Antipodes

Global Long

Global Long-Short

Asia Long-Short

Quarterly Report 31 March 2021

Contents

Further information

+44 7525 395 116

invest@antipodespartners.com

Australia Head Office
Antipodes Partners Limited
Level 35, 60 Margaret St
Sydney NSW 2000
Australia

UK Office
Antipodes Partners (UK) Limited
6th Floor, Nova North
11 Bressenden Place
London SW1E 5BY UK

Market commentary

Global equities were strong in the first quarter of 2021 (+4.6% in USD) on a robust improvement in economic data and as the rapid rollout of COVID-19 vaccination programs boosted optimism on a sustainable reopening of the global economy, whilst the supportive monetary backdrop alongside further US fiscal efforts supported sentiment.

Against this backdrop, investors exhibited a bias towards cyclical stocks as economically sensitive sectors such as Energy, Financials, Industrials and Materials outperformed. Defensive sectors which benefitted the most from the COVID-19 outbreak such as Consumer Staples, Healthcare and Utilities underperformed. There was a stylistic preference for low multiple - or value - stocks over growth and momentum, whilst small-cap stocks, which tend to be more domestically focused, performed particularly well.

US equities (+5.4%) outperformed as a Democratic victory in the Georgia senate race paved the way for President Biden to embark on massive US fiscal efforts. The successful passage of the $1.9t "Rescue Plan" included a $1,400 payment to individuals and has led to expectations of a significant acceleration in consumption once restrictions are lifted. Biden also proposed a $2.25t infrastructure stimulus program focused on roads, bridges and expanding broadband access, funded by increasing the corporate tax rate. US Treasury yields rose aggressively alongside a steepening of the yield curve on improving growth expectations (US 10Y yield rose to 1.74% from 0.91%), weighing on large-cap technology and high-growth stocks. There were, however, some signs of market fragility during the quarter. In January, an aggressive and coordinated online retail trading community targeted heavily shorted stocks in the US. This was followed by the involuntary liquidation of an Asia-based fund which triggered a series of large trades in an eclectic mix of stocks in March.

Asia (+2.3%) broadly underperformed due to weakness in Chinese equities (-1.5%) on fears of policy tightening from the People's Bank of China (PBOC) due to a surge in loan growth and rising house prices. Regulatory worries resurfaced as the SEC (US regulator) began to implement measures to delist foreign companies that do not comply with US auditing standards for three years in a row, citing concerns that Chinese domestic technology companies have built market power that stifles competition. Separately, reports China is considering setting up a State Owned Enterprise (SOE) to oversee customer data marked a significant escalation in regulators' attempts to tighten their grip over the country's internet sector.

Europe (+4.1%) was a small laggard as the vaccine roll-out has been delayed due to supply constraints (ex-UK) whilst a tick-up in COVID-19 cases led to fresh lockdowns, including in Germany and France. Meanwhile, Germany's constitutional court has blocked the ratification of the €750bn EU Recovery Fund, delaying much needed fiscal support for the region and risking further delays to the recovery and damaging market sentiment. However, the region benefitted from a relatively greater exposure to economically sensitive parts of the market helped by the strong rebound in global demand for goods, and the financial sector saw a boost from steeper yield curves.

Elsewhere, the USD strengthened (DXY +3.7%) for the first time since the first quarter of 2020. Brent Crude (+21.1%) saw a second quarter of strong gains on further demand optimism. Gold (-10.8%) suffered on a combination of a stronger USD and higher yields.

Figure 1: Region-sector valuation heat-map[1] - Composite multiple vs world – Z-score (Mar 1996 – Mar 2021)

	All	Energy	Materials and Industrials	Hardware	Software and Internet	Pharma	Devices/ Life Sciences	Staples	Domestic cyclical	Comm-unications	Property and Infra-structure	Financials
World	0.0	-1.4	0.4	0.3	1.8	-0.8	2.2	0.6	0.0	-1.9	-1.2	-2.0
North America	1.8	-0.4	2.4	0.4	1.6	-0.8	1.5	0.5	1.2	-1.3	0.3	-1.5
Western Europe	-0.5	-1.0	0.8	0.4	-0.4	-0.9	1.9	0.2	-0.2	-1.2	-0.7	-1.7
Japan/ Korea/ Taiwan	-1.0	-0.8	-1.4	0.2	0.2	0.4	2.6	-1.0	-0.8	-1.0	-1.7	-1.2
Emerging Markets	-0.6	-0.2	0.1	1.1	0.8	-0.4	1.2	1.2	-0.9	-1.5	-1.4	-1.5

Expensive — Cheap

Source: Antipodes, FactSet

1 The Antipodes region-sector valuation heat-map provides a more granular illustration of valuation clustering across sectors and regions. Cell colouring indicates the degree to which a sector's composite multiple relative to the world is above or below its 25-year relative trend (expressed as a Z-Score, the number of standard deviations from the mean). The warmer the colour, the greater the relative composite multiple versus history; vice versa for the cooler blues, with extremes highlighted by the boldest of colours. Composite of forward PE, EV/Sales, EV/Operating Capital Employed (including goodwill) and cyclically adjusted PE and EV/EBIT for industrials, with EV based measures replaced with PB and cyclically adjusted P/Pre-provision profits for financials.

Performance analysis

Summary

Performance[2] as at 31 March 2021

	3 months	1 year	3 years p.a.	5 years p.a.	Inception[3] p.a.	Inception[3]
Global Long	7.0%	60.9%	8.7%	13.6%	11.4%	85.6%
MSCI AC World Net Index	4.6%	54.6%	12.1%	13.2%	10.5%	77.3%
Difference	2.5%	6.3%	(3.4%)	0.4%	0.9%	8.3%
Global Long-Short	6.1%	46.6%	6.2%	10.7%	9.7%	70.3%
MSCI AC World Net Index	4.6%	54.6%	12.1%	13.2%	10.5%	77.3%
Difference	1.5%	(8.0%)	(5.8%)	(2.5%)	(0.8%)	(7.0%)
Asia Long-Short	3.1%	60.5%	10.1%	13.9%	10.6%	78.8%
MSCI AC Asia x Japan Net Index	2.7%	57.3%	8.9%	13.8%	9.4%	67.2%
Difference	0.4%	3.2%	1.2%	0.2%	1.3%	11.6%

Performance & risk summary[4] as at 31 March 2021

	Global Long	Global Long-Short	Asia Long-Short
Average Net Exposure	88.3%	64.0%	73.5%
Upside Capture Ratio	103	81	87
Downside Capture Ratio	90	65	68
Portfolio Standard Deviation	15.6%	12.4%	14.6%
Benchmark Standard Deviation	14.9%	14.9%	17.1%
Sharpe Ratio	0.74	0.78	0.75

2 All returns are net of fees and in USD terms since inception. Calculations are converted to $US and are based on the exit price of the $A managed account with distributions reinvested, after ongoing fees and expenses but excluding taxation. Past performance is not a reliable indicator of future performance.

3 Inception date is 1 July 2015.

4 All metrics are based on gross of fee returns in USD terms since inception. The upside/downside capture ratio is the percentage of benchmark performance captured by the fund during months that the benchmark is up/down. Standard deviation is a measure of risk with a smaller figure indicating lower return volatility. The Sharpe ratio measures returns on a risk adjusted basis with a figure > 1 indicating a higher return than the benchmark for the respective levels of return volatility.

Global strategies

Note: The term "cluster" or "exposure" is used herein to reference a collection of positions which exhibit similarities in their risk profile.

