Quarterly Commentary
June 2022

PELLA
RESPONSIBLE INVESTING

Investment Manager

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Responsible Entity

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Message from the CIO

Jordan Cvetanovski

CIO and Portfolio Manager

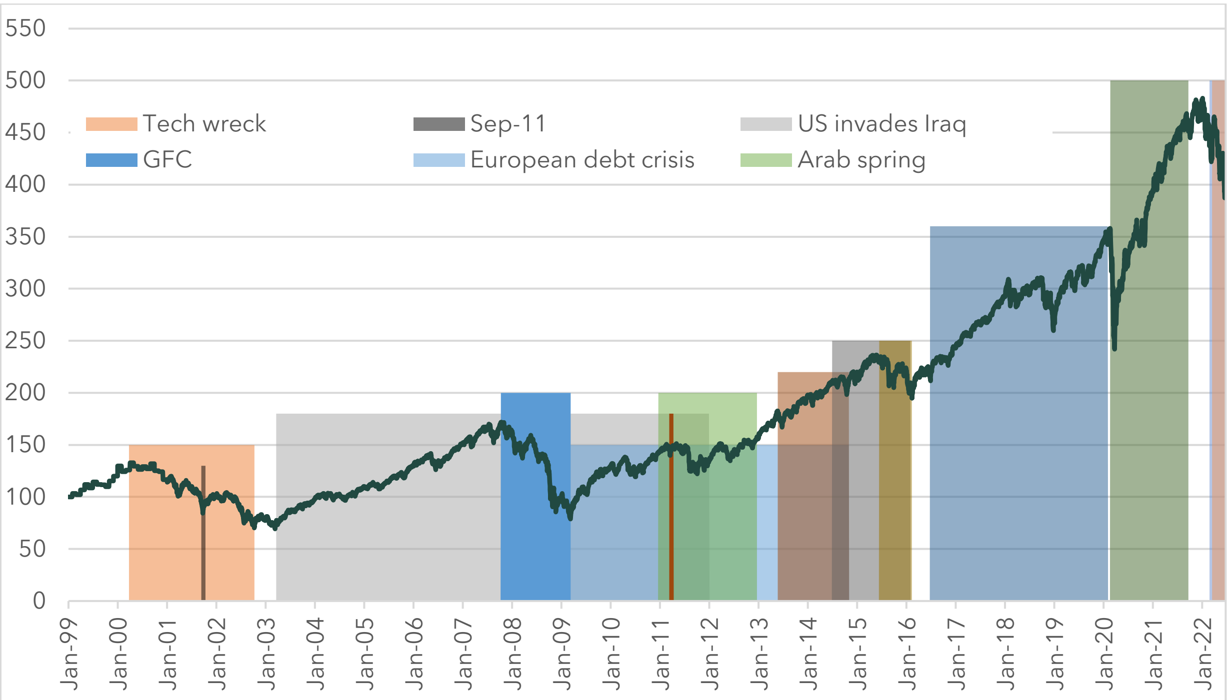
Since the start of 2022 the share market has been weak with the MSCI ACWI declining 15.6%. This is resulting in widespread atrophy and panic as people question whether to invest or not. Pella's approach to this is to stick to its fundamentals and invest when opportunities positioned to grow and trading on an attractive valuation arise.

Having started my career in 2000 I have witnessed several investment shattering events.

- In 2000 it was the Tech Wreck,
- 2001 brought September11, followed by the US invasion of Iraq (2003),
- the GFC occurred in 2007, followed by
- the European debt crisis (2008-2014),
- Arab Spring (2010-2012) and
- Fukushima (2011),
- Taper Tantrum (2013-2014),
- oil price plunge (2014-2016),
- China bear market (2015-2016),
- Brexit (2016-2020),
- Covid (2020-2021),
- Russia's invasion of Ukraine (2022), severe inflation and monetary tightening (2022).

Figure 1 illustrates these events and demonstrates that there have been few if any meaningful periods of placidity. Yet, through all these events there have been investment opportunities. This is because regardless of the worry de-jour, **there is always a place to invest.**

Figure 1 – MSCI ACWI total return index performance



Source – Pella Funds Management, Factset

Looking into some of the crises we find that there were areas that generated acceptable returns even if we invested in those areas in the middle of the crisis and held the investment for three years. Table 1 illustrates some of these opportunities. For example, investing in Water Utilities during the Tech Wreck and holding onto that investment for three years would have generated a 70% total return. Investing in Korea during the GFC would have generated a 35% total return over three years. Investing in Health Care Equipment & Services during the Taper Tantrum would have generated a 48% total return. Investing in virtually any industry or geography during Brexit would have generated healthy returns.

