30 SEPTEMBER 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	-2.78	-1.95	13.52	18.28	12.19
S&P/ASX 200 – Total Return Index	-2.84	-0.77	13.46	11.00	5.20
Excess Return	0.06	-1.18	0.06	7.28	6.99

*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

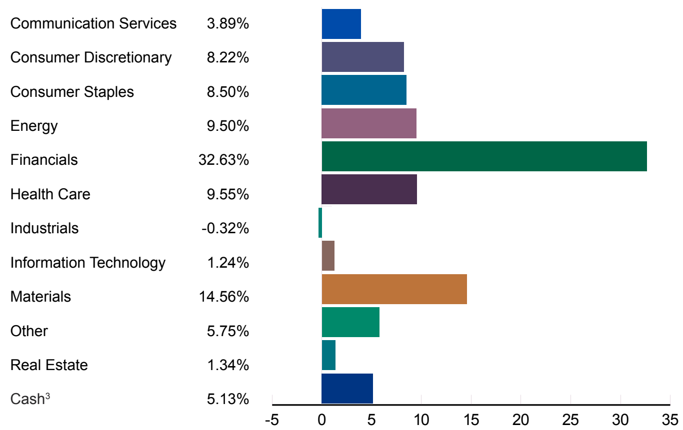
Tom Richardson

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	115.57
Short	-20.70
Net	94.87

SECTOR ALLOCATION



KEY DETAILS	
Number of Holdings	79
Portfolio Dividend Yield	4.28%
Fund Size (AUD)	$126M
Redemption Price	$1.2080

TOP 10 POSITIONS	WEIGHT %
BHP Group Ltd.	12.72
Commonwealth Bank of Australia	6.59
Wesfarmers Ltd.	6.32
National Australia Bank Ltd.	6.25
ANZ Group Holdings Ltd.	5.53
Woodside Energy Group Ltd.	5.36
Resmed Inc.	4.76
Telstra Group Ltd.	4.12
CSL Ltd.	3.81
Santos Ltd.	3.49

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 fell this quarter on weakening economic growth and as higher interest rates impacted valuations. The MSCI World Net Total Return Index fell 3.4% (in USD)[1] versus the June 2023 quarter. The S&P/ASX 200 Total Return Index eased 0.8%.

Inflation remained stubbornly high. US Core Personal Consumption Expenditure (PCE) Inflation (which is the US Federal Reserve's (FED) preferred measure) was still an elevated 3.9% in August, driven now by increasing Energy costs. FED officials only increased rates once this quarter, however commented that monetary policy will need to stay restrictive for "some time". This resulted in the US 10-year Treasury yield selling off 73bp to 4.57%, which is a cycle high.

Energy was the best sector in Australia over the quarter, delivering an 11.2% total return, on the back of the Brent oil price rising 27% (in USD) to US$95 per barrel. Financials rose 2.4% on the back of CBA's August result continuing to evidence that the loan loss cycle has not started. Consumer Discretionary rose 5.3% boosted by ongoing consumer strength. On the other hand, Consumer Staples fell 5.9%, and Health Care 8.6%, on disappointing stock specific results.

Key themes from Aug-23 reporting season

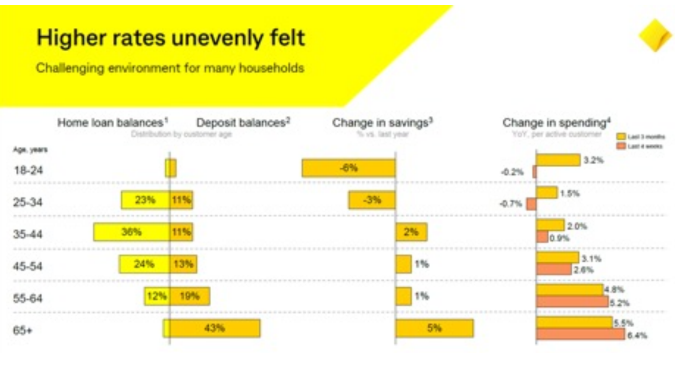
The Financials (in particular Banks) and Consumer sectors (namely Consumer Discretionary and Consumer Staples) demonstrated ongoing resilience, with little evidence of household balance sheet stress to date. Retailers' results came down to execution, with "value" retailers who executed well on inventory management and costs faring better.

