30 JUNE 2023

# EQUITY ALPHA PLUS FUND

PARADICE
INVESTMENT MANAGEMENT

| PERFORMANCE NET (%) | 1 MONTH | 3 MONTH | 1 YEAR | 3 YEAR | SI* P.A. |
|---|---|---|---|---|---|
| Equity Alpha Plus Fund | 1.62 | 1.39 | 18.86 | 19.89 | 13.57 |
| S&P/ASX 200 – Total Return Index | 1.76 | 1.01 | 14.78 | 11.12 | 5.74 |
| Excess Return | -0.14 | 0.38 | 4.08 | 8.77 | 7.83 |
| | | | | | *Since Inception date (SI) – 12 July 2019 |

Past performance of the Fund is not a reliable indicator of future performance. The value of an investment in the Fund may rise or fall. Returns are not guaranteed by any person. Fund returns are calculated before tax, after ongoing management costs and any accrued performance fees, and assumes the reinvestment of distributions. Returns greater than 1 year are annualised.

## INVESTMENT OBJECTIVE

The Fund aims to outperform the S&P/ASX 200 Total Return Index (after fees and before taxes) over the long term.

## LEAD PORTFOLIO MANAGER

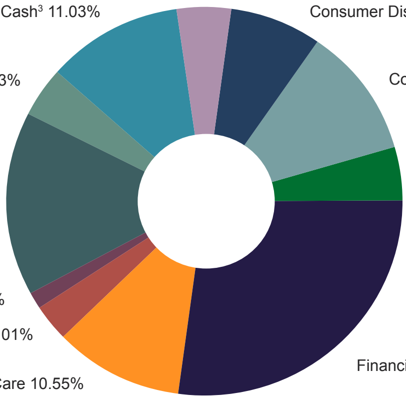
Tom Richardson

## FUND OVERVIEW

This Fund uses a detailed fundamental research process to invest in stocks that are well placed for the future (longs) and takes advantage of stocks we believe have cyclical and structural headwinds (shorts). The Long/Short investment style is designed to enhance returns and manage downside risks.

| MARKET EXPOSURES | |
|---|---|
| Long | 111.52 |
| Short | -17.75 |
| Net | 93.77 |

## SECTOR ALLOCATION




| KEY DETAILS | |
|---|---|
| Number of Holdings | 82 |
| Portfolio Dividend Yield | 3.92% |
| Fund Size (AUD) | $131M |
| Redemption Price | $1.2931 |

| TOP 10 POSITIONS | WEIGHT % |
|---|---|
| BHP Group Ltd. | 10.64 |
| CSL Ltd. | 7.18 |
| Commonwealth Bank of Australia | 5.85 |
| National Australia Bank Ltd. | 5.64 |
| Wesfarmers Ltd. | 5.50 |
| ANZ Group Holdings Ltd. | 5.03 |
| Coles Group Ltd. | 4.17 |
| Telstra Group Ltd. | 3.81 |
| Woolworths Group Ltd. | 3.22 |
| QBE Insurance Group Ltd. | 2.69 |

| FUND DETAILS | |
|---|---|
| APIR Code | ETL8096AU |
| Distribution Frequency | Semi-Annually |
| Management Fee[1] | 0.99% p.a. |
| Performance Fee[2] | 15% p.a. |
| Buy Sell Spread | +/- 0.30% |
| Minimum Investment | $20,000 |
| Stock Range | Long 20–60, Short 0–50 |
| Cash Range | 0–20% |

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*Performance in AUD unless otherwise noted.*

## MARKET REVIEW

Global equity markets advanced again this quarter on surprisingly robust ongoing economic growth. The MSCI World Net Total Return Index rose 6.83% (in USD)[1] versus the March 2023 quarter. The JP Morgan Global Composite Purchasing Managers Index (PMI) has risen every month this year and was at an expansionary 54.4 for May, with strength mainly in Services and in the US, Japan and Europe. The S&P/ASX 200 Total Return Index though improved just 1.0%. Australia underperformed global markets due to a greater exposure to Materials which underperformed, and smaller weighting to IT which outperformed.

Materials were one of the weakest sectors of the S&P/ASX 200 Total Return Index, declining 2.5%, as China's post-COVID reopening has disappointingly not been meaningfully boosted by government stimulus and the Bloomberg Commodities Index fell 2.6% (in USD). Healthcare though was the worst sector, declining 3.2%, as CSL warned of slower growth. IT was the best sector, rising 21.1%, boosted by strong updates from Xero and WiseTech. Positive sentiment from the US Technology laden NASDAQ's performance potentially also helped as it rose 13.1% (in USD) on optimistic artificial intelligence news flow. Insurance performed well (+10.7%) on ongoing premium rate rises. AREITS outperformed slightly (+3.4%) as they found some valuation support.

The prospect of recessions globally remains on the horizon. In the US, their 2-to-10-year yield curve inversion is now out to 106bp, which is up another 50bp over the quarter. US Headline inflation has eased somewhat as logistics constraints and Goods demand has largely normalised. However the Core Personal Consumption Expenditures (PCE) Inflation (which is the Fed's preferred measure) was 4.6% in May, so remains stubbornly high, driven by ongoing Services demand. Bloomberg contributing economists' US 2023 Real GDP growth expectations is just 1.3%, and they are forecasting a 65% probability of a recession.

