LAKEHOUSE GLOBAL GROWTH FUND

MONTHLY LETTER

31 January 2022

LAKEHOUSE CAPITAL

Dear Lakehouse Investor,

January was another volatile month for global equity markets as investors continued to fret about the prospect of rising interest rates on the back of elevated inflation. As we've noted over the last several months, these concerns have triggered a broad-based rotation away from growth stocks toward more cyclical and economically sensitive sectors of the market. Given our high-conviction, growth-oriented strategy, this period has been challenging for the Fund, but that said, markets have also been under pressure more broadly. Whilst such periods are obviously never enjoyable, they come with the territory of investing in the share market for the long haul.

Fund Metrics	
Companies Held	22
Cash Allocation	3.9%
Top 10 Portfolio Holdings	59.4%
Net Asset Value per Unit (mid)	$1.9945
Fund Net Asset Value	$349.1 million
Benchmark	MSCI All Country World Index Net Total Returns (AUD)

That said, there is a silver lining to such selloffs as they can provide some wonderful opportunities for discerning and patient long-term investors. We were the most active in January we've been on the trading front in a long time, taking advantage of share price weakness and adding to a number of our existing high-conviction holdings where in our view, the fundamentals and future prospects remain very bright (note that the Fund's cash position has decreased from 11.6% to 3.9% over the last 4 months). We also harvested gains on our remaining position in Charles Schwab - more on that later - and initiated three new smaller positions for the Fund. We will hold off disclosing these positions for now as we may still grow them in the near term, pending results and ongoing volatility, but look forward to detailing each of them in future letters.

Turning to performance, the Fund returned -8.1% net of fees and expenses for the month compared to -1.9% for its benchmark. Over the last 12 months, the Fund has returned 4.3% compared to 23.3% for its benchmark. Since inception at the start of December 2017, the Fund has returned a total of 114.7% compared to 64.5% for its benchmark. In annualised terms, the Fund has returned 20.1% since inception compared to 12.7% for its benchmark.

	1 Month	3 Month	1 Year	3 Year (p.a.)	Inception (p.a.)
Lakehouse Global Growth Fund	-8.1%	-10.1%	4.3%	24.4%	20.1%
Benchmark	-1.9%	2.9%	23.3%	16.7%	12.7%
Excess Return	-6.2%	-13.0%	-19.0%	7.7%	7.4%

**Performance calculations are based on exit price with distributions reinvested, after fees and expenses, since inception on 30 November 2017. Benchmark: MSCI All Country World Index net total returns (AUD). Past performance is not indicative of future returns.*

Despite recent relative performance, we remain confident in our investment strategy and our ability to deliver superior long-term performance for our investors. Our focus is on finding and owning high-quality, competitively advantaged businesses with long and attractive reinvestment runways. Whilst we do not invest based on specific macro views, we do constantly observe the economic backdrop and consider what various scenarios could mean for our portfolio companies. To that end, we would like to reiterate that even if inflation does prove to be more persistent going forward, we are comfortable with the portfolio and its ability to perform in such an environment for two core reasons.

Firstly, pricing power is a key trait that we seek in all of our portfolio companies. The ability to pass on cost increases to customers without impairing end demand is an extremely valuable trait to have. This is true in any type of economic environment, but particularly one where inflation is running hot. For example, well-known luxury brand Louis Vuitton recently re-emphasised its pricing flexibility given its cachet with its target consumer. Or consider the lesser-known CoStar Group, which provides a mission-critical data service that is widely acknowledged as the industry standard for the US commercial real estate market. Their contracts have a minimum 4.5% (sometimes up to 10%+) annual price increase built in. Both are core holdings in the Fund.

Secondly, we also own a number of businesses that have 'toll booth' like business models, whereby revenue is effectively a percentage of the dollar value of all transactions crossing their ecosystem. Companies of this nature, such as Amazon and MercadoLibre in e-commerce or Visa and PayPal in payments, are very well placed for an inflationary environment due to their natural inflation protection. Further, if one does believe the current narrative that central banks will increase interest rates materially to chase down inflation, then our avoidance of highly leveraged companies should also serve us well.

The Fund's largest sector allocations at month end were to information technology (35.2%), communication services (25.2%) and consumer discretionary (21.2%). We expect to have material allocations to these sectors over time as the sectors, or at least subsets of them, are overweight business models that lend themselves to strong long-term performance, namely intellectual property, network effects, and loyalty.

