EQUITY ALPHA PLUS FUND

PARADICE
INVESTMENT MANAGEMENT

PERFORMANCE NET (%)	1 MONTH	3 MONTH	1 YEAR	3 YEAR	SINCE INCEPTION* P.A.
Equity Alpha Plus Fund	-3.84	2.66	1.02	12.14	11.78
S&P/ASX 200 – Total Return Index	-6.17	0.39	-7.69	2.67	2.76
Excess Return	2.33	2.27	8.71	9.47	9.02

*Inception date – 12 July 2019

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

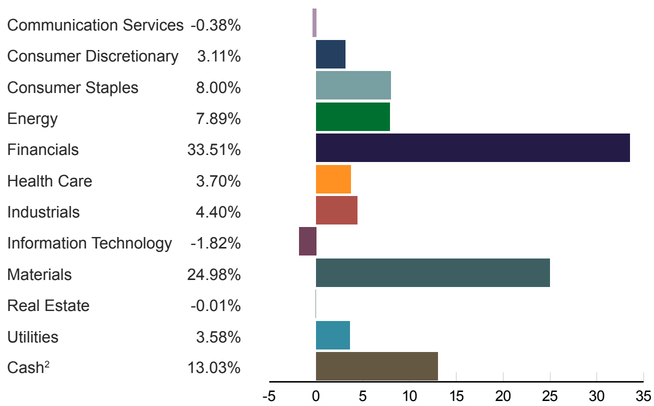
Tom Richardson

FUND OVERVIEW

With a focus on capital preservation, this fund uses a detailed fundamental research process to invest in stocks that are well placed for future growth (longs) and takes advantage of stocks we believe have structural headwinds (shorts). The Long/Short investment style is designed to enhance returns and manage downside risks.

MARKET EXPOSURES	
Long	107.47
Short	-14.51
Net	92.96

SECTOR ALLOCATION



KEY DETAILS	
Number of Holdings	68
Portfolio Dividend Yield	5.98%
Fund Size (AUD)	$105M
Redemption Price	$1.1387

TOP 10 POSITIONS	WEIGHT %
BHP Group Ltd.	13.60
National Australia Bank Ltd.	8.77
Commonwealth Bank of Australia	5.22
Woodside Energy Group Ltd.	4.84
Coles Group Ltd.	4.03
CSL Ltd.	4.01
QBE Insurance Group Ltd.	3.71
Westpac Banking Corporation	3.70
Rio Tinto Ltd.	3.68
Macquarie Group Ltd.	3.67

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

EQUITY ALPHA PLUS FUND

PARADICE
INVESTMENT MANAGEMENT

Performance in AUD unless otherwise noted.

MARKET REVIEW

Global equity markets fell over the quarter on concerns inflation will remain higher for longer and as central banks raise interest rates to choke off inflation, a deteriorating economic growth outlook with a heightened possibility of recession, and concerns of worse humanitarian outcomes from Russia's war on The Ukraine. The MSCI World Net Total Return Index fell 6.19% (in USD)[1] over the quarter. The S&P/ASX 200 Total Return Index however eked out 0.4%. The smaller decline in Australian equities was due to less exposure to Technology stocks which suffered heavy falls overseas, and greater exposure to Coal and Battery-material stocks that performed well.

Headline inflation remained elevated at 8.3% in the US in August 2022 yoy, and accelerated to 6.1% in Australia in the June quarter yoy, due to ongoing impacts from the Ukraine invasion and COVID overstimulation. The US Federal Reserve lifted their target rate by 150bp over the June quarter from 1.75% in June to 3.25% in September. The Reserve Bank of Australia (RBA) lifted rates 105bp over the quarter, plus another 25bp on 4 October, from 0.85% in June to 2.6% on 4 October. The US Fed's moves could be characterised as hawkish, but the RBA's 25bp increase on 4 October was less than the 50bp risk case as the Board appeared to favour a 'pause' given "The cash rate [had] been increased substantially in a short period of time". So, while the bond market futures now imply US rates peaking at ~4.4% (for April 2023), which is broadly in line with prior peak expectations, the domestic futures implied peak rate came back to ~3.5% (for May 2023), from a prior peak of ~4.0%.

Bloomberg contributing economists' US 2023 Real GDP growth expectations fell back to 0.8% from 1.9% in June, and they are now forecasting a 50% probability of a recession. The US 10-year government bond yield rose 82bps and the 2-to-10-year US yield curve flattened 51bps to become inverted by 45bp, which is an indicator of an impending recession. The situation is not as dire in Australia with the Bloomberg economists' 2023 Real GDP growth expectations still at 2.2%, versus 2.5% in June, and only a 25% probability of recession. The Australian 10-year rose 23bps and 2-year 68bp, so although the curve here also flattened 46bp, the curve remains positive by 58bp.

