Dear Fellow Investors,

As material investors in the fund, we, the staff at Arnott Capital, want to share with you, our fellow investors, our thoughts, and reflections on our job as portfolio managers and guardians of investor capital.

In this letter, we will cover the following topics:

1) Our investment approach and performance over a longer timeframe
2) Performance summary over the last 12 months and lessons we have learnt
3) Macro risks and opportunities for the portfolio
4) A few of our Current Themes and Ideas

HOUSEKEEPING ISSUES - *We run one strategy across two funds. For simplicity and consistency all performance references in this letter will be for the Arnott Opportunities (Cayman) Fund Ltd.*

1) OUR INVESTMENT APPROACH AND PERFORMANCE OVER A LONGER TIMEFRAME

The Arnott Opportunities Strategy ('Strategy') is managed with the intention of delivering annual positive absolute returns over the long term, irrespective of any financial market performances. 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 firstly finding good investments, and secondly, not losing money in the pursuit of realising these good investments.

We strive to achieve asymmetric returns through a thematic investment process. This process 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. We find our investment themes from four general opportunity subsets: asset backing, temporarily out of favour ideas, supply / demand imbalance opportunities, and early-stage secular trends. Typically, this does not involve investing in the popular equities of the time (Amazon, Facebook, Google etc.), but instead sees us traversing the road less travelled. When we consider new themes, we always consider downside risks first. In our opinion, these opportunities require a lateral thinking approach. Lastly, we always keep an eye on macro drivers. This is where we find genuine asymmetry and come across unique investment opportunities.

Since 2013, the Strategy has delivered annualised returns of positive 24.81% (see Table 1 below). Importantly, these returns have been delivered with significantly less downside than the equity market (Global MSCI). This has resulted in the peak to trough drawdown of the Strategy at negative 11.61% vs 21.44% for the broader market (MSCI Global Index). The Strategy performance metrics are shown below in Table 1.

Table 1. Arnott Opportunities Strategy performance metrics

	From May 2013	
	Arnott	**MSCI**
Annualised returns	24.81%	9.60%
% Positive months	66.99%	66.02%
Average monthly return	1.94%	0.84%
Avg return in MSCI up months	1.77%	2.93%
Avg return in MSCI down months	2.26%	-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	4.34	0.96
Sharpe ratio	1.84	0.71

FOCUS ON A CAREFULLY CURATED PORTFOLIO

The core of our asymmetric returns is thematic investing. We put together a collection of investment themes that are uncorrelated and have separate opportunities and linkages that will affect them. Linkages are defined as drivers that affect the underlying theme. For example, banks are affected by the yield curve structure and shape, so it is important to have a view of where the yield curve is going. It is possible for us to gather a diverse collection of opportunities due to the large and unconstrained universe from which we find investment themes. The fund may invest in different physical and derivative assets in commodities products, carbon products, crypto products, fixed income, equities, and other assets and derivatives from time to time.

A key reason why we bucket our opportunities together in themes, rather than the traditional approach of sectors, is not only because they represent a group of opportunities, but they also represent a group of risks. By forcing ourselves to think about what risks will drive the underlying investments in one theme we are identifying external risks that may occur. We then think about how those risks apply to other themes in the portfolio.

This is a considerable challenge to take on as an investor. It would be far easier to be a pure investment opportunist without having regard to macro risks; find good ideas and invest in them. It is also easier to be a pure risk manager; never run much risk. The most difficult choice for an investor is to be an opportunistic portfolio manager who is responsible for producing reasonable returns, while concurrently responsible for ensuring the survival of the portfolio under difficult external and often unexpected events. Balancing these two opposing objectives is a very demanding task for any investor and is at the heart of asymmetric investing. This is what we think about every day in the management of our portfolio we run for our investors, including ourselves.

One of the side benefits of constructing a portfolio of idiosyncratic themes with a focus on asymmetry, is that the Strategy typically is uncorrelated with every major asset class. This includes global equity markets, and other asset classes and indeed other alternative asset managers. This is shown in the table below.

Table 2. Arnott Opportunities Strategy correlation vs other global indexes and assets

