



# ALIUM MARKET NEUTRAL FUND

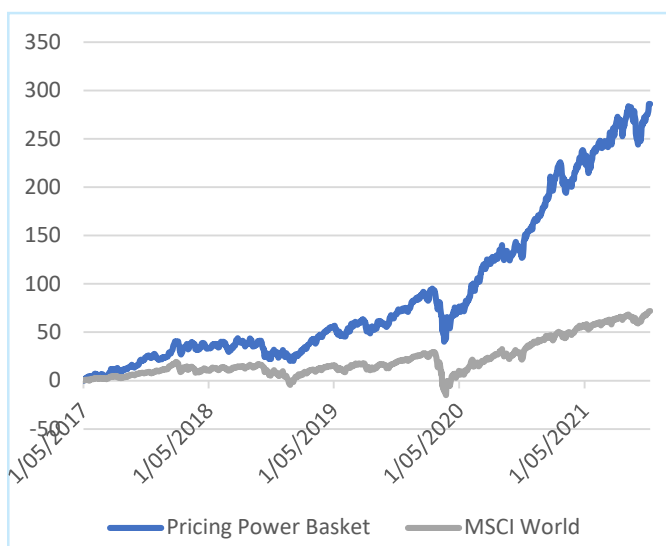
## October 2021

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	0.4			7.8%
Inception													55.5%

## Dear Investor,

Equity markets were mixed in October. Slowing economic conditions in China led the markets of its major trading partners in Asia to underperform. Japanese stocks fell 2% in October while the Australian market was flat. US and European equities have been much stronger, with the trend continuing into November. The Nasdaq Composite Index is up 10 days straight at the time of writing, with last week culminating in a solid US payrolls report and Pfizer's announcement of a highly effective treatment for Covid-19. The latter point has caused many of the 'reopening stocks' in travel and leisure to rally strongly, reversing a period of weakness brought on by the Delta strain. Third quarter corporate earnings reports are now largely complete and a few wobbles in big tech and from some manufacturers with cost and supply chain issues have been quickly shaken off. Despite high valuations and the prospect of interest rates rising sooner than anticipated, many are now calling for a year-end 'Santa Claus' rally to cap off a solid year for most developed markets.

## Pricing Power Thematic



Inflation remains the most persistent macroeconomic talking point. The bears (inflation hawks) continue to believe that current inflation of around 5% is sticky and we are at the start of a potential wage/price spiral that will end in a stagflation shock. The bulls point out that some inflation is healthy, it is likely temporary in nature and that profitable companies who can pass on price rises in line with costs will increase their earnings. In any case, inflation is still proving to be more persistent than central bankers originally thought. The RBA (Reserve Bank of Australia) recently abandoned its defence of keeping interest rates at close to zero all the way out to 2024. This has pushed the prices of fixed rate mortgages higher and, coupled with macroprudential regulation, elevated house prices and minimal immigration for the last 2 years, has led us to close our bullish view on the Australian housing market, expressed through building materials and banks. Macquarie Bank is now our only long bank position in Australia. Recent results from the large commercial banks show that margins are being impacted by intense competition in the mortgage market.

A review of the best performing longs and shorts in the Fund so far this year shows that the companies with pricing power have again outperformed. These are businesses with dominant market positions and the ability to raise prices. Many of these are long-held positions. The leading companies in the semiconductor space, such as equipment maker ASML (+74% YTD) and chip designer Nvidia (+135%) remain years ahead of competitors. Battery materials are our preferred way to invest in future mobility and energy storage and we continue to be long lithium miners Orocobre (+115% YTD) and Gangfeng Lithium (+63%). Some of the best short positions this year have been those exposed to the rebalancing in China as increased regulation, the journey to common prosperity and an economic slowdown put pressure on stocks, especially those in healthcare, education and property. Ping An Healthcare was down 25% in October and has fallen 67% this year.

We gain increased conviction when a stock crosses over multiple themes. We discuss the Metaverse as theme this month and find that TSMC and Nvidia, existing longs in the Pricing Power Theme, are also plays on the Metaverse.



