Q3 FY20 STATUS REPORT

"Our focus, trust"

"Accounting for every trade"

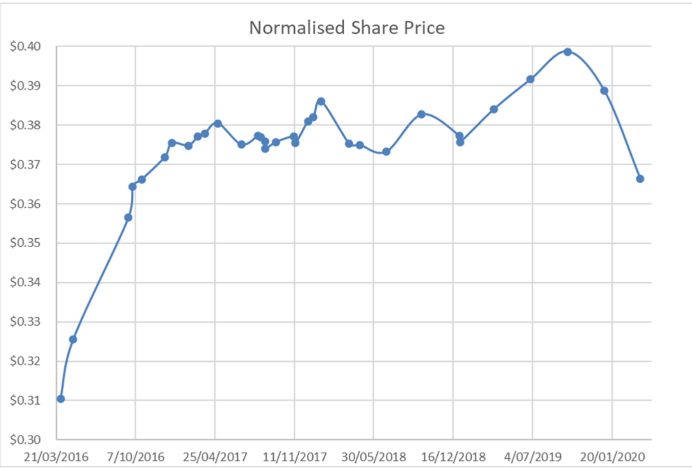
Investment Performance of Deployed Capital

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

31/03/20 Snapshot		
Top 4 Equity Holdings	Ave Entry Price	Market Price
ANZ	$23.43	$16.96 (Q3 perf: -$7.67)
BOQ	$8.13 (reduced $2.31)	$5.00 (Q3 perf: -$2.25)
NAB	$20.37 (reduced $5.32)	$16.68 (Q3 perf: -$7.95)
	Current Market Value	

FY20 Dividends to-date	
FY20 Interest to-date[1]	
Cash Holdings	

Note 1: Does not include interest currently being accrued in term deposit accounts.



Well that was sudden. And whilst it was the culmination of what we have been expecting for so long. The catalyst was not the macroeconomic backdrop we have been telegraphing. It was the need to deal with the virus, and the economic fallout. The US stock markets were riding their highs and then suddenly….."oh".

The chart above, showing the US S&P 500 (GSPC, purple line) compared to the ASX S&P 200 (AXJO, blue line), provides a visual of the suddenness and scale of the drop. The peak to trough decline in the ASX S&P 200 index was 38.5%. For the US S&P 500, it was 35.4%.

Given the above backdrop, we find ourselves being pleased with the Auduco result. The share price is only down 5.7% for the quarter, 8.1% from our peak price. It is even more pleasing, given the trades outlined in the last update did not go our way. We also attempted some speculative / growth stock longs in the lead up to the crash (EXL and BWX) – taken on technical signals and stopped out for small losses.

Nonetheless, the result is a demonstration of why we adopted the long-telegraphed strategy.

We missed our chance to be short. It moved so fast, and much like the bull market, way beyond what could be conceived as reasonable. To try to short during the ensuring wings on the way down would have been guesswork. So, we refrained from further shorting.

Synopsis

The question now is where to from here. We have already taken action on the way down, having purchased additional NAB between $20.5 and $14.00 (mean ~ $16.20) and BOQ at $5.5.

From this point we wait and watch with capital ready to deploy.

Central banks and governments have announced their stimulus packages; e.g. $2.2 trillion by the US government and a $4 trillion backstop by the US Fed, which also dropped the funding rate by over 2% to 0. The irony to this was the US, in particular, were already throwing emergency-measure stimulus at the markets during the march to the all-time highs. We are watching for the market's response to this.

At the time of writing the S&P500 has already regained 50% of the lost ground. We do not expect it to hold, but need to be mindful of all that stimulus in observance of the axiom of the last 12 years (stocks rise when central banks print more money).

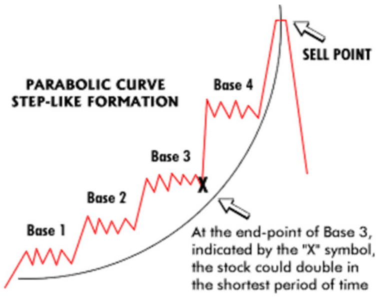
However, the scale of disruption from Covid-19, the mass layoffs (16 million over the last weeks of March in the US, arguably as their government was only just starting to take virus seriously), the severe drop in oil prices, one would expect a long time for the full market recovery to occur.

Of course, with the stimulus factor, we could get a Y-shaped recovery in the markets, with the present bounce being the commencement of it. Who knows?

Regardless of the speculation on market direction, a wave of dilution is highly likely to befall retail investors. A swathe of listed companies will undertake capital raisings to strengthen their balance sheets and retail investors will be collateral that results.

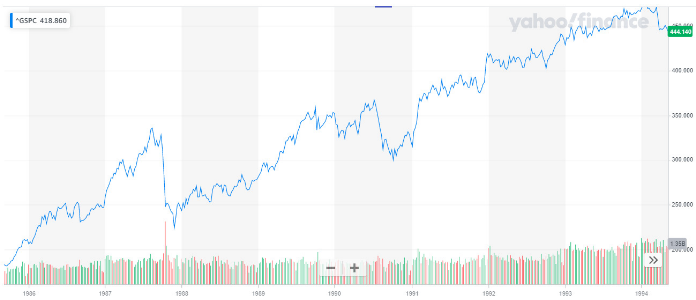
So where to for the markets from here is anyone's guess. The logical guess is a long, drawn out consolidation period with a downward bias. This supported by the long-held axiom that when bubbles pop, there is no quick recovery. It takes years for the knock on effects to wash through the system and confidence to return.

