TO OUR UNIT HOLDERS

Our Fund's Performance (after fees) to 30 September 2021

Returns post fees	1 Month %	3 Months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Incep^ % p.a.
EGG Small Companies Fund	-3.30	4.98	25.53	8.50	9.58	11.62	11.41
S&P/ASX Small Ord Accumulation Index (XSOAI)	-2.14	3.44	30.41	9.43	10.18	7.70	7.18
Outperformance	**-1.16**	**+1.55**	**-4.88**	**-0.93**	**-0.59**	**+3.93**	**+4.24**

Returns post fees	1 Month %	3 Months %	1 Year %	2 years % p.a.	3 years % p.a.	4 years % p.a.	Incep^ %p.a.
EGG Emerging Companies Fund	0.81	12.02	39.32	24.84	20.92	23.56	24.36
S&P/ASX Small Ord Accumulation Index (XSOAI)	-2.14	3.44	30.41	12.28	9.43	12.06	12.04
Outperformance	**+2.95**	**+8.59**	**+8.91**	**+12.56**	**+11.49**	**+11.50**	**+12.32**

**Inception September 2003*
^Inception March 2017

Market Review & Strategy

For the quarter the Eley Griffiths Group Small Companies Fund and Emerging Companies Fund finished +4.98% and + 12.02% respectively versus the Small Ordinaries Accumulation Index of +3.44%.

September capped off an extraordinarily busy time for investors and fund managers alike. The broader market made historic highs, an estimated $40bn in dividends from 350 companies were paid/declared and household interest in equities and managed funds grew strongly.

Western stock markets maintained their march upward through the September quarter with a shallow retracement in mid July around possible economic impacts of the Delta variant and perceptions that the US economy might be trending close to peak-growth. Any disquiet here was shrugged off with buyers returning, however by late September markets were again in search of a correction catalyst and this surfaced with the deteriorating China Evergrande Group situation and a hawkish shift emanating from the September FOMC meeting.

Headlines from China would feature during the three months to September end with a continuation of the June quarter downtrend in Chinese stock prices, a long way from their zenith in February 2021. This market downdraft reflected concerns around tightening financial conditions and a growing number of central government policy initiatives and regulator decrees. Pitched in the name of 'common prosperity' but likely designed to put a few billionaires in their place and avouch the Chinese hierarchy, these edicts included:

- Regulators sought to halt all Chinese IPO's in the US as well as increasing scrutiny over the activities of Alibaba, Tencent and DiDi to name a few
- Bans on private, for-profit edu-tech companies and restrictions on children's videogaming participation
- Outlawing of cryptocurrency mining and crypto transactions generally
- Property sector balance sheets to be progressively de-levered and Evergrande likely to face a controlled-implosion.
- Load shedding directives to power stations in favour of residential consumption
- A flat steel output target (2021 v 2020) that ushered in a 40% slump in iron ore price

The culmination of these developments has seen international capital take flight. The **NASDAQ Golden Dragon Index**, a benchmark of US listed Chinese companies finished September 51% down from the February 2021 highs, an arresting investor capitulation.

The August reporting season was well received by the market with UBS' beat/miss ratio of ~2.9x above the average 1.5X and the highest chalked up since 2014. Earnings revision momentum however did not reflect this with a minority of companies tweaking estimates higher for FY22. Most management teams opted to defer detailed outlook commentaries, availing themselves of the trading period immediately prior to the October-November AGM season before venturing a read on trading.

The season saw secular growth stories deliver on earnings and be rewarded by the market. Eley Griffiths Group holdings **ARB Corporation**, **EBOS**, **Mainfreight** and **Macquarie Telecom** being cases in point. Supply chain disruptions were a recurrent theme as was evidence of vigorous corporate cost cutting. Enhanced pay-out ratios were popular and buyback announcements were not uncommon. Pleasingly, volatility around result day and the days following seemed milder than in previous reporting periods.

Macquarie Equities advised that the Australian market was on track to see ~$350bn in merger and acquisition activity in 2021. Significant in that this comfortably eclipses the last peak of $193bn recorded in 2018 and is testimony to corporate confidence in a post covid19 world as well as confirming debt and equity markets are open and willing to finance deals.

