Building wealth in FY23 and beyond

Key themes in global and Australian equities, and credit markets, for FY23.

A differentiated perspective.

JUNE 2022

Contents

PM Capital

Important information

This document is issued by PM Capital Limited

(ABN 69 083 644 731, AFSL No. 230222) as responsible entity for the:

PM Capital Global Companies Fund	PM Capital Australian Companies Fund	PM Capital Enhanced Yield Fund
ARSN 092 434 618	ARSN 092 434 467	ARSN 099 581 558

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The Index for the PM Capital Global Companies Fund is the MSCI World Net Total Return Index in Australian dollars, net dividends reinvested. See www. msci.com for further information on the MSCI indices. The Index for the PM Capital Australian Companies Fund is the S&P/ASX 200 Accumulation Index. See www.asx.com.au for further information. The Index for the PM Capital Enhanced Yield Fund is RBA Cash Rate. See www.rba.gov.au for further information.

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Paul Moore's FY22 Investment Letter

As the end of financial-year 2021-22 (FY22) approaches, PM Capital provides an overview of the events and decisions that drove our portfolio positioning over that year. We then provide our insights for building wealth in the next 12 months (FY23). In mid-July, we'll provide further insights in our quarterly reports and video updates.

Key points

- The tide has turned for global equity markets. Global government bond yields are rising after four decades of falls. That reflects market expectations for higher inflation and rising interest rates in FY23.
- This cycle has a long way to run. The initial response to higher rates was falling global equity valuations in the second half of FY22. For lower-quality companies, we are yet to see the full extent of earnings downgrades, dilutive equity capital raisings and forced selling. Elevated equity-market volatility in FY23 is likely.
- These conditions will provide opportunities for patient, long-term investors who focus on valuations and ignore macro-economic "noise". Global banks and commodity producers remain PM Capital's preferred themes.

FY22 will be remembered as the "Great Inflexion" or "Great Reset", as some are calling it. That is, a major turning point for global equity markets as the tailwinds of low inflation and interest rates became headwinds. We are witnessing the unwinding of excess cheap money – and a retreat from globalisation as geopolitical volatility rises. These changes have profound implications for equity investors. Current conditions also challenge asset managers that relied on a rising "macro tide" to lift portfolio returns. That tide is receding.

The Great Inflexion is best explained in three parts. First, the events leading to the point of inflexion (the first half of FY22). Second, the market adjustment during the inflexion (second half of FY22). Third, what investors should expect (in FY23) as the inflexion unfolds – and how PM Capital has positioned its portfolio to benefit.

Of course, every market turning point is different. But through my investment career spanning almost four decades, I have seen recurring patterns during inflexion points. This thinking informs PM Capital's consistent, disciplined investment style – and our response to changing market conditions. I encourage you to read the Portfolio Checklist in this report for our insights on successful investing.

FIRST HALF OF FY22 (PRE-INFLEXION)

The events leading to the inflexion were a textbook case of "in-crowd investing".

Commentators argued that rising inflation was a "transitory" response to COVID-19. Supply-chain bottlenecks and labour-market shortages that drove prices higher would unwind as life returned to normal. Central banks espoused the same view. In early November 2021, Greece's three-year government bond yield turned negative, such was the market's view of "lower inflation for longer". These erroneous views saw markets underestimate the risk that central banks would have to raise interest rates sooner and higher than expected, to tame inflation.

At the time, PM Capital argued that rising inflation would be a bigger problem for equity markets than realised. We warned that loss of purchasing power (as inflation rose) would be this decade's biggest investment risk. That has been the case so far.

PM Capital also warned about the dangers of buying tech and other long-duration growth stocks at peak valuations. Low rates boost valuations of growth companies, many of which are unprofitable. They fuel speculation in low-quality companies. Investors buy supposedly "star companies" based on their share-price momentum rather than their fundamentals.

Hype about the latest star sector and star asset manager was unrelenting in the first half of FY22. New investment funds were launched to cash in on "peak sentiment". Witness the boom last year in thematic technology Exchanged Traded Funds (ETFs). This was the point of maximum in-crowd investing and record valuation dispersion (between growth and value stocks).

SECOND HALF OF FY22 (INFLEXION)

The inflexion point began in late 2021 when the market narrative about inflation changed. After believing inflation would be "lower for longer", then "transitory due to COVID-19", markets finally accepted higher inflation was here to stay. German bond yields moved from negative to positive this year. US tech stocks sank after more than doubling since the March 2020 low.

Predictably, there was denial from some asset managers and product promoters who argued the sell-off was a buying opportunity.

When Russia invaded Ukraine in February 2022, market fears escalated. Soaring oil and gas prices strengthened expectations of higher inflation and rate rises. Worse, Russia's aggression suggested a new phase in autocracies challenging the liberal democratic order and globalisation (the China-US trade war is an example). De-globalisation began.

Energy security risks intensified. The market realised that the push to decarbonise economies was creating national security risks (as Europe relied on Russia for energy supply) and was more inflationary than thought (through higher oil and gas costs).

The market now faced two inflexion points: financial and geopolitical. Some investors panicked. Low-quality tech stocks fell 70-80% from their peak. Good stocks sold off with the bad. By late FY22, a new bear market in US shares emerged, amid the prospect of global recession.

FY23

How will markets play out during and after this inflexion period? As I wrote earlier, every market turning point is different. The rise of passive funds (ETFs) – and the market illiquidity they create – is a big change this time around.

But some patterns repeat. Investment behaviour changes slowly. People underestimate how far – and for how long – sectors can fall when the tide turns. Initially, many investors don't believe the bad news. When Alibaba in China or Netflix in the US fall, some investors "buy the dip" because their expectations are anchored on the past rather than the future. They don't realise that the first earnings downgrade is rarely the last.

For the past year, PM Capital has argued that investors should hold a combination of cash, while they wait for opportunities to arise, and select equities that meet their criteria (and no government bonds or other long-duration assets). Holding equities provides potential for a higher real return that counters the loss of purchasing power as inflation rises. Holding more cash provides optionality to add equity exposure during inevitable market corrections.

