30 SEPTEMBER 2023

AUSTRALIAN EQUITIES FUND

PARADICE INVESTMENT MANAGEMENT

PERFORMANCE NET (%)	1 MONTH	3 MONTH	1 YEAR	3 YEAR	5 YEAR	SI* P.A.
Australian Equities Fund	-2.90	-1.15	10.39	14.27	6.34	8.36
S&P/ASX 200 – Total Return Index	-2.84	-0.77	13.46	11.00	6.67	7.60
Excess Return	-0.06	-0.38	-3.07	3.27	-0.33	0.76
						*Since Inception date (SI) – 2 August 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 S&P/ASX 200 Total Return Index (after fees and before taxes) over a rolling three to five year period.

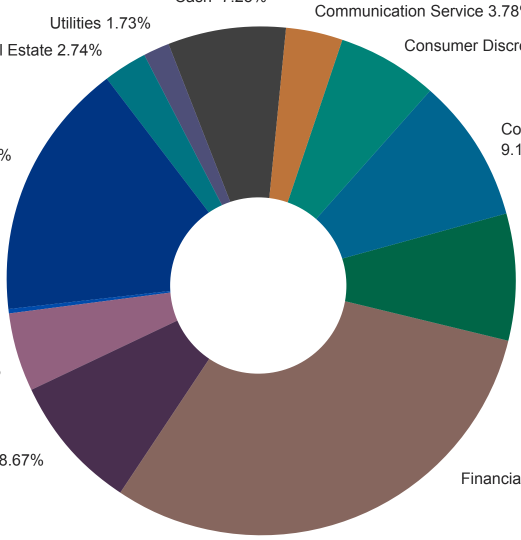
LEAD PORTFOLIO MANAGER

Troy Angus

FUND OVERVIEW

The highly experienced team use a detailed fundamental research process to find stocks that are growing faster with better outlooks over the next 3–5 years. The Fund is agnostic of investment style and employs a long term 'bottom up' approach to investment.

SECTOR ALLOCATION



KEY DETAILS	
Number of Holdings	38
Portfolio Dividend Yield	4.22%
Fund Size (AUD)	$82M

TOP 10 POSITIONS	WEIGHT %
BHP Group Ltd.	11.17
National Australia Bank Ltd.	6.62
Commonwealth Bank of Australia	6.31
Woodside Energy Group Ltd.	4.94
ANZ Group Holdings Ltd.	4.92
CSL Ltd.	4.78
Coles Group Ltd.	4.46
Wesfarmers Ltd.	4.23
Resmed Inc.	3.89
Woolworths Group Ltd.	3.68

FUND DETAILS	
APIR Code	ETL8084AU
Distribution Frequency	Semi-Annually
Management Fee[1]	0.75% p.a.
Performance Fee[2]	15% p.a.
Buy Sell Spread	+/- 0.20%
Minimum Investment	$20,000
Stock Range	Typically 30 – 50
Cash Range	0 – 10%

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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 in the 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

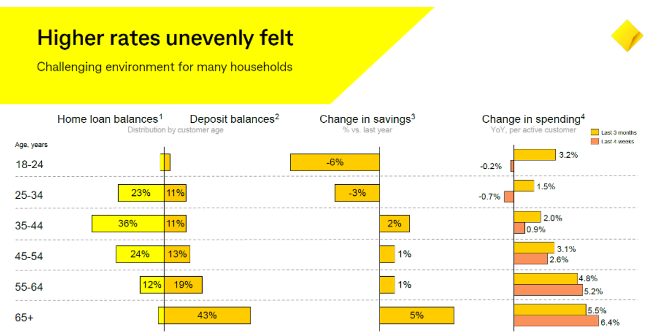
The Financials (in particular Banks) and Consumer sectors (namely Consumer Discretionary and Consumer Staples) demonstrated ongoing resilience, with little evidence of household balance sheet stress to date. Retailers' results came down to execution, with "value" retailers who executed well on inventory 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 0.38% over the quarter. Portfolio holdings across most sectors contributed positively, led by Industrials (overweight CPU, underweight TCL), Real estate (underweight) and Materials (overweight JHX, underweight battery material stocks). Health was the largest detractor driven by an overweight position in ResMed (RMD).

Contributors/Detractors

Positives

National Australia Bank (NAB) Overweight

NAB outperformed on a lack of evidence of any loan loss cycle having started in Australia.

Transurban (TCL) Underweight

TCL underperformed as higher bond yields and expectations of higher-for-longer interest rates weighed on the distribution outlook.

Computershare (CPU) Overweight

CPU outperformed on expectations of higher-for-longer global interest rates being sustained. The core business also showed signs of improvement in 2H23 as the company tamed inflationary wage pressures.

Woodside (WDS) Overweight

Woodside rose on higher oil prices, improving free cash flow outlook and an asset sell-down.

James Hardie (JHX) Overweight

James Hardie rose on better than expected earnings, improving market share and better outlook.

Negatives

Res<Med (RMD) Overweight

ResMed fell on an earnings miss due to lower margins and perceived deteriorating medium term outlook from weight loss drugs possibly being an alternative to their sleep therapy CPAP devices.

Block (SQ2) Overweight

Block declined on a lower quality earnings result, the release of a negative short seller report , a client-facing IT outage, and along with global peers, on fears concerning the health of lower income consumers.

