



**NOVEMBER 2017**

**A MESSAGE FROM MIKE: STRATEGY ON THE MIND**

**TUESDAY 7 NOVEMBER, 2017**



**Many milestones**

It's almost 10 years to the day since I launched the first Growth Fund and next month we are going to celebrate the history of Pie in the December newsletter. That first fund launched with just \$3 million and has returned 348% as at 31 October. So that brings me to today, and here we are raising \$100 million for my new strategy. Pie has certainly come a long way!

## **My new fund**

The Multi-Strategy Fund is going to be an exciting product to manage. It has the flexibility to invest in our best investment ideas, regardless of asset class or region. However, don't expect this fund to be fully invested at all times. Some years, I may only come across a handful of really compelling ideas. The objective is to have a very high threshold for investment and if that hurdle cannot be met, then despite the temptation to "do something", the best thing is to do nothing. I only want to put your money to work when I believe the odds of making money are stacked in our favour.

### **I only want to put your money to work when I believe the odds are stacked in our favour.**

Over the past six months, as you would expect, I have been running a test portfolio, which you will be pleased to know performed well. But the real proof is in the pudding and there is a high hurdle to meet, if we are to match the standards set by previous launches of Pie products!

I would also like to note, the Multi-Strategy Fund is designed to complement an existing investment portfolio (not replace it).

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## **Leadership strategy: New faces to the Board**



**NOAH HICKEY**

**Director**

Noah has extensive experience in the managed funds sector. He spent over four years on the executive team at Fisher Funds and being a leader in the industry for over seven years. Noah has a passion for technology and recently spent three years at Pushpay as the General Manager of Enterprise in New Zealand and Australia. This has seen Noah continue that passion in his role as an Executive Director of New Zealand startup Whip Around. He is also a member of the Wellington Phoenix Football Club Board and you may recognise him from his ten years representing New Zealand in the All Whites.



## JACQUELINE TAYLOR

### Advisor to the Board (JUNO)

Jacqueline has been involved with Pie Funds in various different roles since inception in 2007. Currently she is the Co-founder, Editor-in-Chief and Publisher of JUNO magazine. She holds a Bachelor of Science, Graduate Diploma in Teaching and a Diploma in Freelance Journalism, and has worked as a teacher, journalist, writer and TV Presenter over her career. Jacqueline holds shares in Pie.

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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](mailto:mike@piefunds.co.nz).

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NOVEMBER 2017

## MIKE'S NEW FUND: LET'S TALK STRATEGY

TUESDAY 7 NOVEMBER, 2017



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*Written by Mike Taylor, Founder, CEO and CIO  
Portfolio Manager of the Multi-Strategy Fund*

### OVERVIEW

## The bull market in everything

Earlier this month, the economist cover page was entitled, The Bull Market in Everything. Later in the piece the economist went on to describe this bull market as being “the bubble without any fizz”. The first point is that they are right (but not everyone has profited from this), and the second point is that often this type of media serves as a

good contrarian indicator!

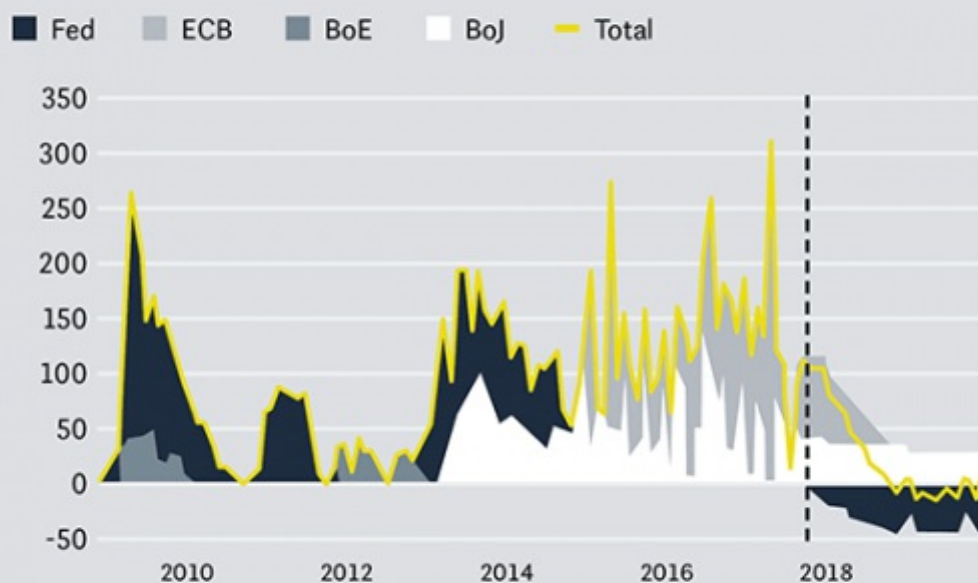
Low interest rates and nearly a decade of Quantitative Easing (QE) have forced even the most risk averse investors up the risk curve in the hunt for yield or return, causing virtually every asset class to rise. But things are starting to change. For a start, QE is being tapered off (Figure 1) and valuations have risen across the board.

