FORAGER

CHIEF INVESTMENT OFFICER LETTER

QUARTERLY LETTER SEPTEMBER 2020

www.foragerfunds.com

FORAGER FUNDS PERFORMANCE SUMMARY (as at 30 September 2020)								
	1 month return	3 month return	6 month return	1 year return	3 year return (p.a.)	5 year return (p.a.)	10 year return (p.a.)	Since inception* (p.a.)
Forager Australian Shares Fund	2.00%	25.66%	74.99%	-6.85%	-5.52%	4.98%	10.32%	8.92%
Forager International Shares Fund	1.63%	13.36%	39.82%	27.43%	9.70%	10.98%	-	14.08%

Past performance is not indicative of future performance and the value of your investments can rise or fall.
Performance in FASF is calculated using Net Asset Value (NAV), not the market price.

*8 February 2013 for FISF and 30 October 2009 for FASF

THE UPSIDE OF VOLATILITY

In 2020, each quarter has felt like a year. After March's meltdown, both funds added significantly to the June quarter's stupendous recovery in the past three months. The Australian and International Funds delivered quarterly returns of 26% and 13%, respectively. Those are numbers most of us would be happy with over a full year.

I doubt the end of the year is going to be any quieter. We still have a US election, final Brexit negotiations and decisive news on several of the most promising COVID-19 vaccines to come.

I'm up to the very first US election in *These Truths*, Jill Lepore's excellent history of the United States of America. She writes that the peaceful transfer of power from the first elected president, John Adams, to the second, Thomas Jefferson, was "remarkable" and that the two-party system "insures the peaceful transfer of power, in which the losing party willingly, and without hesitation, surrenders its power to the winning party". Might she need to rewrite that section shortly?

We don't have a strong view about the likely US election outcome, what sort of Brexit will unfold or whether there will be a COVID-19 vaccine. We do know that all of this uncertainty is creating a lot of stock market volatility. And that can be a wonderful thing.

VOLATILITY: RISK FOR WHO?

"Risk adjusted returns". That's one of the common phrases you'll see on fund manager websites. After all, it's what the whole industry is trying to do: provide maximum returns for minimal risk.

The return part of that equation is a straightforward number. But how do we measure risk? And who should we minimise it for? These are difficult questions. Certainly more difficult than the industry would have you believe.

In finance theory, the main measure of risk is volatility. The theory goes that the more a share price bounces around, the higher the chance that it will be at a low point when you need the cash. This is true if you need the money in the near future. But it's not true for everyone.

Firstly, your time horizon is crucial. If you need to sell your shares next week, then stock price variability is a significant risk for you. But if you have the capacity and intent to hold an investment for five or 10 years, what happens next week doesn't matter. In fact, your average return over that period becomes far more important than variability along the way.

Secondly, volatility is itself a variable. A stock that has historically shown very little volatility can suddenly become highly volatile, and vice versa. Look no further than March's meltdown, where shares in airports went from trading like infrastructure safe-havens to highly volatile tourism stocks.

Most importantly though, for an investor with a long time horizon, volatility can be more friend than foe.

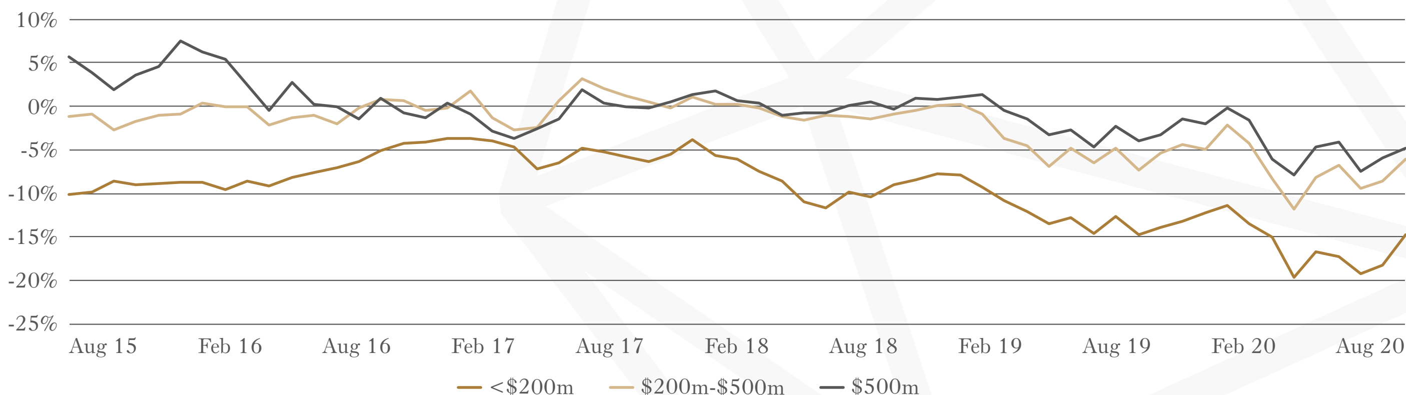
LOW PRICES EQUAL LOWER RISK

We want to buy shares at highly attractive prices. The more a share price bounces around, the more chance that, at some point in time, it trades well below its fair value.

