



Quarterly shareholder update 30 June 2020

**Antipodes Global
Investment Company Limited
(ASX:APL)**

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Letter from the chairman

Dear fellow shareholders,

Welcome to the first edition of the Company quarterly update, a comprehensive review of the Company's performance, portfolio and outlook by Antipodes Partners Limited (Antipodes), the Manager of the Company's portfolio of assets.

Inside you will find a number of important sections that should bring the Company's portfolio to life. The update starts with commentary from Antipodes on the overall market during the past quarter in order to provide shareholders with context about the performance of the Company's portfolio. Next we provide a comprehensive review of the Company's portfolio performance, dividend history and some reflections on the initiatives the Board of the Company has undertaken to tackle the persistent discount to net tangible assets (NTA) the Company share price has traded at for much of the last 12 months.

Antipodes then provide a comprehensive update on the drivers of the Company's portfolio performance during the quarter as well as the current portfolio positioning, both especially relevant this past quarter given the COVID-19 market sell-off in March 2020 and the subsequent sharp rally in global equities since then. In the feature article for this update, Antipodes has written a piece on Europe, a focus area of the Company's portfolio. Finally, Antipodes provide its outlook for the period ahead and how COVID-19 may have sown the seeds for the next up-cycle in value style investing.

We hope you enjoy the update, part of the Company's drive to improve communication with shareholders. For more information on the Company and additional portfolio updates from Antipodes, please visit the new Company website at <https://antipodespartners.com/apl/>. Finally, we are very focused on trying to ensure our shareholders receive electronic communication from us, the most timely and cost-efficient manner for us to communicate with you. If you have not done so, please click on this link to see a short video on the benefits of doing so and instruction on how to do so [APL Go Paperless](#)

Yours sincerely,

Jonathan Trollip

Chairman

Market commentary

Global equities rebounded sharply during the second quarter of 2020 (+6.0% in AUD, +19.2% in USD). Unprecedented fiscal and monetary response from governments and central banks to the COVID-induced economic crisis, combined with an easing in lockdown measures, led to a bounce in economic activity.

Investors failed to exhibit a clear cyclical or defensive bias during the quarter. Value lagged whilst momentum and growth styles outperformed as Technology continued to be strong. Economically sensitive sectors such as Consumer Discretionary and Materials performed well, having been amongst the worst performing sectors during the sell off. Whilst all sectors were higher, Utilities, Consumer Staples and Financials underperformed.

Against this backdrop, US equities outperformed (+21.6% in USD) with the benchmark S&P index rising the most since the fourth quarter of 1998 as the Fed's balance sheet increased by US\$2t to a record US\$7t. US incomes have been supported by stimulus cheques and generous unemployment benefits. Almost all states began relaxing lockdown orders relatively early compared to other developed nations. However, towards the end of the quarter infections were rising again. US technology mega-caps have been consistently resilient through the crisis as consumers and businesses make greater use of their services. The focus on politics intensified as Joe Biden took the lead over Donald Trump in the polls ahead of the US presidential election in November 2020.

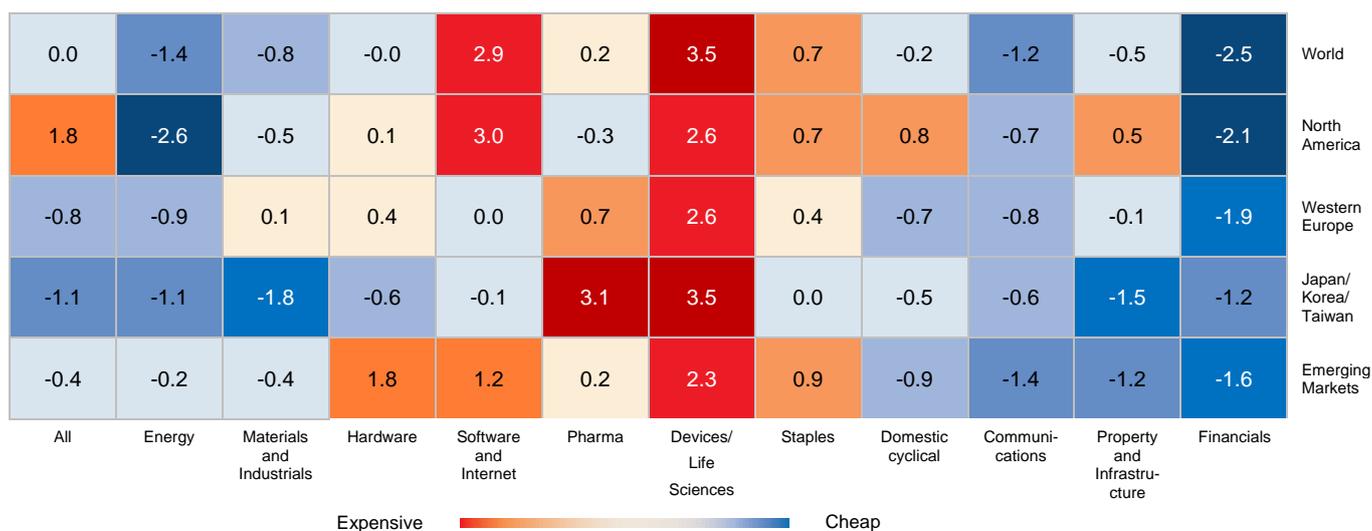
European equities posted strong gains (+15.3% in USD) but underperformed the broader global index as the market awaits the final details of a coordinated €750b Recovery

Fund plan inclusive of grants to countries hardest hit by the virus. Europe saw new infections fall and lockdown restrictions were eased, with the worst affected countries such as Spain, France and Italy relaxing measures later in the quarter.

Asian equities (+14.7% in USD) broadly lagged other regions after outperforming during the first quarter of 2020, having passed the peak of the virus impact earlier than the rest of the world. Geopolitical concerns weighed on China (+15.4% in USD) as tensions with the US expanded beyond trade to technology, and after China announced a new national security law in Hong Kong. Japan (+11.6% in USD) materially underperformed the strong rise in the global index as the lockdown trajectory fell behind other nations resulting in domestic stocks lagging the globally exposed areas of the market.

Elsewhere, Brent Oil rose materially (+56.6% in USD) as OPEC and Russia agreed to make temporary production cuts and credit spreads tightened significantly. The US dollar weakened (DXY -1.7%) with traditional risk currencies strengthening. Gold (+9.9% in USD) gained for a seventh consecutive quarter as investors looked for an inflation hedge as central banks continued to print their way out of a global slowdown.

