CV Capital Pty Ltd

11 April 2022

SHAREHOLDER REPORT AS AT 31 MARCH 2022

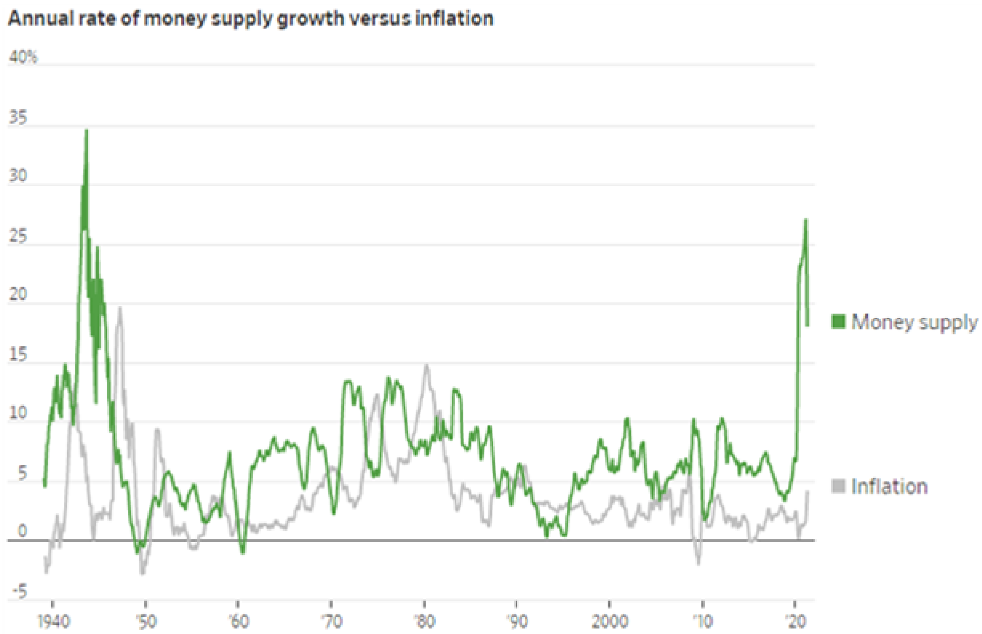
To my fellow shareholders & partners,

We live in an unpredictable environment. In my last report barely 3 months ago, the world was at peace but today this has been upended with a brutal war raging in Ukraine. The current pandemic is another example of this unpredictability. Covid took the world by complete surprise in 2020, no one predicted the spread, scale and extent of it. Looking at the oil markets, two years ago WTI (West Texas Intermediate) oil price futures traded at negative $37 but today it is currently trading above US$100 per barrel. The world can be volatile and very unpredictable.

Unfortunately, no one has a crystal ball and making future long term predictions accurately is almost impossible. This is a key reason why I now lean more towards investing in companies with a competitive advantage. Whilst this strategy does not guarantee positive returns, it does reduce the probability of business failure relative to run-of-mill companies.