Further, the larger the gap between your purchase price and fair value, the lower the risk of permanent capital impairment. And that's the long-term investor's version of risk. Our valuations typically include a base case, worst case and best case. For a top quality stock like **Autodesk**, we have a valuation pencilled in at $270 per share as a central case, $160 downside and $340 best case. At $150, where we recently purchased it, we can afford for plenty to go wrong and still make money over the long term.

When used to invest at low purchase prices, higher volatility can actually reduce investment risk for the long term investor. But it can be stomach churning. It's hard to enjoy your breakfast when reading about the billions of dollars "lost" on global sharemarkets.

But all of this volatility has been wonderful for Forager's funds' returns. As a Forager client, you should cross your fingers for a messy US election and anything else that might lead to panic. With volatility comes the genuine opportunity for higher risk-adjusted returns.



Source: Bell Potter

LICS NOT SO LIT IN 2020

It used to mean someone was slightly drunk. Now, the kids tell me, "lit" means something is excellent. That's not what they are saying about LITs (Listed Investment Trusts) this year. Or LICs (Listed Investment Companies), for that matter.

These investment vehicles are listed on the stock exchange. Rather than the fund manager issuing or redeeming units to meet investor demand, investors buy and sell their units (or shares) to other investors on the stock exchange.

After a frenzy of capital raisings in 2016 and 2017, most of them now trade at a significant discount to their underlying net asset value (NAV), including our own Forager Australian Shares Fund (ASX:FOR).

The reasons include poor performance, high expenses (particularly in smaller vehicles) and a lack of liquidity. But the discounts also tend to be largest when the wider market is most pessimistic, and at their narrowest when enthusiasm abounds. For investors looking to capitalise on pessimism, there are few simpler, more profitable places to look when markets are in turmoil. A LIC's underlying portfolio will often be trading at attractive prices, and you get to invest at a further substantial discount to that.

Our own Forager Australian Shares Fund (ASX: FOR) traded as low as 55 cents on the 23rd of March. The heavily beaten up NAV that day was 65 cents. Unlike many other vehicles, the manager of this fund absorbs listing fees and administration costs, so the maximum base fee of 1.1% represents the total running costs for an investor. There is no long-term management agreement. And the performance fee benchmark compounds at 8% per annum, so that person who bought at 55 cents won't be paying performance fees unless they have made a lot of money (the NAV would currently need to get back to $2.04 before performance fees apply).

The NAV was down by more than half and confidence in Forager was at a low ebb. But the principle applies across the sector. It's common for the discounts to be widest when the underlying portfolios are most attractive.

Even today, you can still buy FOR at a 10-15% discount. We have hopefully restored some confidence. Our returns have averaged almost 10% per annum since we started 11 years ago and, as those profits are realised, they get paid out to investors as distributions. Today's buyer gets a free 10-15% boost to whatever those distributions are in future.

That, we might say, is lit.

AUSTRALIAN ECONOMY

We've seen widespread good results from the companies in both funds. Consumers have remained remarkably resilient and companies remarkably adaptable. Some, like **Thorn Group** and **NZME**, got the shove they needed to make long overdue changes.

Much of the resilience, however, is due to unprecedented government assistance. Based on the Federal government budget released this month, it's a helping hand that is going to be pushing for several years to come.

It's easy to criticise the "bailouts". It's easy to whine about Australia's house prices and our obsession with keeping them high. But it struck me, again, on budget night. We are incredibly fortunate.

The Australian government's net debt position is expected to peak at around 50% of GDP, a level most Western governments would be envious of prior to the pandemic. We have the ability to support those most affected by this crisis and we have done so in a fast, mostly efficient manner.

Our stockmarket has performed much worse than the US this year but I think we are well placed to manage an unprecedented economic hit. It's been a good place to be invested for the past century and I don't expect that to change dramatically.

FISF FEE CUT

We have just signed a new agreement with Fundhost, the International Fund's administrator. The extended agreement includes a 0.05% p.a. reduction in administration costs, which has been passed on to investors in the form of a lower base fee.

It won't make an enormous difference, but it's another small improvement to add to the changes made over the past few years.

All fund managers go through rough trots. We've certainly had ours over the past few years. Rather than throw our toys, though, we've worked exceptionally hard and made some tough decisions. We've amended fee structures to more closely align ourselves with investors and pay our staff for success. We've improved our risk management and research processes, and attracted new talent. And when markets went haywire, we capitalised on the opportunity.

It is great to see some outstanding results.

Kind regards,

Steven Johnson
Chief Investment Officer