Blackwattle Long-Short 130/30 Quality Fund

Blackwattle Investment Partners

December 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 Quality Fund
APIR	ETL3029AU
Inception Date	8 August 2023
Typical no. of Stocks	30-55 Long, 15-25 Short
Cash Limit	30% (typically +10% to -10%)
Cash Distributions	Semi Annually
Redemptions	Daily
Buy Sell Spread	0.25% upon entry and 0.25% upon exit
Fees	Management 0.92% | Performance 17.94%
Constrained Capacity	$5.0b (or up to 25bps of the benchmark)
Platforms	BT, Netwealth, HUB24, Macquarie, Expand
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.

Ratings

Recommended Lonsec Research

Zenith RECOMMENDED

Fund Performance[1]

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

	1 month	3 months	6 months	1 Year	2 Years	3 Years	Inception p.a[2]
Fund (Net)	-4.58%	-3.64%	4.07%	10.67%	-	-	11.71%
Benchmark[3]	-3.15%	-0.80%	6.93%	11.44%	-	-	12.61%
Active Return	-1.42%	-2.84%	-2.86%	-0.77%	-	-	-0.90%

[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. *Inclusive of Goods and Services Tax (GST) and net of any Reduced Input Tax Credits (RITC).

Track Record of Investment Strategy

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

	1 month	3 months	6 months	1 Year	2 Years	3 Years	Inception p.a[2]
Fund (Net)	-4.58%	-3.64%	4.07%	10.67%	12.17%	9.14%	13.69%
Benchmark[3]	-3.15%	-0.80%	6.93%	11.44%	11.93%	7.41%	11.07%
Active Return	-1.42%	-2.84%	-2.86%	-0.77%	0.24%	1.73%	2.62%

[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

ALS | CAR Group | LIGHT & WONDER | News Corp | ResMed

Market Commentary

The S&P/ASX 200 Total Return Index declined by 3.2% in December, bringing its cumulative returns for 2024 to 11.4%.

Reflecting on 2024, it was a remarkable year for risk assets, driven by six major themes:

1. The rapid rise of artificial intelligence (AI).
2. Animal spirits and market euphoria.
3. A return to Trump-o-nomics.
4. Chronic housing shortages.
5. The persistent slowdown of China's economy.
6. Increasing industrial action.
7. The ascent and decline of several founder-led CEOs.

Put simply, 2024 was a year of divergence, with Financials (+33%) and Technology (+48%) leading the way, while Materials (-14%) and Energy (-13%) lagged.

Trump's resounding victory brought US exceptionalism into focus. Protectionist policies, coupled with a resilient economy and strong job market, recalibrated interest rate expectations.

While this initially appeared positive, several high-quality cyclical US-exposed companies such as James Hardie (JHX), Bluescope (BSL) and Reece (REH) underperformed during the year, presenting opportunities to increase our holdings.

China's prolonged downturn and the potential impact of Trump's tariffs weighed heavily on resources in 2024. Comparisons between China's slowdown and Japan's lost decades have emerged, driven by negative population growth, contracting money supply, and stagnant housing markets.

We don't disagree with market views that China is challenged, but the quandary investors face is that resources valuations have becoming relatively compelling, even with a long-term iron ore price of $75-$80t. The growing valuation gap between materials and the broader market created opportunities to add to holdings where commodities face supply constraints, including South32 (S32), Whitehaven (WHC), and Anglo American (AAL).

Market returns in the year passed were also driven by shifting investor expectations. Recessionary fears, initially stoked by inverted bond curves and pessimistic market forecasts, gave way to economic resurgence. Bond yield volatility persisted, with the US 10-Year Treasury Yield closing the year at 4.7%, up from its October low of 3.6%.

Structural shifts in market behaviour are becoming more noticeable, spurred by the growth of index and thematic ETF funds alongside larger pools of wholesale capital. A peculiar case was Life360 (360), whose market cap surged 20% (+$0.9 billion) as it neared inclusion in the Russell 2000 index in September, only for that index change to be reversed, eroding gains.

