marlin
growing globally

QUARTERLY NEWSLETTER

1 April 2022 – 30 June 2022

Share Price	MLN NAV	PREMIUM[1]
$1.12	$0.89	26.2%

as at 30 June 2022

Throwing the baby out with the bathwater

This was another tough quarter for international equity markets, as the focus shifted from high inflation to fed tightening and the potential for a recession. Marlin ended the quarter with gross performance down -14.8% and adjusted NAV down -14.0%, compared with our global benchmark which was down -10.4%.

Global market backdrop

As the Federal Reserve tries to tame persistently high inflation, recessionary fears have risen. Economists now predict a 33% chance of recession in the next 12 months, up from 15% in March. While we can question the track-record of economist forecasts, the Federal Reserve has clearly stated the only tool they have to bring inflation down is to dampen demand and slow down economic growth.

This is not a favourable backdrop for equities. This quarter saw the S&P 500 Index enter a bear market (being a 20% decline), with the more tech-heavy Nasdaq having already achieve this ignominious milestone back in March.

Underneath these headline numbers is a pronounced rotation out of growth stocks into value names, particularly energy and defensives (lower growth but more stable industries like utilities or consumer staples) as investors seek refuge from the twin concerns of inflation and a recession.

The speed and severity of this shift in both directions has been extreme. The 24% underperformance of growth versus value in the last seven months, is at levels last seen in the 2000 tech sell-off. And like the tech-bubble, speculative companies with unsustainable business models rose to ridiculous valuations post COVID, supported by an accommodative Fed and government stimulus. Once the tide of easy money went out, these business models were found wanting, and these stocks are (justifiably in our view) down 70%, 80% or even 90%.

Like Pets.com in 2000, Peloton may be the poster child of this post COVID madness. Described by some as 'an iPad on a bike,' Peloton's share price increased eight-fold during 2020 to a market cap of nearly $50 billion. It has now fallen 95%. Or take Nikola, an electric truck manufacturer, which reached a market cap of $28 billion, despite having not produced a single vehicle. It is now worth $2 billion.

As we often see in periods of macroeconomic concerns, equity markets are driven more by sentiment than fundamentals. Investors are unwilling to look beyond the clouds on the horizon and instead rush for the exits. These selloffs are usually indiscriminate. In the scramble for the door, companies are sold-off regardless of longer-term fundamentals. High-quality, established, and profitable companies have been 'thrown out with the bathwater' alongside their more speculative counterparts.

Take Affirm, which like Afterpay was one of more than 100 'buy-now-pay-later' companies that took-off in recent years. This is a competitive space, barriers to entry are low and these companies are all loss-making. At its peak, Affirm was worth nearly $50b, despite only processing $12 billion of transactions in 2021, and has since fallen 90%.

Compare that to our portfolio holding PayPal. It is the leading ecommerce payment platform, processing over $1.2 trillion of transactions last year and growing, with 20% profit margins. That is 100-times the transaction volumes of Affirm. Yet at the market peak last year, PayPal's valuation was only 7-times higher. With PayPal's stock now down 70% to $80 billion, we think there is a large disconnect between near-term sentiment and the underlying fundamentals of this business.

This market myopia is evident across our portfolio. Companies like Meta or Floor and Décor are pricing in little to no future growth. These are both high-quality names with proven business models and robust growth runways, yet the market has treated them like a speculative tech start-up. History has shown that periods of extreme negative sentiment have typically led to strong future returns, and sentiment on quality growth companies is currently as negative as we have ever seen.

Near-term, the risk of a recession is a real concern. But looking further out, there are many opportunities for the patient and long-term investor, and we believe our portfolio is well-positioned to deliver strong returns.

Company performance

Alibaba (+4.5% in local currency in Q2) rose alongside other Chinese tech names. Tencent (-4.9% in Q2). While the US economy decelerates, the opposite is occurring in China. The economy is improving as the country moves past recent COVID lockdowns, coupled with supportive fiscal and monetary policy. The Government has also slowed the pace of regulatory reform, instead publicly supporting the China tech industry. With a more supportive economic and regulatory backdrop we expect sentiment to continue to improve and align with the long-term fundamentals of these names.

Dollar General (+10.5%) and **Dollar Tree** (-2.7%) benefited from the shift to defensive names on recessionary fears, and strong underlying performance despite the worsening consumer and inflationary backdrop. Historically these two companies have benefitted from a recession. In the Global Financial Crisis, comparable store sales growth accelerated as consumers traded down and shopped closer to home, and we are seeing a repeat of this.

Netflix (-53.3%) was our worst performer for the quarter. We added Netflix to the portfolio earlier this year, as concerns around increasing competition and slowing growth saw the share price halved. Our thesis is that the unmatched scale of Netflix's content is a competitive advantage and that new initiatives like advertising and minimising password sharing will help the company capture the full value of this content over the longer term. In the near-term however, the company continues to face pressure on subscriber growth, which we believe the market is unfairly extrapolating out to the future.

