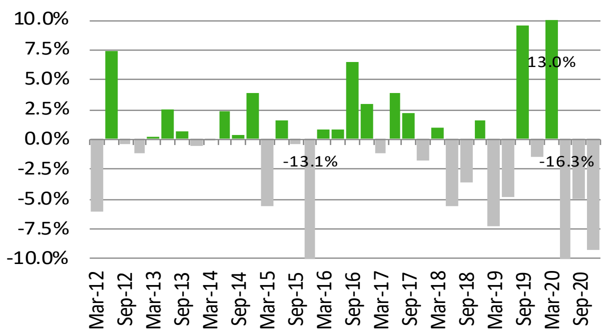
Investment returns are quoted after all fees and costs and before tax (i.e. excluding capital gains tax and the benefit of franking credits). Multi-year period returns have been annualised. Inception date is 20 February 2012. Volatility is measured using standard deviation. Performance information relates to ARK's original client portfolio (referred to as the Reference Portfolio), other client portfolios may have experienced different performance.

Investments go up and down. Past performance is not a reliable indicator of future returns.

Returns since inception



Quarterly performance relative to benchmark



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Global Investment Environment

Coronavirus

Markets responded euphorically to the news that multiple vaccine candidates had successfully completed efficacy and safety trials during the quarter. While the vaccine rollout will take time and pose logistical and operational challenges to health systems, it eliminates the worst-case outcomes and has illuminated a path for battered communities approaching breaking point. The vaccination programs are not without uncertainty with the potential for widespread vaccination to reveal complications such as unanticipated side-effects and elevated risk factors that were not apparent during the relatively rushed clinical trials. Nonetheless, the development of a handful of apparently effective vaccines in such a short period of time is an extraordinary achievement. If vaccination proceeds relatively smoothly and proves effective in the real world, it is likely that most of the developed world could be vaccinated over the next 12 months with the developing world to follow shortly after.

Provided the vaccines remain effective against future virus mutations, there is the potential for northern hemisphere transmission to peak in early spring (March/April 2021) before the seasonal summer slowdown, with only a lesser acceleration during the onset of the northern winter. That said, the next few months could be very difficult in these regions as extremely transmissible forms of the virus circulate. The outlook absent vaccines would be very bleak indeed. In Australia vigilance will likely be required through the coming winter until the vaccination program completes.

The view that COVID's impact, at least in the northern hemisphere, may be dramatically reduced by the middle of the year requires further consideration of what implications the experience of the past 12 months will have for the post-COVID economy. We subscribe to the view that the post-COVID economy will resemble but not recreate its pre-COVID form and that many of those differences will disturb to some degree existing economic arrangements. While acknowledging human resiliency, it seems unlikely that so many previously unimaginable events could occur in such quick succession without impacting the future behaviours of people and organisations. We expect to be surprised by the economic implications such as increased online shopping, teleconferencing, working from home, supply chain resilience, and potentially reduced services consumption. Over the longer term we expect significant social, political and economic consequences from increased debate around elevated wealth inequality, social unrest, government interventions, expectations of government support, and increasingly extreme and unsustainable fiscal and monetary policy. We would be surprised if we are not living with the echoes of 2020 for some time.

Like most, we expect a strong release of pent-up global demand as confidence improves, restrictions are lifted, and government stimulus continues to flow. However, we also see an elevated risk that the recovery in economic activity over the medium-term could be slower than many expect as stimulus necessarily subsides.

Commodities

The quarter has been extraordinary for commodity producers with prices rising strongly for most commodities, including iron ore, copper, corn, soybeans, wheat, nickel, and oil. This has been driven by a combination of supply disruptions, reflation expectations, USD weakness, increased demand for goods, and fiscal stimulus (particularly stimulus supporting fixed asset investment in China). The price moves have been very positive for commodity exporting economies with undisrupted supply capacity, such as Australia. However, Australia's ability to fully participate in this bonanza remains complicated by heightened diplomatic and trade disputes with China which has forced Australian exporters to identify and build trading relationships with new smaller customers. While uncomfortable in the short-term, this process should ultimately improve the resiliency of Australian exports by reducing dependence on a single and somewhat volatile trading relationship. However, concern continues to grow over the longer-term implications of a deteriorating relationship with our largest trading partner and the primary Asian power.

