Equity Trustees

March 2023
Quarterly Report

EQT EIGHT BAYS GLOBAL FUND

FUND STRATEGY

The Eight Bays Global ETF strategy is a portfolio of Exchange Traded Funds (ETFs) designed to complement domestic equity portfolios by investing in global growth industries and equities not available on the ASX. Due to the depth and liquidity of the US ETF market, we invest only in ETFs listed on US exchanges. The portfolio has a bias towards industry ETFs with sound growth prospects and attractive structural characteristics. The portfolio holds between 5 and 15 ETFs and any given time, with a maximum cash weighting of 20%.

INVESTMENT PHILOSOPHY

Industry factors are one of the primary drivers of shareholder value over the longer term. Industry dynamics such as growth rates, fragmentation, concentration, disruptive forces and regulation are major drivers of equity performance. One of the most cost-effective ways to invest in attractive industries is via an appropriate ETF.

MARKET COMMENTARY

Global equity markets rallied in the March quarter led by strength in Developed Markets. In local currency terms, the MSCI All Country World Index (ACWI) ex Australia Index rose 9.32% in AUD terms. In local currency terms, the US S&P500 rallied 7.5% while major European markets (Euro Stoxx +13.7%) such as France (+13.4%) and Germany (+12.2%) also rebounded strongly. The standout performer was the yield sensitive US Nasdaq (+17%). Japan's Nikkei surged by 8.5%, while Asia-Pac markets (ex-Japan) rose 4.1%. Emerging markets underperformed Developed Markets by 3.71%.

In March, the failure of Silicon Valley Bank and other US regional banks as well as the acquisition of Credit Suisse by UBS increased volatility in markets. Swift action by US regulators limited the impact but tightening bank lending standards became even more restrictive and credit spreads widened. Bank deposits were withdrawn an invested in money market funds. US regional banks fell 31% over the quarter. Concerns about how contracting credit might impact on certain long duration assets impacted sectors such as US office REITs.

Bond yields fell across the curve for most bond markets. Investors bet that central bankers would not need to raise rates as much as previously anticipated due to slowing inflation, increasing economic risks and tighter bank lending standards. Perversely, lower bond yields supported asset valuations, but given increased liquidity concerns leveraged sectors such as property suffered.

Most economies delivered stronger than expected economic results. Consumer spending held up better than expected, while manufacturing PMI's rose from depressed levels in the early parts of the year. China continued its re-opening from Covid lockdowns and low gas prices supported European households and businesses.

FUND PERFORMANCE

	1 MONTH	3 MONTHS	1 YEAR	SINCE INCEPTION (P.A.)[4]
Income return[1]	0.00%	0.00%	0.00%	0.00%
Capital return	4.19%	10.41%	-0.83%	-3.00%
Total net return[1]	4.19%	10.41%	-0.83%	-3.00%
Benchmark[2]	3.97%	9.32%	3.61%	1.61%
Active return[3]	0.21%	1.09%	-4.44%	-4.60%

Table 1

[1] Income and Total net returns include the deduction of ongoing fees and expenses.

[2] MSCI ACWI ex Australia Net Return Index (AUD)

[3] Calculated as Total net return less Benchmark.

[4] The inception date is 1 July 2021

Past performance is not an indicator of future performance.

The EQT Eight Bays Global Fund recorded a total net return of 10.41% in the March 2023 quarter which was 1.09% above the Benchmark MSCI All Country World Index (ACWI) ex Australia index.

Since the Fund was officially launched (inception on 1 July 2021) the Fund has a net return of -3.00% which is -4.60% below the benchmark. The Fund has a focus on higher medium-term growth industries and innovation. With interest rates increasing and recession widely forecasted we have maintained allocations to some more defensive positions such as Healthcare (18% of Fund portfolio) that still have growth attributes.

