Blackwattle Long-Short 130/30 Quality Fund

Blackwattle Investment Partners

October 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.

Key Information

Fund Name	Blackwattle Long-Short 130/30 Quality
Inception Date	August 2023
Typical no. of Stocks	35-55 Long, 15-25 short
Cash Limit	30% (typically +10% to -10%)
Cash Distributions	Semi-Annually
Redemptions	Daily
Constrained Capacity	$1.0bn
Objective	Outperform the benchmark (after fees) over the long term.
Research Ratings	Zenith - Recommended Lonsec - Recommended

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

	1 month	3 months	6 months	1 Year	2 Years	3 Years	Inception p.a[2]
Fund (Net)	-2.67%	0.52%	7.22%	24.19%	-	-	14.32%
Benchmark[3]	-1.31%	2.10%	8.44%	24.89%	-	-	13.95%
Active Return	-1.36%	-1.58%	-1.22%	-0.71%	-	-	0.36%

[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 8 August 2023, Returns greater than 1 year are annualised' or "calculated on an annualised basis. [3] S&P/ASX 200 Accumulation Index

Track Record of Investment Strategy

Historical performance of the investment strategy applicable to the fund[4] (net of fees) as at 31 October 2024

	1 month	3 months	6 months	1 Year	2 Years	3 Years	Inception p.a[2]
Fund (Net)	-2.67%	0.52%	7.22%	24.19%	14.69%	10.32%	14.55%
Benchmark[3]	-1.31%	2.10%	8.44%	24.89%	13.39%	8.01%	11.40%
Active Return	-1.36%	-1.58%	-1.22%	-0.71%	1.30%	2.32%	3.15%

[4] 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

carsales | The Lottery Corporation | ResMed | News Corp | Telstra

Market Commentary

The S&P/ASX 200 Accumulation Index returned -1.31% in October.

October saw a significant global bond market sell-off, with the US 10-year bond yield rising by 50bps to 4.3%. The shift was largely driven by strong economic indicators, including US payroll data (254k vs. 150k expected) and inflation (0.3% vs. 0.2% expected), along with election positioning that favoured a Republican presidential win.

Trump's presidency will lead to greater protectionist policies, particularly towards China (e.g., BYD vs. Tesla), and lower corporate tax rates. Additionally, a deregulatory agenda could also spur increased investment and merger and acquisition activity and onshoring, benefiting ASX companies with USA-based exposure. Combined with import tariffs, the Republicans' victory will likely be more inflationary, potentially leading to a slower pace of rate cuts or a higher neutral rate in the US.

In the rest of the world, peaking inflation and slowing growth continue to support gradual reductions in cash rates, especially with rates now 150-200 basis points above core CPI—a differential not seen for some time. After the US election, attention will turn to China for any policies it may introduce to counter Republican-led tarrifs.

During the month, the materials sector retraced gains following the announcement of stimulus policies in China, and the US election outcome posturing. Although details on these policies remain limited, some impact is apparent, with secondary home prices beginning to improve. Month-on-month, home price declines slowed to 6% year-over-year (from a 14% decline last quarter), with 52% of cities in China reporting sequential price increases.

Given the significant underperformance of the materials sector relative to domestic financials, we continue to monitor these developments closely, with a preference for base metal and coking coal exposure over iron ore given more favourable supply dynamics.

Domestically, trading updates from AGMs continue to reflect a mixed economic outlook, with weakening conditions in interest rate-sensitive sectors such as housing, household goods, and leisure spending, coupled with more thrifty shopping within staples. Banks have reported a modest uptick in arrears for the September quarter, though net interest margins remain robust, and strong capital positions are enabling capital management programs.

Portfolio Commentary

The Blackwattle Long Short Quality Fund declined by 2.67%, underperforming the benchmark by 1.36%.

Flight Centre (FLT) detracted from performance following a weaker Q1 trading update relative to consensus expectations. Despite this, we believe the underlying quality of the business has significantly improved since 2020, particularly with the growth of its FCM corporate travel business. Total corporate transaction value has grown by more than 30% to $12bn since 2019, representing organic market share gains in a market still down 10-15% from pre-pandemic levels. A leaner cost base and new corporate mandates should drive profitability over time. While leisure travel has peaked, increasing airline capacity and softer demand may result in higher commissions for distributors like Flight Centre. Led by founder Graham "Scroo" Turner, Flight Centre has a history of innovation and resilience in an industry that has decimated traditional travel agencies.

Commonwealth Bank (CBA) also detracted from performance. While the fund holds a moderate position, its portfolio weight is significantly below the benchmark weight of 10%. CBA is a high quality bank, with a strong brand and leading deposit and mortgage businesses. This translates into healthy net interest margins, a low cost-to-income ratio and ultimately a superior return on equity compared to its Australian peers. However, high levels of household debt in Australia and continuing price competition in mortgages (spurred by brokers who originate 75% of new home loans) means future earnings growth is muted, and sector arrears are rising. Yet CBA's valuation of 25x forward EPS is 3.5x standard deviations above its historical mean and far higher than similarly profitable global peers.

Mineral Resources (MIN) is befitting of a Shakespearean trajectory, following revelations of governance breaches, including undisclosed related party transactions and personal tax matters concerning founder Chris Ellison. While Ellison's business achievements should not be understated, these allegations overshadow them. The board faces a difficult decision, as Ellison is central to the business, but governance issues must be addressed. Given Ellison's critical role in our thesis for holding Mineral Resources, we exited the position, as poor governance often fosters poor cultures that can undermine any business. This decision to exit also aligns with leadership instability amid the ramp-up of the Onslow project.