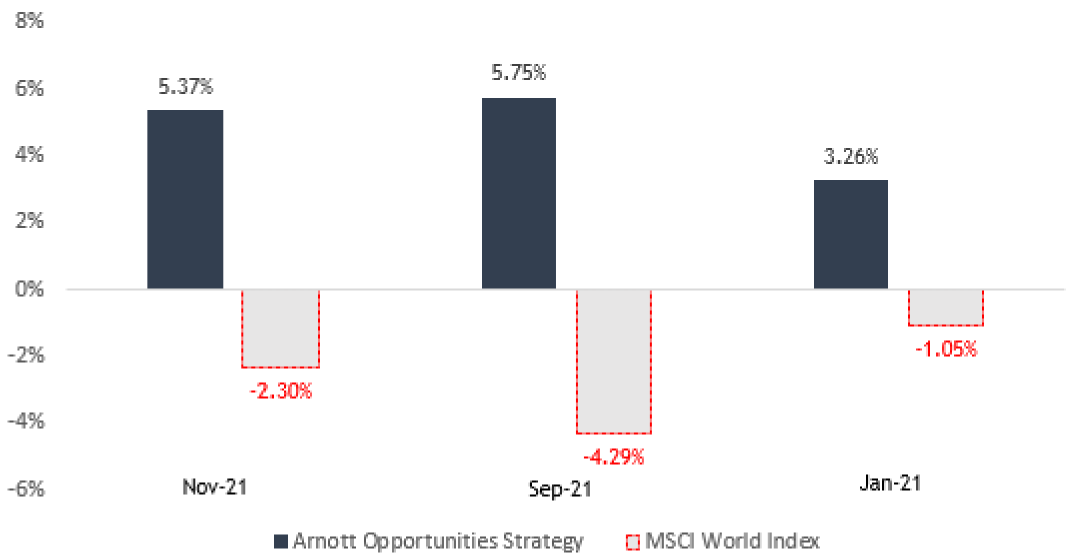
MSCI Index	0.05
US Government Bond Index	-0.08
US$ Gold	0.02
Bloomberg Commodities Index	-0.04
Hedge Fund L/S	-0.00

2) PERFORMANCE SUMMARY OVER THE LAST 12 MONTHS AND LESSONS WE HAVE LEARNT

For the 12 months ended 31 December 2021, the Strategy generated a net return of positive 41.60%. The Strategy's net average monthly exposure over this period was 63% long and average gross exposure was 132%. This takes our average annual return to positive 24.81% p.a. since 2013.

Whilst it was a strong year performance wise for the Strategy, for us, the standout aspects of the Strategy's performance through the year was the returns in equity market down months (as measured by the MSCI World Index). In every equity market down month through 2021, the Strategy performed very strongly on the upside.

Figure 1. Strategy performance in MSCI Down months



The table below lists the most significant thematic contributors and detractors to the Strategy's performance over the 12 months to 31 December 2021.

Table 3.

TOP CONTRIBUTORS TO RETURNS IN PERIOD TO 31 DEC 2021	CONTRIBUTION
Uranium	14.04%
Carbon Credits	7.99%
Connecting the Future	6.13%
Content Anywhere Anytime	4.29%
Commodity Bull Market	3.17%
Index Hedges	-2.35%

URANIUM contributed +14.04% to performance over the twelve-month period to 31 December 2021. As we wrote 6 months ago, we were of the belief the Uranium market was on the cusp of breaking free from the 13-year bear market that saw prices decline by over 80% from a high of US$140 p/lb. With the violent price appreciation seen through the second half of 2021 we can safely say the new uranium bull market has commenced, with the spot price rallying from US$32.50p/lb to close the year at US$42 p/lb.

As the only reliable source of green baseload power, nuclear energy is coming back into vogue as global economies face the reality of attempting to achieve net zero carbon emissions by 2050. This shift in attitudes towards nuclear energy has resulted in many nuclear power plants, that were commissioned for shut down, being granted life extensions; increased research and development into the next generation of nuclear reactors, Small Modular Reactors; and increased commitment from China & India to hasten their nuclear power plant construction efforts. Simply put the demand profile for Uranium has improved drastically in recent history at a point in time where supply is becoming increasingly uncertain.

The only cure for supply deficits is higher prices. At the current spot price of US$42.00 p/lb, the price is still below the industry marginal cost to produce of US$50 p/lb. However, the real problem over the coming decade is we need a lot more Uranium and the only way to get this is from new mine development. For Junior explorers (many of which were burnt by the recent 13-year bear market) to commence the long journey of permitting and developing a Uranium mine will need to see a near term Uranium price of at least **US$60-US$70 p/lb**, to justify any development plans.

Despite our belief that we have entered a new bull market in uranium, with plenty of upside in Uranium prices, we have commenced reducing our equity exposure to our Uranium theme. The share prices of Uranium equities, being Uranium explorers and producers, are priced to reflect a spot price that has already risen to what reflects our bull case for the Uranium market, leaving little fundamental upside. Accordingly, we have exited all Uranium equity exposure and have concentrated our Uranium theme solely to spot price proxies, where we still see tremendous upside in the coming years. This is a great example of how we dynamically shift exposures as the asymmetry of the investment theme shifts.

CARBON CREDITS contributed +7.99% to performance over the twelve-month period to 31 December 2021. As the newest theme in the portfolio, and one we expect to be a core part of our portfolio in years to come, we have provided a more in-depth analysis of this theme on page 7 of this letter

CONNECTING THE FUTURE contributed +6.13% to performance over the twelve-month period to 31 December 2021.