Figure 1: Region-sector valuation heat-map¹ - Composite multiple vs world – Z-score (June 1995 – June 2020)



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

Performance² as at 30 June 2020

	3 months	1 year	3 years p.a.	Inception ³ p.a.	Inception ³
Company	(1.1%)	(3.5%)	3.6%	6.2%	25.3%
MSCI AC World Net Index	6.0%	4.1%	10.0%	11.4%	49.4%
Difference	(7.1%)	(7.5%)	(6.4%)	(5.2%)	(24.1%)

Performance & risk summary⁴ as at 30 June 2020

	Company
Average Net Exposure	62.4%
Upside Capture Ratio	68
Downside Capture Ratio	70
Portfolio Standard Deviation	8.5%
Benchmark Standard Deviation	10.8%
Sharpe Ratio	0.67

Dividend history as at 30 June 2020

	Dividend per share	Ex date	Record date	Payable	Franked
APL	2c	05/03/20	06/03/20	27/03/20	50%
APL	2.5c	06/09/19	09/09/19	14/10/19	50%
APL	2c	07/03/19	08/03/19	22/03/19	50%
APL	5c	19/10/18	22/10/18	31/10/18	50%

² All returns are in AUD terms since inception. Movement in NTA before tax for the period, adjusted for dividends and income taxes paid and the dilutionary effect of options granted to shareholders upon the Company's initial listing. This figure incorporates underlying portfolio performance net of portfolio related fees and costs, less administration costs of the Company.

³ Inception date is 11 October 2016.

⁴ All metrics are based on gross of fee returns of the underlying portfolio in AUD 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.

Company commentary

While the Company's performance lagged the benchmark for the quarter given the sharp rally in global equities since the COVID induced lows in March, the Company's portfolio has achieved its second objective of protecting investor capital during this volatile period. While Antipodes, the Manager, has been very focused on steering the Company's portfolio during this difficult market, the Board of the Company has spent a lot of time over the quarter discussing a range of initiatives to close the persistent discount to net tangible assets (NTA) that the APL share price trades at.

The outcome of those discussions were communicated with shareholders and posted in an ASX announcement that can be found here: [May Company Update](#). The large on-market share buyback remains the primary tool that the Company is undertaking to reduce the NTA discount. At the Company EGM on 21 April, the buyback was increased by a further 10% of shares outstanding, bringing the buyback size to in excess of \$100m since inception of the buyback, the largest on market LIC buyback in history on the ASX.

Portfolio commentary

Note: The term "cluster" or "exposure" is used herein to reference a collection of positions which exhibit similarities in their risk profile including an irrational extrapolation around change, end-market, style and macro characteristics.

Key contributors to performance over the quarter included:

- **Consumer Cyclical - Developed Markets (DM)** cluster, including Lowe's which has been a COVID-19 beneficiary as home improvement has proven resilient during lockdown. Further, the company reported a strong result with low-teens same store sales growth which accelerated into April and May. Strong execution resulted in better conversion of sales to profits relative to peers.
- **Online Services - DM** cluster, notably Facebook. Facebook is another COVID-19 beneficiary with usage of its core Facebook and Instagram social media platforms up 20% from pre-COVID levels, advertising revenue benefiting from an acceleration in e-commerce sales and advertising rates back near pre-COVID levels, and an exciting product pipeline headlined by Facebook Shop.
- **Industrials** cluster, including Siemens and Continental, as the market took a more constructive view of industrials following news of reopening during the quarter. Siemens

To end June 2020, the Company had bought back \$61.0m of shares at an average price of \$0.96 per share, equivalent to a volume weighted average NTA discount of 13.9%.

Buybacks at a discount are accretive to the NTA per share. The Company share buyback has aided in ensuring the NTA discount has not widened further, as seen by many other global equity LICs in this quarter but has not yet had a meaningful impact in reducing the absolute level of the NTA discount.

The APL discount to NTA as at 3rd July 2020 was 13.8%. NTA discounts continue to be a challenge for ASX listed global equity LICs with the average NTA discount for those LICs with assets greater than \$200m of 14.6% (per Taylor Collison estimates) as at 3rd July 2020.

The Board of the Company remains committed to reducing the NTA discount and aside from the share buyback outlined above, has introduced daily NTAs to provide shareholders with greater portfolio information, one of only a handful of equity LICs on the ASX to do so, and maintained a steady distribution profile.

also reported a solid result driven by Digital Industries and, pleasingly, orders continue to increase. Siemens Energy remains on track to be spun out in September.

- **Gold** cluster, including Barrick Gold and Newcrest, as the gold price rose 10% over the quarter given accommodative central bank policy. Gold has now appreciated 30% in the last 12 months and is priced just below the all-time highs set in 2011. Both companies continue to deliver solid operational results with Newcrest also reporting encouraging exploration results emphasising the depth of its resource base.
- **Online Services - Asia/Emerging Markets (EM)** cluster, including JD.com and Tencent. JD.com reported a strong result with revenue growth of more than 20% YoY, which looks to have continued into the second quarter. The company is taking market share in e-commerce, users have risen more than 20% YoY driven by growth from lower tier cities, and profitability is improving thanks in part to an improvement in the logistics business. Tencent reported strong mobile gaming revenue, a deep pipeline of games for release and e-commerce initiatives.
- **Electricite de France (Infrastructure/Property - DM)** cluster), as generation volumes run materially ahead of

the company's worst-case target, estimated at the onset of COVID-19. While negotiations regarding tariff restructuring (and subsequent company restructuring) have been delayed by COVID-19, they appear to be moving forward and will be the next catalyst for the stock.

Key detractors to performance over the quarter included:

- **Healthcare** cluster, notably Merck on lacklustre full year guidance at the March quarter result and concerns over its concentration on Keytruda. This should be offset by progress in Merck's vaccine business, its expanding drug pipeline and animal health optionality.
- General Electric (**Industrials** cluster), as the market remains concerned about a protracted downturn in air travel due to uncertainty around COVID-19 and the

subsequent impact on the earnings and balance sheets of companies in the aerospace sector.

- KB Financial (**Consumer Cyclical – EM** cluster) which lowered its full year guidance by 10% as a result of the COVID-induced slowdown in economic activity. Importantly, the company has indicated credit costs are stable with no change to near-term dividend policy. US-based private equity fund Carlyle Group has joined as a strategic investor, which may provide growth opportunities to utilise capital.
- **Shorts**, which protect the portfolio in down/volatile markets (as seen last quarter) but can act as a headwind in strong upwardly moving markets. The portfolio is short businesses that are expensive, vulnerable to competition and in many cases have highly geared balance sheets.