We retain the view that banks will benefit as interest rates rise and we favour energy and other commodity producers during conditions of higher inflation. We expect a larger proportion of our portfolio's total return in FY23 will come from rising dividends. Our European bank and energy holdings, in particular, have potential to return excess capital to shareholders in FY23 through dividends or share buybacks.

I'm pleased to report that PM Capital was well-positioned for this inflexion point, long before it arrived. That is reflected in the strong outperformance of our global and Australian equity funds over one, three and five years[1]. Our challenge now is to maximise the opportunity this decade and capitalise on PM Capital's investment strategy.

I hope you find this report useful and would be delighted if you refer it to friends, families or colleagues who might benefit from our insights.

I encourage you to follow PM Capital's latest thinking on markets, sectors and companies through our regular video and written insights on the PM Capital website (www.pmcapital.com.au), and our quarterly and monthly reports.

For a more in-depth analysis of key themes in PM Capital portfolios, I refer you to our recent report, "*5 of our current investment themes*", available at www.pmcapital.com.au/invest_differently

Good investing,

Paul Moore

Founder and Chief Investment Officer

PM Capital

Summary: Key FY22 trends and PM Capital's FY23 views

What happened in FY22	What we expect in FY23
Inflation	
Market narrative changed from inflation being "lower for longer" to "transitory" and now "persistently higher" as commodity, energy and wage costs rose. Markets panicked.	Elevated short-term peak inflation to subside, but settle at a higher sustained level than experienced over the previous decade. Short-term supply constraints in energy and other commodities will continue to pressure input costs.
Interest rates	
In response to soaring inflation, central banks began to lift interest rates. The market priced in a series of aggressive rate rises this year to cool inflation. Because they were slow to act on inflation, central banks now have to lift rates faster and higher than they previously thought.	Consistent with a higher sustained level of inflation, short-term interest rates to continue rising from stimulatory monetary policy settings, then towards more neutral settings. This is a key reason why PM Capital favours global banking stocks.
Coporate earnings	
Corporate earnings generally held up as companies globally benefitted from strong demand during the COVID-19 recovery. However, CEOs have this year noted rising cost pressures and the potential impact on profit margins and earnings.	Earnings downgrades will increase as companies face rising costs and slowing demand. Walmart's downgrade to its 2023 earnings, announced in May 2022, is a portent of things to come as rising costs eat into profit margins.
Global economy	
Global growth slowed from 6.1% in 2021 to a projected 3.6% in 2022, according to the IMF[2]. Solid growth in the US and high (though slowing) growth in China offset weaker growth in the Eurozone and Japan. In the second half of FY22, economists began to lower global growth forecasts.	The IMF projects global growth to remain at 3.6% in 2023[3]. That forecast will be hard to meet as China battles COVID-19 and property risks; the US faces rate hikes; and Europe faces the prospect of long-drawn-out conflict in Ukraine. Globally, it is difficult to predict economic growth outcomes as the impact of these headwinds continues to be offset by high consumer savings and strong underlying consumer demand. However, risks are rising.
Geopolitics	
Russia's invasion of Ukraine signalled a more aggressive approach from autocracies – and elevated sovereign risks for companies and investors.	A continued retreat from globalisation as more companies manufacture at home to safeguard supply– a move that could be inflationary.

How PM Capital's strategy differs from the investment "in-crowd"

The in-crowd's view	PM Capital's view
Europe	
European equities will continue to underperform as Eurozone economic growth slows due to the Russia-Ukraine war and the impact of sharply higher energy costs. European banks and housing developers will be most affected by slowing demand.	By domicile, European companies have the largest weighting in the PM Capital Global Companies Fund[4] because some sectors, such as European banks, trade at bottom-quartile valuations. We also have positions in housing developers in Spain and Ireland.
Commodities	
The rally in commodity prices will slow or end as global economic demand weakens and short-term commodity supply increases as the world recovers from COVID-19. An end to the Russia-Ukraine war will reduce pressure on energy prices.	A new commodities supercycle is starting, which will be supply rather than demand driven. Russia's war on Ukraine will affect commodity markets for years; there has been chronic long-term underinvestment in new mining projects; deposits in copper and other metals are becoming more complex to mine; and there are new commodity demand drivers, such as electric vehicles (which will support long-term copper demand, for example).
ESG/Fossil fuels	
The in-crowd became increasingly reluctant to invest in oil and coal stocks, due to Environmental, Social and Governance (ESG) concerns. They missed the rally in global energy stocks in 2021 and 2022.	By sector, energy has the second-highest weighting in the PM Capital Australian Companies Fund and third-highest weighting in the PM Capital Global Companies Fund[5]. We expect rising dividends from energy companies as they return capital to shareholders.
Technology stocks	
The in-crowd continued to drive tech prices higher for most of the first half of FY22, buying at peak valuations. After sharp falls in Total Addressable Market (TAM) tech stocks this year, some in-crowd commentators argued investors should buy the dip.	The tech rout has further to go in FY23 as interest rates rise. Selling in low-quality tech might ease (after 70-80% falls from the peak), but we are yet to see the full extent of tech earnings downgrades or emergency capital raisings in the sector.