Our ability to work from home, stream endless hours of Netflix and looking slightly further into the future, autonomous vehicles, and smart cities, is dependent upon critical digital infrastructure being in place. Most of this critical digital infrastructure sits within *'boring'* telecommunication companies that are deeply undervalued. Whilst this theme focuses on the rise of digital infrastructure and cloud computing, which we acknowledge is a mature macroeconomic trend with very full valuations, it is how we are investing within this theme that ensures we stay true to our disciplined asymmetric investment process.

More than half of the Connecting the Future return, through 2021, was generated from a long position in Telstra corporation ('TLS'). At the beginning of 2021, TLS was a deeply unloved *'boring'* telecommunication company that was trading well below asset backing and priced as if the earnings downgrade cycle that plagued the company in recent history was to continue. This was despite the company's management flagging potential asset sales as well as industry pricing data reflecting higher industry returns. Fast forward 12 months and Telstra has returned +45%, including dividends, as asset sales focused the markets attention on the imbedded value of Telstra's assets and the roll out of the 5G network saw market participants realise the dawn of a new upgrade cycle.

We continue to find deeply undervalued opportunities that are set to benefit from the tailwinds of increased digitisation, that have been left behind due to the perception of being ***'boring'*** telecommunications companies.

INDEX HEDGES detracted **-2.35%** from performance over the twelve-month period to 31 December 2021, averaging around 20% of the total portfolio for the period.

Whilst it is never ideal to discuss a losing thematic, index hedges, as mentioned previously are a core part of our risk management process. We run index hedges to protect the portfolio from equity market drawdowns, while still providing the opportunity for our investments to generate absolute returns through the cycle.

It is our belief that 2022 will likely see the end of this grinding equity bull market (discussed in more detail in the next section) as we enter a new market regime characterised by higher volatility and more defined trading ranges. Should this market environment prevail we expected our index hedge book to become a material contributor to fund performance over the coming 12 months as we seek to take advantage of increased volatility and more dynamically adjust net portfolio exposures.

3) MACRO RISKS AND OPPORTUNITIES FOR THE PORTFOLIO

"Earnings don't move the overall market, it's the Federal Reserve Board… focus on the central banks and focus on the movement of liquidity… most people in the market are looking for earnings and conventional measures. ***It's liquidity that moves markets****."*

Stanley Druckenmiller

2021 was a very good year for risk assets as the global economy continued to recover from the pandemic induced recession early in 2020.

- Global GDP growth for 2021 was just shy of positive +6% for the year, despite supply chain disruptions;
- The consumer had never been in better shape with record high savings levels, driven by assistance from Governments around the world that have supported their citizens recovering from the pandemic for the past two years; and
- Interest rates remained at historically low levels as central banks around the world continued their ultra-accommodative monetary policy, justifying ever increasing asset prices.

According to most market strategists 2022 is shaping up as another strong year of performance for risk assets.

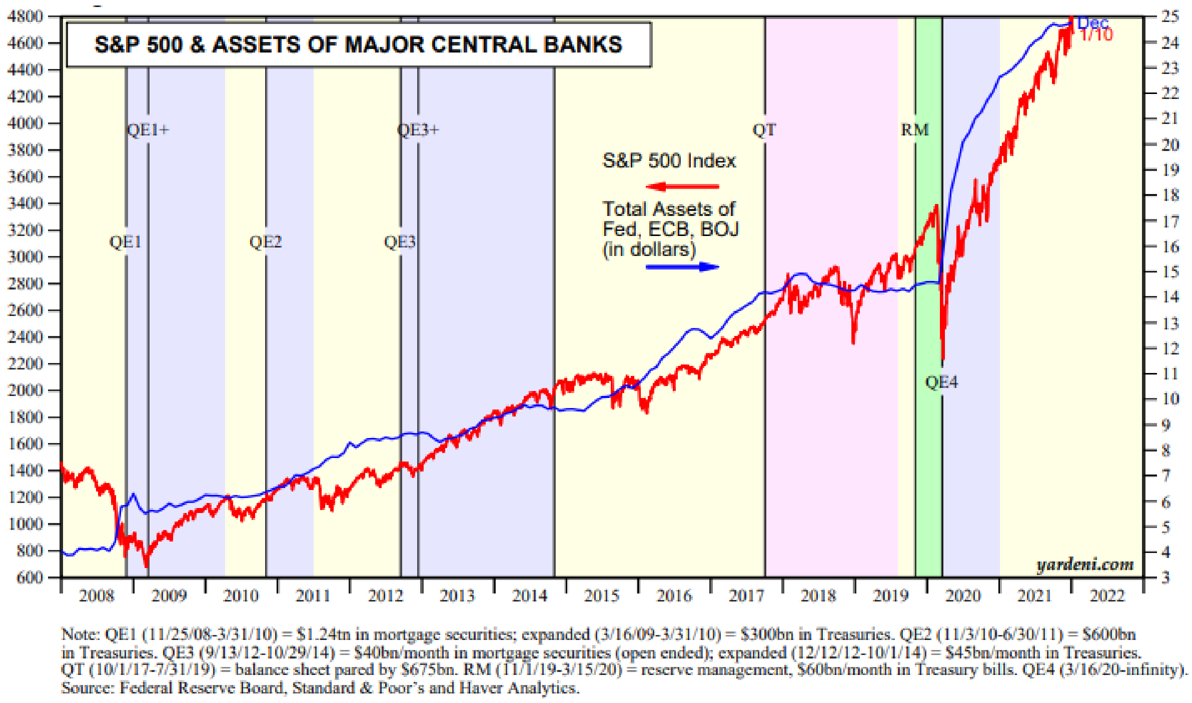
- Global GDP growth is forecast to rise positive +4% this year supporting increasing earnings estimates;
- The consumer is in fantastic shape with high levels of cash ready to unleash on the global economy;
- The Omicron strain of Covid-19 is being touted as the *"end of the pandemic"* leading to a surge of global mobility and easing of supply chain disruptions; and
- Rising interest rates can easily be digested by global equity markets.