Top 5 contributors & detractors

Top 5 contributors	
Siemens	0.8%
Facebook	0.6%
Lowe's	0.5%
Barrick Gold	0.5%
Wuliangye	0.5%

Top 5 detractors	
General Electric	(0.4%)
<i>Short (Online Service – DM)</i>	(0.4%)
<i>Short (Connectivity/Compute)</i>	(0.3%)
Merck	(0.3%)
KB Financial	(0.3%)

Portfolio positioning

Key changes over the quarter included:

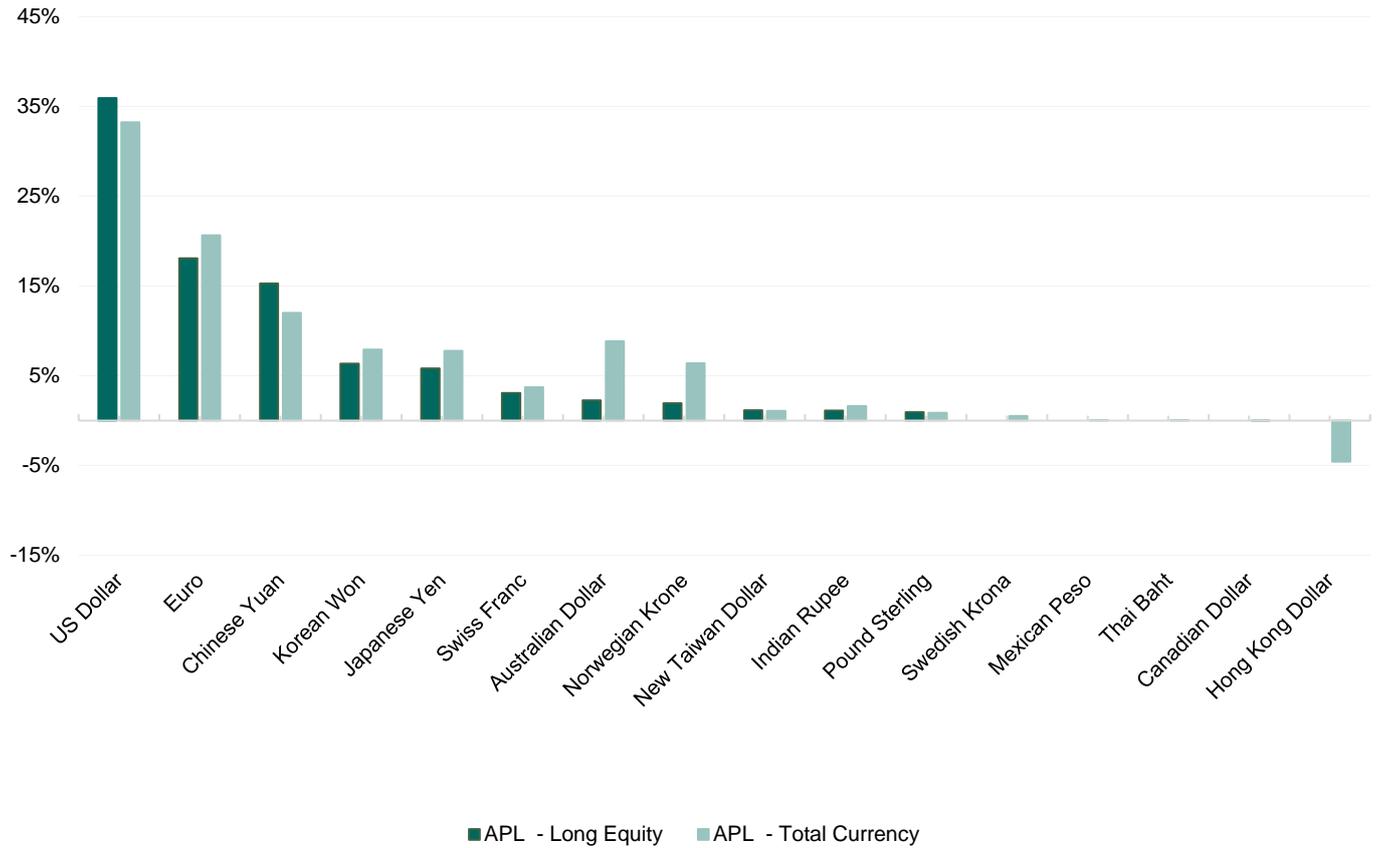
- Adding to **Infrastructure/Property - Developed Markets (DM)** cluster via Simon Property Group, which provides exposure to a leading retail A grade mall portfolio in the US. COVID-19 is accelerating the retail industry shakeout but the scarcity of quality real estate will still command a long term premium.
- Adding to **Healthcare** cluster including Sanofi which has an underappreciated pipeline, a well-funded balance sheet to facilitate additional pipeline acquisitions, a highly defensive vaccines business and a globally leading consumer health business which alone could be worth €30b, or 25% of market cap.
- Rotating exposure within the **Connectivity/Compute** cluster via exiting Cisco, given its exposure to small and medium businesses which may be disproportionately impacted by COVID-19, and reducing exposure to Qualcomm, whilst taking positions in MediaTek, Micron and Dell Technology. MediaTek is well-placed to benefit from a 5G-led handset upcycle having narrowed the gap with tier 1 suppliers and has exposure to high growth end markets such as gaming, datacentres and IoT. Micron will benefit from a memory upcycle in 2021 and a mix shift toward more profitable datacentre applications. Dell Technology's leading position in virtualisation software and hardware infrastructure mean it is well-placed to assist enterprise customers make the transition to hybrid cloud infrastructure.
- Rotating exposure in **Software** via exiting SAP, given the risk of virus-induced delays to the rollout of their new ERP system, and initiating a position in VMware which is now Amazon Web Services' largest cloud partner and well-placed to benefit from large enterprises transitioning to the cloud in a hybrid fashion.
- Rotating exposure in the **Industrial** cluster via reducing exposure to General Electric, as the aerospace business will remain challenged while airline miles flown remain substantially below trend and business travel in particular may not experience a rapid normalisation with reopening, and trimming exposure to Komatsu given the strong bounce from recent lows, and initiating a position in Volkswagen, a scale incumbent auto-producer with a range of globally competitive products from luxury to mass market. The company has a strong position in the Chinese market and is well-positioned for EV demand given the investment it has already made in developing an electric range.
- Reducing exposure to **Online Services – DM** via trimming Facebook to maintain position size following a period of strong outperformance, and reducing exposure to Uber which has likewise outperformed but where the core ride hailing business will be impacted by reopening in the key US market and consequently may take time to normalise.
- Rotating exposure in **Consumer Cyclical – Asia/Emerging Markets** via exiting ICICI Bank and recycling into HDFC Bank. Whilst both banks are priced at 2008 financial crisis-like valuations, the premium for HDFC Bank as the leading retail bank in India has narrowed relative to ICICI Bank and as such it represents better value.
- Reducing **Infrastructure/Property** via exiting the Chinese telecom operators as competitively priced 5G tariffs impact ARPU growth, and on concerns that 5G capex will ramp up faster than expected.
- Reducing exposure in **single stock shorts** and rotating some exposure into tail risk hedges (equity and credit) where we see better risk/reward protecting capital.

