

# Blackwattle Long-Short 130/30 Quality Fund



July 2024

## 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 short 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

<b>Fund Name</b>	Blackwattle Long-Short 130/30 Quality
<b>Inception Date</b>	August 2023
<b>Typical number of stocks</b>	35-55 Long, 15-25 short
<b>Cash limit</b>	30% (typically +10% to -10%)
<b>Cash Distributions</b>	Semi-Annually
<b>Redemptions</b>	Daily
<b>Constrained Capacity</b>	\$1.0bn
<b>Objective</b>	Outperform the benchmark (after fees) over the long term.

## Portfolio Managers



**Ray David B. Eco**, Gdip Fin  
20+ years' investment experience. Previously Portfolio Manager Long-Short Schrodgers, and Director of Emerging Companies UBS.



**Joe Koh B. Bus**, CFA  
25+ years' investment experience. Previously Portfolio Manager Long-Short Schrodgers, and for Regal across Absolute, Market Neutral and Long-short funds.

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

Blackwattle Australian Long-Short 130 30 Quality Fund Performance (net of fees) as at 31 July 2024

	1 month	3 months	6 months	1 Year p.a.	2 Years p.a.	3 Years p.a.	Inception p.a. <sup>2</sup>
<b>Fund (Net)</b>	4.57%	6.67%	9.99%	-	-	-	17.37%
<b>Benchmark<sup>3</sup></b>	4.19%	6.21%	7.31%	-	-	-	15.10%
<b>Active Return</b>	0.38%	0.46%	2.68%	-	-	-	2.27%

<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 August 2023. <sup>3</sup> S&P/ASX 200 Accumulation Index

## Track Record of Investment Strategy

Historical performance of the investment strategy applicable to the fund<sup>4</sup> (net of fees) as at 31 July 2024

	1 month	3 months	6 months	1 Year p.a.	2 Years p.a.	3 Years p.a.	Inception p.a. <sup>2</sup>
<b>Fund (Net)</b>	4.57%	6.59%	9.99%	15.77%	15.15%	11.25%	15.39%
<b>Benchmark<sup>3</sup></b>	4.19%	6.21%	7.31%	13.53%	12.59%	7.44%	11.58%
<b>Active Return</b>	0.38%	0.46%	2.68%	2.24%	2.55%	3.81%	3.82%

<sup>4</sup> The Blackwattle Australian Long-Short 130/30 Quality Fund (Fund) has been operating since 8 August 2023. The Fund employs the same Long Short strategy, investment philosophy and investment universe that was used by Ray David and Joseph Koh who managed the Schroder Australian Equity Long Short Fund. To give a longer-term view of our performance using this investment strategy, we have shown longer returns for the Schroder Australian Equity Long Short Fund. Schroder Investment Management Australia Limited, ABN 22 000 443 274 was the responsible entity of the Schroder Australian Equity Long Short Fund and was managed by the investment team whilst they were part of the investment team at Schroder Investment Management Australia Limited. Returns shown for the period from 27 August 2020 to 31 March 2023 reflect the returns of the Schroder Australian Equity Long Short Fund calculated based on exit price with distributions reinvested, after ongoing fees and expenses but excluding taxation (historical performance). This historical performance has been provided for information purposes and has been adjusted to reflect the ongoing fees applicable to the Fund. Past performance is not a reliable indicator of future performance.

## Top 5 Active Holdings



## Market Commentary

The ASX 200 accumulation index returned more than 4% in July – a strong month by any measure. Investors were buoyed by relatively tame inflation numbers released for June, both in the US and Australia, paving the way for interest rate cuts by respective central banks.

Consumer Discretionary was the strongest performing sector in the market, with updates from retailers such as Accent and Universal Store showing strong same-store sales growth: +4.1% and +6.6% respectively for 2H24, representing a material acceleration from 1H24 growth rates in each case. These data points indicate that Australian households are navigating higher interest rates and cost-of-living pressures well, and certainly better than many investors expected. With inflation under control and a robust consumer, July seemed like a Goldilocks scenario come true, with the economy neither too hot nor too cold.

In a similar vein, Financials was the second-best performing sector in July, driven in large part by the major banks (with the notable exception of ANZ, which faced regulatory scrutiny around their government bond trading activities and alleged market manipulation). Total system credit grew a healthy 5.6% in June, year-on-year, with mortgages growing 4.7% and business credit growing 7.7%. Healthy credit growth, combined with easing net interest margin pressures and the lack of major bad debt concerns propelled bank valuations even higher, from arguably already lofty levels.