Portfolio activity

While cognisant of the recessionary concerns, we have been taking advantage of the negative sentiment towards quality growth stocks. Having added three new names to the portfolio last quarter, this quarter we increased our weight in attractive opportunities including **Amazon**, **PayPal**, and **Salesforce**. We funded these additions by exiting **Hexcel**, a leading manufacturer of composite components for aircraft. With the onset of COVID, Hexcel was the hardest hit company in our portfolio. Following recent strong relative performance, we think the risk/reward is now less attractive than other names in our portfolio and we have reallocated the capital accordingly.

Ashley Gardyne
Senior Portfolio Manager
Fisher Funds Management Ltd
15 July 2022

[1] Share price premium to NAV (using the net asset value per share, after expenses, fees and tax, to four decimal places).

SIGNIFICANT RETURNS IMPACTING THE PORTFOLIO DURING THE QUARTER IN LOCAL CURRENCY

NETFLIX	PAYPAL HOLDINGS	SIGNATURE BANK	AMAZON	STONECO
-53%	-40%	-39%	-35%	-34%

PERFORMANCE

as at 30 June 2022

	3 Months	3 Years (annualised)	5 Years (annualised)
Company Performance			
Total Shareholder Return	(7.4%)	+18.4%	+18.4%
Adjusted NAV Return	(14.0%)	+6.8%	+9.9%
Portfolio Performance			
Gross Performance Return	(14.8%)	+9.7%	+13.0%
Benchmark Index[1]	(10.4%)	+6.4%	+7.5%

[1] Benchmark index : S&P Large Mid Cap/S&P Small Cap Index (hedged 50% to NZD)

Non-GAAP Financial Information

Marlin uses non-GAAP measures, including adjusted net asset value, adjusted NAV return, gross performance return and total shareholder return. The rationale for using such non-GAAP measures is as follows:

- » *adjusted net asset value – the underlying value of the investment portfolio adjusted for capital allocation decisions after expenses, fees and tax,*
- » *adjusted NAV return – the net return to an investor after expenses, fees and tax,*
- » *gross performance return – the Manager's portfolio performance in terms of stock selection and currency hedging before expenses, fees and tax, and*
- » *total shareholder return – the return combines the share price performance, the warrant price performance, the net value of converting any warrants into shares, and the dividends paid to shareholders. It assumes all dividends are reinvested in the company's dividend reinvestment plan, and that shareholders exercise their warrants, (if they were in the money), at warrant expiry date.*

All references to adjusted net asset value, adjusted NAV return, gross performance return and total shareholder return in this newsletter are to such non-GAAP measures. The calculations applied to non-GAAP measures are described in the Marlin Non-GAAP Financial Information Policy. A copy of the policy is available at http://marlin.co.nz/about-marlin/marlin-policies/

COMPANY NEWS

Dividend Paid 23 June 2022

A dividend of 2.13 cents per share was paid to Marlin shareholders on 23 June 2022, under the quarterly distribution policy. Interest in Marlin's dividend reinvestment plan (DRP) remains high with 40% of shareholders participating in the plan. Shares issued to DRP participants are at a 3% discount to market price. If you would like to participate in the DRP, please contact our share registrar, Computershare on 09 488 8777.

PORTFOLIO HOLDINGS SUMMARY

as at 30 June 2022

Headquarters	Company	% Holding
China	Alibaba Group	6.6%
	Tencent Holdings	5.6%
Ireland	Icon	5.5%
United Kingdom	Greggs Plc	3.2%
United States	Alphabet	8.1%
	Amazon.Com	7.3%
	Boston Scientific	4.5%
	Dollar General	3.1%
	Dollar Tree	3.0%
	Edwards Lifesciences Corp.	2.1%
	First Republic Bank San Francisco	3.7%
	Floor & Décor Holdings	5.6%
	Gartner Inc	3.0%
	Mastercard	3.9%
	Meta Platforms Inc	7.8%
	Microsoft	3.5%
	Netflix	2.5%
	NVR Inc	3.1%
	PayPal Holdings	6.7%
	salesforce.com	5.1%
	Signature Bank	4.7%
	StoneCo	1.0%
	Equity Total	**99.6%**
	New Zealand dollar cash	1.3%
	Total foreign cash	0.1%
	Cash Total	**1.4%**
	Forward Foreign Exchange	(1.0%)
	TOTAL	**100.0%**

FOREIGN TAX COMPLIANCE ACT (FATCA) AND COMMON REPORTING STANDARD (CRS)

As a result of the New Zealand Government agreeing to participate in the exchange of information with other jurisdictions under the Foreign Tax Compliance Act (FATCA) and Common Reporting Standard (CRS), Financial Institutions are required to undertake due diligence to determine the account holders' jurisdiction of tax residence. All shareholders will have received a Tax Residency Self-Certification form from Computershare depending on when they first purchased their securities. Please ensure you complete and return this important document if you have not already done so. For more information please visit the IRD website: https://www.ird.govt.nz/international-tax/exchange-of-information/crs/registration-and-reporting or contact Computershare if you are unsure of whether you have completed your form.

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