AUDUCO

Q3 FY22 STATUS REPORT

"Our focus, trust"

"Accounting for every trade"

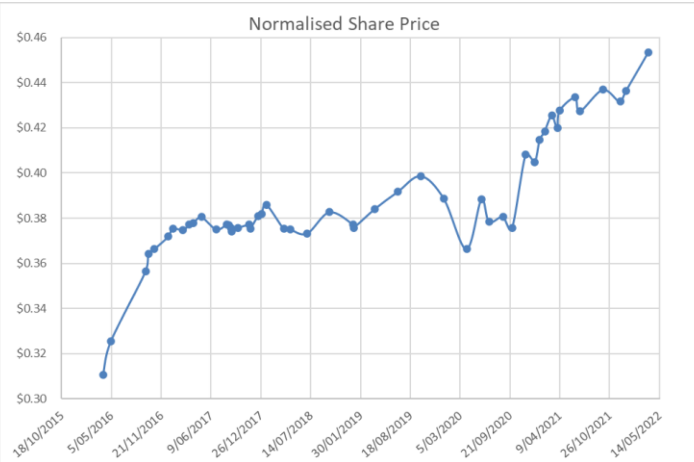
Investment Performance of Deployed Capital

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

31-Mar-22 Snapshot		
Top 5 Equity Holdings	**Ave Entry Price**	**Market Price**
ANZ	$23.43	$27.60 (Q1 perf: $0.09)
BOQ	$7.96	$8.68 (Q3 perf: $0.59)
NAB	$19.01	$32.35 (Q4 perf: $3.51)
WBC	$19.88	$24.24 (Q4 perf: $2.89)
WPL	$23.28	$32.10 (Q4 perf: $10.17)
	Current Market Value	

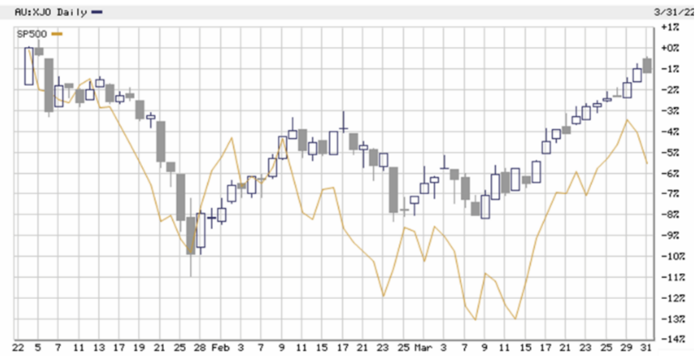
FY22 Dividends to-date	
FY22 Interest to-date#	
Cash Holdings	

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



"I love it when a plan comes together."

Despite a local market that was net flat the Auduco normalised share price is up appreciably. From the figure below, we see that the S&P ASX 200 (XJO) actually experienced a typical bull market correction but outperformed the global market barometer index, the USA's S&P 500.



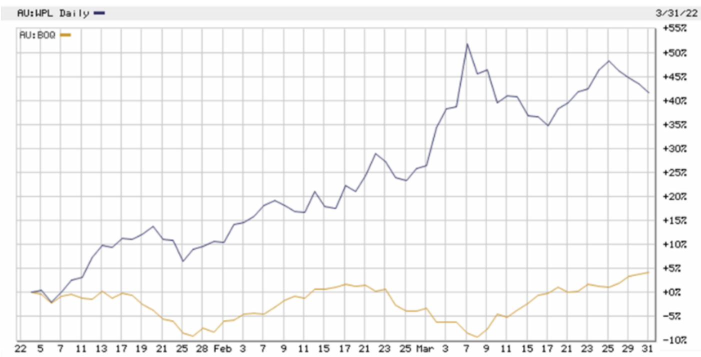
Our share price rising in the face of a market correction reflects stronger evidence of the rotation to value we have been mentioning in the previous two updates, with some war and COVID induced supply and demand dynamics thrown into the mix.

Our smaller speculative holdings did not do much.

