Constantia Investment Partners

Quarterly Note
3rd Quarter 2022

Dear fellow investor

For the quarter ending September 2022, the AIM Global High Conviction Fund delivered a return (after all fees) of +4.90% compared to a benchmark return of +0.33%. We estimate that AUD weakness added roughly +4.0% to our absolute quarterly return.

Market Volatility Abounds

During September, the Federal Reserve increased its benchmark interest rate by an additional 75 basis points, bringing the total increase for the calendar year to date to 3.0%. The so-called 'hawkish' pivot towards the Fed putting up interest rates to combat inflation has – since January – been well telegraphed, though the Fed's own assumption of how high rates need to go before they stop hiking (the so-called 'terminal' rate) has shifted materially upwards from December 2021. At present, the Fed expects the target interest rate to be around 4.0% - 4.25% by the end of 2022, and around 4.5% - 4.75% by the end of 2023.

The Fed's actions have prompted other central banks to act, and the world is now seven months into a global rate hiking cycle across major developed markets. The full effect of tightening monetary policy is usually only observable with a lag of between 12 to 18 months, meaning that at present, it remains too early to say with a high degree of confidence what impact these successive rounds of rate hikes (alongside simultaneous quantitative tightening) will have on inflation, unemployment and global growth. While varying by location, early indications seem to be that consumer spending patterns are changing at the margin, whilst healing supply chains are beginning to show up in deflation for certain categories of goods. Services inflation remains stubbornly high, however.

With developed market central banks likely in full inflation-fighting mode for the foreseeable future, everyone is trying to 'pick the pivot' – the moment that the Fed turns dovish, signalling the end of the monetary tightening cycle and the lowering of rates in order to stimulate economic activity. In the best case, this is the 'soft landing' that many market participants speak of: inflation declines to acceptable levels without the global economy tipping into recession. Given the various macro-economic crosscurrents currently at play (among others: the slowing Chinese economy, the ongoing war in Ukraine, rising energy costs due to underinvestment in supply, and heightened geopolitical risk), the soft-landing scenario – whilst not impossible – appears increasingly unlikely.

How We Are Navigating Markets

We don't think trying to 'pick the pivot' is a particularly good use of our time, as it effectively amounts to market-timing by trying to call the bottom. We acknowledge that markets are unlikely to stabilise and begin to broadly rally until such a point is reached. During these periods of heightened volatility, our preference is by far to acquire businesses that meet our quality criteria and trade with a reasonable margin of safety, particularly when general market weakness leads to the proverbial baby being tossed out with the bathwater.

Such a situation appears to be unfolding in the United Kingdom, where markets have been unsettled by questionable fiscal policy (since partially reversed) proposed by the newly appointed political leadership. While supply-side reforms of the type proposed *can* boost growth, the macro-economic context against which this is done matters. Given that the initially proposed fiscal policies of Prime Minister Truss and Chancellor of the Exchequer Kwarteng would a) require additional government borrowing to fund, and b) seemed directly opposed to the monetary tightening the Bank of England had been pursuing, the observed level of volatility in UK assets, government gilts and the British pound was not altogether unexpected.

These types of dislocations create opportunities for patient investors. The Fund currently has direct exposure to two UK listed companies: Croda International (a speciality chemicals company) and Games Workshop (a gaming IP owner and manufacturer of table-top wargaming figurines). While domiciled in the UK, both earn the majority of their revenues outside of its borders, meaning they would benefit from a weakening Pound. In the case of Games Workshop – which exclusively manufactures its figurines in Nottingham – a weak currency should be even more beneficial.

Both businesses have been sold off in the recent tumult. Games Workshop released a trading update during the month, indicating that demand remained solid. While margins softened due to the dramatic increase in energy costs caused by manufacturing solely in the UK; we believe Games Workshop's demonstrable history of pricing power will more than offset these costs over time. Management also used the trading update to increase their dividend. To our thinking, a business with demonstrable pricing power, high levels of free cash flow generation, clearly outlined and rational capital allocation priorities, credible management and a clean balance sheet, earning stellar returns on invested capital (north of 50%) has just gotten materially cheaper. Notwithstanding any near-term slowdown in consumer spending, the long-term drivers of value creation do not seem impaired. Buying businesses in the UK seems like the last thing one would want to do right now, but of such dislocations are opportunities made.

Performance to 30 September 2022

	GHCF	Benchmark
Financial Year 2023	+4.9%	+0.3%
2022 (Calendar YTD)	-17.1%	-15.7%
2021	+31.1%	+29.3%
2020	+14.2%	+5.6%
2019 (Strategy Inception: 31 Aug. 2019)	+5.3%	+6.3%
Cumulative Since Strategy Inception	+30.7%	+22.3%
Annualized Since Strategy Inception	+9.1%	+6.8%

Total returns shown for the AIM Global High Conviction Fund have been calculated using exit prices after taking into account all the product's ongoing fees and assuming reinvestment of distributions. No allowance has been made for entry fees or taxation. Past performance is not indicative of future performance. Benchmark is MSCI World Net Total Return in AUD (source: Apex Group.)