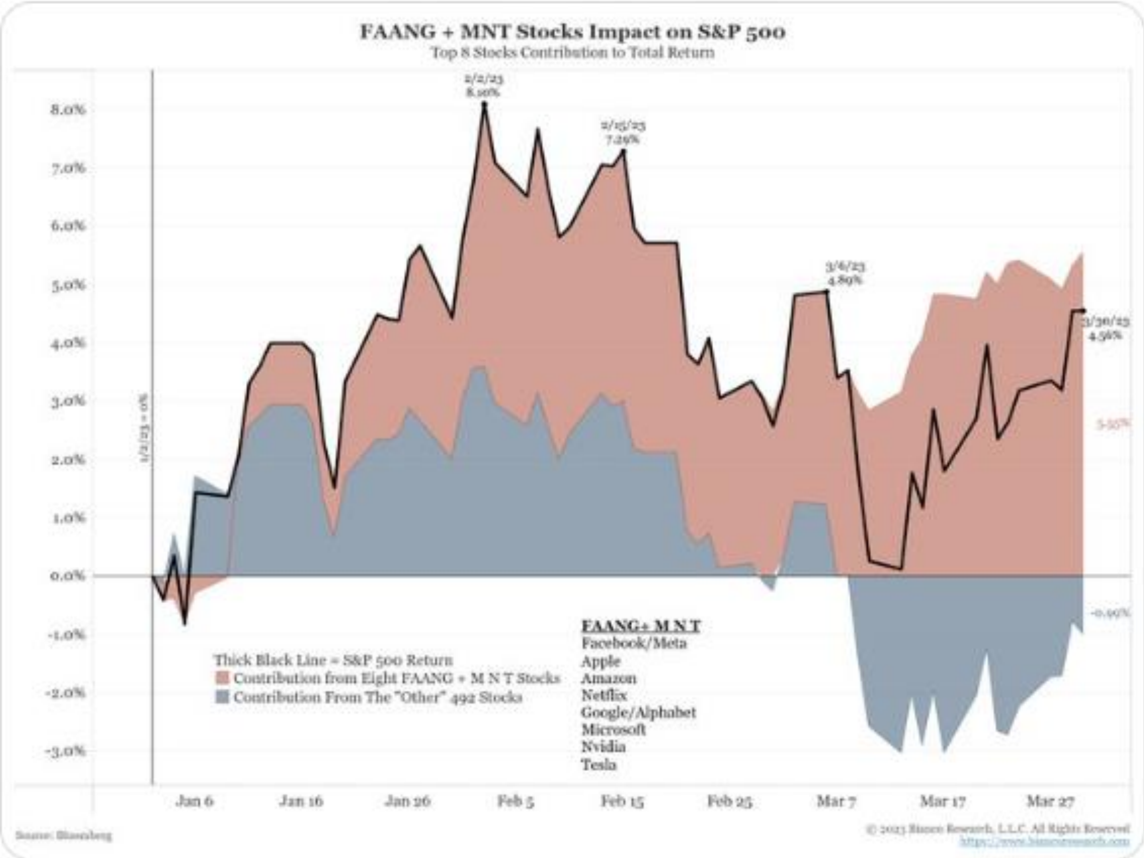
PERFORMANCE SUMMARY

The best performing Exchange Traded Fund (ETF) positions were Semiconductors and Robotics /Artificial Intelligence (AI) both up 28%. This was driven by interest generated by the Open AI / Chat GPT presentations and the perception that Graphic Processing Unit (GPU) leader Nvidia would be a major beneficiary of AI adoption. Nvidia is 5% of the Information Technology ETF and 9% of the Robotics/AI ETF. Nvidia increased 90% in the first quarter, which effectively recovered all its share price decline over the last year.

The Information Technology and Communications Services positions both increased 18% in value in the March quarter. Information Technology leader Apple increased 28%, perhaps driven by recognition of its huge cash pile and immunity from banks in the wake of the Silicon Valley Bank collapse. Microsoft gained 20% driven by its reported $US10 billion investment in Open AI/Chat GPT which generated an initial $US200 billion increase in Microsoft's market capitalization – arguably an overenthusiastic reaction.

