



RESEARCHIP

Qualitative Fund Research

Fairlight Global Small and Mid Cap Fund

15 May 2023

 RESEARCHIP Rating



The views and opinions in this document are considered valid from one year from the date published.

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Research Factor Weighting

Research Process Category	Model Factor Weight	Analyst Average Score	Maximum Factor Score
Corporate & Investment Governance	15%	4.25	/ 5
Investment Philosophy & Process	20%	3.80	/ 5
People	25%	3.33	/ 5
Portfolio Construction & Implementation	15%	3.50	/ 5
Risk Management	15%	4.20	/ 5
Investment Fees	10%	3.86	/ 5
Overall Average Score		3.77	/ 5

What We Look At?

The qualitative rating of a fund is a function of the Research IP Research Factor Weighting process, which incorporates the following:



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Meet the Manager

Fairlight Asset Management is a boutique firm investing exclusively in global small and mid cap equity markets. We are focused on contributing to superior investment outcomes for our clients through exceptional performance. Our team take an ethically-aware, quality-driven approach to investing, dedicated to deep fundamental research of both the quantitative and qualitative aspects of investee companies. Further information about the Manager can be found in its [online profile](#).

Fairlight's [investment philosophy](#) is designed to find businesses that have a demonstrable track record of earning outsized returns on capital with characteristics that will allow these returns to persist into the future, available at attractive valuations.

Fairlight is a signatory to the United Nations Principles of [Responsible Investment](#) (UNPRI).

These funds are managed by a team of 5. The Manager has provided [individual bios for the team](#).



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Key Takeouts

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Quantitative Tear Sheet - <https://platform.research-ip.com/>

Platform is FREE to access via registration – performance data updated monthly.

[Factsheet](#)

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[PDS](#)

[Articles / Views](#)

For important Fund Facts view the [RIPPL Effect](#)

The Fund

Fund Details	Fairlight Global Small and Mid Cap Fund
Investment Objectives	<p>The Fund is an international equities fund, targeting undervalued small and mid capitalisation securities on the world's stock markets. Global small and mid cap companies are the largest investment universe with the least amount of broker research coverage. Historically, global small and mid cap companies have generally outperformed global large cap companies over the long term.</p> <p>The Fund's goal is to produce superior long-term returns, generally from a portfolio of 30–40 businesses with market capitalisations between US\$500m and US\$30bn. The Fund's investment objective is to outperform the MSCI World Small & Mid Cap Index (Net) over a rolling 7-year period after all fees and expenses.</p>
Benchmark	MSCI World Small and Mid Cap Index (Net) in Australian Dollars
Alpha Objective	Benchmark +3% (estimated 8-12% p.a through the cycle)
Management Fee	1.25% p.a. (inclusive of GST)
Performance Fee	The Fund charges a management fee of 1.25% (inclusive of GST) and a capped administration fee of 0.05%. The performance fee is 15% of any outperformance relative to the benchmark (being the MSCI World SMID Cap Index Net in AUD), after deduction of all fees and expenses and provided any relative underperformance from previous periods has been recovered. Should the absolute performance of the Fund be negative in the period, a performance fee will not be paid. The performance fee is accrued daily, reflected in the unit price, and, if payable, paid bi-annually.
Estimate of Total Fund Charges	1.30% (inc GST) – 29/06/2022

The Fairlight Global Small and Mid Cap Fund (“the Fund”) invests in a portfolio of global small and mid capitalisation companies drawn from international equity markets outside Australia.

The Fund is an international equities fund, targeting undervalued small and mid capitalisation securities on the world's stock markets. Global small and mid cap companies are the largest investment universe with the least amount of broker research coverage. Historically, global small and mid cap companies have generally outperformed global large cap companies over the long term.

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Factor	Lower Limit	Upper Limit	Reference
Listed securities (or to be listed) on international exchanges	80%	100%	
Cash or cash equivalents including short term money market instruments.	0%	20%	

The Fund takes a bottom-up approach to investing with deep fundamental research of both the quantitative and qualitative aspects of investee companies. The Fund is benchmark unaware as the Investment Manager believes this unconstrained approach allows maximum flexibility to pursue attractive risk adjusted investments. The intention of the Fund is to hold high quality businesses that generate attractive returns on capital employed through a full market cycle with low levels of debt, managed by competent executive teams that are highly aligned. In addition, FX contracts may be used to hedge the currency exposure of assets held by the Fund in one currency, against movement in other currencies, including but not limited to the Australian dollar.

Using this Fund

The Fund is a relatively concentrated, actively managed, global equity strategy investing in approximately 30-40 small and mid cap companies. The Fund would fit into the growth component of a diversified portfolio.

