DAILY CLASS

L1 CAPITAL

Australian Equities Fund

Quarterly Report | June 2020

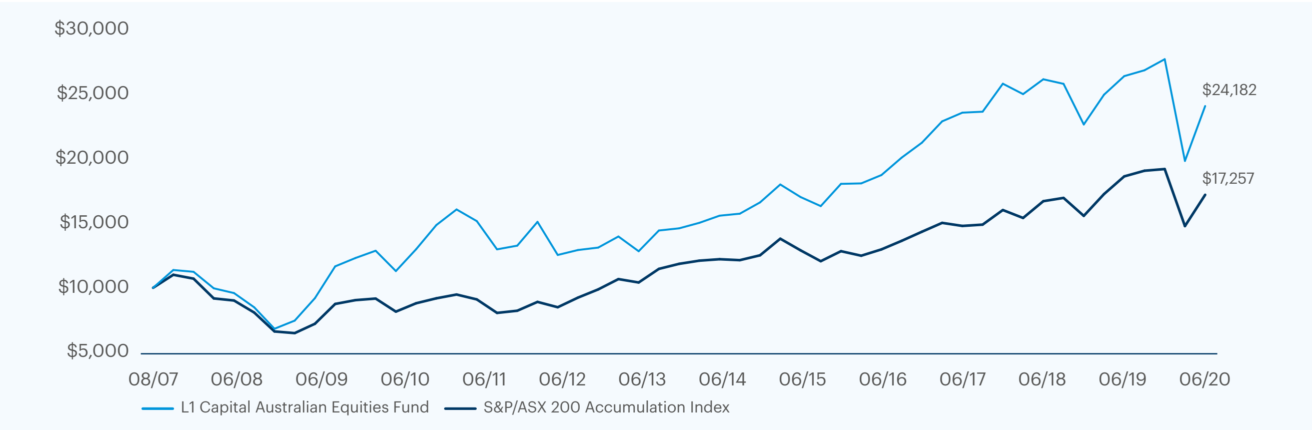
Inception Date: 23 AUGUST 2007 | Unit Price: 1.4796[1,2] | Fund Nav: $67m

AEF Unit Trust

	FUND*	ASX200 (AI)	Alpha (net)*
Three months	21.53%	16.48%	5.05%
One year	−8.80%	−7.68%	−1.12%
Three years (p.a.)	0.72%	5.19%	−4.46%
Five years (p.a.)	7.20%	5.95%	1.25%
Ten years (p.a.)	7.90%	7.80%	0.10%
Since inception (p.a.)	7.10%	4.33%	2.77%
Since inception (cumulative)	141.82%	72.57%	69.25%

*All performance numbers in this update are quoted after fees. All performance numbers prior to 15 September 2017 relate to the L1 Capital Australian Equities Fund wholesale class of units. The L1 Capital Australian Equities Fund PDS and RG (first issued 5 September 2017, last updated 19 March 2019) are a daily class of units. Past performance is not predictive of future returns.

Fund Performance vs S&P/ASX 200 Accumulation Index – Growth of $10,000 invested since inception (after fees)



Over the June quarter, the Fund returned 21.5% (net), outperforming the ASX200 Accumulation Index by 5.0% (net).

The Fund bought oversold stocks in mid-late March (during the height of investor panic), which was a key driver of outperformance over the quarter.

The Fund performed very strongly in the June quarter, recovering almost all of the underperformance of the March quarter. The decision to selectively buy stocks that we believed were dramatically oversold and increase weights in a selection of existing positions proved instrumental in the Fund's rapid recovery. We took advantage of the extreme, non-fundamental and indiscriminate sell-off to establish new positions in Atlas Arteria, Transurban and Scentre Group near the market's lows, funding these positions by exiting more defensive names such as Coles that had outperformed in the lockdown environment. In addition, we added to our holdings in Star Entertainment Group and Oil Search, when both stocks had been significantly oversold.

At the time of our buying, investor sentiment was as bearish and negative as we have ever seen (very reminiscent of the dark days of the GFC). While it was definitely not an easy decision to turn positive at that time, we believed that almost every signpost told us that it was a great time to be buying. Anecdotally, the vast majority of fund managers, brokers or clients we speak with remain outright bearish or "still pretty nervous/cautious", which suggests to us that this positioning/rotation has much further to go.

So why were we so positive in mid-late March, when virtually every investor/broker/economist had turned maximum bearish?