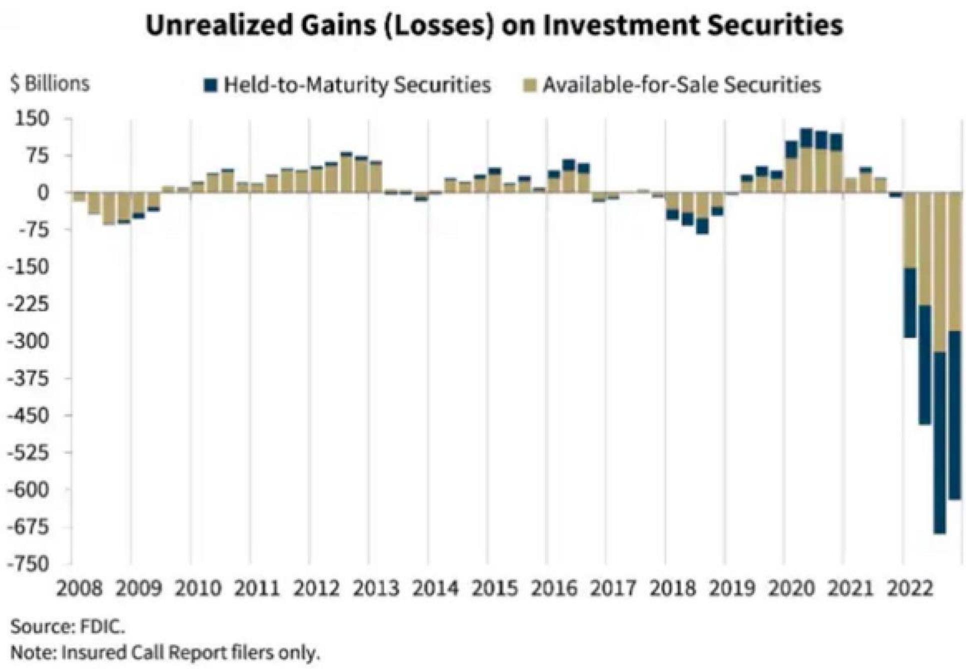
The Communications Services ETF was driven by a continued recovery in Meta (Facebook) up 76% from its depressed levels at the end of 2022. This was driven by a renewed "efficiency focus," including staff layoffs and a general sense that the untrammelled expenditure on the Metaverse project (Meta's Reality Labs lost $US14 billion in 2022) may be moderated. Alphabet (Google) initially underperformed due to the perception that Open AI and its followers would threaten Google's dominance in search and associated advertising revenues but still ended the quarter up 17%.

The chart below from Bianco Research illustrates the March quarter dominance of just eight stocks in the S&P 500. The outperformance of large cap technology was further boosted in March by a perception that the problems in Silicon Valley, Signature Bank and other smaller and regional banks experiencing deposit outflows and losses on hold to maturity bonds might induce the Federal Reserve to cease interest rate rises in the US.



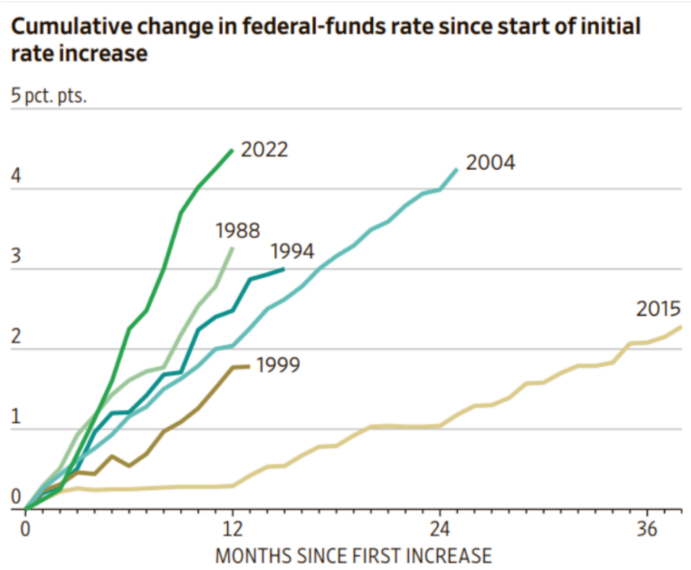
Source: Bianco Research 31 March 2023

The speed of interest rate rises has exacerbated the problems for banks that have too much exposure to 10-year bonds at very low interest rates, imputing large unrealised losses on a hold to maturity portfolio.