The profile of the Fund would be suitable for investors with a higher risk profile. Given the smaller number of stocks, there is a greater chance of volatility in the short term. Investors should be aware that this type of Fund may experience significant periods of negative returns. Research IP believes an investor should have a minimum investment time horizon greater than seven years, preferably longer.

Special consideration should be given to currency given the Fund is invested in global markets. The Fund is managed in Australian dollars.

What the Manager Says?

Insight	Manager view	Research IP opinion
<p>Who is accountable for managing the fund?</p> <p>Is the investment teams work history relevant to the funds they manage?</p>	<p>Nicholas Cregan, Ian Carmichael, Will Dowd and Alvis Peggion are the portfolio managers for the fund. The team follows a collegial decision-making process, however Cregan has ultimate say where there isn't a consensus.</p> <p>Nicholas has ~19 years investment experience in the domestic, US and international markets and Ian has 14 years' experience in financial markets and a further six years as an engineer. Will has 12 years' experience, and Alvis 10.</p> <p>All four members of the Investment Team are equity Partners in Fairlight AM.</p>	<p>The Fund is managed by a small team with ample experience in global equity portfolio management and analysis.</p> <p>Despite being a relatively young team, the team of five have good breadth of experience across differing backgrounds. Educational qualifications span accounting, law, finance, and chemical/biomedical engineering, with three members of the team being CFA charterholders.</p> <p>Research IP believe Cregan's experience in small and mid cap portfolios (Evans and Partners, and Schroders) previous to Fairlight is valuable. As at the date of this report Carmichael has relinquished direct stock coverage. He will assume a greater operational role and maintain a focus on ESG inputs.</p> <p>The team experience is underpinned by strong quantitative and fundamental analysis with Dowd and Peggion (both were promoted to portfolio managers in early 2022). The team has only worked together a relatively short time, though risk in new teams is mitigated somewhat through equity ownership within the investment team.</p> <p>Research IP highlights that there has been turnover within the investment team with the new hire of Abbey Cook (May 2023), taking over direct stock coverage duties from Carmichael.</p>
<p>Has the CIO/ PM personally invested in the Fund? Are they paying the same fees as other investors?</p>	<p>All four members of the investment team have a meaningful portion of their personal assets invested in the Fund. The team originally invested alongside initial seed investors in the Founders Round, which included a discount on the base fee.</p>	<p>The team's alignment of interest with investors is close to as good as it gets within the managed fund industry. 100% of the investment team are invested in the Fund. This alignment is backed by each of the team member's equity holdings in Fairlight.</p>
<p>Why would you allocate to this fund?</p>	<p>The Fairlight Global Small & Mid Cap Fund is an international equities fund, targeting undervalued small and mid capitalisation securities on the world's stock markets. Global small and mid cap companies are the largest investment universe with the least amount of broker research coverage. Historically, global small and mid cap companies have generally outperformed</p>	<p>The Manager uses an active management approach to seek investment returns by exploiting a combination of the 'small-cap' and 'quality' underlying style factors.</p> <p>The strategy can provide diversification in the global equity space. A typical investment portfolio will likely use a large</p>

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	<p>global large cap companies over the long term. The Fund's goal is to produce superior long-term returns, generally from a portfolio of 30–40 businesses with market capitalisations between US\$500m and US\$25bn.</p> <p>Australian investors understand the case for including domestic small and mid cap (SMID) companies in their portfolios and have typically benefited from these allocations. This is however, at odds with their more sparing allocations to global SMID, leaving them underweight this non-trivial USD \$13 trillion asset class (approximately 40x the size of the Australian SMID market).</p> <p>Whilst it is understandable from a behavioural perspective that investors naturally gravitate toward large and well-known foreign companies when investing offshore, Fairlight believes that there is a compelling case for also including an allocation to Global SMID for several key reasons:</p> <ul style="list-style-type: none"> - Over long period, smaller companies outperform larger companies - An allocation to the SMID market improves the risk/return characteristics of a global equity allocation - The absolute risk characteristics of global SMID are attractive relative to Australian equities. 	<p>cap biased reference index such as MSCI World or MSCI ACWI as its global equity benchmark.</p> <p>The small and mid cap stock universe has greater potential alpha given less analysis of the smaller companies across the ~5,000 stock universe.</p> <p>The Manager's investment approach is underpinned by robust fundamental analysis alongside constructive quantitative analysis. The small and mid cap segment of the global equity universe is inherently risky given the size of the companies, though this is mitigated somewhat through the Manager's awareness of risk (at the company and Fund level) and focus on quality.</p>
<p>What are key factors in the buying and selling decisions of the Fund?</p>	<p>The Fairlight Investment Team maintains a focus list of 200 stocks which meet Fairlight's quality criteria and have passed the due diligence process. The portfolio is then constructed from this list with discount to Fairlight's valuation the primary consideration. Additional considerations include risk assessments, end market exposures, existing correlations within the portfolio and tenure of coverage.</p> <p>Fairlight's approach to portfolio construction is highly collaborative with team debate occurring on the relative merits of the various inputs before the Portfolio Managers construct the portfolio with reference to both valuation and risk considerations.</p> <p>While we have a robust framework for buying securities, we employ equal effort in ensuring discipline in our sell decisions. We break our sell discipline into categories including valuation, opportunity cost and assessment against original investment</p>	<p>Research IP believes the Manager employs a disciplined investment process. Investments go through a four-stage process before inclusion in the portfolio.</p> <p>The first stage is the initial screening of the investment universe. The universe is reduced by screening for market cap, sectors (consumer, technology, industrials, and healthcare), profitability metrics, and risk and governance metrics. This process essentially reduces the potential investments from over 5,000 companies down to 200.</p> <p>The second stage involves initial due diligence to get a better idea of the company and determine whether the investment is worth a deeper look. The aim of this step is to focus on the better investments out of the initial 200 ideas without committing too much time and resource straight away. The investment</p>

