AUDUCO

Q2 FY22 STATUS REPORT

"Our focus, trust" *"Accounting for every trade"*

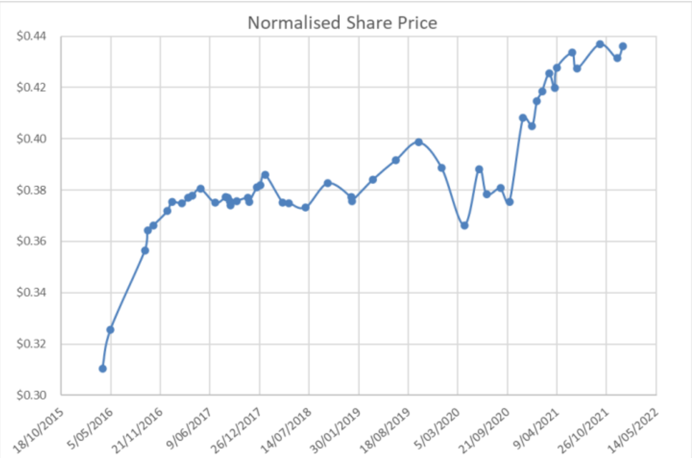
Investment Performance of Deployed Capital

Auduco Pty Ltd's current investment position and normalised share price are summarised in the table and figure below.

31-Dec-21 Snapshot		
Top 5 Equity Holdings	Ave Entry Price	Market Price
ANZ	$23.43	$27.51 (Q1 perf: -$0.64)
BOQ	$7.96	$8.09 (Q3 perf: -$1.27)
NAB	$19.01	$28.84 (Q4 perf: $1.01)
WBC	$16.18	$21.35 (Q4 perf: -$4.65)
WPL	$23.28	$21.93 (Q4 perf: -$1.95)
	Current Market Value	

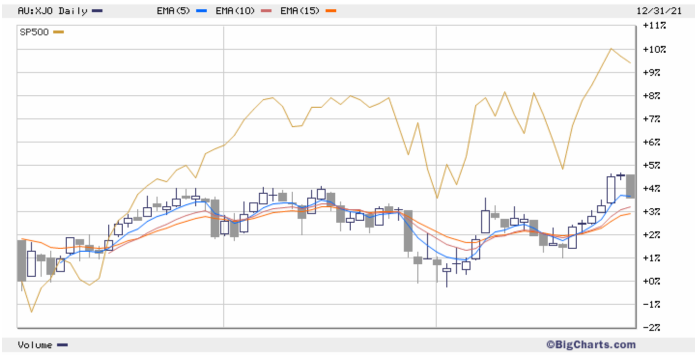
FY22 Dividends to-date	
FY22 Interest to-date#	
Cash Holdings	

Note #: Does not include interest currently being accrued in term deposit accounts.



Lacklustre quarter for our local market, with the Australian share market consolidating (in an essentially sideways direction), whilst being outperformed yet again international markets, per the chart below.

The S&P ASX 200 (XJO) exhibited a shallow correction for the greater part of the quarter. Several major markets were similar. The figure below shows the comparison (XJO versus S&P 500). The Auduco share price is up regardless, anecdotally suggesting rotation to value. Locally at least.



Major markets experienced some mild (by historical standards) 'elevator down' scares from mid-November to mid-December due to the identification of the new Oricon Covid-19 strain. The financial media took the scare seriously as there was quite a bit of 'this might be a top' talk. Nonetheless, both the XJO and bellwether S&P500 index ticked up into new highs and they generated 'buy' signals, signifying the extremely long uptrend remains in place.

Most of our holdings tracked down during the quarter but the potential drag on our capital was offset by the strength of our largest position, which is outperforming its peers as previously proffered. Hence, the normalised share price has held firm. We have taken up some additional equity in Westpac following the new overall market long signal and the assessment provided in last quarter's summary that indicated we could be entering a value outperformance cycle. WBC exhibits a dividend discount model (DDM) based valuation of ~$32,[1] so an entry made sense.

Synopsis

Overall, the macro news is not too different from last quarter – Inflation versus timing of rate rises and quantitative tightening, Covid-19 and Evergrande implications. More novices losing their life savings on cypto due to over-leverage. So there is not much to add this quarter. The net result of these factors, as reflected in price and, as noted above, is that the trend remains intact.

The break to new highs following the November-December stutter in the markets could be due to seasonality. It simply could be the steadfast belief that central banks will step into prop markets up, just as has been done repeatedly since 2008. Any correction at this point would be natural, healthy, and not have to translate to a market collapse or a traditional bear market, as much we think it is long overdue.

[1] Is the Westpac Banking Corp share price overvalued, Rask Media, https://www.raskmedia.com.au/2022/01/02/is-the-westpac-banking-corp-asxwbc-share-price-overvalued-4/

Any sign that the US Fed will deliver on its jawboning to remove stimulus and stop stepping in is likely to result in something severe. We saw this in 2018 when the Fed had eventually acted as telegraphed and had barely begun to actually tighten. Market falls were sharp and only abated by the Fed backing down. Mr Market does not want to go back to traditional conditions absent of 'easy money', as that stimulus is holding back deflationary forces.