Source: US FDIC 13 March 2023

The chart below from the Federal Reserve illustrates the impact of the steep interest rises over the last year compared to previous tightening cycles.



Source: US Federal Reserve 11 March 2023

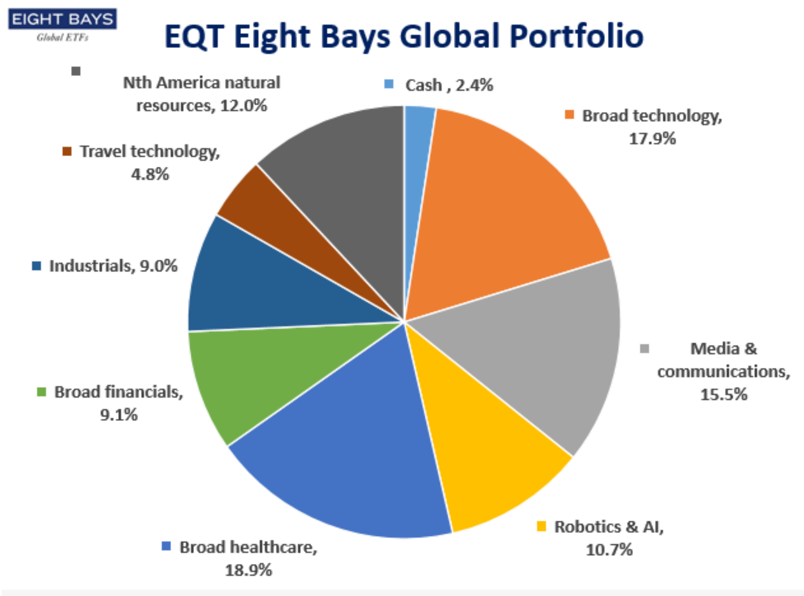
Underperforming Fund positions in the March quarter were Financials – 7%, Broad Healthcare – 5% and North American Natural Resources -2%.

FUND ACTIVITY

In the first quarter of 2023 the specialized Cybersecurity ETF (CIBR) was sold. This ETF was a 5% portfolio position, and we retain exposure to Cybersecurity through the Information Technology ETF which has grown to a 18% portfolio position. The funds generated by the sale of the Cybersecurity ETF were allocated to Information Technology and Communications Services.

Cybersecurity has been a focus of the Eight Bays strategy over the last 3 years, and it has been interesting to watch the rapid evolution of the industry to a mainstream investment thematic. It was determined that the specialized Cybersecurity industry had evolved in a way that there was less benefit having a broad exposure to nascent pre-earnings Cybersecurity companies. The Information Technology ETF (VGT) has a 17% allocation to Microsoft which has quietly built a substantial Cybersecurity platform.

SECTOR EXPOSURE



Source: Eight Bays Investment Management
Note: Semiconductors sold 5 April 2023, Portfolio as at 6 April 2023

The Information Technology ETF focuses on the more established Cybersecurity companies, such as Accenture and Cisco Systems which have significant Cybersecurity divisions, and specialized Cybersecurity leaders Palo Alto Networks, Fortinet, Snowflake and Crowdstrike.

There will still be opportunities for the specialized cybersecurity companies as the large Cloud computing companies such as Microsoft, Amazon, Alphabet and Oracle seek to integrate cybersecurity features into their products.