### **Currently the world is in its first coordinated upswing since the GFC.**

Regarding equities, in particular in the US stock market, much has been made of the CAPE Shiller index, which has only been higher on two occasions, 1929 and 2000, and we all know how that ended (Figure 2). Without wanting to sound too clichéd, how is this time different? There are some things worth noting. To start, the rise hasn't been as rapid as 1929 and the length of expansion hasn't been as long as the 2000 top. Don't get me wrong, I certainly see worrying signs starting to appear – it's hard to find value, the market is complacent, volatility is low, but the market is going up because earnings are going up. As you can see from Figure 3 and 4, the price change in 2017 is not about an increase in the Price per Earnings ratio (PE ratio), it's about an increase in the earnings.

**Figure 1: Asset purchases under QE programmes**

\$ billion (converted at prevailing exchange rates)

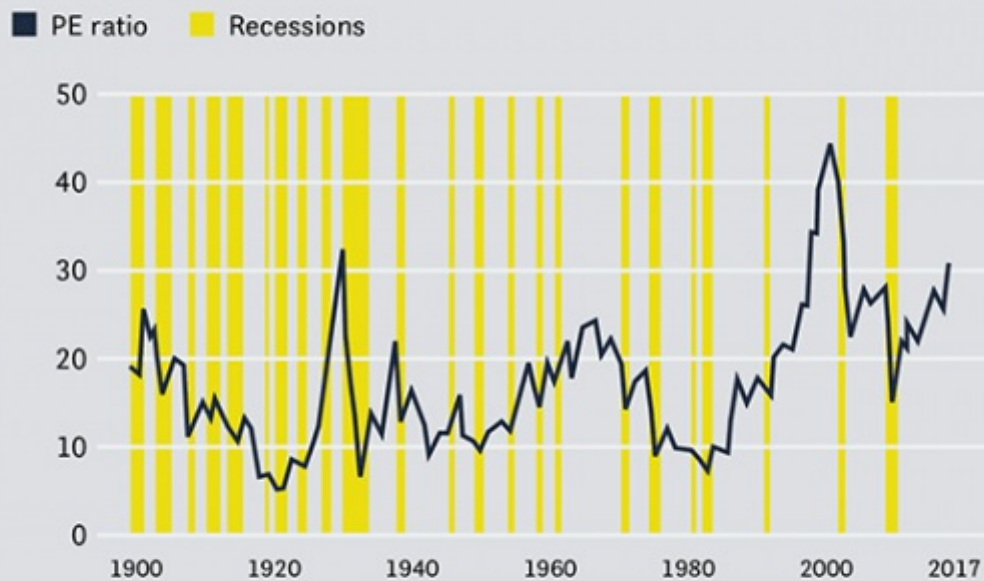


Source: Thomson Reuters, Capital Economics



## Figure 2: CAPE crusader

US\$ cyclically adjusted price earnings ratio



Source: Yale University, Bloomberg and NBER

At this juncture, I'm reminded of Sir John Templeton's famous quote:

**“Bull markets are born on pessimism, grow on scepticism, mature on optimism and die on euphoria”.**

I believe we are currently in the late stage of optimism and will soon enter the exciting and irrational euphoria phase, where everyone forgets about recessions and believes we have entered a new paradigm.

# Financial Phases

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2009 - 2012

Pessimism Phase

2013 - 2015

Scepticism Phase

2016 - 2018?

Optimism Phase

2018 - 2019?

Euphoria Phase

Of course, bull markets can come to an abrupt end at any time due to a black swan event like North Korea or the 1970's oil crisis. However, currently the world is in its first coordinated upswing since the GFC. All major economies are growing, and this is being reflected in company earnings.

