30 JUNE 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	-0.91	-2.01	9.85	3.17	7.53	7.45	7.52
Mid Cap Composite Benchmark[1]	-1.38	-3.42	7.42	2.86	7.71	8.37	8.31
Excess Return	0.47	1.41	2.43	0.31	-0.18	-0.92	-0.79

*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).

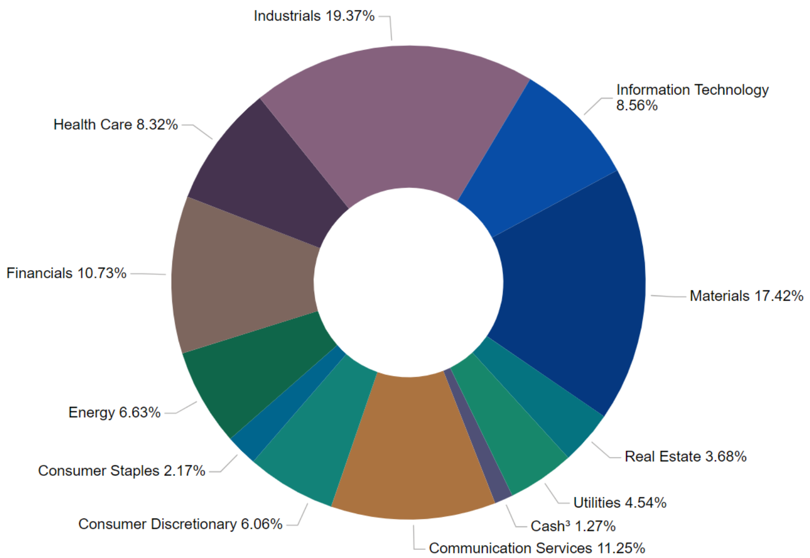
LEAD PORTFOLIO MANAGER

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	46
Portfolio Dividend Yield	2.3%
Fund Size (AUD)	$ 69M

TOP 10 POSITIONS	WEIGHT %
CAR Group Ltd.	6.38
Orica Ltd.	5.11
Seven Group Holdings Ltd.	4.50
Vicinity Centres	3.68
Qube Holdings Ltd.	3.67
NEXTDC Ltd.	3.61
REA Group Ltd	3.51
Worley Ltd.	3.50
Cleanaway Waste Management Ltd.	3.32
ALS Ltd.	3.14

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

Higher inflation and sustained economic growth have been the dominant themes for global equities during the June quarter. In the background, escalating geopolitical tensions, political elections, the ongoing advancement of Artificial Intelligence (AI) and energy security continue to be dominant themes that impact the market and individual companies.

The MSCI World Net Total Return Index ended the quarter +2.9% (in USD), with both developed and emerging economies rising amid improving global sentiment. Global growth has been revised up and the quantum and magnitude of rate cuts has been revised down.

The US, after an aggressive Fed rate hike cycle, now appears to be edging closer to taming inflation, and appears ahead of the RBA on this front. US PCE was 2.6% in May, in line with expectations, and the lowest level since this inflationary period began. The Goods component is currently in deflation and Services inflation continues to come down.

This backdrop has supported corporate earnings, with a strong US 1Q earnings season, driven again by the "Magnificent 7" technology stocks, and a sanguine outlook for the June quarter. While the Magnificent 7 had led the charge, we are also seeing a broadening in market strength, with the S&P 500 Total Return Index which gained 4.28% (in USD) during the quarter and the NASDAQ Total Return being +8.5% (in USD).

Turning domestically, inflation in Australia has proven stickier, with Australia unique among developed economies in bracing for another potential rate hike. The latest CPI figure showed a reversal of the recent disinflation trend, with CPI increasing YoY from 3.6% in April to 4.0% in May. The bond market is now pricing in a ~50% chance of a rate hike in the September RBA meeting. The S&P/ASX200 Total Return Index (ASX 200) declined by 1.1% over the quarter, Mid Cap[1] (-3.0%) and Small Cap[2] (-4.5%). Of the ASX 200, Utilities were the best performing sector driven by higher electricity prices. Financials also outperformed, driven by the Banks. Materials underperformed, driven by earnings downgrades and REIT's by interest rates.

In terms of Commodities, performance was mixed over the quarter. The lithium market's bounce proved short-lived, as news flow of slower EV demand and increasing supply, despite several maintenance cuts and expansion delays, pressured the lithium price. Spodumene was down 12.4% and carbonate down 15.4% (both in USD). Conversely, the Iron ore price rose 4.4% (in USD) and appears to be finding support around US $100/T. Copper started the June quarter very strongly, rallying 25% in April on prospects of better economic growth, although consolidated and declined, closing the quarter +8.6%. Aluminium rose 8.0% on supply disruption after RIO declared force majeure on its Queensland alumina refineries.

The US 10-year Treasury yields rose 20bp over the quarter to 4.40% due to improving outlook for economic growth. The yield curve remains slightly inverted, although the 2-10yr spread narrowed modestly over the quarter. Domestically, Australian bonds sold off reflecting the stickier inflation outlook, with the 10-year Treasury yield increasing 35bp, and 2-10 year curve steepening by 5bp. The currency markets reflected these relative interest rate moves, with the AUD strengthening 2.3% against the USD.

