31 DECEMBER 2024

AUSTRALIAN MID CAP FUND – CLASS B

PARADICE
INVESTMENT MANAGEMENT

PERFORMANCE NET (%)	1 MONTH	3 MONTHS	1 YEAR	3 YEARS	5 YEARS	7 YEARS	SI* P.A.
Australian Mid Cap Fund - Class B	-4.59	1.81	12.77	2.47	7.91	6.68	8.00
Mid Cap Composite Benchmark[1]	-3.55	-0.80	11.22	2.57	8.23	7.58	8.80
Excess Return	-1.04	2.61	1.55	-0.10	-0.32	-0.90	-0.80

*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).

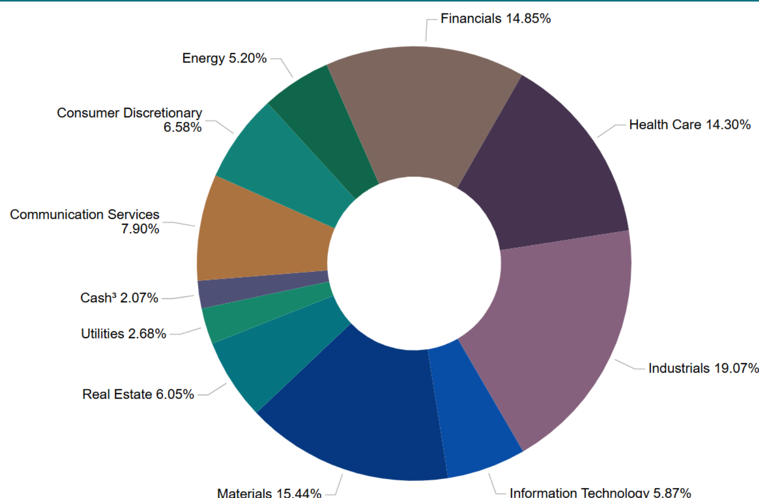
LEAD PORTFOLIO MANAGER

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	46
Portfolio Dividend Yield	1.89%
Fund Size (AUD)	$ 64M

TOP 10 POSITIONS	WEIGHT %
SGH Ltd.	4.81
ALS Ltd.	4.27
REA Group Ltd	4.14
Block, Inc.	3.88
Pro Medicus, Ltd.	3.73
Orica Ltd.	3.61
JB Hi-Fi Ltd.	3.59
Qube Holdings Ltd.	3.44
Vicinity Centres	3.19
Technology One Ltd.	2.99

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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[1] The Mid Cap Composite Benchmark is 70% of the S&P/ASX Mid Cap 50 Total Return Index and 30% of the S&P/ASX Small Ordinaries Total Return Index (the "Index") and is the exclusive property of S&P Opco, LLC, a subsidiary of S&P Dow Jones Indices LLC (SPDJI) and/or its affiliates. Paradice has contracted with SPDJI to calculate and maintain the Index. Neither SPDJI nor any of its affiliates shall be liable for any errors or omissions in calculating the Index. For more information, please visit www.spdji.com. [2] Applies to the investment performance achieved by the Fund (after management fees and costs) in excess of the Benchmark. Refer to PDS for more information. [3] The Cash percentage in the Sector Allocation chart is inclusive of derivatives held in the Fund, if any.

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Performance in AUD unless otherwise noted.

MARKET REVIEW

Domestically, the market exhibited a relatively subdued performance during the quarter, with the Mid Cap Composite benchmark returning -0.8%, in line with the S&P/ASX 200 Total Return Index and slightly ahead of the S&P/ASX Small Ordinaries Total Return Index, which returned -1.0%. However, this performance masked significant intra-month volatility. The Mid Cap Composite fell 1.46% in October, saw a sharp 4.37% rally following Trump's election win in November, and then gave up 3.55% in December as more thought was given to the implication of the election result. Australian returns were more subdued in USD terms, largely due to a 10.5% decline in the AUD/USD exchange rate.

Globally, the US emerged as a significant winner from the Trump election result. Market returns were driven by large-cap and technology stocks, with the NASDAQ returning 6.4% and the S&P 500 Total Return Index delivering 2.4% (both in USD). Both indices were notably boosted by a 54.4%(in USD) rally in Tesla, which benefited from Elon Musk's growing influence in the incoming administration. In contrast to the previous quarter's broad-based gains, US performance was more concentrated in larger companies, with the Russell 2000 Total Return Index gaining just 0.3% (in USD).

