Blackwattle Large Cap Quality Fund

May 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.

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 (or up to 25bps of the benchmark)
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 May 2024

	1 month	3 months	6 months	2 Years p.a.	5 Years p.a.	10 Years p.a.	Inception p.a[2]
Fund (Net)	0.71%	1.86%	11.74%	-	-	-	9.77%
Benchmark[3]	0.92%	1.16%	10.66%	-	-	-	9.36%
Active Return	-0.21%	0.69%	1.08%	-	-	-	0.41%

[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

carsales JamesHardie News Corp ResMed RioTinto

Market Commentary

The S&P/ASX 200 Total Return index returned 0.92% in May, on strong equity market confidence despite weakening macroeconomic data.

Construction activity for 1Q2024 fell 2.9% quarter-on-quarter, compared to consensus expectations of slight (0.5%) growth. Building approvals in April were also weak, falling 0.3% month-on-month, while retail sales grew at a slower-than-expected +0.1% month-on-month.

Meanwhile, April CPI was higher than expected, at 3.6% (or 3.8% seasonally adjusted) compared to consensus expectations of 3.3%. Both goods and services contributed to the uplift, with the biggest swings in price inflation seen in fruit and vegetables, apparel and healthcare categories. The higher CPI print and broadening of inflation persistence reduces the likelihood of an early RBA rate cut, with market pricing now implying the first 25bps cut in 1QCY2025.

Nevertheless, Australian corporate activity continues apace, with BHP twice upping its bid for Anglo American before ultimately walking away, coupled with news of Guzman Y Gomez's impending IPO.

During the month, the technology sector outperformed, aided by strong results from Xero (XRO.AX). Sentiment towards the sector also benefited from Nvidia's strong results given the global investment wave in artificial technology.

The 2024-25 Federal budget saw government spending increase to combat cost-of-living pressure, driving a forecast $9.3bn surplus in FY24 to a $28bn deficit in 2025. The fiscal boost from this change is equivalent to about 1.3% of GDP in 2025 – the strongest in a decade, outside the pandemic.

Spending initiatives included energy subsidies of $300 per household and $325 for some businesses, amounting to an estimated $3.5bn expenditure by the government. This will directly benefit AGL's and Origin's energy retailing businesses, propelling Utilities to be the second-best performing sector.

Communications was the worst performing sector in May (-2.6%), driven by Telstra (TLS.AX). While the company announced job reductions of up to 2,800 positions, the removal of CPI-linked annual price reviews for its postpaid mobile plans has raised concerns around margin pressure in the business, while management's maiden FY25 profit guidance was slightly weaker than consensus estimates.

May also saw the 1H March 24 results of three of the four major banks (ANZ.AX, NAB.AX and WBC.AX). Stabilising net interest margins and strong capital positions (allowing for sizeable share buybacks) characterised the results, along with cost containment and still modest bad debts.

While there are signs of increasing household financial pressures, including higher delinquencies, these have not yet translated to significant bad debt problems, and the backdrop of higher house prices provides a safety net for some distressed borrowers. This drove the S&P/ASX 200 banks index up +3.6% in May (and the broader Financials sector +2.6%).

Portfolio Commentary

The Blackwattle Large Cap Quality Fund returned 0.71% in May, net of fees, slightly underperforming the S&P/ASX 200 Total Return index by 0.21%. From a sector perspective, Fund positions in Communication Services and Consumer Discretionary were the largest contributors to performance, while Healthcare and Financials detracted.

Within Communication Services, News Corp (NWS.AX) added to performance, as it announced a multi-year deal with OpenAI for use of its news content. While no financial details of the deal were disclosed, the Wall Street Journal reported the deal is worth $250m over five years. Such deals as this – and past deals with Facebook and Google – highlight the latent value of the company's content generation, which is not always fully reflected in current year earnings or market forecasts.