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	<p>rationale. The sell discipline also differs by investment type to overcome the disposition effect of selling our best ideas too early and adding to our losers too readily (special situations and stable compounders are sold close to fair value, high quality growth are sold more gradually).</p> <p>A 15% relative under performance of a position compared to the benchmark triggers a stock discussion to assess evidence of investment thesis drift. The team assess the original investment thesis against its operating performance. If there is material drift the stock is sold.</p>	<p>team will discuss ideas before discarding them.</p> <p>The third stage involves more comprehensive due diligence such as research trips, management calls, and market/industry research. A discussion on stock ideas takes place before ideas are discarded.</p> <p>The final stage involves purchasing the best ideas and portfolio construction. New portfolio positions will start at a lower weight, the Manager will build the size of the position up to approximately 3% of the portfolio or more as they learn more about the stock.</p> <p>The Manager categorises portfolio holdings into three underlying investment types, with soft portfolio target weightings applied:</p> <ul style="list-style-type: none"> - High quality growth (40%) - Stable compounders (40%) - Low risk turnarounds and special situations (15%) <p>The remaining 5% is to cash. The weighting to cash is a residual position. For example, in the case of a recent sale, the Manager doesn't want to be forced into purchasing any new stocks it has no conviction in, so will hold cash until the right opportunity arises.</p> <p>Research IP highlights the collaborative approach which is evident through each stage of due diligence. Discussions take place as ideas develop through the investment process. This approach is made easier with a smaller team. Company research through the process is recorded in detail and available to the team through the internal analytics system used.</p> <p>Research IP observes the Manager's active portfolio management approach with trailing twelve-month turnover ranging between approximately 40%-60% since inception. As at the date of this report, turnover was just below the lower range. Expected annual turnover is around 30-50%.</p>
<p>What are the key drivers of the Fund's performance?</p>	<p>The Fund is benchmark unaware and with a portfolio of 30-40 stocks it is idiosyncratic factors associated with individual stock holdings that will be the primary driver of returns.</p>	<p>Within the broader benchmark of 5,223 constituents, MSCI notes the 'small' factor as the key driver of risk and return. The Manager combines this factor with 'quality' to seek alpha over the long term.</p>