The market anticipates the incoming administration will be pro-business, with a focus on oil and gas drilling, reduced regulatory burdens, an increase in tariffs and potential trade wars. On this last point, there is some conjecture as to what extent tariffs will be used as a bargaining chip and hence what the final levels will be. There could also be an array of geopolitical/strategic changes that arise.The US gains came at the expense of other global markets. The MSCI World Total Return Index posted a -1.0% return (in USD), while European indices underperformed: the FTSE 100 Total Return Index fell 6.8% (in USD), and the DAX Total Return Index was down 3.9% (in USD). While currency movements, particularly the rally in the DXY (Dollar Index), played a significant role, there are also concerns over the potential effects of US trade policies on global markets.

China was the biggest loser for the quarter with the Total Return Index down 7.7% (in USD). While clearly a target of more aggressive trade policies, the issues in China are more widespread. A team member visited China during the quarter and came away disappointed with action taken to date after what had appeared to be positive signs in the September quarter. Of the announced stimulus only a little over 20% is "direct" with the majority coming in the form of refinancing of local government debt. Housing inventory levels were also higher than expected—around 2 to 3 years of supply—with additional stock being held in the secondary market. The government seems more focused on stabilising property prices and the stock market, rather than stimulating significant growth in these sectors. While this is not inherently negative, it falls short of the market's higher expectations.

Concerns that action in China has been more rhetoric rather than genuine steps forward was reflected in commodity markets. We saw falls in Iron Ore (9.1)%, Copper (10.9)% and Nickel (12.5)%. Gold held relatively steady (-0.4)% whilst energy bucked the trend with Brent up 4.0% and JKM (LNG) up 8.5% (all in USD). At the time of writing, concerns are emerging as to what a cold Northern hemisphere winter could mean to gas supplies and pricing, particularly in Europe.

On the macro front the steady decline in US inflation has tapered. Additionally, many of the new policies of the Trump administration are anticipated to be inflationary. Despite there being a combined 50bps of rate cuts by the Fed in the quarter they have signalled a more subdued outlook for rate cuts in 2025. This saw US 10 year yields rise 79bp to 457bp at quarter's end.

Australia has remained a laggard on the global interest rate cycle as it raised rates later, engaged in expansionary fiscal policy and saw a continuing strong wage pulse. Australia now appears to be getting closer to a rate cut as inflation comes under control and risks to unemployment rise. This has been reflected in the far more accommodative statements from the RBA in recent months. Despite Australian 10 year yields rising 39 bp in the quarter, they came back into the period end, unlike the US where rates finished on a high.

From a sector point of view the best performers domestically were Financials ex Property 5.9%, driven by the ongoing strength in Banks, Industrials 3.3% and Communication Services 2.2%. The weakest sectors were Materials (11.9)%, driven by commodity price weakness, Property (6.0)%, on rising interest rates and Energy (5.4)% despite the strength in the oil price.

Despite a limited number of financial results in the December quarter, it was a data-heavy period with AGM updates and high-profile conferences, notably UBS. Overall, the updates were more negative than positive. In our market segment we saw downgrades from Reece (REH) and Endeavour (EDV), with our holdings in Bluescope (BSL) and Ampol (ALD) (underweight) also downgrading due to weaker steel spreads and refining margins, respectively. A number of stocks we don't hold, including Flight Centre (FLT), Aurizon (AZJ), Viva Energy (VEA), ARB (ARB), and NIB Holdings (NHF), reported weak trading conditions, though many expressed hopes for improvement in the coming half. We remain wary of hope driven strategies and will look to evidence of actual improvement in the coming reporting season. We also saw Iluka (ILU) (nil holding) underperform as it pushed ahead with its Eneabba Rare Earths refinery despite a major cost overrun and spot commodity prices that are dramatically below that envisioned in the business plan.

On the positive side we did see very strong results and outlooks from Technology One (TNE) (overweight) and Block (SQ2) (overweight) (both described below) as well Orica (ORI) (overweight) where we have increased our holding. We also saw upgrades from Pro Medicus (PME) on contract wins and HMC Capital (HMC) on new fund raisings (both overweight).

Consumer strength was more mixed during the period in terms of overall trading updates. As we saw from EDV and the supermarket majors trading in consumer staples has been more subdued as the ongoing post Covid normalisation takes place. Feedback in apparel was also weaker (Super Retail (SUL) and Premier Investments (PMV)). Consumer electronics remain a high point given their role as the new "necessity" with strong updates from JB Hi-Fi (JBH) (overweight) and Harvey Norman (HVN). As of writing, we are still awaiting post-AGM updates from most retailers. Early feedback suggests a strong Black Friday period, though it's unclear if this has pulled forward sales from Christmas and Boxing Day.

PERFORMANCE

The outperformance for the quarter occurred during a data heavy period for companies that was dominated by updates during the AGM season and at a number of major conferences (most notably UBS) as described above. The Fund/portfolio was largely on the right side of the updates which included a reasonable level of profit downgrades that were mostly avoided. Although not by design around a US election prediction the portfolio was also largely on the right side of the Trump election trades described above.