There were essentially five factors that led us to become very positive on the outlook for equities:

(1) Valuations: The extreme sell-off we witnessed between 20 February and 23 March had made valuations the most attractive we had seen since the depths of the GFC (the ASX200 fell 37%, from 7162 to 4546 in only 5 weeks). We found countless stocks with conservative upside of 50-100%+ even allowing for a very weak outlook for the global economy.

(2) Investor positioning was extremely bearish and defensive, with record levels of cash holdings and extreme short interest. This tends to be a classic contrarian indicator and aligns with the oft-quoted Buffett expression, "Be fearful when others are greedy and greedy when others are fearful". We observed hedge fund positioning close to the lowest net long on record, with stock and market short interest at record levels.

(3) Liquidity & Stimulus: Central banks (especially the Fed) and governments conducted the most aggressive stimulus and liquidity injection we have ever seen – even more extreme than stimulus during the GFC. Furthermore, the liquidity injection was done in one hit, amplifying the impact (during the GFC the stimulus was spread out over almost a year).

(4) Likely fall in COVID-19 cases: Our analysis suggested that COVID-19 cases were likely to begin falling in April given the extreme lockdown and quarantining measures that had finally taken effect as a result of surging case numbers. We had observed in China and other regions where restrictions had taken place that there was typically a 2-4 week lag between the time measures were enacted and a clear decline in infection rates beginning to be evident.

(5) 'Non-fundamental' selling of stocks was extreme – margin calls, retail investor panic, fund redemptions, ETF selling and quantitative/systematic selling (such as volatility targeting strategies), were all driving share prices far below what fundamental analysis suggested was warranted. Each of these sell orders was emotional (based on fear) or systematic (based on rising market volatility or negative price momentum), rather than an objective assessment of a business' future cashflows and prospects. Over time, buying during these periods has tended to be incredibly rewarding for investors who can withstand the short-term volatility.

While Australian equities have recovered around half of their February/March losses, we believe the outlook for equities remains positive, albeit we continue to expect elevated volatility over the next 1-2 quarters as incremental news flow comes through on COVID-19 spread, policy responses, vaccine progress and real-time economic data. We believe the vast majority of this "information" is actually "noise" in that it does not provide additional insight into the medium-term outlook for equities but may lead to large swings in share prices in the near-term.

On a medium-term basis, some of the reasons for our continued optimism about equities, particularly value and cyclical stocks, are that valuations remain attractive, especially compared to other asset classes like cash and bonds (which continue to enjoy record inflows as investors continue to be very risk averse) and expectations for the global economy remain overly negative (the outlook is soft, but not as weak as the consensus expects given our views on government stimulus measures and COVID-19 vaccine efficacy).

From a government stimulus standpoint, there was growing concern that stimulus measures such as the CARES Act in the U.S. and JobKeeper in Australia would end abruptly on 31 July and 28 September respectively and create a fiscal cliff. We do not believe this will occur and expect there will be continued government payments to support certain subsectors that remain deeply impacted by COVID-19. We believe it would be politically unpalatable to totally withdraw government assistance which would lead to a clear spike in unemployment and countless small businesses collapsing. In an Australian context, we expect a moderation in the JobKeeper stimulus from September (which would achieve the Government's aim of fiscal restraint, while still supporting the sectors that remain badly impacted, such as tourism, hospitality and education).

From a COVID-19 standpoint, we have conducted an enormous amount of detailed research on the prospects for a vaccine and have come away more positive than the consensus view. We are more positive than the market on both the likelihood of a safe and efficacious vaccine and also about the likely timeframe. Our head of healthcare research at L1 Capital is Dr. Andrew Lin, who is a medical doctor as well as being fluent in Mandarin. We have been in direct contact with most of the leading vaccine companies, such as Pfizer/BioNTech, Moderna, AstraZeneca, Inovio, Novavax, Sinovac, CanSino Biologics and numerous other promising biotech companies both in the Western world and China. We believe that by Q4 of 2020, we will have Phase 3 data available from Sinovac (China's most advanced vaccine player), Moderna, Pfizer/BioNTech and AstraZeneca/Oxford University, which should give equity markets comfort that there is some light at the end of the tunnel. The typical narrative we hear that a vaccine will take 3-5 years to come to market (because that has always been the case historically), is simply not recognising that this is the first time in a century that we have had a full-blown global crisis that has induced every government, regulator and vaccine company to expedite the entire vaccine development process, with unlimited global resources being thrown at it. Importantly, in the leading group of vaccine companies alone, there are a wide range of strategies being pursued (such as mRNA, Adenovirus, Inactivated virus, DNA plasmid, glycoprotein, etc) which provides numerous "shots on goal" for success. While there is still uncertainty as to the exact percentage efficacy that will be achieved (and the durability of any vaccine), we believe it will be enough to enable people to resume near-normal activities, such as visiting a shopping centre, going to a café, working from the office, taking a flight, etc.

