ALIUM CAPITAL MANAGEMENT

ALIUM MARKET NEUTRAL FUND — SEPTEMBER 2021

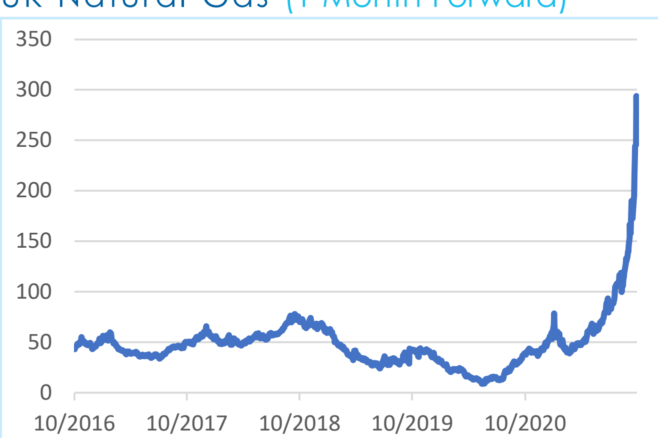
Performance (%)	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YTD
2017					0.9	1.4	1.7	1.2	-0.3	-1.4	-0.2	-0.8	2.5%
2018	3.6	3.1	2.2	1.2	0.7	0.0	-0.3	-2.3	1.2	0.8	4.3	1.6	17.1%
2019	-1.9	1.8	1.8	-1.4	1.7	-0.5	-1.6	1.8	1.1	-1.0	0.9	0.7	1.0%
2020	1.3	1.8	7.1	-0.6	2.4	1.4	2.1	-3.1	2.8	0.4	-0.5	2.9	19.3%
2021	-0.4	1.1	2.4	1.4	0.9	-0.5	1.9	0.4	-0.2				7.3%
Inception													54.9%

Dear Investor,

An eventful September has given pause to the 18-month rally in equity markets. Global growth and inflation are now both squarely heading in opposite directions. Soaring energy and power prices have caused central bankers to re-think just how transitory inflation actually is. This is adding to woes from disrupted supply chains and scarcity of labour and is starting to hurt corporate earnings. House prices have likely peaked in China and are slowing in many Western countries as affordability and regulation become headwinds.

The energy shock is significant and is particularly acute in Europe and China. It is a result of many factors. Cold winters in Europe and North Asia depleted gas and thermal coal stockpiles. This was followed by resurgent GDP growth this Northern summer accompanied by poor hydroelectric power generation in China and Brazil and little wind in Northern Europe. This has caused a scramble for spot cargoes of LNG (Liquified Natural Gas) and thermal coal, both of whose prices have multiplied. The increased power demands of data centres, EV charging and 5G networks are compounding this. For example, data centres use up 3% of electricity in China and are growing at over 40%. Should the Northern Hemisphere have a particularly cold winter, there is a risk of blackouts. Russia, which controls the supply of gas to Europe, is promising to supply as much as possible, but it's interest will be to maximise the price/volume equation.

UK Natural Gas (1 Month Forward)



China is reducing production of many energy intensive materials such as steel, aluminium, glass, paper and cement. It is aiming to produce 18% less steel over the rest of the year, for example, so the implications for economic growth are clearly negative. Even street lighting has been cut in some cities to conserve energy. The longer-term conclusion is that the energy transition from fossil fuels to renewables requires more investment in the grid, storage and baseload power.

More normalised growth accompanied by inflation means that central banks are tapering and in some economies such as New Zealand this week, actually raising rates. Australia is also now seeking to cool house price inflation via macroprudential regulation. Very low rates mean that although mortgage interest payments are easy to service, household debt continues to rocket. In China, much attention has been given to the balance sheet of major developer Evergrande. The bigger picture there is that one of the aims of economic rebalancing and 'common prosperity' has been to cool the housing market. Such depreciation rarely occurs in a straight line and with over 70% of Chinese household wealth in property, a loss of confidence in housing as an asset and developers as businesses will have longer-term ramifications. Additionally, many local governments have funded themselves by selling land to developers, so this can impact the creditworthiness of provinces as well as that of companies and households.