Below we show the relative performance over a selection of our holdings over the quarter. NAB and WBC are shown in the first of two figures. Both bank holdings reflect plans coming together. NAB is our largest holding and we have been accruing it over a long period, particularly when it was underperforming its sector despite sound fundamentals. It has outperformed all major Australian banks over the past 6 months.

WBC was our big add at the start of Q3, as mentioned in the last update. It represented good value based on a dividend discount model (DDM) based valuation of ~$32. We initially added at $21.78 and have taken more shares since. The price has since performed well.

The second of the two figures on relative price performance shows our best and worst performers (of our largest holdings) over the quarter. WPL managed over 40%, driven by sentiment around the Russian invasion of Ukraine. It was underperforming for an extended period leading up to its current run. BOQ is currently undergoing a cycle of underperformance. It was outperforming peers ~9 months ago, along with CBA. We believe it has a positive future as a growth alternative to the big four Australian banks and will add to our position in due course.



Synopsis

There is obviously a lot of negative newsflow out there right now. The net effect on the markets was a bull market correction (i.e. nothing catastrophic). An old saying is that "markets like to climb a wall of worry". They often do this, with the newsflow cycling from one negative theme to another. Most of these "worries" prove temporary until, of course, something triggers a change.

We are seeing more of that here. We have been talking about the inflation theme for some time now. The Ukraine war has amplified the that theme. Ukraine is a major supplier of Wheat. Russia a major supplier of oil, gas. It also supplies the majority of the world's palladium. Palladium spiked short term (we traded it with success) but has since fallen back into its recent normal range. The Russian Ruble collapsed in response to the war and accompanying sanctions but has since recovered. This recovery is unexpected and could be temporary.

The Ukraine war has signalled a change. Aside from the supply shocks and the confirmation of the inflation theme, particularly around commodities, a key change is in the mindset of Europe to the Russian threat. Western European countries will likely ramp up their defence spending in response. (Not really needed given that NATO's aggregate firepower eclipses Russia's.) This is adding to the trend of Indo-Pacific countries revising their defence agendas in response to China's military build-up and positioning.

The Ukraine war has also prompted Europe to get serious about seeking alternative energy supplies. Germany halted development of the Nord Stream 2 Gas project in response to the invasion.[1] The situation opens the door for suppliers such as the United Arab Emirates and even Australia to supply Europe with natural gas. It also strengthens the case for alternative energies, and we include nuclear in that category. Unsurprisingly, United Kingdom just announced a plan to triple its nuclear power capacity to improve its energy security.[2]

What does this mean for investors? Look for opprtunities in the defense and Uranium sectors, for example.

When you see commodities fall back in to range, like Palladium (Gold, Silver and Platinum too), it often due to USD increases resulting to a "flight to safety" response that can mute short term moves. It does not mean that the trend will not continue. The USD has also been trending up, primarily in response to anticpated Fed moves to combat inflation. These factors are always in competition and lead to short term volatility in both directions, that can distract traders.

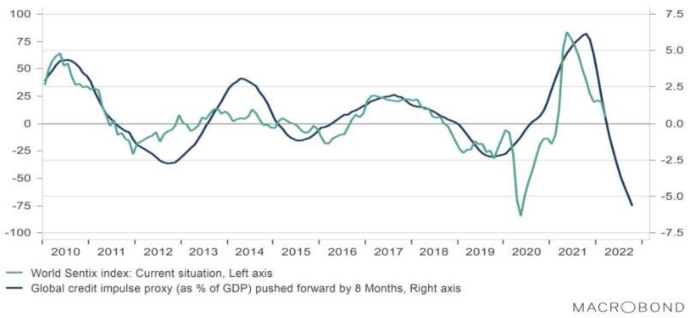
Given the backdrop above, the biggest themes to keep abreast of remains inflation (in the face of massive leverage globally), supply shocks and central banks needing to tighten.

The Australian Reserve Bank is the only OECD Bank that has not raised rates, but has just telegraphed that one is coming soon. This is a pivot from its position, as recently as 6 months ago, that they will not need to raise rates until 2023/2024. We advised an earlier rate rise would likely prove to be the case in previous updates.