The Sydney Aviation Alliance unveiled the largest ever cash bid for an Australian company with a $32bn (including debt) lunge at **Sydney Airport**. US listed Square, Inc and Afterpay entered into an all-scrip scheme of arrangement valuing the group at ~$39bn. Brookfield and **APA** fought over **AusNet services**, **Wesfarmers** and **Sigma** duelled over perennial disappointer **Australian Pharmaceutical Industries**. **Santos** merged with **Oil Search**, Brazilian group JBS bid for **Huon**. Swedish PE group EQT Private Equity approached and withdrew an indicative offer to acquire **IRESS** during the period in review.

Corporates also took advantage of market liquidity to divest minority shareholdings in one-time strategic targets or long-term positions. 360 Capital sold its 33% stake in **Global Data Centres**, **Woolworths** quit its 10% stake in **Marley Spoon**, **Mineral Resources** sold its 5% holding in **Pilbara Resources** and Education Australia (representing 38 Australian Uni's) sold 15% of **IDP Education** and in-specie distributed the remaining 25% to member universities).

The REIT space saw outsized activity in September. Five REIT's raised a combined $1bn whilst there was ~$6.5bn in announced deals, including a **Charter Hall** consortium bid for **ALE Property Group** valued at $1.7bn.

<u>During the quarter, Eley Griffiths Group announced that its Emerging Companies Fund would close to new investors once its funds under management passed through $300m. This looks set to occur prior to year end.</u>

Technical Summary

Stocks/Bonds

The **S&P500** is presently experiencing mild turbulence, having staged a snap pullback late in the quarter. Hardly surprising given the near completion of the Fibonacci measured move target of 4595, a level set in stone back in April 2020.

The index touched 4546 on September 2. I would also draw readers attention to the deteriorating breadth of the 2021 rally. 47% of S&P500 names are presently above their 100 day moving average versus 70% at June end and 93% back in March. Greater participation will be required for the next up-leg which will surely come after the market draws breath, which may include a possible move down to 4056.

Curiously, speculative positioning in S&P 500 e-Mini Futures sits around 1.2:1 long which is where it sat at June end. This is a benign setting and marries nicely with the current US investor survey findings from the AAII that highlights souring investor sentiment with 41% of correspondents bearish (historical average 30.5%), the highest reading of the past 12 months. So much for an overheating rally!

Speculative positioning in the **Nasdaq 100** and **Russell 2000** is also a long way from exuberant. Traders should note that the Coppock Indicator across many of the major US indices appears to be working out a bottom. This is a slow moving measure

whose reputation is grounded in picking important turning points from lows in price action, none more pertinent than the March 2020 signal.

Locally, the **All Ordinaries** spent most of the September quarter consolidating an 18 month rally, including posting a historic high for the benchmark. A decisive move lower on September 9 confirmed a break of the primary trend with a known support level of ~ 7474 catching the price action and providing a base from which the market might continue to congest. Failure to hold this level would see the index move quickly to 7154.

The **Small Ordinaries Index** has traded to levels not seen since 2008 but failed to move to record highs during the quarter, contrasting with mid-caps which have been setting all time highs throughout 2021.

A long-term chart of the **Small Resources Index** looks very bullish, whereas shorter term charts indicate the sector being in a consolidation stage of its wider advance. Trading at 3419 at the time of writing, it seems a momentous effort will be required to attain the high of 7185, struck in 2008. Unlike the **ASX300 Metals and Mining Index** that until recently was in the rarefied air that a record high brings.

The **US 10 year note** has almost certainly exhausted its rally with 2 attempts to move through 1.126% (late July and early August) proving the line of least resistance is up (for yields). Our year-old targets reflect Fibonacci prescribed levels, 1.78% (0.50) and 2.13% (0.618) and repeating our confident call that the March 2020 low of 0.314% will be the eternal low in yields that we will be talking to our grandchildren about. The 'bear steepener' stage of the yield curve shift we are witnessing now virtually preordains the forecast up leg in the 10 year note yield.