In September, although we had, and continue to have, a view that inflation will be more persistent, we were more inclined to express this through mining stocks than energy. As discussed above, energy has been the root cause of the current bout of inflation, while miners have suffered from the slowdown in China. Australian energy stocks outperformed materials by a massive 26% in September. We put a short on in iron ore miner Fortescue early in the month and the stock fell 28% which helped to offset some of the falls in other China-exposed stocks such as Iluka and Japanese robot-maker Fanuc. We have also been reluctant to pursue the 'reopening trade' in Australian travel and leisure stocks at current valuations well-above where they were pre-COVID. We are buying Japanese re-openers instead, which we discuss in the theme below.

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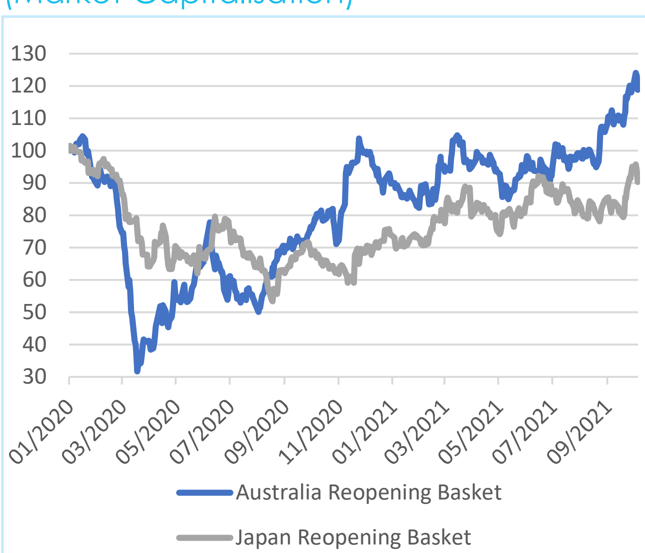
Theme: Japan's Reopening

In the May 2021 newsletter, we revisited our long-running "Experiences vs Goods" Thematic - the trend of consumers to spend more on services as a percentage of overall consumption. Of course, that trend was flipped on its head during COVID-19, as lockdowns prohibited travel & leisure and meanwhile households spent stimulus checks on household items. However, with vaccination rates increasing and the world slowly opening borders, a simple reversion to the mean would suggest that service exposed businesses should once again outperform. This is broadly known as "the reopening trade".

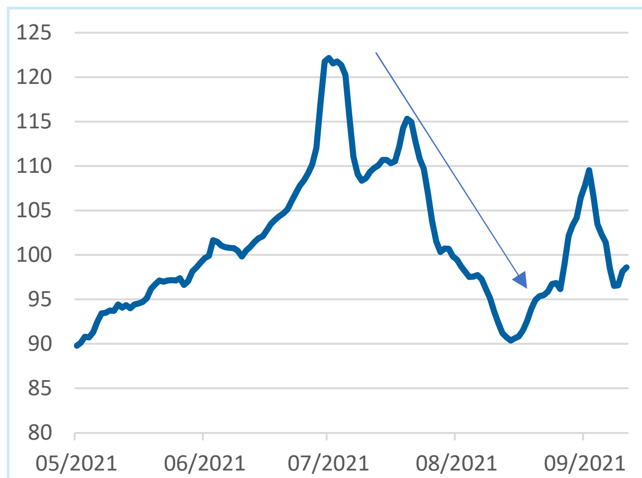
In regions such as the US and here in Australia, reopening beneficiaries have rallied strongly and, many are trading well above pre-COVID levels. The top-right chart presents a basket of Australian listed reopening beneficiaries such as airlines, travel agents and airports, compared with a basket of their Japanese equivalents. These have been indexed back to pre-COVID levels and presented in market capitalisation terms (to adjust for dilutionary capital raisings). As can be seen, the "Australian Reopening" basket is trading at a 20% premium to pre-pandemic levels. This compares to the "Japan Reopening" basket which trades at a 10% discount. There is good reason to believe this divergence should close.