Cluster exposure & quarterly change⁵

Sector/cluster	Long	Short	Net	Quarterly net change	Long cluster examples	Short cluster examples
Global	43.8%	(9.9%)	33.9%	0.7%		
Industrials	12.0%	(2.9%)	9.1%	0.6%	GE, Siemens, Continental, Honda	Aerospace & automation roll-ups
Oil/Natural gas	5.0%	(1.5%)	3.5%	(1.4%)	ENI, Inpex, TechnipFMC	Expensive oil
Healthcare	11.9%	(2.5%)	9.4%	1.4%	Merck, Roche, Gilead	Weaker competitors
Connectivity/Compute	10.0%	(1.9%)	8.1%	(0.1%)	Qualcomm, Samsung Electronics	Weaker competitors
Software	5.0%	(1.2%)	3.8%	0.4%	Microsoft, VMware	Narrow feature-sets vulnerable to platform competition
NA/Europe domestic	23.5%	(5.8%)	17.7%	1.7%		
Online services	5.0%	(0.8%)	4.1%	0.4%	Facebook, Uber	Narrow feature sets vulnerable to increasing competition
Consumer defensive	3.8%	(1.7%)	2.1%	(1.2%)	Coca-Cola, Pepsi	Under investing brands
Consumer cyclical	9.1%	(2.8%)	6.3%	0.2%	ING, UniCredit, Capital One	US domestic exposures vulnerable to disruption
Infrastructure/Property	5.6%	(0.5%)	5.1%	2.3%	EDF	Infrastructure assets under competitive pressure
Asia/EM domestic	21.1%	(2.1%)	19.0%	0.9%		
Online services	8.3%	(0.2%)	8.1%	1.7%	Alibaba, Sony	Narrow feature-sets vulnerable to platform competition
Consumer defensive	6.8%		6.8%	0.3%	Ping An, Yum China	Under investing brands
Consumer cyclical	4.0%	(0.3%)	3.7%	0.3%	KB Financial, HDFC Bank	Chinese property developers with weak balance sheets
Infrastructure/Property	1.9%	(1.5%)	0.4%	(1.4%)	KT Corp	Gas utilities facing competitive and/or regulatory headwinds
Tail risk hedge	3.5%	(7.0%)	(3.5%)	2.1%	Barrick Gold, Newcrest	Indices
Total	91.9%	(24.7%)	67.2%	5.4%		

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.

Currency exposure



Feature: Green and envied

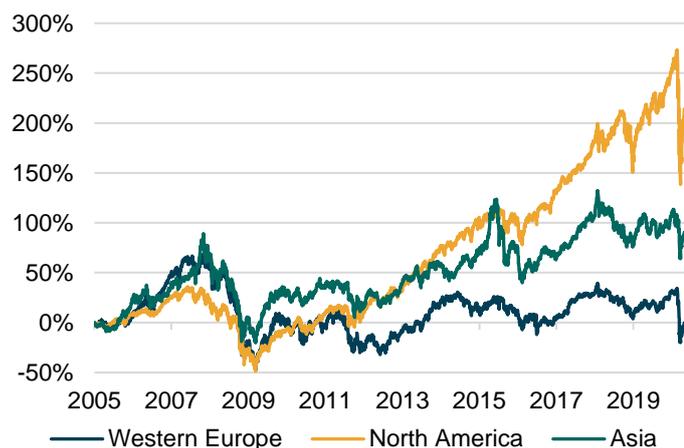
Europe's future proofing plans (finally) coming together

Already facing an unfortunate series of obstacles heading into the 2020s, including a weak industrial economy, stubbornly high unemployment in the poorer periphery, Brexit and undemocratic tremors in Eastern Europe, COVID-19 delivered a further tragic blow to Europe's heart. Italy, already the poster child of southern European struggles, became the epicentre of the COVID-19 pandemic in Europe.

Eurocrats

In the sovereign debt crisis of 2011-2012 Europe's inability to act decisively became famous; Europe became synonymous with bureaucracy and inaction. As populism festered and Europe quivered, the UK voted for Brexit. Investors, rightly or wrongly, remained sceptical with the startling underperformance of domestic facing European equities relative to that of the US and Asia.

Figure 2: Domestic⁶ sector index performance (USD, total return)



Source: FactSet, Antipodes

The seeds of change, however, were sown in late 2019 with the changing of the guard in Europe. Ursula Von Der Leyen, a long serving Merkel aide, pitched a multi trillion Euro fiscal stimulus package under the broad title of the "European Green Deal" in her inaugural address as newly appointed head of the European Commission. It was met with scepticism; such is the consensus that Europe cannot deliver.

For the Northern European countries, characterised by low government debt and debt-averse populations, debt mutualisation is worrisome. This has held back many pan-European plans in the past. But things have finally changed. European politicians see a need to act, recognising the risks of a job-destructive virus given youth unemployment is already close to 15% across the continent. Further, COVID-

19 reinforced an existing slow-down in the supposed powerhouse, with the German economy in the first quarter suffering its largest contraction in GDP since the financial crisis (-2.3% YoY).

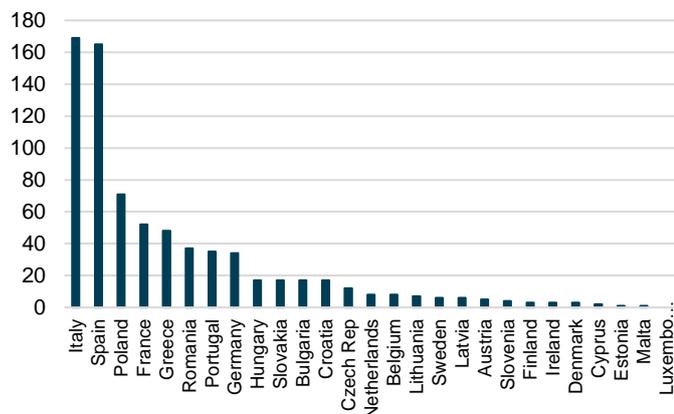
Following the virus-induced downturn, the old rulebook has been thrown out; fiscal transfers have become an acceptable discussion, we've seen a renewed focus on green policies and greater foresight in recognising that there will be a need for re-skilling as traditional jobs are lost in the longer term modernisation of the EU economy. In a bid to ensure a broad-based consensus by appeasing nations that might suffer from such dramatic shifts in economic focus, €40bn has been allocated as part of the "Just Transition Fund" to ensure no region is left behind as the wider European economy modernises. It seems reasonable to state that equitable Pan-European growth as an objective is on the agenda.