EQT EIGHT BAYS INDIVIDUAL LOOK THROUGH STOCK EXPOSURE (6 APRIL 2023)

	Holding	Weight
1	Apple Inc.	4.1%
2	Meta Platforms Inc. Class A	3.4%
3	Microsoft Corporation	3.1%
4	NVIDIA Corporation	2.1%
5	Alphabet Inc. Class A	1.9%
7	Alphabet Inc. Class C	1.7%
8	UnitedHealth Group Incorporated	1.5%
9	Visa Inc. Class A	1.4%
10	Johnson & Johnson	1.4%
11	Intuitive Surgical, Inc.	1.2%
12	Exxon Mobil Corporation	1.2%
13	Mastercard Incorporated Class A	1.2%
14	Berkshire Hathaway Inc. Class B	1.2%
15	Freeport-McMoRan, Inc.	1.0%
16	Keyence Corporation	1.0%
17	Chevron Corporation	1.0%
18	AbbVie, Inc.	0.9%
19	Merck & Co., Inc.	0.9%
20	Fanuc Corporation	0.9%

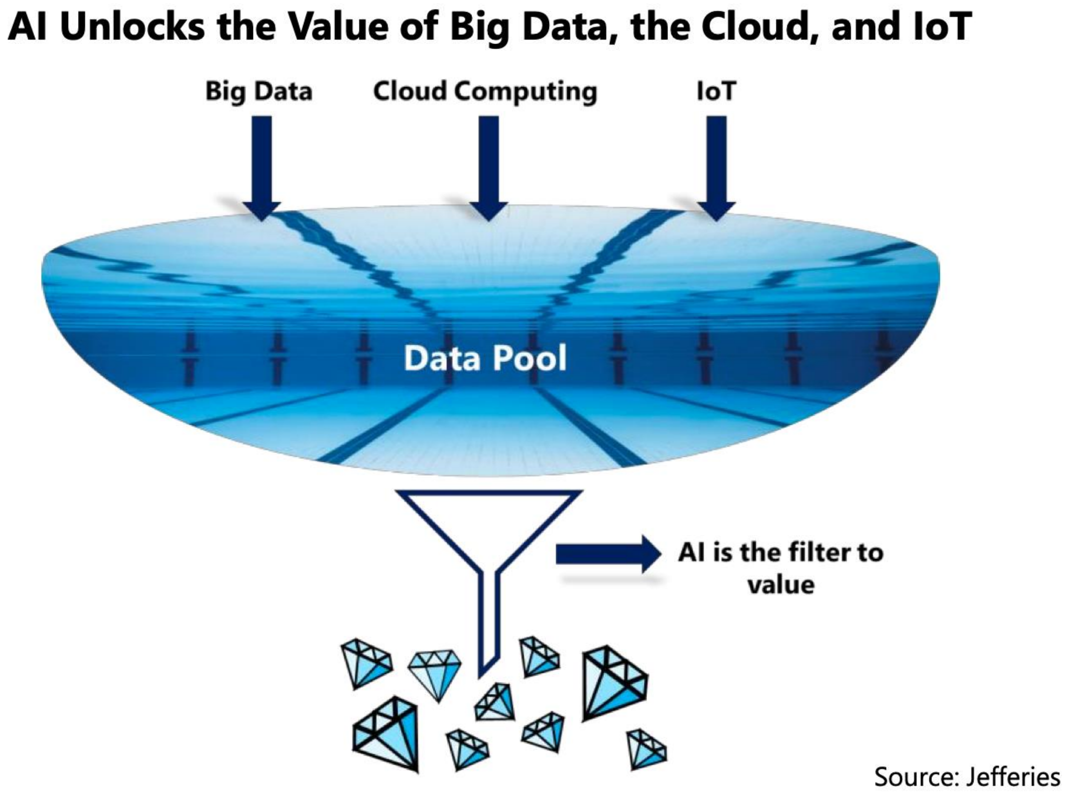
Source: Eight Bays Investment Management

STOCK IN FOCUS – MICROSOFT

The EQT Eight Bays Fund has an effective 3.2% portfolio allocation to Microsoft through the Information Technology ETF. During the March 2023 quarter we noted three points of interest for the Microsoft investment case, in addition to their core software business.