Japan vs Australia – Reopening Basket (Market Capitalisation)



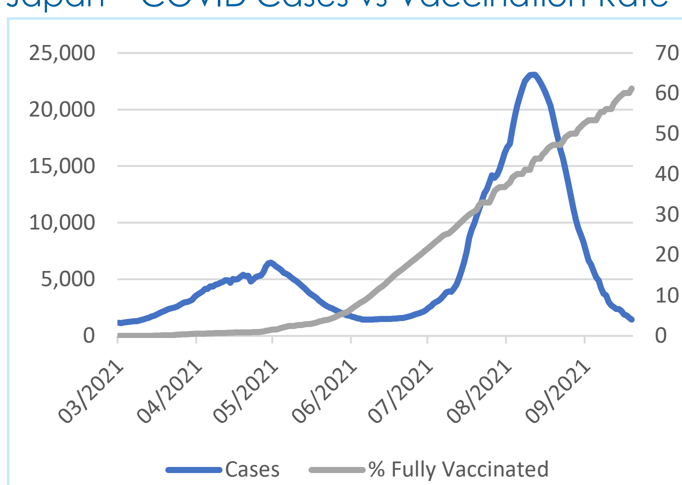
Whilst Japan hasn't been subject to the type of lockdowns that have been in place on much of the Australian Eastern seaboard, Tokyo, along with 19 prefectures in Japan have been in a "state of emergency". Citizens are urged to avoid crowded areas while restaurants are closed by 8pm and are not permitted to serve alcohol. The current state of emergency has been in place since the 12th of July and has since been extended twice. Per the mobility data below, while not a '*hard lockdown*', the measures put in place have seen a high degree of compliance. It should be noted too that the decline was despite hosting the Olympic Games.

Japan – Apple Mobility Data (7-day Moving Average)



However, after peaking at close to 25,000 new cases a day in August, we have witnessed a rapid decline. This has coincided with vaccination rates (2 doses) passing 60% of the adult population.

Japan – COVID Cases vs Vaccination Rate



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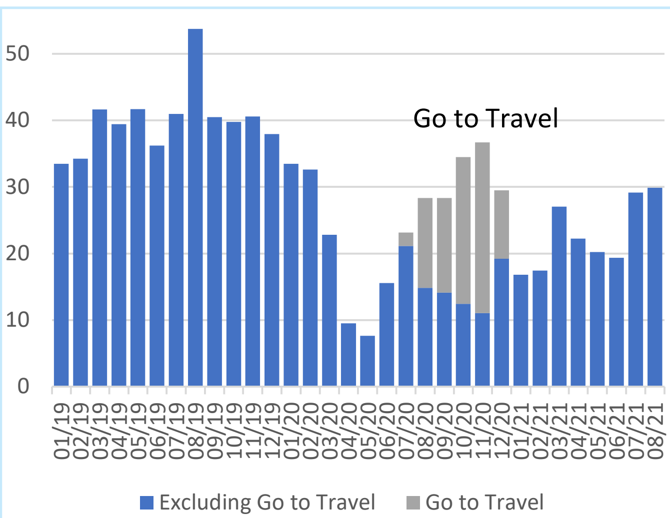
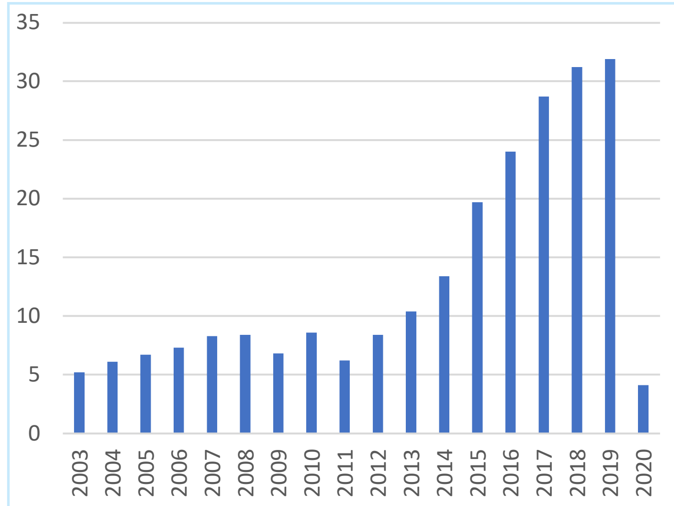
Amid increasing anger over his government's handling of COVID in the wake of the Olympics, Prime Minister Yoshihide Suga announced in September that he would not seek re-election. In his place, the Liberal Democratic Party have selected Fumio Kishida. The new Prime Minister has argued for vaccine passports to help fast-track reopening, particularly for travel-related sectors. Meanwhile, his new Tourism Minister Tetsuo Saito recently commented that the government was considering when to restart its "Go To Travel" campaign. The program was in place from October to December last year, and consisted of a government subsidy of up to 50% on eligible transportation, hotels and restaurants. According to data from the Ministry of Land, Infrastructure, Transport and Tourism, the number of Japanese overnight travelers recovered to 90% of pre-Covid 2019 level during that time.