One area of market concern, however, was the economic softness in China. It was hoped by many investors that the third plenum – a major plenary session convened by China's Central Committee – would unveil a large-scale stimulatory package to boost Chinese economic activity. None was forthcoming. Consequently, there was broad weakness in commodity-related stocks in July, which flowed through to the Materials sector, as well as Energy and Utility sectors – the three worst performing sectors in July and the only ones to decline in an otherwise very strong month.

Contributing to the weakness in the Materials sector were several stock-specific developments. Among them was South32's US\$554m write-down of their Worsley Alumina operations. This was driven by onerous conditions proposed by the Western Australian Environmental Protection Authority (WA EPA) on new bauxite mining developments required to supply South32's alumina refinery. Separately, a large (\$1.9bn) block sale of Fortescue shares, representing around 3.2% of the company, was transacted at an almost 9% discount to the previous closing share price, weighing on the stock price towards the end of July.

It should also be noted that, in the early days of August, the stock market has since materially sold off. This was triggered by concerns of a weaker US economy, given a worse-than-expected jobs growth number for July: non-farm payrolls grew by 114k, slowing from 179k in the previous month and lower than the 175-185k expected by the market, raising the risk of a recession should the economy stall.

At the same time, a surprise increase in interest rates by the Bank of Japan also contributed to market fears. Even though the rate increase was modest (from a range of 0-0.1% to 0.25%), an unwinding of the yen carry trade (borrowing yen at very low rates to invest in foreign currency and other financial assets) has seen quite violent movements in both currency and equity markets.

Goldilocks is not quite out of the woods yet.

## Portfolio Commentary

The Blackwattle Long Short Quality Fund returned 4.57% in July, outperforming the ASX200 Total Return benchmark by 0.38%

The Fund's overweight position in ResMed (RMD.AX, +11%) was the largest single stock contributor to this outperformance in July, marking a sharp reversal from the previous month when it was a large detractor due to concerns around GLP-1 drugs and recent drug study results reported by Eli Lilly. Ongoing evidence, however, suggests to us that these drugs are not a mortal threat to RMD's sleep apnoea devices – or even a material headwind, given many countervailing factors already noted in our prior commentaries (such as the benefit of combined weight loss and sleep apnoea treatment, higher rates of sleep apnoea testing and the side-effects and temporary nature of GLP-1 drugs). The company's FY24 result, announced early August, continued to confirm our thesis, with continued revenue growth (+11%) and improving gross margins – hardly a business that is succumbing to an existential threat.

Another stock that reversed from being a significant detractor from Fund performance to a large contributor in July was James Hardie (JHX.AX, +16%). Prior concerns over weaker end-market demand from US R&R (repair and remodel), higher input costs and higher operating expenses saw the stock sold down by investors in May. But the prospects of a looming rate cut in the US, spurring housing activity, drew market attention back to the growth potential for JHX (as well as the broader homebuilder names). We remain confident in the long-term prospects for JHX, supported by strong pricing power and ongoing market share gains against alternative siding materials such as vinyl.

Also contributing to performance was not owning South32 (S32.AX, -16%) and Fortescue (FMG.AX, -12%), which fell for reasons outlined above, dragged the index lower in July.

Fund positions in Consumer Discretionary detracted from performance, driven by both short and long positions in the Fund. On the long side, an overweight in The Lottery Corporation (TLC.AX, -2%) underperformed its more cyclical consumer peers and the broader market, given the defensive, stable nature of its revenues (despite being technically discretionary). We remain confident in the investment and note the resilience of its sales through various economic conditions as a key strength of its business, supplemented by longer-term margin improvement as it grows its online penetration and game enhancements that drive larger jackpots and consumer interest.

At the same time, short positions in more cyclical consumer names detracted from Fund performance given the recent strong retail sales data points. With evidence of a more robust consumer, we reassessed our assumptions and have reduced some of the Fund's short positions in this sector.

