LAKEHOUSE SMALL COMPANIES FUND

MONTHLY LETTER

31 December 2021

Dear Lakehouse Investor,

Fund Metrics	
Companies Held	22
Cash Allocation	7.1%
Top 5 Portfolio Holdings	35.6%
Net Asset Value per Unit (mid)	$2.1532
Fund Net Asset Value	$409.2 million
Benchmark	S&P/ASX Small Ordinaries Accumulation Index

December was another volatile month for global equity markets as inflation remained elevated, the US Federal Reserve further positioned for inflation-fighting mode, and the Omicron variant continued its out-of-control march across most of Australia and many parts of the world.

There's some irony to the COVID-19 spread in the current 'inflationary' environment as it weighs heavily on parts of the economy. This slowing economic impact, combined with the recent stumbling of Biden's cornerstone US$2 trillion infrastructure package, has potential to moderate the Federal Reserve's inflation-fighting stance. Recent events serve to highlight how fraught predicting the macro landscape can be, and underscores our focus on long-term investing principles.

In relation to the out-of-control spread of Omicron, health authorities point to the silver lining of less-severe symptoms for this more-infectious variant. Nonetheless, the risk remains the ability of domestic and global health systems to cope with greater caseloads. Fortunately, the world knows much more about the virus and is much better equipped to prevent or treat the population than it was two years ago. We continue to observe how the data is unfolding but spend little time trying to position the portfolio for any short-term predictions.

We continued to take advantage of the volatility throughout December, topping up positions that we viewed as compelling to patient investors and shrinking the portfolio's cash allocation from 8.9% to 7.1% in the process. The Fund returned -1.0% net of fees and expenses during the month compared to a 1.4% return for the benchmark. Over the last 12 months, the Fund has returned 4.0% compared to 16.9% for its benchmark. And, since inception in mid-November 2016, the Fund has produced a net total return of 177.8% compared to 76.9% for the benchmark. In annualised terms, the Fund has returned 22.0% per year since inception compared to 11.8% per year for the benchmark.

We talked about a number of specific stocks and addressed many investor questions in the recent investor webinar. Here's the recording for those who were unable to join. Our concentrated, high-conviction investment strategy means that at times the portfolio will experience significant moves on stock specific short-term news, and we've certainly seen that over the past 6 months. Our focus remains on generating long-term outperformance through consistent execution of a process that focuses on businesses with superior economics and bright long-term prospects that offer asymmetric outcomes to our high-conviction portfolio. We are pleased with the long-term progress made toward this goal.

	1 Month	3 Month	1 Year	3 Year (p.a.)	5 Year (p.a)	Inception (p.a.)
Lakehouse Small Companies Fund	-1.0%	-4.1%	4.0%	26.3%	23.3%	22.0%
Benchmark	1.4%	2.0%	16.9%	15.7%	11.2%	11.8%
Excess Return	-2.4%	-6.1%	-12.9%	10.6%	12.1%	10.2%

The Fund's largest sector allocations are to information technology (43.7% of total capital), financials (15.3%) and consumer discretionary (12.3%) while the benchmark's largest allocations are to materials (20.1%), consumer discretionary (15.1%), and real estate (14.8%).

We embrace a bottom-up process that seeks out and emphasises businesses with extremely loyal customers, network effects, and unique and enduring intellectual property. Most of those businesses tend to end up in some specific sectors (e.g. IT) while are rarely found in others (e.g. materials), hence our continued differentiation.

Company News

Turning to specific companies, the Fund's most significant contributor to performance during the month was Nanosonics (+15.6%), with no fundamental news. The biggest detractor was Nitro (-29.8%), which fell after US-listed peer, DocuSign, missed third quarter earnings. More on both shortly.

The Fund's five largest holdings as of the end of the month accounted for 35.6% of the portfolio and are named in order of the Fund's allocation: Netwealth, EML Payments, Nanosonics, Pinnacle Investment Management and Xero.

Turning back to Nanosonics which moved higher in December after a prominent broker initiated coverage with an 'overweight' rating. This prompted an increase in attention from the market toward the stock. Our fundamental view of the company has not changed: its core product remains underpenetrated globally, long-term growth is further driven by an increasing portfolio of new products, and the business remains self-funding thanks to the high-margin annuity stream trailing installations of the core product.

Nitro fell off the back of weak numbers by DocuSign, suggesting the 'buying urgency' of cloud software driven by COVID-19 and distributed work may be coming to an end. Further, there may be some concerns about heightened competition moving forward, as DocuSign continues to ramp up its sales and marketing initiatives. However, Adobe's strong results for its Document Cloud business suggest that the weakness could be specific to DocuSign. For its part, Nitro provided a strong third quarter update, with annual recurring revenues and eSign volumes up 50% and roughly 100%, respectively. Nitro is a small position in the Fund today, as we've taken some profits. We continue to monitor the competitive landscape.

Finally, turning to EML. Shine Lawyers filed a class action lawsuit against the company on 23 December alleging it *'failed to disclose information about correspondence received in May 2021 from the Central Bank of Ireland (CBI) in a timely manner.'* It is not unusual to see ambulance-chaser law firms circling after such precipitous share price moves, however, it is an unwelcome distraction for the management team on the back of seven months of working through the CBI issue. On a more positive note, and following the November news of the CBI loosening its broad-based limits on PFS-related programs, EML launched 22 programs in Europe in December. We've written and discussed EML at length in previous letters and have little further to add here other than it is pleasing to see business is back.

Looking Ahead

January will see a pick up in newsflow as quarterly and half-yearly trading updates are released by current and prospective portfolio companies. We look forward to working through these in preparation for the more extensive half-year reporting in February.

As always, thank-you to all our investors for your time and trust.

Best Regards,

Lakehouse Capital

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