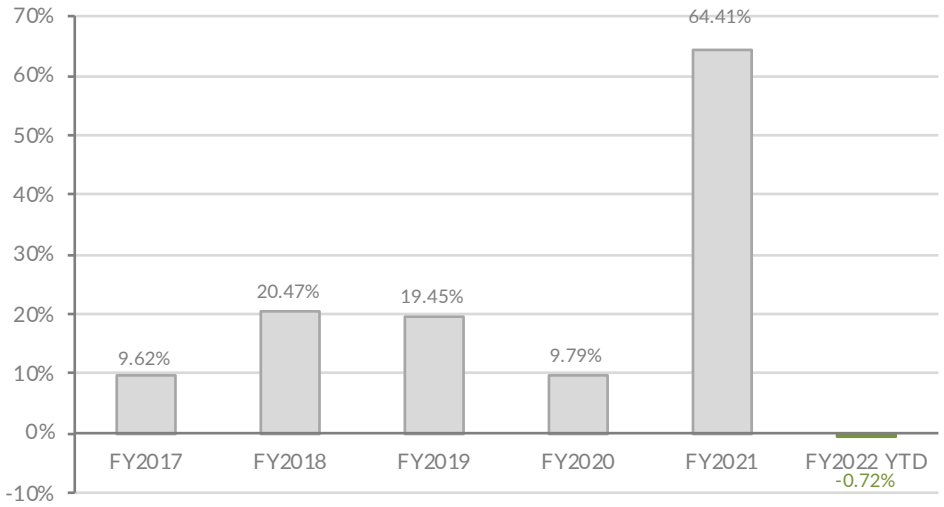
LIGHTHOUSE FUNDS

Lighthouse Global Equity Fund

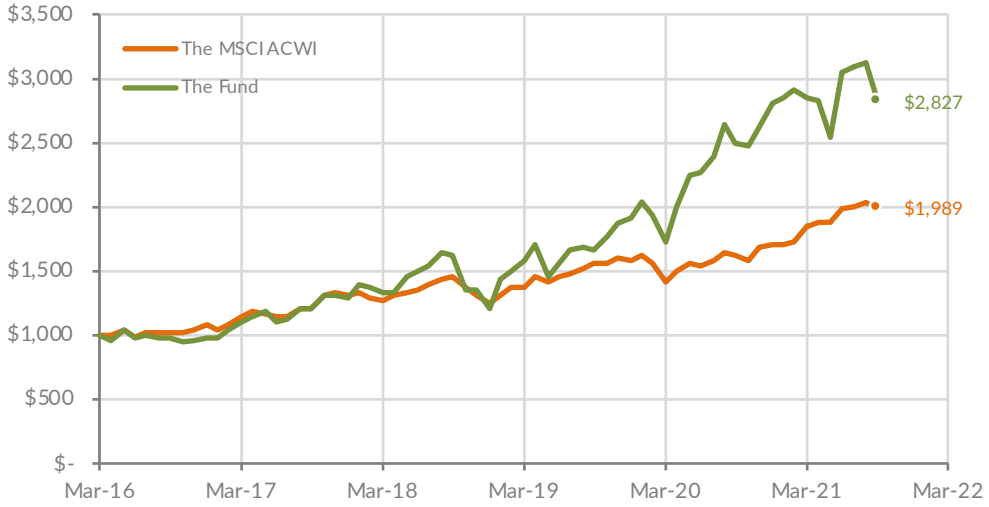
Monthly factsheet for September 2021

As at 30 September 2021	1 month	6 months	1 year	2 years	3 years	5 years
Lighthouse Global Equity Fund, net returns, after fees but before tax	-9.45%	-0.72%	13.52%	29.97% pa	20.36% pa	23.58% pa
MSCI All Country World Index, net, in NZD	-2.19%	14.99%	22.11%	13.11% pa	11.10% pa	14.40% pa

NET RETURNS BY FINANCIAL YEAR



CUMULATIVE NET RETURNS



FUND OVERVIEW

Objective: To out-perform the MSCI All Country World Index (net, in NZD) by at least 2% pa

Approach: Invests in international equities listed on the major United States exchanges

FUND FACTS

Base fee: 1.05% pa (including GST)

Performance fee: 30% of the Fund's returns above the MSCI All Country World Index (net in NZD) plus 2% pa, subject to a high water mark

Risk indicator:

1	2	3	4	5	6	7

This factsheet provides key information about the Lighthouse Global Equity Fund. It tells you how the fund has performed and it will help you to compare it with other investments. It is based on information that we believe to be accurate and reliable but we can't guarantee that this is the case. The returns information uses a blend of this fund, across its full history, and returns from a wholesale fund Lighthouse Funds manages that uses the identical strategy. Values that include returns from the wholesale fund are shown in lighter grey. Past performance does not guarantee future returns. For more information refer to the Product Disclosure Statement, the latest Quarterly Fund Update, or contact us at enquiries@lighthousefunds.nz

LIGHTHOUSE FUNDS

Lighthouse Global Equity Fund

Monthly factsheet for September 2021

LOOKING BACK OVER SEPTEMBER 2021

Stock markets do have some seasonality, and within that seasonality September is the worst month of the year. September often delivers a loss and, sadly, 2021 continues that trend.

