MEREWETHER CAPITAL

31 December 2022 Investor Update

Merewether Capital Inception Fund Performance Summary (at 31 December 2022 net of fees and expenses)					
1 Month	3 Months	6 Months	1 Year	2 Years (p.a.)	Since Inception* (p.a.)
-0.28%	-1.12%	4.09%	-30.08%	-	-29.96%

Indicative performance is reported net of all fees and assumes reinvestment of distributions. Past performance is not a reliable indicator of future returns. * Inception Date 26 November 2021

Dear Investor,

The Merewether Capital Inception Fund (the "Fund") began the month with a unit price of $0.7024 and ended the month with an indicative unit price of $0.7004 for a -0.28% return.

While December was a quiet month for company and economic news, markets globally were weaker into the end of the year. It was a fitting end to 2022 as it seemed many market participants wanted to reduce exposure into the Christmas/New Year break and return to 2023 with fresh cash to invest.

So far January has seen a lot of confidence return with markets ripping higher as a consensus that inflation has peaked and a "soft landing" is emerging. While current data suggests this could be true (inflation and employment numbers in particular), it is likely that the effect of interest rate rises are especially lagging with a higher proportion of fixed loans insulating consumers for now.

I suspect that the consensus is correct that inflation has peaked, but whether it remains at elevated levels (4-5%) will be the key to medium and longer term returns moving forward. Corporate earnings are also now in the spotlight, 2022 was a year where the multiple the market was willing to pay for earnings was crunched, and 2023 will be dependent on whether those earnings can now grow or contract.

The only obvious area of the market where an earnings contraction is clearly being priced in is the retail sector where a basket of high quality retailers trade on mid-single digit price to earnings ratios (roughly half of their long term averages) as the market expects earnings to be sharply down in the coming years as consumers are impacted by rising interest rates.

But otherwise, most areas of the market are far from pricing in economic weakness. Banks continue to trade on elevated historical multiples, major miners and energy producers trade at multi-year highs and even many tech companies who were the face of 2022's pain have recovered most of their losses.

The market is not pricing in any earnings contraction for these businesses, despite housing weakness seeping through to banks loan books, iron ore and oil prices well below the levels of last year impacting miners and energy producers revenue and the commentary and outlook from most major tech firms is uncertain and many are laying off staff in anticipation of what may come.

The clear question from these two factors is whether they can co-exist. Can we have a consumer recession that doesn't have contagion to the wider cyclical economy? I would argue it's very unlikely but in the three years since Covid I am unwilling to say anything is impossible.

Asking a fund manager for their view on the market is usually akin to asking a barber whether you need a haircut, but if we are entering a market where prices are driven more by earnings than sentiment or multiple valuations shifting on macroeconomic factors then I look forward to 2023.

While there are reasons to be bearish on the broader market given the potential for earnings to surprise to the downside, in the micro and small cap end of the market the same enthusiasm hasn't returned yet meaning prices remain depressed. Finding the businesses who can grow their earnings in 2023 but trade on 2022 depressed valuations is the key for returns this calendar year.

Turning to portfolio news, December was an exceptionally slow month.

8Common (8CO) announced they signed an additional $2.1m implementation contracts with the Federal Government for the ongoing rollout of their expense8 solution. While part of the overall program, the total contract value doubles the amount 8CO has won so far despite only being for a relatively small number of users (5,300). Clarifying with management, 8CO are winning more of the implementation pie rather than Government departments implementing themselves or using a third party managed service provider.

More importantly though the $2.1m is expected to be received in the first half of 2023 and likely bridges the gap to the business being cash flow positive from its recurring revenue base.

Aerometrex (AMX) also had an announcement during the month about the sale of some 3D US city models to Google which represented the largest off-the-shelf sale for the emerging segment. The exact value wasn't provided but the strategic value of selling to a cornerstone client like Google is valuable.

As I write this we are entering the busy period for January as many micro-cap businesses report their quarterly cash flows. I expect a common theme will be a strong focus on positive cash flows and businesses demonstrating their sustainability. In the current market sentiment the shift from loss-making to sustainability is likely to act as a catalyst for many stock prices.

As always, if you ever have any questions about the Fund or its holdings, please call me on 0423 510 004 or email luke@merewethercapital.com.au

Thanks for your on-going support.

Luke Winchester (Portfolio Manager)