NORSE CAPITAL

January 2022 Monthly

Returns 31-Dec-12 to 31-Jan-22

	Norse Capital	All Ords Accum	Outperformance	Small Ords Accum	Outperformance
Inception	380.90%	123.44%	257.46%	83.93%	296.97%
Inception per annum	18.86%	9.25%	9.61%	6.93%	11.93%
CY2022 (ytd)	-7.47%	-6.56%	-0.90%	-9.00%	1.53%
CY2021	16.86%	17.74%	-0.88%	16.90%	-0.04%
CY2020	26.36%	3.64%	22.73%	9.21%	17.15%
CY2019	43.44%	24.06%	19.38%	21.36%	22.08%
CY2018	7.46%	-3.53%	10.99%	-8.67%	16.13%
CY2017	15.55%	12.47%	3.08%	20.02%	-4.46%
CY2016	9.31%	11.65%	-2.33%	13.18%	-3.87%
CY2015	36.80%	3.78%	33.02%	10.16%	26.65%
CY2014	10.81%	5.02%	5.79%	-3.81%	14.62%
CY2013	19.24%	19.66%	-0.41%	-0.76%	20.00%
1m	-7.47%	-6.56%	-0.90%	-9.00%	1.53%
3m	-8.15%	-4.39%	-3.76%	-7.99%	-0.16%
6m	-5.25%	-3.30%	-1.95%	-4.61%	-0.65%
1y	7.71%	9.68%	-1.97%	6.65%	1.06%
2y pa	12.69%	4.35%	8.33%	6.00%	6.68%
3y pa	23.43%	10.78%	12.65%	10.12%	13.32%
5y pa	19.57%	9.10%	10.47%	9.63%	9.94%
7y pa	19.75%	8.10%	11.65%	9.67%	10.08%
Sharpe Ratio	1.18	0.61	1.92x	0.40	2.92x
Sortino Ratio	2.10	0.85	2.48x	0.58	3.64x
Annualised standard deviation	14.34%	13.58%		16.25%	
Highest monthly return	11.91%	10.16%		14.27%	
Largest monthly loss	-8.94%	-20.94%		-22.38%	
Largest drawdown	-14.04%	-27.33%		-29.11%	
% positive months	73.15%	67.59%		60.19%	

The recent market love affair with volatility continued into 2022 with the spectre of inflation leading to multiple potential Fed rate hikes continuing to spook equities, particularly the high growth and tech sectors of the market. We took an almost -7.5% hit at January close and consider that result fortunate given intramonth lows close to double that to the downside. The result was also pretty much par for the course compared to the equity indices we follow with the All Ords down -6.6% and the Small Ords down -9% while in the US the S&P 500 gave up -5.3% and the Nasdaq -9%. Also of note, the ASX All Tech index dropped -15.3%. One indicator of the volatility has been the share price responses of mega-cap tech trading with small cap volatility into and out of earnings.

So given that carnage, where to from here? Unfortunately the crystal ball we ordered from amazon.com all those years ago seems to still be stuck in transit, with customer support now blaming supply chains and Covid. Absent the crystal ball, my macroeconomic prognostications have to be taken with a mountain range of salt. With that, if we can look past the short-term, downward pressure on inflation is appearing on the horizon:

1) 2H22 inflation will be lapping higher comparables.
2) A capital expenditure response in some supply-constrained sectors is coming down the pipe – e.g. vs the well-publicised worldwide semiconductor shortages, Taiwan Semiconductor has set this year's capex budget at $40-$44b, a record high and a +40% increase (at the midpoint) vs last year's $30b budget. Amazon spent close to $60b in capex last year (vs ~$17b in 2019), ~40% on infrastructure (mostly AWS), ~30% on fulfillment, ~25% in transport capacity (including making its own cargo containers to bypass port bottlenecks). (Now if they would only put some of that capex to finding my crystal ball…)
3) In the long run (assuming we're still around), disinflationary pressures from technology coupled with high debt levels in Western economies should (in my opinion) help to cap eventual interest rate peaks at lower levels than in the (distant?) past.

However, while multiples on high growth equities have obviously come down in the bloodbath of the last few months, they are still arguably high on a historical basis. While cloud software multiples closed January below pre-Covid levels, the higher growth segment medians are still near previous peaks in 2019; meanwhile overall software basket multiples still have downside to reach historical averages and there is no axiom that guarantees the pendulum will stop there. Against that, the rush to the exits has dropped hedge fund positioning in tech relative to the S&P 500 to the lowest levels ever recorded by Goldman Sachs. So how do we think of our holdings given the above? Critical inputs into dcf valuation models (as opposed to relative valuations using multiples) include:

1) Discount rates - a negative given Fed rate hikes on the near horizon.