Key contributors to performance over the quarter included:

- **Industrials** cluster, including Siemens and General Electric, which performed well as the market began to view cyclical businesses through a more favourable lens following confidence around vaccine-led reopening and positive implications for economic activity. Volkswagen was a notable contributor due to better than expected sales and cash flow guidance for this financial year despite the ongoing investment in electrification and digitalisation, anticipation around the company's upcoming EV launches, and a decline in rebates as supply and demand for new vehicles broadly remains tight due to semiconductor chip shortages.
- **Consumer Cyclical Developed Markets (DM)** cluster, including ING Groep and Capital One Financial, on improvement in the economic outlook. ING and Capital One have consistently reported lower than expected credit costs over the last 12 months, dividends and buybacks have recently lifted, and both companies have considerable excess capital to facilitate additional capital distributions.
- **Oil/Natural Gas** cluster including Exxon and Equinor on positive outlook for energy demand with vaccine-led reopening whilst supply growth remains disciplined.
- **Hardware** cluster notably TSMC and MediaTek. TSMC continues to benefit from strong demand for leading edge semiconductor manufacturing in the company's key end markets and is taking market share with customers reinforcing its dominant position. Likewise, MediaTek continues to report strong order growth as the company closes the gap with Tier 1 competitors, taking market share in handsets, gaming and datacentres.

Key detractors to performance over the quarter included:

- EDF in the **Telco/Infrastructure DM** cluster suffered as a decision regarding the company's new regulation and restructure, expected early in the year, was delayed. News flow post quarter end indicated the process is back on track and the stock recouped almost all of its losses.
- **Software/Internet Asia/Emerging Markets (EM)** cluster, notably JD.com and Meituan Dianping, amidst ongoing domestic scrutiny of Chinese internet platforms. Despite near-term regulatory issues, the long-term outlook for Chinese internet/e-commerce remains attractive given opportunities to increase penetration in lower tier cities, expand into new categories, and in digital advertising where ad penetration lags most developed markets.

Global Long-Short

Top 5 contributors & detractors

Top 5 contributors	
Volkswagen AG	1.4%
ING Groep	0.9%
Siemens	0.6%
Capital One Financial	0.6%
Norsk Hydro	0.5%

Top 5 detractors	
Electricite de France	(0.4%)
JD.com	(0.2%)
Meituan Dianping	(0.2%)
Geely Automobile	(0.2%)
Japan Steel Works	(0.2%)

Global Long

Top 5 contributors & detractors

Top 5 contributors	
Volkswagen AG	1.4%
ING Groep	0.9%
Capital One Financial	0.6%
Norsk Hydro	0.5%
Siemens	0.5%

Top 5 detractors	
Electricite de France	(0.5%)
JD.com	(0.2%)
Japan Steel Works	(0.2%)
LG Chem Ltd	(0.1%)
Merck	(0.1%)

Asia strategy

In addition to the relevant positions discussed above, key contributors over the quarter included:

- **Consumer Cyclical** cluster, including financials such as HDFC Bank India, China Merchants Bank and KB Financial Group, as well as travel related exposures, notably Trip.com, given increased confidence around vaccine-led reopening and continued economic normalisation.
- **Software/Internet** cluster, notably Kuaishou Technology, a leading short form video app in China (similar to Tik Tok) that has around 500m monthly active users, with high levels of engagement following its February listing, and Tencent following confidence around continued economic normalisation and its implications for online advertising spend.

In addition to the relevant positions discussed above, key detractors over the quarter included:

- **Consumer Defensive** cluster notably TAL Education and Wuliangye. TAL Education and peers have been impacted by regulatory concerns around tutoring businesses in China, and Wuliangye's share price has consolidated following a period of sustained outperformance.

Top 5 contributors & detractors

Top 5 contributors	
Kuaishou Technology	0.9%
MediaTek	0.9%
KB Financial	0.8%
TSMC	0.7%
Cloopen Group	0.6%

Top 5 detractors	
TAL Education	(0.8%)
Wuliangye	(0.4%)
Meituan Dianping	(0.3%)
LONGi Green Energy	(0.3%)
Pinduoduo	(0.2%)

Portfolio positioning

Global strategies

Key changes over the quarter included:

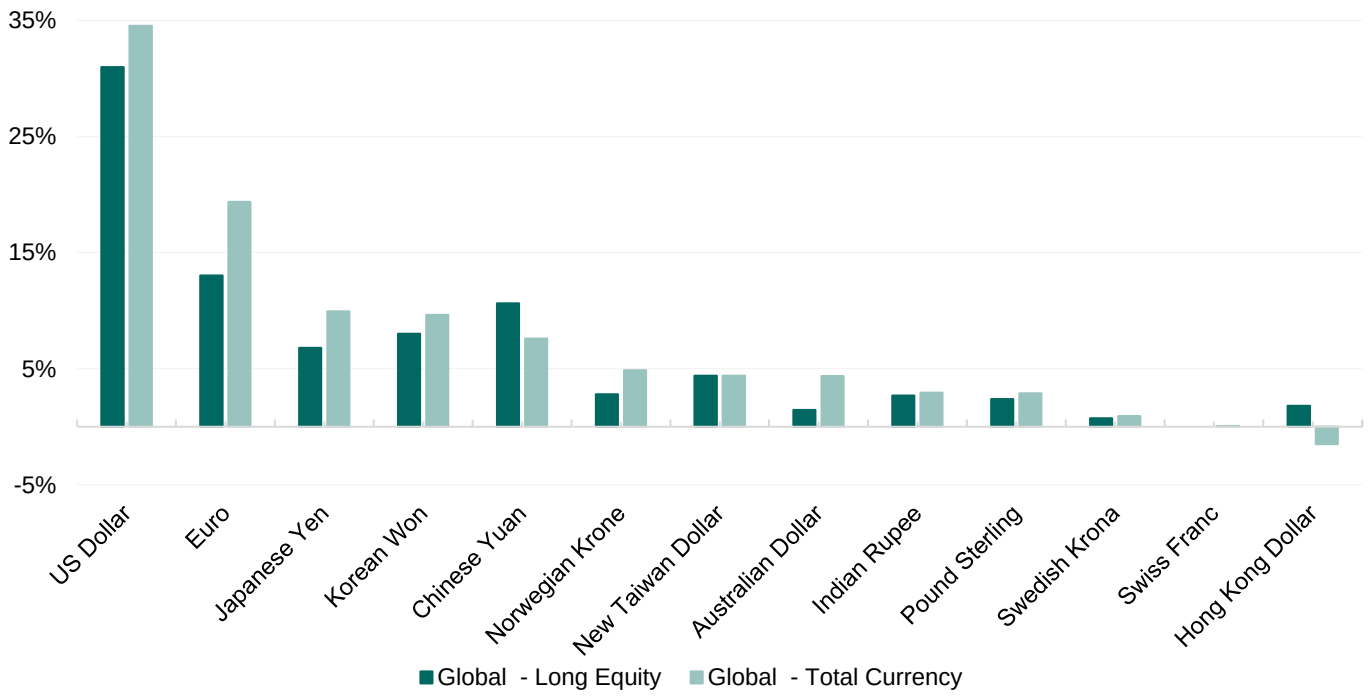
- Adding to **Industrials** cluster via reopening beneficiaries such as Airbus, given the company's structural advantage in narrow bodied planes which we expect to take share in the next cycle, and autos given pent-up demand as a result of a weak cycle prior to COVID-19. We also increased exposure to materials companies that are key to renewables and electrification.
- Adding to **Software/Internet Developed Markets (DM)** cluster, including Facebook, as online advertising will benefit from continued normalisation in economic activity. Engagement from users and advertisers remains positive and the Instagram platform remains deeply under-monetised.
- Reducing exposure to **Consumer Defensive - Asia/Emerging Markets (EM)** cluster, including exiting Yili as our price target was reached.
- Reducing exposure to **Telco/Infrastructure DM** cluster via exiting Simon Property Group as our price target was reached.
- Reducing exposure to **Consumer Cyclical DM** cluster via trimming Capital One Financial following a period of strong performance.
- Rotating exposure in **Software/Internet Asia/EM** cluster. Whilst we expect domestic regulation around China's internet platforms to ebb and flow, we exited Alibaba which appears to be in the spotlight given its market position. Regulation, however, presented an opportunity to add to Tencent, where online advertising is expected to grow with the rebound in economic activity. We also re-initiated a position in Meituan Dianping, which has leveraged its scale and market position in food delivery in lower tier cities to dominate the community buying group segment in a matter of months.