In Consumer Discretionary, an overweight position in Aristocrat (ALL.AX) contributed to performance. The company reported its 1H March 2024 results, which showed continuing market share gains in the North American gaming market. ALL's installed base of poker machines grew by 3.2k units (to 67k units), accounting for almost all of the industry's growth in the last six months. Management's confidence of a similar growth outcome in the second half of the year suggested that customer orders remain strong, despite strong new product launches from competitor Light and Wonder. Meanwhile, the mobile games business Pixel United saw margins significantly improve as costs were managed down, with a more mature portfolio of games requiring lower user acquisition spend.

The Healthcare sector was the greatest detractor for the Fund. A long position in Ramsay (RHC.AX) impacted performance, as cost pressures continue to build, patient numbers remain subdued and pricing growth is limited (especially in France and the UK). Post month end, the private sector struck a resolution with the Government that will give multi-year certainty in tariff levels and parity rates with the public sector. The increased certainty on tariffs could lead to a restructure of ownership, which would reduce the company's debt load.

We remain constructive on Ramsay, and expect that increased payer rates with local insurers, a resolution of the underperforming French business (where much of RHC's debt resides) via a corporate transaction and gradual normalising of operating conditions will ultimately see returns improve materially for one of Australia's leading private hospital operators with assets that are nigh impossible to replicate.

ResMed (RMD.AX) is a large overweight Fund position, and after strong price performance in April on the back of strong operating results that showed minimal impact from GLP drugs, the stock gave back some of its gains in May.

The financials sector also detracted from Fund performance. As mentioned, the bank reporting season saw a broadly benign set of results coupled with share buybacks, and the Fund's underweight in the sector was a drag on performance. Meanwhile, general insurers Suncorp (SUN.AX) and IAG (IAG.AX) gave back much of April's share price outperformance the following month.

At the stock level, an overweight position in James Hardie (JHX.AX) was the largest detractor to Fund performance. While the FY24 results came in at the top end of market expectations, a combination of weaker end-market demand from R&R (Repair and Remodel), higher input costs and higher operating expenses saw a disappointing guidance for FY25.

It should be noted, however, that much of the higher operating expenses are related to marketing and R&D spend, which we believe will contribute to (and grow) the ongoing competitive advantage the company enjoys over its competitors. While there may be near term cyclical pressures, the business franchise and long-term prospects for JHX remain as strong as ever given the underbuild in housing since the GFC

During the month, we engaged with Rio Tinto (RIO) regarding its dual class shareholding structure. We communicated our views that the dual-class structure is antiquated and advocated for a shift towards a single-class structure, in line with best corporate governance practices. At present, the current implied valuation discount between Rio Tinto PLC and Rio Tinto Limited is 18%. This implies a total valuation discount of USD $27 billion in market value, to the determinant of Rio Tinto PLC shareholders.

For a full copy of the letter sent to the Board of Directors, please click the following link:

https://blackwattlepartners.com/wp-content/uploads/2024/06/14052024-Rio-Tinto-Letter-to-Management-BW.pdf

