Blackwattle Large Cap Quality Fund

January 2024

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 January 2024

	1 month	3 months	1 Year	2 Years p.a.	5 Years p.a.	10 Years p.a.	Inception p.a[2]
Fund (Net)	0.95%	12.19%	-	-	-	-	5.92%
Benchmark[3]	1.19%	13.99%	-	-	-	-	7.25%
Active Return	-0.23%	-1.80%	-	-	-	-	-1.33%

[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

BHP

CommonwealthBank

CSL

nab

ResMed

Market Commentary

The S&P/ASX 200 index returned 1.2% in January, a solid result following very strong performance in November (+5.0%) and December (+7.3%).

The market's focus remains on central bank interest rate policy and relevant macroeconomic data, and whether a so-called 'soft landing' can be achieved, particularly in the US. Recent comments by Federal Reserve Chair Jerome Powell have curtailed expectations of a rate cut as early as March 2024.

In January, US non-farm payrolls data came in stronger than expected, building on a strong December, with an additional 686k jobs added over the two months. This was almost double expectations of just 361k over those two months. The robust employment data combined with falling inflation suggest a soft landing might just be achieved – a rare feat for central banks and arguably more difficult in an economy that is now more highly geared than in past cycles.

Energy was the strongest performing sector in the S&P/ASX 200 index, returning 5.2% in the month. It was buoyed by stronger oil prices (+6.1%) and by Santos's (STO) favourable court ruling allowing its Barossa gas development in the Timor Sea to proceed in the face of a legal challenge from the Environmental Defenders Office. The ruling allayed investors' fears of ongoing and costly delays in Australia's oil and gas development projects more broadly due to environmental and cultural heritage concerns.

Financials was the second strongest performing sector (+4.9%), supported by indications of a subsiding mortgage price war among the major banks.

Materials was by far the worst performing sector, declining -5.2% in January. The iron ore price declined by almost 9% in January, on fears that China's economy could be facing a period of secular stagnation given property sector woes. Fears were amplified following a Hong Kong Court's ruling ordering the liquidation of Evergrande, one of China's largest property developers. BHP (-6.2%) slumped on weak production volumes, particularly in metallurgical coal where output was hampered by wet weather.

The lithium sector also underperformed, as spodumene prices fell below US $900/t, which has subsequentially led to several mine closure announcements or project deferrals.

Portfolio Commentary

The Blackwattle Large Cap Quality Fund returned 0.95% in January, net of fees, slightly lagging the S&P/ASX 200's return of 1.19%.

Healthcare and Communication Services sectors positively contributed to the Fund's relative performance, primarily due to stock-specific factors.

In Healthcare, the Fund's long position in ResMed (RMD, +14.8%) contributed to performance as the company reported improved gross margins following price increases, lower freight costs, currency movements and a favourable mix shift towards its new AirSense 11 product.

ResMed also provided select data showing no negative sales impacts from GLP1 weight loss drug usage and highlighted the benefits of combining those drugs with CPAP devices to address sleep apnoea. In addition, competitor Philips agreed on a consent decree with the FDA, which effectively prohibits it from selling new devices in the USA in the immediate future.

In Communication Services, long positions in Car Group (CAR, +6.0%) and News Corp (NWS, +3.9%) contributed to performance. While there was no company-specific news during the month, we believe both companies have strong market positions and pricing power, and significant growth opportunities outside Australia, with supportive valuations.

Offsetting these were the Financials and Materials sectors, which detracted from performance.

The performance drag from the Financials sector was broad based, with the Fund being underweight what was the second strongest sector in January. Signs of easing mortgage competition supported bank share prices, where the Fund was underweight. Strong financial markets and increased mergers and acquisition transactions also supported Macquarie Group (MQG, +3.7%).

In Materials, the Fund's exposure to lithium via positions in Mineral Resources (MIN, -14.4%) and IGO (IGO, -16.5%) detracted from performance, as lithium price weakness continued amid evidence of high inventory levels throughout the electric vehicle (EV) battery value chain. Despite weakness in lithium prices, we have continued to add to these positions. At the same, the fund has select short positions in higher cost lower quality miners that are loss making at current prices.

We believe Mineral Resources' diversified business and the Onslow Iron Ore project is not fully reflected in the market price. The company stated that it plans on monetising some of its infrastructure assets in the coming six months, reducing gearing levels. The Onslow Iron Ore project ramping up by June this year should also accelerate debt reduction.

