Blackwattle Large Cap 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 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 December 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)	6.80%	6.75%	-	-	-	-	4.92%
Benchmark[3]	7.26%	8.40%	-	-	-	-	6.00%
Active Return	-0.46%	-1.65%	-	-	-	-	-1.08%

[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 Active Holdings

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 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%) all performing well during the month.

Portfolio Commentary

While the Blackwattle Large Cap Quality Fund returned 6.8% during December, net of fees the fund lagged the ASX200 Gross Total Return Index by 0.46%.

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.

James Hardie has been a strong performer in 2023, driven by stronger-than-expected earnings flowing from market share gains and resilient prices in the face of a weaker US housing market. JHX also benefited from cost pressures easing, further 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 were stocks 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 the industry's marginal production cost does not, in our view offer an attractive risk-to-reward proposition.

Holdings in the general insurers IAG Group (IAG) and Suncorp (SUN) also detracted 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.

Outlook

The Following years of disruptions from supply chain bottle necks and unpredictable consumer behaviour due to Government and monetary stimulus, 2024 is shaping up as a return to more normal operating conditions.

The consumer will still have to contend with the post COVID spending hangover, but this is being offset by resilient labour markets and Government investment in infrastructure.

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

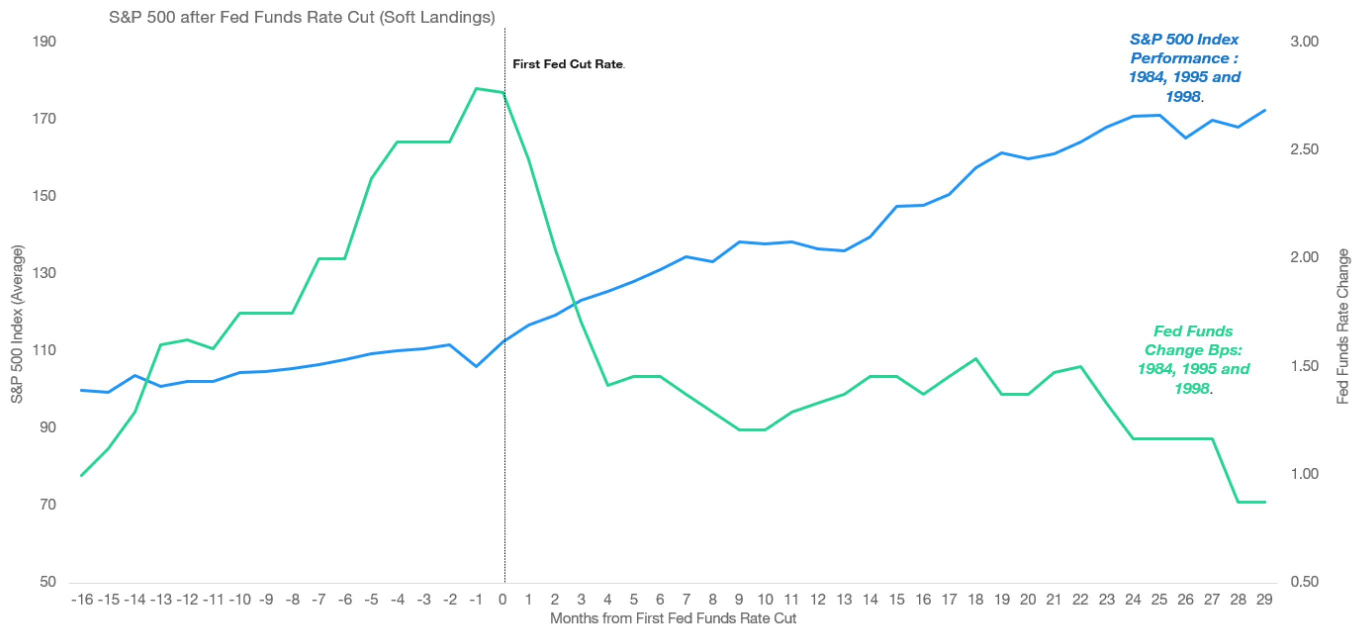
When it comes to forecasting, there are two types of forecasters: those who don't know and those who don't know they don't know.

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 at attractive valuations.

Chart of the Month

In most cases, when the central bank starts cutting interest rates, its due to recessionary conditions. However, in the rare cases where rates fall in non-recessionary conditions, this has resulted in strong equity market returns as seen below.

Interest Rates – Equity Markets in Soft Landing Scenarios*



Source: Blackwattle Investment Partners Research. As defined by NBER

How to Invest

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

Contact Details

Investor Services
Apex Fund Services
Ph: 1300 133 451
E: registry@apexgroup.com

Investment Enquiries
Maggie Mills (Head of Distribution, and Partner)
Ph: 02 7208 9922
E: MMills@Blackwattlepartners.com