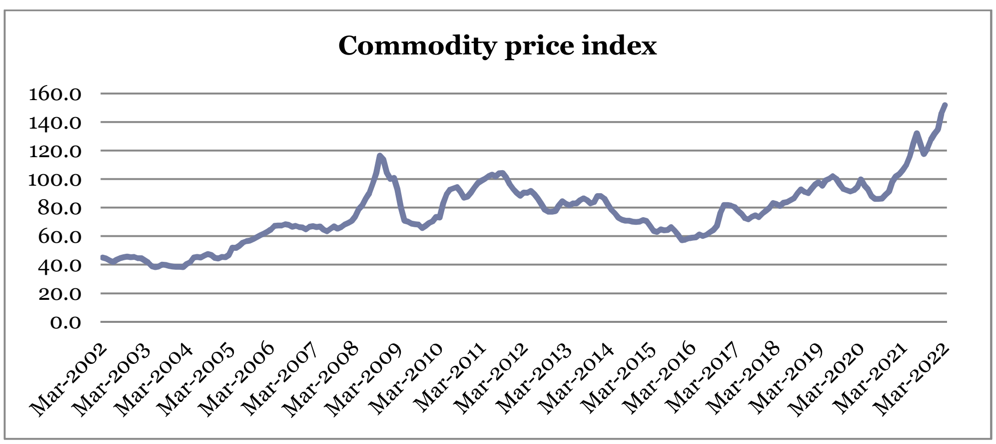
Inflation

In 2021, US CPI (consumer price index) was up 7%, its largest annual increase since 1982. Australian CPI for 2021 was 3.5%, lower that the US but still significantly higher than the RBA's target inflation rate of 2%. It is quite clear that inflation is on its way up and we may be entering a period of higher inflation relative to the past 3 decades. The chart below shows annual growth in money supply and inflation. It shows that an increase in money supply is usually later accompanied by periods of elevated inflation and central banks globally have printed a lot of money to support their economies during the Covid pandemic.



Note: Money supply is M2 measure; Inflation is CPI
Sources: St. Louis Federal Reserve; NBER; Citi

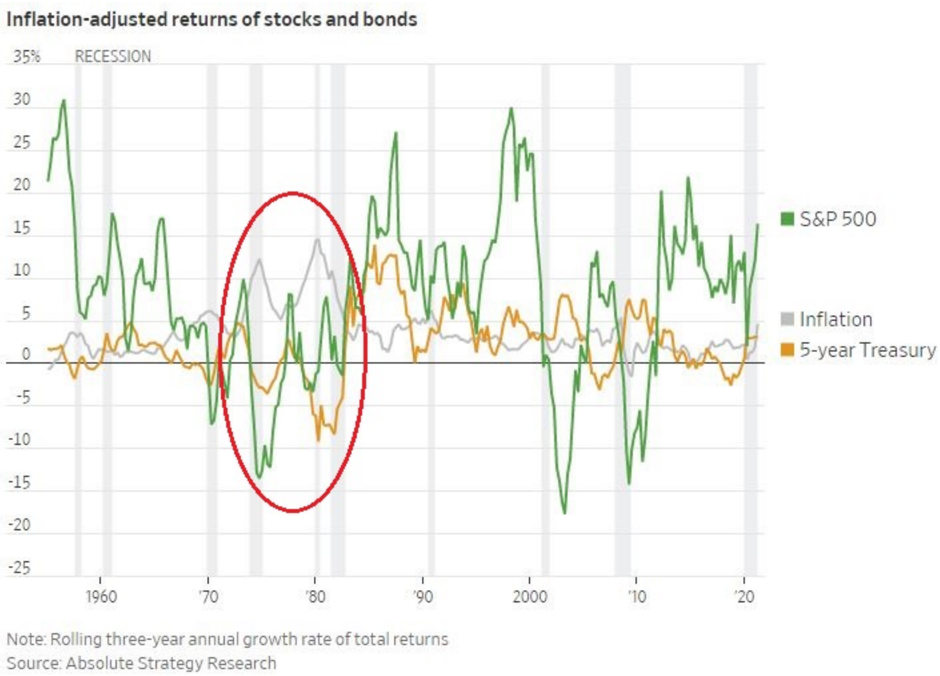
This wall of money had found its way into commodity prices which started rising since early 2021. The current Ukrainian war has only push commodity prices even higher. Increases in raw material prices will flow through all goods in the economy.



