

Public Newsletter for the period ended
31 March 2022

Welcome to the Lighthouse Advisors newsletter for March 2022.

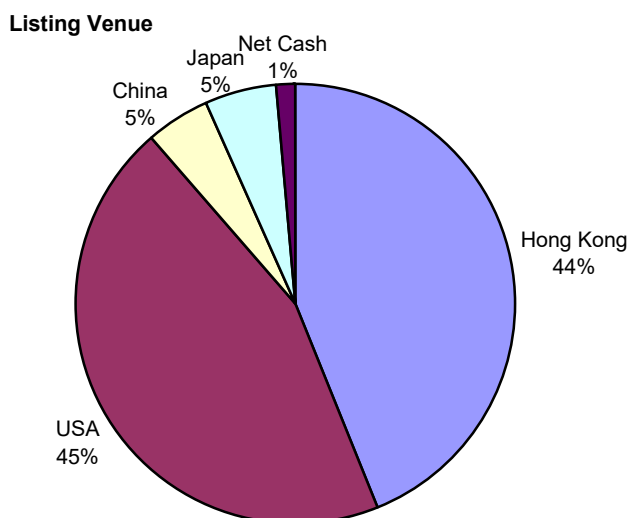
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1. Summary

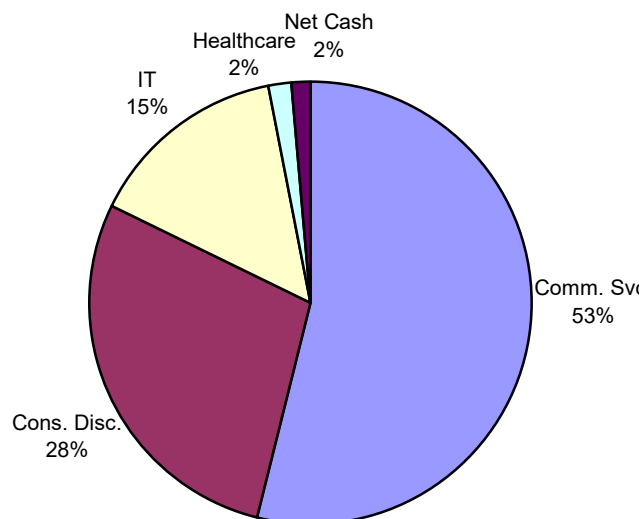
The NAV for March 2022 was USD 70.58 (SGD: 95.63). Year-to-date return was -14.8% (SGD: -14.4%).

| Market Index | 1Q22 |
|----------------|---------------|
| Hang Seng Tech | -19.6% |
| NASDAQ | -9.1% |
| Fund | -14.8% |

19 securities made up 98% of the Fund's holdings, with the balance in cash and cash equivalents. The following charts show the approximate exposure by place of listing and GICS sector (percentages may not add up or match exactly due to rounding).



Sector Exposure



NAV values (USD and SGD) are tabled in Annex II.

2. Market Commentary

Inflation from high energy prices and supply chain disruptions have combined with higher interest rates to spook investors. The sell-offs have been steepest in speculative securities, but blue chip stocks have also been sold down.

Cryptocurrencies have come under pressure after the collapse of “stablecoin” **Terra** (now renamed Terra Classic, **USTC**) and its sister token **Luna** (now Luna Classic, **LUNC**)¹. The fallout has spread to other crypto-linked assets, such as non-fungible tokens (NFTs).

The abuse of cryptocurrency novices was perhaps best exemplified by Sky Mavis' game *Axie Infinity*, which promised that players could “play to earn” but was fundamentally dependent on new players paying as much as US\$1,000 to join i.e. it was simply a Ponzi scheme masquerading as a game, as earnings

¹ *The Fall of Terra: A Timeline of the Meteoric Rise and Crash of UST and LUNA, Coindesk, 1 Jun 2022*

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of existing players came from cash paid by new players^{2,3}.

Chinese technology stocks have mostly been stable since the government resumed approving video games in April, while US stocks have been sold down as investors worry about inflation.

The next newsletter will be written for the period ending 30 June 2022.

Benjamin Koh
Chief Investment Officer
Lighthouse Advisors
23 June 2022

3. Portfolio Review

To protect the interest of clients, detailed discussion is confined to the client-only version of this newsletter. Client newsletters are embargoed for one year, after which they are made available online.

4. Buy Now Pray Later

Buy Now Pay Later (BNPL) has become increasingly popular in recent years. Companies like **Klarna**, **Afterpay**, **Affirm** and **Zip** are some of the better-known players.

Proponents call BNPL a financial innovation, splitting a purchase into a small number of equal interest-free installments. This improves affordability, which in turn encourages the consumer to buy more: BNPL increases the basket size by over 50%⁴. For merchant and consumer alike, it looks like a win-win. Is the BNPL provider a winner too?