Economic Activity

China is one of the few countries expected to record economic growth during 2020 with a strong rebound in the second half of the year. Indications are that China's growth through 2020 has been largely fuelled by stimulation of industrial production and fixed asset investment with data implying relatively weak domestic consumption. The headline growth numbers from the first country to enter and successfully mitigate the pandemic are encouraging, but the compositional mix casts some shadows over the optimistic outlook for global growth.

Activity in Europe and North America slowed further through the quarter as the intensity of the pandemic increased. The short-term outlook is weak for these economies as they grapple with a resurgent virus but should materially improve through 2021 as the impact of the pandemic reduces and confidence increases assisted by additional fiscal stimulus in some regions.

Financial Markets

Markets responded strongly to successful vaccine developments during November which acted to stabilise a then wobbly equity market. Speculative activity supported by positive sentiment and flows from abundant excess liquidity and increased retail participation has been a feature of financial markets through 2020. Speculation remained extremely elevated during the quarter judging by indicators such as extreme valuations, social media activity, trading account openings, cryptocurrency price moves, frenzied IPO pops, the proliferation of blank check companies, and the increasing use of investor leverage through derivatives and margin loans.

Trading data on call options shows the increase in speculative activity in the US stock market and the high level of retail participation. This narrative of retail speculation is prima facie supported by the data showing massive growth in equity call options transactions during 2020 with most of this growth in relatively small trades. The narrative is further supported by the divergence between sentiment and activity in the markets for options over individual stocks and options over indices. The put/call ratio for options over individual stocks reached a multi-year low during the quarter indicating very bullish sentiment and a high level of speculation. At the same time, a relatively high put/call ratio for index options indicates relatively bearish sentiment in this market. The divergence between these two markets also fits the narrative of bullish retail participants undertaking increasingly aggressive speculation while more bearish 'sophisticated' investors are hedging market exposure.

The short end of the yield curve remains pinned near all-time lows, but longer-term yields continued to rise over the quarter, steepening the curve to incorporate increasing long-term inflation expectations. A continuation of this trend through 2021 may begin to pressure investors in long term income streams, especially long bonds and bond proxies such as real estate, and could support a shift in equity investor preferences from distant income streams (growth stocks) to near term income streams (value stocks).

Local Conditions

Australian employment conditions continued to improve from the extremes experienced earlier in the year but remain well below their levels of 12 months ago. Unemployment at 6.8% (+1.7 ppts versus pcp) and underemployment at 9.4% (+1.1 ppts versus pcp) show underutilisation running at 16.2% (+2.8 ppts versus pcp). On the positive side, the participation rate recovered to pre-COVID levels in November. Employment metrics have enjoyed a tailwind from the closure of international borders with reduced inbound migration requiring far less job creation to keep unemployment stable. In 2020 job creation was restricted to part time employment, with the decline in full time employment (-110,900) only partially offset by additional part time employment (+27,800). We also note our standard disclaimer that these numbers continue to be distorted by ongoing stimulus programs supporting wages, job retention and consumption.

Expenditure on the JobKeeper program reduced significantly during the quarter as entitlements reduced and eligibility was tightened. JobKeeper recipients peaked at 3.8 million early in the year but had declined to 1.6 million in October. Eligibility and entitlements will reduce further in the current quarter before the program terminates in March. The ongoing prohibition on international travel suggests that termination of this program will leave several industries in a very difficult operating environment (notably education, tourism and their adjacent industries) and we would not be surprised if the Federal Government introduced smaller industry specific support programs.

Retail Sales. Retail sales continued their very strong performance during the quarter with November data assisted by the growing Black Friday event and a rebound in Victoria, as that state exited lockdown releasing pent-up demand. Excluding café, restaurant and take away food, all categories of retail trade are well above their pre-COVID levels.