Table 1 - Areas generating acceptable returns if invested in middle of a crisis

	Returns over three years	
Crisis	**Sectors (5)**	**Geographies (6)**
Tech Wreck (1)	Water Utilities (+70%), Food, Beverages and Tobacco (+33%), Retailing (+31%), Banks (+27%), Energy (+24%),	Thailand (+87%), Indonesia (+78%), Korea (+67%), Australia (+10%)
GFC (2)	Media & Entertainment (+20%), Telecommunications Services (+18%),	Chile (+62%), Indonesia (+52%), Thailand (+44%), Korea (+35%), Sweden (+23%), India (+21%),
Taper Tantrum (3)	Semiconductors (+62%), Health Care Equipment & Services (+48%), Consumer Services (+22%), Diversified Financials (+21%), Capital Goods (+20%)	USA (+56%), India (+48%), Japan (+39%) China (+36%), Australia (+20%), Switzerland (+14%)
Brexit (4)	Every industry except for Energy, Automobiles, and Banks	Virtually every geography except for Brazil, Poland, Indonesia, Thailand, Malaysia

Source – Pella Funds Management, Factset

(1) Assumes investment for three years starting in Jun-01
(2) Assumes investment for three years starting in Jun-08
(3) Assumes investment for three years starting in Feb-14
(4) Assumes investment for three years starting in Apr-18
(5) S&P Global 1200 total return industry indexes, measured in local currency
(6) MSCI ACWI indexes, measured in AU

The key message of the above analysis is that there is always somewhere to invest, even in the depths of a crisis. However, one word that must not get lost in that sentence is '*invest*'.

As far as Pella is concerned, investing is not guessing the direction of the stock market, betting on something simply because it is going up, or have a short-term mindset. Investing involves putting your money to work into productive assets that generate sufficient cash flow to compensate for the initial cost of the asset. It takes time for the asset to generate these cash flows, which means investing requires a minimal three-year time frame.

At present some areas that Pella is investing due to their likelihood to benefit from structural themes includes companies that benefit from tightening monetary policy, or inflation, or consumer trade down.

Derivative exchanges such as CME Group (CME-US) and Deutsche Börse (DB1-DE) are key beneficiaries of tightening monetary policy. During Quantitative Easing ('QE'), central banks were the biggest purchasers of government debt. This is a headwind for derivative exchanges as the central banks don't hedge their government debt holdings. The end of QE means that future government debt issuances will be purchased by investors that normally do hedge their government debt holdings, boosting the derivative exchanges' volumes. Furthermore, the winter of interest rate stability heralds an increase in interest volatility, which should result in volatility across all asset classes, which is a meaningful positive for derivative exchanges. With CME trading on a 24x PE and DB1 on a 19x PE, Pella believes their valuation is attractive relative to their outlook.

Commodities are typically beneficiaries of inflationary environments, particularly if the commodities are supply constrained. Copper fulfills these requirements following ten years of under investment into that commodity, coupled with expected booming demand from Electric Vehicles (EVs), which use 4x the amount of copper as Internal Combustion Engines (ICE) vehicles. Pella has an investment in Antofagasta (ANTO-GB), which is a Chilean copper producer with an AA MSCI ESG rating, and Boliden (BOL-SE), a Swedish industrial metal company with a AAA MSCI ESG rating.

Inflation will concurrently eat away at real income forcing households to trade down, which will likely accelerate if the tightening monetary policy results in a recession. Partly reflecting this, Pella has an investment in Dollar General (DG-US), a US discount retailer. DG is trading on a 3.2% FCF yield, which we believe is reasonable given its massive growth opportunity.

Venturing out of the sector straitjacket Pella has also identified several companies that satisfy our growth-valuation criteria. Examples of these investments are listed in Table 2 and one of the most striking observations of these companies is their diversity. While we can't predict how the share price of these companies will fluctuate in the short term, they fulfill our definition of investing and should generate sufficient cash flow to justify their valuations and commiserate share price performance should follow.

