Blackwattle Large Cap Quality Fund

October 2023

Blackwattle Investment Partners

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 underweight 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 Large Cap Quality
Inception Date	August 2023
Typical number of stocks	30-55
Cash limit	10% (typically +5% to -5%)
Cash Distributions	Semi Annually
Redemptions	Daily
Constrained Capacity	$5.0b
Objective	The Fund aims to outperform the S&P/ASX 200 Total Return Index (after fees and before taxes) 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 Large Cap Quality Fund Performance (net of fees) as at 31 October 2023

	1 month	3 months	1 Year	2 Years p.a.	5 Years p.a.	10 Years p.a.	Inception p.a[2]
Fund (Net)	-3.95%	-	-	-	-	-	-5.59%
Benchmark[3]	-3.78%	-	-	-	-	-	-5.91%
Active Return	-0.17%	-	-	-	-	-	0.32%

[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 8th August 2023.
[3] S&P/ASX200 Accumulation Index

Top 5 Holdings

Market Commentary

The Blackwattle Large Cap Quality Fund declined by 3.95% during October, underperforming the ASX200 Gross Total Return Index, which fell by 3.78%.

Geopolitical events in the Middle East and more hawkish commentary from central banks contributed to rising treasury yields and equity market volatility. During the month, the USA 10-year treasury yield surged to 4.98%, a level not seen since June 2007. Stronger CPI and retail sales in Australia also saw markets price in a greater probability of another increase in the cash rate in November.

Rising interest rates became Mick Jagger's "Beast of Burden" for sectors with long-duration cashflows. Just as a sturdy workhorse can bear heavy loads, interest rates shoulder the weight of asset valuations. When rates rise, companies with more of their valuation subject to cashflow forecasts in future years are disproportionately affected. As such, the worst performing sectors were Information Technology, which declined by -7.6%, Healthcare -7.2% and REITs -6.2%. As investors repeated Jagger's words, "Am I rich enough?" to own these sectors, it became clear that valuation multiples attached to companies with longer-dated cashflows were too high.

On the other hand, companies with nearer term cashflows perform better in a rising rate environment. This is a seismic change from the depth of COVID when TINA (There Is No Alternative) was the investor war cry and asset valuations increased to euphoric levels. As rates rise, higher required rates of return on incremental capital is required, which supports commodity prices in mining, chemicals and energy as supply is slower to come on.

During the month, the best-performing sectors were Materials (-0.8%), aided by a flight to gold equities given geopolitical events, and Communications (-2.9%), reflecting a flight to companies with pricing power.

Portfolio Commentary

Fund performance was impacted by underweights in gold equities and overweights in chemicals sectors, partially offset by underweights in REIT and healthcare sectors.

Our discussions with various REIT companies highlight the conundrum investors face in this sector. For example, listed market valuations for office REITs are now below replacement cost of c$6000-$8000 sqm, which means new supply will likely evaporate over the next decade. Longer term, that is a positive.

However, in the short term, the starting point is fragile given rising vacancy, high debt levels in the private market (prompting more sellers and reducing buyers), and higher rates pressuring rental yields. This will likely lead to continued depressed valuations and possible recapitalizations, particularly in lower-quality portfolios. The lesson for investors is that debt can cuts both ways.

Lower-geared REITs with solid balance sheets are well-placed to acquire assets below replacement costs. During the month, Vicinity Centres (overweight) acquired a 49% interest in Chatswood Chase for $307m, 6.5% below book value, and 45% below what GIC paid for its interest six years ago.

Within materials, underweights in gold equities were a significant source of underperformance, as well as overweight positions in IGO and Mineral Resources, which were impacted by declining lithium prices. We remain positive on the long-run outlook for lithium demand and favour miners that have long reserve lives and are first and second quartiles on the cost curve.

With C1 and capital costs rising rapidly across the industry, we believe supply growth will be slower than consensus forecasts. In our view, IGO and Mineral Resources are attractively valued compared to other listed producers. Many other listed producers face development risk execution and require significant production growth to justify market valuations based on our long-run spodumene price assumption of USD 1,300 per tonne.

Outlook

The rise in bond yields is a welcome occurrence for the valuation-discerning investor, as the cost of capital has been restored. The restrictive mood of central banks coupled with the megatrends of decarbonization and deglobalization is likely to result in a higher level of interest rates than in recent times. We expect valuations in parts of the equity market will continue to adjust, providing tailwinds for our portfolio positioning.

How to Invest

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

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