Commodities/Currencies

Gold continues to drift aimlessly. The unequivocally bullish signal from the Coppock Indicator unveiled in last quarter's *The Encyclical* seemed only good for an $80/oz rally. Price action of late appears non-committal and speculative futures positioning is not ideal at 2.3:1, long to short.

Armed with this information it is easy to conclude that gold equities are not ready to meaningfully rally, notwithstanding the broadly constructive **A$ Gold price**. I recently reviewed 9 ASX names through the lens of stochastic and Coppock indicators, a sector wide quasi-key reversal (September 29) and recent traded volumes. 4/9 yielded at least 2 favourable observations, the standout being **West African Resources** with 3. The stock moved to historic highs in the weeks that followed the key reversal.

North American equities (ref GDX US and GDXJ) have spent their time back-tracking from the August 2020 highs having faithfully rallied from significant basing structures before stalling and appear unexciting at this time.

Brent crude at the time of writing was within reach of the October 2018 high of US$86.74. The long-term chart will make readers sit up and take note. Oil is in the process of clearing a downtrend line from 2008 that will free it up for a move to US$97.33 (Fibonacci 0.50) before an eventual assault on the old highs of US147.50. A move to the old highs will require navigating significant congestion between US$97.33-US$117. I would expect the 'black gold' to do some work around current levels ahead of the next leg upward.

Traders continue to position to the long side of the **US Dollar Index (DXY)** play and so far they have been correct, but at 3.5:1 long to short the trade is beginning to get crowded. Just to remind readers, the DXY is working through a six year rectangle (consolidation), hidebound at 100.25 to the topside and 89.50 on the downside. Whilst the ultimate breakout direction can't be known with certainty, the odds favour a move above 100.25 with the one certainty being a slow and exhaustive campaign will continue to play out here.

ELEY GRIFFITHS GROUP

The Log

The Log is a new addition to *The Encyclical* and aims to share different perspectives from the team at Eley Griffiths Group. This issue of *The Encyclical* introduces our investors to how we incorporate the principles of Environmental, Social and Governance (or ESG) analysis to our investment process. Below is an excerpt from one of our recent reports.

ESG In Focus: **PointsBet Holdings** (ASX:PBH)

PBH is a licensed corporate bookmaker with operations in Australia and United States and operates within the sports gambling industry. EGG have given the stock an overall ESG score of 0 (E +1, S -1, G 0). A score of 0 puts PBH in the bottom quartile of ESG scores in the EGG portfolio.

As part of the EGG investment process, each company in the portfolio is tested for ESG compliance at the pre-analysis and pre-trade stage. Each company is given a score of -1, 0 or +1 for each of its E, S and G credentials. The aggregation of these three scores provides us with the company's total "ESG score".

The total ESG score ensures a precise conversation can be had between analyst and management regarding ESG issues, the ultimate aim being better ESG outcomes for investee companies and EGG portfolio's. At this point in time, we believe an outcomes-based approach will have the most success in achieving better ESG outcomes in the portfolio.

The ESG scoring process for PBH highlights two main areas of concern for the investment team.

1) The company operates in the sports gambling industry

2) The company doesn't demonstrate best practice in terms of diversity of the board and management team

These are both Social issues within ESG and given the materiality of risks associated with these issues the stock has been assigned a -1 for Social.

The company has a high score (+1) for Environmental as it has a very small environmental footprint with the largest impacts coming from travel, energy and consumables.

PBH has a neutral score (0) for Governance with our primary concern relating to the lack of an independent majority at the board level. We have found this is more common with high growth, early stage, founder led businesses and have discussed this extensively with management. As a result the company has been penalised from a +1 score on this measure. We have discussed this matter with management and believe that progress to a majority independent board will be achieved in the medium term.

<u>Outcomes:</u>

The investment team has met frequently with PBH management over the last two years and raised our ongoing concern relating to the industry it operates in and the lack of diversity (female representation) in the senior management and board.