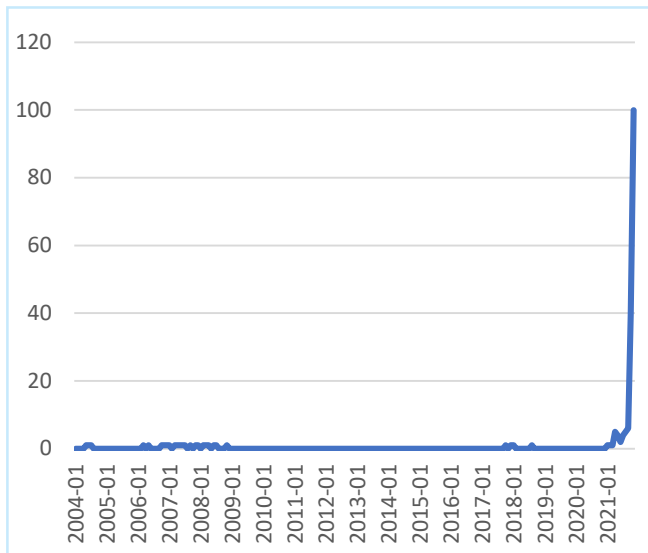
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## Theme: The Metaverse

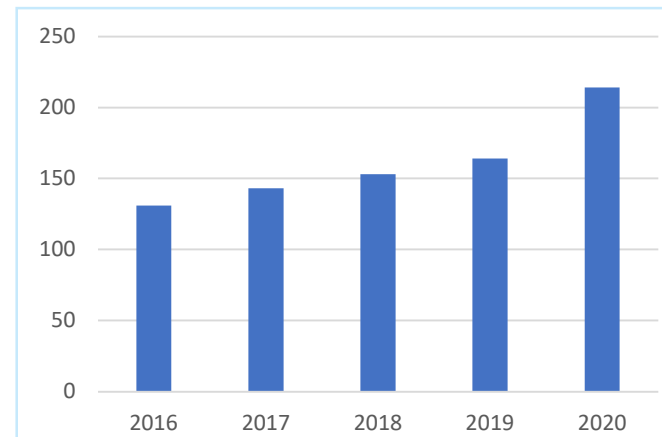
The term “Metaverse” pre-dates the recent fanfare with which Mark Zuckerberg renamed Facebook, “Meta”. In fact, the term can be traced back to a science fiction novel by Neal Stephenson titled Snow Crash, which was published in 1992. Defined loosely, it refers to an immersive virtual world in which you will be able to share experiences in real-time with others online, and within which, real economies will develop. In Stephenson’s book, the Metaverse refers to a virtual urban environment where users appear as Avatars and virtual real estate can be bought and developed. A more recent example includes a 2019 concert by popular DJ Marshmello, held within video game, Fortnite. An estimated 10.7 million players turned up for the event, even purchasing concert merchandise in the form of skins (a graphic download that changes your character’s appearance, not ability).

### Google Trends – Metaverse (Worldwide)



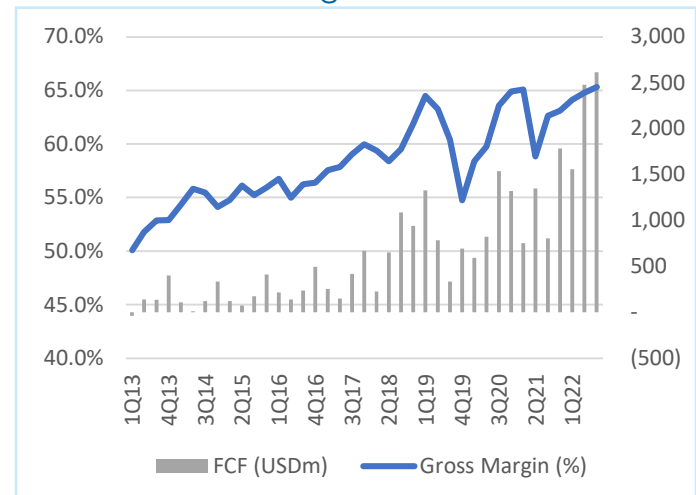
So why is this term coming into prominence now? Firstly, COVID related lockdowns globally forced communication for both business and leisure online. It also saw an explosion in the number of people of all ages playing video games. It is estimated that the US saw 50 million new gamers in 2020, roughly 4-5x than added in the prior 3 years. In recent times we have also seen the advancement of a number of technologies that have enabled the building blocks of the Metaverse. 5G internet, ever faster graphics cards and blockchain have all gone mainstream. Below we discuss some of those building blocks, as well as the companies set to both benefit and be disrupted.

### Number of US Gamers (m)



**More compute power.** Latency is the natural enemy of real-time rendered 3D graphics. Part of the solution has been increasing bandwidth via the proliferation of high-speed broadband and 5G networks. However, rarely do internet speeds keep pace with computing power. And hence, more of the compute will need to be done near the source of the data (in this case whatever device you are using to access the Metaverse). This is known as Edge Computing, and will mean the structural demand for leading edge chips such as those produced by **TSMC (TSM US)** should be sustained. Similarly, **NVIDIA (NVDA US)** is the inventor and leading producer of graphics processing units (GPUs). The company is at the forefront of combining Artificial Intelligence and Graphics Cards to deliver realistic graphics at speed. It has even developed its own “NVIDIA Omniverse” for Enterprise applications.