Global Long-Short

Cluster exposure & changes[5]

Sector/cluster	Long	Short	Net	Benchmark	3 month net change	12 month net change	Long examples
Global	**43.8%**	**(5.0%)**	**38.8%**	**33.5%**	**5.2%**	**8.9%**	
Industrials/Materials	24.6%	(3.7%)	20.8%	14.2%	5.1%	12.1%	Volkswagen, Siemens, GE
Oil/Natural gas	3.7%	(0.4%)	3.3%	2.6%	0.7%	(2.2%)	Equinor, Technip Energies
Hardware	8.9%	(0.6%)	8.3%	7.3%	(0.8%)	0.1%	Samsung Electronics, TSMC
Healthcare	6.6%	(0.3%)	6.3%	9.4%	0.2%	(1.0%)	Sanofi, Merck
NA/Europe Domestic	**33.5%**	**(4.6%)**	**28.9%**	**51.9%**	**(0.2%)**	**7.4%**	
Software/Internet	12.8%	(3.6%)	9.1%	16.7%	(0.6%)	0.4%	Facebook, Microsoft, Amazon
Consumer defensive	6.3%	-	6.3%	7.6%	1.7%	2.3%	Coca-Cola, Walgreens
Consumer cyclical	9.2%	(1.0%)	8.2%	20.3%	1.0%	2.2%	ING, Lowe's
Telco/Infrastructure	5.2%	-	5.2%	7.3%	(2.4%)	2.4%	EDF
Asia/EM Domestic	**17.4%**	**(0.6%)**	**16.8%**	**14.2%**	**(2.3%)**	**0.2%**	
Software/Internet	6.2%	-	6.2%	3.5%	0.9%	1.3%	Tencent, JD.com
Consumer defensive	1.6%	-	1.6%	1.1%	(2.3%)	(1.7%)	Yum China
Consumer cyclical	6.7%	-	6.7%	7.5%	(0.6%)	0.1%	Ping An, KB Financial
Telco/Infrastructure	2.9%	(0.6%)	2.3%	2.2%	(0.3%)	0.5%	KT Corp
Tail Risk Hedge	**1.4%**	**(14.9%)**	**(13.5%)**	**0.4%**	**(7.6%)**	**(7.3%)**	**Newcrest**
Total	**96.1%**	**(25.1%)**	**71.0%**	**100.0%**	**(4.9%)**	**9.1%**	

Currency exposure



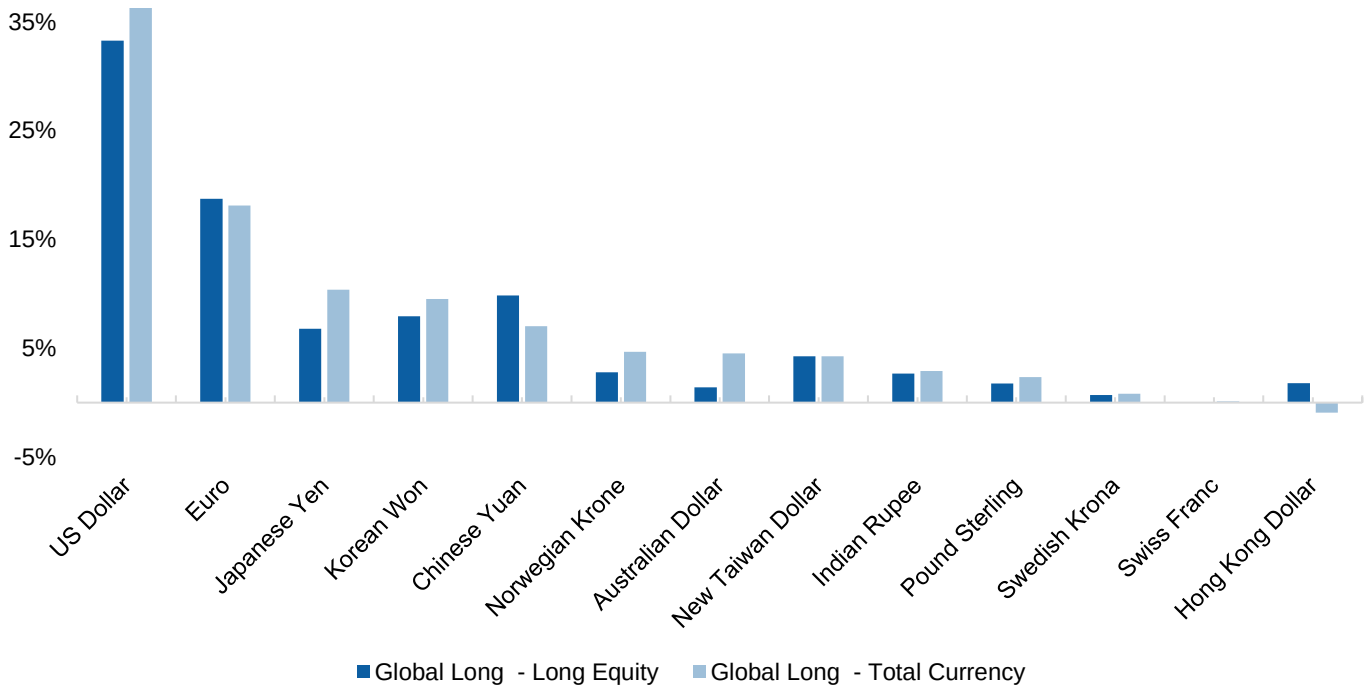
5 Options exposure represents the market downside. For put options (typically used to limit potential downside) delta-adjusted exposure is used and for call options (typically used to capture potential upside) exposure is calculated using the current option value.

Global Long

Cluster exposure & changes[5]

Sector/cluster	Long	Benchmark	3 month net change	12 month net change	Examples
Global	**43.3%**	**33.5%**	**4.6%**	**8.5%**	
Industrials/Materials	24.4%	14.2%	5.4%	14.1%	Volkswagen, Siemens, GE
Oil/Natural gas	3.7%	2.6%	1.0%	(1.6%)	Equinor, Technip Energies
Hardware	8.8%	7.3%	(1.0%)	0.1%	Samsung Electronics, TSMC
Healthcare	6.5%	9.4%	(0.8%)	(4.1%)	Sanofi, Merck
NA/Europe Domestic	**30.8%**	**51.9%**	**(0.9%)**	**3.6%**	
Software/Internet	11.3%	16.7%	(0.0%)	(0.4%)	Facebook, Microsoft, Amazon
Consumer defensive	6.2%	7.6%	0.8%	1.2%	Coca-Cola, Walgreens
Consumer cyclical	8.5%	20.3%	0.3%	1.3%	ING, Lowe's
Telco/Infrastructure	4.8%	7.3%	(1.9%)	1.4%	EDF
Asia/EM Domestic	**16.5%**	**14.2%**	**(2.7%)**	**(2.0%)**	
Software/Internet	5.4%	3.5%	0.1%	0.0%	Tencent, JD.com
Consumer defensive	1.6%	1.1%	(2.2%)	(2.1%)	Yum China
Consumer cyclical	6.7%	7.5%	(0.6%)	0.1%	Ping An, KB Financial
Telco/Infrastructure	2.8%	2.2%	(0.0%)	(0.0%)	KT Corp
Tail Risk Hedge	**1.4%**	**0.4%**	**(0.2%)**	**(2.3%)**	**Newcrest**
Total	**92.0%**	**100.0%**	**0.8%**	**7.7%**	