Balance sheets came into focus, as higher capex and interest costs eroded free cashflow across a number of miners and industrial companies. Increased labour and other costs were noted at several companies including the banks and supermarkets. Consensus FY24 (June) earnings were revised down by 3% over the August month of reporting.

Chart of the reporting season

CBA data reiterated the uneven impact of higher interest rates, which disproportionately benefit the older population who have significant savings and continue to increase spending, whilst inflicting a handbrake on the consumption power of the younger population burdened with mortgages.

CBA, Full Year Results Presentation, June 2023



Source: CBA, Results Presentation and Investor Discussion Pack 30 June 2023 1. Principal balances net of offsets. 2. Deposit balances exclude offset accounts. 3. Savings include offset accounts and all forms of deposits (transaction, savings and term). Excludes all customers originated since FY20. 4. Consistently active CBA card holders spending on consumer debit and credit cards (last 4 weeks: 4 weeks ending 23 July 2023, last 3 months: 13 weeks to 2 July 2023, compared to prior corresponding period).

PERFORMANCE

The Fund underperformed by 1.18 % over the quarter. Much of the underperformance was driven by the long book which underperformed the Benchmark over the quarter. Three stocks largely contributed to this; ResMed, Block and Coles Group. Block de-rated on US recession concerns. We believe the company is progressing their strategy and the valuation is compensating us for the likely deceleration in revenue as consumer spend slows. We continue to hold a small position. Coles was a good example of a defensive business that missed expectation and was punished. The company underperformed its key competitor through the last reporting period. We reduced our position. The Short book performed broadly in line with the market with some large winners offset by a handful of names that reported better than expected earnings.

ENVIRONMENTAL, SOCIAL, GOVERNANCE ISSUES (ESG)

This past quarter saw the majority of ASX-listed companies post either half year or full year financial results during the August 'reporting season'. While the focus in the related investor briefings continues to be financial performance, the trend in recent years of including more ESG content has continued.

Pleasingly, we have also seen the release of more 'integrated' annual reports – combining both key regulatory filings with material ESG information – and for those companies which produce a separate ESG or sustainability report, the publication of these at the same time as the annual report and as part of the full reporting suite. In the past, in many cases there has been a significant delay in the publication of such reports. Further, sustainability reports were often not formally included in the annual reporting suite published to the ASX.

The reporting season saw a number of updates on companies' decarbonisation efforts, including progress against established targets. We also saw two companies – Rio Tinto (RIO) and Boral (BLD) – highlight the near term challenges in decarbonising, both with rising costs and project delivery issues. Rio Tinto admitted its 2025 emissions target was at risk unless the company purchased carbon offsets, while Boral revised down its interim 2025 reduction target citing regulatory approval delays. Pleasingly, of the remaining 34 ASX200 companies which have an interim 2025 target, the majority are on track, with some even having met the target ahead of schedule.

Reported safety performance was mixed, which tragically included an uptick in the number of worker fatalities, with our research indicating over 19 fatalities have occurred in the past 12 months across both large and small caps. This has occurred in the context of tight labour markets, increased use of contractors by some, and some continued issues arising from operational re-starts post COVID. Sectors which generally saw Total Recordable Injury Frequency Rates (TRIFR) improve included Materials, Chemicals and Energy. Companies across Consumer Discretionary and Mining had mixed performance.

An emerging theme this reporting season was Artificial Intelligence (AI), which added to the growing focus on cyber, data management and digital capabilities seen in recent years. Many companies were keen to highlight how they have been or are in the early stages of applying AI across areas such as unlocking operational efficiencies, reducing costs, improving safety and customer experience. A number had already documented productivity gains, while others also called out efforts to develop internal guidelines around the responsible use of AI.