Similarly, the meteoric rise in Commonwealth Bank (CBA) shares wrong-footed many managers, including us. CBA is now the world's most expensive bank, with a 1-year forward PE ratio of 26x—a statistical outlier, reflecting extreme valuation, or in other words, "Irrational Exuberance".

These developments highlight growing market inefficiencies, further challenging the Efficient Market Hypothesis. For active managers like us, this does create opportunities to construct portfolios of high-quality companies at reasonable valuations, positioning the portfolio for outperformance in more normalized market conditions.

Portfolio Commentary

The Blackwattle Long Short Quality Fund underperformed the S&P/ASX 200 benchmark by 1.42% in December.

Positive contributors

Transurban (TCL): The fund had been progressively adding TCL as its underperformance relative to the ASX200 improved its relative valuation. TCL is a collection of high-quality long duration assets, with significant pricing power. The NSW Government review into toll roads concluded during the month, with the NSW Government announcing a draft in Principle Agreement. While little information was disclosed, Transurban and investment partners expect to finalise the agreement shortly.

News Corp (NWS): During the month, News Corp announced the sale of Foxtel to DAZN for an enterprise value of A$3.4bn, representing 7x FY24 EBITDA. As part of the transaction, News Corp will re-coup its shareholder loans of $0.5bn and will hold a 6% interest in DAZN. DAZN is a private company which makes assessing the merits of this deal tricky, but from what we can see DAZN is growing rapidly (+50% yoy) and has over US$3.6bn in revenue.

The transaction implicitly values DAZN at US$17bn or c 25x-50x EBIT assuming DAZN makes a 5-10% margin, which of course is a very big assumption. Despite this, we see this transaction as a significant positive, given the market was essentially ascribing zero value to Foxtel. The sale de-levers NWS (by the deconsolidation of Foxtel debt), reduces the group's capital intensity, and provides a free option on DAZN's growth.

The deal clears another hurdle in NWS's simplification journey, leading to more focus on growth divisions i.e. Dow Jones, Digital Real Estate Services and Book Publishing.

Negative Contributors:

Carsales (CAR): During the month, CAR was elevated into the ASX 50 Index, which resulted in index tracking funds reducing their holdings. Beyond this, expectations of a shallower rate cycle have impacted new vehicle funding rates, which could mean a slower recovery in Carsales USA business, Trader Interactive (TI) for recreational vehicles and Power Sports.

Despite this, we are optimistic that CAR can generate strong medium-term revenue growth in Trader Interactive. Firstly, it's a clear leader with 3.0x the audience leadership of its nearest vertical leader, and its product offering is nascent compared with Australia, which presents opportunities to grow revenue from products that have been successful in Australia such as media, premium ad packages, data, as well as growth from new categories like Boating.

Bluescope (BSL): Underperformance reflects the collapse of USA Northstar Steel spreads (-22%), which is a proxy for EBIT per ton generated. Despite this, we continue to see Bluescope positioned well for a recovery, given:

1. Import tariffs on China steel imports, which will solidify domestic steel manufacturing economics;
2. Improved steel demand from onshoring and a recovery in end markets;
3. A strong balance sheet to withstand cyclical weakness, buttressed by significant freehold land holdings.

While Bluescope may not fit the traditional definition of Quality due to volatile earnings, we believe its Australian business is unique due to its ColourBond brand vertical integration which allows it to generate superior profitability relative to traditional steel mills.

Secondly the NorthStar Business is one of the lowest cost steel makers in the USA, driven by high utilisation and proximity to customers. Management also has a strong track record of value creation, as evident from the growth of ColourBond and the NorthStar acquisition.

The short book was a significant detractor to performance, driven by the outperformance of several low-quality speculative companies on little news flow. In fact, some of these holdings were quick to utilise share price strength to raise capital to fund operating losses and what we see as business models with weak fundamentals.

We aim to mitigate our shorts through hedges within the long book with higher quality companies within the corresponding GICS sector, however December proved to be a difficult month for the short positions based on strong market conditions. Our experience is that this volatility can be short lived, and if the fundamental outlook remains unchanged, market valuations will eventually reflect the earnings power of the business.