Table 2 – Examples of companies fulfilling Pella's growth-valuation criteria

Name	Sector	FCF yield	Growth [1]
Adobe	Software	3.8%	13.1%
Ashtead Group	Industrials	4.5%	9.8%
BMW	Automobiles	17.7%	5.8%
Cigna Corp.	Health Insurance	7.2%	5.5%
Fiserv	Payments	6.0%	7.3%
JD Sports Fashion	Consumer Discretionary	10.3%	6.9%
Samsung Electronics	Technology Hardware	13.6%	6.7%
Sunrun	Renewable Energy	6.4%	15.1%
VINCI	Construction & Engineering	7.0%	4.2%

Source – Pella Funds management

(1) Forecast growth based on the median of consensus three year revenue growth forecasts.

In summary, Pella believes even during times of turmoil there are attractive investment opportunities. This has been the case throughout crises that I have witnessed in my investment career and the current market shake out is likely to be no different. However, the key is to 'invest' by seeking companies positioned to generate growing cash flows and trading on good valuations, rather than speculating on the short-term share market direction. Pella has identified several such opportunities and is poised to invest in many others should the market decline further.

Fund Commentary
Portfolio Positioning

During 2Q22 the predominant prevailing market themes were largely bearish, contributing to the MSCI ACWI (AUD) declining 7.9% over the quarter and taking its decline YTD to 15.6%. Pella believes the current themes are valid and has positioned the portfolio accordingly.

The most discussed topics in the markets were inflation and interest rates. The former severely curtailing consumer confidence and the latter compacting asset valuations, particularly for companies whose value lies in earnings expected to occur far out in the future (growth stocks). The severe multiple contraction experienced by growth stocks resulted in the MSCI ACWI Growth index (AUD) declining 13.4%, materially underperforming the MSCI ACWI Value index (AUD), which declined 4%. over the quarter.

Tightening monetary policy coupled with the moribund consumer confidence figures, early signs of a decelerating labour market and industrial production, raised the spectre of a US, and likely broader, recession. This was reflected in the market's sectoral performance with the outperformers being traditionally defensive sectors such as Consumer Staples, Utilities, and Healthcare. Energy also performed well due to the rising oil and gas price catalysed by the Russia-Ukraine war. Meanwhile, the weakest sectors were those most exposed to rising interest rates and a potential recession, including Information Technology, Consumer Discretionary, and Materials.

Emerging markets generally also tumbled with South and Central America and Eastern Europe being particularly weak. Asia Pacific performed relatively well, largely on the back of the Chinese market regaining some of the losses it experienced over the prior year.

The Pella Global Generations Fund ('*PGGF*') performed broadly in line with the Benchmark over the quarter, delivering a -8.5% return versus the Benchmark's -7.9%. FX was a headwind as the Fund held all its cash in AUD and was overweight the EUR and excluding FX the Fund's underperformance relative to the Benchmark materially narrows.

The Fund did more selling than buying during the quarter as we exited Medtronic, Lumentum, and Coinbase. Meanwhile, we added to Dollar General, with the thesis discussed below, and Mosaic.

The positions that made the largest positive contribution to the Fund's performance were Dollar General, Cigna, and UnitedHealth. The positions making the largest negative contribution were RingCentral, ASML, and Boliden. RingCentral and ASML declined due to rising interest rates and a fear of a recession and Boliden declined due to a weakening in commodity prices.

The Pella Global Generations Fund has a high allocation to quality companies with strong financial and ESG attributes that have diversified revenue streams. These companies are not reliant on a particular cycle and enjoy various long-term structural growth trends such as ageing population, emerging market consumption and the transition to a green economy. The Fund holds approximately 15% in cyclical companies that benefit from inflationary pressure. We always keep an eye out for quality fast paced opportunities when their valuations become attractive. In our view, the portfolio on aggregate has higher growth potential than the market, is cheaper on a FCF yield basis and has superior ESG and quality attributes than the market. We believe these factors have the potential to produce meaningful outperformance over the long term.