Despite the incredibly positive economic backdrop, we are of the belief that 2022 will be a tough year of performance for risk assets.

The key difference we see in 2022, compared with that of 2020 and 2021, is the record amount of liquidity injected into the global financial system by central banks and governments will now begin the process of unwinding. By the end of Q1 2022, most central banks will cease their bond buying programs removing a significant amount of liquidity from the global financial system, setting the stage for developed economies to commence the process of raising interest rates. A path that is being paved by the Bank of England and the Reserve Bank of New Zealand.

For 2022, we struggle to construct a scenario where equity markets (measured by the S&P 500 Index) can move materially higher from here given the likelihood that 2022 brings with it a significant tightening of financial conditions and a removal of liquidity.

Figure 2. S&P 500 & Assets of major central banks



Source: Yardeni Research

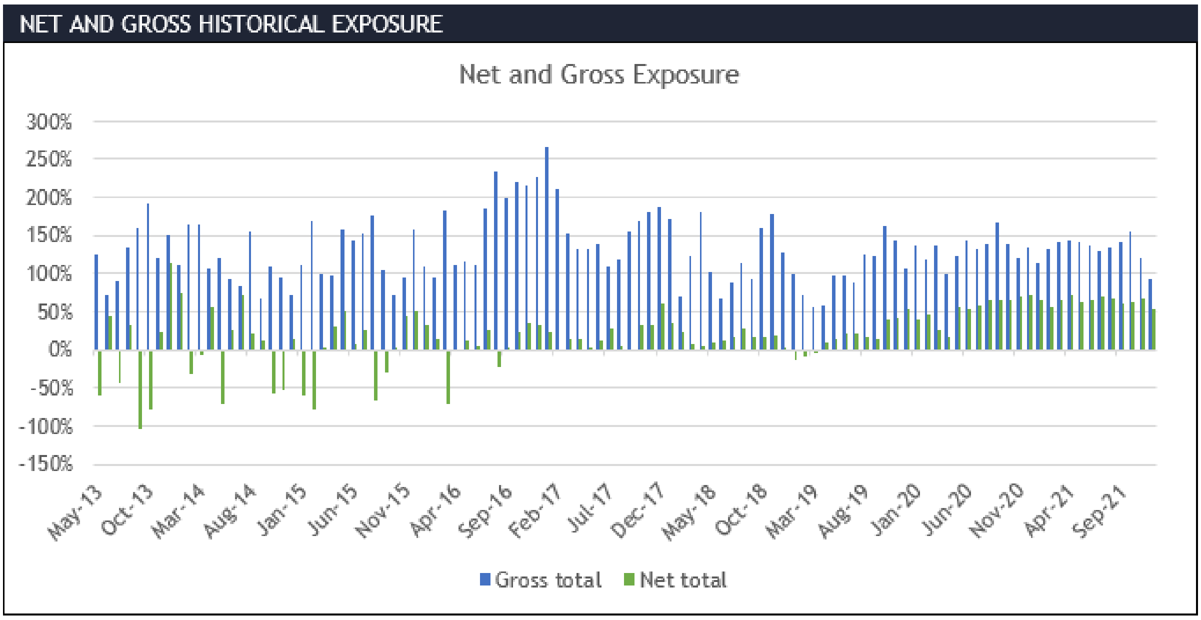
In recent history risk assets have displayed a dependence on burgeoning liquidity to support asset price appreciation. We are therefore of the belief that the greatest risk for markets lies in the withdrawal of liquidity. By the end of Q1 2022 the federal reserve will cease injecting liquidity into the financial system and likely commence raising rates. This backdrop, despite strong global growth, is not a pro-risk environment in our opinion. The old adage of ***'don't fight the Fed'*** could not ring truer than at this point in time.

Opportunities & Portfolio Positioning

During the first tapering period, that began in late 2012, when Jerome Powell had recently joined the Fed's board, he wanted to end the quantitative easing, calling for a plan to taper bond purchases and "ending them before 2013 year-end."

