Blackwattle Long-Short 130/30 Quality Fund

Blackwattle Investment Partners

December 2023

About the Fund

Our investment philosophy is to own businesses with a competitive advantage and good corporate governance, priced below intrinsic value.

The fund aims to outperform the S&P/ASX 200 Accumulation Index (after fees and before taxes) over the long term. Quality companies at low or reasonable valuations underpin overweight positions while poor quality companies with high valuations facing near-term pressures underpin short positions. Risk is managed through portfolio diversification, strict exposure limits and process discipline utilising our proprietary valuation and portfolio construction tools.

Blackwattle Investment Partners

Blackwattle is a new generation, highly aligned, Australian investment manager investing in quality businesses and people.

Alignment
Shared staff ownership, zero personal trading, profit and personal salary reinvestment, and most importantly significant personal investment alongside our clients.

Quality
We aim to buy businesses that have a forward advantage, trustworthy aligned management, priced below intrinsic value.

Trust
We believe that honesty and transparency builds trust with our clients, stakeholders, and community.

Invest Better. Live Well.

Key Information

Fund Name	Blackwattle Long-Short 130/30 Quality
Inception Date	August 2023
Typical number of stocks	35-55 Long, 15-25 short
Cash limit	30% (typically +10% to -10%)
Cash Distributions	Semi-Annually
Redemptions	Daily
Constrained Capacity	$1.0bn
Objective	Outperform the benchmark (after fees) over the long term.

Portfolio Managers

Ray David B.Eco, Gdip Fin
20+ years' investment experience. Previously Portfolio Manager Long-Short Schroders, and Director of Emerging Companies UBS.

Joe Koh B.Bus, CFA
25+ years' investment experience. Previously Portfolio Manager Long-Short Schroders, and for Regal across Absolute, Market Neutral and Long-short funds.

Fund Performance[1]

Blackwattle Australian Long-Short 130 30 Quality Fund Performance (net of fees) as at 31 December 2023

	1 month	3 months	1 Year	2 Years p.a.	3 Years p.a.	10 Years p.a.	Inception p.a[2]
Fund (Net)	6.52%	7.01%	-	-	-	-	5.54%
Benchmark[3]	7.26%	8.40%	-	-	-	-	6.00%
Active Return	-0.74%	-1.39%	-	-	-	-	-0.46%

[1] Returns are calculated after fees have been deducted and assume distributions have been reinvested. No allowance is made for tax when calculating these figures. Past performance is not a reliable indicator of future performance. Source: Apex.
[2] The inception date for the Fund is 8 August 2023. [3] S&P/ASX 200 Accumulation Index

Track Record of Investment Strategy

Historical performance of the investment strategy applicable to the fund[4] (net of fees) as at 31 October 2023

	1 month	3 months	1 Year	2 Years p.a.	3 Years p.a.	10 Years p.a.	Inception p.a[2]
Fund (Net)	6.52%	7.01%	13.68%	8.39%	13.39%	-	14.61%
Benchmark[3]	7.26%	8.40%	12.42%	5.45%	9.24%	-	10.96%
Active Return	-0.74%	-1.39%	1.26%	2.93%	4.15%	-	3.65%

[4] The Blackwattle Australian Long-Short 130/30 Quality Fund (Fund) has been operating since 8 August 2023. The Fund employs the same Long Short strategy, investment philosophy and investment universe that was used by Ray David and Joseph Koh who managed the Schroder Australian Equity Long Short Fund. To give a longer-term view of our performance using this investment strategy, we have shown longer returns for the Schroder Australian Equity Long Short Fund. Schroder Investment Management Australia Limited, ABN 22 000 443 274 was the responsible entity of the Schroder Australian Equity Long Short Fund and was managed by the investment team whilst they were part of the investment team at Schroder Investment Management Australia Limited. Returns shown for the period from 27 August 2020 to 31 March 2023 reflect the returns of the Schroder Australian Equity Long Short Fund calculated based on exit price with distributions reinvested, after ongoing fees and expenses but excluding taxation (historical performance). This historical performance has been provided for information purposes and has been adjusted to reflect the ongoing fees applicable to the Fund. Past performance is not a reliable indicator of future performance.

Top 5 Holdings

News Corp | Mineral Resources | ALS | nab | ResMed

Market Commentary

The ASX 200 index staged a remarkable rally in December, rising by 7.3%.

Animal spirits were ignited by the Chair Jerome Powell's affirmation that the Federal Fund's rate has indeed peaked, with the FOMC predicting the Federal funds rate to decline by nearly 100bps in 2024, and another 100bps in 2025. To quote Treasury Secretary Janet Yellen, "What we're seeing now I think we can describe as a soft landing".

If Yellen is correct, the narrow path less travelled appears closer to reality, which equity markets and other risk assets have now fully embraced. To put things into perspective, the ASX200 index was flat for the eleven months to November, with the December month accounting for all the entire year's gain. The extent of the rally highlights how market psychology can be the driver of market prices in the short term, with markets previously bracing for slower economic growth.