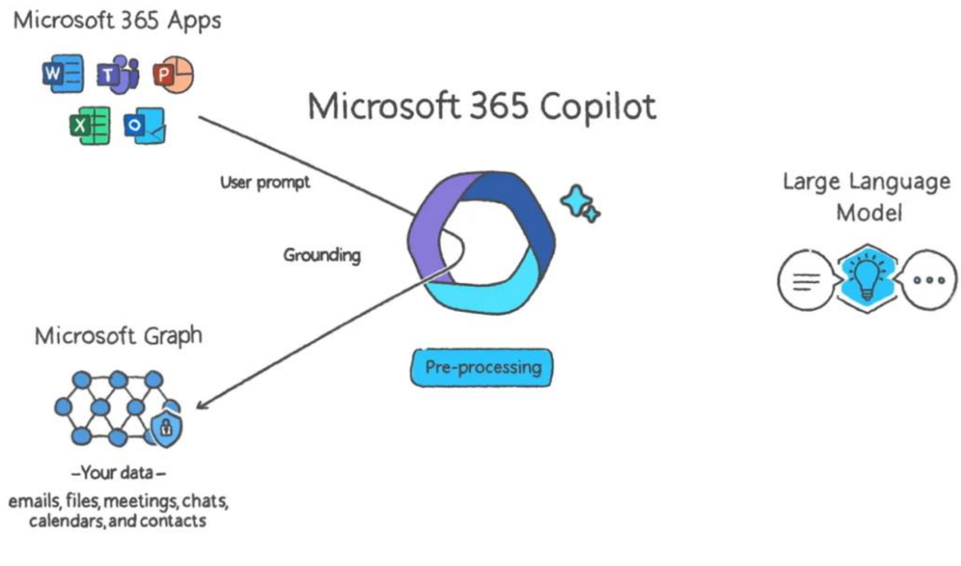
Microsoft Investment in Open AI/Chat GPT

As mentioned earlier Microsoft extended its investment in Open AI/Chat GPT – reported to be an effective 49% stake in the Generative Artificial Intelligence platform. Open AI now runs its technology through Microsoft's Azure Cloud Computing platform, so it's the evolution of AIaas (AI as a service). It is early days and there will be several powerful players, however Open AI is in a strong position, with Chat GPT being widely adopted.



Source: Jefferies March 2023

In March 2023 Open AI launched Chat GPT 4 with further enhancements in image to text process and several bug fixes. Also, Microsoft announced an AI productivity tool – Microsoft 365 Copilot that neatly integrates Microsoft 365 applications such as Word, Excel, Outlook, Teams and Powerpoint.



Seamless Synergy: Copilot Bridges the Gap Between Office Suite and Microsoft Graph

Source: medium.com 17 March 2023

Microsoft an emerging Cybersecurity leader

Microsoft has built a significant and growing Cybersecurity offering, integrating with its Cloud Computing / Software core business. It has deftly acquired several smaller specialist Cyber companies, while attracting little attention from competition regulators.

MSFT's Cybersecurity M&A

Company	Announced	Category
Miburo	June 2022	Threat Analysis & Research
CloudKnox	July 2021	CIEM
RiskIQ	July 2021	Attack Surface Management
ReFirm Labs	June 2021	IoT/Intelligent Edge Security
CyberX	June 2020	IoT Security
Semmle	Sept 2019	DevOps Security
BlueTalon	July 2019	Data Security
Hexadite	June 2017	Incident Investigation/Remediation
Secure Islands	Nov 2015	Data Security
Adallom	Sept 2015	Cloud Security

Source: Citi Research 15 March 2023

While the Cybersecurity industry remains somewhat fragmented, there is logic to government and competition regulators retaining a degree of separation. An example was the US Pentagon's decision in 2022 to replace its 2019 "Jedi" Cloud Services Microsoft-only-contract with a new Cloud contract split between Microsoft, Amazon, Oracle and Alphabet.

In the following table, Jefferies Equity Research strongly rates the Microsoft (MSFT) cybersecurity offering across 4 of 6 categories as Microsoft effectively builds out its cybersecurity product suite.