At present, a significant proportion of the stocks globally are trading at deeply discounted levels because of the fear and uncertainty that the normal (pre-COVID) way of living may never return. We believe this set-up has created one of the greatest investment opportunities of our careers.

Portfolio Positioning

While we build our portfolio "bottom-up" from our stock research (selecting stocks that represent the best combination of value and quality), when we step back and look at the major themes and opportunity sets we see at present, they broadly fall into four buckets.

Fund – Key Themes:

(1) Monopoly Real Assets – companies such as Chorus, Atlas Arteria, Aurizon.

These companies look incredibly attractive at present. In general, these companies own monopoly or privileged assets that cannot easily be replaced or substituted. They are expected to generate dividend yields (or free cash flow yields) of at least 6-7% p.a. in coming years with continued growth in dividends beyond that. Some also offer the potential for additional capital management given they currently have under-geared balance sheets. In a world where long-term bond yields continue trading at 0-1%, we believe these stocks represent an extremely attractive alternative for investors seeking safe yield.

(2) COVID-hit Stocks – companies such as Star Entertainment, Scentre Group, Downer.

These companies have had a major hit to their earnings or business models due to COVID-19, yet the shares are now pricing in a much worse long-term outlook than we believe is likely. These are the companies that would most likely benefit most from signs of vaccine progress. In most cases, the shares are trading 30-50% below the levels they traded at in January (i.e. 40-100% upside if shares were to recover to January levels), yet the business is resilient and is likely to re-emerge "post-COVID" with only modest lasting damage to their earnings or cashflow. In our forecasts, we allow for weaker earnings (and in some cases a potential capital raising) and we still see very significant upside on a 1-2 year view.

(3) Resource-related stocks at a cyclical low point – companies such as Oil Search, Worley.

We are contrarian investors and like to buy high quality cyclical stocks at a low point in their cycle (and equally, we look to sell stocks at a cyclical peak). Commodities such as oil have all reached an extreme cyclical low over the past few months and share prices are now reflecting an unsustainable situation, where a large proportion of the world's production is simply not viable at current pricing. In the words of the legendary hedge fund manager, Stanley Druckenmiller, when discussing commodity prices "the cure for low prices is low prices". In other words, the low prices themselves create the remedy by causing production cuts to rebalance the market and send the commodity prices higher.

(4) Conglomerates with high quality assets and a valuation catalyst – companies such as News Corporation, Iluka.

When investing in conglomerates we look for three main factors before investing, namely: a selection of high quality, market leading assets, a material discount to the sum of the parts valuation of these assets and most importantly an upcoming catalyst that will result in the market better reflecting this underlying value. News Corporation and Iluka strongly meet the above criteria, with major positive catalysts on a 12 month view that should lead to material upside potential:

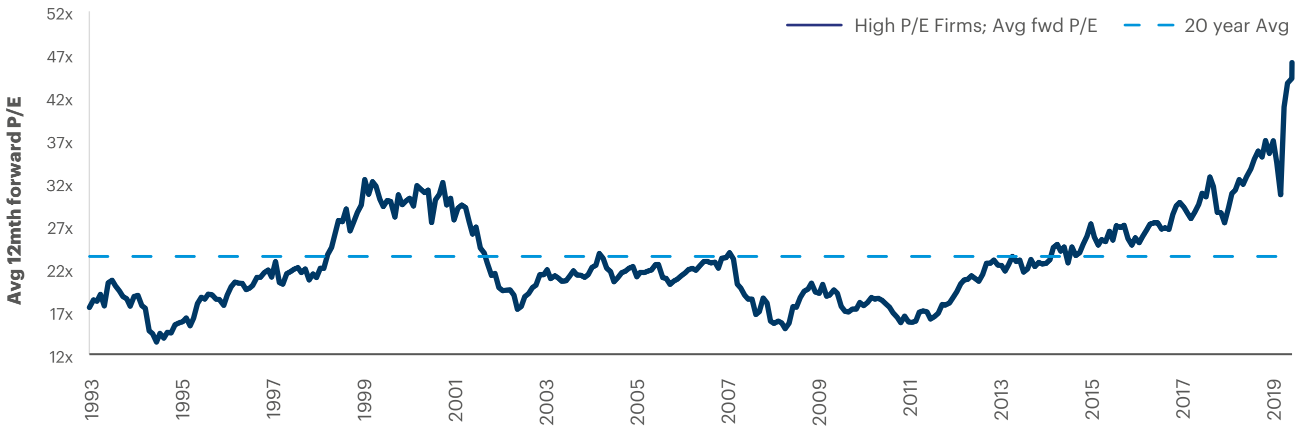
- News Corporation – Potential restructure/demerger of the digital real estate assets (such as REA & Move) or the Wall Street Journal
- Iluka – Demerger of Mining Area C Royalty later this year.