Currency exposure



Asia strategy

Key changes over the quarter included:

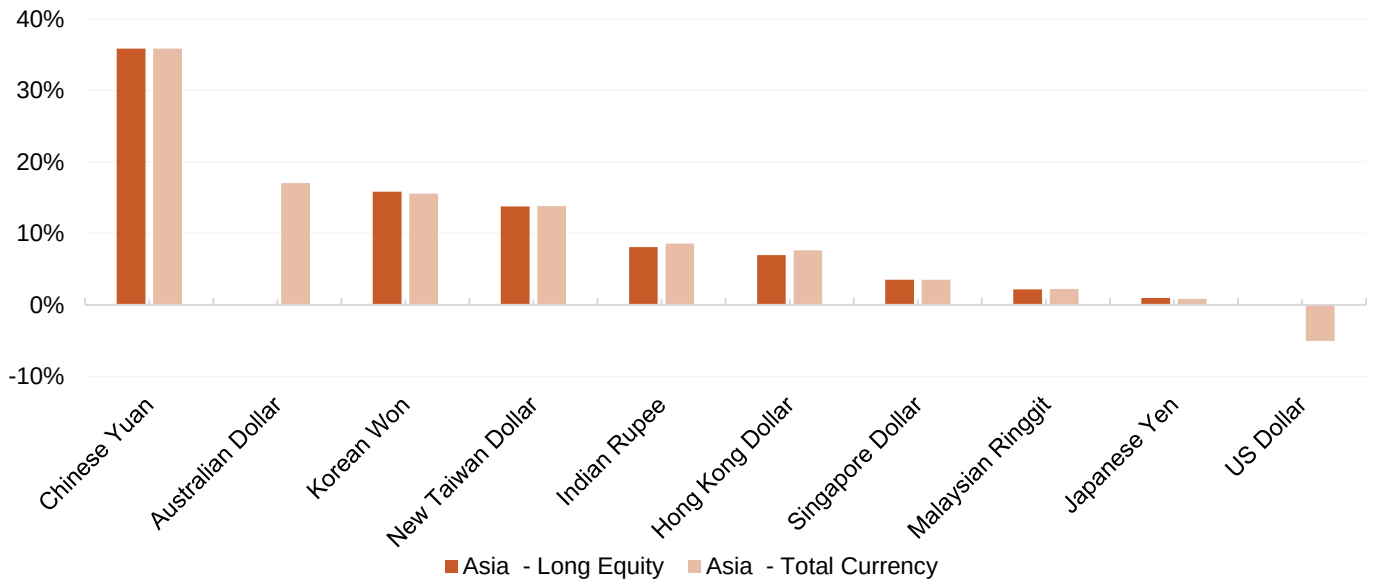
- Adding to **Industrials** cluster via reopening beneficiaries such as autos given pent-up demand stemming from a weak cycle prior to COVID-19, commodities key to renewables and electrification and basic materials which will benefit from a rationalisation of capacity in China where a reduction in carbon emissions is taking priority.
- Rotating exposure in **Software/Internet** cluster. Whilst we expect domestic regulation around China's internet platforms to ebb and flow, we exited Alibaba which appears to be in the spotlight given its market position. Regulation, however, presented an opportunity to add to Tencent, where online advertising is expected to grow with the rebound in economic activity, and Meituan Dianping which has leveraged its scale and market position in food delivery in lower tier cities to dominate the community buying group segment in a matter of months. We also added to a leading e-commerce platform in SE Asia.
- Reducing exposure to **Consumer Cyclical** cluster via exiting Geely Automobile and reducing exposure to Chinese travel stocks. The portfolio also trimmed its exposure to Indian financials as the rise in COVID-19 infection counts creates some uncertainty in the economic backdrop, and this follows a period of strong outperformance from the Indian financial sector.
- Reducing exposure to **Consumer Defensive** cluster via exiting Yili which reached our price target, trimming exposure to Chinese education stocks given the uncertain regulatory backdrop, and trimming exposure to Chinese life insurance companies as sales take time to normalise (insurance policies are predominantly sold face to face).

Asia Long-Short

Cluster exposure & changes[5]

Sector/cluster	Long	Short	Net	Benchmark	3 month net change	12 month net change	Long examples
Global	**31.1%**	**(0.9%)**	**30.1%**	**37.8%**	**0.8%**	**8.7%**	
Industrials/Materials	8.7%	(0.9%)	7.7%	11.9%	0.1%	2.3%	LG Chem, Toyota
Oil/Natural gas	-	-	-	1.0%	(0.9%)	(5.9%)	
Hardware	22.4%	-	22.4%	20.8%	1.7%	13.9%	TSMC, Samsung Electronics
Healthcare	-	-	-	4.0%	-	(1.6%)	
Asia/EM Domestic	**58.8%**	**(0.5%)**	**58.3%**	**62.1%**	**(6.4%)**	**6.3%**	
Software/Internet	24.1%	-	24.1%	21.1%	4.7%	8.5%	Tencent, JD.com
Consumer defensive	11.1%	-	11.1%	5.4%	(3.9%)	2.7%	Li Ning, Wuliangye
Consumer cyclical	22.5%	-	22.5%	28.1%	(7.7%)	(1.1%)	HDFC Bank, KB Financial
Telco/Infrastructure	1.1%	(0.5%)	0.5%	7.5%	0.5%	(3.7%)	Bharti Infratel
Tail Risk Hedge	**-**	**-**	**-**	**0.0%**	**-**	**2.4%**	
Total	**89.9%**	**(1.5%)**	**88.4%**	**100.0%**	**(5.6%)**	**17.4%**	

Currency exposure



Feature: Volkswagen

The past three years have been extremely challenging for the automotive sector, with a global market downturn occurring concurrently with a raft of new entrants, raising questions about the viability of the business models of the traditional OEMs and their place in an electrified and connected world. That narrative began to change in 2020 as legacy OEMs demonstrated abundant technological capability, an ability to defend themselves against perceived disruption, and robust financial performance. The coming years should reinforce that shift in tone, with VW front and centre.

Irrational extrapolation

The global auto market peaked in 2017 with the expiration of stimulus measures in China, the world's largest market. Sales volumes had been on a gradual downtrend until COVID-19 provided a brutal end to a long downcycle. Global auto sales in 2020 were nearly 20% below the levels seen in 2017, an unusually severe peak to trough swing.

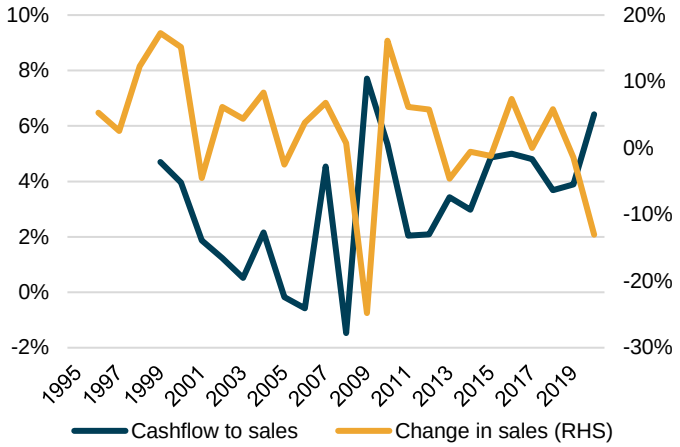
At the same time the automotive world has embarked upon the biggest transition since the industry began, with electrification and digitalisation becoming the mantras of the industry. New entrants raised valid questions of the incumbent OEMs regarding their ability to compete in this new world. However, not all legacy OEMs were asleep at the wheel. While some may have been slower to market, companies like VW, Toyota, Honda, Hyundai and GM have the technical capability and financial wherewithal to compete in the new world. We expect that message to be reinforced by empirical evidence in the coming years.

