

# Blackwattle Mid Cap Quality Fund

May 2024



## About the Fund

The Blackwattle Mid Cap Quality fund is a concentrated yet diversified portfolio of some of the highest and most improving quality companies on the ASX. We believe that high quality companies have the potential to consistently outperform over the medium term, as their competitive advantages may allow for compounding shareholder returns through market cycles.

The fund is concentrated on the team's best ideas, driven by fundamental research to establish differentiated views on the outlook of company quality, valuation and earnings. The fund is targeting long term ownership of high-quality companies to generate a consistent outperformance profile, compounding shareholder returns through market cycles.

## 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.

Invest Better. Live Well.

### 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 Mid Cap Quality Fund
Inception Date	August 2023
Typical number of stocks	20-35
Cash limit	10%
Cash Distributions	Semi Annually
Redemptions	Daily
Constrained Capacity	\$2.0b (or up to 25bps of the benchmark)
Objective	The Fund aims to outperform the S&P/ASX300 Accumulation Index - S&P/ASX20 Accumulation Index (after fees and before taxes) over the long term.

## Portfolio Managers



### Tim Riordan CFA, FRM

15+ years' investment experience. 5 years as Head of Direct Equities at Aware Super and Lead PM of the Aware Super Mid Cap Industrial Fund. Was Co-Head of Research and Portfolio Manager at Altair Asset Management.



### Michael Teran CFA

13+ years' investment experience. Associate PM of the Aware Super Mid Cap Industrial Fund. Also Long-Short Equities Analyst at Point72 Asset Management in Hong Kong. And Equities Analyst at Colonial First State Global Asset Management (now First Sentier Investors).

## Fund Performance<sup>1</sup>

Blackwattle Mid 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. <sup>2</sup>
Fund (Net)	0.90%	2.59%	16.95%	-	-	-	12.69%
Benchmark <sup>3</sup>	-0.93%	0.66%	11.45%	-	-	-	6.28%
Active Return	1.83%	1.93%	5.50%	-	-	-	6.41%

<sup>1</sup> 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.

<sup>2</sup> The inception date for the Fund is 8<sup>th</sup> August 2023

<sup>3</sup> S&P/ASX300 Accumulation Index - S&P/ASX20 Accumulation Index

## Top 5 Holdings



## Market Commentary

The ASX300 ex-20 was down 0.9% in May. Global markets were stronger with the S&P500 recovering 4.8%, having dropped 4.2% in April. Financial markets have shifted from inflation concerns to a weakening economic growth outlook, reigniting expectations for central bank easing again in 2024. The best performing sector was Information Technology, following offshore leads combined with strong earnings results. Consumer Discretionary was the most significant underperformer given multiple, weak trading updates from domestic retailers.

## Portfolio Commentary

The Blackwattle Mid Cap Quality portfolio outperformed the ASX300 ex-20 benchmark by 1.83% during the month.

### *Key Contributor – Xero (XRO AU)*

Xero was the largest positive contributor to performance during the month. XRO rose 11% in May, on the back of a very strong FY24 result and solid outlook. XRO is a market-leading, global accounting SaaS platform. XRO's FY24 result showcased the benefits of the cultural change brought in by CEO Sukhinder Singh-Cassidy in early 2023, balancing top-line growth with profitability. XRO delivered a record EBITDA margin of 31% and free cash flow growth of over 280%, significantly beating market expectations. This result has cemented our view of XRO being one of the highest quality companies on the ASX. We continue to see significant upside for XRO, as they continue their journey to being the market-leading, global accounting software for SMEs, while delivering strong financial metrics.

### *Key Detractor – Treasury Wine Estates (TWE AU)*

Treasury Wine Estates was the largest negative contributor to performance during the month. TWE fell 6% in May on market concerns around consumer weakness. TWE is a luxury, global wine company known for its market leading Penfolds brand. The market has become acutely focused on earnings risk in the consumer discretionary sector after companies like Baby Bunting, Eagers Automotive, Michael Hill Jewelers, Kogan and JB Hi-Fi all provided softer than expected trading updates. We believe TWE is mostly protected from this initial consumer weakness given ~80% of earnings are from luxury brands (Penfolds, DAOU etc.), and the wealthier consumer has continued to be more resilient. Beyond short term earnings, we see significant upside from multiple levers for TWE: reopening of China post tariff reductions for Penfolds, integration of DAOU into a global luxury focused portfolio (including Beringer, Stags Leap, Frank's Family and BV), continued global structural trends towards luxury consumption and unlocking value by divesting TWE's global masstige/premium portfolio (19 crimes, Wolf Blass, Lindemans, Matua etc.). TWE will be updating the market in June with a US winery site visit and a Penfolds global pricing update, which we see as strong short-term catalysts within a longer-term opportunity.

## Outlook

The portfolio performed well in May, driven by a series of strong earnings announcements or trading updates from almost half our portfolio companies. These earnings updates are an important opportunity for our high-quality companies to highlight their ongoing financial strength, and tend to be positive short-term catalysts, incrementally driving outperformance towards a longer-term investment thesis. The portfolio also received a takeover bid for PSC Insurance (PSI), a high-quality, small cap insurance broker. This is the second takeover of our portfolio companies since inception less than a year ago and demonstrates that undervalued, high-quality companies will not go unappreciated for long, considering corporates are healthy and private equity dry power is significant.

May was a stronger month for equity markets, rebounding from a small correction in April. While inflation appears stickier than expected, global economic data has softened, reigniting expectations for central bank easing again in 2024. This shift was confirmed with the Bank of Canada and ECB being the first developed central banks to cut rates in early June. This remains a highly uncertain economic environment, and while financial markets hope for a soft landing and further central bank easing, the potential outcomes of a hard landing or stagflation are still possible.

Our focus on quality provides us with confidence that our portfolio companies can remain resilient, and indeed take advantage of any weakness to further entrench their industry-leading positions. The outperformance of high-quality stocks over low-quality stocks is well-documented in financial research, with strong empirical evidence across regional markets and especially during the slowdown/downturn phases of the economic cycle.

This uncertain environment also remains highly conducive to actively managed portfolios. We have taken profits from outperformers to invest in 2 new positions, both with significant, longer-term value creation potential. The first business is another high-quality, global insurance broker, replacing PSI post the takeover bid. We are attracted to insurance brokers given their highly profitable, lower risk, capital-light business model with strong scaling benefits and ability to reinvest for growth. The second business is a highly specialized, market-leading industrial with significant competitive advantages. This business has managed to scale globally and now has exciting growth opportunities placing its products into new industries. These portfolio changes are driven by our continuous tandem goals of improving the overall Quality Score of the portfolio whilst maintaining a highly attractive portfolio level risk/reward skew.

Thank you for investing alongside us, Mike & Tim.

## How to Invest

To invest click on the link [www.blackwattlepartners.com/invest/](http://www.blackwattlepartners.com/invest/) or call 02 7208 9922.

## Contact Details

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