Outlook

As we enter 2025, themes from 2024 remain influential. However, the leadership of 2024's winners is not guaranteed, especially given stretched valuations in certain areas.

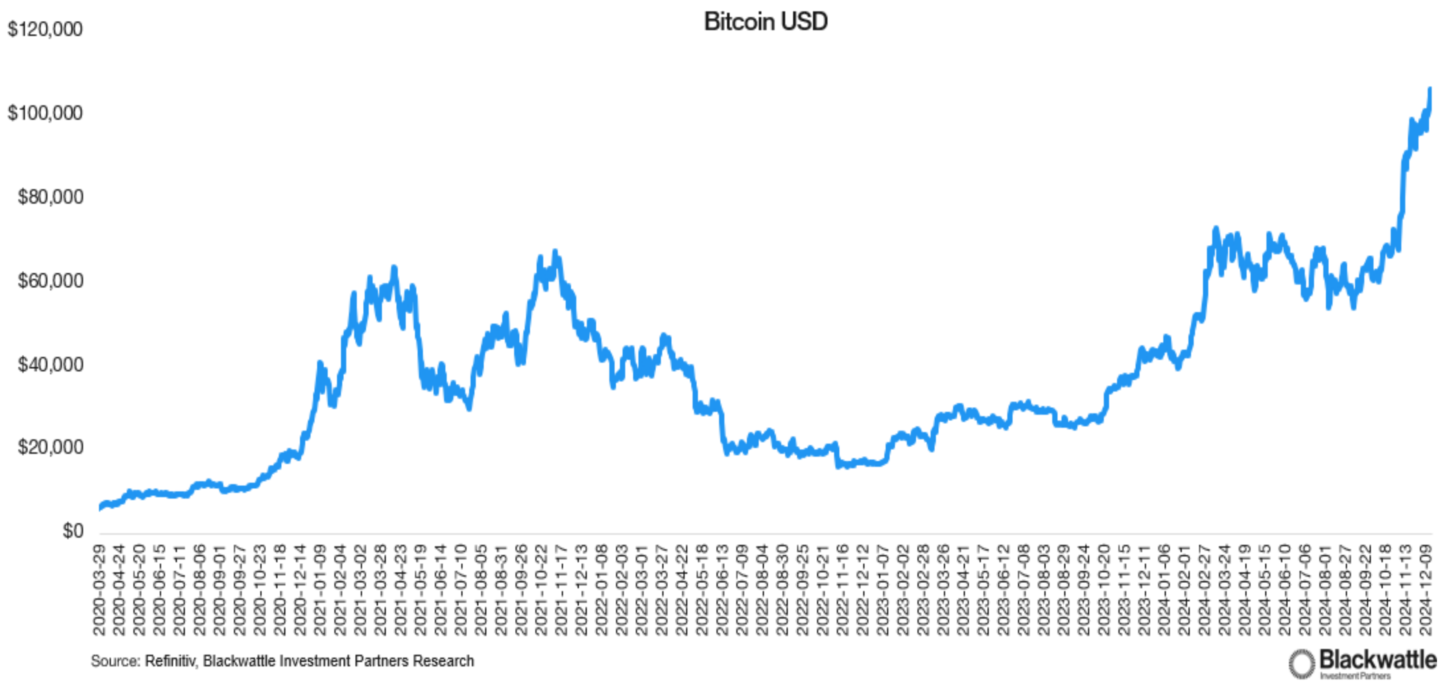
While the fund's recent underperformance has been driven by the strong outperformance of Banks, extreme valuations within these sectors set up the portfolio well to outperform if market conditions normalise.

While it is always difficult to call market turning points, our philosophy is that true investment success lies not in predicting the future but in adapting and thriving as it unfolds. By maintaining a disciplined approach focused on companies with strong qualitative attributes, aligned management teams, and reasonable valuations, we position ourselves to deliver long-term outperformance.

Chart of the Month

It is always hard to separate luck from skill in bull markets.

Animal Spirits and Market Euphoria



As always, we are invested alongside our clients.

Ray David | Joseph Koh | David Meehan

How to Invest

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

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