Portfolio Segments

Core:

On the surface it appears that we were relatively inactive in the Core segment during the quarter where we exited a single position (Medtronic) and did not add any new Core positions. However, the apparent inactivity belies a lot of activity as we continued to develop our list of stocks to buy should they hit our buy price, which is looking increasingly likely due to market weakness. If the market continues its current trajectory, we anticipate adding several new positions during 2H22. Meanwhile, to address the potential risks of heightened volatility in markets we have investments in companies like CME and Deutsche Bourse which benefit from market dislocations and may act to cushion losses in weak market environments.

Cyclical:

Cyclical investments are concentrated on industries where there is an expected tightness in supply of the material or service. Within these industries we focus on companies with superior ESG that seek to increase supply in a responsible way. Examples in the Fund include Boliden, a Swedish producer of copper and zinc and Stora Enso, a Finnish forestry, packaging, and woods products business. Over the quarter, we initiated a position in Mosaic, a producer of potash and other fertilizers, which compliments the existing Nutrien exposure and is a hedge against the Russia-Ukraine conflict. Both Russia and Ukraine command a large share of global grain production and Russia and Belarus are key suppliers of potash which is a key ingredient for complex fertilisers.

Innovation:

As communicated in the 1Q22 quarterly report we have been scouring the market and remain underwhelmed by the valuations of many companies, particularly in the innovation space. Reflecting that, Innovation is currently just 2% of the Fund, which is the lowest weight Innovation has had in this strategy since its inception. As explained in the Core section we are actively scouring Innovation companies and we anticipate adding some positions should they continue to decline to our target valuation.

Stock in Focus

Ronald Yu, CFA
Investment Analyst

Dollar General is one of the largest discount retailers in the US with more than 18,000 stores offering a broad selection of merchandise, including consumable items, seasonal items, home products and apparel. Dollar General provides a broad base of customers with their basic every day and household needs, supplemented with a variety of general merchandise items, at everyday low prices in conveniently located, small-box stores. Approximately 75% of Dollar General stores are in towns of 20,000 or fewer people and approximately 75% of the US population are within five miles of a Dollar General store.

Why are discount retailers attractive?

The increasing rich poor divide continues to drive overstretched consumers away from traditional retailers such as pharmacies and supermarkets towards discount retailers in search of better value. Furthermore, consumers also tend to trade down during tough times, whether that be driven by high inflation or a weak economy, resulting in a new customer base that would not normally shop at these discount retailers.

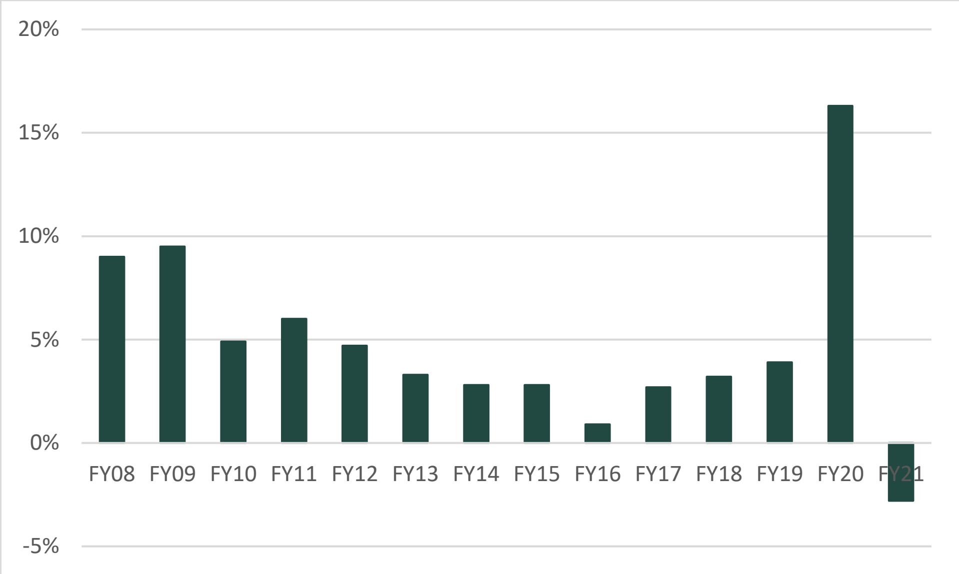
This structural trend has seen many discount retailers globally gain market share at the expense of pharmacies and supermarkets, which according to Dollar General, are 40% and 20% respectively more expensive than discount retailers and mass merchants. For example, Dollar General, Dollar Tree and Five Below in the US, Dollarama in Canada, Jeronimo Martins in Poland, and B&M European Value Retail in the UK have all generated strong sales growth in the last decade through a combination of new store openings and same store sales growth.