Why value and cyclical stocks?

Growth stocks have dramatically and consistently outperformed value stocks going all the way back to 2008. While much of this move has been completely justified by the structural dominance and earnings growth of sectors such as large cap U.S. technology stocks and the structural headwinds that have faced sectors like banks and energy stocks, we believe the most recent “melt-up” has overshot and we are likely to see an inflection point as COVID-19 passes and economic activity recovers from multi-decade lows. We have never seen a more extreme divergence in share price performance between growth and value stocks in our 18 years in the market. For anyone doubting the magnitude of this move, Morgan Stanley’s Factor Baskets illustrate the point. So far this calendar year, Morgan Stanley’s US Growth Stock Index is up 37%, while its US Value Stock Index is down 53% (as at the time of writing on July 9). That is a 90% difference in performance across a very broad index of stocks in just over six months!

Chart 1 below shows how extreme the rally in high P/E stocks has been in Australia this year. These stocks had already been trading at levels never before seen in the past 20 years and in the space of only 6 months have just added another 10 P/E points to their valuation (with no meaningful change in their outlooks).

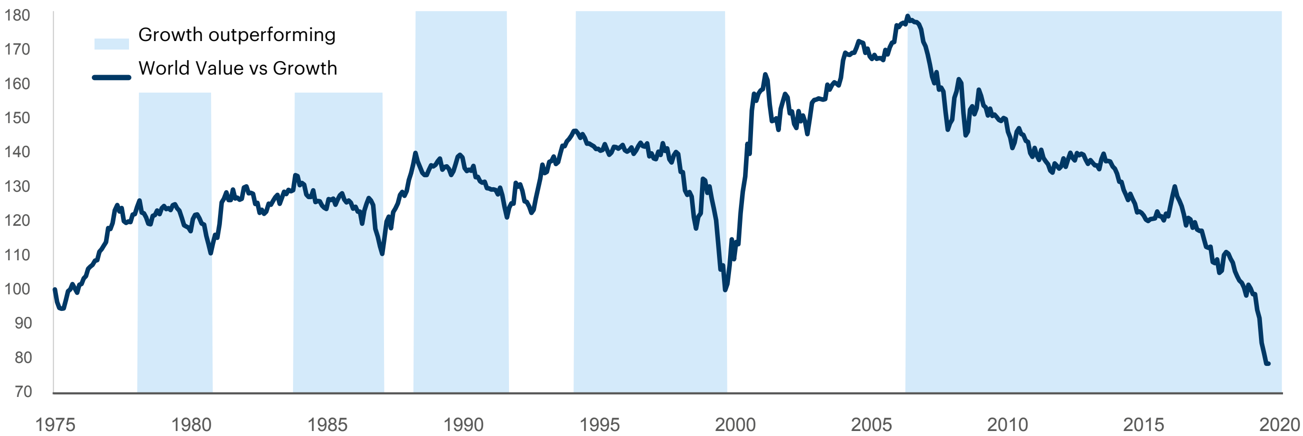
Chart 1: High P/E firms trade an average forward P/E of 46.0x, which is 97% above the 20 year average



Source: FactSet, Goldman Sachs Global Investment Research.

On a global basis, you can see that this period of ‘growth stocks’ outperforming ‘value stocks’ has been far longer and larger than any other period on record. While it is difficult to predict the timing of a reversal or normalisation, we believe the odds now clearly favour value stocks.

Chart 2: Growth has outperformed value since the GFC (relative price performance in local currency)



Source: Datastream, Goldman Sachs Global Investment Research.