The most significant near-term union-wide policy to be put into action is the €750b Recovery Fund, where it is hoped that the bulk of funding will be distributed to member states in the form of grants rather than loans. This is significant, given northern Europe's traditionalist view is to avoid direct fiscal transfers flowing south. Importantly, distribution will be tilted towards regions most impacted by the virus i.e. Spain and Italy will be the largest recipients.

The total funding of €750b in recovery funding and €1.1t in the 2021-2027 multi-year budget brings the EU's firepower to €1.85t, along with €540b in pandemic financial support through the European Stability Mechanism. Contextually, this €2.4t in total support is ~14% of total Eurozone 2019 GDP.

⁶ Domestic sectors include Financials, Internet, Retail, Housing, Media, Commercial Services, Construction, Transport, Health Services, Communications, Infrastructure and REITS/Development

Figure 3: Estimates of what nations may receive from the Recovery Fund (EUR, billions)



Source: European Commission, Morgan Stanley Research

But it isn't just at the supranational level that the purse strings are loosening. Nation states have also promoted their own domestic recovery packages. Germany's national stimulus package alone is worth €130b, and includes a broad range of measures from a VAT cut, aid for midsize enterprises, €300 per family in the form of a child bonus and measures to encourage the purchase of less polluting vehicles. France has likewise responded with an €8b package to support the auto sector, which includes EV subsidies.

Table 1: Estimates⁷ of selected programs' impact if targets are to be met

Objective	Est. impact	Explanation
Increasing renewables within Europe's energy mix	€250b	Plans to reduce coal within Europe's energy mix
Increase in R&D to a globally competitive level with focus on digital industry	€280b	R&D to ~4% of GDP
Widespread green transport adoption	€200b	Investments to bring about large scale e-mobility adoption
Energy efficient renovation of existing building stock	€120b	Reducing energy consumption
Hydrogen developments	€25b	Building of large scale electrolyzers
Reskilling of workers	€40b	Retraining of employees from legacy industries

Source: Antipodes

Our attention is focused on the broadly termed European Green Deal, a multi-faceted investment strategy sitting within the multi-year budgetary plans covering everything from auto

stimulus (geared towards electric vehicles), to energy renovation of building stock and a transition fund for Eastern Europe's coal heavy power grids to join the renewable revolution. This can create a new source of demand for Europe's industrial exporters – namely Germany and France – making the logic for funding such a program much more attractive.

At over €2t of spending, the Green Deal plans are unambiguously ambitious. Whilst the finer details are still being determined, it is significant that both Germany and France have voiced their support.

Markets are notoriously poor at pricing long-dated risks, such as those presented by inequality and resultant populism or the effects of climate change. Europe is attempting to transition from income to investment-led stimulus supporting a sustainable recovery in economic activity and employment. In some ways this represents a belated attempt to catch-up. Europe runs the real risk of trailing China and the US in the adoption of highly disruptive cloud and 5G technologies. With growing urgency, European policy makers realise the need to push towards a more technically advanced economy (with higher productivity), with a greener electricity grid and attempts to level-out geographic income inequality through investment.

Irrational extrapolation

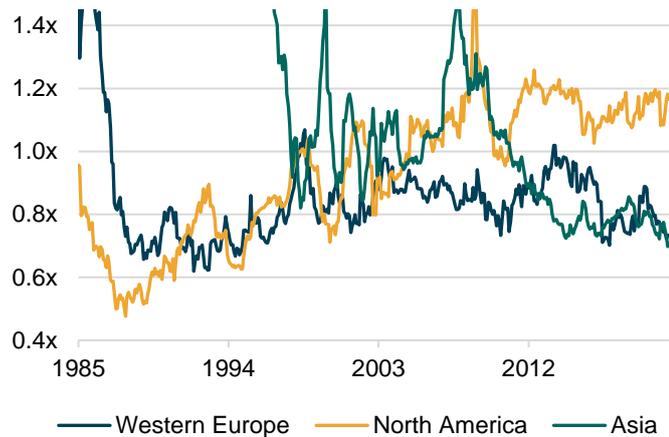
With the market's preference for secular growth made more acute by the supply/demand shock of COVID-19, it has been forgotten that Europe is home to some of the world's best industrial and automated machinery companies globally. It is these industries which will be the direct beneficiaries of investment led stimulus. Whilst Europe's historical failure to deliver has led to concern over investing in Europe, we see a recovery path driven by the 'now or never' action of the European Union.

Margin of safety

While there will be a digital and efficiency skew to this investment stimulus (EVs, 5G), investment into physical infrastructure (rail, power, buildings) should support the cyclical/low-multiple areas of the market too. Further, the relative valuation of domestic facing European businesses stand in contrast to peers in the US.

⁷ Estimates are based on our view of the investment requirements to meet the EU's planned goals and do not denote direct funding.

Figure 4: Domestic sector⁶ PE (multiple of world PE)



Source: FactSet, Antipodes

De-carbonisation/renewable investment is both labour and capital intensive. Hence this type of stimulus will create both domestic demand and jobs and help moderate Europe's historic reliance on trade and Chinese import demand as the key source of growth.

Antipodes' global portfolios, with around 25% exposure to Western Europe, are well positioned to benefit from policy action via exposure to:

- Siemens, a globally leading German industrial conglomerate with premier positions in factory automation, offshore wind farms and gas turbines. The company stands to benefit directly from greater automation in manufacturing and decarbonisation of grid systems.
- Cleaner energy via EDF, France's leading low-carbon electricity producer.
- Continental and ST Micro, key in the supply of essential components for the electrification of vehicles.

- Volkswagen, a scale incumbent auto-producer with a range of globally competitive products from luxury to mass market, including a strong position in the Chinese market. Volkswagen is well-positioned for EV demand growth given the investment already made in developing an electric range.
- Norsk Hydro, a sustainable aluminium producer (using hydropower) where demand is set to increase thanks to demand from electric vehicles and energy efficient buildings, in addition to an increased focus of supply-chain carbon footprint.
- Leading retail banks, which are direct beneficiaries of reopening and increased economic activity, and where income stimulus will provide some backstop to credit costs.

Margin of error

Whilst we see the potential for positive outcomes from European wide growth stimulus, risks remain on the political front – and much remains to be done for policy to deliver. Fragilities remain a decade after the 2008 financial crisis, with high public debt burdens in Europe's south, although households (Italy in particular) have relatively healthier budgets. Cohesion in the continent's banking systems (a banking union) remains a topic of debate but will be critical to longer term stability. Youth unemployment remains stubbornly high and this, together with broader inequalities, risks further political fracturing.