	Network Security (Firewalls, NGFW/Unified Threat Management, Intrusion Protection Systems, VPNs)	Internet and Web Security (Secure Web Gateway, Web Application Firewall, DDoS Protection)	Endpoint (Enterprise Protection Platforms and Enterprise Detection and Response; Consumer Endpoint Security; Other)
Buy	PANW, FTNT, CHKP		MSFT
Hold	NET, ZS	NET	CRWD, S
Underperform	IRNT		

	Security Analytics, Intelligence, Response, and Orchestration	Identity and Access Management (Single Sign On, Authentication, Privileged Access, and Identity Governance)	Messaging/Email Security
Buy	MSFT, SPLK	OKTA, MSFT	MSFT
Hold	ESTC, VRNS, ZFOX		
Underperform			

Source: Jefferies Equity Research January 2023

Microsoft takeover of Activision Blizzard

In January 2022 Microsoft agreed to acquire the leading US game development and interactive entertainment company Activision Blizzard (ATVI) for $US68 billion. The US Federal Trade Commission announced that it would oppose the deal and over the last 12 months Microsoft has been seeking approval from regulators around the world.

The Fund holds ATVI in the Communications Services ETF (XLC) where ATVI has a 4% weighting. ATVI has traded well below the $US95 per share offer price due to uncertainty that the deal would proceed. However, in the first quarter of 2023 substantial progress was made leading to an increase in ATVI's share price from $US76/share to $US85/share. In late March a decision in Japan to approve the deal despite strong opposition from dominant competitor Sony. The UK regulator seemed reassured by Microsoft's offer to make leading game 'Call of Duty' available across its competitor's platforms such as licencing to Sony's Play Station. This should also ameliorate European Commission concerns so we believe that it will be difficult for the US FTC to maintain effective opposition given Sony's more dominant market position.

Microsoft remains strongly committed to the deal. In the interim, ATVI has reported strong results and will receive a $US3 billion fee from Microsoft if the deal does not go ahead.

ETF IN FOCUS - FINANCIALS

At the collapse of Silicon Valley Bank (SVB) in early March the Financials ETF (FNCL) had a 0.34% allocation to SVB. A review of 11 smaller banks held in the FNCL ETF revealed a total exposure of 1.5% of the ETF's holdings. The largest position was a 0.46% holding in First Republic Bank that is the recipient of a $US30 billion deposit boost from a consortium of 11 large US banks for at least 120 days.

Following a review of the Financials holding at the end of the quarter, in early April the FNCL ETF was replaced with the Financial Select Sector SPDR ETF (XLF). This risk reducing switch cut the weighting of smaller financials and increased exposure to Berkshire Hathaway and payments companies. At the end of the March quarter the large payments companies Visa and Mastercard were transferred from the technology index to the financials index. With a combined market capitalisation of $US800 billion these stocks become large positions in the XLF and now represent about 20% of this ETF. We believe these changes improve the earnings quality of the XLF, hence our re-positioning.

The late March actions of the Federal Reserve, US Treasury and FDIC to provide banks with access to affordable liquidity may ease deposit flight but looking forward it is likely that the regional banks will be far more limited in their ability to lend to small business. As much as a long queue outside a main street bank was an effective spark for a run-on deposits, Twitter and Co are the perfect accelerant and in an era of online banking there is scant logic for the individual to maintain deposits with a smaller less secure financial institution.

FINANCIALS SELECT SECTOR SPDR ETF - XLF

Symbol	Holding	% Assets
BRK.B	Berkshire Hathaway Inc. Class B	12.64%
JPM	JPMorgan Chase & Co.	8.55%
V	Visa Inc. Class A	8.40%
MA	Mastercard Incorporated Class A	6.97%
BAC	Bank of America Corp	4.43%
WFC	Wells Fargo & Company	3.18%
SPGI	S&P Global, Inc.	2.59%
MS	Morgan Stanley	2.51%
GS	Goldman Sachs Group, Inc.	2.48%
BLK	BlackRock, Inc.	2.24%

Source: ETFDB 6th April 2023

It is likely that over the next quarter focus may switch to commercial property, where the market share of smaller/regional banks has grown to 70% of commercial real estate loans. It seems probable that with office vacancy rates rising rapidly in some large cities (e.g. San Francisco 20% and rising) the squeeze of higher interest rates and falling valuations is unlikely to end well.

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