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	<p>Investors should be aware that the Fairlight team is committed to staying within our circle of competence. As such, the Fund invests primarily in four sectors: Consumer Staples/Discretionary, Technology, Industrials and Healthcare and in developed markets only.</p>	<p>Conviction in 30-40 stocks is sought through fundamental analysis. An example of the Manager's commitment to this is the willingness of an analyst to travel to the US during part of the global pandemic. The analyst was vaccinated early in the hope that as the country opened up to business he would be able to meet management teams at the earliest availability.</p> <p>Less analytical coverage of companies listed in the small-mid cap segment of the global equity market means a less efficient market. This should provide the Manager with a greater chance of achieving alpha through stock selection as compared to the larger end of the market.</p>
<p>What are the risks of investing in this Fund?</p>	<p>The Fund is a long only equity fund that does not short securities or employ leverage or other derivatives. As such, the primary risk for investing in the Fund is market risk (short term changes in the market price of portfolio holdings) and business risk for the underlying portfolio holdings. It is Fairlight's view that a portfolio of the highest quality businesses will outperform over the long term whilst protecting and preserving client capital.</p>	<p>Research IP believes the Manager has a strong awareness of the risks regarding underlying style factors.</p> <p>The Manager actively monitors the market capitalisation of individual portfolio holdings and inherent liquidity risks, which are greater than large cap stocks. The Manager actively measures this in absolute terms (US\$) and relative terms against the MSCI SMID Cap Index (ranges from approximately US\$14 million to US\$36 billion as at March 2023). Historically, the absolute measure increased, though relative to the benchmark the portfolio weighted average market cap decreased. However, given market falls through 2022, both the benchmark and portfolio weighted average market cap has fallen. Research IP highlights this point as an example of how style drift can be monitored for a small-mid cap fund such as this one.</p> <p>The Manager also assesses valuation of purchases and sales through time. There are few examples of the stock purchases occurring at high P/E ratios (>30x) over the past couple of years. Valuation is crucial.</p> <p>The Manager utilises a FactSet global equity risk model to monitor underlying risk exposures. This is combined with individual security analysis covering business risk and valuation, end market exposures, correlations, scenario analysis, and opportunity cost whilst</p>

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		<p>considering volatility and ability to recycle capital.</p> <p>Currency exposure is primarily unhedged and is factored into the risk modelling. A large portion of the portfolio is denominated in USD. The Manager believes this can provide a reliable cushion in market drawdowns given the USD has historically strengthened against the AUD through these periods e.g. through much of 2022.</p>
<p>On what basis are the fees charged justified?</p>	<p>Fairlight has market leading transparency and hurdles for fees charged to investors. Unlike many other funds in the market there are no additional expenses charged to the Fund, the quoted fees are all inclusive.</p> <p>The Performance Fee has a non-resettable relative high water mark and is charged after all fees. This means a performance fee will only ever be charged when outperformance has been delivered to a client and there is no performance fee 'double dipping'.</p>	<p>Research IP believes the Manager is transparent from a fees perspective. Fees are disclosed in the Product Disclosure Statement. Research IP observes that the Manager's basic fee is in the higher half compared to sector peer relevant funds in New Zealand. This is to be expected for an actively managed global equity fund investing in the smaller segment of the market with less analytical coverage.</p> <p>Research IP believes the MSCI World Small & Mid Cap Index is appropriate for the performance fee calculation. However, a lower base fee in combination with the performance fee would be preferable.</p> <p>Research IP observes that recoverable fund expenses are at the lower end of the scale, which is a positive, though the buy/sell spread is on the higher side.</p>
<p>Describe the quality of the organisational and investment governance processes?</p>	<p>The Fairlight Fund has industry leading governance practices, with all processes outsourced to institutional grade service providers. The Responsible Entity is an independent third party (The Trust Company – Perpetual), the Administrator is Mainstream BPO and the Fund is audited annually by EY.</p> <p>Fairlight itself has partnered with Perennial, who have over 20 years of experience in successfully managing equities portfolios on behalf of many retail and institutional investors. Perennial has extensive operations, compliance, legal and marketing teams which are at Fairlight's disposal.</p>	<p>Research IP believes the use of Perennial partnership provides valuable extra oversight. Investors benefit because the Manager can focus more freely on investment management, with less time spent on distribution and sales.</p> <p>Research IP highlights the custom-built analytics system utilised by the Manager. The system provides the investment team with easy access to stock summaries, notes, financials, graphs, ESG considerations, bench research, and portfolio decisions over time. A full look-through on snapshot basis of portfolio characteristics is available to the team. FactSet risk modelling is also used to inform investment decisions.</p>
<p>Describe the Manager's ESG, Corporate Sustainability policies and engagement.</p>	<p>Fairlight is a signatory to the United Nations Principles for Responsible Investment. Through implementation of the Principles, Fairlight seeks to analyse and engage companies on their significant governance, environmental and social issues that have</p>	<p>The Manager applies multiple approaches in considering ESG factors. The Manager sees this as critical to understanding company risk and thus risk within the overall Fund.</p>