2) Growth rates – assuming good stock selection (a big assumption), high enough growth means outright valuation can outrun declining multiples. Needless to say, our (no doubt biased) opinion is our particular holdings in aggregate display this characteristic.
3) Duration of growth – most valuation models typically project a decline in growth before reaching a terminal growth rate (often related to GDP or an estimated fixed rate lower than today's, e.g. 10%). However, the actual experience shows many cloud businesses exhibiting elevated growth rates enduring (much?) longer than previously expected. A good proxy for cloud software demand can be seen in the recent reports from GCP, MS Azure and AWS all of which showed tremendous growth at massive scale. AWS is now at a $71b run rate and accelerated to 40% growth yoy. (Credit to the excellent data from https://cloudedjudgement.substack.com). The growth duration expectations input into our valuation models are among the main drivers of conviction in our holdings. As always (but perhaps even more so now), stock selection is critical.

The above prognostications were a bit of a tangent from our usual monthly report format. Hopefully not too boring for readers. A quick recap on positions of note this month follows.

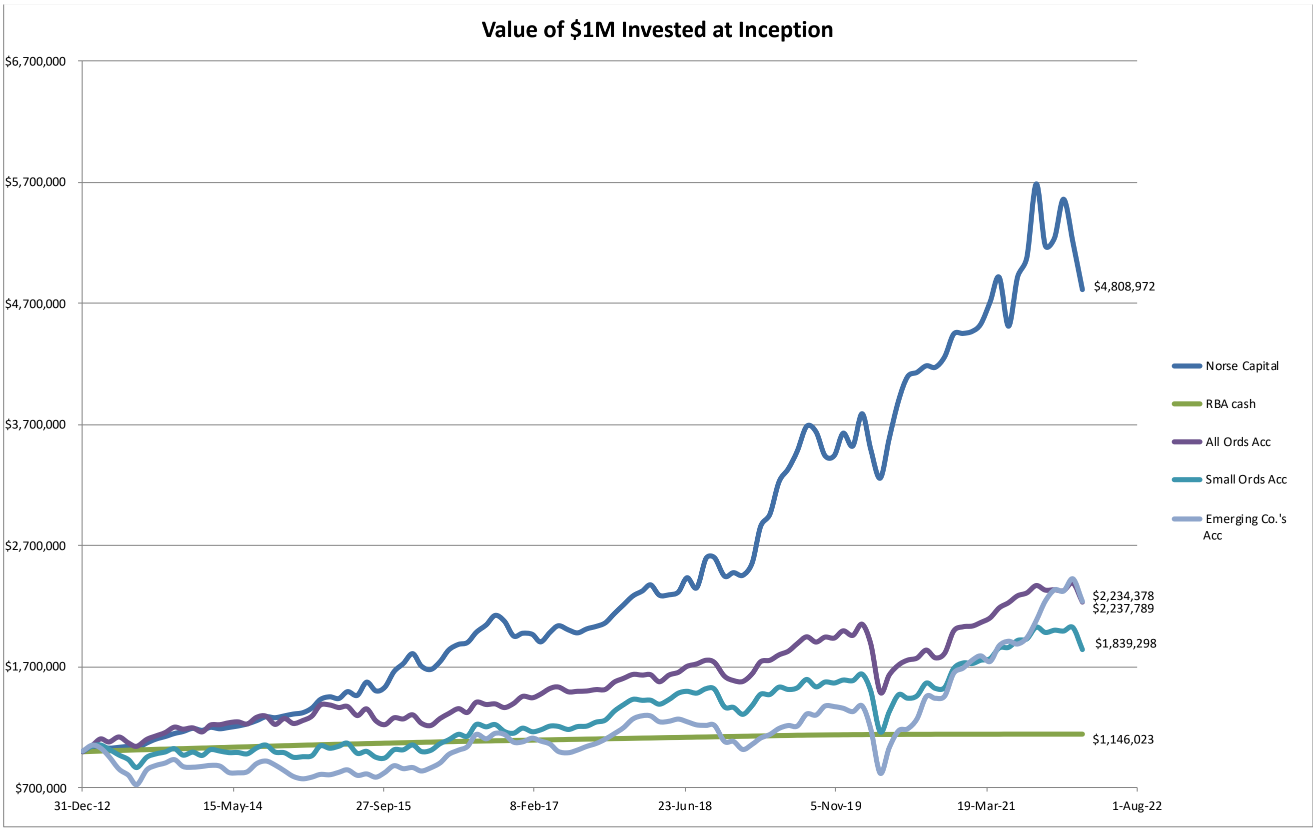
Not surprisingly our enterprise software basket was the biggest drag on performance, responsible for ~-4.3% to the portfolio in January, with individual holdings dropping between ~-12% (CRWD) to ~-30% (SHOP). The almost ~-28% drop in PME cost more than ~-2%. Most of the rest of the portfolio also contributed negatively. On the positive side of the ledger, the release from escrow of some of our holding in MIGI helped that position contribute >~+3% despite the shares themselves falling ~-14% with Bitcoin itself falling ~-19% for the month. Shorts and hedging added a paltry +0.3% while the ~-2.7% fall in the AUD currency added ~+1.1%