But this September's loss is the worst we've seen in the last six years. We think that's due to the combination of the "regular" September blues and also a repeat of the "wall of worry" we saw in late-2018.

The regular September blues tend to be driven by three events. Firstly, the Jewish high holidays, which is a fortnight-long period that falls in September where the Jewish community typically steps away from work and so trading volumes on the markets are subdued. Secondly, a "triple witching" option expiry event on the third Friday in September where an unusually large number of index and equity options expire on the same day. And, thirdly, the end of the quarter bringing a bout of portfolio rebalancing. We're not surprised if those regular September blues bring a 1%-2% loss.

But this September also saw markets crumble under a "wall of worry". This has been overhanging the market for at least the last quarter (and we write more on it on the next two pages, where we discuss the six months to September) but while in July and August the market was able to struggle on in September it gave way.

What happens in these "wall of worry" type times is that demand for shares, the "buy side", slows down. Share prices reflect the balance between buyers and sellers. In a notionally "normal" market there's a balance between the volume of buyers and the volume of sellers and the shares should trade at what we'd think is "fair value". But in times like this, where there's some uncertainty about key future events such as the recovery from Covid, energy prices, the political setting and the Federal Reserves' next steps then many buyers hold back. That shifts the balance between the buyers and the sellers and so prices sag to the point where enough cautious buyers have come back so as to restore the balance between the buyers and the sellers. So you can see quite quick drops as share prices move to a new balance point that mainly reflects buyers' worries and hesitancy rather than company and financial fundamentals.

Typically what goes hand-in-hand with this slowdown in buyers' demand for shares is that investors end up with higher cash balances - analysts will say there's "a lot of cash on the sidelines". That does seem to be the case at the moment. Eventually the worries resolve or ease and that cash comes back into the market as the buyers return. At which point the demand balance shifts because there's now relatively more buyers and sellers and so share prices rise quickly. That will happen at some point in the near-ish future.

Basically what we're describing is how investor confidence and emotion overlays on the market and company fundamentals. There's a famous Warren Buffett quote where he paraphrases Benjamin Graham in saying "In the short-run, the stock market is a voting machine. Yet, in the long-run, it is a weighing machine." That is to say that in the short-run share prices are driven by emotion but in the long-run they move with factual data.

We take a 3-5 year perspective as we invest this Fund. We think our 3-5 year returns validate that approach. But it does make this Fund more vulnerable to short-term volatility, such as we see here in September 2021 and have seen since May. For existing investors in the Fund we feel your disappointment, but we urge you to hold calmly to the 3-5 year horizon. This will pass, most likely with a very strong bounce upwards. For potential investors in the Fund, this is a good entry point - our stocks are on sale.

LIGHTHOUSE FUNDS

Lighthouse Global Equity Fund

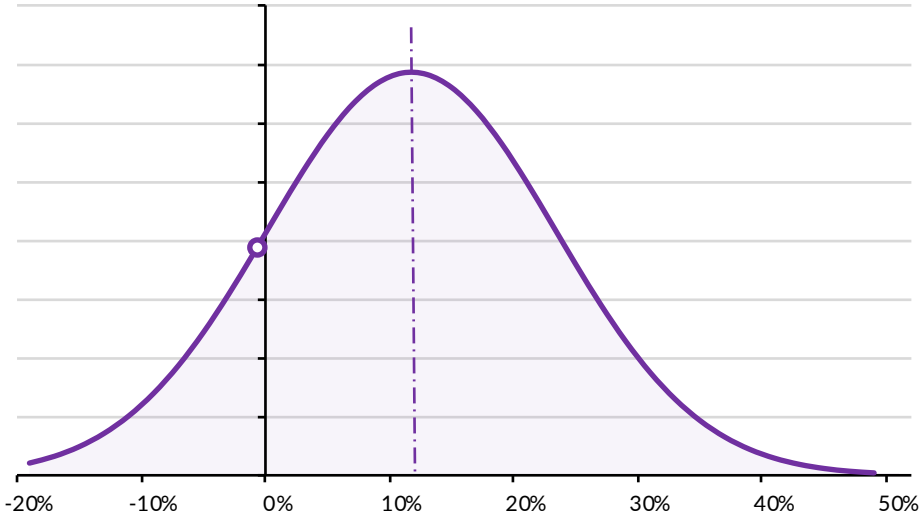
The first half of FY2022

LOOKING BACK OVER THE FIRST HALF YEAR

HOW THE FUND PERFORMED

In the six months from April to September, the first half of FY2022, the Fund returned -0.72%. We're always disappointed with a loss, but we are realistic that losses will occur and that they are the price of admission for being in equity markets.