Food retailing continued to decline from its lockdown high, but sales remain well above historical levels. We expect this historically stable dataset to inform our understanding of the extent of normalisation of consumer sentiment and activity.

In percentage terms the largest increase in retail activity has been in household goods (eg electronics, whitegoods, furniture, hardware and garden supplies etc.). It is unsurprising that people forced to spend additional time in their homes sought to upgrade their living arrangements assisted by an increased capacity to do so through reduced expenditure and elevated fiscal support. Of course, this trend would appear vulnerable to the widespread belief that activity will normalise next year. Café, restaurant and take away food spend continued to increase during the quarter but remained ~10% below its 2019 levels in November.

Increased goods consumption has been enabled by an explosion in household saving. Bank deposits of businesses and households have each increased by over $100 billion over the course of 2020. This equates to approx. $10,000 of additional savings for each of Australia's roughly 10 million households. Of course, these savings are not equally distributed across the population but it does give an idea of the ready cash available to households at present. This extraordinary increase in savings has been enabled by: (i) reduced consumption of services, and (ii) government support programs.

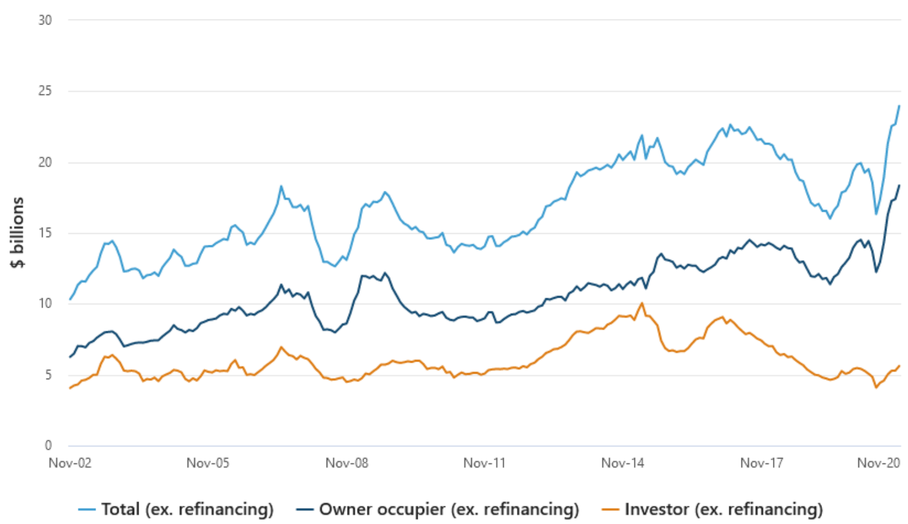
The transition from consumption of services to consumption of goods has been a net negative for domestic economic activity. As you would appreciate, most goods sold in Australia are imported and goods sales are increasingly conducted online. Together these characteristics ensure that only a small portion of the value of these sales remains in Australia compared to the services industry where most of the sales value is retained locally, particular in wages. The reduced labour intensity of online retail sales relative to services emphasises the need for services consumption to fully recover to pre-COVID levels. The one exception of course has been imported services, particularly international travel, where the redirection of spending to domestic retail sales has been net positive for the Australian economy. To date these negative impacts have been largely offset by government programs supporting employment and consumption.

The second factor underpinning this increase has been government policies supporting household consumption including direct fiscal support, monetary policy, loan deferrals, and permitting early access to superannuation. Most of the direct fiscal support for households and businesses has now been provided and ongoing support will wind down this quarter. We expect retail sales to slow over coming periods as consumption of services partially normalises and government support winds down. In our opinion, whether services demand recovers sufficiently quickly to offset the withdrawal of government stimulus will be very important for employment market conditions in the short term.