Our view is the biggest risk to catalyse a large stock market correction, absent of a black swan event, is the US Fed raising of rates and shrinking its balance sheet. This is the same thesis as our 2018-2019 view, which was proving correct until the Fed did an about face and ceased to contract their balance sheet.

Fed jawboning on this has continued with a strong consensus being achieved at the March FOMC meeting on the path forward.[3] Following the March hike of 0.25% there are strong indications that the increase in May could be 0.5% to combat inflation. Moreover, the balance sheet runnoff is telegraphed to be $95 billion per ($60b in treasuries, $35b in mortgage-backed securities) for 3 months commencing May. This is double the last attempted effort between 2017-2019, but note the balance sheet has more than doubled since then.

Back then, our bearishness was also due to declining credit impulse / growth, which was trending to zero and below. The credit impulse represents the flow of new credit from the private sector as a percentage of GDP and is a large driver of economic growth. A fall below zero typically translates to a large correction and corresponding recession. The figure below, from Macrobond, shows the credit impulse forecast for the three largest world economies (US, China, eurozone) against current market participant sentiment (Sentix indicator).



Last time, it took the Fed abandoning its quantitative tightening plans to keep the markets kicking on. If central banks are serious about reducing balance sheets to 'normal levels' they will have to accept that equity markets will likely take a hit. Naturally, they

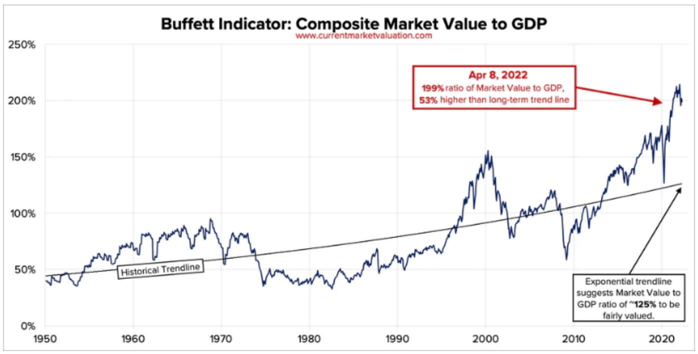
[1] Germany freezes Nord Stream 2 gas project as Ukraine crisis deepens, Reuters, https://www.reuters.com/business/energy/germanys-scholz-halts-nord-stream-2-certification-2022-02-22/

[2] UK unveils plan to triple nuclear power capacity, uranium stocks march higher, Seeking Alpha, https://seekingalpha.com/news/3821773-uk-unveils-plan-to-triple-nuclear-power-capacity-uranium-stocks-march-higher

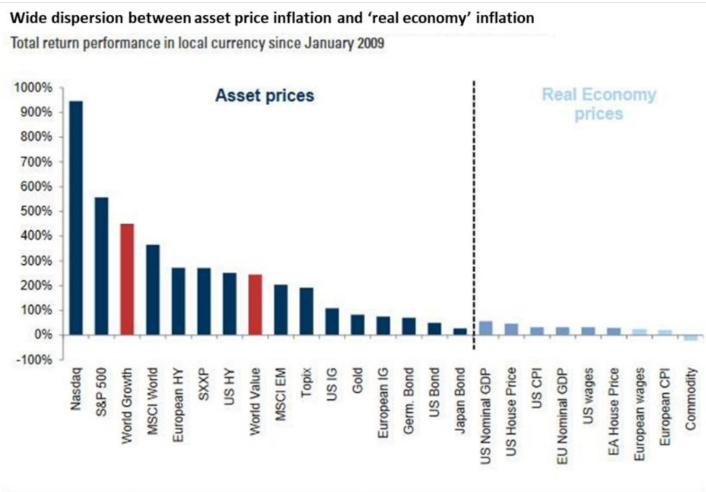
[3] Fed officials plan to shrink the balance sheet by $95 billion a month, meeting minutes indicate, CNBC, https://www.cnbc.com/2022/04/06/fed-minutes-march-2022-meetings-.html

will try to orchestrate a shallow breather, rather than a deep correction. Whilst the key narritives are simple the, dynamics are complicated such that we will never be able to do it justice here.