6 Key observations

1 The market convinced itself that inflation would be "lower for longer"

Chart 1: Four decades of falling global government bond yields

Source: BofA Merrill Lynch Global Investment Strategy, Bloomberg, Global Financial Data.
Chart shows simple average 10-year yield

Oct 1979: Volcker declares war on inflation (running at 13% pa). ***"Containment of inflation is fundamental to a restoration of sound economic growth."***

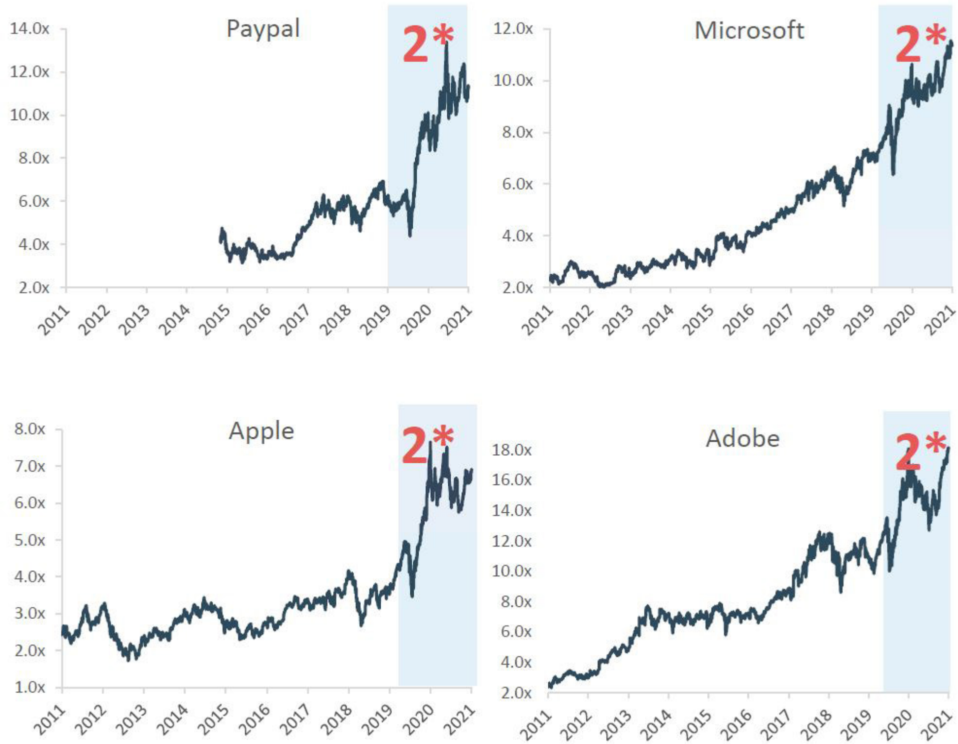
Dec 2019: Powell declares war on deflation; *"I would want to see...a significant move up in inflation that's also persistent...That's my view."*

Chart 1 shows the fall in global government bond yields over four decades. The blue dot at the peak of the chart (October 1979) was when Paul Volcker, the former Chairman of the US Federal Reserve, declared war on annual inflation (then 13%). The red dot at the trough of the chart (December 2019) was when Jerome Powell, the current Chair of the US Federal Reserve, declared war on deflation.

The chart shows two main things. First, that bond yields, which reflect the market's inflation and interest-rate expectations, move in long cycles. Second, we could see the emergence of secular inflation (persistent higher inflation over a longer period). That informs PM Capital's portfolio positioning in sectors, such as banks and mining and energy companies, that can benefit as inflation and rates rise.

2 Low inflation and rates underpinned a boom in tech and other growth stocks

Chart 2: Enterprise Value to Sales Ratio in leading US stocks

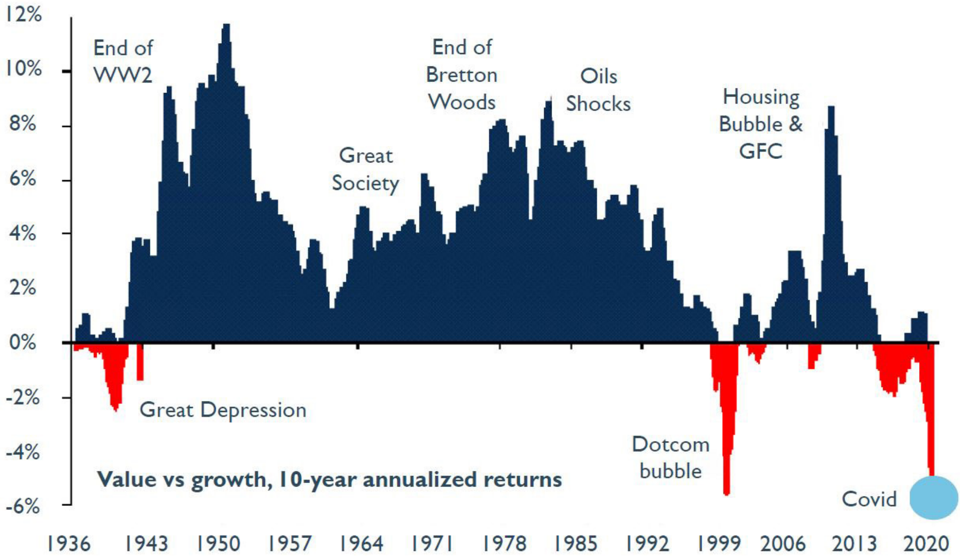


Source: Facset

Chart 2 tracks the Enterprise Value to Sales Ratio for leading US tech stocks. This ratio compares the total value of a company to its sales and is used to value technology companies. Generally, the lower the ratio, the cheaper the company. As the chart shows, this metric increased two or more times in 2020 and 2021 for tech stocks as interest rates worldwide fell during the COVID-19 pandemic. Microsoft's EV/sales ratio was almost six times higher than a decade earlier. This reinforced PM Capital's view that valuations for growth stocks were at record levels and unsustainable.

3 Record valuation dispersion between growth and value stocks

Chart 3: Value stocks horribly out of favour



Source: BofA Research Investment Commmittee, Fama & French

Chart 3 shows the massive underperformance of value stocks relative to growth stocks during COVID-19 (the blue dot) when interest rates fell. The term "value stocks" refers to companies that appear to trade at a lower market price relative to their fundamentals, such as earnings or dividends. Often, value stocks are out of favour with investors. In contrast, "growth stocks" refer to companies expected to grow at a higher rate than the market average. Typically, growth stocks trade on higher Price Earnings (PE) multiples.

This chart has two big takeouts. First, the gap between the return of growth and value stocks was the largest in more than 80 years. Second, that value stocks tend to outperform growth stocks as inflation and rates start to rise. PM Capital's portfolio was positioned to capitalise on record dispersion between growth and value.