However, and this is the big caveat, like Auckland property, the drivers of the bull market are changing. The sands are shifting. QE is coming to an end, interest rates are starting to rise, inflation is coming off the lows and the labour market is tightening. Unfortunately, Central Banks cannot stop the economic cycle. Inevitably this cycle – like all that have gone before - will end.

There are a number of other indicators I'm watching, which are all very positive. I'm worried because of experience and the duration of the bull market (implication being that we are closer to the end than the beginning), but I'm not concerned by any of the data yet – apart from the fact that valuations are higher today than five years ago.

To sum up, the drum is beating, the music is on, the crowd is getting up to dance, but nobody is yet on the tables and the police are a way off. Still I'm cautious, the odds are changing but I see nothing yet to move the Multi-Strategy Fund into net short nor shift Pie's other funds to full cash. My base case is that I believe the equity bull market still has another year to go – and a recession won't occur until 2019 at the earliest. As you would expect, I'm reviewing this constantly and if the facts change, I change my mind.

**I believe the equity bull market still has another year to go – and a recession won't occur until 2019 at the earliest.**



### Figure 3: Contributions to changes in MSCI local currency equity indices

2017 YTD (pp)



Source: Capital Economics

### Figure 4: Contributions to changes in MSCI local currency world index

2009 - 2017 YTD (pp)



Source: Capital Economics

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## INVESTMENT IDEAS

### Equities

#### Long

Don't fight the tape. The number of companies providing positive guidance in the US has climbed to a six-year high. Those providing positive guidance exceeded those providing negative guidance for a second quarter in a row, with the gap also at a six-year high. We are in a bull market, so therefore I'd suggest thinking longs, not shorts for the main part.

As you would expect with around 70 direct holdings across our existing portfolios we have a few strong ideas. Currently amongst our portfolio EML Payments is my most preferred position for the following reasons:

#### 1. **High checklist score**

EML Payments ticks a lot of boxes: strong management and chart, recent earnings upgrades, Founder and CEO alignment, Pie forecast forward EPS growth > 50%;

#### 2. **Market cap and liquidity**

The company has just broken through AU\$500 million. Our research shows that, in the past, when ASX companies break AU\$500 million for the first time, they go through a 44% jump in valuation on average. This typically means the PE multiple rises by 44%. Why? Because as liquidity rises, more brokers seem to initiate research and the number of fund managers looking at this market cap range increases; and

#### 3. **Conviction**

I have followed EML for 4-5 years and know the business well, so my conviction level is high.

Globally, I really like Amazon. I think many people don't realise that Amazon is the 21st century equivalent of an infrastructure asset; shopping, web services, grocery etc. Amazon recently released its quarter three results which beat expectations. As a result, the stock rallied 13% in a day, which when you consider its market cap is huge – adding US\$60 billion+ in valuation just like that.

There are at least another ten companies both inside our portfolios and outside that I'm looking at for potential inclusion.

We are also using quantitative analysis to screen 6,000 stocks globally for those with the best and worst valuations (relative to their traded history), and the best and worst momentum. We have engaged the assistance of a French firm to provide financial modelling for this screening.

**Figure 5: MSCI global equity index (20 years)**



Source: IRESS

## Short

There will come a time when the equity portion of the portfolio is made up predominantly of shorts, but right now I feel that's dangerous. The bull is rampaging, the global economy is booming again and you can get burned being short, even if ultimately you are right. The market can remain irrational longer than you can remain solvent. Therefore, outside specific opportunities that present, a large short book is too dangerous to manage until the market rolls over. Business disruption is a good hunting ground and the likes of SKY TV, Trade Me and Z Energy are on that list.

Interestingly, having originally looked at Netflix for a long, I came away thinking that it's possibly a short, but I may be a bit early still, as subscriber growth is still strong. It's worth noting that Disney is pulling its content to start its own version, Amazon is producing content itself and Netflix expects to spend US\$8 billion next year on content! Wow!

## Interest rates

I think they are on the rise. That's probably all I need to say, but worth exploring why because I did think rates were bottoming a few years back, but they went lower. As discussed above, the reason I believe rates have bottomed and are heading higher are central banks rolling back QE, wage inflation and strong global growth.

The interesting thing is that this is still not a consensus trade. The market has been slow to price rate hikes.

**The reason I believe rates have bottomed and are heading higher are central banks rolling back QE, wage inflation and strong global growth.**

The investments I have in mind are shorting German Bunds futures, which currently still have a negative yield (you profit as interest rates rise) and shorting high yield (junk debt).