Why invest in Dollar General?

Dollar General is a core position in the Pella Global Generations Fund as it is an excellent operator with a strong track record of growing same store sales and opening new stores, has significant white space opportunities, has attractive new store economics, and is both recession and inflation resistant. Dollar General also generates significant free cash flow and is trading on a reasonable valuation given the defensive nature and stability of the business.

Dollar General has grown same store sales for 31 consecutive years prior to FY21, with the 2.8% decline in same store sales in FY21 the result of the strong 16.3% increase in same store sales in FY20. With that behind us, Dollar General should now be able to resume growing same store sales by at least low single digit, with 3.0-3.5% currently expected for FY22.

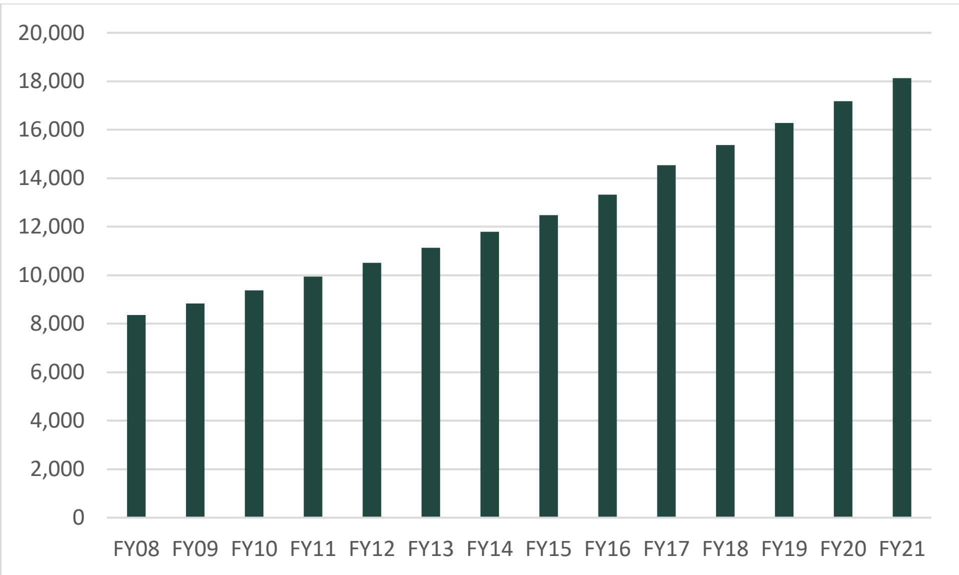
Figure 2 – Dollar General same store sales



Source – Dollar General

Although Dollar General has opened around 10,000 stores in the last 13 years, there is still significant white space opportunities in both existing and new store formats. Dollar General sizes the opportunity at 17,000 new stores, of which 13,000 stores are in the existing format, 3,000 stores are in the new '*pOpshelf*' format, which has a different product mix and targets a different set of customers, and 1,000 stores are in the DGX format, which are smaller stores targeting urban areas. Dollar General plans to open more than 1,000 stores in FY22, which translates to mid-single digit growth in selling square footage, and this will likely continue for at least the next 5-10 years.

Figure 3 - Number of Dollar General stores



Source – Dollar General

The cost to open a new Dollar General store is about $0.3m including fixed assets and working capital, which is very low compared to other retailers. With strong sales productivity in year one, a new store has a payback period of less than two years, generating average returns of 20-22%, which is extremely attractive.

Dollar General is both recession and inflation resistant, with strong same store sales growth during the global financial crisis (9.0% in FY08 and 9.5% in FY09) and COVID-19 (16.3% in FY20). Dollar General prices most of its products at $10 or less, with approximately 20% of products priced at $1 or less, and with more than three quarters of sales coming from consumables such as paper, cleaning products, packaged food, perishables and snacks, this combination has been extremely resilient.

While other value retailers such as Target and Walmart have been struggling with inventory management and cost increases in the current high inflation environment, Dollar General has had no such issues. In fact, Dollar General has started to see some trade down activity and believes this will probably pick up as the year progresses. Trade down customers have a household income of $60,000-75,000, much higher than Dollar General's core customer which has a household income of $40,000 or less, and these customers have shopped with Dollar General previously and have started to return.

