LIGHTHOUSE GLOBAL EQUITY FUND

JULY 2024

Net return for July 2024	Net return for FY2025 to date	Net return for FY2025 to date for the MSCI ACWI	If you'd invested $10,000 five years ago it'd be worth
-5.08%	-5.40%	5.27%	$24,960
After fees, pre-tax	After fees, pre-tax, March y/e	March y/e	At 0% PIR tax

Net Returns As At 31 July 2024	1 month	6 months	1 year	2 years (pa)	5 years (pa)	Inception (pa)
Lighthouse Global Equity Fund	-5.1%	15.7%	41.4%	22.1%		
Lighthouse Funds' investment strategy	-5.1%	15.7%	41.4%	22.1%	20.1%	18.7%
MSCI ACWI net in NZD	4.2%	16.5%	22.6%	18.1%	13.4%	13.1%

COMMENTARY FOR THIS MONTH

July was a disappointing month, with a drop of just over 5%. The Fund posted gains for most of July, but then seemed to be one of the earliest to be hit by the current market down-draught. As we write in early-August it appears that financial markets are going through one of their periodic corrections, which happen about once a year.

All corrections share some common characteristics, but each one also has its own circumstances. We've outlined some thoughts on those common characteristics on the third page, and here we'll set out our thoughts on this specific event.

Equity markets made a strong start to 2024, supported by improving economic conditions and excitement about artificial intelligence. The economic news has continued to stay positive through 2024. Inflation is near to central banks' targets. US GDP growth remains strong, although Europe and China are a little problematic. Corporate profits are rising.

But by late-July two things had changed. Firstly, the US Federal Reserve didn't drop rates in July, although they did signal a cut is likely in September. This fuelled a concern that the Fed is behind the curve as inflation falls, just as they'd been behind the curve when it rose in 2022. Then, the very next day, US unemployment data showed a slowdown in new job creation. To be clear, the US economy is still adding jobs, just not as many as had been expected. There's an argument this is a one-off due to Hurricane Beryl but markets didn't want to listen.

The slowing job growth cemented the view that the Fed is overly restrictive and risks tipping the US economy into recession (see also, the RBNZ here).

Meanwhile the earnings reports for the April-June quarter highlighted that many of the big tech names were spending heavily on AI infrastructure but as yet have no clear path to AI revenue let alone AI profits. Share prices are tied to free cashflow rather than profit, and free cashflow is measured after capex spend is taken out. Even though profits are up the high capex means free cashflow is down, and so share prices fell. That rattled the AI narrative that's been a big part of 2024.

Our view is that economic news is always a bit lumpy and you need to look at trends across multiple months rather than just one datapoint (or jobs report). The Fed is arguably late to act, but they can easily catch up via a larger rate cut in September. Meanwhile this Fund is invested in companies that are selling into the AI capex, not spending on it – a "selling shovels to miners" story. So AI capex is a good thing for the companies the Fund is invested in, and we expect the market will eventually discern that.

But in the short-term this correction will likely continue into August. All corrections feel like the end of the world at the time, and this will be the biggest market decline since the last correction you don't remember (Sep 2023). It is the toll investors pay for equity markets' superior long-run returns.

KEY INFORMATION

FUND FEATURES

The Lighthouse Global Equity Fund is a portfolio of very large market capitalisation “blue chip” stocks, listed on the major United States exchanges, that have growth characteristics. The Fund intentionally seeks companies with high liquidity, very conservative levels of debt, and strong histories of revenue and profit growth. This is a high conviction portfolio of 15 to 20 positions.

The Fund’s objective is to deliver long-run net returns that are at least 2% pa higher than those of the MSCI All Country World Index. That index has averaged 13% pa over the last 5 years, so the Fund targets long-run net returns of at least 15% pa.