The economic outlook for Australia deteriorated over the quarter. Prospects for our biggest trading partner, China weakened. Core inflation for the March 2023 quarter was a problematic 6.6%. The RBA increased the Cash Rate Target 50bp over the June quarter. The Westpac consumer confidence index dropped to 79.0 in May (from its peak of 118.78 in April 2021). The Australian 2-to-10-year yield curve deteriorated 54bp and became inverted (by 19bp) for the first time this cycle. Bloomberg contributing economists' Australian 2023 Real GDP growth expectations weakened slightly to just 1.5%, and they are now forecasting a 50% probability of a recession, which is up from 35%.

The Bloomberg Commodity Total Return Index (in USD) declined 2.6%. All the key commodities fell, largely due to China's failing to provide any material stimulus. Iron Ore fell 12.2% (in USD) and Coking Coal 13.4% (in USD). Brent eased 6.1% despite OPECR's commitments to reduce supply. Gold was down only 2.5% (in USD) as financial market risks remained.

BHP completed its acquisition of OZ Minerals. Allkem signed an agreement to acquire Livent. Liontown Resources rejected a proposal from Albemarle.

## ENVIRONMENTAL, SOCIAL, GOVERNANCE ISSUES (ESG)

The Australian Government's announcement of a Critical Minerals Strategy last month is the latest in a slew of global policy developments related to critical minerals as countries look to ensure they have the resources needed for both the energy transition and sovereign capability. Critical minerals include lithium, cobalt, nickel, copper, manganese and rare earth elements, inputs needed for decarbonisation technologies such as Electric Vehicle (EV), wind turbines and solar power infrastructure as well as other essential products.

Significant demand growth is forecast for critical minerals as countries move to meet emissions reduction goals, and governments have been increasingly wary of both ensuring supply and building capabilities to refine these materials. Currently, China overwhelming dominates global supply chains when it comes to many critical minerals. Even where other countries have large endowments of raw minerals, they may face challenges as the processing and refining of critical minerals can be expensive, technically complex and energy intensive.

Australia has joined the European Union and United States, among others, in policy responses ultimately aimed at diversifying global supply chains. The Critical Minerals Strategy provides a framework for Australia to grow the sector out to 2030 and came with a funding commitment of an additional $500 million for critical minerals projects (through the Northern Australia Infrastructure Facility). This is on top of a $2 billion Critical Minerals Facility previously announced. While the strategy itself lacks certain detail and funding commitments close to the scale of investment required, it evidences the direction of travel with respect to policy support for the sector.

International partnerships will also be a key part of the equation and Australia has already inked deals with allies. In May the Australia-US Climate, Critical Minerals and Clean Energy Transformation Compact was signed. Alongside agreements such as this, we are delving deeper into the possibilities for Australian companies and projects that will be able to access the benefits of the groundbreaking US Inflation Reduction Act. Earlier in the year, Australia also advanced an investment partnership with India to develop critical minerals supply chains between the two countries.

In Australia's case, a country with abundant mineral resources, there are significant opportunities across the mining sector to become a reliable alternative supplier of many critical minerals. Australian companies may also have unrealised opportunities in value-adding processes such as refining raw materials into usable products, rather than just extraction. As policy support deepens, we see upside for the increasing number of ASX-listed miners with exposure to these resources.

## ENGAGEMENT

During the quarter, we undertook a total of 24 engagements in which we explicitly discussed ESG matters, with 17 companies relevant to the strategy. Of these, 42% were held at either board or executive level, with the majority this quarter with sustainability or other relevant internal teams. The engagements covered a range of issues and most meetings discussed multiple ESG matters. The most commonly discussed topics were climate transition, conduct and stakeholder relations (including Traditional Owners), and environmental management.

In the period we held a meeting with Telstra Corporation and the heads of several business functions dedicated to climate change and cyber resilience. We sought to better understand how climate analysis had been undertaken and offered feedback for forthcoming reporting. The company's use of carbon offsets was also a focus; pleasingly Telstra is working towards a portfolio dominated by removal and co-benefit credits. With respect to cyber resilience, Telstra was able to give us comfort that it has a leading approach, driven by a highly capable team. A current focus of the cyber and data teams is assessing ways to use generative Artificial Intelligence safely.

We also had a modern slavery focused meeting with relevant Coles Group team members. We learned more about how the company coordinates its response across multiple business functions, as well as how the company is supporting capacity in Australia for social audits through its contracts with two audit firms. This approach also means it can share social audit costs with some of its smaller agricultural-based suppliers.

[1] For the purposes of comparison commentary is quoted in Australian dollar terms and Australian sector returns refers to the S&P/ASX 200 Total Return Index unless stated otherwise.

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PARADICE
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## OUTLOOK AND POSITIONING

Interest rate expectations in Australia moved higher through the quarter. This will ultimately act to slow the economy. Australian rates, although rising, still lag many developed market peers. The current strength of economic data suggest rapid disinflation appears unlikely. The Fund remains defensively positioned, although we own several cyclical businesses that are appropriately priced for the higher interest rate environment. These include Wesfarmers, Bluescope Steel and Domain Holding.