30 JUNE 2023

AUSTRALIAN MID CAP FUND – CLASS B

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INVESTMENT MANAGEMENT

PERFORMANCE NET (%)	1 MONTH	3 MONTH	1 YEAR	3 YEAR	5 YEAR	SI* P.A.
Australian Mid Cap Fund – Class B	0.98	2.07	9.83	9.45	5.10	7.15
Mid Cap Composite Benchmark[1]	0.76	3.03	15.08	10.99	6.85	8.46
Excess Return	0.22	-0.96	-5.25	-1.54	-1.75	-1.31
						*Since Inception date (SI) – 15 May 2017

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 Mid Cap Composite Benchmark[1] of 70% of the S&P/ASX Mid Cap 50 Total Return Index and 30% of the S&P/ASX Small Ordinaries Total Return Index over a three to five year period (after management costs and before tax).

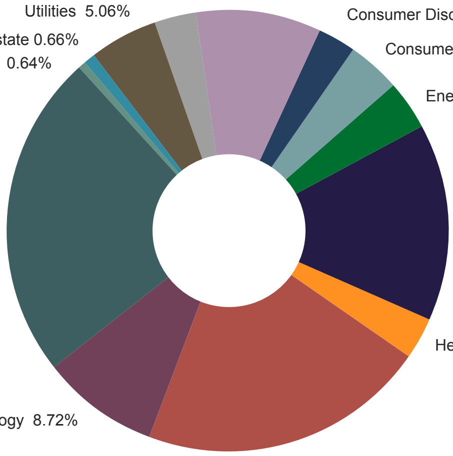
LEAD PORTFOLIO MANAGER

John Lake & Matthew Riordan

FUND OVERVIEW

The highly experienced team have a focus on downside protection and aim to generate strong, long term risk-adjusted returns.

SECTOR ALLOCATION



KEY DETAILS	
Number of Holdings	51
Portfolio Dividend Yield	2.74%
Fund Size (AUD)	$80M

TOP 10 POSITIONS	WEIGHT %
Carsales.Com Ltd.	5.10
Wisetech Global Ltd.	4.52
Orica Ltd.	3.74
Steadfast Group Ltd.	3.50
Aurizon Holdings Ltd.	3.37
Seven Group Holdings Ltd.	3.26
AGL Energy Ltd.	3.21
IGO Ltd.	3.20
ALS Ltd.	3.16
Ampol Ltd.	2.91

FUND DETAILS	
APIR Code	ETL8772AU
Distribution Frequency	Semi-Annually
Management Fee	1.10% p.a.
Performance Fee[2]	15% p.a.
Buy Sell Spread	+/- 0.25%
Minimum Investment	$20,000
Stock Range	Typically 40–60
Cash Range	0–10%

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Performance in AUD unless otherwise noted.

MARKET REVIEW

The Australian market was resilient over the June quarter despite ongoing rate hikes from the RBA. The S&P/ASX 50 Mid Cap Total Return Index led the way with a total return of 4.59%. The S&P/ASX 50 Total Return Index generated a total return of 0.66% whilst the more consumer impacted S&P/ASX Small Ordinaries Total Return Index returned a negative 0.54%. The USA market was the standout, with the tech heavy S&P 500 Total Return Index up 8.7% (in USD), the NASDAQ Total Return Index itself up a whopping 13% (in USD) and the more industrial driven Dow Jones Industrial Average Total Return Index up 3.8% (in USD).

The equity market moves were all seemingly at odds with the fixed interest rate markets. The Australian 10 year bond rate increased from 3.3% to 4% over the quarter, whilst the US 10 year bond yield increased from 3.5% to 3.8%. There seemed to be some bounce back after the regional bank scare in the March quarter plus markets looking for growth, despite the "duration" nature of tech stocks versus bonds and, as mentioned above, the Nasdaq was again the standout global index in the June quarter. In late May NVIDIA Corp provided a very positive update, drawing the markets attention to the rapid adoption of generative Artificial Intelligence. This provided further focus on the growth attributes to be found within the sector.

Inflation, interest rates, employment and recession continued to be dominant themes through the quarter. After hiking the Fed Funds target range by 25bps from 5.0% to 5.25%, in May, the Fed paused in June. The rationale was to allow time to assess the impact of the prior rate hikes on the economy and the effects of banking stresses on credit availability. In Australia, the situation was not too dissimilar. After a pause in April, the RBA raised rates by 25bps in each of May and June meetings, taking the cash rate to 4.1%. Since the quarter end, the RBA paused with its hiking cycle in early July. With the RBA having a "flexible" inflation target of 2 to 3% "on average, over time", and the RBA May monthly CPI indicator signalling 5.6% versus the last actual March quarter CPI read of 7.0%. The key areas to watch going forward are the risks of a wage spiral which will underpin ongoing spend, and services inflation (holiday travel, medical services, rents etc) which has been continuing to rise.

Anecdotes from the market would indicate that there are signs of consumer stress with a number of consumer related stock downgrades. This has been reflected in the underperformance of the Consumer Discretionary sector as the market expects further negative retail spending trends. Whilst there has been a lot of focus on the "mortgage cliff" (fixed rate mortgages entered into at enticing low rates during COVID rolling over into variable rates in some cases 3 times higher), the steady climb in rates for variable mortgage holders would also be starting to bite.

Employment remains strong. The May unemployment rate sat at 3.5%, where it has been for the better part of the last year. With pressures on sourcing labour, the borders have been opened with some sources estimated net migration could reach 300,000 versus treasury forecasts of 225,000. This has raised the questions of accommodation shortages, with rental costs rising strongly from COVID driven lows, and house price growth being positive in many areas, despite all the rate hikes.