Loan growth

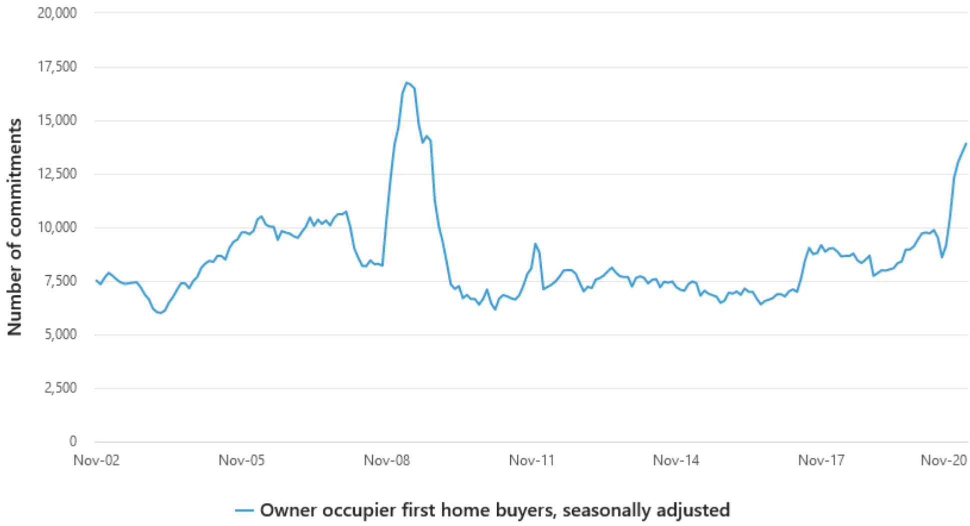
Housing lending data showed growth continuing through November. The recovery in lending commitments to owner occupiers was very strong, with first home buyer demand supported by HomeBuilder. Investor activity is growing but remains considerably below its peak.

New loan commitments, total housing (seasonally adjusted), values, Australia



The HomeBuilder program was extended during the quarter to 31 March 2021 but at a lesser rate ($15,000 versus $25,000). The requirement to commence construction relatively quickly will ensure detached housing contruction activity remains elevated through 2021/22. The impact of HomeBuilder is very clear in housing approvals data for detached housing which grew strongly in the second half of the year. There are risks associated with bringing forward demand for building activity in this way, but we expect the government to sidestep this risk through accelerating the immigration intake in 2022 and beyond.

New loan commitments to owner occupier first home buyers (seasonally adjusted), number, Australia



Dwellings approved, by building type, seasonally adjusted

Loan commitment growth remained low in Victoria where it is yet to rebound from the extended lockdown. Assuming Victoria follows the path of other states in coming months this data should be expected to rebound significantly.

Portfolio Positioning

In the short-term we expect financial markets to remain driven by positive investor sentiment and readily available liquidity. However, risks are accumulating in some of the more extended parts of the market and, over a longer timeframe, we see the potential for rising US yields, amongst other factors, to challenge the stability of this upswing. While the curve out to 3 years remains pinned, the longer end has been showing signs of life during the quarter with the 10-year recovering towards 1%. Should this 'normalisation' of yields continue in the new year, we would expect pressure to ultimately increase on equity flows and asset prices. Portfolio positioning remains defensive with an elevated cash holding given concerns over current extended market conditions, uncertainty around the future direction of rates, and potentially unstable speculative activity.

Historical Monthly Returns

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2012		0.87%	2.38%	-0.21%	-0.91%	-0.12%	1.40%	1.56%	1.55%	2.32%	0.52%	3.69%	**13.75%**
2013	4.81%	3.68%	1.45%	-1.13%	-1.74%	-1.18%	7.24%	3.50%	2.51%	2.98%	-3.60%	1.92%	**21.83%**
2014	-0.71%	-0.99%	3.14%	-1.09%	-0.08%	0.44%	3.51%	2.88%	-1.72%	2.50%	1.40%	0.29%	**9.81%**
2015	0.05%	1.10%	0.69%	2.70%	-1.93%	-3.84%	1.07%	-3.20%	2.06%	-3.77%	-0.01%	2.71%	**-2.67%**
2016	-2.48%	-0.25%	2.52%	1.78%	1.19%	-0.57%	6.10%	4.49%	3.81%	-1.25%	-0.48%	2.14%	**17.99%**
2017	-2.58%	1.57%	1.83%	0.60%	0.45%	2.85%	1.90%	1.27%	1.52%	1.96%	3.46%	3.12%	**19.35%**
2018	-0.63%	0.71%	-1.32%	-1.65%	2.79%	0.15%	-0.74%	1.16%	-0.59%	-6.43%	-1.64%	-4.18%	**-11.98%**
2019	1.24%	4.64%	-0.50%	2.53%	-0.94%	-1.02%	4.24%	0.56%	8.26%	-1.26%	0.53%	0.13%	**19.51%**
2020	1.13%	-6.34%	-9.05%	2.93%	5.23%	-3.55%	0.16%	2.55%	-0.78%	-1.51%	4.31%	0.03%	**-5.74%**