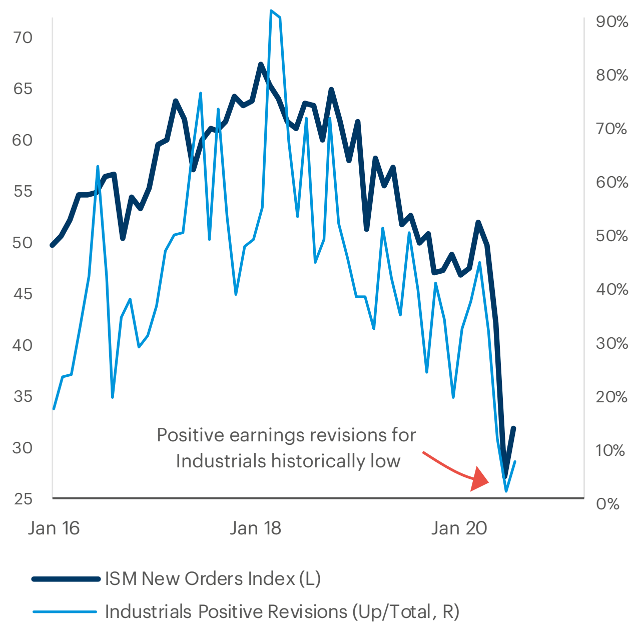
Why do we expect an inflection point over the next 1-2 years?

Historically, one of the best leading indicators of economic activity has been the ‘New Orders’ component of the ISM index (a closely watched monthly data set). We have seen a clear inflection point higher for the New Orders index over the past couple of months (the latest reading was 56.4 for June, up from 31.8 in May), consistent with the positive inflection in money supply and bond yields. Importantly, during periods of sharply rising New Orders data (as we are now observing), we tend to see strong outperformance from value and cyclical stocks. While this economic cycle is unique in terms of the nature of the crisis (a global pandemic), it is not unusual in terms of how liquidity, stimulus and bond yields are predictive of likely future economic activity. This supports our view that the coming year will see a rotation out of the safe haven stocks, such as technology and healthcare, which have been viewed as the true defensives in this crisis, given they generally have less negative impact from COVID-19, modest economic sensitivity and safe balance sheets. As COVID-19 passes and the impact of massive stimulus takes effect, we would expect to see these sectors become funding sources to enable investors to buy bombed out cyclical stocks, such as energy, miners (excluding iron ore), banks, consumer discretionary and transport stocks that are trading at 10-20 year lows.

Chart 3 shows that expectations for industrial stocks are extremely depressed and have tended to be highly correlated to the ISM New Orders data, which is now trending strongly higher (the latest reading is not included in this chart, as referenced above this has surged to 56.4).

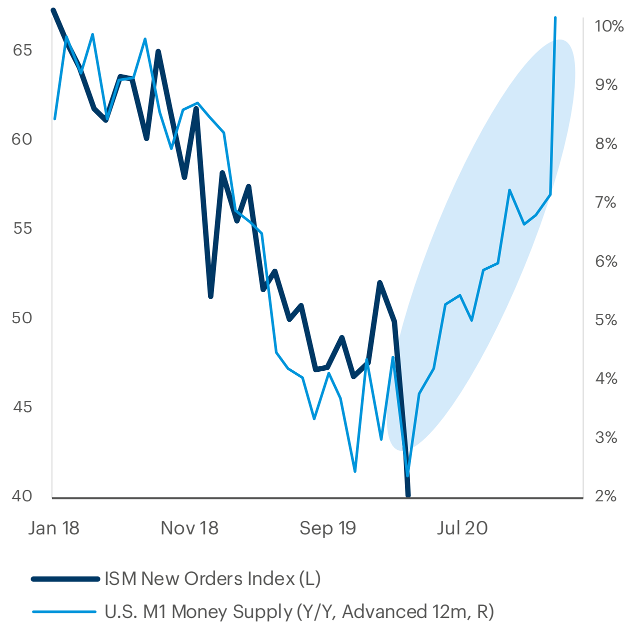
Chart 4 outlines how changes in the Money Supply (M1) tends to lead the ISM New Orders data by around 1 year and suggests a very strong improvement is likely in economic activity over the next 12 months.