4 Growth stocks lose favour as inflation and rate expectations rise

Table 4: Tech sector bears brunt of global equities sell-off

TAM Stocks	
Company	% from 3 year high
Virgin Galactic Holdings	-90%
Peloton Interactive	-92%
Carvana	-90%
Beyond Meat	-87%
Zoom Video Communications	-84%
Zillow Group	-82%
Pinterest, Inc. Class A	-77%
Spotify Technology	-73%
Snap	-72%
Block	-70%
NASDAQ-100	-26%
S&P 500	-17%

Nasdaq Top 10	
Company	% from 3 year high
Netflix	-74%
PayPal	-74%
Meta Platforms Inc.	-48%
Nvidia Corporation	-47%
Amazon.com Inc	-42%
Tesla Inc.	-35%
NASDAQ-100	-26%
Alphabet Class C	-24%
Alphabet Class A	-24%
Microsoft	-21%
S&P 500	-17%
Apple	-15%

Source: Nasdaq, FactSet. Market close to May 12, 2022. Top 10 list as at December 2021.

Table 4 shows Total Addressable Market (TAM) stocks on the left, and the 10 top stocks on the US NASDAQ exchange on the right. TAM stocks refer to companies that are often promoted on the size of the market opportunity they target. TAM stocks tend to be more speculative and often have low or no earnings. Low rates benefit TAM stocks because they can borrow more cheaply to grow; and because a lower discount rate is used to value them (which lifts their valuation). In contrast, the top NASDAQ stocks are far more established, profitable companies, mostly in technology.

The TAM table shows huge falls from their peak share price, as expectations of rising inflation and interest rates sparked the equities sell-off. That was no surprise: speculative technology companies tend to fall first and hardest and rising rates lead analysts to downgrade valuations. The next catalyst, earnings downgrades from established NASDAQ companies, is starting to play out. Most notable to date has been PayPal and Netflix, which have declined in excess of 70% from their 3-year highs.

PM Capital avoided TAM stocks and large benchmark NASDAQ-100 constituents, believing they were overvalued. The PM Capital Global Companies Fund had a short position in Carvana, an online used-car dealer in the US, to benefit from expected share-price weakness in that stock. The Fund closed out that position in early March. Carvana has fallen 89% year-to-date.[6]

The PM Capital Australian Companies Fund has a short position in REA Group, an online property advertising platform. We believe REA's valuation does not adequately reflect its challenging growth outlook as activity in Australia's residential property market slows, amid rising interest rates. REA is down 36% year-to-date.[7] The PM Capital Australian Companies Fund also holds a short position in Seek, an online job-advertising platform. Seek is down 32% year-to-date.[8]

5 The first profit downgrade is rarely the last

Chart 5: Alibaba and the dangers of "buying the dip"

Source: Factset

Chart 5 tracks the share price of Alibaba Group Holding, a Chinese e-commerce giant and former market star. In late 2020, Alibaba traded on a forward Price Earnings (PE) multiple (Next Twelve Months, or NTM) of 30x. By December 2021, the PE was compressed to 14x and the share price had slumped by almost two-thirds. Rising interest rates and the Chinese Government's regulatory crackdown on the country's technology sector led to a sudden change in investor sentiment towards Alibaba. An earnings downgrade followed as Alibaba struggled with China's slowing economy and rising competition. Fears of forced selling for some Alibaba shareholders compounded the losses.

This chart is a timely reminder that growth stocks can fall faster – and further – than many investors realise. History shows there can be multiple waves of selling in former market stars when the tide turns before valuations fully unwind. The danger is investors buy into potential recoveries too early. The time to buy quality technology companies is when they trade at bottom-quartile valuations. We are not there yet.

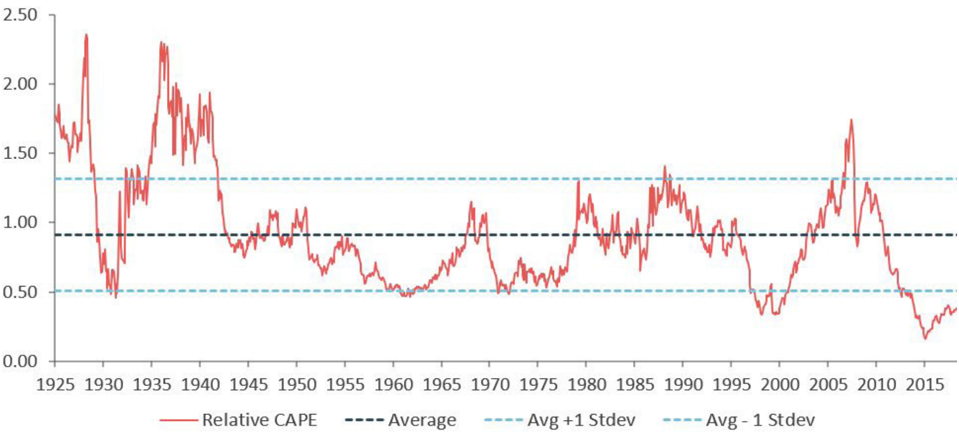
6 Global banks and resources appeal in conditions of higher inflation/rates

Chart 6: Banks vs S&P 500, relative performance (USD)

Source: BofA Merill Lynch GLobal Investment Stratgy, Bloomberg, Datastream, Ibboston, Global Financial Data Chart

Chart 6 shows the underperformance of bank stocks relative to the US sharemarket, as measured by the S&P 500 Index. Banks have underperformed the market during a period of falling inflation and interest rates (as shown in Chart 1 earlier). PM Capital believes banks will outperform over this decade as they benefit from rising Net Interest Margins (the difference between interest received and paid).

