

COMMENTARY

The fund returned positive 5.60% for the month of August 2021. Net exposure averaged 67% long, while gross average 134%. This brings our Calendar Year return to positive 25.12% and since inception (2013) return to positive 23.80% p.a. net of fees.

“Music gives a soul to the universe, wings to the mind, flight to the imagination and life to everything” - Plato

It is unquestionable that Music is an essential part of the human experience resulting in many hours of our time spent listening to it, dancing to it and creating moments around it. Despite the key prominence that music plays in our lives, it is one of the most under monetised forms of entertainment with the average cost per hour of entertainment for a music streaming subscription sitting at 10 cents per hour.

The reason being, that as the world transitioned into the internet age, the music industry was one of the big losers. With the launch of file sharing services over the internet, piracy was rampant seeing music industry revenues decline by over **50%** from 2000 - 2015 with no plug to fill the hole that piracy was taking out of the industry. However, with the emergence of music streaming, the music industry has been brought back to life with revenues growing in the mid teen percentages for the past five years as consumers begin to sign up to one of the many available music streaming services.

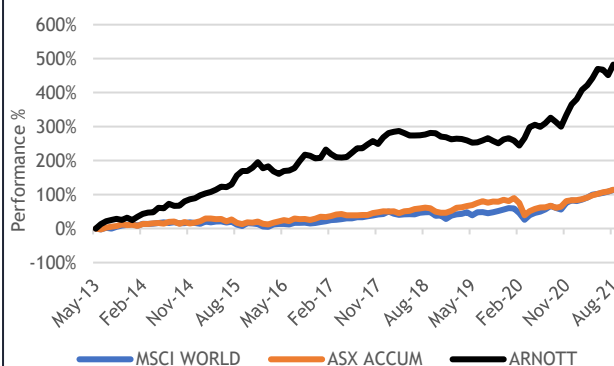
PERFORMANCE METRICS

	From May 2013	
	Arnett	MSCI
Annualised returns	23.80%	9.63%
% Positive months	65.66%	66.67%
Average monthly return	1.87%	0.84%
Avg return in MSCI up months	1.74%	2.87%
Avg return in MSCI down months	2.12%	-3.21%
Best month	13.07%	12.66%
Worst month	-6.09%	-13.47%
Largest drawdown	-11.61%	-21.44%
Longest drawdown (mths)	24	20
Sortino	4.39	0.93
Sharpe ratio	1.78	0.71

CORRELATION TO ASSETS (2013 to Current)

MSCI Index	0.07
US Government Bond Index	-0.08
US\$ Gold	0.03
Bloomberg Commodities Index	-0.05
Hedge Fund L/S	0.02

CUMULATIVE FUND PERFORMANCE (2013-current)



MONTHLY SUMMARY METRICS

NET RETURN	AV GROSS EXP	AV NET EXP
5.60%	134%	67%

STRATEGY HISTORICAL PERFORMANCE (%)