### NVIDIA – Gross Margin and Cash Flow



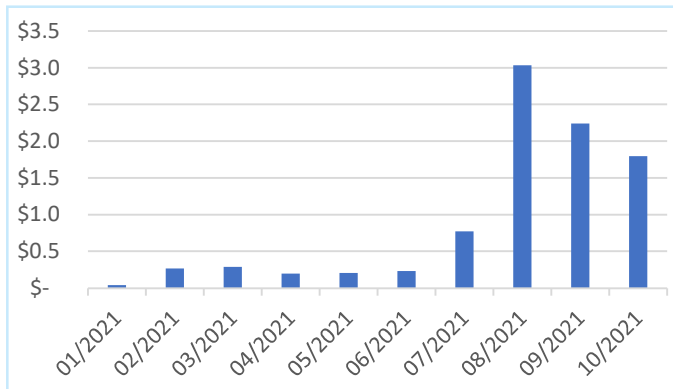


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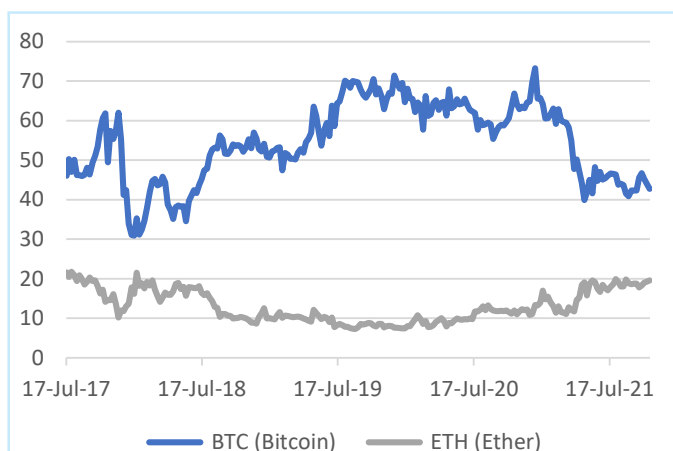
**Non-fungible tokens (NFTs).** Just as virtual places in the Metaverse will be persistent, so too will the objects and identities of those moving through them, allowing digital goods and identities to move from one virtual world to another. This is known as interoperability and will have a material impact on the video gaming sector (more on this below). Imagine buying a digital piece of art, and being able to share that with your friends and family in the Metaverse. Now imagine, that the provenance of that art could be proven. This requires digital ownership – an innovation afforded by blockchain technology. A Non-Fungible Token (NFT) is a blockchain-based way of proving ownership of a digital asset.

NFT Monthly Sales (USD**b**)



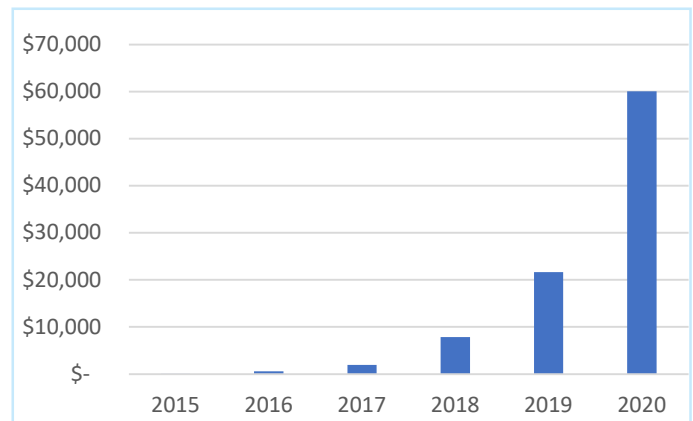
Most NFTs are part of the **Ethereum (ETHE US)** blockchain, which has become the dominant blockchain for smart contracts, NFT trading and decentralised finance applications. We have previously written about the attractiveness of Exchanges as a business model (see Pricing Power & New Casinos). Cryptocurrency exchange **Coinbase (COIN US)**, is the second largest exchange for Ether, and at time of writing has ~2.5 million people on the waitlist for its NFT Marketplace.