FUND FACTS

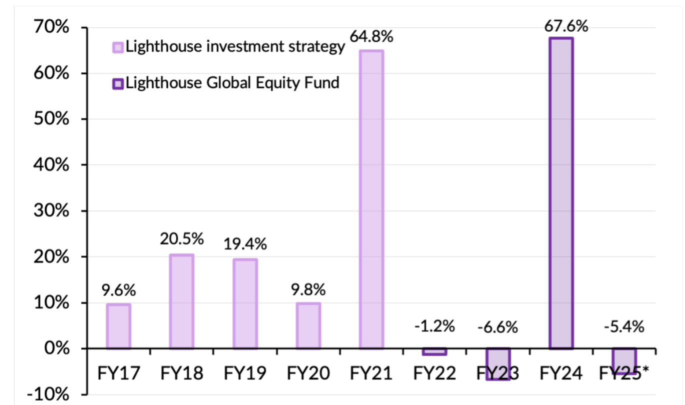
Fund name	Lighthouse Global Equity Fund
Fund type	PIE unit trust
Benchmark	MSCI ACWI, net, in NZD
Management fee	1% pa + GST (approx. 1.05% pa)
Performance fee	30% of returns in excess of the MSCI ACWI + 2% pa (we expect this hurdle to average 14-15% pa over time), with a perpetual high tide mark
Buy/sell spread	0.10%/0.10%
Manager	FundRock NZ
Investment manager	Lighthouse Funds
Supervisor	Public Trust
Custodian	Adminis
Auditor	KPMG

TOP 10 HOLDINGS

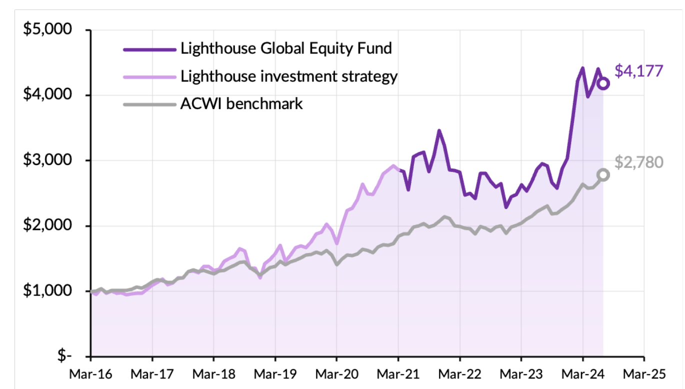
Holding	% of Fund NAV
Royal Caribbean Cruises	11.6%
Nvidia	11.4%
Arista Networks	11.3%
Deckers Outdoors	11.1%
AppLovin Corporation	10.3%
Super Micro Computer	10.0%
Invesco QQQ Trust	7.2%
Monolithic Power Systems	6.4%
KLA Corporation	6.0%
Alnylam Pharmaceuticals	5.8%

PERFORMANCE

Returns by financial year (March year ends)



Cumulative returns



RISK

1	2	3	4	5	6	7

The risk indicator is rated from 1 (low) to 7 (high). The rating reflects how much the value of the Fund’s assets goes up and down (volatility). A higher risk generally means higher potential returns over time, but more ups and downs along the way.

IMPORTANT NOTICE

This factsheet is produced by Lighthouse Funds LP (Lighthouse) and provides key information about the Lighthouse Global Equity Fund. It tells you how the fund has performed and it will help you to compare it with other investments. It is based on information that we believe to be accurate and reliable but we can’t guarantee that is the case. The returns information shows the net returns for this retail unit trust, since it began operations in March 2021, and also the net returns from the investment strategy Lighthouse Funds’ uses in both this retail unit trust and in a wholesale fund that has been operating since March 2016. The returns for the wholesale fund have been provided by Lighthouse Funds from the audited financial statements for that fund. Past performance does not guarantee future returns. The information in this factsheet is not intended to be financial advice for the purposes of the Financial Market Conduct Act 2013, as amended by the Financial Services Legislation Amendment Act 2019. For more details please refer to the Product Disclosure Statement (PDS) and the latest quarterly fund update. You can find these documents at https://lighthousefunds.nz/library or contact us at enquiries@lighthousefunds.nz

CORRECTIONS ARE NORMAL

FALLS ARE A REGULAR MARKET REALITY

Equity markets don't travel in a straight line, and investors quickly experience that markets will fall as well as rise.