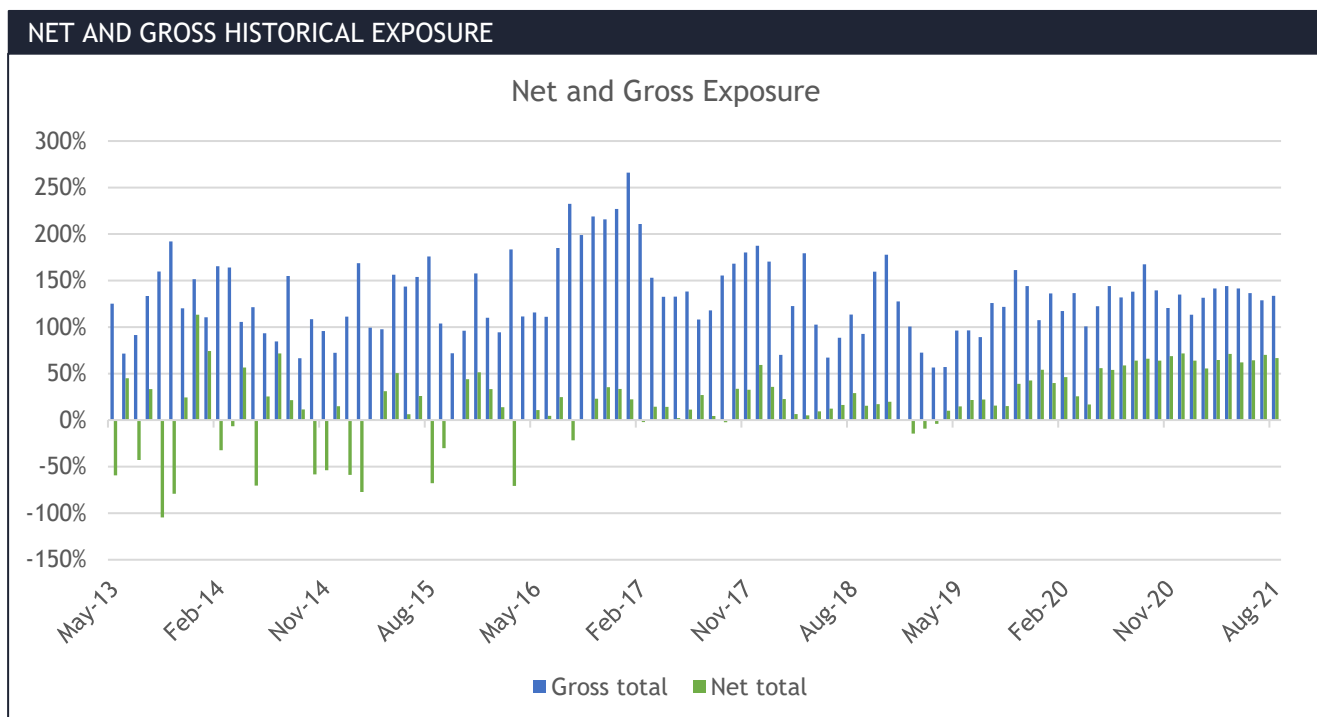
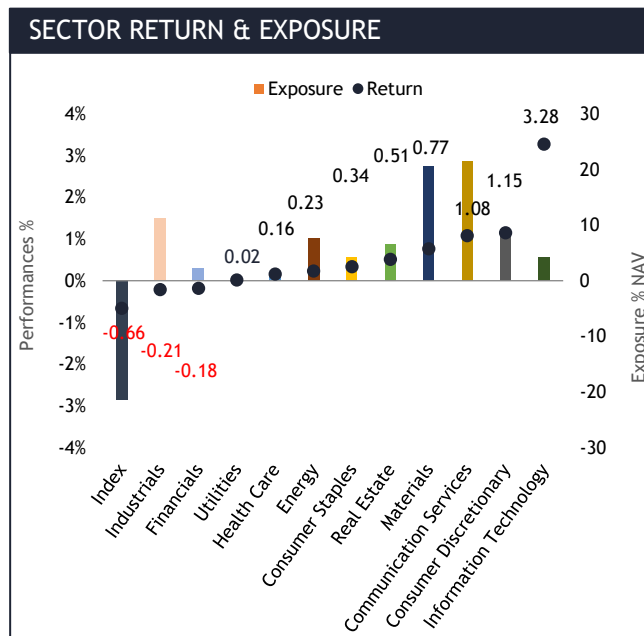
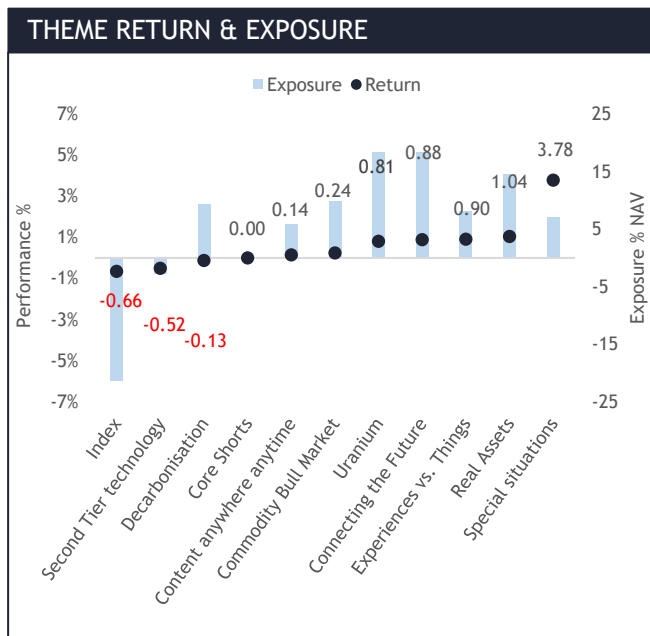
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annual
2013						13.07	7.63	2.97	2.82	-2.69	5.23	-5.25	25.00
2014	7.61	6.56	2.43	0.77	8.87	-0.93	8.46	-3.78	0.34	7.78	3.24	1.92	51.59
2015	4.46	2.88	1.99	3.19	4.12	-0.52	3.44	11.47	5.23	0.00	3.67	5.72	55.80
2016	-6.09	2.14	-5.17	-2.83	3.30	0.40	2.69	7.49	6.29	-1.15	-2.34	0.48	4.33
2017	7.99	-4.01	-2.94	-0.34	0.43	4.08	4.21	-0.02	3.37	2.79	-2.32	5.51	19.58
2018	3.47	0.88	0.72	-1.68	-1.86	0.09	0.03	0.66	1.24	-0.18	-2.61	-0.50	0.12
2019	-1.66	0.53	-0.30	-1.16	-1.90	0.29	1.70	1.72	-2.10	-2.04	3.20	1.05	-0.82
2020	-1.90	-4.03	6.32	8.76	1.82	-1.47	2.69	3.82	-2.94	-3.32	8.59	7.22	27.23
2021	3.26	5.69	2.74	3.93	5.03	-0.40	-2.81	5.60					25.12