ResMed (RMD) remains the fund's largest active position and continues to report strong sales and earnings growth, countering market concerns about GLP drugs. New patient activations are driving double-digit revenue growth, and its "razor and blade" model (with masks and accessories) is supported by re-supply as well as new patients. ResMed's latest platform, AirSense 11, is progressing well, with gross margin expected to improve as production scales. Additionally, ResMed is about to launch a new mask, the N30i, with a proprietary fabric-wrapped system for comfort. For context, RMD's price-to-earnings multiple is at a 10% discount to its ten-year average, just one point above CBA.

News Corp (NWS) was a top contributor to fund performance, without any notable news. During the month, we highlighted the enduring quality of News Corp in our article "Four Founder-Led Companies Worth Watching" (insert hyperlink). Under the leadership of Executive Chairman Lachlan Murdoch and CEO Robert Thomson, News Corp has transformed into a company with rapidly growing digital assets, now comprising over 70% of group EBIT. We believe the market is underestimating News Corp's exposure to the growing demand for AI platforms, as exemplified by its $250 million licensing deal with OpenAI over five years.

The short portfolio made a negligible contribution during the month, following a poor September. We are observing strength and volatility in lower-quality small to mid-cap companies, which we typically focus on due to their higher-than-average red flags. Although we attempt to mitigate this risk through diversification, the short book can be a drag on performance in strong market conditions. Over time, we believe prices will align with fundamentals, with red-flagged companies eventually correcting, as observed over 20 years of ASX200 index data, where poor accounting and economic metrics lead to bottom-quartile returns.

Outlook

The market remains sentiment-driven, influenced by growing passive and quantitative strategies and large wholesale funds. The narrow performance in market leaders is being compounded by cyclical headwinds for many ASX companies and investor reluctance to look beyond these challenges. CBA's meteoric rise exemplifies this sentiment, as investors accept lower returns for lower earnings risk, despite stretched valuations.

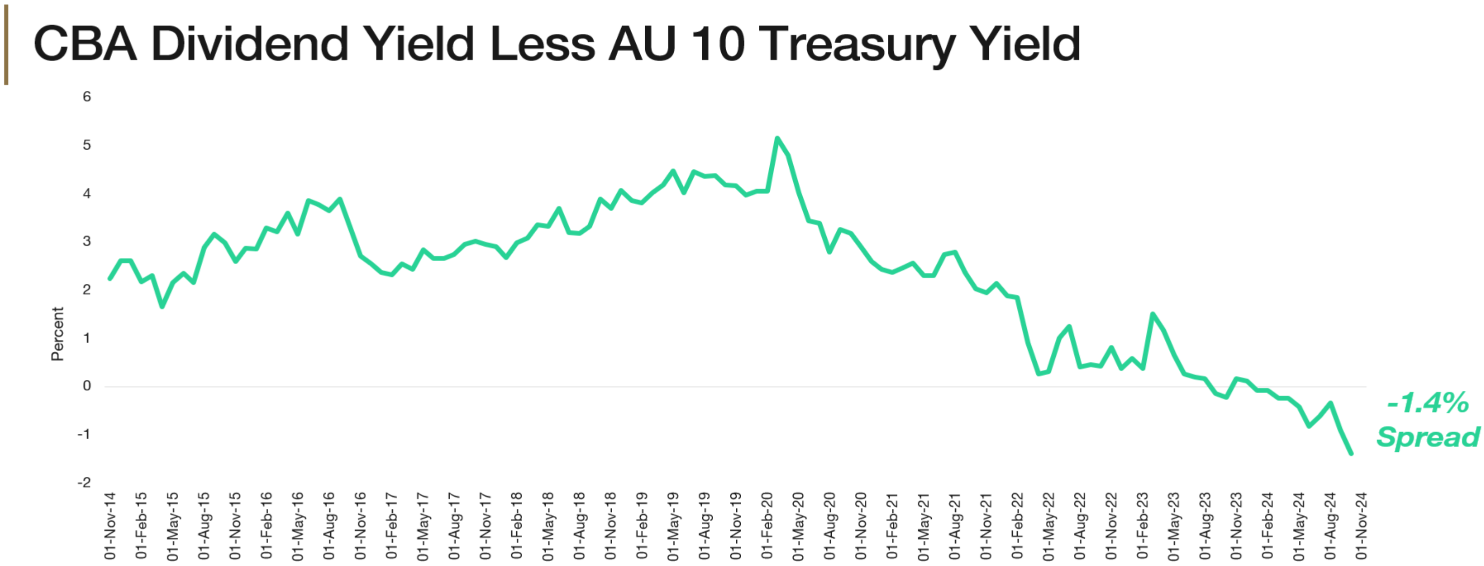
This environment is presenting opportunities for more patient investors such as ourselves, where we are finding attractive opportunities within housing-exposed, select discretionary retail, and interest-rate-sensitive sectors, where companies with long-term growth prospects and market positions remain strong despite recent sell-offs.

As always, we are invested alongside our clients.

Ray David   Joseph Koh   David Meehan

Chart of the Month

The spread between CBA's forward dividend yield and the 10-year Australian Treasury yield is now negative -1.4%.



Source: Blackwattle Analysis

How to Invest

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

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