Outlook

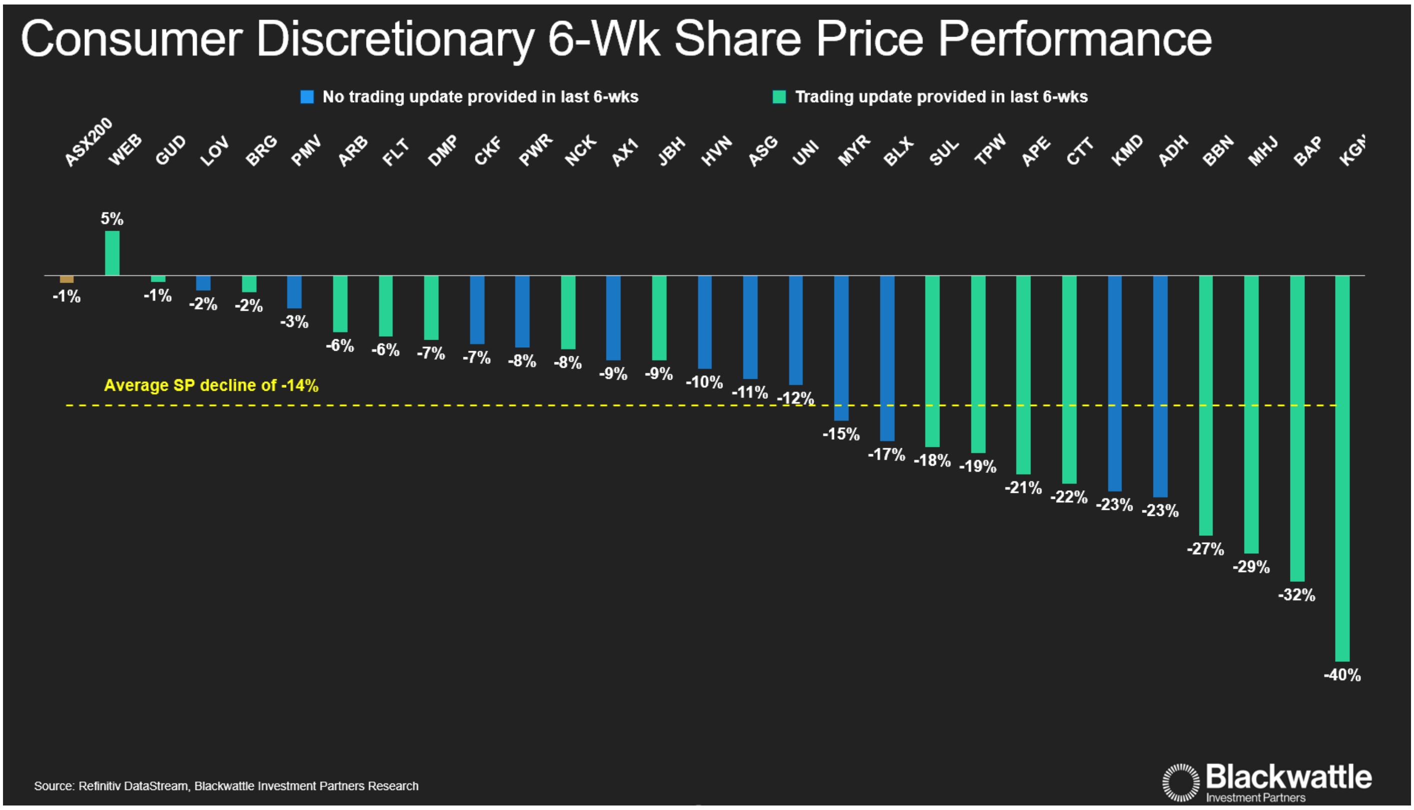
There are some tentative signs of a weakening consumer and, more generally, a slowing economy. Government spending initiatives and tax cuts will help offset this, though risk delaying interest rate cuts from the RBA.

At the same time, conservative corporate balance sheets and healthy bank capital levels are conducive to M&A activity, IPOs and share buybacks. Well managed businesses with pricing power and other competitive advantages continue to navigate inflationary pressures successfully, and still offer attractive investment returns over the long term.

Ray David, Joseph Koh and David Meehan

Chart of the Month

Recent trading updates from some of Australia's leading retailers to May 2024, reversing the gains made early this year.



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

Distribution and Sales Team

Matt Dell
Executive Director
0423 793 456
mdell@blackwattlepartners.com

Maggie Mills
Head of Distribution
0498 183 569
mmills@blackwattlepartners.com

Nick O'Hare
Senior Account Director
0423 773 837
nohare@blackwattlepartners.com

Sid Cavallaro
Account Director
0409 405 617
scavallaro@blackwattlepartners.com