Dollar General has relatively low working capital requirement, allowing it to generate strong operating cash flows which are more than enough to fund new store openings, repurchase shares and pay a dividend without the need to utilise excessive debt.

On a free cash flow yield of 3.2% in FY22 increasing to 3.8% in FY23 as capital expenditures normalise, Dollar General is not obviously cheap. However, given its defensive nature, anticipated high single digit growth rate, and stability of the business, it fits into Pella's valuation framework.

Responsible Investing

During the quarter, the PGGF was certified by the Responsible Investment Association Australasia (RIAA). This recognises that Pella is delivering on our responsible investment promise and meeting the Australian and New Zealand Standard for responsible investing.

2Q22 was a busy period for shareholder votes as many of the companies held by the PGGF had their AGM. Pella voted in the meetings it was able to do so but was unable to vote in three meetings (all in Sweden) due to issues with Pella's sub-custodian's Power of Attorney in that country. We will seek to rectify this issue, so it does not reoccur. As per Pella's policy, the full voting track-record for the quarter is listed below (

Table 3). In addition, the full Financial Year's voting track-record is disclosed in Pella's 2022 Responsible Investment Report (RIR).

The RIR is also a rich source of Pella's other Responsible Investing initiatives. It includes a record of every position held by the PGGF during FY22 and a discussion of the Fund's performance against its excluded activities requirements, norms-based requirements, ESG performance, portfolio carbon intensity, the fund's exposure to positive impact activities, and Pella's Responsible Investing initiatives.

We highly recommend that you read the report, which is proceeding through its final compliance checks at the time this Quarterly was prepared. For those of you who don't read the RIR, the key message is Pella delivered against all its Responsible Investing targets during 2022, but there is more work to be done.

Pella is currently preparing for one of its key initiatives in 2023, which will be to prepare a shareholder resolution for Marsh & McLennan AGM, following that company broking insurance for a controversial oil pipeline. Pella considers MMC's actions as a controversy requiring attention from its shareholders, rather than just exiting the business, and maintaining the status quo. Our current attention is to prepare a resolution that would demand improved reporting and justification by MMC of its fossil-fuel related activities.

Table 3 – Company voting disclosure

Company name	Meeting type	Voting String
AIA Group Ltd.	Annual	FFFFFFFFF
Alphabet, Inc.	Annual	FFFFFFFFFFFAFFFFFFFFAFFFFFFFAF
Amedisys, Inc.	Annual	FFFFFFFFFFF
Antofagasta Plc	Annual	FFFAFFFFFFFFFFFFFFFF
ASML Holding NV	Annual	FFFFFFFFFFFFFFFF
Atlas Copco AB	Annual	FFFFFFFFFFFFFFFFFFFFFAAFFFAAAAFAFFFFFFFFFF
BMW	Annual	FFAFFFFFFFFFF
Boliden AB	Annual	FFFFFFFFFFFFFFFFFFFFFFFFFFFFFFFFFFFFFF
Cigna Corp.	Annual	FFFFFFFFFFFFFFFF
CME Group, Inc.	Annual	FFFFFFFFFFFFFFFFFFAFFF

Company name	Meeting type	Voting String
Coinbase Global, Inc.	Annual	WFWFF1
Deutsche Börse AG	Annual	FFFFFFFF
Dollar General Corp.	Annual	FFFFFFFFFFF
Epiroc AB	Annual	FFFFFFFFFFFFFFFFFFFFFFFFFFFFFFFFFFFFFFFFFFFF
Fiserv, Inc.	Annual	FFFFFFFFFFFF
Flow Traders NV	Annual	FFAAFFFFFFFFFF
ING Groep NV	Annual	FFFFFFFFFFF
Marsh & McLennan Cos.	Annual	FFFFFFFFFFFFFFF
Nutrien Ltd.	Annual	FFFFFFFFFFFFF
Ping An Insurance	Annual	FFFFFFFFFFFFFFF
Schneider Electric SE	Annual/Special	FFFFFFFFFFFFFFFFFFF
STMicroelectronics NV	Annual	FFFFFFFFFF
Sunrun, Inc.	Annual	WWFFFF
Texas Instruments	Annual	FFFFFFFFFFFFFFF
Thermo Fisher Scientific	Annual	FFFFFFFFFFFFFF
UnitedHealth Group, Inc.	Annual	FFFFFFFFFFFF
VINCI SA	Annual/Special	FFFFFFFFFFFFFFFFFF
Vulcan Materials Co.	Annual	FFFFF
Weyerhaeuser Co.	Annual	FFFFFFFFFFFF

