



AUGUST 2017

A MESSAGE FROM MIKE: NO "DRY JULY"

FRIDAY 4 AUGUST, 2017

No sign of a drought

While some of you may be supporting "Dry July", at Pie there is no sign of 'drought'. In fact, July has proven to be our most fruitful month each year. Over the past decade, July is the only month that our funds have never been down. This is quite a strange phenomenon and after 10 years is probably providing us with enough data to suggest there is a pattern forming.

I believe the main reason for positive July is that during the months of May and June in Australia it is tax-loss selling season. Therefore, in July the market usually bounces once the selling has finished. Strangely though, this year the ASX had its worst July in six years! So perhaps this is just a Pie phenomenon. None of this of course explains the positive performance for our international funds every July, but with only four years of data I'll put it down to luck at this stage!

Unsurprisingly, the Australasian funds led the charge this month and it's great to see Growth 2 back to its highs at \$1.37, and +7% in the last three months. As discussed previously, Growth 2 is near capacity and we expect it to soft-close in the coming weeks.

Howard Marks

Also in July, investment guru Howard Marks put out a memo entitled, There they go again...again. In summary, Marks states that we have the seeds in place for a boom, which ultimately could and, in his view will lead to a bust.

These are similar seeds to previous cycles. For example, history repeats or rhymes. He cites;

- high valuations for stocks;
- low volatility;

- popularity of the FAANG group (Facebook, Amazon, Apple, Netflix and Google);
- US\$1 trillion moving into passive ETFs;
- lowest yields in history on bonds;
- EM debt yields low;
- most funds raised in history for private equity;
- biggest fund of all time raised for leveraged tech investing and billions in digital currencies whose value has multiplied dramatically.

He's not saying that the stock market is too high or that it can't go higher, but rather that investors are not taking in to account risk because things have been so good for so long now. What worries me the most is all the passive money being poured into ETFs. Nobody is doing any analysis of the stocks – literally. In some ETFs 40% of the portfolio is invested in the FAANGs. The more they go up, the more the ETFs buy. This may end in tears.



American investment travel journal

During July, I briefly escaped this years' appalling New Zealand winter travelling through Wyoming, Montana and California. Other than the fact that it was over 30 degrees Celsius every day, there were a couple of notable things I observed that are worth sharing:

Firstly, the opinions of Trump remain polarised. Americans are either terribly embarrassed he is their president or they are quietly in favour. Depending on which state you are in determines the majority view.

Secondly, while the green-tech revolution is at the forefront in places like Los Angeles and San Francisco, with an abundance of Tesla vehicles, through the mid-west and mountain states, fossil fuels still dominate. In Montana, I drove past several coal trains that stretched for miles. And with petrol so cheap – with prices ranging from US\$30 to fill-up an average car to US\$60 to fill my rental “truck” with its 100L tank – there was no reason for electric cars! While California is leading the green way, the rest of America is in favour of the good ol' pick-up truck (dominating vehicle sales and taking out the number 1-3 spots).

Rank	Best-selling Vehicle	Five months (2017)
1	Ford F-series	351,965
2	Chevrolet Silverado	212,425
3	Ram P/U	207,370
4	Nissan Rogue	161,340

Finally, the US economy is performing very well, with areas like construction and housing strong. Retail apparel is weak, but overall small business and consumer confidence is high.

Risk aware

Here at Pie, we are very much focused on risk management and I'm mindful that the equity market has delivered good returns for many years now. This won't continue ad infinitum. However, as I like to remind investors, equity markets don't die of old age, but eventually they do die.

Each week, as part of my CIO report to the team, I monitor several factors that have in the past been warning signs for investors, such as the yield curve (interest rates), jobs data, car sales, investor optimism, trailing returns, market multiples and even our own investment team sentiment. I don't have a crystal ball but I am focused on what's going on around us always.

As part of our risk management strategy, we've recently converted some of our cash in each of the funds to USD.

New product brewing

Finally, because we know that markets don't always go up, behind the scenes Pie is looking at a new fund that will be designed to take advantage of rising and falling markets, which I can hopefully discuss with you later in the year.

As always, thank you for your support. If you have any questions please don't hesitate to call me on (09) 486 1701, or email me, mike@piefunds.co.nz.

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AUGUST 2017

INTERNATIONAL REVIEW: A BUSY MONTH

FRIDAY 4 AUGUST, 2017



Written by Daniel Sims, Investment Analyst

Keywords Studios

One of the more pleasing announcements was yet another upgrade from Keywords Studios. Keywords has been a core holding in the Growth UK and Europe Fund since inception and it is now trading well in excess of twice what we originally paid, after closing the month up 44%. Keywords exemplifies what we look for here at Pie – an under the radar company going through the “discovery phase”, where the market begins to take notice as the stock passes through certain market valuation thresholds.

"Having more than doubled our earnings over the last 12 months, we have decided to take profits."

The top performers for the month were Keywords Studios, STM Group and Quixant. Having more than doubled our earnings in KWS over the last 12 months, we have decided to take profits. The bottom performers were ThinkSmart, ESI Group and IMI Mobile.