The US Fed has decelerated its bond purchases, telegraphed earlier rate rises (3 forecast for 2022 – magnitude unknown). The December 2021 Fed meeting minutes (released 5 Jan 22) sees Mr Market now fearing an additional rate rise and reductions to the balance sheet (not just decelerated bond purchases).[2] The mechanism telegraphed is to let contracts expire rather than rolling them over or closing them out early. Will a significant paring back of stimulus ever happen? Ask Japan.

In fact, it is interesting that we have come full circle with a recycling of the Jim Chanos hypothesis[3] on China in the form of Cathie Wood, 11 years on. The hypothesis is on the parallels between China now and Japan in 1989 (which was seen as unstoppable back then, much like China nowadays) and since has experience 30 years of stagnation following its property market crash. Whilst not precisely analogous, China's property bubble is considered more overblown than Japan's was, accounting for 29% of its GDP (compared to say 6.2% of GDP in the USA at present - % figure for Japan in 1989 not found) and 62% of household wealth. The average cost of property across China is now ~17x median income, >40x in some cities (Japan was slightly higher on average), compared to ~7x for Australia. The Chinese property market is does not tend to yield income - it is based more so on the speculation of ever-increasing prices (and faith that there will always be a greater fool to grab the hot potato). The misallocation of capital has been so great as to enable forests of high-rise apartments to be built where no one would live (recall from last update, 90 million empty homes), and now the Chinese government is ordering some of these to be destroyed.

The formal Evergrande default has not led to a Lehman-type contagion catalyst. Can it lead to a lost decade as predicted by Cathie Wood (and Jim Chanos)? Yes? Do we agree with the arguments presented? Absolutely. Will it happen as predicted? No longer sure. It certainly can have a greater impact on the Australian economy than others due to our export reliance etc. Iron ore price crashing has not affected jobs and projects yet. But as Cathie Wood believes, the 'collapse' in China may have already begun with Evergrande and its peers - 17% drop in property sales in a month and associated burgeoning civil unrest in places - and, if it persists, it will be a matter of time for the effects to spread. Property is pretty much the only savings and speculation mechanism readily available to people in China. So falling prices will impact consumer demand etc. We have steered clear of taking positions in iron ore equities as a result. Fortescue Metal's share price is rising again from attractive (~$15) levels, but the consensus broker forecasts see it at $16 in 12 months. We do hold some lithium, gold and uranium equities, all light holdings compared with our bank holdings.

Recall from last update:

It could mean the Chinese demand boom is over, as many insiders believe the downward trend in China is the new normal rather than a temporary blip.

To make things interesting, the impact of Covid may yet be a negative catalyst on markets. In just a few weeks, the Omicron variant has been the prime driver in the orders of magnitude proliferation of cases globally. Across Europe and America, the number of cases have rapidly exceeded their early pandemic peaks. In Australia, early infection levels have been dwarfed. In China, authorities are implementing very harsh lockdowns again to contain any spread, including mandatory testing for millions of people. [4]

Markets recovered quickly following headlines that the severity of the Omricon variant were generally mild. However, the World Health Organisation has recently come out saying otherwise.[5]

Some experts have indicated the pandemic will end in 2022, based on Omricon's muted severity.[6] This is contrary to reports early in the pandemic that suggested it could last seven years. Mckinsey, in the meantime, have released analysis that Omricon related hospitalisations could peak around May 2022 in the USA,[7] but didn't conclude much else except to say it the virus mutates rapidly.

We mention Covid here because it is another potential tipping point. The sheer scale of infections being observed (potentially undercounted according to headlines), even if milder, may just be enough to overwhelm support infrastructure and supply chains, as much or more so than the previous infection surges. As with the 2020 Covid crash, Western markets did not reach their 'Oh' moment until several months into tireless media coverage.

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[2] Federal Reserve puts wheels in motion for balance sheet reduction, CNBC, https://www.cnbc.com/2022/01/05/fed-minutes-december-2021.html

[3] Jim Chanos Prediction of Chinese Property Market Crash, https://en.wikipedia.org/wiki/Jim_Chanos#Prediction_on_Chinese_real_estate_crash

[4] Harsh Covid lockdown in Chinese city Xi'an triggers online anger, NBC, https://www.nbcnews.com/news/world/xian-china-harsh-covid-lockdown-triggers-anger-coronavirus-rcna10989

[5] Covid: Deadly Omicron should not be called mild, warns WHO, BBC, https://www.bbc.com/news/world-59901547

[6] Why 2022 and Omicron variant will mark the end of the Covid-19 pandemic, NEWS, https://www.news.com.au/world/coronavirus/australia/why-2022-and-omicron-variant-will-mark-the-end-of-the-covid19-pandemic/news-story/f4529253f1c5bc9b84d487fadfa518da

[7] When will the Covid-19 Pandemic End, McKinsey, https://www.mckinsey.com/industries/healthcare-systems-and-services/our-insights/when-will-the-covid-19-pandemic-end