Chart 7: CAPE Multiple – Mining relative to market (S&P 500) since 1925



Source: Bernstein, BofA Merrill Lynch Global Investment Strategy, Bloomberg, Datastream, Ibbotson, Global Financial Data

Chart 7 compares mining-stock valuations relative to US shares in the past decade. It uses the Cyclically Adjusted PE Ratio (CAPE), which uses Earnings Per Share over 10-year periods to smooth earnings fluctuations. PM Capital initiated a position in copper in 2018, before rotating into energy stocks. Both positions have performed strongly.

GLOBAL COMPANIES FUND: FY22 VIEWS

Key points

Zenith FUND AWARDS WINNER 2021

- New positions in European industrials, online sports betting
- European banks continue to offer attractive value
- Energy sector appeals

New positions

In FY22, the Fund took advantage of volatility in global equities markets to initiate or add to positions in European industrials. Key examples include Siemens, Airbus and Flutter Entertainment plc.

PM Capital believes Siemens, a German multinational, is strongly positioned to benefit from industrial automation and growth in the use of artificial intelligence in global manufacturing.

The Fund added to its holding in Airbus, a European aerospace company, which we believe will become the market-share leader in the world's largest duopoly. Airbus operates in a structurally growing market amid rising travel demand from Asian middle-class consumers. The Fund initiated a position in Airbus in late 2021, taking advantage of market volatility as the Omicron COVID-19 variant emerged. We were attracted to Airbus's strong balance sheet, high free-cash flow and potential to make a full recovery after the pandemic. The market could re-rate Airbus over the next few years as its market share grows and profit margins expand.

Recently, the Fund initiated a position in Flutter Entertainment plc, owner of market-leading online sports-betting products in the UK, US and Australia (Flutter owns Sportsbet in this market). Flutter could outperform this decade due to more favourable regulatory conditions and rising demand for online sports betting, particularly in the US, which only legalised online sports betting in 2018. Moreover, substantial industry consolidation in sports betting has created greater scale for industry incumbents and increased barriers to entry for rival wagering firms.

European banks

By sector, the Fund's largest position is in European banks with a 19% weighting.[9] The Fund also has a 13% weighting in US banks.[10] For the past year, PM Capital has argued that European banks are trading at bottom-quartile valuations and are the market's most undervalued sector today. For example, ING Groep NV (a Fund holding) is on an adjusted Price Earnings (PE) multiple of about 6x. [11] European banks have underperformed banks in the US and Australia because interest rates in Europe fell lower, even turning negative in Germany last year.

Three factors underpin our positive view on European banks. **The first is interest rates.** The German 10-year government bond has risen from negative 0.12% [12] to positive 1.32% [13] this year amid expectations of rising inflation. European bank earnings have high exposure to rising rates. Analysis by UBS, an investment bank, shows a 1% increase in rates equates to a 20% increase in bank earnings.[14] **The second factor is capital returns**. FY22 was an inflexion point for European banking regulation. European banks now have sufficient capital, so they are able to return excess capital in the form of higher dividends and share buybacks. All European banks held in the

Fund have a buyback program in place. PM Capital expects higher dividend yields across the European banking sector in FY23, with banks generally paying out about half of their earnings. **The third factor is industry consolidation.** Ireland's banking sector now has three main players, from five, after consolidation (Bank of Ireland and Allied Irish Banks are Fund holdings). In Spain, CaixaBank (a Fund holding) merged with Bankia last year, creating that country's largest domestic bank. Industry consolidation will improve European banking scale and profitability – and reflects low valuations in the sector.

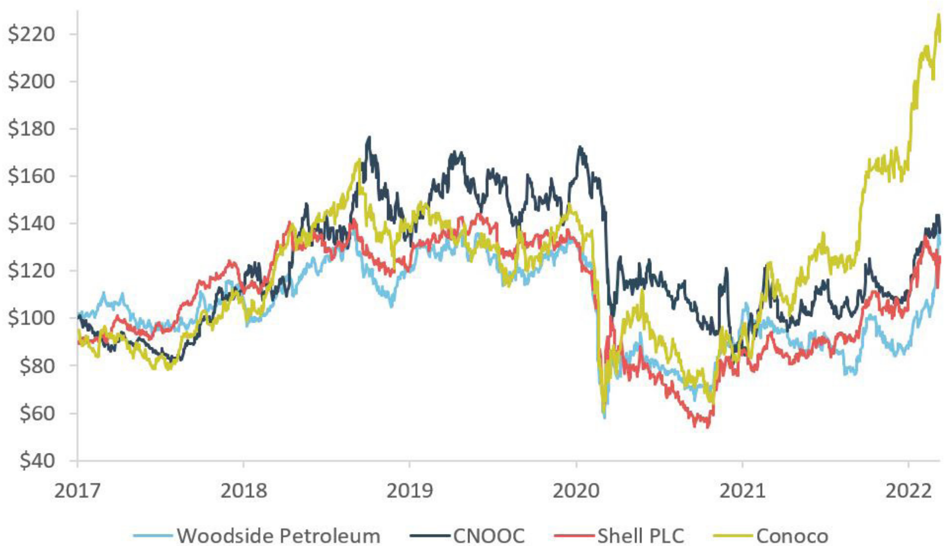
Energy sector

In 2018, the Fund initiated a position in global copper producers and added to it in 2020. After strong gains from its copper holdings, the Fund believed valuations in the sector were no longer extreme (but retains a positive long-term view on copper). The Fund realised gains in copper and began building a position in the energy sector, which at the time was out of favour with investors. A position in Shell plc was initiated in 2020. The Fund's other energy holdings include the Chinese National Offshore Oil Corporation (CNOOC) and Woodside Petroleum.

There were parallels between the Fund's copper and energy strategies. The Fund initiated positions in leading producers in these sectors when they traded at bottom-quarter valuations. We believed the market underestimated long-term supply constraints in copper and oil, and that lower investment in new projects (compared to the previous commodity supercycle) would underpin higher copper and oil prices. Oil production was also affected by the boom in ESG investing as activists and some governments discouraged investments in new fossil-fuel projects.