² *Axie Infinity's financial mess started long before its \$600 million hack*, **The Verge**, 8 Apr 2022

³ *Axie Infinity – a developing world's Messiah or the biggest Ponzi Scheme in crypto?* **Medium.com**, 10 Aug 2021

⁴ *Buy Now Pay Later: Will Regulation Burst the Bubble?* **Endava.com**, 1 Feb 2022

Installment payments are not new. Homes have been bought on mortgage for centuries, and since the last century cars have been bought on credit. But houses and cars are good collateral – they can be seized and resold by the lender to raise cash to pay off the loan.

Financing consumer goods is a different game. Furniture retailers and department stores have offered installment plans (hire-purchase) for big-ticket items like sofas, beds, televisions and washing machines for decades. But it is a problematic business model: demand is traditionally highest in the weakest economies, but weak economies generate high default rates. Defaults are a problem – most of the goods have very little value when seized and resold. The high cost of repossessing goods means it is seldom worthwhile to do so. In other words, a default often results in a total loss on the remaining balance, unlike houses or cars, where a substantial sum can be raised from auctioning off the seized asset. As a result, installment plans typically charge high rates of interest to compensate for defaults.

BNPL companies mostly do not charge interest to the consumer. So how do they make money? They buy the receivables from the merchant at a *discount*, and aim to collect the full balance from the consumer. So a merchant who sold \$400 of goods to a consumer would deliver the goods, but sell the \$400 receivable to the BNPL company at a discount, perhaps at \$380. The BNPL company in turn bills the consumer in equal installments e.g. 4 equal payments of \$100. Essentially, the BNPL company is a short-term lender.

Buying and selling receivables is also not new. It is known as **factoring**. The difference is that typically, it is business-to-business receivables that are bought and sold. Finance companies purchase receivables outright at a discount and eventually collect the full value from the paying party. BNPL providers buy consumer-to-business receivables and similarly take over the collection of the full sum.

However, when a finance company buys receivables, it performs credit analysis to

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assess the odds of a default. If it is unsure, the discount is large, or it declines to purchase. In contrast, BNPL providers start with no **specific** data on the consumers who owe the money. While they may impose penalties for late payments and blacklist repeat offenders, these are *reactive* measures that cannot prevent the original loan from going bad.

Combining the low effective interest rates charged, the high cost of repossession, and the low resale value of seized goods, it becomes clear that BNPL companies cannot afford to have any meaningful defaults on their portfolio. Yet, because BNPL financing is not reported to credit bureaus, it is possible for imprudent consumers to use several BNPL services at the same time, with each BNPL operator none the wiser until it is too late. Essentially, the business model of BNPL companies is **Buy** (receivables) **Now**, then **Pray Later** that defaults are low.

As it happens, the global economy is now weakening. How are BNPL companies faring? In a word: poorly.

Klarna booked revenues of SEK 4bn and net losses of SEK 7bn in 2021. In 2022 Q1 revenue were up 19% to SEK 856m, but losses increased nearly *4 times* to SEK 2.5bn.

Affirm reported revenues of US\$985m and losses of US\$521m for the 9 months ended 31 Mar 2022.

Afterpay was bought by Block (then named **Square**) in February for US\$39bn. In April, Block reported that Afterpay's pre-tax losses increased from US\$76m to US\$502m. One analyst estimated that Afterpay's bad debt ratio was actually *13%*, not the claimed 1.2%.

Zip reported that for the 6 months ended 31 Dec 2021, revenues were up 89%, but bad debt rose 403%.

While the sage is not over yet, it seems BNPL companies need a better business model than just assuming end-users are good credits. In fact, it seems wiser to assume the converse. For now, BNPL shareholders can only... pray.

❧ End ❧

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Annex I

NAV in USD (Official)

| | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | YTD |
|-------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|
| 2008 | | | | | | | | | | 34.16 | 33.49 | 35.62 | 4.3% |
| 2009 | 34.57 | 33.52 | 33.37 | 36.69 | 46.20 | 46.00 | 50.06 | 49.68 | 52.66 | 54.17 | 56.68 | 59.94 | 68.3% |
| 2010 | 59.05 | 61.09 | 65.17 | 68.27 | 64.14 | 65.69 | 70.65 | 72.24 | 81.06 | 83.56 | 85.10 | 90.30 | 50.6% |
| 2011 | 87.21 | 86.29 | 88.13 | 92.81 | 90.85 | 91.35 | 91.17 | 83.69 | 69.04 | 78.23 | 73.00 | 72.88 | -19.3% |
| 2012 | 77.40 | 82.90 | 82.52 | 83.32 | 76.36 | 77.25 | 77.27 | 77.91 | 80.57 | 79.44 | 82.70 | 84.92 | 16.5% |
| 2013 | 91.43 | 97.36 | 99.96 | 100.24 | 99.14 | 95.09 | 98.50 | 100.00 | 100.86 | 102.24 | 102.63 | 102.93 | 21.2% |
| 2014 | 99.15 | 101.78 | 99.80 | 101.84 | 105.45 | 106.57 | 109.05 | 108.58 | 103.60 | 103.91 | 101.87 | 99.94 | -2.9% |
| 2015 | 97.97 | 98.16 | 97.74 | 103.80 | 103.69 | 100.99 | 96.17 | 85.91 | 84.17 | 88.91 | 86.20 | 86.35 | -13.6% |
| 2016 | 81.56 | 83.81 | 88.82 | 92.18 | 91.50 | 91.52 | 94.48 | 94.86 | 94.87 | 93.34 | 91.92 | 90.20 | 4.5% |
| 2017 | 93.18 | 97.08 | 101.10 | 101.39 | 105.74 | 107.11 | 109.67 | 108.57 | 109.35 | 112.57 | 108.28 | 109.41 | 21.3% |
| 2018 | 113.04 | 109.56 | 109.03 | 105.39 | 109.62 | 104.37 | 101.26 | 93.71 | 94.25 | 85.19 | 86.83 | 86.66 | -20.8% |
| 2019 | 91.98 | 92.36 | 90.04 | 90.21 | 82.80 | 84.21 | 82.57 | 78.45 | 76.52 | 77.82 | 78.75 | 82.80 | -4.5% |
| 2020 | 78.58 | 75.37 | 67.15 | 71.23 | 70.50 | 77.22 | 82.23 | 88.36 | 84.97 | 86.77 | 90.34 | 93.20 | 12.6% |
| 2021 | 99.54 | 99.36 | 94.98 | 99.37 | 96.76 | 96.86 | 86.54 | 87.88 | 85.09 | 90.51 | 85.32 | 82.81 | -11.1% |
| 2022 | 78.21 | 74.05 | 70.58 | | | | | | | | | | -14.8% |

Note: The Net Asset Value of the Fund has been linked to the rebased NAV of the Reference Account, which had the same investment style. Until the launch of the Fund, the Reference Account served as the model portfolio for all the separately-managed client accounts. Its trading records were distributed to clients as proof that the Manager's interests were fully aligned with those of the clients. The Reference Account was started at the end of 2008 and became inactive following the launch of the fund on 1 September 2013.

The following data is for the convenience of SGD-based investors and is for reference only.

NAV in SGD (for reference only)

| | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | YTD |
|-------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|
| 2008 | | | | | | | | | | 50.68 | 50.69 | 51.20 | 2.4% |
| 2009 | 52.22 | 51.91 | 50.74 | 54.21 | 66.70 | 66.59 | 72.06 | 71.60 | 74.19 | 75.67 | 78.50 | 84.15 | 64.4% |
| 2010 | 83.11 | 85.83 | 91.17 | 93.55 | 89.79 | 91.72 | 96.10 | 97.84 | 106.70 | 108.12 | 112.34 | 115.86 | 37.7% |
| 2011 | 111.57 | 109.76 | 111.06 | 113.64 | 112.11 | 112.14 | 109.75 | 100.70 | 89.85 | 97.91 | 93.64 | 94.48 | -18.5% |
| 2012 | 97.39 | 103.46 | 103.79 | 103.05 | 98.44 | 97.76 | 96.12 | 97.20 | 98.89 | 96.95 | 100.95 | 103.74 | 9.8% |
| 2013 | 113.19 | 120.44 | 124.03 | 123.50 | 125.34 | 120.54 | 125.55 | 127.49 | 126.57 | 126.83 | 128.86 | 127.81 | 23.2% |
| 2014 | 124.51 | 128.55 | 125.58 | 127.84 | 132.26 | 132.85 | 135.95 | 135.58 | 132.14 | 133.61 | 132.91 | 132.34 | 3.5% |
| 2015 | 132.68 | 133.74 | 134.11 | 137.66 | 139.74 | 136.08 | 131.71 | 121.30 | 119.78 | 124.68 | 121.53 | 122.26 | -7.6% |
| 2016 | 116.13 | 117.82 | 119.59 | 123.86 | 126.08 | 123.36 | 126.71 | 129.30 | 129.32 | 129.95 | 131.79 | 130.54 | 6.8% |
| 2017 | 131.35 | 135.81 | 141.22 | 141.04 | 146.29 | 147.44 | 148.75 | 147.28 | 149.30 | 153.38 | 146.00 | 146.32 | 12.1% |
| 2018 | 148.13 | 145.04 | 142.95 | 139.64 | 146.74 | 142.24 | 137.76 | 128.59 | 128.83 | 117.98 | 119.13 | 118.06 | -19.3% |
| 2019 | 123.77 | 124.86 | 123.01 | 122.81 | 113.88 | 113.93 | 113.02 | 108.85 | 105.83 | 105.92 | 107.71 | 111.33 | -5.7% |
| 2020 | 107.23 | 105.02 | 95.47 | 100.41 | 99.64 | 107.68 | 112.93 | 120.15 | 116.02 | 118.55 | 121.20 | 123.14 | 10.5% |
| 2021 | 132.30 | 132.32 | 127.74 | 132.16 | 127.85 | 130.26 | 117.21 | 118.19 | 115.50 | 122.11 | 116.41 | 111.73 | -9.3% |
| 2022 | 105.70 | 100.32 | 95.63 | | | | | | | | | | -14.4% |