Forager update – 20 March 2020 letter to investors

Dear Investor,

I don't normally write to you twice in a week, but these are not normal times. These are the most tumultuous market conditions I have ever experienced, worse than the financial crisis. Monday's 10% fall was the worst one-day fall for the Australian market since 1987, yet dramatic moves have become so frequent that it is rapidly starting to feel normal.

While dysfunctional markets create extraordinary opportunities, they only occur when there is a lot to worry about.

A humdinger of a recession

I'm sitting at home writing this letter. Almost all of Forager's staff are doing the same. We're mitigating the potential impact on the business of multiple people getting sick at the same time, and also doing our bit to avoid spreading the virus. But that means we're not buying breakfast, lunch and coffee. We've cancelled all travel and aren't staying in hotels. Most of us eat dinner out a couple of times per week and aren't doing that.

It might be good for my health. But the economic consequences of shutting down the whole population of Australia are going to be dramatic. Australia has not experienced a recession since before I started my career in 1996. This one is going to be a humdinger. I have little doubt that there will be fewer companies listed on the ASX by the end of 2020. Emergency capital raisings will be required for most travel and retail companies to survive.

So tread carefully. Yes, the stockmarket is the cheapest it has been since 2009. Yes, we will recover from this and share prices will be higher. But those companies that are fragile and weak are particularly risky propositions as we navigate a certain recession.

A humdinger of a financial crisis

This crisis is different in many ways. It has grown from another virus in Asia - which most of us thought would be similar to its predecessors - to become a global catastrophe. With interest rates already low, central banks have only small bullets left to fire. And governments and economists are struggling to fathom how you stimulate demand while telling everyone to stay inside.

As financial crashes go, however, it shares many similarities with those that have come before it. What starts as a rational reaction to an economic contraction swells into a crisis of confidence and a tsunami of forced selling that feeds on itself.

It is not just equities that are getting pummelled. Financial markets for bonds, currencies and derivatives are all in distress. Funds trying to meet redemptions and investors needing to repay debt have no regard for the value of what they are selling. They just need the cash. A recent article in the *Financial Times* summarised the turmoil well:

"Bond yields in the US and Europe rose to their highest levels in weeks as fund managers under pressure to return cash to investors were forced to dump their most liquid holdings, according to traders."

Mike Ridell, a portfolio manager at Allianz Global Investors, added "A lot of people need cash and they're liquidating the only things they can".

This selling is causing dislocations, even in the markets for bonds of blue chip companies. In small and illiquid stocks, the dislocations are extreme.

Concentrated funds and extreme volatility

Market prices for the stocks in our portfolios have been hammered as a result, particularly in the Australian Fund where the volume of shares traded in some holdings is low. On Friday last week, the share price of marketing services company Enero Group closed at $1.295. On Monday morning the best price bid for the shares was $1.00 and the best offer $1.30. The first trade was 720 shares at $1 each, causing a 23% mark down in the “value” of our shares. Forager’s Australian Shares Fund owns 5.4 million of them, so that $720 trade decreased the value of our portfolio by some $1.6m.

I’m not for a second suggesting that the real value of Enero is unaffected by the recession we are about to face. In Monday’s webinar I’m going to run through both portfolios in detail and discuss how they are positioned to navigate this crisis.

The point is simply that, as these prices move around wildly, you can expect extreme short-term gyrations in net asset value for both funds. The performance numbers for March are already horrendous and, if someone decides they need to sell 10,000 Enero shares at $0.50 a share, it might well get worse. If someone needs to liquidate a small cap fund that owns the same stocks as us, it might get a lot worse.

Our aim is to make the most of the situation. The Forager business remains well capitalised and the team are working furiously to find crazily priced bargains to add to the portfolios. In a few months’ time, if the dust has settled, we can reflect on our performance. For now, it is best if you are able to ignore the noise.

Please join us for the webinar on Monday afternoon. I want to run investors through the holdings in both funds and our exposure to recession in Australia and globally. There will also be plenty of time for questions.

Finally, I’ve received a lot of supportive texts, emails and phone calls this week. Thank you. Your concern for our welfare when your portfolios are suffering means a lot.

It is going to be an incredibly difficult period for the whole country over the next six months. Where you can do so from an appropriate distance, try and spend some money. And be nice to each other. We are all going to need it.

Kind regards,

Steve Johnson