

Blackwattle Small Cap Quality Fund

December 2024



Blackwattle

Investment Partners

About the Fund

The fund aims to deliver outperformance through the cycle, irrespective of market direction or factor leadership. Our goal is to achieve higher relative returns with lower volatility.

As fundamental investors, we employ in-depth bottom-up research to identify the best quality Small Cap opportunities. We manage diversified portfolios, seeking returns from all sectors.

We prioritise active risk management and consider capital preservation at every stage of our investment process.

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 Small Cap Quality Fund
APIR	ETL0788AU
Inception Date	12 September 2023
Typical number of stocks	30-60
Cash limit	20% (typically 0-10%)
Cash Distributions	Semi-annually
Redemptions	Daily
Buy Sell Spread	0.25% upon entry and 0.25% upon exit
Fees	Management 1.13% Performance 20.5%
Constrained Capacity	\$750m (or up to 25bps of the benchmark)
Objective	The Fund aims to outperform the S&P/ASX Small Ordinaries Accumulation Index (after fees and before taxes) over the long term

Portfolio Managers



Robert Hawkesford

20+ years investment experience. Most recently in a small team at Ellerston Capital managing the institutional Australian Small Cap portfolio. Member of Ellerston's ESG and Broker Review Committees.



Daniel Broeren

20+ years investment experience. Extensive long and short experience. Most recently Portfolio Manager, Watermark Funds Management (Australian Long/Short). Previously Portfolio Manager of the Invesco Small Companies Fund.

Fund Performance¹

Blackwattle Small Cap 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)	-2.91%	-2.71%	9.77%	16.63%	-	-	19.88%
Benchmark³	-3.07%	-1.01%	5.46%	8.36%	-	-	11.53%
Active Return	0.17%	-1.70%	4.32%	8.27%	-	-	8.34%

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 12 September 2023. Returns greater than 1 year are annualised' or "calculated on an annualised basis. ³ Small Ordinaries Accumulation Index. * Inclusive of Goods and Services Tax (GST) and net of any Reduced Input Tax Credits (RITC).

Top 5 Holdings



MAAS

PEXA



ZIP

Market Commentary

The ASX Small Ordinaries Accumulation index fell 3.1% in December, with both Small Resources and Small Industrials falling by 3.1%. Energy and defensive sectors such as Consumer Staples and Healthcare performed strongest, while a sharp rebound higher in bond yields, driven by an upward revision to the US Federal Reserve's "dot plot" mid-month, led to some profit taking in Financials and Tech, which were two of the best performing sectors in 2024.

Overall, in 2024 Small Caps achieved a gain of 8.4%. Growth stocks were the standout performers for the year, led by tech and wealth platforms. Resources stocks performed the worst, as strength in gold was offset by weakness in energy, and China-facing commodities including bulks and critical minerals.

Portfolio Commentary

The Blackwattle Small Cap Quality Fund outperformed the ASX Small Ordinaries Accumulation index by 0.17% in December.

Key Contributors to performance in December were Beach Energy (BPT) and not owning Ventia (VNT).

Beach Energy (+13.4%) hosted a site trip this month to its Waitsia gas plant development outside of Perth. Delays to the completion of this project have weighed on the share price for most of CY24, so an announcement that the project is now on-track for completion was well received, seeing the stock up 13% in the month. At full ramp-up Waitsia will bring significant cash-flows to the Group and therefore optionality for management. We see BPT as a potential consolidator of domestic energy assets, with the completion of Waitsia being the key facilitator.

Ventia Services fell 20.9% in December after the ACCC announced it had initiated civil cartel proceedings against the company. The ACCC is alleging that both Ventia and Spotless (a subsidiary of Downer (DOW)) engaged in price fixing of 'Estate Maintenance and Operation Services' (EMOS) contracts for the Department of Defence. Investigations are underway with the key risks being reputational damage and the potential impact on future Defence contract wins. The fund does not own Ventia or Downer.

Key Detractors from performance in December were Mesoblast (MSB) and WEB Travel Group (WEB).

Mesoblast Limited shares rose 75% in December however the company was not held by the fund. MSB received FDA approval for Ryoncil, a cell-based therapy for the treatment of SR-aGvHD, a severe complication of stem cell transplantation. This is the first cell-based drug to be approved by the FDA and Mesoblast's approval process has been drawn-out and complicated. As the company now approaches commercialisation phase of Ryoncil it will require a different management skillset which we are unsure MSB management has. Nonetheless, gaining FDA approval has increased the value of the business which might evidently be worth more in the hands of others.

WEB Travel Group (-10.9%) was a detractor in December, largely reflecting a consolidation of gains from November. The fund initiated a position in the company post a downgrade to the near-term earnings outlook in October. The share price was down 50% from its July highs where the stock had rallied post a March strategy day where highly regarded CEO John Gusic outlined his long-term plans for the business including growth in Total Transaction Value (TTV) from \$4bn this year to \$10bn in 2030. The softness in near-term trading outlined in October gave cause for the market to question the viability of management's long-term targets. However, at the company's recent interim result announcement in November Gusic reaffirmed his commitment to the long-term targets. While time will tell if these targets are achievable, we believe there is little in the current price for them with the stock trading at 17x FY26 EPS, and Gusic's stellar track record suggests he deserves the benefit of the doubt.

Outlook

The 8.4% performance achieved by the ASX Small Ordinaries in 2024 was a relatively poor result given the strength of the ASX100 (+11.7%) and global equity markets (S&P 500 +23.3%). The much-anticipated outperformance of small caps is yet to take place.

As mentioned above, leadership within the Small Cap index has been driven by a small basket of high-quality growth companies and the gold sector. This has seen valuations between the most expensive stocks and the cheapest stocks expand materially.

While not impossible, the valuation disparity emerging is unlikely to continue at the same rate, suggesting the winning trades of recent times will be harder to sustain. Adding to this a more hawkish tone for future interest rate moves from the US Fed in December has the potential to derail long-duration stocks that have led market performance for the last 2 years. Indeed, there is a risk that the Fed doesn't deliver any interest rate cuts at all in 2025. This concern was already evident in December where the market pullback saw a number of 2024's top performers impacted most; ZIP (-13%), GTK (-11%), 360 (-11%).

If the rally is to continue, we will likely need to see a broadening of the market which may favor stocks that were left behind in 2024. As such, we have been focused on recycling profits into new opportunities that not only protect prior gains but set up the fund for another leg. Our factor settings are largely neutral, reflecting heightened market volatility. Our core strategy remains focused on companies with competitive advantages and excellent management teams positioned to excel in any macro environment.

Dan & Rob

How to Invest

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

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