PERFORMANCE

The Paradice Australian Mid Cap Fund (the Fund) delivered a positive return for the quarter of 2.07%, which was 0.96% below the Mid Cap Composite Benchmark. The main contributor to this was more stock specific than from a sector perspective which is evident in the positives and negatives from an attribution perspective in the next section of this quarterly update.

Corporate activity was fairly muted. BHP's takeover of OZ Minerals was completed and a proposed merger between USA listed Livent and Allkem was put to the market.

Positives

Bank of Queensland (BOQ) – Underweight

Management changes and question marks over integration of ME Bank.

Vicinity Centres (VCX) – Underweight

Retail shopping centre owner: raising cap rates and a consumer under pressure.

AUB Group Ltd (AUB) – Overweight

Insurance Industry doing very well in current environment and optimism over Tysers acquisition.

Perseus Mining (PRU) – Underweight

Perseus operates gold mines in Africa and one of the planned new projects is located in Sudan where there has been recent unrest.

AGL Energy (AGL) – Overweight

AGL is benefitting from the squeeze in energy availability for the retail market and could also enter into some attractive new energy partnerships.

Negatives

EBOS Group (EBO) – Overweight

EBO lost the Chemist Warehouse contract to Sigma.

Champion Iron (CIA) - Overweight

Iron ore price weakness on the back of Chinese growth slowdown.

ALS Limited (ALQ) – Overweight

ALS has been sold off on the back of concerns that resource mineral exploration is cooling off, leading to less samples being processed by ALS.

IDP Education (IEL) – Overweight

Pearsons received approval for their English Language Test to be used for student visa applications, a market where IDP has previously had dominance via its IELTS offering.

A2 Milk Company (A2M) – Overweight

Despite attaining re-registration from China for A2 Infant formula, the sell off is due to concerns about the Chinese birth rate and concerns about excess old stock as A2 moves to the new formulation.

PORTFOLIO CHANGES

Purchases

AGL Energy Limited (AGL)

We added AGL as confidence grew about the resilience of their earnings going forward and their ability to capture greater margin given the energy environment we are in as the transition to greener alternatives plays out over time.

Aurizon (AZJ)

We increased our position in AZJ given the infrastructure like nature of their earnings.

Evolution Mining (EVN)

Improving operating metrics for this large scale gold producer.

IGO Limited (IGO)

We increased our exposure to IGO for their Lithium and Nickel exposures.

NIB Holdings (NIB)

NIB offers good exposure to the Health Insurance sector plus their entry into assisting in the management of the large NDIS program offers further upside.

Sales

ALS Limited (ALQ)

Profit taking as we see some shorter-term risk over the level of capital raises amongst junior miners to fund exploration.

Ampol (ALD)

Concerns over an increase in global refiner capacity which will negatively impact refiner margins.

Corporate Travel (CTD)

We believe the recently awarded UK Home Affairs contract to accommodate refugees elevates human rights issues and could pose some unforeseen risks for CTD.

Incitec Pivot (IPL)

IPL has been a perennial disappointment with gas contract supply concerns for Phosphate Hill which raises concerns about the company's ability to return excess capital from asset sale to shareholders.

OZ Minerals (OZL)

OZ was acquired by BHP.

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 overwhelmingly 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 21 engagements in which we explicitly discussed ESG matters with 15 companies relevant to the strategy. Of these, 86% were held at either board or executive level. The engagements covered a range of issues and most meetings discussed multiple ESG matters. In this period, the most commonly discussed topics were climate transition, environmental management and workplace health and safety.

One company of focus during the quarter was Orica Ltd. We had two meetings with Orica in the period, one at board and one at executive level. While decarbonisation was the topic of focus, with the board we also discussed executive pay, safety and employee retention. The second meeting exclusively focused on climate change. We covered scenario analysis, internal climate capabilities and internal grants for decarbonisation activities. Orica is also considering the integrity of carbon offsets and potentially generating its own credits.

OUTLOOK

While global inflation has fallen from its recent peak it still remains relatively "sticky" and elevated versus targeted levels. We believe that central banks have learned the lessons from the past about prematurely reducing interest rates in an inflationary cycle and hence are likely to keep them elevated for longer despite what the market might wish for. Wage increases are also likely to see pressure remain on inflation, particularly in Australia. Worryingly, productivity growth in Australia is in decline. As mentioned in the opening commentary, accommodation affordability is becoming a bigger issue especially with net migration added to the mix. Rental growth adds to the inflation mix and overall, services inflation and employment levels will be key inputs into the rates cycle. Given the lagged impact of rate rises and the expectation that another rate hike or two should be expected, we do feel that we are entering into a more difficult economic environment.

China remains a key component of the global growth outlook. Geopolitically relationships between the USA and China continue to appear fragile and internally China is having to deal with a subdued housing market, high youth unemployment and an ageing population. Annual births have dropped from 17.86m in 2016 to an estimated sub 9m in 2023. Stimulus in China is expected in the latter half of 2023 however the extent and targets of this stimulus is not clear as yet. This is arguably behind the yuan (CNY) depreciation as capital flows out. We have recently had a couple of Paradice staff members travel to China, the first since COVID started. Feedback has been for a cautious approach in the near term.

Against this backdrop and entering into the FY23 reporting season (companies report over August), we do not anticipate too many companies painting a rosy outlook for the coming 6 months. In addition, the cost and access to capital (equity and debt) has to be watched closely as a key issue for some companies to manage in this current environment. We continue to maintain a bias towards companies that have resilient earnings and/or are exposed to strong thematics such as infrastructure spend and clean energy needs. That being said we are conscious that cyclical underperformance can provide attractive entry points to otherwise high quality stocks.

Key sector exposures include remaining underweights in the property and retail sectors with overweights in infrastructure and utility providers (e.g. AZJ and AGL) and mining services (e.g. ORI and SVW).