The spread on high-yield, which is the difference between US treasuries and high yield rates, is at an all-time low (Figure 6). During times of stress in credit markets or in recessions, spreads widen and investors demand a higher return for junk debt.

In addition, when the equity markets look like rolling over, I'd say a move into US treasuries would also be appropriate (Figure 7). I would potentially look to initiate this trade if the yield curve inverts. Yield inversion is when short-term interest rates are higher than long-term rates.

**Figure 6: US high yield option-adjusted spread**



Source: BofA Merrill Lynch

**Figure 7: 10 year treasury yield curve**

Minus six month T-Bill bond-equivalent yield



## Property

The horse has well and truly bolted with NZ property but probably has further momentum in other countries around the world, in particular the US or Germany. But there are no screaming buys here and I'm not inclined to buy a property REIT. Potentially there are some short opportunities here with the decline in mall traffic (due to online) and rising interest rates.

## Commodities

Lithium is the latest thing that has taken off. Some say that Lithium could be the next Iron Ore. There are a few listed Lithium players locally. All have run very strongly in the past three months so it's a wait and see approach at present.

Oil is the other surprising one. Perhaps everyone has got ahead of themselves with the EV revolution. The market supply is now quite tight. Oil was a favourite hedge fund short six months ago, but I see some potential for this to get squeezed in the new year. In addition, Oil stocks haven't recovered in line with the oil price (still too many bears), so I will continue to explore this idea.

## Volatility

This should probably read 'lack of volatility'. The markets are complacent, and volatility has died away. A common trade of hedge funds in recent years has been to short volatility. This is dangerous in my view because it's one of those trades that works until it doesn't, and the day it doesn't you just blew your P&L. On the other hand if like me, you believe volatility will increase dramatically at some point there are various ways to trade this theme.

## Hedging

Whilst the number of shorts available is limited (given world growth), it's prudent to be carrying regular portfolio hedging to provide insurance against a market correction or black swan event. As such, during a bull market the fund will be looking to buy put options on various markets, namely the S&P 500. Note, in my opinion, there is no point buying insurance in a bear market. It's like buying hurricane insurance during a hurricane. It's expensive and you might not get the cover you need.

Expect this fund to spend at least 1.5% of net assets on "insurance premiums" during most years.

# Infrastructure

Infrastructure spend is likely to remain a key theme for western governments over the coming five years. Post GFC, there has been under investment, and this is now ramping up again as stronger GDP is giving the flexibility for budgets to enact this. In addition, it's also key policy for the populist movement we are experiencing. Build that wall, right?

# Currency

The Kiwi has fallen quite a bit since the election result. As recently as two months ago I was quite bearish on the Kiwi dollar, but markets react swiftly, and I'd want more compelling reasons for a further fall. Despite this, I think the trend is now probably down, as NZ is likely past its peak and the rest of the world is improving.

Betting or predicting currency moves is a bit of a mug's game. There are only three factors I consider:

1. Mean reversion – how far away from the long-term average is the NZD? Are the odds stacked?
2. NZD is always vulnerable during a global recession or shock; and
3. The consensus view is usually wrong.

# Cryptocurrencies

I think it's a bubble– the herd is all over it. This reminds me of the world of tech stocks in 1999. You could float the Titanic if it had '.com' in the name. Like the tech wreck, there is some method to the madness. Blockchain is a useful technology. Ultimately, some of the currencies will survive and may be in widespread use in 10 years. However, they need to go through their Armageddon moment first. There is so much out-and-out fraud occurring presently, it's all going to come crashing down one day. I'd say most likely regulation will be the catalyst. Do you really think governments are going to allow this to continue un-regulated?

# Clean energy

As you may know I'm a big fan of clean energy, we already have exposure through the Global Fund to one of the best operators in the US. Next Era Energy Partners (NEP) owns and operates a number of wind and solar project across America. NEP has rallied a lot recently, so I'm cautious to buy it here, however we believe the long-term prospects are sound. I have looked at clean energy ETF's but would prefer direct exposure where possible.

# Unlisted, private equity and alternatives

Over the life of the fund, ideas will be presented and assessed by myself and the team based on their merits.

# Emerging markets

I have an Indian small cap ETF on my radar. I like what Modi is doing and so do financial markets. If one is looking for a high-octane exposure to emerging markets then you need go no further than Indian small caps!

In addition, at Pie we are strong believers in mean reversion. That means if we see a market has had low returns for a period of years we believe the probability of strong returns increases. Brazilian equities collapsed during their recent recession however, in the last year or so, the BOVESPA has been one of the best performing markets globally.