Contributors/ Detractors

Positives

Block Inc (SQ2) – Overweight

The market seemed to finally recognise the steps being taken by the company to manage costs and boost margins. Additionally, there is evidence that the company is working towards improving Gross Payment Volume (GPV) in its Square division which is perceived as an important measure by the US market (where it is dual listed).

De Grey Mining (DEG) – Overweight
Received a scrip bid from Northern Star (NST) which recognises the potential for the Hemi deposit which is currently being developed into a tier one global asset.

Reece Limited (REH) – Nil Holding
Downgraded earnings at the AGM over a tougher than expected outlook for its US division.

Endeavour Group (EDV) – Nil Holding
Downgraded earnings at the AGM. EDV is experiencing similar headwinds to the major supermarkets with reduced customer spending and increased promotional activity hurting sales and margins.

Negatives

Web Travel Group (WEB) – Overweight
Experienced continuing competitive margin pressure in its WebBeds B2B business.

Telix Pharmaceuticals (TLX) – Underweight
Telix has experienced solid sales growth in its Illuccix product (an imaging agent for prostate cancer) and has a strong pipeline of potential new products.

Orora Limited (ORA) – Overweight
It appears to be taking longer for momentum to return to the Saverglass end customers. Saverglass is the controversial acquisition that ORA made in Europe, the end customers being high end beverage companies.

Champion Iron Limited (CIA) – Overweight
Ongoing weakness in the steel complex, especially in China, is dragging on iron ore prices.

PORTFOLIO CHANGES

Purchases

Telix Pharmaceuticals (TLX)
Telix has experienced solid sales growth in its Illuccix product (an imaging agent for prostate cancer) and has a strong pipeline of potential new products that will likely see it exceed market forecasts for near term and mid term revenue growth.

HUB24 Limited (HUB)
Continues to increase market share in the platforms business at the expense of incumbents as it adds new products and features.

Technology One (TNE)
SaaS software group that is driving high teens profit growth through increasing penetration of its existing customers via product development as well as new customer growth, particularly in the nascent UK market.

Sales

CAR Group (CAR)
Reduced our holding as the stock moved into the ASX 50. We still remain active in CAR and are attracted to its dominant global market positions and strong management team.

Orora (ORA)
Per above we sold out of this position due to discouraging signs from the Saverglass division. We are concerned that the elevated profit levels at the time of purchase may have included significant one-off benefits driven by Covid era consumption.

Northern Star (NST)
Sold out of this position as we now have exposure through our position in De Grey Mining (DEG) which has received a scrip bid from NST. DEG also remains exposed to the potential upside from an interloper entering a bidding war.

ENGAGEMENT

During the quarter, we undertook a total of 32 engagements in which we discussed ESG matters with 27 companies relevant to the strategy. A majority (78%) were held at either board or executive level. The engagements covered a range of issues with most covering multiple ESG matters. In this period, the most discussed topics were the climate transition, conduct and executive remuneration.

We met with BlueScope Steel (BSL) as the company published an updated Climate Action Plan in the quarter and we met with the CFO and sustainability team members to discuss it in detail. We were pleased to see more granularity in both climate exposures and mitigations efforts across regions and assets. The company has performed, what appears to be, robust scenario analysis and provided examples of how it has informed capital allocation decisions. We also received updates on the outlook for emerging technologies and the collaboration with BHP and Rio Tinto.

TRIP TAKEAWAYS

Alongside our normal company visitation program, during the quarter a team member conducted a trip to China via the Lynas (LYC) Rare Earths processing plant in Malaysia.
Given the overlap to the US election outcome and the weakness in commodities during the quarter a lot of the conclusions from the trip are summarised in the Commentary and Outlook sections. Most team members have now visited China following its post Covid re-opening (the first trip being May 2023). This time Matt returned for the first time since Covid. As a multi decade veteran of China trips his observations on recent changes are:

- China is reverting to its socialist roots with “peak capitalism” probably having occurred around the 2008 Beijing Olympics. This is reflected on the policy side around initiatives that are really for “the greater good” and the discouragement of speculative investment in housing and other fields. It is also subtly visible in areas such as public displays of wealth being heavily discouraged, e.g. high-end restaurants were only frequented by Westerners during the trip and there were less aspirational fashion labels being worn by much of the population.
- The country has a significant demographic issue with deaths far exceeding births, subdued marriage rates and non-existent immigration. Our perception is that this is unlikely to change any time soon as it’s difficult to legislate people into changing their personal lives.
- Old-fashioned stimulus is less likely to be seen (residential building, “general” infrastructure, etc). On this front steel demand looks to have peaked.
- On the flip side there has been a real focus on investing in “new industries” such as EVs, battery technology and solar where China is a clear global leader. Unfortunately, they are facing trade sanctions in these areas from western countries who are trying to protect legacy industries, such as the Internal Combustion Engine (ICE) automotive industry.