We also saw some classic parabolic action. This occurred in a large number of stocks that drove the US indices up, and in the US indices themselves. Recall from the chart below from the last update. This action is symptomatic of a bubble (, normally applies to individual stocks, not indices) and strengthens the traditional argument that the markets should take a while to recover.



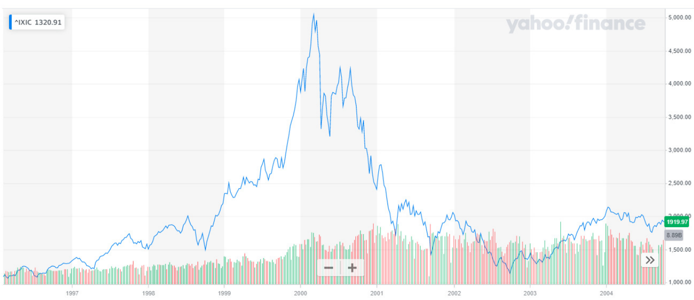
If this transpires, what it means for Auduco is more time to accumulate good companies at reasonable prices

Hitherto macro evidence not withstanding, the market collapse was sudden with very little warning technical warning in the price action. The two closest US benchmark analogues to this are 1929 and 1987:

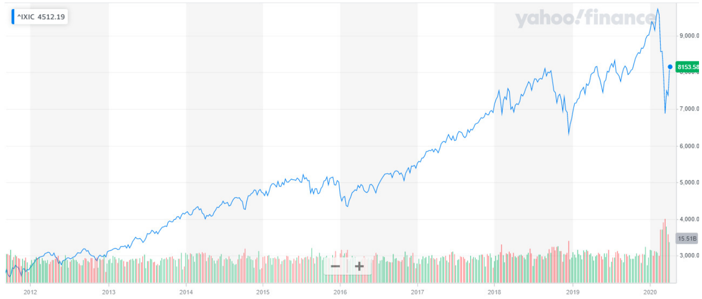


Both exhibited different fallout. Following 1987 the market marched on, whereas in 1929, after the initial bounce, it was just the beginning of a relentless downtrend. The Federal reserve intervened in 1987, whereas it did not in 1929. 1987 was also a caused more by 'technical issues' with the mechanics of the financial system, whereas 1929 was associated with the typical leveraged excess of a boom and was accompanied by massive job losses in the aftermath.

The Nasdaq in 2000 also applies (and exhibited a relentless downtrend) but it was not representative of a diversified market at that time; viz:



In recent terms, as we have discussed previously, the largest technology stocks were the main drivers of the market index gains in the NASDAQ and S&P 500. These were the key stocks undergoing parabolic price moves. It was the biggest crash in history, and occurred over a calendar month. Such ferocity and brevity are unprecedented. But the recent crash lows experienced by these markets represents a relatively small dent on the gains during the cycle. Here is the Nasdaq as a visual:



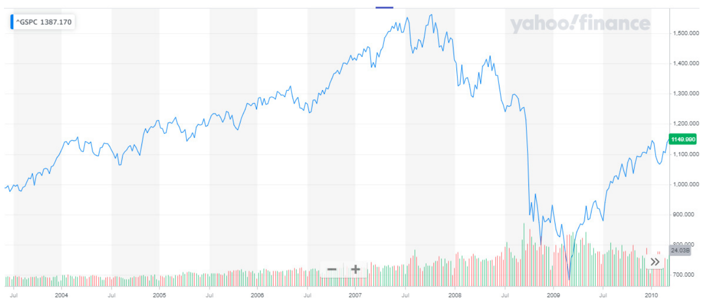
This means, per previous updates, these indices remain expensive. Earnings are expected to decrease, which means that prices should fall until P/E ratios reach less elevated levels. The S&P 500 is currently trading at a forward P/E ratio of 17.3, which is above its 5-year average of 16.7 and 10-year average of 15.0.

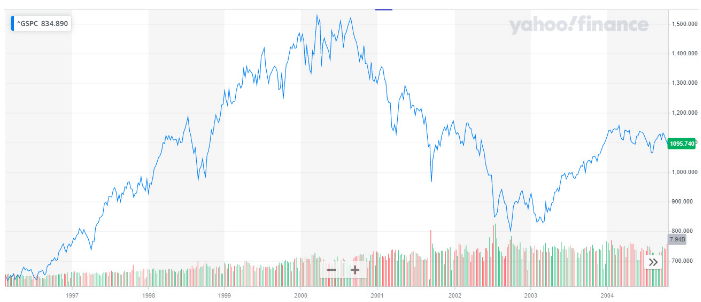
Even the big technology stocks should experience this. In an environment where professional services work can be undertaken from home, technology companies should do relatively well. Advertisers may not be able to afford the add space though, and consumers may hold off on discretionary spending. Companies will defer spend on IT upgrades and obsolescence programs. That being said, Amazon just announced intention to hire 75,0000 new workers to meet demand…

In Australia, it's slightly a different story. The same earning pressures will be experienced. But the market gave up a lot of ground, and had not risen anywhere near the same amount as its US counterparts over the cycle. So, buying equities like banks at levels that they saw during the GFC is a risk worth taking. Nonetheless, resource stocks held up well, not falling as much as we would have liked. Overall, should central bank intervention fail to produce a buy the dip bonanza, it should be "flatter" for longer.

Underlying macro weakness, virus generated disruption vs even more stimulus. Watching, waiting, getting set to deploy.

Just a final "Academic" note: Sudden market index price collapses are not typical. When crashes occur the market indices typically turn down and some sort of downtrend commence in advance. The lead up to 2008 and 2000 (for the S&P 500) are examples:





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