The Bloomberg Commodity Total Return Index declined by 4.1% (in USD). Thermal coal rose 12.37% (in USD) as Europe removed restrictions on coal fired electricity generation. Spodumene jumped 24.22% (in USD)% on continued strong demand, particularly from Chinese auto manufacturing. Brent weakened 23.39% (in USD) as China and India bought Russia's oil exports. Iron Ore fell 18% (in USD)% on slower demand from China.

Energy was the strongest sector of the S&P/ASX 200 Total Return Index rising 5.9% on the back of the stronger oil price. Banks rose 3.77% on an improved Net Interest Margin outlook helped by higher rates. Materials were largely in line, but with Battery-material stocks driving strong positive performance within the sector on the back of higher Spodumene. Staples, Industrials, REITS and Utilities underperformed due to a deteriorating earnings outlook and/or as their valuations were negatively impacted by higher rates due to the long-dated nature of their cashflows. On corporate activity, BHP bid for OZ Minerals, and private equity bid for Genex Power, while Atlas Arteria and Ramsay Health Care takeover offers were withdrawn.

OUTLOOK AND POSITIONING

We anticipate elevated inflation and increasing interest rates to continue medium term, albeit expectations are peaking. A recession in the US and Europe is a possibility, and economic growth will slow in Australia. The prospect of a humanitarian crisis in Europe over winter and war is real.

Material US higher inflation surprises are now likely behind us. Headline US inflation should ease over the next 3 to 6 months as Goods demand (relative to Services) normalises, although core inflation still faces headwinds from higher Shelter and Services costs. There are signs though that the US Federal Reserve's rate rises so far are having the desired effect. The September 2022 Institute of Supply Management (ISM) reading fell back to 50.9, where 50 indicates neutral. Parcel service operator, Fedex said mid-September that volumes are declining in every region globally. On Employment, there was a ~10% reduction in US job openings in August 2022 MoM. Technology companies, Google and Meta are now showing restraint in new hiring. Economists' forecast the US Federal Reserve likely needs to raise the Fed Funds rate to circa 4.0% to 4.5% to choke off these inflation problems, which has remained broadly stable. The Fed still has a narrow path to walk to achieve a slowdown without tipping the economy into a recession. Economists' forecast the possibility of a US recession at 50%.

Europe and the UK however appear more vulnerable to a hard landing given double digit inflation exacerbated by the energy crisis, prompting an aggressive rate hiking responses from the Bank of England. The significant depreciation of the EUR and GBP has resulted in headwinds for companies with exposures to these regions.

In Australia, the challenge so far doesn't appear as great as wage growth has been a more acceptable 2.6%. However, Australia now faces increased inflationary risks as the Fair Work Commission decision on Minimum Wages has filtered through to other sectors with the Financial Services Union, for example, asking for 5% plus an extra week of holiday, equating to 7% in total; and as other price increases continue, for example, the supermarkets are now on their third round of increases. The RBA chose to 'pause' in making the decision to increase only 25bp on 4 October, and not the more aggressive 50bp alternative, which may risk elongating this cycle. That all said, economists still conclude the challenge in Australia is less than in the US, and rates may not need to go as high. Economists forecast the possibility of a recession in Australia at 25%.

Growth expectations have come back to more normal levels as mentioned above. However, monetary authorities have not managed a slowdown of this magnitude in the past without it ultimately leading to a recession. That said, given the current strength of the economy, we don't see a recession in Australia as likely in the short-term. Employment is currently strong, and households and Small and Mid-sized Enterprises (SMEs) have considerable savings to buffer against higher mortgage rates and inflation for a period. There does not appear to be a systemic risk to the economy like there was in the lead-up to the Global Financial Crisis.

The Fund is overweight Commodities where supply and demand fundamentals are attractive, due to underinvestment, lifting cash flow generation and valuation support. Exposure to battery material stocks has been reduced following share price outperformance, and as the stocks moved ahead of their commodity price indexes; however, an overweight has been maintained due to the sector's long-term strategic outlook.

The Fund is now overweight Banks on an improved Net Interest Margins (NIM) outlook due to higher rates, and on expectations loan losses will take longer to materialise. The portfolio is still exposed to Insurance companies, which are now benefiting from increasing their pricing.

Within Consumer, the Fund is positioned in air travel where we see pent up demand. The Fund is overweight defensive Consumer Staples. Within Industrials overall, the portfolio is only exposed to stocks with pricing power to take advantage of the inflationary environment. We see margin expectations for Industrials generally too high. Strong demand over COVID may be replaced by cost inflation next.

The Fund is underweight IT, Healthcare, Infrastructure and Communications where valuations tend to be negatively impacted by rising rates due to the long-dated nature of their cash flows.

[1] Australian sector returns refers to the S&P/ASX 200 Total Return Index unless stated otherwise.