[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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ENGAGEMENT

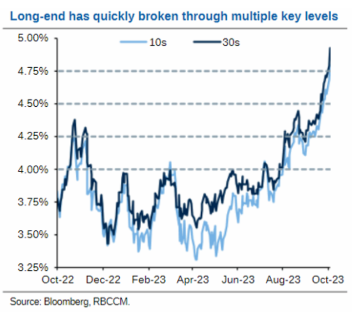
During the quarter, we undertook a total of 22 engagements in which we explicitly discussed ESG matters, with 18 companies relevant to the strategy. Of these, 95% were held at either board or executive level, with the majority this quarter with chief executive or financial officers. The engagements covered 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 human capital management.

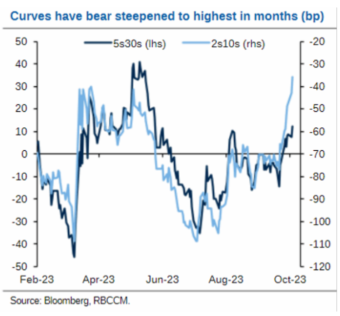
We had two engagements with Qantas Airways (QAN) in the quarter. We had one meeting with both the outgoing and incoming CEOs after the FY23 results came out, which occurred prior to additional developments relating to the baggage handler outsourcing ruling and the ACCC commencing proceedings. In that meeting, we encouraged Qantas to address the COVID-era credit issue and pay additional attention to staff morale. We also sought to further understand its knowledge of the Qatar Airways decision made by the Government and potential reform of airport landing spots. After the ACCC development, we wrote to the Chair to express concern regarding the ongoing reputational damage and the need to restore customer trust, as well as convey our expectations regarding remuneration outcomes to appropriately reflect the poor outcomes seen. Unfortunately to date, the Board response has fallen short. We will continue to engage the company in advance of the forthcoming Annual General Meeting.

In our post results meeting with the Woolworths Group (WOW) CEO we included a discussion on workplace health and safety, after the company had unfortunately reported two fatalities. We learned more details about both incidents to understand whether they reflected poor controls on the part of the company. Both related to equipment failure, but nevertheless Woolworths is acting to address this and apply learnings. One incident also involved some degree of human error – the company has enhanced signage and training at the distribution centre in question. We note that 10% of the executives' short term incentives will be withheld.

OUTLOOK AND POSITIONING

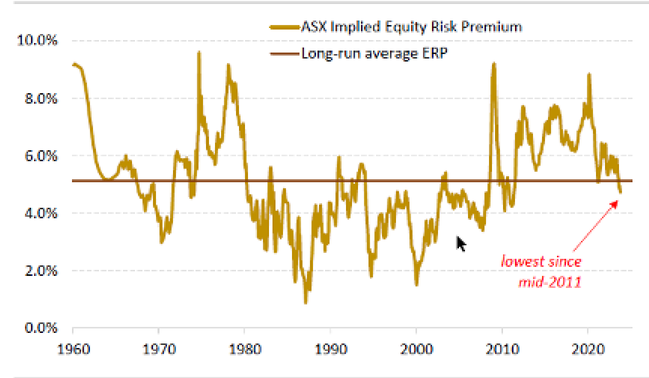
Since the July Federal Open Market Committee (FOMC) meeting, yields have surged almost relentlessly, with the US 10-year yields having risen ~90bp to a cycle high of 4.57% as at end of September. This is a headwind for all risk assets.





The equity risk premium in Australia is at the lowest level since 2011, i.e. there is less "insurance" today for owning risky assets than in the past given the rapid increase in the cost of capital and the ongoing threat of sticky inflation.

Equity Risk Premium - Australia



Source: UBS financials team analysis, *median cash allocation of Australian equity
As at 5th October 2023.

As such we have increased defensive positioning in the portfolio and increased the size of the short book.