Whilst revenue growth from a low base has been stellar, this is truly only the beginning. Paid music streaming subscriptions are incredibly underpenetrated. Every smartphone is an available customer and we have only seen 13% of the world's smartphone users subscribe to a paid subscription service.

For music streaming the revenue opportunity is large, in its infancy, is under monetised with low levels of penetration providing for powerful tailwinds to support strong revenue growth in the coming years. It is therefore no surprise we have seen the emergence of big technology names such as Amazon, Google and Apple all launching subscription music services. Whilst music streaming platforms have a long revenue runway ahead, we believe the best investment opportunities sit with the record labels, in particular Warner Music Group which we have recently materially upweighted within the portfolio.

The top three record labels (Universal Music Group, Sony and Warner Music Group) have a circa 70% market share of all recorded music forming a cosy oligopoly in this rapidly growing industry. This confers strong and growing pricing power at the record labels as more streaming platforms vie for control of our ears. Why this moat exists is due to the immense back catalogues that these record labels have. Not only do consumers want to listen to the current hot hits of today, but they want to be able to listen to the oldies. The record labels control this intersection between the distribution platforms (Spotify, Apple music etc) and the artists. This powerful moat results in incredibly attractive economics for the record labels, with an average take rate of 70% on revenues generated by the streaming platforms.

As competition intensifies for our ears, we believe that Warner Music Group will not only benefit from the secular growth tailwinds of the music streaming industry underpinning double digit growth rates for the years ahead but will also benefit from asset appreciation in the value of their rich back catalogue of music.



INVESTMENT STRATEGY

The Arnott Opportunities Strategy is managed with the intention of delivering annual positive absolute returns, regardless of how any financial market performs. We seek to achieve this through our Asymmetric Investment Approach. In simple terms, asymmetric investing is about producing above average returns with below average drawdowns. We seek to achieve this by;

1. find good investments, and
2. not lose money in the pursuit of realising these good investments.

We strive to achieve asymmetric returns through a thematic investment process. This has four pillars.

1. Find asymmetric themes
2. Invest in the best ideas within those themes
3. Focus on macro drivers for risk & opportunities
4. To generate an asymmetric return profile

FUND INFORMATION			
BASE CURRENCY	AUD	ARNOTT CAPITAL PTY LTD	AFSL License 233743 ABN 23086081889
STRATEGY INCEPTION	1999	CIO KENNY ARNOTT	kma@arnott.com.au
MINIMUM SUBSCRIPTIONS	AUD \$100,000	CONTACT DETAILS	investor@arnott.com.au
WITHDRAWALS	Monthly	PRIME BROKER	Morgan Stanley
PERFORMANCE FEE	20%	FUND ADMINISTRATOR	Mainstream
MANAGEMENT FEE	1.5%	FUND AUDITOR	Ernst and Young
SUBSCRIPTIONS	Monthly	LEGAL ADVISORS	Ernst and Young

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