PointsBet acknowledges the negative by-products associated with the industry and strictly adheres to all relevant codes and practices which vary by jurisdiction. We believe the board and management are acutely aware that long-term success relies on continuously improving the company's reputation and the way in which it serves the community and the company is responding, to wit:

1. PBH won three awards last year at the eGaming Reviews, including the award for most socially responsible operator, with the judge there noting that PBH is a 'clear market leader in social responsibility in the industry'.

2. PBH has a wide range of initiatives and tools to tackle responsible gambling including i) front end client education/awareness functions, ii) ongoing RSG reports produced on demand and alerts generated (triggers such as multiple accounts, checks against exclusions from database signups etc), iii) deposit limit/duration settings, iv) client 'take a break' features and options, and v) permanent self-exclusion.

3. PBH signed a 5 year agreement with University of Colorado last year, allowing the University opportunity to earn extra revenue for new customers linked to ads it displays. $75k annually will go to support development of student athletes and agreement also allows student athletes opportunity for future internships/job placements.
4. The recent hiring of the strongly credentialed Teresa Fiore as head of Responsible Service of Gambling
5. PointsBet Wins Sports Betting Operator, Socially Responsible Operator and US Rising Star Honors at EGR North America Awards 2020.

The company concedes it has work to do in the area of diversity. We understand that the company's Remuneration and Nominations Committee in conjunction with the Board and management are in the process of setting meaningful targets for further advancement of diversity within the company. The aim of this is to increase the number of women in leadership roles at the Board, Executive level and Management roles.

Outlook

Perhaps it is time that investors be reminded of a few market truisms. The first is that liquidity is the irrefutable lifeblood of markets, second, confidence of the consumer and the firm is critically important to the functioning of economies and third, market and economic cycles in conjunction with liquidity, dictate the trajectory of financial assets. Occasionally a black swan event disrupts the rhythm of markets, like the March 2020 meltdown or the circumstances that gave rise to the GFC in 2008 but these are transient, albeit impactful, events.

Markets appear to have arrived at that point in the journey where investors are becoming anxious that the best is behind them, that corporate profits are peaking, financial conditions will likely tighten and higher interest rates will ruin the party. US investor surveys, as discussed earlier, are printing bearishly, the US Federal Reserve appears to have suddenly turned hawkish with tapering morphing into tightening and the unfolding China Evergrande situation seems almost certainly to point to a systemic crisis taking hold in the middle kingdom. No wonder markets have retraced.

Now let's look at matters objectively. Central banks and western governments stepped in during March quarter 2020 and provided timely liquidity and fiscal safety nets and these are now being progressively wound back. This shouldn't come as a surprise with the forecast backdrop to be one of continuing low interest rates but with some additional fiscal imposts. Followers of *Marshallian K* (liquidity = money supply growth less GDP or industrial production growth) will have noticed this measure turned negative in recent months, suggesting that excess liquidity is increasingly finding its way to the real economy rather than to financial assets. This has the potential to hold back some of the benzene from the fire but it does prove that the system is repairing from covid19 with a revival in consumer and business confidence underway and a lift in business investment to follow.

The yield curve is in a 'bear steepener' phase (inflation expectations, earnings, UST10 all rise →cyclical/resource stocks) informing us that recovery is afoot. Sometime in mid-late 2022 this will revert to a 'bear flattener' (inflation expectations, earnings and UST10 to level off → Growth/quality stocks). A rotation between stock sectors will occur during this stage of the market cycle.

Technically the US stock market has encountered natural resistance with consequent volatility which short term might have further to play out. In the process, these events tend to correct excessive investor positioning.

The economic travails in China in 2021 have been well documented and western investors are learning first-hand of the idiosyncrasies of how command economies manage crises. Our experience tells us that economic stimulus from the central government/PBOC is likely to be close at hand. Evergrande might just be the catalyst.

Meanwhile I will make do with benign credit markets, compelling equity risk premiums, robust corporate health (and resultant M&A activity), a growing tactical allocation globally from cash to equities and confidence that the economic/market cycle is keeping to the script.

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