Historically, small pullbacks of 5-10% happen several times a year. Larger corrections with a 10-15% fall happen about once a year (we're likely in one now). Bear markets with more than a 20% fall might happen every three years or so (2022). And market crashes of 30% or more might happen every decade (2000 dotcoms, the 2008 GFC and the 2020 Covid crash).

Yet despite this market indexes show long-run returns of about 12% pa, and this fund has returned nearly 20% pa over its history. So how should we think about how market falls fit into the investing story?

WHAT DRIVES PRICES IN THE SHORT-TERM?

A simple rule-of-thumb is that both market indexes and individual share prices are nearly always in a band that is +10%/-10% of what you might think is their "fair value"[1]. Optimism and greed push values towards the "+10%" end, where we might say an asset is over-bought. Fear and panic push values towards the "-10%" end, where we might say it's over-sold.[2]

Prices don't smoothly track down the centre of that band – instead they move up and down within it. But when the index or share price gets too close to the edges of that +10%/-10% band then there's a rubber band type effect that wants to snap it back towards the centre. Or beyond the centre and out towards the other extreme.

Another of our simple rules-of-thumb is that a share price (and by extension indexes like the S&P500 and NZ50) is a number from today multiplied by a story about tomorrow. And the story changes much faster than the numbers.

Combine these two simple guides and the message is that as that "story about tomorrow" changes it can easily drive a share price up and down through as much as a 20% movement (say from +10% to -10% of fair value).

For example, as we write this Nvidia shares are down 22% in the last three weeks. It's probably fair that three weeks ago they were over-bought and at the top of a sensible price range, but we'd also argue they're now over-sold and at the other extreme of that range. There's no credible argument that Nvidia's financial performance has changed –they can still sell every chip they can make in the next five years several times over at eye-watering margins so the "number from today" is still the same. But the "story about tomorrow" has changed.

The majority of investors are emotional, even supposedly professional investors in big institutions. Their stories about tomorrow are driven by emotions and sentiment. You will know from your own life experience that emotions can change quickly – particularly so in the case of fear.

The other key thing about fear is that it's contagious. A sense of panic will sweep through the emotional investors like a wildfire. So now we have a critical mass of people whose story about tomorrow has changed quickly.

That different way that fear and greed work out in our psyche is why market falls tend to happen quickly, while the climbs tend to be slow and steady. We're still talking about prices largely moving within a +10%/-10% band, but the drops in that band tend to happen in days while the climbs happen over weeks or months.

SO HOW CAN WE BEST AVOID MARKET FALLS?

Here's a third simple rule-of-thumb … more money has been lost trying to avoid corrections and bear markets than has actually been lost in corrections and bear markets.

Yes, you can construct low volatility portfolios that provide a smoother ride, but it's at the cost of long-term returns. If your investment horizon is, say, three years or longer then sacrificing performance to avoid daily or monthly swings is overly conservative. You're giving up returns just so you can feel better along the way.

Charlie Munger, arguably the best ever thinker on investing, said "If you're not willing to react with equanimity to a market decline of 50% two or three times a century then you're not fit to be an equity investor and you deserve the mediocre result you're going to get". A century is quite some timeframe, but to be fair to Charlie he did live to be 99.

But paraphrasing his quote … there will always be volatility in the markets and at times that will be emotionally trying, but as much as we might prefer a smooth ride that won't get you a higher standard of living on the day you retire – only the portfolio balance matters.[3]

For most investors the key organ is the stomach, not the brain. If you can tolerate the pullbacks, corrections, bear markets and crashes then equity investing will deliver superior long-term returns. But that's the biggest challenge that most investors face.

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[1] Just what fair value is, and how you could try to calculate it, is a whole other subject that is far too complex to cover here. Let's just agree that there is such a thing, and that market prices approximate it over time.

[2] Indexes and share prices can also at times find themselves a lot more than 10% above or below fair value, but that's rarer and it's where you get to events like market crashes. Here we'll just look at the more frequent pullbacks and corrections.

[3] Which echoes a drum we bang often … the biggest risk with KiwiSaver is under-performance. Nearly all KiwiSaver funds use portfolios that reduce short-term volatility but at the cost of your eventual retirement balance.