European research: STM Group

In mid July, Chris and I spent two weeks in London and Western Europe, where we had the chance to meet with the senior management of over 45 companies. These research trips form an integral part of our investment process as they help us understand the business models and competitive dynamics of potential investments.

One highlight was our meeting with the team at STM Group, a recent addition to the portfolio. We had high expectations leading into this meeting but were blown away by the organic and acquisitive growth options available to the firm. This meeting solidified our original investment thesis and gave us the conviction to increase our stake to 5% of the fund.

"We were blown away by the organic and acquisitive growth options available to the firm."

A key takeaway was that businesses tend to be doing quite well, against what has been a tough macro and geo-political back-drop. Unfortunately for us, in many cases, this optimism has already been reflected in the market price for companies, and we are struggling to find many attractive opportunities from a risk-reward perspective. However, this does not mean that the trip was a poor use of time. By meeting with companies and performing the preliminary due-diligence, we continue to build an extensive watch list of companies that we would be happy to own, should "Mr Market" offer us an attractive price. We continue to remain cautiously invested at present.

This article is for information purposes only. It is not intended to be financial advice and has been prepared without taking into account any particular persons financial situation or investment objectives. Past performance is not a guarantee of future returns. Material or views expressed on specific companies are not recommendations to buy, sell or hold financial products.



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AUSTRALASIAN REVIEW: REPORTING SEASON

FRIDAY 4 AUGUST, 2017



Written by Chris Bainbridge, Senior Investment Analyst and Portfolio Manager

July was strong with all our Australasian Funds up for the month: Growth 2 3.0%, Growth 2.2%, Emerging 1.3% and Dividend 2.2%.

Some positive contributors were Rhipe Limited (ASX:RHP) after it confirmed that it would meet full year guidance of \$4 million EBITDA, and Adairs Limited (ASX:ADH) after it announced that it would come in at the top end of previously announced guidance range. A negative contributor was Yowie Group Limited (ASX:YOW) after it announced that revenue would be below previous guidance, sales slowed in the US and its cash burn increased.

This month is reporting season in Australia, so the investment team is flat out reviewing, report writing and speaking with the circa 50 Australasian investments we own, as well as analyzing at least another 50 we are interested in. Therefore, the summary is fairly brief this month and we will provide a wrap-up of events in September, and a profile on one of our new investments.

This is not financial advice or a stock recommendation. It is a summary of our investment thesis which may change from time to time.



AUGUST 2017

INVESTOR DAYS: WELLINGTON AND CHRISTCHURCH

FRIDAY 4 AUGUST, 2017



On 26 July and 2 August, Pie Funds held its Wellington and Christchurch Investor Days. Te Papa was the venue in Wellington and Chateau on the Park was the venue in Christchurch. Thanks for turning on such brilliant weather Wellington!

Mike focused his presentation on evolving trends in world markets, including the impact that the FAANG stocks (Facebook, Amazon, Apple, Netflix and Google) have had on the US sharemarket. Chris Bainbridge covered our Australasian Funds, and Chris Wright, fresh off the plane from meeting 46 companies in the UK and Europe, covered our International Funds.

Thank you to all of our supporters and attendees. If you missed either of the events, feel free to call our Client Service team for an update.



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ARE WE AT RISK OF A NEW CREDIT BUBBLE?

FRIDAY 4 AUGUST, 2017

Article by Liam Dann, originally published in the NZ Herald

Commentators are now talking about the third credit bubble since the 1990s, driven by the ongoing era of low interest rates, says Pie Funds chief executive Mike Taylor.

After the GFC and the last credit crunch the debt overhang was never properly dealt with, it was passed to central banks, he said.

"What that has meant is that asset prices like property, shares and bonds have all gone up," he said. "Now capital is not being allocated taking into account the appropriate risks."

With stock market around the world still pushing through record highs it was important to pay close attention to the interest rate yield curves, he said.

Absent of a major external shock, equity markets had their worst periods during recessions.

Yield curves had tended to be a very reliable indicator of recessions, Taylor said.

With a normal yield curve short term interest rates are typically lower than long term rates.

As inflation returns and a boom takes hold the yield curve starts to move in the other direction, so short term rates rise to match or surpass long term rates.

"The yield curve starts to invert, that's the worrying sign, if you see that then we're almost certainly headed for a recession," Taylor said. "Every recession since World War II has been preceded by an inverted yield curve."

In the US there were now signs that the Federal Reserve was slowing its projected track of rate rises, again.

The failure of Donald Trump to push through any economic stimulus has the market picking one more hike this year instead of three.

"So if that's what the Fed's doing perhaps this cycle can last a little bit longer before the yield curve starts to [invert], he said.

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SCHEME ANNUAL REPORT AVAILABLE NOW

FRIDAY 4 AUGUST, 2017



As part of our ongoing disclosure obligations under the Financial Markets Conduct Act, we have recently prepared the Pie Funds Management Limited scheme annual report. This document outlines important information about our funds for the year to 31 March 2017.

The annual report is available on the Pie Funds Management Limited scheme register:
www.companiesoffice.govt.nz/disclose

If you have any questions or would like to request a copy free of charge, please contact the Client Services team on (09) 486 1701 or **clients@piefunds.co.nz**