Materials positioning remains underweight as global growth slows. Although we closed the size of the underweight by buying BHP. Iron ore prices have been more resilient than expected owing to increased steels and infrastructure spend. A recent field trip (notes below) supported our thesis that we are seeing a stabilisation in China demand.

Elsewhere within Materials we are underweight lithium and overweight rare earths. The portfolio is neutral gold stocks as the stocks represent fair value.

Within Consumer, the portfolio is overweight defensive Staples, which are seeing defensive toplines whilst Covid costs drop out. The portfolio is also overweight discretionary retailers such as JB Hifi and also Wesfarmers, whose value focused offering via Bunnings and Kmart should outperform in weaker economic conditions.

The portfolio is overweight Financials overall, but underweight banks where we see valuations as full. The portfolio is overweight Insurance, which is benefiting from ongoing increasing pricing and better investment yields; and holds positions in Challenger, and Medibank.

The portfolio is neutral Healthcare, with ResMed (RMD) the only overweight position. We believe fears around GLP1 obesity drugs are overblown given low adherence rate in the real world, inhibitive cost, very limited evidence of replacing CPAP therapy. We reduced our CSL position in reporting season as RMD provides a more compelling investment opportunity.

Field trips - China

David Feng travelled through Hong Kong and China for 2 weeks in September, visiting a range of tier 1 and 2 cities with a consumption-oriented research agenda.

2023 started as a hopeful year for China economy after the pandemic reopening, but increasing challenges faced by local government debt issuers and property developers forced central government to step in earlier than expected with more stimulation policies to stabilize the economy.

Consumption downgrade is often mentioned in meetings. Compared to busy restaurants and flooded orders on Didi platform in April, we saw a tangible slowdown in consumer spendings this time. However, this is mainly happening in high tier cities; consumption resilience and upgrades continue to take place in lower tier cities driven by incremental supply and new product developments. Online penetration seemingly peaked in the near term, and the next growth phase will be mainly from mass groups with lower income.

Low expectation on income growth and higher youth unemployment led by mismatched job supply and demand were frequently spoken about in meetings. While this certainly put pressure on consumption and other social issues such as household formation, we see it's a contained issue but will take time to solve.

Travel is a bright spot from the trip, particularly in railway and domestic flights. While spending per capita hasn't recovered, partially driven by 20% increase in hotel and flight costs versus pre-pandemic, travel intention has never been so strong, and the trend extended into the Golden Week in October. Overseas travel demands are still recovering and seeing green shoots in neighbouring countries and Europe.

Overseas study intention continues to be strong even though pent-up demand was said to already have washed through. Australia as a destination country faces good growth opportunities in the next few years driven by recent improvement in QS World University Rankings and highly competitive study programs. Chinese government continues to support overseas study, and favourable policies related to property purchasing for students returning from Australia) made it a standout candidate among other countries.

The Electrical Vehicle industry is perhaps the fastest growing sector in China and even the manufacturing capacity is said to have already exceeded demand in the near term. It's very hard to find a non-EV taxi in big cities, and all buses have been upgraded to EV.

Overall, the trip in China has helped the team to gain firsthand intelligence on how the giant country is progressing its recovery post the initial reopening stage of the pandemic, and consolidated base knowledge for future expectation and forecast. We will factor these observations into future investment decisions and look forward to providing further updates to our investors.

Increasing challenges for property developers: Nanjing property inventory was reported as having 13.5 months sales equivalent.

Travel insights: A busy railway station in Shanghai on Tuesday 8am.

Other Insights: Penfolds have a strong product range on shelves, including those imported pre-tariff and new products from US/France; however store staff are suggesting in-store sales has been slightly soft.

Wholesale retailer, Sam's Club, a major channel for The A2 Milk Company (A2M) product distribution in China, reported category sales down 20% YTD. A2M growth also moderated this year. A2 products also sharing primary shelf space with other brands in Kids Wonder where we attended a well organised in-store promotion. In both cases inventory manufacturing dates reflecting reasonable turnover levels.