The financial history of the automotive sector is largely a sorry tale of poor capital allocation and extreme cashflow volatility during demand swings, which rightly led to the application of a low multiple to that earnings stream. But 2020's financial performance demonstrated surprising resilience, coming at a time when the greatest transition in the history of the industry is consuming significant resources.

We challenge the assertion that these twin transitions – electrification and digitalisation - are exclusively a threat for the traditional OEMs. They are, of course, in part, but for incumbent OEMs with the right strategy they also present significant opportunity.

Front and centre of this selective opportunity is VW, which has the most aggressive electrification strategy of any traditional automaker along with significant plans in digitalisation.

Figure 2: MSCI World Autos and Components (ex Tesla) sales and FCF/sales



Source: Bloomberg

Multiple Ways of Winning

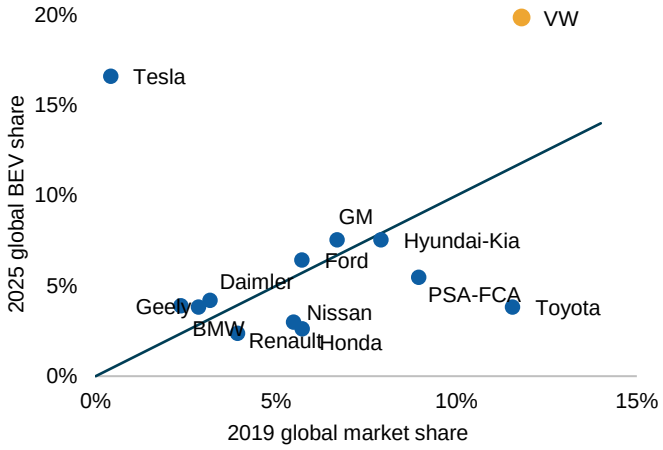
Competitive dynamics & product cycle

VW today is already one of the world's largest car makers, roughly on a par with Toyota, with a little over 10% of the global market. As the world transitions to EVs, VW has the opportunity and scale to significantly increase that market share thanks to an all-in approach to electrification, while other legacy automakers have taken a more gradual approach. Based on currently available data, VW's share of the EV market in 2025 is likely to be significantly higher than its global market share in 2019 and with the number one position in Europe and China, which are expected to be the two fastest growing EV markets.

Market share is critical to the future financial performance of the VW group. Automotive, like any business with a meaningful fixed cost base, is in part a game of scale, something which VW has in abundance. And it's not only VW's own volumes across all group brands over which they are able to spread the development costs. Other automakers lacking the resources or desire to develop an internal EV platform may choose to partner with VW, e.g. Ford is using VW's platform for European EV models. New market entrants like tech companies could also add volume and

thereby spread costs. It is not inconceivable that VW could become a platform company, though this not our base case.

Figure 3: 2019 global share versus 2025 battery electric vehicle (BEV) share



Source: LMC, company data, Antipodes

The position VW finds itself in today is one borne out of a self-inflicted crisis, namely the diesel emissions scandal in 2015, or 'dieselgate', when VW was found to have been using software to cheat emissions tests. It's not hyperbole to describe this as an existential crisis. The company incurred massive fines, faced numerous lawsuits, and was forced to recall and replace the affected vehicles. The brand image was heavily tarnished. After significant soul-searching VW responded by aggressively committing to full electrification, seeing it as the most effective and efficient way to rationalise the model line-up and restore reputation. VW's EV offensive is more aggressive than any other legacy automaker - arguably it needed to be in order to restore faith in the company and VW's position today is a direct result of those post-crisis decisions.

Management continues to take proactive and forward-looking decisions to protect the company against the changing landscape. In March this year, VW announced plans to internalise future battery production in partnership with its current battery suppliers. This partnership approach is a sensible one, reducing the capital cost to VW while securing supply. Battery cost deflation is a key contributor to the future profitability of EVs. Industry prices today are around $140/kwh but VW is targeting cost reduction of 30% to 50% by the end of the decade which will take battery cost significantly below $100/kwh at which point cost parity between EVs and combustion engine vehicles will likely be achieved.

Given the upfront cost, it's easy to see why other legacy automakers have taken a more moderate approach to EVs and digitisation without the platform investment, particularly given that four or five years ago when these decisions were made it was hard to confidently assess consumers' appetite for electric vehicles. What at times has seemed like a high-risk strategy for VW now appears to be paying off.

The transition towards software applies to both vehicle operating systems and the potential for increasing levels of autonomy. These are areas of meaningful investment for all OEMs, with the former an increasingly important influence on consumer choice, whilst timelines for the commercial deployment of higher-level autonomy are consistently delayed. It seems improbable that autonomy will be a winner takes all market given the amount of capital the industry is attracting, the number of credible players and the regulatory hurdles to mass adoption.

Regulatory

While it was largely a company phenomenon, dieselgate focused attention on the industry's dirty little secret, which was that real world emissions for most vehicles were higher than what was recorded on the test bed, even without manipulation software. This was widely known but politicians and regulators chose to turn a blind eye, not wanting to destabilise a sector which is large for both employment and output. Notwithstanding, EV adoption has powerful regulatory drivers with tighter emissions standards both visible and likely to ratchet up further, globally. But adoption extends to more than just regulation and is increasingly driven by proactive consumer choice.

Those consumer choices are currently being nudged by government subsidies, but in the next few years it will be raw economics which drive demand. For consumers, EVs will offer a lower total cost of ownership despite the higher upfront purchase price, even without subsidies. It is inevitable that the regulation of emissions from internal combustion engines will continue to tighten in the coming years, with many countries already laying the groundwork to mandate either an outright ban on internal combustion engines or stringent new regulations.

Regulatory and consumer focus will also increase across all industries on lifecycle emissions rather than just the emissions produced in use. In relation to this, VW has also disclosed it is building out a vast European charging network, again with partners, and a very significant push towards battery recycling to ensure minimal environmental footprint through the production value chain. This is the most complete and holistic vision that any traditional automaker,

and arguably any automaker, has presented for selling EVs with a low well to wheel environmental impact.

Management and Financial

For those car makers with the right strategy, EVs will deliver compelling margins at scale.

For VW, the question is what such an aggressive transformation of a large and historically inflexible entity will mean for profitability and margins in the medium term; we believe it's higher than in an internal combustion engine world once they hit scale. There are two key reasons for this. Firstly, the company's all-in approach, standardising its EV offering around two scalable platforms each of which cost tens of billion Euros to develop and which have future evolution embedded. There is increasing evidence that these platforms are delivering best in class economics. Secondly, the volume of vehicles that VW sells. Few other traditional automakers are in the same advantaged scale position.

EV sales are already accretive to VW's earnings though the margin is understandably lower than an equivalent vehicle with a combustion engine given lower volumes. Today's EV profit stream is derived from sales volume of around half a million units. Profitability should meaningfully increase as EV sales are expected to double in 2022 and materially increase from there. Here we have the combination of rapidly increasing sales against fixed depreciation cost and on top of that falling battery prices. Crucially, by around the middle of the decade we think VW's margins on EVs will start to exceed those on equivalent combustion engine vehicles.