Chart 3: Expectations for cyclicality are very low



Source: FactSet, UBS

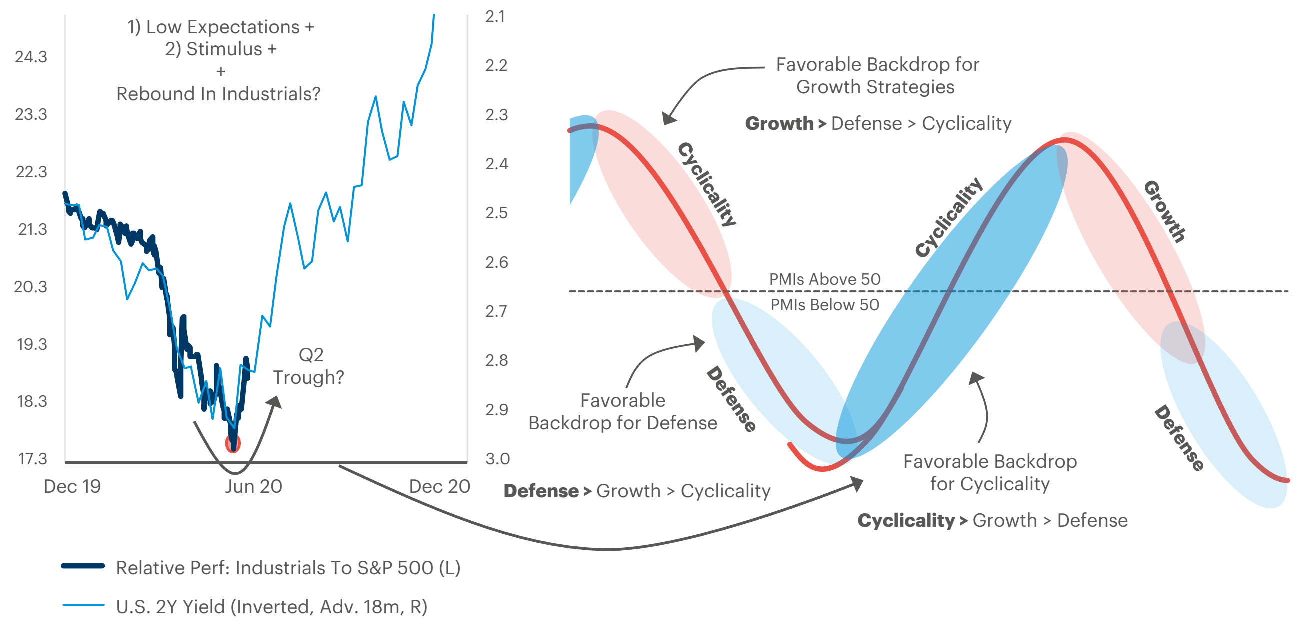
Chart 4: A lot of stimulus in the pipeline



Source: FactSet, UBS

Lastly, Chart 5 illustrates the historic correlation between U.S. 2 year bond yields (advanced 18 months) and the relative performance of Industrials versus the S&P 500. The move in bond yields suggests a period of strong outperformance in Industrials/Cyclicals is likely over the next 12-18 months. The stylised chart on the right hand side also suggests that investors should rotate into defensives as the PMI data falls below 50 (economic contraction), but should move into cyclicals as the PMI recovers past 50 (economic expansion) and look to rotate again into Growth stocks once the PMI peaks (declining rate of economic growth).

Chart 5: A rebound from cycle lows is typically the sweet spot for cyclicals



Source: FactSet, UBS

Key stock contributors

Atlas Arteria rose 21%, as traffic started to show a meaningful recovery post the easing of COVID-19 restrictions in France. ALX shares had declined by around 50% from February highs of ~$8.50 as French and US lockdowns precipitated traffic declines of up to 90% on company toll roads. We initiated a large position in ALX in March/April, buying the bulk of our position for around ~$5.00. In May, ALX launched a placement and SPP to raise up to $495m to strengthen the balance sheet. This equity injection will enable them to benefit from the likely investment opportunities emerging as the French Government encourages infrastructure stimulus spending to boost economic recovery. We still see further substantial upside in ALX as dividends return in 2021 and 2022 towards our previous expectations.

Oil Search rallied 51%, broadly following the moves in energy markets, with oil prices recovering over the quarter after prices cratered in mid-April under the dual impact of dramatically falling demand and a breakdown in the OPEC+ cartel. Oil Search is one of the highest quality energy stocks listed in Australia, given its low cost of production, long life assets, attractive growth options and partnership with a high quality operator (Exxon Mobil). Oil Search has a large stake in two very substantial growth projects in PNG and Alaska and, as oil prices recover, we believe the market will likely reincorporate some meaningful value for these projects in group valuations. Furthermore, we believe the more difficult economic backdrop in PNG is likely to incentivise the PNG Government to resolve their differences with the joint venture to enable this project to proceed (subject to market conditions).

Downer gained 47%, recovering strongly post the sell-off in the prior quarter as COVID-19 concerns moderated. Downer shares had fallen in the prior quarter due to concerns that they may be unable to complete the sale of their mining services division and broader COVID-19 disruptions through various business units in Australia and particularly New Zealand. We believe the shorter-term COVID-19 related risks are being overstated and that delivery of a weak (but acceptable) full year result and more constructive FY21 outlook (as well as the expected divestment of the mining services and laundries assets over the coming year) will lead to a re-rating of Downer as a capital-light (and lower risk) services business exposed to growing, annuity-style contracts.