We will be using our French software to scan for the cheapest markets, industries and regions to find opportunities.

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Past performance is not an indicator for future performance. This is not intended to be financial advice and does not take into account any particular person's circumstances. Before relying on this information, please speak to an independent financial adviser.



NOVEMBER 2017

## NEW FUND VIDEO: MULTI-STRATEGY FUND

TUESDAY 7 NOVEMBER, 2017

# Multi-Strategy Fund Now Open

Hear what CEO and Portfolio Manager Mike has to say about the new fund.

For more information, email [multi-strategy@piefunds.co.nz](mailto:multi-strategy@piefunds.co.nz).

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NOVEMBER 2017

## INTERNATIONAL REVIEW: HAPPY BIRTHDAY GROWTH UK & EUROPE

TUESDAY 7 NOVEMBER, 2017



*Written by Daniel Sims, Investment Analyst and Co-Portfolio Manager*

**"Day 2 is stasis. Followed by irrelevance. Followed by excruciating, painful decline. Followed by death. And that is why it is always Day 1."**

*Jeff Bezos Amazon.com 2016 Annual Report*

### Happy Birthday

This month marks the one-year anniversary of the Growth UK & Europe Fund's inception, and we couldn't be happier with how our first year played out. For the year ended 31 October, we managed to achieve a return of 21.5% while holding an average cash balance equivalent to ~50% of the fund. The allocation to cash continues to remain high as we recycle our capital from recently realised investments into new positions. Despite a very acceptable performance to date, we are not resting on our laurels and in the words of Jeff Bezos, would like to remind our investors that it is still day 1. We remain as hungry as ever to continue seeking out the undiscovered gems that will help lead to long run wealth creation in the stock market.

# Top Performers

01

122% Keywords Studios

02

54% dotDigital

03

50% SafeCharge

*Note: return is based on average sale price (for exited positions) or last traded price as at 31/10/17 (for current positions)*

## SafeCharge: The life of the party

We thought a brief discussion of our investment rationale for SafeCharge would be of interest as it highlights many of the key indicators we look for in a potential investment. SafeCharge provides payment services to predominantly online businesses with a key focus on being extremely reliable for high transaction volume clients. The business had several tailwinds such as the growth in e-commerce at its back and this allowed the company to triple sales from 2012 to 2015.

Despite achieving this level of growth while increasing the profitability of the firm, the stock had fallen from an all-time high of 295p to around 200p. Given the business had been growing profits over this time, the fall in the share price was driven by a decline in the multiple on which the market was valuing the business. At the time of our purchase, we estimated the stock was trading on a dividend yield of ~8%. Dividends are rare in the high growth world of payment software and to find one with a yield this high seemed too good to be true. However, through further investigation of publicly available information, we discovered that one of the company's largest shareholders had been continuously selling since the all-time high was reached.

Therefore, we came to the conclusion that the stock was trading so cheaply because of non-fundamental, liquidity related reasons. We were able to use the liquidity to our advantage and secure a position, and the stock quickly re-rated higher once the selling pressure abated. This type of situation, where the stock price and business fundamentals are not lining up, continue to be a key hunting ground for us, as they allow us to take advantage of

market irrationality.

**This type of situation, where the stock price and business fundamentals are not lining up, continue to be a key hunting ground for us.**



## **It won't always be celebration time**

As always, we'd like to remind investors that while we would love to achieve 20%+ returns every year, that it is an unrealistic expectation. 2017 was a very good year for stocks but we don't know what the future holds. We continue to focus on partnering with capable, shareholder aligned management teams, operating competitively advantaged businesses with bright future prospects. Over time, we hope this will lead to strong investment results.

**2017 was a very good year for stocks but we don't know what the future holds.**

## **Thank you**

From the whole Pie Funds team, especially Chris, Mike and myself, we thank you for entrusting us with your hard-earned savings and look forward to continuing to grow our capital together, over the long run. Finally, due to Multi-Strategy commitments Mike has stepped down as Portfolio Manager of this fund and I have stepped up as Co-Portfolio Manager with Chris.

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*Written by Victoria Harris, Senior Investment Analyst and Co-Portfolio Manager*

## **Global Fund in full flight**

The Global Fund delivered a strong 4.4% return for October, it's strongest monthly return since inception. This

impressive return was generated by a combination of currency tailwinds and positive performance from our direct holdings. The weak NZD had a positive impact on the Fund's performance as, despite the large cash holding in the Fund, the majority of this was (and still is) held offshore.