As Chart 8 below shows, the Fund's core energy holdings have rallied. Despite these gains, we continue to hold these positions because their valuations are yet to fully factor in the increasingly favourable supply dynamic for oil in FY23 and beyond – and its implications for a higher oil price and rising oil-company earnings and dividends. We expect the Fund's oil holdings to pay higher dividends in FY23 as they return excess capital to shareholders.

Chart 8: Energy sector holdings



Source: Bloomberg

AUSTRALIAN COMPANIES FUND: FY22 VIEWS

Key points

- Leveraged to Mergers and Acquisitions (M&A) activity
- Energy holdings outperform

M&A activity

The Fund benefitted from M&A activity in Australia in FY22. Since its inception in 2000, the Fund has held a number of stocks that have been acquired. Just as M&A firms seek to acquire undervalued companies, PM Capital's investment style is to identify companies trading at bottom-quartile valuations.

The Fund this year exited its position in iCar Asia, an online car-advertising network in Southeast Asia, after Carsome Group acquired that business. The Fund also exited its position this year in Crown Resorts after Blackstone Inc's, proposed acquisiton of the Australian casino operator.

Having realised gains in its Crown holding, the Fund initiated a position in The Star Entertainment Group, a rival Australian casino operator. In a similar scenario to Crown, The Star's has been negatively affected by the dual headwinds of Covid-19 disruption and the current regulatory review of its operations after allegations of money-laundering at its casinos. A consistent stream of management departures this year have added to bearish market sentiment towards the business.

A sharp sell-off since governance failures were publicly reported in October 2021 has presented the Fund with an attractive entry point. Much like Crown, we believe downside at The Star is supported by the valuation of its property assets in New South Wales and Queensland. Furthermore, after a rebasing of earnings expectations through the pandemic, and with the Company's Queen's Wharf Brisbane property set to open in 2023, we see scope for long-term earnings growth. As regulatory overhangs are slowly removed, we expect the share price to react positively. If its valuation remains depressed, The Star could also attract interest from a private-equity suitor or an opportunistic offshore gaming operator attracted to the Company's portfolio of tier-one casino assets.

Energy holdings outperform

The Fund initiated a position in Australian oil and coal stocks in the first half of FY22. After strong gains in its core copper holdings, the Fund reduced its position and rotated into energy stocks. In September 2021, the Fund built a new position in Woodside Petroleum, Australia's largest energy stock. The rally in Woodside Energy shares since then has contributed to the Fund's outperformance over one year.[15]

In December 2021, the Fund initiated a position in Coronado Global Resources, a metallurgical (met) coal producer in Australia and the US. The Fund has a positive view on met coal, a key ingredient in steel production. Like copper and oil (other commodities that PM Capital favours), met coal faces supply constraints. There have been few new supply-side developments in met coal. The largest met-coal producers are not committing to new investment or are divesting some of their coal assets. Stable or declining coal production, and slightly higher global steel production, will likely support a higher met coal price in the next few years.

Like oil, met coal supply has been affected by ESG concerns over new fossil-fuel investments. It is harder to get financing for new coal projects, meaning a rising cost of capital. Shareholders of large coal companies are seeking higher dividends rather than investment in new projects.

Coronado was out of favour when the Fund built its position. The company raised equity capital twice during COVID-19 as low coal prices persisted and as the market reacted negatively to the company's capital-allocation strategy to use debt to fund a large dividend. As the market focused on Coronado's financial challenges, coal prices improved in late 2021. Coronado generated substantial earnings, its balance sheet had enough cash to offset all its debt, and it had high leverage to the rising met coal price due to its large production of coal.

Coronado's current share price[16] is more than double the Fund's average entry price[17]. In May, Coronado declared a special dividend and has indicated it will distribute 60-100% of free cash flow each year to shareholders. Despite its share-price gain this year, Coronado trades on a lower valuation multiple than comparable thermal coal miners, even though thermal coal is likelier to be disrupted by the move toward wind and solar power. Technology to displace met coal in steel production is still in its infancy.

In March 2022, the Fund initiated a position in Stanmore Resources, another Australian met coal producer. In May, Stanmore completed its acquisition of BHP Group's 80% interest in BHP Mitsui Coal (BMC). When the deal was announced in November 2021, coal prices were lower than today. Stanmore raised equity capital at $1.10 a share, a price that we believed did not reflect met coal's improving prospects. The Fund initiated its position in Stanmore through that capital raising.

As coal prices hit record highs in March, Stanmore was well-positioned to benefit from higher prices. The Russia-Ukraine war encouraged more customers to move away from Russian coal supply (Russia is a dominant supplier of lower-grade coking coal – PCI - which is the grade Stanmore mostly produces).

Stanmore's high debt, a potential risk in November 2021 when coal prices were much lower, has enabled it to increase its leverage to rising coal prices. As part of its financing contracts, Stanmore will likely pay down debt rapidly in the current coal-price environment, de-risking its balance sheet. The Fund's investment in Stanmore and Coronado again emphasised the benefits of buying out-of-favour energy assets that are mispriced.

ENHANCED YIELD FUND: FY22 VIEWS

Key points

- Focus on capital preservation
- Adding short-dated interest-rate exposure
- Consistent outperformance over long periods

Focus on capital preservation

At the start of FY22, the PM Capital Enhanced Yield Fund had near-zero interest-rate risk. We believed higher inflation was not just a "transitory" response to COVID-19 supply-chain bottlenecks and expected interest rates to rise.

The Fund mostly held floating-rate notes (a type of bond) that have a variable (floating) coupon interest rate that tracks short-term rates. Floating-rate notes have two benefits in a rising rate environment. First, the floating rate effectively preserves the bond's capital value when rates rise. Second, the coupon interest rate is usually reset quarterly: as rates rise, the floating-rate note has a higher coupon payment.

The Fund avoided fixed-rate bonds that have a fixed coupon rate (which does not change, from when the bond is issued to its maturity). When interest rates rise, the price of fixed-rate bonds fall. The Fund's early focus on floating- rather than fixed-rate bonds helped preserve investor capital in a volatile interest-rate market.