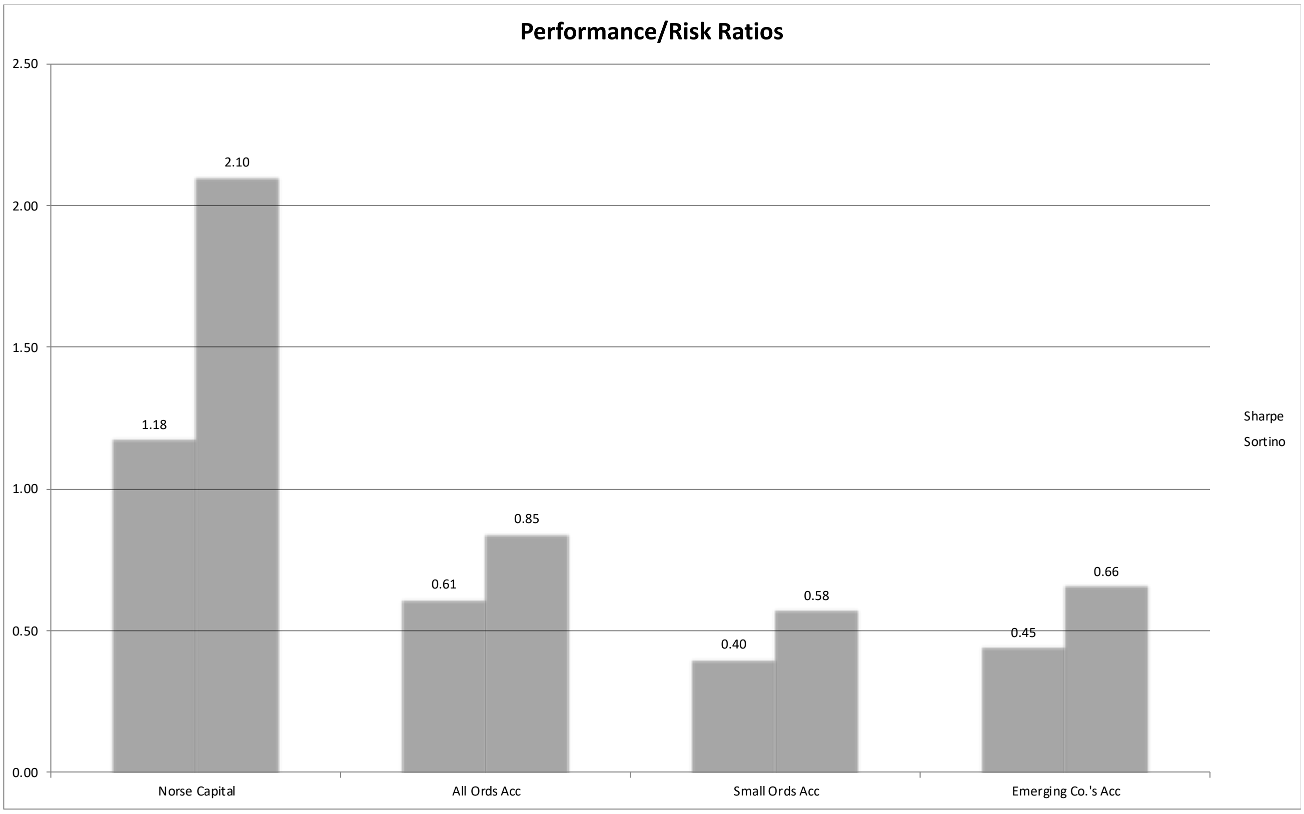
<u>Portfolio Holdings:</u>

Cash:	19.5% (AUD and USD)
Non-AUD exposure:	44.7%
Longs:	75.4%
Shorts:	-2.4%
Options delta:	1.2%

Net exposure: 74.2%
Top 5 equities (alphabetical): AAPL, MIGI, PME, RMD, RUL

The same top 5 positions continue. Our net exposure has dropped by almost 8%, thanks to the even bigger drop in our options delta to bring our net exposure back to typical historical levels. (Our big regret has been that we were too slow to sell down our net exposure when cash was taken out of the portfolio last year, such that we entered the downturn at a higher net exposure level than historically). Hedging includes outright SPY and QQQ puts as well as put spreads on IGV and ARKK (specifically hedging the software and high growth areas).





Performance/Risk Ratios
2.50
2.00
1.50
1.00
0.50
0.00
1.18
2.10
0.61
0.85
0.40
0.58
0.45
0.66
Norse Capital
All Ords Acc
Small Ords Acc
Emerging Co.'s Acc
Sharpe
Sortino