Backdrop-wise, the Buffet indicator remains close to its highest ever divergence to the long-term GDP trendline (for the USA, see figure below). So Equities are obviously expensive and have been for some time.

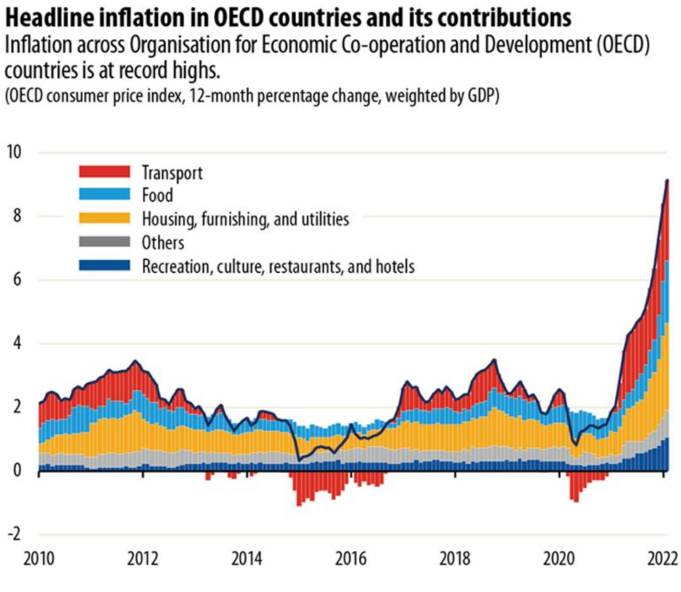


The cost of other assets, such as property are also high. So is the oil price. Spikes in oil have historically preceded recessions; it spiked to over $140 prior to the GFC, for example. But the asset inflation that has occurred since the GFC has not been uniform by any stretch, with commodites as a group being by far the worst performer (per the figure below). This has translated to generally subdued prices for consumer goods over the past decade, which would have been a relief for many as wage growth was also subdued (negative in real terms in some cases).



Source: Datastream, STOXX, Haver Analytics, FRED, Goldman Sachs Global Investment Research

But now, with inflation rising sharply (see "Headline Inflation" figure below[4]) consumption is likely to be impacted. An indication that increasingly higher prices are on the way for consumers comes from Chinese factory data: 8.2% year on year in March amid rising energy prices and supply chain disruptions.[5]



Source: IMF Calculations based on OECD data.

Central Banks may need to raise rates higher and faster than their adjusted telegraphed trajectories to combat the inflation gradient being experienced, particularly if the Ukraine war and Chinese Covid lockdowns become prolonged. The 2 year versus 10 year yield curve has also recently inverted (which, over the past 70 years has usually (but not always) precedes a recession). The inversion is still quite shallow and the US Fed, at least, has confidence that raising rates will not tip the economy in into recession due to historically low unemployment, which is roughly equal to pre-pandemic levels, and twice as many job openings as before the Covid recession.[6]

Where does this leave Australia? In the face of commodity inflation, Australia has a good hedge. It means greater national income if exporters can maintain (and even boost, if positioning allows) their production levels, to the extent that the import nation net earnings reduction will allow.

In terms of Auduco, it means sticking to the plan. Waiting for value stocks to fall to good purchase levels and not to panic sell existing long terms holdings. We are happy to hold our blue chip positions through a large correction.

We will cut it there and save the system update for the next report. Current focus is negotiation with e-comerce platform providers.

For more information contact Dr Gianluca Paglia, 0425 388 222

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[4] The Future of Inflation, International Monetary Fund, https://www.imf.org/en/Publications/fandd/issues/2022/03/Future-of-inflation-partI-Agarwal-kimball

[5] China's prices surge past forecasts amid lockdowns, Ukraine war, Al Jazeera, https://www.aljazeera.com/economy/2022/4/11/chinas-inflation-beats-forecasts-amid-lockdowns-ukraine-war

[6] March 2022 FOMC Meeting: Fed Raises Interest Rates To Fight Record Inflation, Forbes Advisor, https://www.forbes.com/advisor/investing/fomc-meeting-federal-reserve/#:~:text=The%20Fed%20raised%20its%20target,to%20eight%20times%20in%202022