## Monthly highs and lows

Within the direct holdings, Blue Sky Alternative Investments, dotDigital and Chegg were the strongest positive contributors. The main detractors from the Fund's performance for the month were Tecnoinvestimenti and Aurelia Metals. These are both small positions (<1.5%) so their impact to the Fund's overall performance was minimal.

## Highest monthly return for the Global Fund since inception

### BlueSky soars

BlueSky is a global alternative asset manager based in Brisbane, Australia. It has over AU\$3 billion in funds under management across four divisions: Private Equity, Real Assets, Real Estate and Hedge Funds.

### BlueSky has returned approximately 50% since initiating our position in August.

This is a company Pie Funds has had a relationship with for a long time and the Fund has actually owned it in the past. We initiated a position in the Fund a few months ago due to the significant tailwinds of the Australian funds management industry (especially in alternative investments), the superior management team that has consistently delivered strong earnings results and the attractiveness of the scalability and defensiveness of the business model. BlueSky has returned approximately 50% since initiating our position in August.

Blue Sky are holding their Annual General Meeting and Investor Day in November so we hope to see an announcement of continued positive company performance.

Past performance is not an indicator for future performance. This is not intended to be financial advice and does not take into account any particular person's circumstances. Before relying on this information, please speak to an independent financial adviser.





NOVEMBER 2017

## SIMPLIFIED REPORTING: GRAPHS AND FACT SHEET

TUESDAY 7 NOVEMBER, 2017



### Interactive graphs

We're excited to announce that you can now view our fund return graphs online. They are interactive and simple to use, and make interpreting fund performance data a whole lot easier.

Set the desired date range for the fund you're interested in, and hover over the data line to see end of month figures. Easily flick between funds and focus on the statistics that are important to you.

[Click here to view.](#)

### Fact sheet

Feedback from our investors is that they wanted clearer and more concise monthly reporting.

Therefore, we have condensed these fact sheets down to two simple to follow pages with the following categories; details, performance, market indices, regions, and top five holdings.

Along with our online interactive graphs, we hope that you find our new simplified reporting to be much more user friendly and easier to navigate.

[Click here to read the latest fact sheet.](#)



**NOVEMBER 2017**

## **AUSTRALASIAN REVIEW: OCTOBER PERFORMANCE**

**TUESDAY 7 NOVEMBER, 2017**



*Written by Mike Ross, Investment Analyst*

### **October performance**

The Australasian funds all generated positive returns in October: Emerging up 3.0%, Growth 2 up 2.7%, Dividend up 2.4% and Growth up 1.4%.

Key contributors for the Australasian funds during the period included Scott Technology, EML Payments, 3P Learning, Bravura, Johns Lyng Group and Alliance Aviation Services. Key detractors included Yowie, Pacific Current Group and Empired.

The funds continue to hold significant cash weightings ranging from 21% to 38% at month-end. While relatively high levels of cash provide the portfolios with downside protection, we remain willing to deploy cash into attractive investment opportunities as and when we find them.

### **Strong FY17 for Scott**

Scott Technology, which is held in the Growth Fund, reported a strong FY17 result during October, finishing the month 16% higher. The company commenced the new year with a strong order book and a solid balance sheet

with \$27 million cash and no debt.

## Exposure to mining services

Small cap resources continued their strong performance during October and are now up around 20% since June 2017. While the Australasian funds tend not to invest in the resources sector directly, we have benefitted from this resurgence through exposure to a number of mining services businesses listed on the ASX.

## Busy month ahead

November is shaping up as a busy month for the investment team. We are off to Sydney next week to meet with a range of companies, both existing investments and new prospects. We are also in the midst of AGM season and expect a number of our key holdings to update the market on how they are tracking year to date.

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**NOVEMBER 2017**

**TEN YEAR ANNIVERSARY AND CHRISTMAS CELEBRATION**

**TUESDAY 7 NOVEMBER, 2017**



**Join us for some Christmas sparkle and cheer as we celebrate this special time of the year. The celebration coincides with the 10 year anniversary of the launch of our first Growth Fund.**

Thursday 7 December, 6:00 - 8:00pm

Pie Funds Office, Level One, 1 Byron Avenue, Takapuna

Please RSVP to [tanja@piefunds.co.nz](mailto:tanja@piefunds.co.nz) before 1 December.

**We hope to see you there! Limited spots available.**