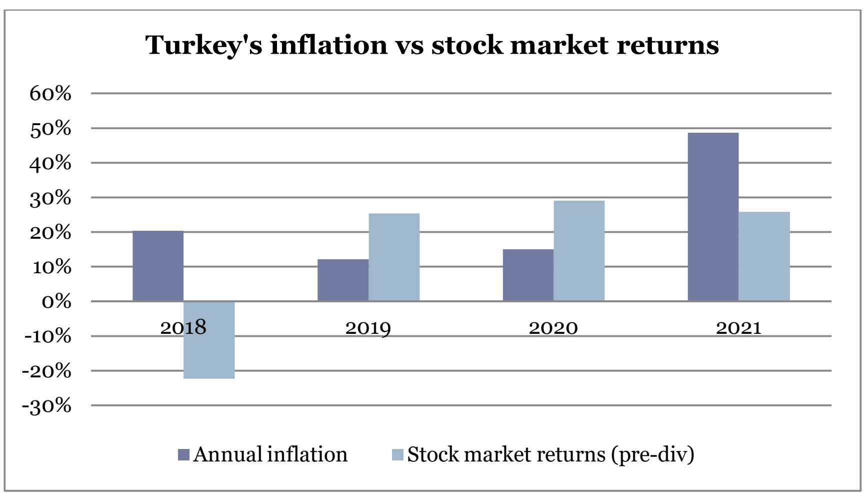
Source: RBA

I see sustained higher inflation to be a key risk for the economy. The textbook way to tame inflation is to increase the cash rate (which reduces money supply) but with house prices and household debt at such high levels, it would not be so easy to increase interest rates without substantial economic pain. The RBA's balancing act will get trickier as inflation bites.

I bring up inflation to discuss its effects on stock market returns. The early 70s to early 80s period was a period of high inflation. Looking at a chart below, this period was also when US stock market returns underperformed inflation for the longest period of time, roughly 10 years. However, 1974 also marks the year the nifty fifty stock bubble burst. So this muddles things a bit when trying to understand how elevated inflation impacts the stock market returns.



A more recent example of high inflation is Turkey which has been suffering from an economic crisis since 2018. A comparison of Turkey's annual inflation and stock markets return show that stock market returns (excluding dividends) overall were unable to keep up with inflation since 2018. Over this period inflation was 131% compared to stock market returns of 58%.



Periods of high inflation usually coincides with an economic downturn or in the above cases stagflation (an economic recession combined with high inflation), so it could well be that corporate earnings were negatively affected by the recession which lead to poor stock market performance. The long and short of it is that I see inflation to be a key risk over the short and medium term given the elevated stock market levels and the impact of sustained high inflation on the economy.

Regardless of how inflation affects stock market returns over the short to medium term, the evidence so far shows that the stock market still outperforms inflation over the long term and relative to other assets classes like cash and long duration bonds during periods of elevated inflation, stocks will do much better. Whilst we are cognisant of the inflationary risks, we are not deviating from our strategy of investing in companies with a competitive advantage and pricing power.

Fund Activity

We've exited our position in Schaffer, a position we owned from inception of the fund. Overall this was a profitable investment as we made circa 96% over a 4 year holding period (or 17.4% annual compounded return). The reasons why I exited Schaffer are as follows:

1) Although Schaffer is run by honest and capable management, it isn't a truly exceptional business and at the current share price, I assessed that it is trading just under its intrinsic value.
2) There are other opportunities in the market which I felt have better risk/ reward ratio.
3) Lastly and this was a minor reason, the global chip shortage has reduced their customer's vehicle production output and this will have a flow on effect on their results for FY2022.

We have not added any major positions since the last report. We have continued to make arbitrage trades when opportunities exist.

Fund Performance

CV Capital's return for FY2022 (1 Jul – 31 Mar) is 2.5% and since inception is 13.9% on an annual compounded basis. We report cash results (no accruals) and based on this we are currently trail the index marginally for FY2022. However, we are due to receive a nice dividend from BSP Bank in April which will add 1.9% to our FY2022 returns. Cash and cash equivalents is circa 14.6% of the portfolio.

The share price as at 31 March 2022 is $1.50. Details are as follows:

Securities portfolio value	$1.28
Cash	$0.22
Franking credits	$0.00
Share price	$1.50
Less: Estimated tax liabilities on realised gains	($0.06)
Subscription price	$1.44

YOURS SINCERELY,
DARRELL CHEAH