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	<p>the potential to impact on company perception and performance. This provides a more complete understanding of a range of issues affecting a company which should lead to increased returns and lower risk for a portfolio. By incorporating ESG criteria into investment decision-making and ownership practices, Fairlight seeks to influence companies to improve performance in these areas. This, in turn, contributes to efforts to promote good corporate citizenship and to build a more stable, sustainable and inclusive global economy.</p> <p>For further information on ESG please refer to the Responsible Investment Policy available at fairlightam.com.au</p>	<p>ESG integration – Research IP believes the Manager exercises an in-depth understanding of ESG factors and how these effect individual portfolio holdings over the long term. The Manager factors in ESG considerations to the cost of capital calculation for a company through the valuation process. The depth of analysis is exemplified through consideration of carbon emissions and the capacity to assess not just scope 1 and 2 emissions, but also scope 3 (indirect emissions on the value chain, both up and downstream). An outcome of the Manager’s approach is that the Fund has lower carbon emissions (tCO2/\$m invested) than the MSCI Low Carbon Leaders Index.</p> <p>Negative screening – the Manager avoids stocks within tobacco, armaments, gambling, uranium mining and old growth logging industries.</p> <p>Corporate engagement and proxy voting – the Manager is active and voted on 468 proposals through 2022, 6% of which the Manager disagreed with management, and only 1 case where the Manager disagreed with the proxy service recommendation.</p> <p>For further information on responsible investing refer to Research IP views here.</p>
<p>Is there alignment with the interests of investors through ownership of the Manager and/or remuneration of the investment team?</p>	<p>Fairlight AM has five shareholders, the four Investment Team members and Perennial. As such, remuneration of the Investment Team is directly linked to performance of the Fund. Additionally, all four Investment Team members have substantial allocations of their own personal wealth invested in the Fund. Fairlight believes that through these two mechanisms there is substantial alignment of interests between clients and Fairlight.</p>	<p>Research IP believe the equity ownership of the Manager is evidence of strong alignment of interest with investors. Staff ownership is important when assessing the success of the overall business and alignment with investors.</p> <p>Research IP believe the performance outcome of the product itself and how it is linked to remuneration of the investment team is evidence of strong alignment. The alignment is even more marked given this is the Manager’s only strategy.</p> <p>The investment team live and breathe the ideas that proceed through the investment process. Everyone is expected to have an opinion. Remuneration is not tied to the inclusion of specific stocks in the portfolio, but to the overall Fund performance.</p>
<p>Comment on the assets under management, flow and capacity?</p>	<p>Fairlight manages one strategy, the Fairlight Global Small & Mid Cap Fund which currently has \$790m in AUM, up from</p>	<p>Research IP believe the Manager has adequate resource for coverage of this strategy, though one more would be</p>

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	<p>\$659m a year ago. Capacity is expected to be US\$4bn.</p> <p>Recent inflows have been supported by Recommended ratings from Lonsec and Zenith and the inclusion of the Fund on most major platforms. The Fund is distributed by the Perennial sales force.</p>	<p>preferable as assets under management and number of clients grow. Research IP observes positive net FUM flow over every month except one in the last four years.</p> <p>Total assets are split between hedged and unhedged versions of the Fund. The split is \$299m vs \$491m in favour of the unhedged strategy (approximately 38% hedged / 62% unhedged).</p> <p>Platform availability for the Fund in NZ and Australia is broad.</p>
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The RIPPL Effect

For important Fund Facts, please view the **RIPPL Effect** report:



Fairlight Global Small and
Mid Cap Fund


 RESEARCH IP Rating



RIPPL Effect

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[Glossary of Terms – please explain the jargon in this report](#)

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Research IP has provided client focused qualitative and quantitative financial product and security research since 2015. Research IP was also the consultant to the NZX wholly owned subsidiary FundSource, providing investment research to the New Zealand market since 2015.

Research IP is a specialist investment research provider which is used and trusted by investors & financial advisers for investment, KiwiSaver, Superannuation and other Pension schemes throughout the Asia Pacific region.

Research IP has grown its team and footprint by utilising the specialist skills of its analysts which include;

- ❖ data scientists,
- ❖ equity, bond and alternative asset specialists
- ❖ portfolio managers
- ❖ asset allocation analysts
- ❖ and ratings specialists.

Our experience has been gained in well over 20 years of roles across different facets of the industry, so we understand the key drivers and challenges for managers, as well as the impact for investors and the Financial Advice industry.

By leveraging the skills of specialists, Research IP is able to provide innovative and tailored financial services solutions to the marketplace. Client focused outcomes are underpinned by the belief that the role of business model innovation and accelerating technological change opens up new possibilities, to put client interests at the centre of the financial services industry focus. We have strong philosophical alignment with John Hagel's work on the possibilities for "Disruption by Trusted Advisors" and John Kay's views in "Other People's Money: Masters of the Universe or Servants of the People".

Research IP delivers high quality quantitative and qualitative fund research to financial advisers and the broader financial services industry. Research IP works with a number of expert providers to source this data. Quantitative data is supplied by a variety of sources, including directly from the Fund Manager, while qualitative research is provided by Research IP.

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