To mitigate the risk of continued European economic underperformance our holdings generally have strong ex-European positions and product offerings, in addition to generally strong financial positions.

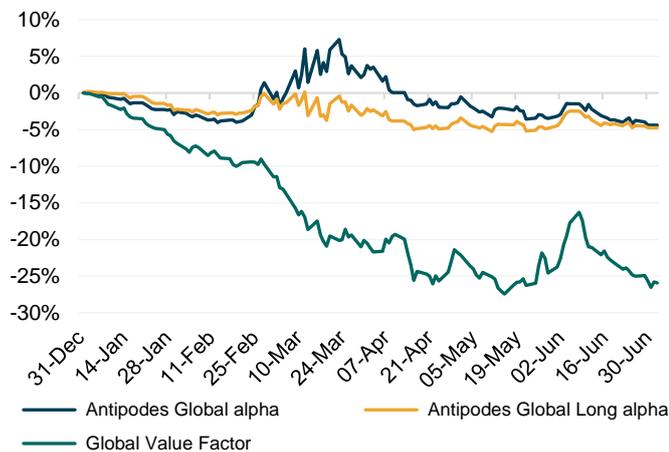
Whilst Europe has struggled to deliver historically, we see the risk-reward skewed favourably for Europe's stimulus plans coming together.

Outlook

Whereas the first quarter of 2020 was the S&P500's worst since 2008, this quarter was its best since 1998 (+20.5% USD). The market herded back into secular growth in the initial stages of the bounce but rotated into low-multiple/value stocks as economies reopened and activity showed signs of stabilising. Pleasingly our portfolios outperformed during this period. This rotation reversed into quarter end as COVID-19 returned to the headlines with 40% of the US population seeing reopening halt or begin reversing.

The US value factor has retraced the entire reopening rally, and European value has given back about half the gains from the low point (Global Value Factor, Figure 5). The question is how to balance near-term risks regarding reopening with the longer-term impact of stimulus on economic activity. The market's preference will likely continue to oscillate between growth and value until there is a clearer path forward.

Figure 5: Performance of cheapest relative to most expensive



Source: FactSet, Antipodes

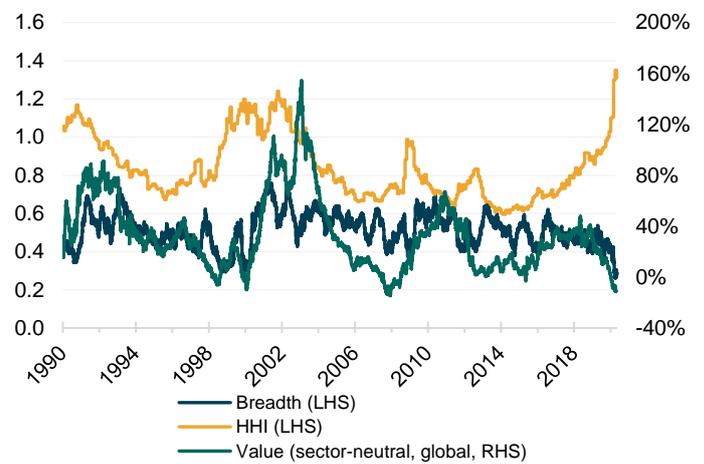
The value factor is really a measure of valuation dispersion. When investors claim the value factor is cheap, what they are really saying is that the valuation multiple that investors are willing to pay for perceived winners is VERY high relative to perceived losers. And it's no secret just how wide this dispersion has become over recent years. Given the acceleration in technological disruption and multiple hits to business confidence it's no surprise that today the lower multiple "losers" are characterised by the more economically sensitive, or cyclical, parts of the market. Returns from value on a global sector-neutral basis are in negative territory on a three-year rolling return basis⁸ (Figure 6), and value as a style has rarely been this cheap.

In this context it is worth noting how narrow performance has become. Year to date around two-thirds of the move in the

⁸ Weights all sectors equally removing the influence of dominating sectors such as banks and energy.
⁹ The Herfindahl-Hirschman Index (HHI), when applied to market capitalisation, is a measure of the size of companies relative to total market capitalisation.

S&P500 can be explained by just five stocks: Facebook, Apple, Amazon, Alphabet/Google and Microsoft. Breadth and market cap concentration are at 30-year extremes (Figure 6). Only 20% of stocks are outperforming the index (breadth) and a smaller number of companies are accounting for an ever-larger percentage of market cap (concentration/HHI).

Figure 6: Market leadership has become extremely narrow⁹



Source: FactSet, Antipodes

Mean reversion in valuation dispersion (outperformance of value) – i.e. reversals in these extremes where the less popular, lower multiple losers begin to outperform the current winners – typically coincides with a cyclical economic rebound combined with some larger shift in investment preferences. The causality here is that during an economic upswing, cyclicals receive a growth boost relative to secular growers and a steepening of the yield curve hits the discounted cash flow of longer duration assets (high PE stocks) harder than shorter duration assets (low PE stocks).

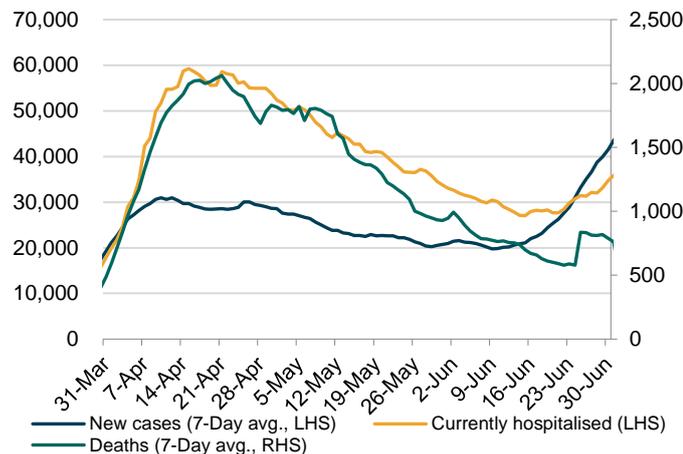
Risks to equities as an asset class

As reopening across the major economies has accelerated, the US is facing difficulty controlling the spread of the virus. R0 – the reproduction rate of the virus – is above 1, and rising in roughly half the US states¹⁰. In contrast with Asia and Europe, the US is struggling politically to implement a

¹⁰ R0 = 1, each infected person will infect on average one other person. R0 > 1, each infected person will infect more than one person meaning the outbreak will accelerate. The opposite is true for R0 < 1.