Source - ISS

Pella Global Generations Fund Performance

Net of all fees	PGGF Class B	MSCI ACWI (AUD, net)	Relative
Since Public Launch (1)	-16.3%	-15.6%	-0.7%
Latest Quarter	-8.5%	-7.9%	-0.6%
1 Month	-3.9%	-4.5%	+0.6%

(1) 1 January 2022

(2) Past performance is not indicative of future performance

Fund Holdings

As of 31 May 2022

Holdings Name	Sector	Country
Adobe	Information Technology	United States
AIA Group	Financials	China
Alphabet	Communication Services	United States
Amedisys	Health Care	United States
Antofagasta	Materials	Chile
Ashtead Group	Industrials	United Kingdom
ASML	Information Technology	Netherlands
Atlas Copco	Industrials	Sweden
Bayerische Motoren Werke	Consumer Discretionary	Germany
Boliden	Materials	Sweden
Cigna Corp.	Health Care	United States
CME Group	Financials	United States
Coinbase Global	Financials	United States
Deutsche Börse	Financials	Germany
Dollar General	Consumer Discretionary	United States
Epiroc	Industrials	Sweden
Fiserv	Information Technology	United States
Flow Traders	Financials	Netherlands
JD Sports Fashion	Consumer Discretionary	United Kingdom
Lumentum	Information Technology	United States
Marsh & McLennan	Financials	United States
Medtronic	Health Care	United States
Microsoft	Information Technology	United States
Mosaic	Materials	United States
Novo Nordisk	Health Care	Denmark
Nutrien Ltd.	Materials	Canada
Ørsted	Utilities	Denmark
Ping An Insurance	Financials	China
RingCentral	Information Technology	United States
Samsung Electronics	Information Technology	Korea
Schneider Electric	Industrials	United States
STMicroelectronics	Information Technology	France
Stora Enso	Materials	Finland
Sunrun	Industrials	United States
Texas Instruments	Information Technology	United States
Thermo Fisher Scientific	Health Care	United States
UnitedHealth Group	Health Care	United States
VINCI	Industrials	France
Visa	Information Technology	United States
Vulcan Materials	Materials	United States
Weyerhaeuser	Real Estate	United States