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The LYC visit was also very interesting and threw a spotlight on the rare earths sector. What became clear is that China dominates the entire supply chain here from upstream to end use with overseas players having a very limited role. Additionally, the quantities needed for areas such as defence have most likely been over emphasised by the media. China is interested in protecting its position through this entire chain and hence we feel it is unlikely that they would let the underlying commodity price rise to the point that it encouraged new upstream production outside the country. This might possibly change for political reasons if things became very heated on the tariff front. It is also clear that producing rare earths is a very complex process (the LYC plant has over 1,000 stages of production) and hence any new plants that are built will likely take some time to ramp up (most likely years).

OUTLOOK

The near-term outlook for the broader markets is most likely to be dominated by the new Trump presidency. We anticipate swift executive actions, particularly in areas not requiring legislative approval. Trade policy is expected to take centre stage, with more extensive tariffs likely targeting Canada, Mexico, Europe, and China. There are no guarantees that Australia will be excluded although we are helped by our strategic alliance and the fact that we are a net importer from the US. Markets have begun to discount tariffs as a negotiation tactic, but this remains a key risk. What happens here will ultimately have implications for many countries and companies and could lead to onshoring and retaliation in various commodities.

Energy policies are expected to pivot toward carbon-based sources and uranium, reversing the emphasis on renewables. There will also be significant implications from the extent to which the Inflation Reduction Act (IRA) is dismantled or varied. On the fiscal side, moves in terms of tax and spending changes will impact upon inflation and interest rate expectations which were already under pressure as the moderation in inflation had begun to stall. We now see a higher path for rates in 2025 than we had anticipated only months ago.

There are also a number of mooted policies which on implementation and outcomes are very hard to gauge. These include measures such as mass deportation, which if successful (ignoring moral judgements) would impact population size and the pool of lower income workers. From a geopolitical standpoint it is also difficult to measure what the impact might be with an already tricky political situation in the Middle East. Additionally, should the change in power lead to an end in the Ukraine/Russia conflict it could potentially lead to a change in trade flows and pricing for various commodities.

The reaction of the rest of the world to new policies will also be interesting. China is clearly prominent in what will happen here. The reading from our visit was that the leadership will take pause to assess the impact of any new policies, particularly on the trade front. It is likely that any new stimulus will be held off until March to give time to assess the best course of action. The question also arises as to what extent additional stimulus would merely offset the damage done by these policies. We would also expect that if the playbook from the 2016 election is followed that the RMB will be allowed to devalue ahead of any tariff changes coming into place. This would be negative for commodity prices in the short term. Clearly many other countries will need to assess what they do in response to any policy changes.

From a thematic point of view 2024 was the year that AI moved from aspirational to a core business focus for many industries. It will be interesting to see to what extent the momentum carries on into 2025 and beyond. On this front the key will be the ability to ultimately commercialise AI products in a profitable manner. If successful AI implementation could also have widespread implications for productivity and large parts of the employment market.

From a domestic perspective we have seen inflation pulling back with some signs of softness in the employment market and early signs of house prices coming back in larger cities. This should see interest rates being cut as we move into the new year. This year will see a Federal election, with. polling close, the early signs are of a divisive campaign with people still reeling from cost of living pressures and the coalition likely to take a page from the unexpectedly successful Trump style of campaigning. Elections have also historically seen a pause in consumer and business spending during the campaign period.

On the corporate side 2025 has begun with the typical headlines of pending M&A activity. Recent announcements add some credence to this with the aforementioned NST bid for DEG and the now contested bid for Insignia Financial (IFL). On the IPO side whilst there does not appear to be anything on the immediate horizon, we saw a reasonably strong finish to 2024 with the listing of the DigiCo Infrastructure REIT (DGT) by HMC. We are also conscious that there are several companies such as Virgin Australia sitting in the hands of private equity that are due to list at some stage. We expect supply to remain healthy on the equity capital markets front with selldowns likely in businesses such as Sigma/Chemist Warehouse (SIG) and Guzman and Gomez (GYG).

Near-term focus remains on mining companies' quarterly production reports (January) and the crucial December reporting season (February). In the December quarter, we prioritised building conviction in new ideas, increasing conviction in existing investments and mitigating exposure to earnings risks, which rewarded the portfolio. Heading into reporting season we feel that there are many companies that still face additional earnings risks. The portfolio continues to be made up of companies where we believe there are strong structural tailwinds to drive ongoing strong earnings growth as well as take advantage of short-term mispricing in the market. Coming into reporting season, we feel confident in the construction of the portfolio, without having a major tilt towards a particular style.

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