Note:

Investment returns are quoted after all fees and costs and before tax (i.e. excluding capital gains tax and the benefit of franking credits). Performance fee accruals (credits and debits) are included in monthly performance, provided the subsequent performance fee has crystallised. Inception date is 20 February 2012. Performance information relates to ARK's original client portfolio (referred to as the Reference Portfolio), other client portfolios may have experienced different performance.

Investments go up and down. Past performance is not a reliable indicator of future returns.

What is the service?

Investors in the Emerging Companies Portfolio Service appoint ARK to actively manage a portfolio of small and mid-cap ASX listed investments on their behalf. The service is structured to allow clients to obtain the benefit of dedicated investment management without relinquishing ownership of their investments.

What are the advantages of the service?

The key advantages of the service are:

- A dedicated manager oversees your exposure to small and mid-cap listed investments.
- You retain legal and beneficial ownership of your investments giving you greater transparency and control.
- You can customise the tax consequences of your investments to suit your individual situation.
- Your assets are separated from other investors.

What investments are considered?

We solely invest in ASX listed small and mid-cap industrial companies and do not invest in resource companies.

Why small and mid-cap industrial companies?

Relative to their larger counterparts, these companies:

- are overlooked by many professional investors,
- tend to be less well understood by the market, and
- often have higher growth prospects and more risk.

These characteristics make this sector of the market an attractive environment for active investment management.

Our disciplined, risk focused investment process is designed to identify attractive investment opportunities in this sector of the market whilst reducing risk.

What is our investment approach?

Our ideal investment targets are well-managed companies with advantageous competitive characteristics that can reliably produce excess free cash flows and have the potential to re-invest those earnings at attractive rates of return. However, we will consider other investments where our risk-adjusted valuation implies an attractive level of return.

We value investments based on our own proprietary research underpinned by extensive analysis. Before investing in a company, we seek to thoroughly understand its business and associated risks and opportunities particularly:

- its financial performance and condition,
- management's integrity and ability,
- the industry's competitive landscape, cyclical outlook and operating environment,
- the key risks and drivers of the business, and
- the market's perception of the company and how, if at all, our view diverges from it.

How is your portfolio managed?

In addition to ensuring that each investment is attractive in its own right, we carefully consider how an investment will affect the risk profile of your portfolio. Our guiding principle is to maximise the profit potential for your portfolio within relatively conservative risk boundaries.

We undertake continuous portfolio review in conjunction with a structured process for the realisation and acquisition of investments. This ensures that individual investment weightings reflect our view of the relationship between price and value for each security, portfolio mix and the relative attractiveness of other investments.

Investment Summary

Investment Manager		ARK Investment Partners Pty Ltd ABN 12 150 856 223 (AFSL No. 487510)
Investment Objective		Outperform the S&P ASX Small Industrials Total Return Index over a 3 year period
Ownership		Legal and beneficial ownership remains with investors
Recommended Investment Period		3+ years
Investment Restrictions		Available to Wholesale Clients only
Minimum Initial Investment		$250,000 (no minimum for additional investment)
Fees	Entry/ Exit Fee	Nil
	Management Fee	Up to 1.0% per annum of the value of the managed capital
	Performance Fee	20% of any out-performance above the S&P ASX Small Industrials Total Return Index

Further Information

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