Adding short-dated interest-rate exposure

We believe market expectations for short-term interest-rate rises are now too aggressive. The Australian market is pricing in an official cash rate of almost 3% by the end of 2022 and 4% by 2023, from 0.85% now.[18] For that to happen, the cash rate would need to rise by 0.4% each month for the rest of this year and keep rising next year.

In our view, home borrowers, on average, could not tolerate that rate trajectory given high record levels of household indebtedness, as shown by RBA data.[19] An official cash rate of 4% by the end of 2023 would imply a variable mortgage rate of 6-7%. That rate is unlikely to materialise because it would damage Australia's housing market and the economy. As such, the RBA will need fewer rate rises to cool inflation than the market currently expects, in our opinion.

At the same time, credit spreads across most sectors have widened as the market worries about the impact of Russia's war on Ukraine, COVID-19 in China and rate rises in the US. Put simply, a credit spread is the difference between the yield on a corporate and government bond at each point of maturity. The credit spread reflects the extra return investors receive for bearing credit risk. Widening credit spreads signal that investors demand a higher yield, all things being equal, to lend money to a particular company.

To capitalise on interest-risk and credit-risk opportunities, the Fund began to add short-dated corporate bonds (1.5 to 2 years) in the second half of FY22. These bonds are mostly fixed-rate and issued by high-quality companies, such as McDonald's Corporation, Coca-Cola Co, US banking giant Wells Fargo and NextEra Energy Inc, a US renewable energy company. In Australia, we added bonds from Aurizon Holdings, a rail operator, and from Queensland Investment Corporation's coveted shopping-centre portfolio. We like the outlook for regional shopping centres as COVID-19 encourages more people to work from home and shop locally.

We focused on interest-rate duration of 1.5-2 years because that is the current "sweet spot" in interest-rate markets. Most corporate bonds added to the Fund will yield around 4% for 1.5-2 years – an attractive return compared to the cash rate (as stated, we don't expect the cash rate will be anywhere near 4% by the end of 2023) and compared to the 10-year Australian Government Bond.

By including bonds from high-quality corporate issuers, we maintain the Fund's focus on capital preservation. In addition to corporate bonds, the Fund has used an Interest Rate Swap to increase its exposure to short-dated securities over approximately two years and take advantage of opportunities in this part of the interest-rate market. Equivalent to about 10% of the Fund, the swap provides only interest-rate exposure; there is no credit risk. An interest-rate swap is a derivative contract between two parties that is used to manage interest-rate risk.

Consistent outperformance over long periods

Celebrating its 20th anniversary this year, the PM Capital Enhanced Yield Fund was designed to provide regular income with low volatility. Investors and financial advisers use the award-winning Fund[20] as a surrogate for investing in cash or term deposits. The Fund has consistently provided a higher return than the RBA cash rate over long periods with low volatility and a capital-preservation focus.

PM Capital was the founding investor in the Fund and continues to be a long-term holder. That creates strong alignment between the Fund and its investors and demonstrates the underlying strength of the Fund's investment style, record and outlook.

Over the past year, in an environment where markedly higher interest rates have resulted in most securities falling considerably in price terms, the fund has broadly preserved investor capital – a pleasing result.

Over three years, the Fund has an annualised excess return of 1.1% over the cash rate[21]. Over five years, the annualised excess return is 1.2%[22]. Since inception in 2002, the Fund has consistently outperformed the cash rate.

Portfolio Checklist: the keys to successful long term investing

LOOK FOR FUND MANAGERS THAT HAVE STOOD THE TEST OF TIME

In a market fixated with short-term performance, look for reputable managers that have had sustained success over multiple investment cycles.

COMPARE FUNDS ON MULTI-DECADE PERFORMANCE

Some investors focus too much on one- and three-year returns, and not enough on annualised 10- and 20-year returns. Wealth accumulators who have a multi-decade horizon, such as Self-Managed Superannuation Fund (SMSF) trustees, should choose funds that deliver attractive multi-decade returns.

ACTIVE VERSUS PASSIVE MANAGEMENT

Investing in an index fund, such as an Exchange Traded Fund, means putting your money into a fund that buys and sells shares regardless of asset valuations. Active managed funds that assess company valuations are the key to building sustainable long-term wealth.

EMBRACE TRUE 'LONG-TERM' INVESTING

Too many investment experts regard long-term investing as "3-5 years", sometimes less. It can take up to a decade for an investment theme to play out, and for companies within that theme to move from bottom-quartile valuations to top-quartile. Patience is a trait of successful investors.

BE SCEPTICAL OF THE 'CONSENSUS' VIEW

Sustained wealth creation requires independent thinking, not the consensus view. Basing investment decisions primarily on 'top-down' views of industry or economic matters – such as central bank comments on inflation and interest rates – can destroy wealth.

GO GLOBAL

It makes no sense that Australian investors allocate, say, 30% of their portfolio to domestic stocks when the Australian sharemarket comprises 2% of global equity markets. Do not ignore better-value opportunities that might be found overseas.

AVOID SHORT-TERM NOISE

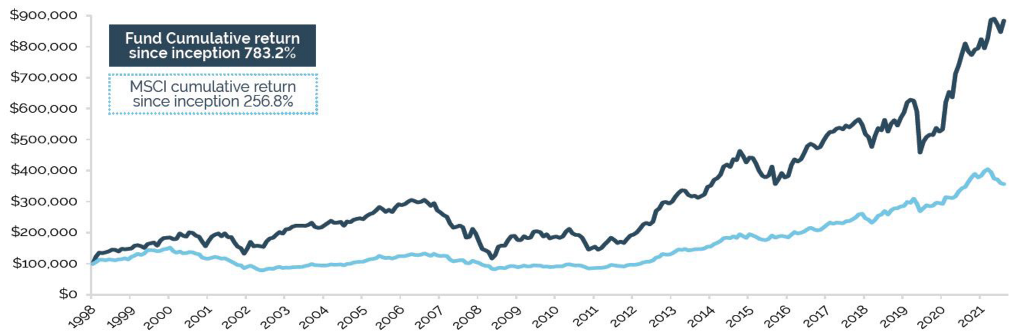
Avoid kneejerk reactions to your investment strategy based on short-term market noise. Remain focused on long-term valuations.