There remain ways that VW can, and must, improve, most notably around corporate governance. The complex ownership structure and various stakeholders have historically made reform slower than has been optimal, with the process of reform remaining a key item for ongoing monitoring. We believe that the company is increasingly aware of the challenges posed by its sub-optimal governance and is in the process of taking active steps to address the issues. These are not changes that will solely benefit shareholders, but will advantage all stakeholders by ensuring that VW remains a globally relevant organisation at a time of rapid change in both its industry along with broader notions of corporate purpose, responsibility and function.

Style and Macro

VW is well-positioned to benefit from a meaningful post-COVID-19 rebound in economic activity and pent-up demand in the auto cycle, as the multi-year downcycle we've seen reverses. Volkswagen is also a great way to get exposure to the strong recovery in China given it is the leader in what is the world's largest auto market. Further, rising bond yields are likely to support relative valuations.

Valuation/margin of error

At just 8x forward earnings, generating free cash flow of over $10bn p.a. - and that's post the investment into the electrification offensive - VW can transition to a secular growth winner as it dominates electrification.

Regardless of how we slice it we see significant value in VW. The Porsche marque is wholly owned by VW, to which the most comparable automotive asset globally is Ferrari, both in brand and financial terms. They both even have the same horse on the logo, the horse of Stuttgart. Where they are very different is implied valuation. Applying Ferrari's multiple to Porsche's earnings, until recently, accounted for the entire market value of the VW group, despite Porsche accounting for less than 3% of VW's 11m units in 2019.

'Sum of the parts' arguments like this are not the sole way to determine the fair value of the equity, but highlights there is significant value within the brand portfolio of the group to which there is little to no value ascribed today.

The same applies to other investments and technical capabilities. VW has stakes in companies at the leading edge of the automotive transition, such as batteries and autonomous vehicles. These are assets to which little value is ascribed today.

As fears of imminent and profound disruption abate, and greater credit is given for recent operating performance, we expect the sector multiple to normalise towards something closer to what we see as fair value. By 2023 we expect VW's underlying earnings per share to be at least €35. Applying an undemanding PE multiple of x10 to this points to a fair value of €350 over the coming couple of years, and we see the possibility of upside to both the earnings and the applied multiple. Reaching that level will require both continued operating execution and governance reform, the signs for both of which are encouraging.

Outlook

The rotation into low multiple stocks gathered pace during the quarter following an acceleration in the vaccine rollout combined with additional stimulus. US Treasuries, which have lagged other expressions of the reopening trade, started to catch up prompting the low multiple – or value – rally to broaden out beyond growth cyclicals. Whilst we have seen some steepening of the yield curve, real yields remain firmly negative which is extraordinary given developments in the global economy. Pleasingly, our portfolios all outperformed over the quarter.

The success of COVID-19 vaccinations in Israel has been well documented, and as expected the US rollout has accelerated as one-third of adults and all citizens over 65 years have received at least one vaccine dose. Infections, hospitalisations and fatalities have already materially declined, and the US remains on track for full vaccination of eligible individuals by mid-year.

Detected infections have risen again in Europe although fortunately, aside from Spain, fatality rates have remained stable. Outside of the UK, vaccine progress has been slower than expected. AstraZeneca missed original production targets and in response the EU has begun restricting exports of vaccines to secure supply for member nations.

We are watching developments in India and Brazil closely, along with the emergence of any new variants (which is to be expected). On current information the increase in infection counts in India appears to be linked to restrictions easing and an increase in social gatherings. Case and fatality counts in Brazil continue to reach new highs which is worrying. As with India, there is likely to be contributing factors driving this surge such as restrictions easing in the latter part of 2020, the slow rollout of vaccines, and the condition of the domestic healthcare system. The Brazilian variant shares some commonality with the South African variant – the E484K mutation – and there is evidence of a broader spread of variants with this mutation e.g. in New York and other US cities. Tracking variants with the E484K and other mutations is important as these may facilitate transmission and escape some antibody defences. As has been reported, existing vaccines have lower efficacy in preventing symptoms of COVID-19 caused by virus harbouring this mutation relative to other strains, however vaccines remain strikingly effective in preventing hospitalisations and fatalities. Interestingly, the situation in South Africa has markedly improved despite limited vaccine rollout, which may indicate the country has developed some level of natural herd immunity. Pfizer and Moderna are well progressed in developing booster vaccines targeting this mutation with emergency use authorisation expected by September.

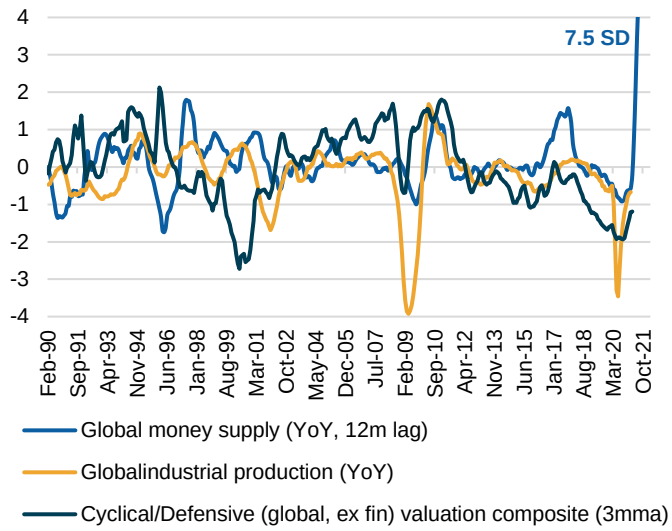
Johnson & Johnson's recent submission of its single shot vaccine to the World Health Organisation (WHO) is likely to accelerate the vaccine rollout in emerging markets ex China, given many emerging economies look to the WHO for endorsement. The fact that this vaccine can be stored for months at refrigerator temperatures makes it a more suitable candidate for less developed economies. China's vaccination programme continues to progress. To meet its target of 75% of the population by year end, vaccinations will need to increase from the current 4.3m per day to over 5m in the second half of the year.

One year on from "coronavirus" entering household vocabulary, the global economic cycle has rebounded (figure 4) but remains below trend. Emerging economies are leading the developed world despite the slower vaccine rollout and little stimulus. A diligent handling of the virus in the early stages (particularly in north Asia) has supported domestic activity and stimulus in the US has buoyed exports. To that point, China's industrial production and exports now exceed 2019 levels. The US economy is motoring along thanks to a fiscal-driven consumption boom, while lingering restrictions in Europe and less stimulus sees the Eurozone limp along. Europe's manufacturing activity has been supported by China's robust recovery, but the services economy remains stubbornly below trend. Arguably, Europe has the most cyclical economic upside as the rollout in vaccines accelerates.

The amount of stimulus undertaken by policy makers globally has reached astonishing levels (figure 4); 40% of all money ever created occurred last year[6], and as previously mentioned it's been led by the US. This is not just in response to COVID-19 but also a result of the rise in populism that's been brewing. Notably, quantitative easing is now being used to fund aggressive fiscal stimulus, which suggests the rebound in the economic cycle is still in its early stages.

6 Money supply is defined as currency and demand deposits at commercial banks.

Figure 4: Global money supply, industrial production & cyclical v defensive (z-score)



Source: BIS, AASE, FactSet, Bloomberg, Antipodes

Central banks seem committed to remain accommodative, though we are watching the People's Bank of China (PBOC) closely as it appears credit creation in China has peaked[7]. The question is whether an acceleration in stimulus from the US can offset any tightening in China.