Japan – Domestic Hotel guests (m)



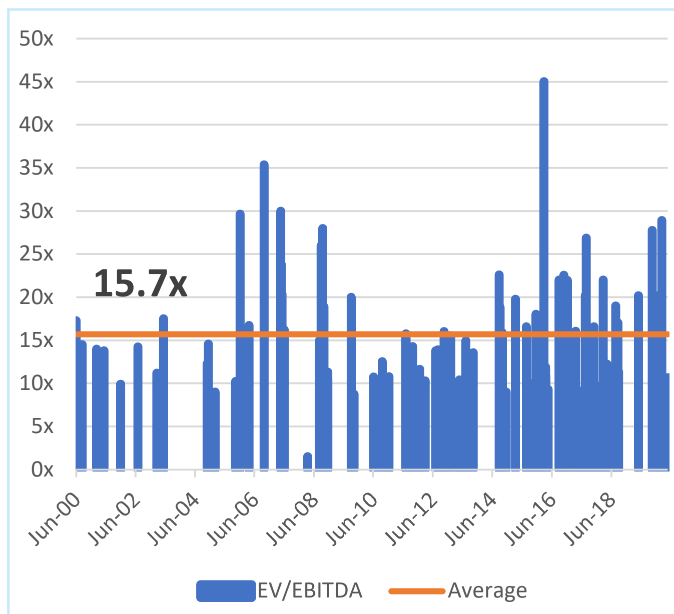
Japan Airport Terminal (9706 JP) operates Haneda Airport, which has the best access to Tokyo (20 minutes by car and 30 minutes by train vs 70 minutes and 60-75 minutes for Narita Airport). Over the 5 years from 2014 through 2019, the number of inbound visitors to Japan grew at an 18.9% compound annual growth rate (CAGR). This was largely driven by the rise of lower/middle-class incomes and passport acquisition rates in surrounding Asian countries. In addition, the airport boasted a low exposure (<15%) to inbound business travel, the segment we believe will face the largest structural headwinds in a post pandemic world.

Number of Inbound Tourists (m)



From a valuation perspective, JAT trades on an FY24 (normalized year of EBITDA as travel recovers) EV/EBITDA multiple of 10x. This compares to Sydney Airports at close to 24x, and the average global airport transaction multiple since 2000 at 15.7x.