Cryptocurrency Market Cap by coin (%)



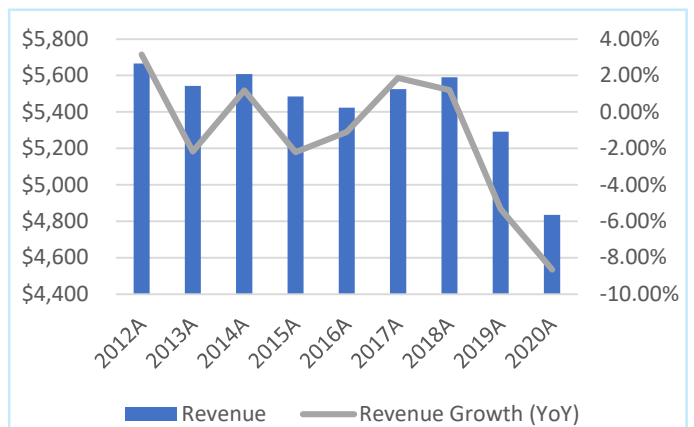
As digital ownership moves to the blockchain we see a high probability of disruption to traditional payment rails. Card issuing company **Marqueta (MQ US)** has become the Application Programming Interface (API) behind Crypto by creating new applications of its platform to allow cryptocurrency to be spent at the point of sale. In fact, Coinbase uses Marqueta’s Platform to build its Coinbase Card, which enables its customers to make purchases online or in stores using their cryptocurrency wallet.

Marqueta’s Annual Total Payment Volume (USD**m**)



Conversely, now that developing countries such as El Salvador are adopting Bitcoin as legal tender and adopting payments infrastructure such as Stripe to make moving money instantaneous, there are increasing risks to traditional cross-border payment businesses such as **Western Union (WU US)**. Across the globe the company still boasts 550,000 agents, largely handling remittance payments despite its share of cross-border money transfers having fallen from 17% in 2008 to 14% in 2020. The business was re-listed in 2006 on the back of peak revenue growth (12.5% in 2005), and has barely grown revenues since.

Western Union – Revenue Growth





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**The future of gaming.** Currently, the largest virtual platforms are Roblox and Minecraft, and, to a lesser extent, Grand Theft Auto Online and Fortnite Creative Mode. **Roblox (RBLX US)**, users spend an average of 2.5 hours/day on the platform, which is 4x more than Meta (formerly Facebook). The platform has grown primarily through word of mouth (network effects), with very little marketing.

Consensus expects that the current leading video game companies will be net beneficiaries of the Metaverse. Intuitively, this makes sense given their understanding of game engines and development studios. Roblox's stunning recent success shows the potential for disruption of this view. However, there is a far bigger, and more systemic threat to the legacy gaming companies posed from recent trends – and that is more value is accruing to the users and creators that contribute to the game. Interoperability, or digital ownership via NFTs, means players will increasingly expect to be able to carry forward in game purchases from one virtual world to another, resulting in less in app revenues, which are a major source of revenue for gaming companies such as Activision **Blizzard (ATVI)** and **Electronic Arts (EA)**.

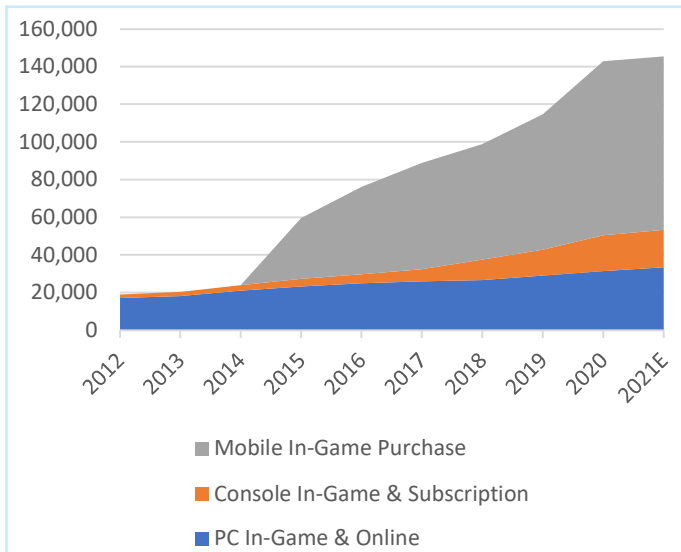
Additionally, on platforms such as Roblox and Axie Infinity, those that contribute to the user experience by playing can earn tokens. Having “skin in the game” is a far more powerful marketing tool than traditional advertising and hence its no wonder these types of games are growing so quickly. This “play-to-earn” phenomenon is reportedly even contributing to labour shortages in the Philippines. Finally, we continue to see headwinds for the gaming and livestreaming companies in China such as **Bilibili (9626 HK)** from regulatory pressure on content moderation and monetisation models.

Kind regards,

THE ALIMUM MARKET NEUTRAL FUND

[aliumcap.com](http://aliumcap.com)

### Video Game Spend – In-Game (USDm)



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