IGO has been a poor performer due to falling lithium prices. We believe IGO provides investors with exposure to the best lithium mine in the world (Greenbushes) which is producing at a cost still well below current weak spodumene prices. Recently we spent some time meeting with downstream lithium converters and cathode manufacturers, and the conclusion was that destocking is gradually easing, and inventories are back down to three months' supply. High-cost Chinese lepidolite supply has also started to reduce given current spot prices.

Outlook

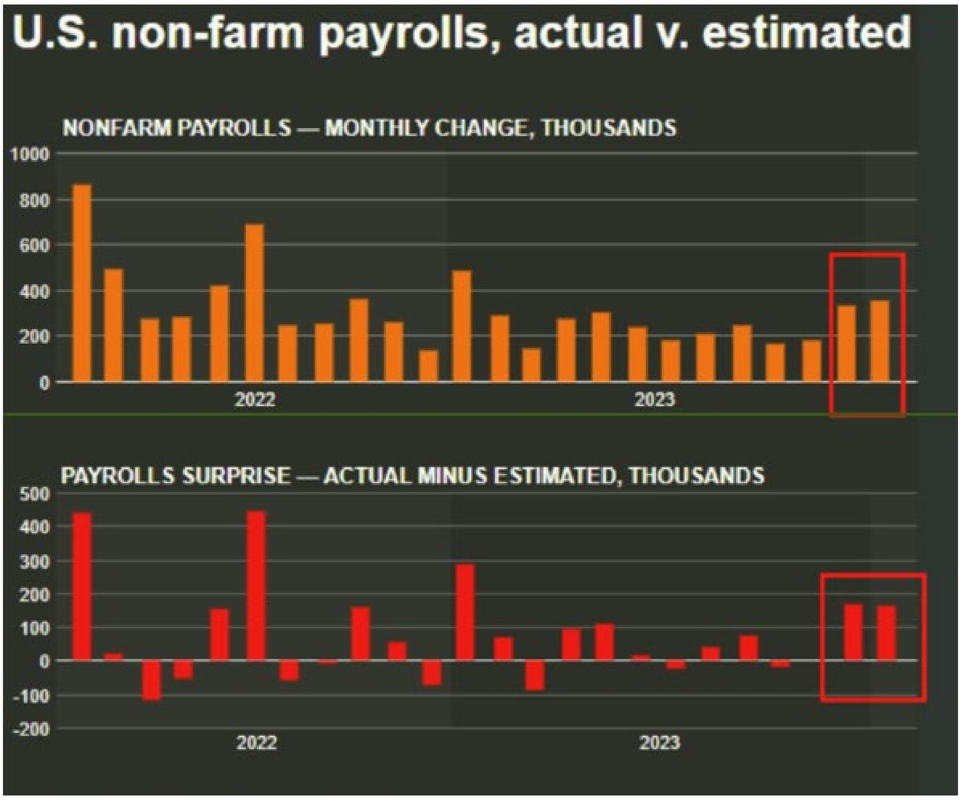
The Soft landings are rare – depending on one's definition, there have been 3 to 5 such occurrences in the US in the last 60 years, with the last one in 2000. Recent strength in equity markets suggests that the market is increasingly confident that governments (via fiscal policy) and central banks (via monetary policy) will be able to achieve the delicate balance required to pull off a soft landing.

Volatility is set to pick up in February with the corporate reporting season underway, but further out, risks remain: geopolitical tensions, signs of weakness in the Chinese economy, and the biggest global election cycle in history (some 4.2 billion people in 76 countries). Strong equity market returns in the last three months are unlikely to continue for the remainder of 2024, but we still expect ample opportunities for both long and short investments.

Chart of the Month

One of the biggest surprises this year has been the strength of the employment market. In January, US non-farm payrolls grew by 353k in January 2024, compared to forecasts of about 192k. The numbers indicate a reasonably buoyant economy that has held up better than expected in the face of steep interest rate increases.

The double-edged sword of soft-landings and a resilient labour market is that market expectations for significant interest rate declines could prove too optimistic in the near-term, with the path of interest rate declines being much more gradual.



Source: LSEG Datastream /S. Culp 02/02/2024

How to Invest

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

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