The Democrats wasted little time following January's success at the Georgia runoffs to approve the $1.9t Rescue Plan Act in March 2021, of which $800b is direct household stimulus. This will deliver a 10% to 30% jump in disposable income for the bottom 60% of US households over the next 12 months[8]. This is predominantly via $1,400 in one-off payments per individual and an increase to and extension of unemployment benefits until September 2021. This is in addition to $160b of stimulus ($600 per individual) distributed by former President Trump in his last days of office in January 2021.

We previously suggested that vaccines would give policy makers the scope to pivot stimulus away from income support to investment programmes. On the heels of the Rescue Plan Act the Democrats' $2.25t Investment and Infrastructure Bill has been recently submitted, to be partially funded by an increase in the corporate tax rate from 21% to 25%-28%. We expect other economic blocs to follow suit, and indeed decarbonisation is already a central pillar of policy across the US, Eurozone and China. Whilst the market has begun to view economically sensitive stocks through a different lens, cyclicals are still broadly cheap relative to defensives (figure 4). Investment led stimulus/growth can lead to a more permanent shift in investment preferences, and a more durable outperformance of low multiple stocks, much like what was seen after the 2000 tech wreck. There will be new candidates that can transition to secular growth winners and some of today's perceived winners will ultimately be revealed as growth traps.

As a result of the degree of income stimulus, US household balance sheets have never looked stronger. Personal savings rates have reached abnormally high levels, around 20% of disposable income versus 7% pre-COVID. Accordingly, households have incrementally saved almost $3.2t in the 12 months to February 2021. Around $1.2t relates to a normal level of savings in any given year, whilst the remaining $2t can be considered true excess savings/increase in future disposable income. This is courtesy of $1t of underspending in 2020 (concentrated in core lockdown services sector i.e. travel, restaurants, recreation) as well as $1t of government stimulus. After factoring in the $800b of incremental household stimulus approved in March 2021, above trend pent-up savings will likely rise to over $3t by mid-year[9], when a full opening of the economy is scheduled. This is equivalent to almost 20% of household spending in 2019 or 15% of GDP, and gives a sense of the firepower that could be deployed. Biden's rumoured c. $1.5 – 2t American Families Plan package, targeting social infrastructure and extending stimulus for lower income households, could bolster consumption even further.

Overall household consumption needs to run 13% or $2t higher than February 2021 levels (annualised) over the next 12 months to close the output gap[10]. Clearly, there are ample savings to fund this and a potential overshoot. However, given there is a natural limit to spending, for example for travel consumption and dining out, households could direct excess savings to big ticket items, 'trading-up', real or financial assets. Consequently, we have rotated our 'Reopening' cluster to position for consumption trends which we believe will emerge, such as autos, while reducing exposure to reopening candidates which have already seen strong performance such as financials, retail, and travel related exposures with a dependence on cross border movement.

Whether this consumption proves inflationary depends on the marginal propensity to consume real goods or services,

7 As measured by Total Social Financing (a broad measure of credit and liquidity, which includes off-balance sheet financing) as a percentage of GDP.

8 American Institute of Taxation and Economic Policy, March 2021.

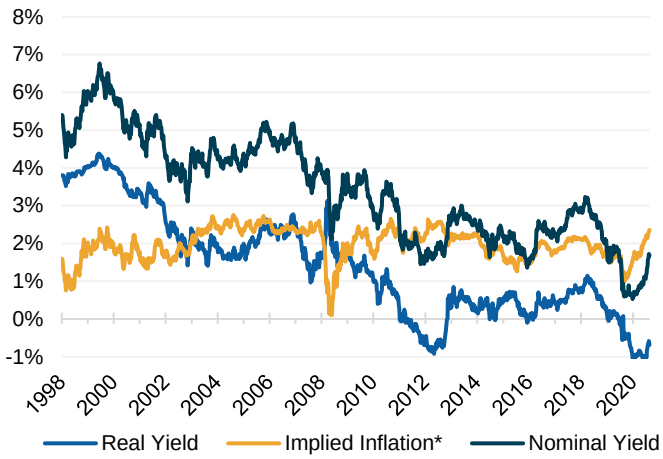
9 This excludes the $1t which can be considered structural savings.

10 That is, return to a more typical 4% growth rate from 2019 levels as well as make up for underspending in prior months.

the velocity at which savings are deployed and the pace at which labour market imbalances are corrected. Combined with broad pressure in supply chains from a shortage of semiconductors, we are likely to see higher volatility in inflation.

While the US Federal Reserve takes the view that current inflationary trends are transitory, and with policy makers committed to avoiding a premature shift to austerity, the US economy will be allowed to run hot with rates remaining anchored at the short end. However, the move in 10Y US Treasury yields over the quarter was significant - from 0.9% to around 1.7% - but largely tracks rising inflationary expectations. Real yields remain negative at c. -0.6%; a disconnect between the bond market and the outlook for the global economy (figure 5).

Figure 5: Nominal yields, real yields & implied inflation (10-year rates)

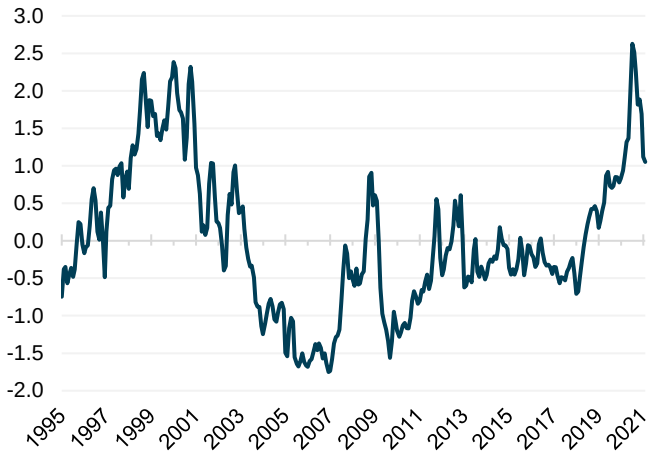


** 10Y average inflation rate expected by the bond market*
Source: FactSet

A normalisation in real yields can act as a further tailwind for cyclical stocks and a material headwind for the overvalued and weaker parts of the growth complex. That is, a move in real rates can act as an additional catalyst to tighten today's extreme multiple dispersion (figure 6).

Undoubtedly some of the excess savings in the US is finding its way into the stock market given inflows to global equities over the last five months has reached more than US$500b. This is roughly 3x higher than previous record inflows (over an equivalent period) since the 2008 financial crisis. Compared to the previous peak in 2018, today's inflows are not only elevated in an absolute sense but also when measured as a percentage of total market capitalisation.

Figure 6: Global sector-neutral composite valuation of expensive relative to cheap (z-score)

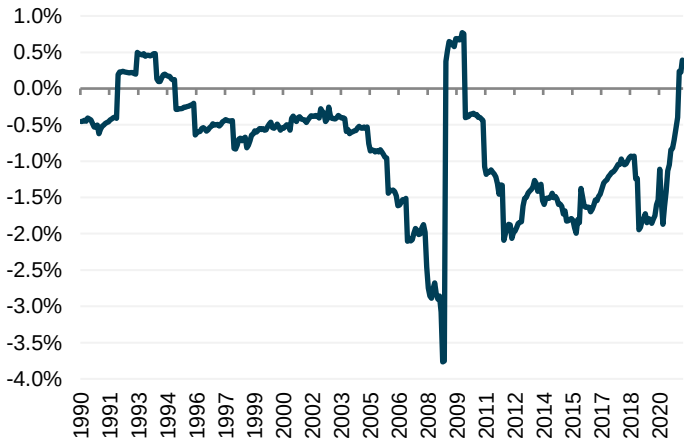


Source: FactSet, Antipodes

History suggests a flood of new entrants to the market driven by 'fear of missing out' is a meaningful medium-term contrarian indicator. The events in late January from the 'GameStop crowd' show just how powerful the online retail community has become. The introduction of zero commission retail trading is a significant shift in market structure; barriers to entry have been removed and the heavy use of derivatives once reserved for sophisticated investors has increased the footprint of retail activity in markets. As a result, it will be prudent to continue to closely monitor crowded longs and shorts.