As an aside, it was interesting to note that a recent Bank of America survey of global fund managers showed that they had the lowest allocation to technology companies relative to the benchmark since December 2008. Conversely, global fund managers are the most overweight cyclical companies (defined as banks, energy, and material companies) relative to the benchmark ever. All that is to illustrate the consensus trade in the market away from technology and into cyclicals is at odds with our long-term view. Whilst we typically avoid taking short term views, we don't think we're speaking out of turn by saying the combination of our preferred style of companies being unpopular, and our least-favourite style of companies being at extreme levels of adulation (and also dominating our benchmark) is a setup that's unlikely to persist forever.

The Fund held 22 positions as of the end of the month, the ten largest of which are listed below:

Company	Headquarters	Lakehouse Investing Fascination
Visa	USA	Loyalty, Networks, IP
Amazon	USA	Networks, IP, Loyalty
Alphabet	USA	IP, Networks
MercadoLibre	Argentina	Networks, Loyalty
PayPal	USA	Networks, Loyalty, IP
CoStar Group	USA	IP, Loyalty, Networks
Tencent	China	IP, Loyalty, Networks
Avalara	USA	Loyalty, IP
Meta (formerly Facebook)	USA	Networks, IP
MarketAxess	USA	Networks, Loyalty

The Fund has a good-sized U.S. presence as that market continues to offer access to the largest source of quality growth companies. The Fund isn't as US-heavy as it might look at first blush, though, with 58% of the revenue from the Fund's portfolio companies coming from outside the US and holdings headquartered in the UK, Netherlands, Canada, Argentina, France, China, Japan, and Norway.

Portfolio News

The biggest contributor to portfolio performance during the month was **Visa** (+7.7%), which delivered a strong result that we'll discuss shortly. Meanwhile, the largest detractor to performance was **Sansan** (-48.7%), which was sold off sharply along with other high growth Japanese companies despite delivering what we viewed as an impressive set of results in early January.

Visa's result was again business as usual as they maintained the trends we have seen in recent quarters. Payment's volume (+20%), cross-border volume (+51%) and processed transaction (+21%) growth across the board accelerated versus the prior quarter, driven by broad-based economic growth and the cross-border travel recovery. The company announced new and expanded partnerships with traditional finance companies, e-commerce platforms, buy-now-pay-later fintechs, and cryptocurrency exchanges to issue Visa cards. This contributed to the increase in the number of Visa cards to 3.8 billion credentials worldwide, up 10% year-on-year. Meanwhile, Visa Direct transactions increased by 35%, showing progress in penetrating into new payment flows outside of consumer payments. Overall, we're pleased with how the business is tracking and remain excited about future opportunities.

Despite a tough macro and e-commerce backdrop, **Amazon** delivered another impressive result along with better-than-feared guidance for Q1 2022. Net sales increased 9% year-on-year to $137.4 billion, while operating profit declined 49% to $3.5 billion as the company continues to invest heavily across the business. While the 9% top line growth number may appear a touch light, it's worth noting that they are currently lapping a tough comparison period from a year ago where revenues were up 40%-plus year-on-year. Our expectation is that as the e-commerce market normalises post pandemic and we move past these tough comparisons, revenue growth will re-accelerate in the back half of 2022.

We were also pleased by the news that Amazon plans to increase the price of Prime, with the annual cost of membership going up 17% from $119 to $139. In our view this price increase is more than justified given the tremendous amount of customer value that has been added since the last price increase was implemented back in 2018 -- which includes the doubling of its fulfillment network and workforce, significant expansion of free same-day delivery and considerable investments in video and music content. Ultimately, we remain positive about Amazon's future and believe that the company's scale and market leadership will continue to drive growth for many years to come.

Alphabet reported strong fourth quarter results with revenue growing 32% to $75.3 billion and net income growing 36% to $20.6 billion. Google Search continued to grow at 30%-plus rates, which is particularly impressive considering the scale of the business as it now generates close to $150 billion in annual revenue. It was also interesting to see that Google Search is now being used more and more to search for physical locations, such as 'gift shops nearby,' which over time has the potential to further expand the company's addressable opportunity. Management also noted that YouTube Shorts continue to be a key drive of engagement, delivering over 15 billion views per day, and that the demand outlook for Google Cloud remains strong. Despite its scale, Alphabet continues to exceed expectations and we remain upbeat about the company's future prospects.