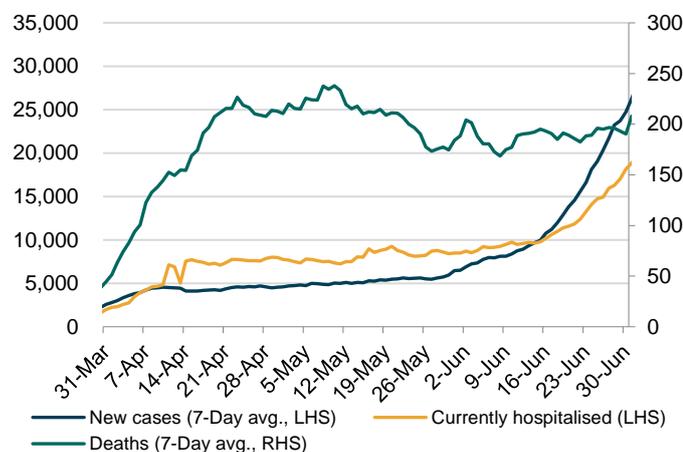
unified virus response exacerbated by social unrest. Infection rates and hospitalisations in key hotspots California, Texas, Florida, Arizona, Georgia and North Carolina continue to increase at an exponential rate – and all except California are Republican states (Figure 8).

Figure 7: US new COVID-19 cases (7d avg) v hospitalisations



Source: COVID Tracking Project¹¹, US State Health Departments, Antipodes

Figure 8: California, Texas, Florida, Arizona, Georgia and North Carolina new COVID-19 cases (7d avg) v hospitalisations



Source: COVID Tracking Project¹¹, US State Health Departments, Antipodes

Tracking hospitalisation and deaths are key to determining the severity of any second wave (Figure 7). The healthcare system’s ability to cope is the most important factor for policy makers in considering any second-wave shutdown. The proportion of infected individuals requiring hospitalisation, efficacy of treatments to manage severity/length of stay and

extent to which hospitals are better equipped to respond (“surge capacity”¹²) are the critical determinants of system capability. Importantly, deaths currently remain relatively stable. Re-flattening the curve in the coming weeks will be crucial to avoid further disruptive nationwide shutdowns.

With a backdrop of COVID-induced weak economic activity and rising social discontent it will pay to watch for a swing to more socialist policies in the US (and Europe), and how this may impact domestically exposed equities. Even if infection rates are controlled in the US, the probability of a Democrat clean sweep in November is rising (the last time this occurred was 2009). Roughly two-thirds or 21 Senators up for re-election are Republicans, seven of these contests look highly competitive¹³ and if just four seats change hands the Democrats will take control of the Senate. A clean sweep by the Democrats could mean greater regulation (risk for tech titans), higher taxes (risk for corporates/wealthy). A reversal of Trump’s corporate tax cut would see a ~14% hit to US domestic earnings.

The ‘social wage’ introduced in the US to manage the impact of COVID-19 may have longer-term implications. The \$600/week supplement takes income support to around \$900/week. Almost 40% of job losses in low-paying leisure, hospitality and retail have seen incomes increase 140%, and aggregate income is 10% higher than pre-COVID levels¹⁴. Europe, on the other hand, followed a pathway of partial income replacement where the employer-employee relationship is maintained, similar to Australia. With rising social discontent there is a risk this will lead to a permanently higher unemployment benefit/minimum wage and a structurally lower participation rate, all of which, all else equal, would add to cost pressures. Further, a focus on onshoring and domestic economic stimulus may see the persistent deflation in traded manufactured goods reverse. However, rather than persistent inflation, we expect to see more volatility around the sources of inflationary pressures and the headline inflation rate.

Thanks in part to this income stimulus the US fiscal deficit is expected to breach 20% of GDP this year. This is an extraordinary figure and compares to fiscal deficits closer to 8-10% in Europe. Every month the income supplement extends beyond July adds another 0.25% to this deficit. Whilst the US cannot sustain income transfers indefinitely any withdrawal of income stimulus before an investment led recovery takes hold is a risk. Given the fractious state of US politics, we question whether there is sufficient goodwill

¹¹ <https://covidtracking.com/about>

¹² Hospitals are cancelling elective procedures to free up ICU/clinician capacity, stockpiling ventilators and protective equipment, re-purposing wards and adding beds

¹³ Source: senate.gov

¹⁴ Source: US Bureau of Labor Statistics

between the Democrats and Republicans for infrastructure stimulus. Europe and China appear to be in better shape from an infrastructure planning and aggregate government debt perspective. Inevitably, open-ended fiscal deficits/government debt in the US and also Southern Europe will come back into the frame, and at what point does the bond market - and the USD - react.

US-China tech rivalry is likely to remain in the headlines. More than half of China's critical semiconductor equipment comes from the US¹⁵. Without access China is unable to reduce its reliance on imported chips, hindering its ability to pursue semiconductor independence and emerge as a global powerhouse in next generation tech. US corporates, however, benefit from access to the Chinese market. Around 6% of S&P revenue is derived from HK/China, though it is much larger for many US multinationals e.g. Intel at 27%, and Apple, Mastercard, Nike at 15 – 20% each. Seemingly both sides appreciate the risk of “mutually assured destruction” from continued escalation, although Trump's next move may be more influenced by deteriorating polls. Companies with large profit pools in both US and China may be vulnerable, and localisation of supply chains seems inevitable.

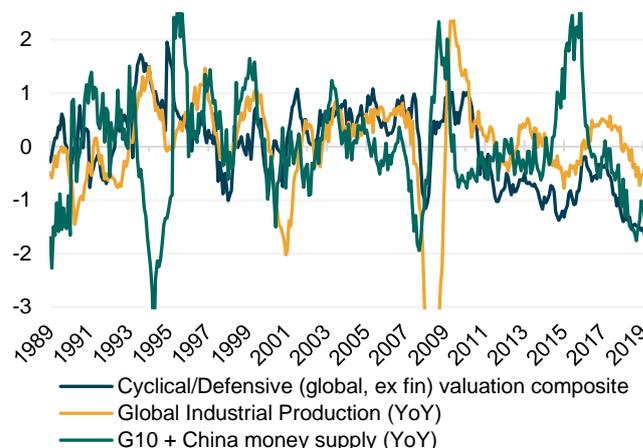
COVID-19, a rise in populism, socialist policies, burgeoning fiscal deficits, and the weak quality of corporate debt and zombification (detailed last quarter) are all related risks. Each outcome reinforces another risk.

Given these risks, could “value” rebound even if equity indices fall? The nature of these risks means they can impact both higher multiple growth/defensives and lower multiple cyclicals. Providing these risks do not derail the cyclical rebound in activity – and there is evidence of a stabilisation in activity - a rotation into value can emerge.

Does COVID-19 sow the seeds for the next up-cycle in value?