The next couple of years proved to be very good years for active risk management as the global economy went through a series of stop and starts. Our portfolio positioning in this type of macro environment is clearly shown in the chart below. The green lines represent our net portfolio positioning. During these types of choppy macro environments, we focus more tactically and are generally nimbler with our exposures.

Figure 3. Strategy net and gross historical exposure



A derivative of this, is that our portfolio is likely to contain some themes of shorter duration. An example of this is our Demand Bubble theme, which we provide more detail on below. Unlike our core investment themes which typically have durations of five years or greater, these themes have durations ranging from 6 to 12 months.

4) A FEW OF OUR CURRENT THEMES AND IDEAS

CARBON CREDITS

The movement to mitigate climate change has undoubtedly garnered wide ranging public support, culminating with a consensus commitment towards a path of net zero carbon emissions by 2050. This movement is fundamentally reshaping global investing frameworks with capital seemingly only being allocated to companies that are perceived to meet or pledge to meet ever tightening environmental standards. In response to this monumental shift in capital markets companies are setting environmental targets at a breakneck pace and committing to extremely aggressive carbon emission reduction targets.

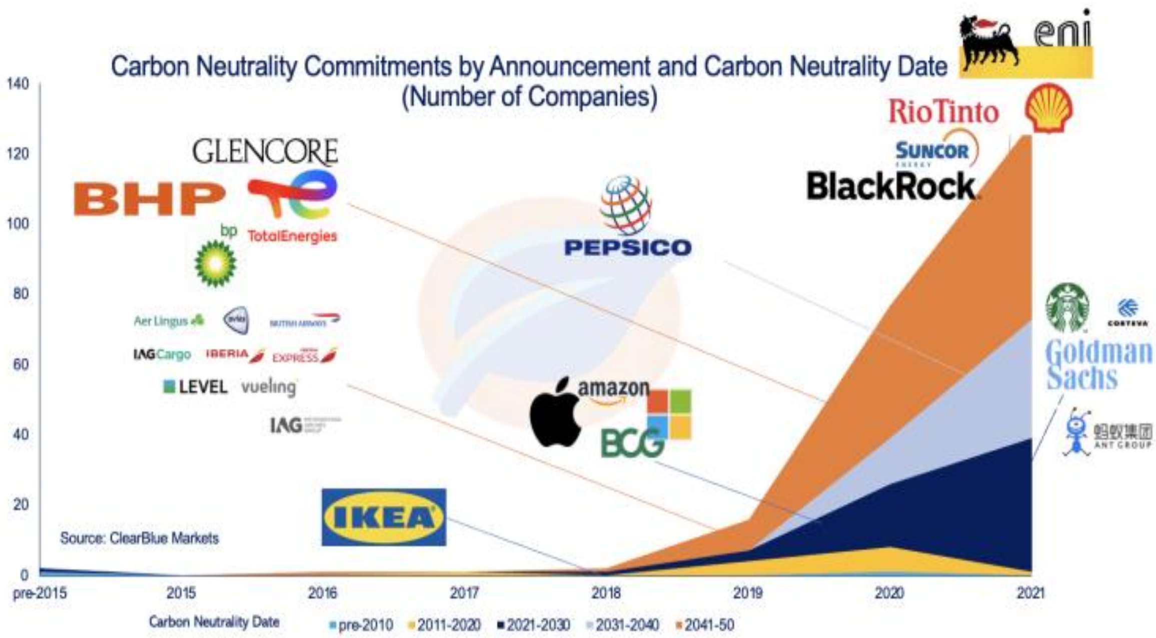
Over the coming decades, the movement to decarbonise whole economies will create one of the most attractive macroeconomic trends we have ever seen. Industry analysts have thrown around estimates ranging from US$2 - 4 trillion dollars per annum to achieve net zero carbon emissions by 2050. This is undoubtedly a trend we will be investing alongside for years to come. Seeking to ride the decarbonisation wave is how we discovered our newest investment theme, **Carbon Credits.** Our investments within this theme seek to benefit from the price appreciation of carbon credits as well as making investments into equities that are beneficiaries from the growth of carbon credit markets.

So, what is a carbon credit? A carbon credit represents the avoidance or removal of 1 tonne of CO_2 from the atmosphere. By acquiring and then retiring a carbon credit you have offset 1 tonne of CO_2 emitted into the atmosphere, enabling a company to report in their sustainability report or chosen form of investor communication a reduction in their carbon emission footprint. The importance of companies reporting a reduction in their carbon emission footprint is increasing every year, with ever increasing valuations being applied to companies showing growing environmental credentials and declining valuations to those not.

Given this, carbon credits will play an integral role in the years to come for companies on their path to net zero carbon emissions. Instead of being confronted with having to make the choice between two undesirable solutions of 1) Do nothing and go on with business as usual and see your cost of capital collapse as more and more investors abandon your equity or 2) Front investors and explain the monumental financial cost to decarbonise your supply chain, likely to put your financial health in danger. Carbon credits are a viable steppingstone for companies seeking to reduce their carbon emissions footprint in line with their announced intentions, whilst slowly investing in changing their ways of doing business.