**Outlook**

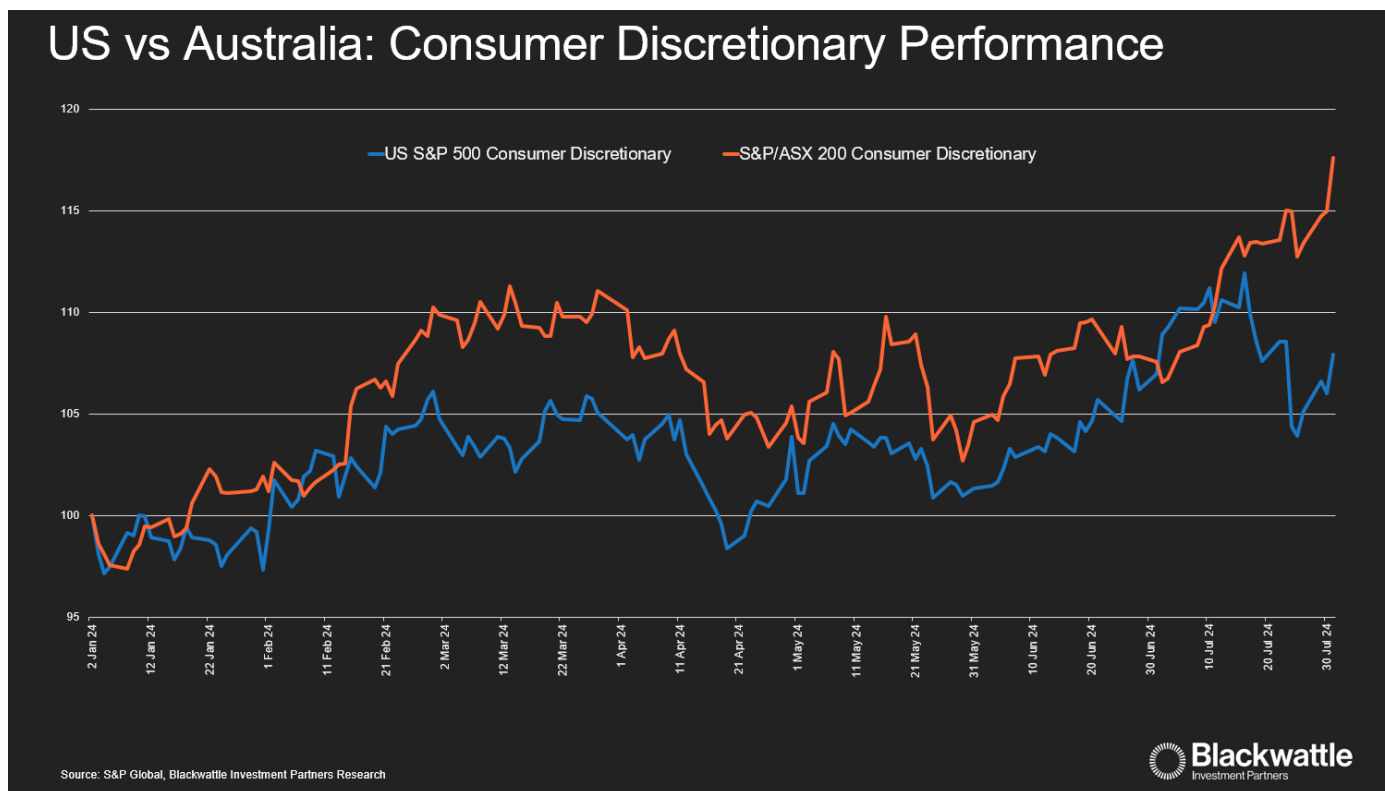
The same factors that contributed to lower inflation and the prospect of lower interest rates in the US and elsewhere (supporting market optimism in July) are now leading to market fears of a recession. Weak macro data from China and the lack of major new stimulus packages from the government is only adding to such worries.

Which is to say, the market is fickle and overly focused on short term results. Stocks that were unloved one or two months ago have become celebrated the next. Market exuberance can turn to dismay – or even panic – just as quickly. The investment maxim of Kenneth Fisher remains: *“Time in the market beats timing the market.”* With market volatility increasing and a very weak start to August, it is tempting to sit on the sidelines until clarity emerges. But complete clarity and certainty is an illusion, the pursuit of which will distract from investing for the long term.

Ray David, Joseph Koh and David Meehan

**Chart of the Month**

Household debt to GDP in Australia is about 110%, compared to the US at around 73%. But that has not hampered Australia’s Consumer Discretionary stock performance this year, relative to US peers.



**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**

**Investor Services**  
 Apex Fund Services  
 Ph: 1300 133 451  
 E: [registry@apexgroup.com](mailto:registry@apexgroup.com)



**Distribution and Sales Team**

**Matt Dell**  
 Executive Director  
 0423 793 456  
[mdell@blackwattlepartners.com](mailto:mdell@blackwattlepartners.com)

**Maggie Mills**  
 Head of Distribution  
 0498 183 569  
[mmills@blackwattlepartners.com](mailto:mmills@blackwattlepartners.com)

**Nick O'Hare**  
 Senior Account Director  
 0423 773 837  
[nohare@blackwattlepartners.com](mailto:nohare@blackwattlepartners.com)

**Sid Cavallaro**  
 Account Director  
 0409 405 617  
[scavallaro@blackwattlepartners.com](mailto:scavallaro@blackwattlepartners.com)

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