Performance Tables (as at 31 May 2022)

Global Companies Fund

Global Companies Fund	Inception Date	Exit Price ($.cum)	1 Month	3 Months	1 Year	3 Years pa	5 Years pa	7 Years pa	10 Years pa	Since Inception pa
Fund performance	**10-1998**	**4.8533**	**4.3%**	**-0.7%**	**9.0%**	**18.9%**	**12.7%**	**10.6%**	**18.1%**	**9.7%**
MSCI World Net Total Return Index (AUD)			-0.9%	-4.6%	2.7%	11.4%	10.5%	9.6%	14.5%	5.5%

Growth of AUD $100,000



Fund Inception 28 October 1998.

Australian Companies Fund

Australian Companies Fund	Inception Date	Exit Price ($, cum)	1 Month	3 Months	1 Year	3 Years pa	5 Years pa	7 Years pa	10 Years pa	Since Inception pa
Fund performance	**01-2000**	**3.3532**	**0.8%**	**9.1%**	**20.7%**	**21.6%**	**12.4%**	**11.5%**	**14.0%**	**11.3%**
S&P/ASX 200 Accumulation Index			-2.6%	3.2%	4.8%	7.8%	8.8%	7.5%	10.4%	8.2%

Growth of AUD $100,000

Fund Inception 20 January 2000.

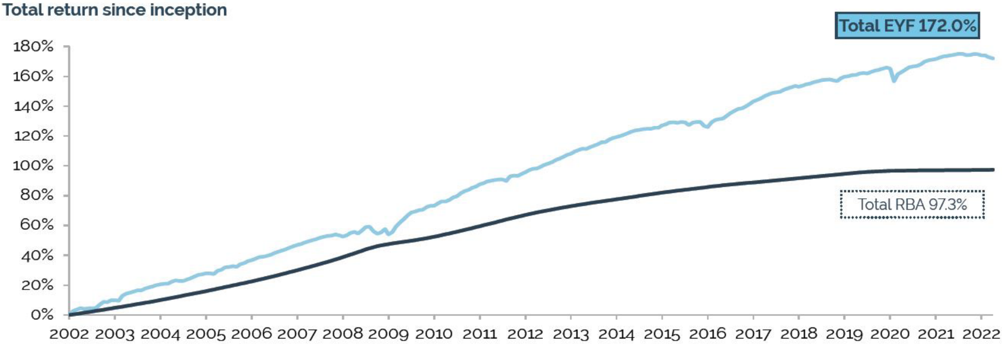
Charts reflect Fund growth net of actual fees. Calculations are based on exit price with distributions reinvested, after ongoing fees and expenses but excluding individual tax. These figures represent past performance only. No guarantees exist of future returns above or below these figures. Past performance is no indication of future performance. Neither PM Capital Limited nor any other person makes any representation as to the future performance or success of, the rate of income or capital return from, recovery of money invested in, or income tax or other taxation consequences of, any investment in the Fund.

Enhanced Yield Fund

Fund performance (net of fees)	Inception Date	Exit Price ($.cum)	1 Month	3 Months	6 Months	1 Year	3 Years pa	5 Years pa	7 Years pa	10 Years pa	Since Inception pa
Enhanced Yield Fund*	**02-2002**	**1.1093**	**-0.25%**	**-0.72%**	**-0.81%**	**-0.6%**	**1.4%**	**2.0%**	**2.5%**	**3.2%**	**5.1%**
RBA cash rate			0.03%	0.05%	0.07%	0.1%	0.3%	0.8%	1.1%	1.6%	3.4%
Excess			**-0.28%**	**-0.77%**	**-0.88%**	**-0.7%**	**1.1%**	**1.2%**	**1.4%**	**1.6%**	**1.7%**
Enhanced Yield Fund (Class B units)**	**05-2017**	**1.1361**	**-0.26%**	**-0.78%**	**-0.93%**	**-0.6%**	**1.7%**	**2.2%**			**2.2%**
RBA cash rate			0.03%	0.05%	0.07%	0.1%	0.3%	0.8%			0.8%
Excess			**-0.29%**	**-0.83%**	**-1.00%**	**-0.7%**	**1.4%**	**1.4%**			**1.4%**

* Performance fee option: Mgmt fee: 0.55%, performance fee: 25% of net excess above RBA Cash Rate (subject to a high watermark).
** Management fee options - Class B units: Mgmt fee:0.79%.

Total return since inception



Fund Inception: 1 March 2002.

Calculations are based on exit price with distributions reinvested, after ongoing fees and expenses but excluding individual tax. These figures representpast performance only. No guarantees exist of future returns above or below these figures. Past performance is no indication of future performance. Neither PM Capital Limited nor any other person makes any representation as to the future performance or success of, the rate of income or capital return from, recovery of money invested in, or income tax or other taxation consequences of, any investment in the Fund.

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Notes and References

1 To end-April 2022.
2 International Monetary Fund (2022). "World Economic Outlook". May 2022..
3 ibid.
4 At 31 May 2022.
5 At 31 May 2022.
6 Year to date performance is from 1 Jan 2022 to 6 June2022.
7 ibid.
8 ibid.
9 At 31 May 2022.
10 At 31 May 2022.
11 At May 18, 2022.
12 At 1 January 2022.
13 At June 6, 2022.
14 UBS (2022), "European Banks". Global Banking Research. 8 February 2022.
15 At 31 May 2022.
16 At 20 May 2022.
17 $1.10 a share.
18 At 7 June 2022.
19 RBA Chart Pack, May 2022.
20 PM Capital's Enhanced Yield Fund (EYF) was awarded the Money magazine Best of the Best Awards 2020: Best Income Fund – High Yield and Credit.
21 At 31 May 2022.
22 At 31 May 2022.

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