Corporate buyers are only just now emerging into the voluntary carbon markets, with more and more companies every day making carbon neutrality pledges as consumers and investors alike increase pressure on these companies. We are at the beginning of a tidal wave of demand that is about to enter these markets, making carbon credits an incredibly attractive investment opportunity. Pre-pandemic it was rare to hear or see any corporations discuss carbon neutrality, now you see 3 to 4 companies a day make commitments. We see commitments as future demand in these markets given the attractiveness of these credits to companies.

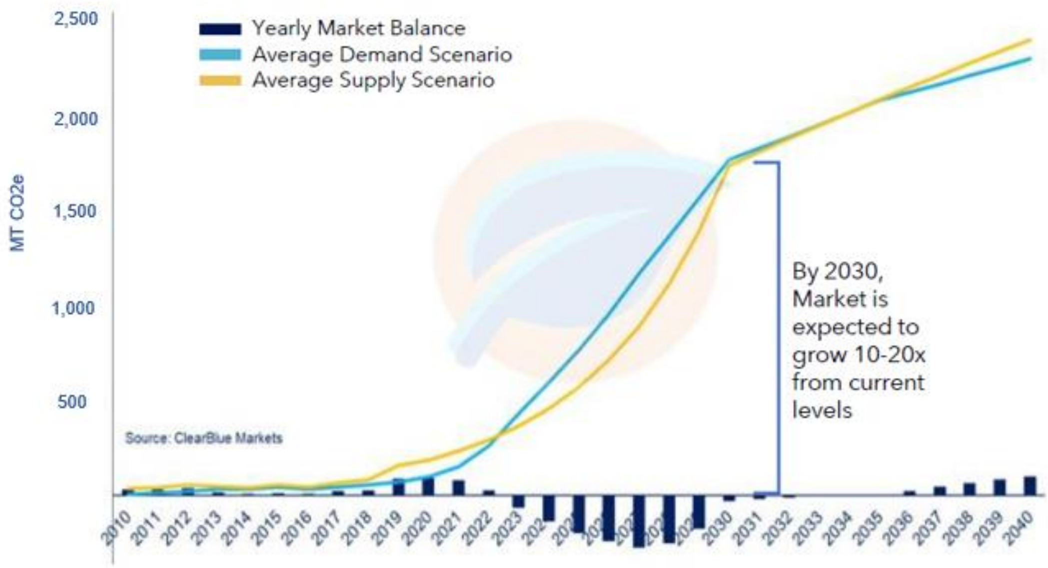
Figure 4. Carbon neutrality commitments by number of companies.



Source: Clear Blue Markets

All this demand is coming into a market that has, since the 1980s, seen very little investment, as quite frankly climate change has been of little concern, *so why would anyone have wanted to voluntarily pay to offset their carbon emissions*. This extensive period of under investment has set the stage for a looming demand and supply imbalance in the coming years as supply struggles to keep up with surging corporate demand.