Global Airport Transactions - EV/EBITDA



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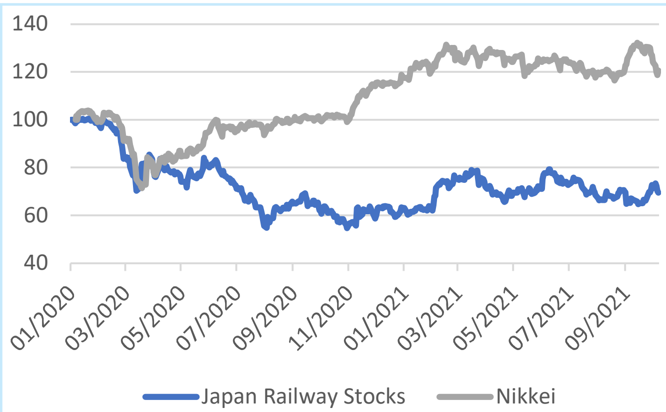
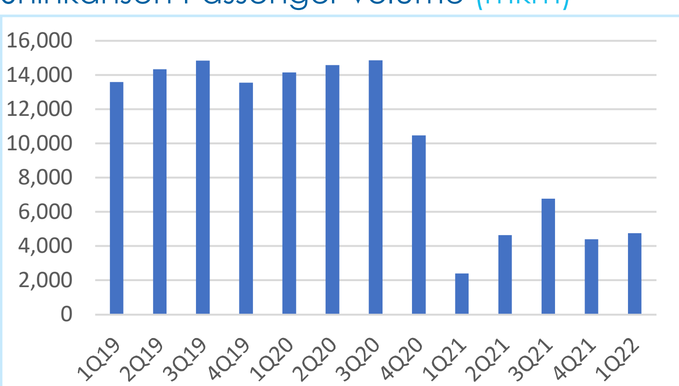
Japanese Railways stocks have been material underperformers when compared to the Nikkei 225 benchmark since the onset of the pandemic. They have faced the perfect storm of elevated leverage, exposure to both domestic and inbound tourism, as well as reduced commutes due to the Out-of-Office thematic.

Japan Railway Stocks vs Nikkei 225



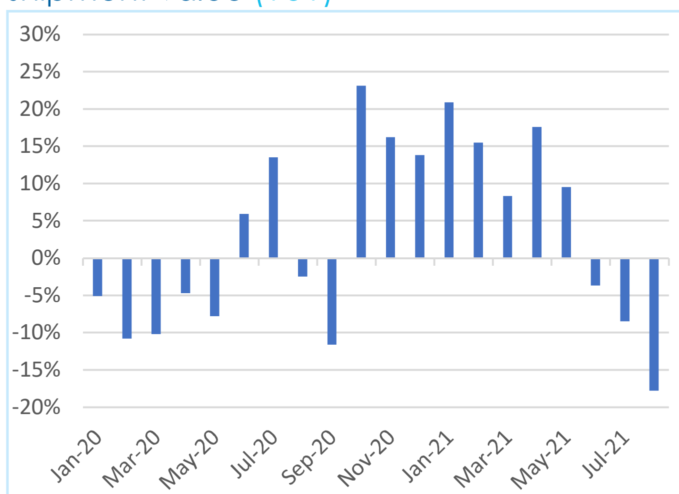
However, a number of these issues are now being resolved for **West Japan Railway (9021 JP).** Prior to COVID-19, its Shinkansen line accounted for roughly 30% of revenue. This a medium/long-haul line and hence it has a relatively large earnings sensitivity to the domestic travel recovery. Meanwhile, it recently completed its first equity raise since the company was established in 1987 through the privatisation of Japan National Railways, effectively repairing its balance sheet.

Shinkansen Passenger volume (mkm)



Conversely, we expect to see weakening in the consumption of goods as the economy reopens. Consumer electrical appliance shipments declined by 17.8% YoY in August to according to data released by the Japan Electrical Manufacturers' Association (JEMA). This was the third straight monthly decline and was steeper than the 3.7% decline in June and the 8.5% decline in July. This bodes poorly for the likes of Panasonic (6752 JP) and Sharp (6753 JP) which are also facing supply chain constrains from chip shortages and COVID related shutdowns in South East Asia manufacturing hubs.

Domestic consumer electrical appliance shipment value (YoY)



Kind regards,

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