Moving on to **PayPal**, and despite reporting strong 23% growth in total payment volumes for the fourth quarter, investors were underwhelmed by several other aspects weighing on the company's recent performance. Management stated that growth will be slower than expected this year due to some challenges retaining infrequent users that were acquired during the pandemic and ongoing supply chain disruptions impacting the company's higher margin cross-border business. It also doesn't help that the company pulled long-term guidance on active user growth, which it recently shared on its investor day last year. Management now plans to shift focus back on average revenue per user growth and improving monetisation with its more loyal customers. This has affected the trust that the market placed in management and as a result, we've seen the price rerate meaningfully lower. The company now trades at roughly the same level as it did during the lows of March 2020 and we suspect that the business and its management will be closely watched by the market over the next few quarters.

Zooming out, we can see that the core indicators of the platform's health continue to move into the right direction. PayPal ended the quarter with 426 million (+13%) active accounts, 45.4 (+11%) transactions per active account, and US$340 billion (+23%) in total payment volume. The company continues to attract new users and engages more with them over time, which drives more payment volume. The company also guided for FY22 revenue growth to be 15-17% and is expecting to add 15-20 million net new users. Overall, we might need to see a few quarters before management regains some of the credibility they have lost. However, the business is still growing at a healthy pace and is now trading at a price that has much lower expectations baked-in.

Meta (formerly known as Facebook) reported solid fourth quarter results with revenue growing 20% year-on-year to $32.6 billion. However, optimism was fleeting as management surprised the market with pessimistic guidance, forecasting revenue growth to decelerate markedly to between 3% and 11% for the first quarter of 2022. The reason for the slowdown was two-fold. Firstly, the company is facing headwinds stemming from Apple's recent changes to privacy settings on its devices. The move makes it more difficult for Meta to track user activity across apps, which in turn impacts ad efficacy and return on investment for advertisers. CFO David Wehner estimated that the iOS changes will cost Meta $10 billion in revenue over 2022, yet they remain confident that the changes are “manageable”. Whilst this may be the case, it's clear that there is no quick fix and it will probably require considerable effort over the next year or so to rework their ad optimisation system.

The second headwind comes in the form of increasing competitive pressure from rival social media app TikTok. Meta’s response to TikTok has been to shift its strategy away from Newsfeed & Stories towards Reels and short-form video. While this is a drag on near-term revenues given Reels currently monetises at lower rates than Feed and Stories, the company believes the shift is necessary for the long-term success of its platform. It's worth noting that Meta has dealt with similar transitions before when it shifted focus from web to mobile, and then Newsfeed to Stories, and the company remains confident in its ability to successfully pivot again. All things considered, it’s fair to say that we were less than thrilled with this update from Meta. However, we had reduced our position meaningfully over the last few months going into the result. We will continue to monitor the company closely as it navigates these short-term challenges but also note that whilst the range of outcomes has widened significantly, the stock has already materially rerated and currently trades on an undemanding 17x earnings with 8% of its market cap in net cash.

Lastly, we’ll wrap things up with a brief comment on our decision to sell our remaining position in Charles Schwab. Part of what attracted us to the business initially was that the company made for an excellent hedge for the Fund as Schwab tends to perform well when interest rates increase, which is generally negative for the rest of the portfolio. Over the last two years, the company has benefited from several tailwinds with the broad-based increase in asset prices, a boom in retail trading on the back of the pandemic, and a complete 180-degree shift around interest rate expectations. In short, the position played out extremely well for us and the cyclical setup today, particularly as it relates to interest rate expectations, strikes us as the polar opposite from when we initially invested. As such, now provided a great opportunity to harvest our remaining gains from Schwab and redeploy them to shares of other growth companies that had gotten cheaper in response to higher rates.

A New Investor Joints the Team

We are pleased to share that a new analyst has joined the team at Lakehouse: Jay Chiu. Jay is an excellent addition to the team as he brings valuable skills and perspective, as well as providing our team more robustness and cross-coverage capabilities. Prior to Lakehouse, Jay worked as an analyst in Sydney, London, and Hong Kong for Goldman Sachs, HSBC, and CITIC CLSA. Jay has a Bachelor in Software Engineering and a Masters in Commerce (Finance) having graduated with high distinction.

Thank You

As always, thanks to all our investors for your time, trust, and support.

Best Regards,

Lakehouse Capital

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