Worley rallied 42%, staging a modest recovery after falling by over 50% during the March quarter. We believe Worley is much better placed to handle this downturn relative to the last cycle. Post the Jacobs ECR acquisition, Worley is more diversified across sectors and geographies, with upstream oil and gas capital expenditure now representing only 20% of group project work and ~45% of revenues derived from customers' operating expenditure (rather than capex investment). Worley's non-upstream business lines should remain relatively resilient in this environment. While upstream capex will likely be very subdued in the near-term, this should normalise over the medium term given the global oil industry faces depletion rates of ~5-6% p.a. requiring oil companies to increase investment just to maintain production levels. Worley held an investor day in early June outlining the greater diversity and resilience of the business post the ECR acquisition and detailing a ~$275m operating savings program primarily driven by efficiency improvements across the business. Worley management have a history of successfully delivering prior cost-out programs and pro-actively managing staff utilisation levels through difficult periods. We continue to believe the shares are undervalued, with the market incorrectly regarding the entire business as a direct exposure to the oil price.

Boral rose 73%, over the quarter continuing its strong recovery since March (the shares had fallen from ~$4.50 in January to ~$2.00 at the end of March). Boral has had a series of earnings downgrades over the last couple of years, with the most recent major disappointment being the identification of financial irregularities in its North American Windows business which would result in a one-off impact to EBITDA of US$20-$30m. We significantly reduced our Boral position in mid 2019 (around $5.00-5.50) given the weaker operational outlook. With the large fall in the share price in March, we increased our position in April as we believed the shares were extremely oversold and have subsequently taken advantage of the recent rally to crystallise some gains. While the near-term outlook is challenged by lower housing activity in Australia and North America, we continue to remain optimistic on the longer term outlook for Boral given its strong leverage to the growth in infrastructure construction that is set to occur on the east coast of Australia over the next few years. During the quarter Seven Group became a substantial shareholder and have publicly expressed the need for a fresh approach at Boral.

Perenti rallied 90% over the quarter, as it continued its recovery after the extreme sell-off in March (the shares had fallen from ~$1.50 in early February to ~$0.50 in mid-March). Perenti is a mining services company operating surface and underground mining across Africa and Australia. The market was concerned about the potential impact COVID-19 would have on the company's earnings, including the potential for large scale mine shutdowns. Perenti provided an update in late June, indicating isolated impacts from COVID-19 and an updated FY20 NPATA guidance range ~8% below pre-COVID levels. We believe Perenti has navigated COVID-19 challenges well to date and delivered a relatively resilient FY20 earnings outcome. Furthermore, the ramp up of recent contract wins in Botswana, Burkina Faso and the U.S. and exposure to a significant tender pipeline are supportive of strong future earnings growth over the medium-term.

Resolute Mining rose 40%, on the back of a stronger gold price and expectations of a better quarter at Syama (its main gold mine) after a weak few months impacted by two production outages, gold price volatility and a mixed first quarter production report. Resolute is trading at a substantial discount to most ASX and Canadian listed peers and we believe the shares will re-rate substantially as Syama fully ramps up in the coming months and as the company rolls out of adverse gold hedges that will enable much stronger cashflow generation.

Key stock detractors

The largest detractors from performance over the quarter were underweight positions in BHP Billiton, Wesfarmers, Commonwealth Bank and Macquarie Group.

Healthcare & biotech sector review

Over the past year, we have significantly increased our coverage of the global pharmaceuticals and biotech space. Our reasoning was that with the increasingly global platform that Australian healthcare companies currently operate in, it is critical to understand the global landscape and implications new developments may have on their business models. Furthermore, with the dramatic impact of the COVID-19 crisis we have invested a huge amount of time and energy into understanding the science, clinical outcomes and current status of a variety of therapies being developed across the world in order to form a considered view on the potential outcome.

