Perpetual Investments

GLOBAL INNOVATION SHARE FUND

QUARTERLY FUND UPDATE

The Global Innovation Share Fund returned 56.1% after fees in 2020, 50.2% ahead of the MSCI AC World Index of 5.9%. While 2020 was in many ways an anomaly for investors, we have left it wiser in terms of what worked, what didn't, and where we're seeing opportunities today. This is best seen through the lens of our stock picks and in the thinking behind various positions taken over the past 12 months.

PERPETUAL GLOBAL INNOVATION SHARE PORTFOLIO NET PERFORMANCE

AS AT 31 DECEMBER 2020

	PORTFOLIO	INDEX	EXCESS
3 months	7.5%	6.5%	1.0%
Financial year to date	22.2%	10.6%	11.5%
1 year	56.1%	5.9%	50.2%
2 years p.a.	43.4%	15.9%	27.5%
3 years p.a.	27.9%	10.6%	17.3%
Since inception* p.a.	24.6%	10.2%	14.4%

Source: Perpetual and RBC.

* Inception date is 1 June 2017. Numbers may not be whole due to rounding. Index used is the MSCI AC World (A$). Accumulation Index. Past performance is not indicative of future performance. Past performance information provided reflects the performance of the Portfolio and not any individual portfolio managed through an SMA provider. Returns will differ for an individual portfolio compared to the Portfolio depending on matters such as inception date, fees and brokerage costs payable, adherence to model portfolio weights, portfolio implementation timing and the fees payable to an SMA provider or financial advisor. The past performance information does not take into account any taxes that may be payable in connection with any returns or gains made from the Portfolio. Past performance is not indicative of future performance. Portfolio and Index return may not sum to Excess Return due to rounding.

CONTRIBUTORS

TOP 5 CONTRIBUTORS (1 year to 31 December 2020)	BUSINESS DESCRIPTION	PRE-FEE CONTRIBUTION (%)
1. Zoom Video Communications	Video conferencing	15.2%
2. Virgin Galactic	Space tourism	5.1%
3. Axon Enterprise	Police body cameras	4.6%
4. Twist Bioscience	DNA synthesis	4.4%
5. Boohoo Group	Online fashion retail	3.0%

Source: RBC Investor services.

ZOOM VIDEO COMMUNICATIONS

We originally made Zoom our largest position as a risk management tactic. As COVID-19 spread through Europe in February 2020, we were concerned that it could get a lot worse and thought owning more Zoom would be a valuable hedge. In other words, if the pandemic did get worse, Zoom would do better. We increased the position further in April and May as it became clear just how transformational the pandemic and the normalisation of video conferencing would be to Zoom's business, leading to the outsized contribution to the fund's return in 2020.

We also made several other changes in late February and early March in response to the pandemic risk. We sold our most exposed stocks (Expedia and Disney), bought new stocks we thought would be resilient (Amazon and Microsoft), and bought put options that provided partial protection against a fall in the S&P 500. Together these changes meant that when the broader market fell 8.9% in March, the fund avoided the worst of the losses and only fell 2.5%, before fully recovering in April. Thinking through potential risks is a critical aspect of running the portfolio.

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VIRGIN GALACTIC

What's the best holding period for a stock?

We take a long-term view when we evaluate businesses and aim to hold our positions for many years. However, if a stock rises quickly and becomes overvalued, we are happy to sell and redeploy that capital elsewhere. The faster the market re-rates your stocks, the higher your returns will be.

That was the case with Virgin Galactic, a space tourism business we profiled in the December 2019 fund update[1]. After buying the stock in December 2019, it quickly quadrupled over the next two months, leading us to sell the position in February 2020. To put that in context, if you believe a "normal" return from equities is 7% per year, then quadrupling should you take twenty years, not two months. After exiting in February, we re-entered the position in May (after it had fallen 56%), but have since sold as we no longer think the stock is cheap.

AXON ENTERPRISE

Long-term investors in the fund would be familiar with Axon Enterprise, the global leader in police body cameras and the Taser maker[2]. The past year has been characterised by successful product and market expansion. The company gained traction with new products in evidence management and police response systems, while picking up new customers in federal agencies and corrections facilities. For example, Corrective Services New South Wales started rolling out body cameras early in the year[3]. The stock rose 67% over the year.

TWIST BIOSCIENCE

We first invested in Twist Bioscience in December 2019. The company is a low-cost manufacturer of synthetic DNA, and in 2020 they saw a rapid expansion in the market for their genetic sequencing products. What drove this is a new generation of cancer diagnostic tests that use blood samples to assess, monitor, and screen for cancer instead of the usual tissue samples. Twist Bioscience is an essential enabler of these new tests, and management now believes that the market is 40% bigger than they thought it was at the beginning of 2020. The stock rose 572% through the year, and we effectively exited the position in January.

BOOHOO GROUP

We first came across Boohoo Group at a conference in Barcelona in late 2016. We were impressed with the company at the time -- it was a high-quality online-only fashion retailer with an efficient system for rapidly testing multiple designs for sale -- but we thought it was expensive so didn't invest. It's not uncommon for us to track stocks for years waiting for the right opportunity to invest, and in Boohoo's case, that opportunity came with a crisis in July.