Whilst we have seen periodic upswings since the financial crisis, cyclicals have underperformed right up to the extreme industrial production collapse that occurred during the COVID-19 outbreak. Cyclicals are now more than two standard deviations cheap versus defensives/secular growth (Figure 9).

Figure 9: Have cyclicals priced the end of the industrial era?¹⁶ (z-score)



Source: FactSet, Bloomberg, AASE, Antipodes

The initial response in 2008 was large fiscal and monetary expansion, but this turned to fiscal austerity from 2010. Central banks were left to stimulate growth in the decade following, but monetary policy alone was inadequate to trigger a broad investment cycle in the private sector. New money inflated asset prices rather than funding a direct transfer from the government to the private sector via the fiscal channel, which would stimulate the real economy.

The COVID-19 supply/demand shock galvanised policymakers to move quickly and forcefully. For the first time in a decade markets are witnessing a wave of large-scale fiscal and monetary stimulus across the world. With wealth disparity widening the pressure on governments to do more is building. Money supply has expanded meaningfully across the G10 + China (Figure 9), and money supply growth has historically been a good leading indicator of the industrial production cycle and performance of cyclical stocks. While money supply growth tends to manifest in higher economic activity, the degree to which this liquidity drives higher production versus asset prices is less predictable. Economies are reopening at different speeds and the marginal propensity to consume may be lower thanks to COVID-19.

That aside, the liquidity response today is better balanced between the real and financial economies. It is more likely to be followed by a cyclical economic rebound, however, an early switch to fiscal austerity will risk plunging economies back into recession. Ample free liquidity inflated initial beneficiaries of COVID-19 such as e-commerce and work from home enablers i.e. secular growth stocks melted higher. As investors gained confidence around reopening and

¹⁵ 55% of China's semiconductor equipment sourced from the US, 25% Europe and 20% Japan

¹⁶ Valuation is a composite of EV/CE, EV/Sales, P/E and EV/7Y avg. EBIT (non-sector neutral)

economic data began to stabilise, lower multiple stocks participated e.g. financials, retail, property (domestic cyclicals).

Ideally fiscal stimulus needs to transition away from income support to investment to generate sustainable activity and employment. Arguably policy makers have little choice given the need to rehabilitate economic activity. Global cyclicals will be the key beneficiaries of investment-led stimulus. We expect China and Europe to lead the way with decarbonisation, EV and 5G adoption (Europe's opportunity discussed in this quarter's feature article "Green and envied"), and consequently have a relatively stronger economic recovery. Importantly the Chinese economy is approaching pre-COVID levels of activity; manufacturing and services activity has been expanding for months, retail and property sales have stabilised and auto sales are growing on a year-on-year basis. In the near-term Europe will disproportionately benefit from the rebound in China as exports generate 20% of Eurozone GDP, compared to just 12% in the US. Just as cyclicals are valued at very attractive multiples, so too are domestic businesses in Europe and Asia.

Whilst uncertainty around the sustainability of recovery and nature of stimulus exists, we believe it makes sense to take a barbell approach to investment: owning cheaper expressions

of secular growth and defensive assets while maintaining exposure to high quality cyclicals/lower multiple stocks with embedded growth opportunities. As opening up/infrastructure stimulus accelerates our barbell will lean further towards the latter group. Even a short, shallow investment cycle would be a boon for low multiple stocks. Antipodes is well positioned to capture this upside.

We also acknowledge life will not revert to the prior status quo. The longer that lock-down anxiety lingers, the more likely certain behavioural changes become permanent. Poorly positioned retail and travel businesses will be impaired, corporates will cut costs which may impact IT budgets, employment, business travel and office demand.

The continuation of long-term disruption is real, however, blindly buying the high multiple, secular growth/defensive part of the market may also be risky. It will pay to remain pragmatic rather than dogmatic around the assessment of value. In this light, there are potentially just as many growth traps today as there are value traps. A "growth trap" is overpaying for a higher growth opportunity, as investors did with great companies like Microsoft during the 2000 tech bubble. Whilst cloud and e-commerce are current long-term secular growth opportunities, investors should look for cheaper expressions and avoid paying any price for growth.

Appendix

Market returns to 30 June 2020 (USD, p.a.)

Absolute performance (%)	3m	1y	3y	5y	10y
Regional equities (MSCI)					
AC World	19.2%	2.1%	6.1%	6.5%	9.2%
USA	21.6%	7.8%	10.4%	10.1%	13.4%
Europe	15.3%	(6.8%)	(0.0%)	1.5%	5.7%
Japan	11.6%	3.1%	3.0%	3.4%	6.1%
Korea	19.5%	0.4%	(1.9%)	4.2%	4.8%
AC Asia ex Japan	16.7%	1.7%	3.6%	4.4%	5.9%
All China	15.4%	12.9%	6.4%	1.0%	6.0%
EM ex Asia	19.0%	(25.2%)	(4.9%)	(2.8%)	(2.2%)
Global sectors (MSCI)					
Consumer Discretionary	28.6%	9.3%	9.7%	8.3%	13.0%
Consumer Staples	9.1%	(0.2%)	2.6%	4.8%	9.0%
Energy	17.8%	(34.0%)	(8.9%)	(6.6%)	(1.1%)
Financials	12.0%	(17.7%)	(3.8%)	0.4%	5.1%
Health Care	15.3%	14.6%	9.8%	6.7%	13.5%
Industrials	17.4%	(7.9%)	1.2%	4.7%	8.3%
Information Technology	30.0%	31.8%	22.3%	20.1%	17.6%
Materials	25.6%	(4.6%)	2.8%	4.2%	3.3%
Communication Services	19.8%	8.9%	5.6%	3.4%	7.0%
Utilities	6.6%	(2.3%)	4.6%	5.8%	5.5%
Commodities					
Crude Oil Brent	56.6%	(36.3%)	(5.4%)	(8.3%)	(5.8%)
Gold	9.9%	25.5%	12.5%	8.6%	3.6%
Bloomberg Commodity Index	5.0%	(18.4%)	(7.7%)	(8.7%)	(6.4%)
Bonds (BAML)					
Global Government	1.4%	4.4%	3.9%	3.7%	2.5%
Global Large Cap Corporate	8.8%	5.7%	4.6%	4.4%	4.5%
Global High Yield	11.5%	(0.6%)	3.0%	4.6%	6.5%
Currency					
AUD	12.5%	(1.9%)	(3.5%)	(2.2%)	(2.0%)
EUR	2.4%	(1.4%)	(0.5%)	0.2%	(0.9%)
JPY	0.1%	(0.1%)	1.4%	2.6%	(2.0%)
CNY	0.3%	(2.9%)	(1.4%)	(2.6%)	(0.4%)

Source: MSCI, BAML, Bloomberg, FactSet



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