

# Blackwattle Mid Cap Quality Fund



October 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.

### 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 no. of Stocks	20-35
Cash Limit	10%
Cash Distributions	Semi Annually
Redemptions	Daily
Constrained Capacity	\$2.0b (or up to 25bps of the benchmark)
Platforms	HUB24 IDPS & Super, Netwealth IDPS, BT Panorama IDPS & Super
Ratings	Lonsec - Recommended Zenith - Approved
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

14+ 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. Anc 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 October 2024.

	1 month	3 months	6 months	1 Year	2 Years	3 Years	Inception p.a <sup>2</sup>
Fund (Net)	0.90%	5.07%	10.47%	38.60%	-	-	18.53%
Benchmark <sup>3</sup>	-1.48%	3.50%	5.58%	25.32%	-	-	10.61%
Active Return	2.38%	1.57%	4.88%	13.29%	-	-	7.92%

<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, returns greater than 1 year are annualised<sup>1</sup> or "calculated on an annualised basis.

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

## Top 5 Holdings



## Market Commentary

The ASX300 ex-20 fell 1.48% in October. Global financial markets were softer in October, ending a 5-month rally, with the S&P500 falling 1.0%. Over the last few months, the US equity market has been in a “goldilocks” period of resilient US economic growth but with expectations of material rate cuts from the US Federal Reserve. However, stronger US economic data in October has shown the US economy to be stronger and inflation to be stickier than expected. Global bond markets have been faster to price this change, with the US 10-year bond yield rising almost 0.5% in October, and over 0.7% since the US Federal Reserve cut rates by 0.5% in mid-September. The Chinese equity market was the weakest globally, down over 3% after jumping over 20% in September. There were no further large and definitive fiscal announcements in October, disappointing the market. However, the policy pivot since September does show increased urgency and intent to provide more monetary and fiscal support to the Chinese economy.

On the ASX, Materials saw an unwind of their strong, Chinese-stimulus driven September performance to be the weakest sector in October. Financials and Communication Services were the best performing sectors, driven by solid results from the smaller banks and REA Group walking away from their attempted takeover of Rightmove UK.

## Portfolio Commentary

The Blackwattle Mid Cap Quality portfolio outperformed the ASX300 ex-20 benchmark by 2.38% during the month.

### **Key Contributor – Arcadium Lithium (LTM AU)**

LTM was the largest positive contributor to performance during the month. LTM rallied 94% in October on the back of a US\$6.7b bid from Rio Tinto (RIO). LTM is a vertically integrated global lithium chemicals producer, formed from the merger of the previously ASX listed Allkem and US listed Livent. We view LTM as highly unique given its vertical integration and growth potential. The Investor Day only a few weeks prior in September highlighted the value creation potential over the next few years. As long-term investors, we were very excited about this opportunity, and believed the stock was deeply undervalued, but needed execution and time, to see this potential value realised.

When details of the deal were leaked at a value of US\$4-6b, we advocated strongly to the LTM board through a public letter<sup>1</sup> to push for a price closer to US\$8b. Later that same week, LTM board announced the recommendation of a RIO bid of US\$6.7b. We were disappointed with this result, and we stand convicted that the sale price for LTM should be closer to US\$8b, based on replacement value and the Arcadium September 2024 Investor Day targets. LTM shareholders should be fairly compensated for the strategic value provided to RIO.

### **Key Detractor – Orora (ORA AU)**

ORA was the largest negative contributor to performance, falling 12% in October. ORA is a diversified, global packaging business with key exposures to glass and aluminum can beverage manufacturing in Australia and France. ORA provided a trading update at its AGM in October, and while there was no outright downgrade, ORA warned that Saverglass still faces a challenging backdrop in the near term. This was echoed in recent updates by European competitors, highlighting weak yet stable demand, disappointing some who expected emerging signs of recovery.

We had previously mentioned ORA as an ‘improving quality’ business that would require patience but was still attractive given the material valuation upside and a very strong balance sheet. The market continues to be fixated with shorter-term earnings without balancing the longer-term intrinsic value. As we have seen with LTM, deep value can retrace extremely quickly, we remain patient to capitalize the long-term valuation upside. Our conviction is supported by the sale of the US Packaging Distribution business, which positions ORA to start on-market buybacks, together with the strength of the high-quality Australian beverage packaging business. ORA now trades below the \$2.55 indicative bid from Lone Star, should the share price continue to languish, we would not be surprised to see further corporate attention.

## Outlook

The portfolio outperformed a softer market in October, with LTM being the key driver of the outperformance. We have been very patient with LTM, taking the long-term view that this highly strategic asset base was significantly undervalued. We have been buying into weakness the last few months to maintain a relevant position. While the Rio Tinto bid has been positive for October performance, we still feel disappointed that LTM Board and Management were willing to accept this highly opportunistic bid at the low point of the cycle, below replacement value. As it is our fiduciary duty to protect our clients’ interests, we will continue to advocate for a better price, and we will be VOTING AGAINST the Scheme of Arrangement in its current form.<sup>2</sup>

<sup>1</sup> <https://blackwattlepartners.com/letter-to-the-board-ltm/>

<sup>2</sup> <https://blackwattlepartners.com/blackwattles-response-to-riointos-us6-7b-offer-for-the-acquisition-of-arcadium-lithium/>

A continuing theme of recent commentary is that this remains a highly uncertain economic environment. This is only compounded with the US election, the only certainty being more fiscal and more debt. Bond markets have completely flipped in the month of October, from pricing in a hard-landing scenario with significant rate cuts to towards a no-landing with only moderate rate cuts remaining. However, equity markets at all-time highs appear to be pricing strong economic growth but more significant rate cuts. The market also continues to wait impatiently for further Chinese fiscal stimulus, especially post the US election with the risk of increased tariffs. This mixed environment tends to be rewarding for high quality companies as earnings certainty becomes a rarer commodity. We believe our portfolio companies are well placed into this dynamic.

There were four portfolio changes in October with 2 new positions. We took profits and sold out of 2 positions given the neutral risk/reward outlook. The first new position is a quality technology business that is moving into an earnings upgrade cycle for the first time in 2 years, which has not been fully captured by the market. The second position is a market-leading, global medical device business that we view as a high-quality, long-term compounder. The share price has materially underperformed since a solid August result was unable to meet inflated market expectations, providing an attractive entry point. 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.

We now look forward to upcoming results as an opportunity for our high-quality companies to demonstrate their ongoing strength, with September quarter earnings announcements due throughout November.

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.

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