Conclusion

While we never try to predict when mispricings may present themselves, we remain nimble to take advantage of them when they do occur. Current market conditions may provide us with an opportunity to deploy a portion of the ~9.0% cash position in the Fund. Given the prevailing mood of uncertainty, the upcoming US earnings season is likely to be choppy. A strong US dollar should lead to many US-domiciled multinational business facing near-term headwinds to revenue and profitability, creating an environment for guidance to be lowered and short-term estimates to be revised downward. Considering all the uncertainty, we believe this is a likely to be a 'sell first, ask questions later' type of environment. Short-term macroeconomic headwinds that do not affect the long-term drivers of value are what – in our experience – create mispricings. These can often deliver excellent entry prices for those whose goal is long-term compounding, particularly when markets have already sold off to the extent they have. The Fund is well positioned to take advantage of such opportunities.

As is customary, you can find at the back of this note the addendum containing our quality scorecard, internal sector allocation, geographic revenue exposure, and the top ten holdings.

Kind regards,

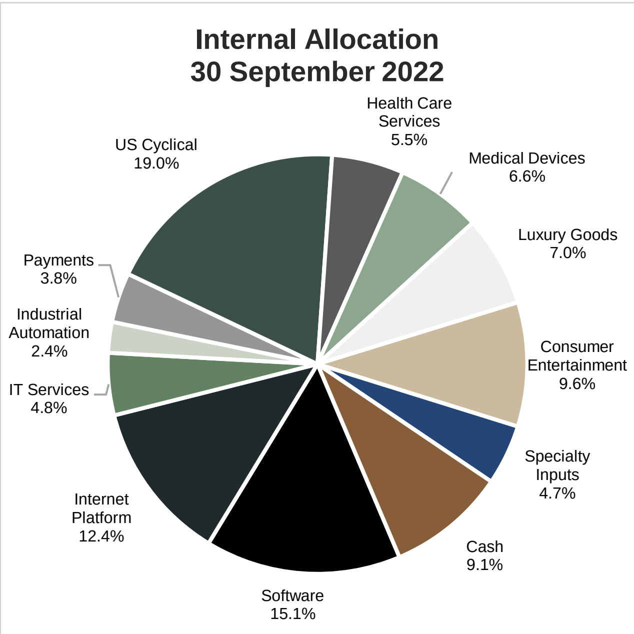
Etienne, Les, Dan & Andrew

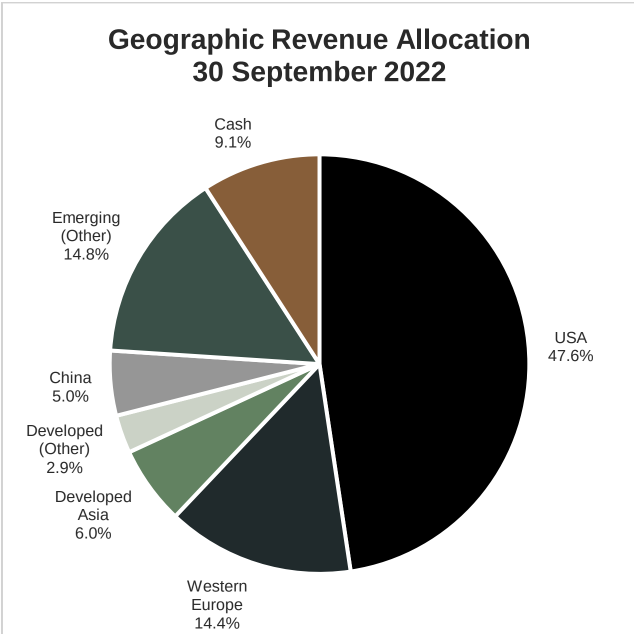
ADDENDUM

Quality Scorecard

Portfolio Characteristic	Dec. 2019	Dec. 2020	Dec. 2021	Sept. 2022
Profitability				
Gross Margin	55.7%	49.8%	52.3%	49.3%
Operating Margin	23.5%	20.1%	24.3%	22.2%
Free Cash Flow Margin	18.9%	17.0%	17.6%	16.9%
Returns on Capital				
Return on Assets (ROA)	13.0%	11.9%	13.7%	13.0%
Return on Equity (ROE)	28.3%	24.9%	30.4%	28.3%
Return on Invested Capital (ROIC)	24.0%	16.5%	20.7%	19.3%
Leverage				
Debt/Equity	87.2%	68.6%	78.3%	75.6%
Net Debt/Equity	19.3%	22.1%	27.3%	24.9%
Valuation				
Free Cash Flow Yield	2.8%	3.2%	2.8%	4.0%
12m Forward Free Cash Flow Yield	3.3%	3.6%	3.2%	4.8%
24m Forward Free Cash Flow Yield	3.8%	4.0%	3.6%	5.6%
Holdings				
Number of positions	19	21	21	22
Active Share	86.5%	87.8%	89.0%	88.9%

Internal Sector & Geographic Revenue Allocation





Source: FactSet, Constantia analysis.

Top Ten Holdings (alphabetical)

Business	Sector
accenture	IT Services
Alphabet	Internet Platform
Berkshire Hathaway Inc.	US Cyclical
Constellation Software Inc.	Software
Fastenal	US Cyclical
HEICO	US Cyclical
Microsoft	Software
Nintendo	Consumer Entertainment
ThermoFisher Scientific	Medical Devices
UnitedHealth Group	Health Care Services