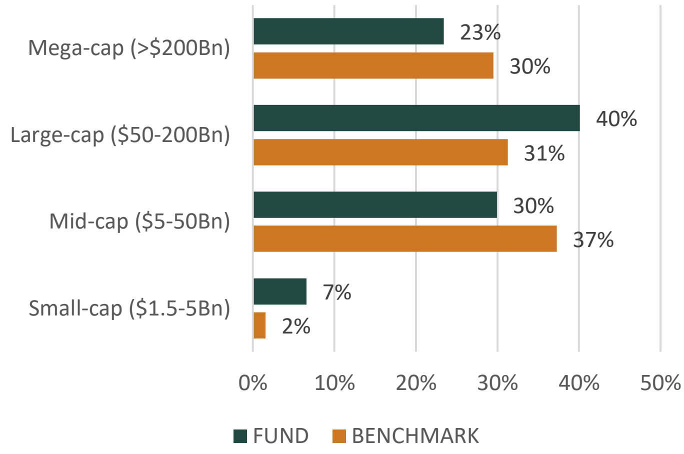
Fund Analytics

As of 30 June 2022

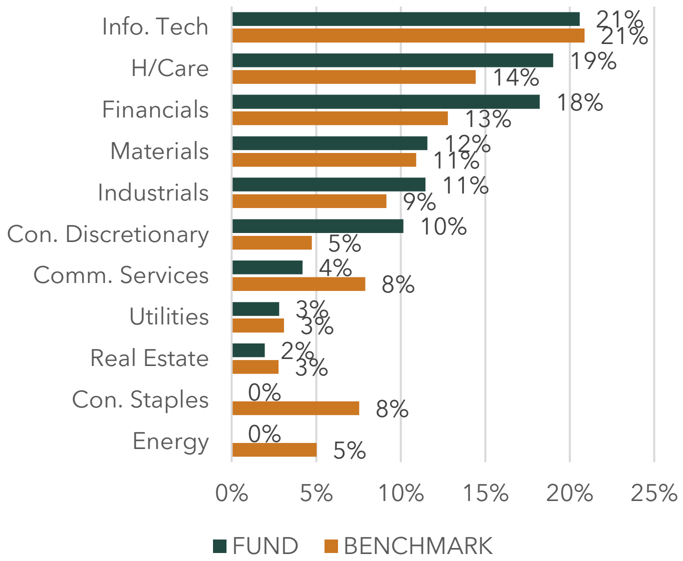
Asset Allocation

Equities	83%
Developed Markets	78%
United States	45%
Europe	29%
Japan & Korea	1%
Emerging Markets	5%
Asia ex-Japan	4%
Latin America	1%
Cash	17%

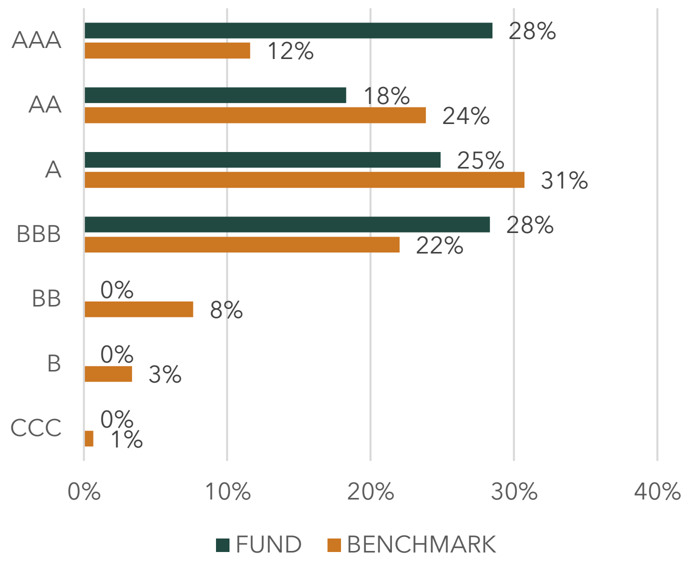
Market-Cap Allocation



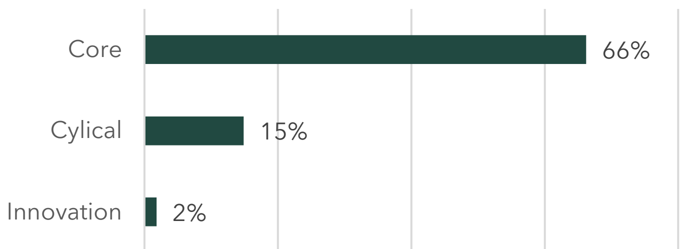
Sector (GICS) Allocation



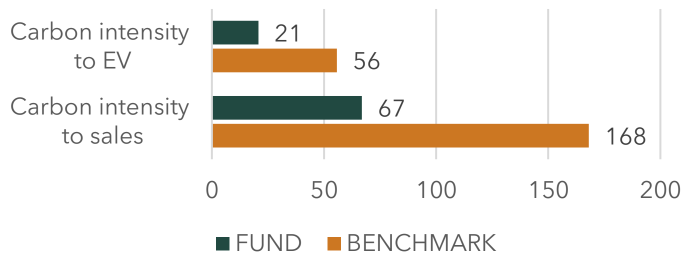
MSCI ESG Rating Distribution



Segment Allocation



Carbon Intensity



Key Information

Portfolio Manager	Jordan Cvetanovski
Inception date	1-January-2022
Price Class B (NAV)	$1.0045 (30 June 2022)
Buy/Sell spread	+0.25% /-0.25%
Minimum	$25,000
Additional Investment	$1,000/ $1,000 per month on a regular savings plan.
Pricing frequency	Daily
Distribution frequency	Annual
Base fee	0.65%
Performance fee	15% above Benchmark
Benchmark	MSCI ACWI (A$, net)
APIR code	PIM5678AU
ISIN	AU60PIM56781
ARSN	653 919 478

Contact Us

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