We closely track the probability distribution of the Fund's returns, and we're always looking to see where we lie within that distribution. The chart below shows the distribution of the Fund's 6-month returns (so this is the expected percentage returns for any given 6-month period) with this April-to-September return highlighted by the circle. For the statistics-minded among you the probability of the Fund having a 6-month period with a -0.72% return or worse is 14%, or about one in seven.



So we're deeply disappointed with the returns from April to September, but it doesn't have us doubting the long-term proposition. Comparing any 6-month periods will show quite a bit of volatility but over the long-run we expect the Fund to deliver the average that's highlighted with the dashed line on the chart, which is 11.8% per half year.

To illustrate this, over the six years this Fund has been operating the April to September (first half year) returns have been -1.9%, 10.5%, 22.8%, 6.1%, 43.8% and now -0.7%. The average of those six values is 13.4%, which is pretty close to that 11.8% long-run average across all 6-month periods.

The way we see it is this is a consolidation phase after the strong run from April 2020 to February 2021. It is a messy consolidation phase, given the unusually high month to month volatility, and we think that volatility reflects the conflict between the general social/political fears and the solid business fundamentals. But it's a pause that is positioning the Fund for its next burst of growth. The companies the Fund is invested in are still growing strongly, their shares show signs of being oversold, and we expect the market will soon return to recognising their business fundamentals.

In summary, we're disappointed but not surprised or panicking.

WHAT WE'RE SEEING IN THE MARKET

2021 started with a lot of optimism, particularly that vaccinations would quickly end the Covid crisis and that President Biden would bring in a calmer and more productive political environment, both in the US and globally.

Lighthouse Global Equity Fund

LOOKING BACK OVER THE FIRST HALF YEAR

But that optimism has been overtaken by a "wall of worries" that has chilled the public mood and stolen direction from the financial markets. The "wall of worries" is made up of a number of concerns. Individually none are so significant as to drive the falls we saw in September and in the first half year, but collectively they're bearing down on the mood of the market at the moment. These current concerns include:

* The resurgence in "delta" covid cases,
* Supply chain disruptions,
* Rising commodity prices, particularly oil and energy prices,
* Political impasse in Washington DC,
* The US debt ceiling, with the risk of default pushing interest rates higher,
* The Federal Reserve's and ECB's plans for tapering,
* Tax increases in the US, albeit these haven't yet been detailed,
* Xi Jinping's increasing authoritarianism in China, and
* Evergrande, and the implications for China's economy.

The financial markets are struggling for direction in the face of these worries, and the push and pull between these concerns and the (still-)healthy company fundamentals has fuelled the month-to-month volatility.

This setting immediately reminds us of the last quarter of 2018, when we saw a similar "wall of worries". In fact the wall of worries in late-2018 was surprisingly similar, centering at the time on oil prices (tick), political impasse in Washington DC (tick), the debt ceiling (tick) and the Federal Reserve's plans for tapering (tick). Reading back through our commentaries for October, November and December 2018 it seems like we could cut-and-paste them into this commentary here.

That October to December 2018 quarter saw both markets and the Fund stumble under that wall of worries, and December 2018 marks this Fund's worst ever 3 month, 6 month and 1 year periods. But January to March 2019 was a very strong recovery (+30.8% for the quarter) and FY2019 still finished with a return of 19.5%.

So as with 2018 and 2019 we suspect that once a positive mood re-asserts itself there will be a strong recovery. We saw a hint of that in June, when the market and the Fund bounced strongly - only to see it stagger again against the delta Covid resurgence that accelerated in the US and Europe through July and August.

Increasing our confidence in a recovery is that although the general mood has been downcast the companies the Fund is invested in continue to deliver on their growth. Three have said they are being held back by supply chain constraints, and another three are heavily exposed to China - but even those companies are continuing to grow revenues and earnings at a rate of more than 15% pa. The other companies the Fund is invested in have expressed no concerns and all indications are they're delivering their expected growth.

So although the Fund has gone sideways for six months the underlying companies it is invested in are creating value. Over the long-term that fundamental value will always be recognised, which lends weight to the scenario of a bounce back in the coming months.

In summary, we understand why the mood of the market at the moment is nervous and pessimistic, and why we're seeing an unwelcome level of volatility. But, with a calmer eye, we can see the Fund's underlying companies continue to grow and their forecasts for 2022 remain healthy. We believe that, as in late-2018, this period will pass.