During December, interest rate-sensitive sectors such as REITs performed strongly, up 10%, as well as healthcare (+9%) and technology (+8.5%). However, more encouraging was the broadening out of the market gains, which we see as a welcome change and a positive signal for markets, with materials (+8.9%), communications (+7.5%), financials (+6.4%), and small ordinaries (+7.1%) during the month.

Portfolio Commentary

While the Blackwattle Long-Short Quality Fund returned 6.5% during December, net of fees the fund lagged the ASX200 Gross Total Return Index by 0.67%.

Our holding in Mineral Resources (MIN) was a positive contributor in the month. As we have chronicled in our previous communications, we believe Mineral Resources can generate significant shareholder wealth through the development of the Onslow Iron Ore project and associated infrastructure, but more importantly, related earnings growth from its best-in-class mining services business. While lithium prices continued to decline, unlike many aspiring producers, Mineral Resources' position on the cost curve will still allow it to generate cash from the Wodgina and Mount Marion mines.

Holdings in James Hardie (JHX) and Reliance Worldwide (RWC) also contributed to performance.

While James Hardie has been a strong performer in 2023, a large portion of this is due to more substantial earnings being generated than previous market expectations. This is due to market share gains and average selling price being much more resilient in a weaker US housing market. At the same time, JHX has benefited from cost pressure easing, supporting industry-leading profitability. As interest rates decline, we expect the renovation segment to start to recover, which is where JHX stands to benefit from selling premium-priced products.

Impacting performance during the month was a case of what we didn't hold, notably Fortescue Ltd (FMG). While Fortescue does sit on the first quartile of the cost curve, the discounts for its lower-grade fines product compared to BHP/RIO (which are the fund's preferred iron exposure) make the earnings hypersensitive to fluctuations in the iron ore price.

For example, at an iron ore price of US$140/t, FMG will generate US$14bn of EBIT. However, at an iron ore price of US$80/t (the 90th percentile), FMG will only generate US$4.8bn before its infrastructure investments, which is still a tidy return on its capital base of US$20bn. A market valuation of US$56bn, and an iron ore price that is well above marginal production simply means we don't see an attractive risk-to-reward proposition to invest our funds in.

Holdings in the general insurers IAG Group (IAG) and Suncorp (SUN) also distracted from performance. The share price weakness likely stems from adverse weather recorded over December and investors anticipating lower future investment returns on technical funds from lower interest rates. Regardless, our positive stance is underpinned by attractive valuations, a favourable domestic industry structure, and the recovery of net insurance margin given easing costs of claims, e.g., used car parts and prices and the flow on impact of premium increases.

Despite a strong month for equity markets, the fund generated positive performance was short positions. Generally, we expect short positions to detract from performance during rising markets and act as automatic stabilizers during falling markets.

However, the short book benefited from positions in high-cost mining companies facing lower-end commodity prices and select positions in what we consider “expensive defensives”, which we believe face earnings headwinds not being anticipated by the market yet.

Outlook

The Goldilocks scenario of declining interest rates, moderating inflation and a resilient labor market bodes well for corporate profits. Soft landings are rare (1966, 1984, and 1995), but when they do occur, they form a positive backdrop for equity markets if previous cycles are a guide.

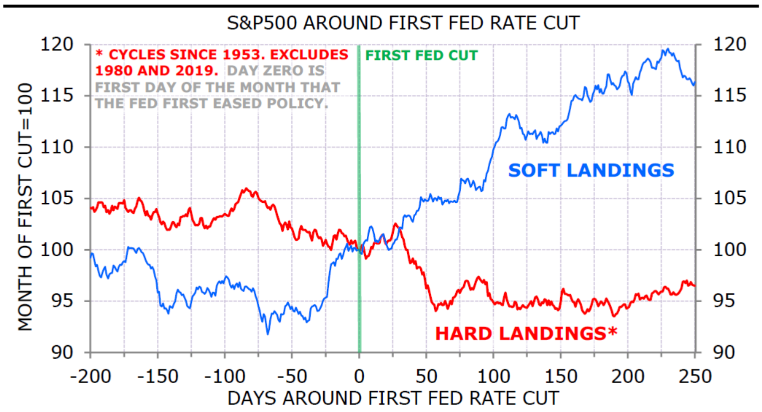
If there was an example of forecasters being spectacularly wrong, 2023 was the case in point where John Kenneth’s quote truly comes alive:

When it comes to forecasting, there are two types of forecasters: those who don’t know and those who don’t know they don’t know.

We expect market volatility will continue as the corporate earnings digest the lagged impact of tighter monetary policy in the upcoming reporting season. As always, we are looking to take advantage of market fluctuations, where we can selectively add or increase our weightings in businesses with strong economic moats led by capable stewards of capital at the right price.

Chart of the Month

Equity markets around the first Fed rate cut



Source: Standard & Poor’s; Minack Advisors

How to Invest

To invest click on the link www.blackwattlepartners.com/invest/ or call 02 7208 9922.

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