Coles (COL) Overweight

Coles weakened on an earnings miss due to higher costs and increased theft, and as a result of time delays and increased costs for new logistics facilities and online fulfilment centres.

Northern Star Resources (NST) Overweight

Northern Star weakened and underperformed on a lower production result and, as the gold price fell as real rates rose.

CSL (CSL) Overweight

There were few surprises in the result, however stock de-rated as bond yields inflected higher.

[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.*

Portfolio Changes

Purchases

ResMed (RMD)

ResMed was increased as the stock was oversold on perceived fears that CPAP therapy was going to be displaced by weight loss drugs.

Goodman (GMG)

Goodman Group was bought following increased confidence in sustainability of industrial development activity.

BHP (BHP)

BHP was bought on the basis of new Chinese stimulus measures that resulted in a better-than-expected iron ore price, which has reopened supportive valuation.

Coles (COL)

Coles was added post the results release, as execution issues are expected to be remediated and valuation looks palatable.

Sales

CSL (CSL)

CSL was bought to increase defensive positioning following an uneventful FY23 results release. However, as bond yields rose rapidly and following a detailed review of CSL's competitive positioning, we have taken a more cautious approach especially given relatively high valuation multiples.

James Hardie (JHX)

James Hardie was trimmed after a strong earnings result drove outperformance and on expectations that surging interest rates will now impact future demand.

Xero (XRO)

Xero was exited as higher bond yields reduced valuation support.

IDP Education (IEL)

IDP was trimmed following outperformance and reduced valuation support.

Mirvac (MGR)

Mirvac was trimmed following outperformance and reduced valuation support.

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.

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.

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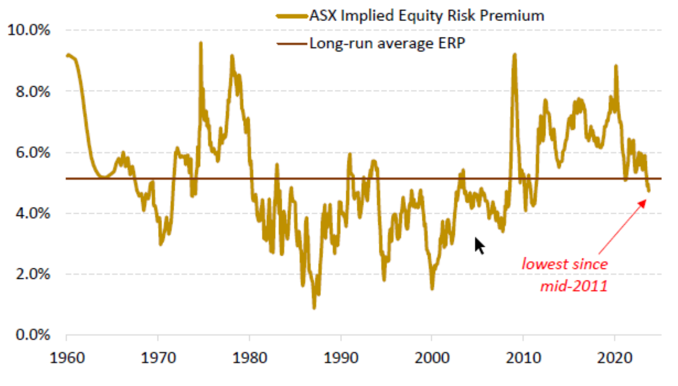
OUTLOOK AND POSITIONING

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.

While jobs and wages data remain strong, excess savings are close to being fully drawn. The recent spike in oil prices also threaten to dampen consumers spending ability, bringing forward the timeline of a likely slowdown.

As such we have increased defensive positioning in the portfolio by reducing select growth and bond proxy exposures, and are underweight technology, real estate, infrastructure and utilities.

Materials positioning is underweight as global growth slows and demand wanes, especially from China. We have increased BHP to a modest overweight position as high iron ore prices have supported earnings and valuation, however remain underweight iron ore.

In China, we have seen a short term improvement in sentiment from the relaxation of deposit and stamp duty criteria in the property market, however continue to see incremental stimulus as supporting rather than boosting demand. Steel production in China has fared better than expected due to combination of Fixed Asset Investment (e.g. grids, renewables), increased steel export and EV production, however the sustainability of these positives remain uncertain. Positively, China industrial profits showed signs of a rebound in August, suggesting the downside may be capped.

Elsewhere within Materials, positions are held in commodities, including nickel and rare earths, where supply/demand fundamentals are attractive medium-term. The portfolio is neutral gold stocks as we see AUD gold price relative strength on slowing economic conditions.

Energy is modestly overweight as OPEC appears in control of supply now due to years of underinvestment, so the medium term oil price outlook is improving, which is driving cash flow forecasts and valuation support.

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 loan defaults as a potential negative catalyst emerging over the next 6 months. The portfolio is overweight Insurance, which is benefiting from ongoing increasing pricing and better investment yields; and holds positions in Computershare, Challenger, and Medibank.

The portfolio is neutral Healthcare, with ResMed 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 have reduced CSL to a modestly underweight position on growing concerns around competitive threats to its high margin plasma and iron products.

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.

A downgrade in consumption was often mentioned in meetings, especially in tier 1 cities such as Shanghai. This is driven by low expectations for income growth and higher youth unemployment, as the mismatch between job demand and supply continues.

For Treasury Wine (TWE), Penfolds continue to command prominent shelf space and have the most complete range of products on shelf, including those imported pre-tariff and new product from US/France; however store staff are suggesting in-store sales has been slightly soft.

Domestic travel was a bright spot. Overseas travel demand is still recovering with green shoots in neighbouring countries and Europe. Overseas study intention continues to be strong. The Chinese government continues to support overseas study, and favourable policies related to property purchasing for students returning from Australia make it a standout candidate among other countries.

A potentially lower rate of newborns in 2024 is a surprise, driven by a weaker economic outlook, providing a challenging backdrop for companies such as A2M.

Electrical Vehicle penetration was high; it was difficult to find a non-EV taxi in the large cities, and many buses have been upgraded to EV. Having said that, manufacturers are suggesting supply is exceeding demand in the short term.