It's worth noting that net equity issuance (i.e. issuance net of buybacks) is approaching historical extremes in the context of the last 30 years (figure 7). This issuance has been most aggressive in the US, particularly at the smaller end of the market, and a noteworthy reversal of the buy-back trend which dominated the US market post the 2008 financial crisis.

Figure 7: US net equity issuance (% of market cap)



Source: Bank of America, Morgan Stanley, FactSet

This is not just IPOs and secondary issuances. Mainstream media is full of headlines of the latest hedge fund/private equity firm/celebrity launching a special purpose acquisition company - or SPAC. SPACs are shell companies and sometimes referred to as a blank cheque company. A SPAC is listed with the purpose of making an acquisition, often any acquisition, in a short window otherwise it's dissolved. SPACs are not new, but popularity has increased considerably to bypass listing requirements under the traditional IPO route – i.e. list quick in a hot market. Data from Dealogic suggests SPACs raised around $80b in 2020 and a massive $25b in January 2021 alone, however the dry powder searching for deals is closer to $500b[11]. To sum this up we have an increase in IPOs and secondary offerings (a reasonable proxy for insider selling), an explosion in 'blank cheque companies', an empowered online retail trading community and stimulus cheques. Take a seat and pass the popcorn.

As we expected, the US lead in vaccine rollout and stimulus-led growth has been positive for the USD, with recent strength arguably exacerbated by bearish positioning over the prior three to six months. This does not change our longer-term view. The USD re-opening exceptionalism is unlikely to last as vaccinations in the rest of the world catch up. Of the major currencies the Yen has the greatest potential from vaccine acceleration. It's worth reiterating that money creation in the US is about 30% higher than the rest of the world and the fiscal deficit is 15% of GDP coupled with a large current account deficit. There is no free lunch. These twin deficits ultimately need to be funded, which can happen via higher rates to attract capital or a weaker currency. We believe it will be the latter. Further, a steepening of the yield curve can act as catalyst for foreigners to increase hedge ratios, a topic we discussed at length in our December 2020 quarterly. The stock of US assets owned by foreigners is at an all-time high (around $16t) while hedge ratios are 50% below their 2016 peak. A small increase in hedge ratios has the potential to overwhelm demand for USD from fresh portfolio flows. We continue to favour current account surplus country currencies with key overweights in the Yen and Euro.

On the geopolitical front, several western brands including H&M and Nike have been in the spotlight for their position against sourcing cotton from the Xinjiang province in China, claiming forced labour practises over the predominantly Muslim Uyghur community. Xinjiang produces around 20% of the world's cotton. Western brands began to take this stance a year ago but the matter recently resurfaced on social media. This prompted Chinese locals to boycott certain brands and, in some instances, brands have been temporarily removed from China's e-commerce platforms. This issue highlights that tensions between China and the West may shift from trade to domestic issues. In that vein regulation around China's internet platforms is expected to ebb and flow as seen with regulation around big cap tech in the developed world, and fear around regulation can create attractive buying opportunities.

A natural healing in the global economy from an acceleration in vaccines can be supported by stimulus, but a dependence on the ongoing development of booster vaccines has the potential to complicate reopening. That is, reopening remains fluid. The Global portfolios' exposure to reopening beneficiaries remains at around 40%, though exposure within these clusters will rotate as reopening evolves. Policy makers globally are expected to remain accommodative with the focus to shift to investment programmes. This can lead to a more permanent shift in investment preferences where extreme multiple dispersion starts to contract. Any normalisation in real rates will accelerate this contraction. Exposure to investment stimulus beneficiaries (c. 30%) – led by our decarbonisation cluster (c. 16%) – sees the Global portfolios positioned to benefit from the structural trends that are emerging.

While headline equity index valuations look reasonably full there is meaningful opportunity for active stock pickers in relative valuations. On an aggregate level, many investor portfolios are not well positioned for these shifts. Net exposure levels across energy, materials, industrials and financials are near historic lows while exposure to technology still remains near historic highs. As reopening and investment stimulus trends persist, investor portfolios will need to be rebalanced.

11 Typically, the SPAC will partner with another investor (e.g. private equity) to raise additional capital c. 4x the initial raise to make an acquisition.

Appendix

Market returns to 31 March 2021 (USD, p.a.)

Absolute performance (%)	3m	1y	3y	5y	10y
Regional equities (MSCI)					
AC World	4.6%	54.6%	12.1%	13.2%	9.1%
USA	5.4%	58.6%	16.8%	16.1%	13.4%
Europe	4.1%	44.9%	5.6%	8.2%	5.1%
Japan	1.6%	39.7%	6.3%	10.5%	7.2%
Korea	1.6%	89.5%	9.5%	14.8%	6.0%
AC Asia ex Japan	2.7%	57.3%	8.9%	13.8%	6.7%
All China	(1.5%)	45.8%	8.5%	13.1%	6.7%
EM ex Asia	2.8%	51.6%	(2.8%)	4.9%	(2.7%)
Global sectors (MSCI)					
Consumer Discretionary	2.3%	77.7%	17.4%	16.2%	13.5%
Consumer Staples	(0.8%)	24.6%	7.1%	5.9%	8.4%
Energy	17.7%	49.9%	(5.1%)	1.1%	(2.8%)
Financials	11.4%	56.9%	4.0%	10.4%	6.4%
Health Care	0.4%	30.2%	13.3%	11.5%	12.9%
Industrials	7.5%	62.2%	9.6%	11.9%	8.4%
Information Technology	1.8%	71.7%	25.7%	26.3%	18.2%
Materials	6.4%	76.6%	10.4%	14.4%	3.1%
Communication Services	6.6%	57.4%	15.7%	9.2%	7.2%
Utilities	0.6%	22.8%	9.1%	7.3%	5.6%
Commodities					
Crude Oil Brent	21.1%	138.1%	(3.3%)	9.2%	(6.1%)
Gold	(10.8%)	4.7%	8.4%	6.4%	1.6%
Bloomberg Commodity Index	6.9%	34.9%	(1.6%)	1.1%	(6.8%)
Bonds (BAML)					
Global Government	(5.8%)	0.2%	1.8%	1.9%	1.7%
Global Large Cap Corporate	(4.5%)	11.8%	4.5%	4.3%	3.9%
Global High Yield	(0.3%)	25.4%	5.9%	7.6%	6.1%
Currency					
AUD	(1.3%)	24.4%	(0.2%)	(0.2%)	(3.0%)
USD	0.0%	0.0%	0.0%	0.0%	0.0%
EUR	(3.9%)	7.1%	(1.5%)	0.6%	(1.9%)
JPY	(6.6%)	(2.3%)	(1.3%)	0.3%	(2.8%)
CNY	(0.2%)	8.2%	(1.4%)	(0.3%)	(0.0%)
SGD	(1.6%)	6.0%	(0.8%)	0.0%	(0.6%)

Source: MSCI, BAML, Bloomberg, FactSet

Antipodes

Fund summaries
antipodespartners.com/fund-updates/

Further information
+44 7525 395 116
invest@antipodespartners.com

Glossary
antipodespartners.com/investing-with-us/glossary/