In the past six months, our healthcare analyst, Dr. Andrew Lin, has met with more than 200 biopharma companies, 100+ clinicians and key opinion leaders and attended 10 global healthcare conferences (one of the positives of the COVID-19 crisis is that we have been able to intensify our company visitation schedule without the tyranny of international travel). We have come away with some high level insights on the COVID-19 crisis as well as international developments that may impact domestic healthcare stocks, which we further outline below:

1. Since the start of the COVID-19 crisis, we have met with numerous clinicians and most of the prominent companies leading the therapeutics and vaccine charge. These include Moderna, Sinovac, Regeneron, BioNTech, CanSino and many others. The Chinese inactivated virus vaccines by China Biotec and Sinovac are currently leading the vaccine race with Phase 3 trials starting this month in Brazil and the UAE. Their Phase 2 trial showed very strong and convincing outcomes that we believe will offer significant protection against COVID-19. The Moderna and Pfizer/BioNTech mRNA vaccines are not far behind in clinical development and have the potential to offer a similar level of protection to the Chinese vaccines. Overall, we believe this means we will have the first safe and efficacious vaccine around November this year, with more widespread availability in the first half of 2021. In the meantime, until a vaccine becomes available, we believe that a new generation of antibody treatments (from companies such as Regeneron and Celltrion) will become available over the next few months that will significantly reduce the severity and mortality of the disease.

2. Personalised therapies have been talked about for decades, but recent advances in delivery technology and accelerated pathways to approval have given birth to a plethora of therapies that are now at or near commercialisation. These include gene therapies which use harmless viruses to deliver missing genes to cells, mRNA therapies which deliver the instructions to new proteins, RNAi therapies which block 'bad' genes and gene editing which could alter specific genetic mutations back to their normal state. Due to their targeted nature, these therapies have fewer side effects, and can deliver persistent benefits that allow for quarterly, annual or even one-off dosing. For those healthcare companies selling traditional therapies, we believe this looming wave of personalised therapies poses an existential threat, as evidenced by CSL's defensive $2 billion licensing deal with UniQure for their Haemophilia B gene therapy. While Sanofi's Fitusiran (RNAi) and Pfizer's competing gene therapy are vying for the same market, we believe this deal could potentially allow CSL to defend a portion of its $800m Haemophilia B franchise.

3. There has been a lot of recent interest in the FcRn antagonist space, given the recent Phase 3 results from Argenx which showed that in Myasthenia Gravis (MG), their drug was highly effective with very few side effects. We believe these results will allow the drug to be approved in 2021, and it will rapidly displace immunoglobulin ("Ig") use for this indication (~5% of total Ig use). Argenx (and other FcRn companies) are also running trials in similar conditions (such as ITP and CIDP), with these conditions in totality representing close to 50% of Ig use globally. We have been meeting with these FcRn companies regularly over the last 12 months and believe that given the impressive results seen in MG, these other trials have a greater chance of success than the market currently assumes. Ig is the largest part of CSL's earnings today and given CSL is currently trading on a P/E of 39x earnings (FY21), we don't believe these serious competitive threats are being factored into the current share price.

We believe we are about to enter a period of unprecedented innovation and disruption in the pharma and biotech space, with COVID-19 acting as an accelerant to these innovation efforts. We will continue to focus and expand our coverage of the sector as we believe the potential path to a COVID-19 vaccine is the single biggest factor that will impact equity markets over the medium-term.

Australian Equities Fund

Quarterly Report | June 2020

L1 Capital Overview

L1 Capital is a global investment manager with offices in Melbourne, New York and London. The business was established in 2007 is 100% owned by its senior staff, led by founders Raphael Lamm & Mark Landau. The team is committed to offering clients best of breed investment products. L1 Capital manages money for a range of clients including large superannuation funds, endowment funds, private banks, insurance companies, pension funds, financial planning groups, asset consultants, family offices, high net worth individuals and retail investors.

L1 Capital uses a fundamental, bottom-up research process to identify investments with the potential to provide attractive risk-adjusted returns. The L1 Capital investment approach is largely style-neutral with modest value and contrarian characteristics. The firm launched the L1 Capital Long Short Fund in September 2014. The net return of 15.7% p.a. since inception has been achieved with strong risk adjusted returns.

Fund Information

Name	L1 Capital Australian Equities Fund
Class of Units	Daily
Structure	Unit Trust
Domicile/Currency	Australia/AUD
Inception	23 August 2007
Management Fee	0.77% p.a. inclusive of GST and RITC
Expenses	Maximum of 0.20% p.a.
Performance Fee	15.38% above S&P / ASX200 Acc Index*
High Watermark	Yes
APIR/ISIN	LCP0001AU / 621 183 195
Minimum Investment	A$25,000
Subscription Frequency	Daily
Redemption Frequency	Daily

Service Providers

Responsible Entity	Equity Trustees Limited
Fund Administrator	Mainstream Fund Services
Fund Auditor	EY
Fund Custodian	JP Morgan
Legal Advisor	Hall & Wilcox

There have been no changes since the last quarterly report.

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Information contained in this publication

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