Figure 5. Demand and supply forecast



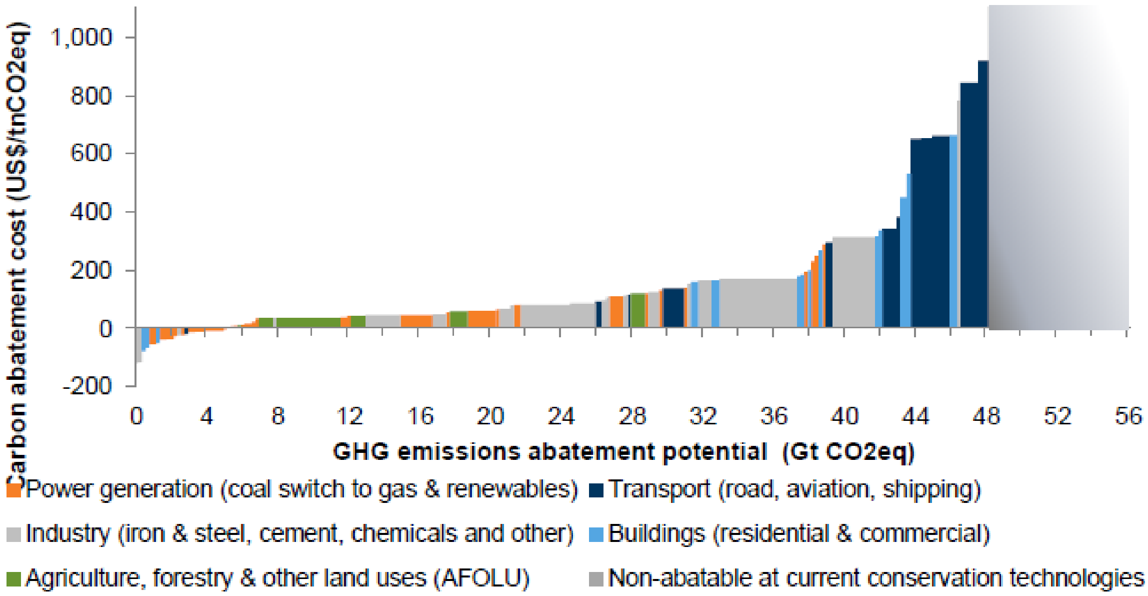
Source: Clear Blue Markets

The commitment to reduce carbon emissions is an expensive task and only increases in cost with every additional tonne of emissions you reduce. The typical carbon emission reduction pledge is net zero by 2050 with a 50% reduction in emissions by 2030. ***Figure 6*** below highlights just how quickly the costs to reduce carbon emissions rise as we seek to decarbonise further. By 2030 if we achieve a 50% reduction in carbon emissions, the marginal cost to abate further will be well in excess of US$100 p/tonne.

Simplistically, we look at the marginal cost to abate as what should be the price of a carbon credit. Whilst not all carbon credits are created equally, we think the cost to abate is a good guidepost for where carbon credit prices will go.

With Nature Based carbon credits currently trading at around **US$14 p/tonne,** a wave of demand only now just entering the markets, a looming demand and supply imbalance and a fundamental price that should exceed US$100 p/tonne by 2030, we see no greater asymmetric investment opportunity in global markets right now.

Figure 6. Carbon abatement cost curve



Source: Goldman Sachs Global Investment Research

We are also investing in equities that are both critical infrastructure providers to this market and beneficiaries of a rising price environment, the 'picks and shovels' of the carbon credit boom. There exist no other markets in the world right now that will experience 1,000% - 2,000% underlying growth and be a key part of the worlds path to net zero carbon emissions by 2050.

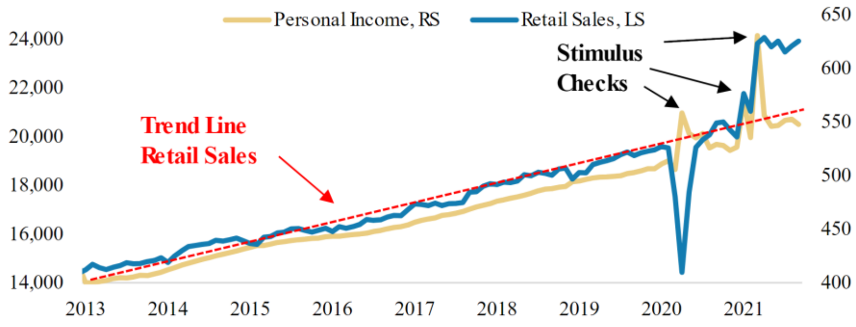
Presently our portfolio exposure is around 15% of capital and we are looking to build this up to 20%-25% as we add more single stock equities exposed to the growth of this market.

SHORT THEME: DEMAND BUBBLE

The Covid-19 pandemic generated unprecedented macroeconomic volatility as the global economy largely shut down in response to the pandemic early in 2020 and has been dealing with continued "on again off again" lockdowns. The policy response to these continued and persistent lockdowns, leaving large amounts of people out of work, small businesses having to shut their doors and ensuring citizens abided by shelter in place laws, was for Governments to provide stimulus cheques to their citizens. The unintended consequence of this was that people became wealthier as personal income (Figure 7) and savings rates (Figure 8) skyrocketed.

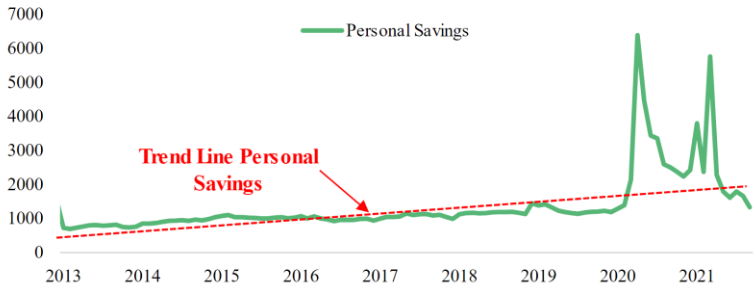
All this excess cash went straight into the consumer economy. Locked down, with limited mobility we spent big on 'things' buying cars, new clothes, DIY projects around the house and the list goes on. The impact is clearly illustrated in Figure 7 below, where retail spending has skyrocketed above a well-established trend rate of growth.