The stock had traded down 30-40% after an article in The Sunday Times came out alleging that an undercover journalist had been offered a below-minimum-wage job at a subcontractor used by one of Boohoo's suppliers. We spent July trying to work out how extensive this issue was, whether it was fixable, and whether it justified a 30-40% drop in the stock. The conclusion we came to was Boohoo had done a poor job of responsibly monitoring their supply chain; however, the issues were fixable and the company was taking the right steps to rectify them. What's often more important than a crisis is how a company responds to the crisis, and we think Boohoo will become a better company because of this one. The stock partially recovered through the second half of the year, making it the fifth-biggest contributor in 2020, and it is currently our largest holding.

Source: Perpetual Investments and FactSet.

OTHER CONTRIBUTORS

We strive to own a diverse portfolio of stocks, which our top five contributors highlight. The overall year's return also came from an extensive mix of stocks, with 37 individual stocks contributing 0.5% or more to the total fund return (on a pre-fee basis).

1. Virgin Galactic was highlighted in December 2019 update, you can contact us for a copy.

2. Axon Enterprise was profiled in the June 2018 update, you can contact us for a copy.

3. Body camera footage of Corrective Services NSW prison officers rescuing inmates from a fire: https://www.facebook.com/nswjustice/posts/2823124091266662

CD PROJEKT

Our biggest detractor was CD Projekt, the Polish game developer behind *The Witcher* series of games. The company launched the highly anticipated *Cyberpunk 2077* game in December 2020, which became one of the most disappointing launches I've seen. Early copies of the game on PC received positive reviews, but when players and reviewers saw console versions, it quickly became apparent that the game wasn't ready for launch and should have been delayed. Bugs and poor optimisation (particularly on consoles) made the game nearly unplayable for some players and helped damage the solid reputation the company had built up over the past decade.

Not all is lost, though. Games can often be fixed post-launch, and we believe the majority of these issues will no longer be there in 6-12 months as CD Projekt patches the game. While a rocky launch isn't ideal, it isn't fatal for single-player story-driven games like *Cyberpunk 2077*, and we believe they will be able to build this into a valuable franchise over time. We increased our CD Projekt position through December, as we felt the sell-off was overdone, and at the end of December it was our largest position. We have subsequently decreased it in January following a 28% rally.

TEAM UPDATE

I'm pleased to announce that Andrew Plummer and Mark Skurnik started working on the Innovation Fund full-time in August 2020 after previously being part of our broader global equities team. Both are highly talented and experienced analysts that have made significant contributions to the Innovation Fund since the fund's first year, and I'm thrilled to have them on board.

Andrew previously spent eight years as a senior analyst at Five Oceans before joining Perpetual in 2014. He has been responsible for past Innovation Fund winners like Synopsys, Tecan Group, and Xilinx, and now focuses on life sciences, vertical software, and industrials.

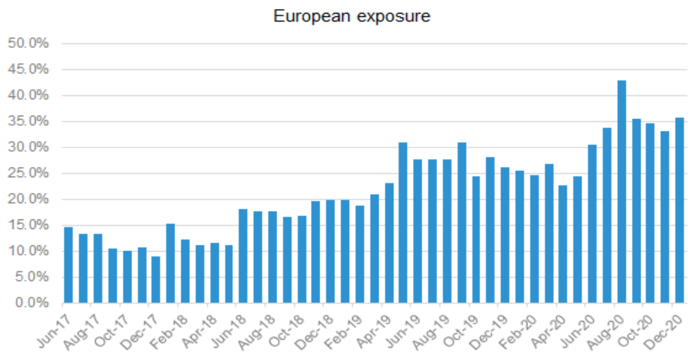
Mark previously spent 12 years at Fidelity International as an analyst, director of research, and portfolio manager before joining Perpetual in early 2018. He's been responsible for past Innovation Fund winners like Euronet, RWE, and PagSeguro, and now focuses on renewables and EVs, fintech, and broader Asian coverage.

OUTLOOK

2020 was a good year for the fund, but I think it's important to recognise that it was also a highly unusual year and nobody should believe that 56.1% is a standard or repeatable return. We've seen many stocks generate triple-digit returns over the past year, which is also unusual, and we're seeing more stocks trading at frothy valuations. Maintaining a strong valuation discipline is core to this fund, so we won't be chasing these names.

We're approaching the current market with cautious optimism -- there are still attractive stocks out there, but there are also many landmines that make stock picking more crucial than ever.

The good news is we're continuing to find plenty of opportunities to invest new capital. We've been particularly interested in stocks related to drug development advancements, which we'll be talking about more in our next update. We're also finding better opportunities outside of the US. Our seven largest positions at the end of December were all in non-US companies, and we think the portfolio is currently well-positioned for the year ahead.



Source: Perpetual Investments and FactSet

Best Regards,
Thomas Rice
Global Innovation Share Fund Manager