Figure 7. US Retail Sales & Personal Income



Source: Morgan Stanley Research

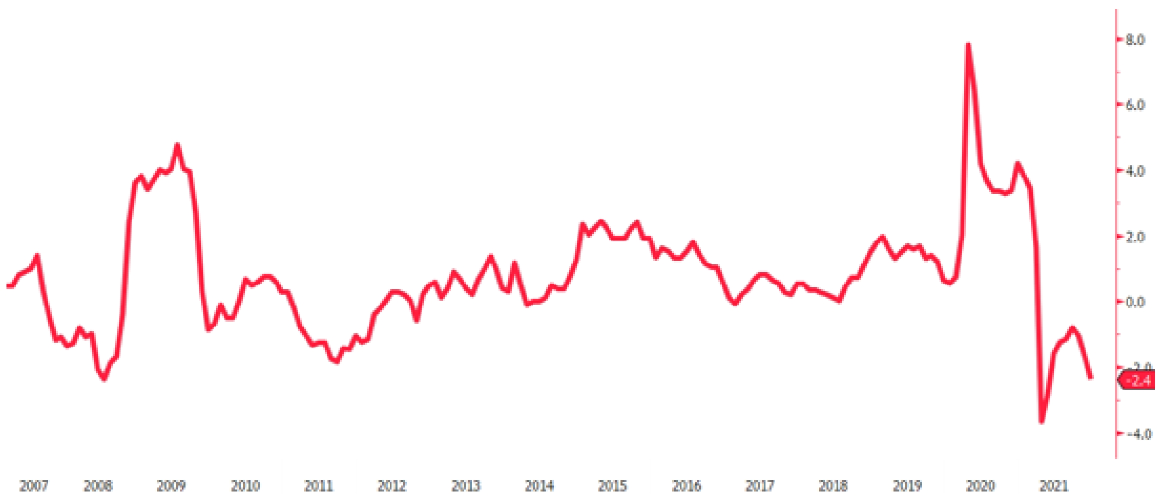
Figure 8. US Personal Savings



Source: Morgan Stanley Research

As we enter 2022, Governments are seeking to transition their economies to '*normal*' moving away from lockdowns removing the requirements to support citizens via stimulus cheques. The removal of consumer support is coming at a point in time when inflation is skyrocketing, which we are beginning to see have a slight negative impact on consumers, that could accelerate in the coming months. With the cost of living rising well ahead of nominal wage increases (Figure 9), consumers go from excess cash to spend on things to a sharp contraction in their discretionary spending.

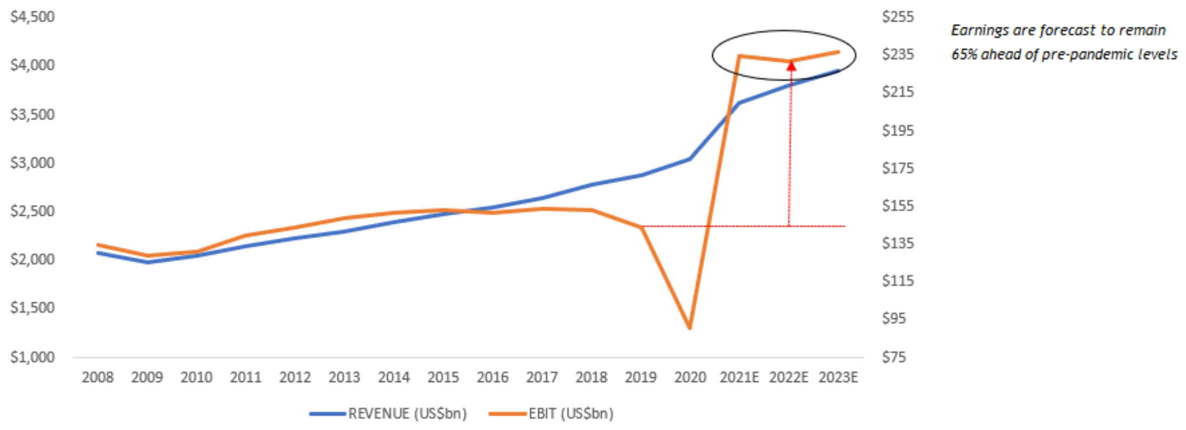
Figure 9. US Real Average Hourly Earnings



Source: Bloomberg

The removal of stimulus, declining real income and increased global mobility hardly paint a bullish picture for US retail sales. Despite this, the market is forecasting the trend of elevated retail sales to persist with consensus estimates for 2022 & 2023 (Figure 10) remaining well ahead of pre-pandemic levels. It appears as if the market is refusing to acknowledge just how much of an aberration retail sales in recent history have been.

Figure 10. Retail Sales and Earnings for basket of US stocks



Source: Hedgeye Research

Despite the declining macroeconomic backdrop for the US consumer, consumer discretionary equities and consumer durable equities are trading near all-time highs as earnings estimates remain stubbornly high for 2022 and 2023. In our opinion this dislocation provides for an incredibly attractive trade from the short side through 2022, as earnings estimates have likely started 2022 at a high point, with downgrades coming as consumer spending trends towards the mean.

We are presently short around 20% of capital in a diversified basket of consumer discretionary and durable names.

<u>IN CLOSING</u>

Thank you for your support throughout the past 12 months and entrusting us with your capital. As we move into 2022, we are more confident than ever in our Asymmetric Investing approach and are tremendously excited for the opportunities that lie ahead.

Yours faithfully,

Kenny Arnott,
Chief Investment Officer

Yianni Gertos,
Co-Chief Investment Officer

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