Corporate activity over the period was subdued, although there were several secondary equity raisings. In a still-lacklustre IPO market, there was much hype around the Guzman Y Gomez listing in late June. Guzman opened very strongly, closing +37% after the first day of trading. In terms of secondary raisings, buoyed by the increasing opportunities presented by the AI thematic, Macquarie Telecom, Next DC and Infratil raised an aggregate cA$2.5 billion to fund data centre build outs. Other noteworthy raisings include Ansell raising $475million to fund an acquisition of ancillary industrial supplies distributor, Kimberly Clarke PPE, AUB completed a small raising to fund an acquisition in line with their strategy, De Grey took advantage of gold prices, raising $600 million to fund development.

[1]*Mid Cap refers to the S&P/ASX Mid Cap 50 Total Return Index.*

[2]*Small Cap refers to the S&P/ASX Small Ords Total Return Index.*

PERFORMANCE

The Fund was down 2.01% for the June Quarter, outperforming the Mid Cap Composite Benchmark by 1.41%. A diverse range of holdings drove the performance during the quarter, largely on positive announcements. Equally, the key negative contributors have been stocks that have had positive announcements that we do not own and Block where we still have conviction in the earnings outlook and strategy.

Positives

GQG Partners (GQG) – Overweight
GQG provided a strong update during the quarter. Fund flows and performance continues to be strong.

Pro Medicus (PME) – Overweight
Pro Medicus rallied on recent contract wins which further solidified share gains. The share price continues to track moves in the AI thematic, namely Nvidia.

AUB Group (AUB) – Overweight
AUB raised profit guidance to the upper end of the range on continued operating momentum. AUB also raised capital to acquire an Australian-based underwriting agency in line with its strategy to invest and build out its portfolio of agencies offering.

AGL Energy (AGL) - Overweight
AGL outperformed during the quarter after upgrading FY24 guidance and rising power price expectations.

Negatives

Block Inc (SQ2) – Overweight
Block fell on slowing growth in their US seller business, highlighting market share losses.

Fisher & Paykel (FPH) – Underweight
Fisher & Paykel reported a strong result.

Ampol (ALD) – Overweight
Ampol fell in sympathy with refining margins during the quarter.

Telix Pharmaceuticals (TLX) – Nil Holding
Telix had a strong sales quarterly result and positive data from the PostACT Select Study trial of TLX591. The decision to pull the US listings was also viewed positively.

PORTFOLIO CHANGES

Purchases

Vicinity Centres (VCX)
Share price weakness provided a good entry point. The retail sector experienced cap rate expansion pre-covid and during covid versus the office sector.

Fisher & Paykel (FPH)
A return to normal operating conditions, confidence around FPH's ability to continue growing new application consumables and margin expansion.

A2 Milk (A2M)
Increased confidence around A2M's ability to expand products and grow market share.

Bendigo Bank (BEN)
During the quarter we increased our holding. BEN has displayed good control of NIM, costs in an inflationary period and is finalising an investment program in new systems which will drive efficiencies in future periods.

Sales

Wisetech Global (WTC)
Due to Wistech moving out of the ASX Mid Cap 50 Index and into the ASX 50 Index we reduced our holding.

Steadfast Group (SDF)
Insurance cycle peaking and declining acquisition opportunities in Australia.

Challenger (CGF)
Recovery in margins peaking and longer term annuity sales being impacted by the flatter yield curve that makes short term fixed rate alternatives relatively attractive.

Sandfire (SFR)
Following the strong rally in copper prices, we reduced our holding in Sandfire on valuation.

ENGAGEMENT

During the quarter, we undertook a total of 32 engagements in which we explicitly discussed ESG matters with 26 companies relevant to the strategy. A majority (88%) 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, human capital management and conduct.

We met with Beach Energy (BPT) twice in the quarter, with one meeting following the release of its inaugural Climate Transition Action Plan (CTAP) and the other after the strategic review undertaken by the new CEO. We were pleased to see climate disclosure enhancements, something we had been engaging the company on. While further detail would be welcome, the CTAP was a good first step, especially considering how quickly the company has moved in the last two or so years. On the strategic review, which included a significant headcount reduction, we sought to understand how the CEO is managing this from a human capital perspective and navigating impacts on morale and culture.

TRIP TAKEAWAYS

Alongside our normal company visitation program, during the quarter, the team conducted several international trips, visiting Europe, China, the US and Canada.

We attended Orora's Saverglass investor tour in France and met with a range of industry experts around Europe. The high price Orora paid for Saverglass and the timing of the deal is not lost on us and the market. While Saverglass is caught in a cyclical rut, we came away with the view that Saverglass has good business characteristics. It has a strong competitive position, dominating the manufacture and decoration of glass bottles for high end spirits and wines, with few competitors.

In Canada, we toured Champion Iron's (CIA) Bloom Lake iron ore mine. At Bloom Lake, we witnessed the expanded Phase 2 operation and construction underway for the direct reduction pellet feed (DRPF) which upgrades CIA's concentrate to a 69% Fe DRPF quality iron ore. Owing to its higher iron content and lower impurities, pricing for DR-grade iron ore attracts a significant premium over traditional high-grade iron-ore. With growing demand from European and Middle Eastern electric arc furnaces, CIA's exposure to China may reduce to ~10%, reducing shipping costs as a result. The Federal Canadian Government's recently added high purity iron ore to its critical minerals list. This potentially provides CIA access to funding for future projects like Kami, expanding production potential and improving returns.


(Photo 1 – Portfolio Manager Jovana Gagic overlooking the Bloom West pit
Photo 2 – Construction of CIA's DRPF circuit)

Further north, in Saskatchewan, we visited NexGen's uranium project Rook I which, when completed, is expected to be the single largest uranium producing mine in the world. While the company awaits regulatory approvals, expected in the second half of 2024, it is doing the early works and ordering necessary equipment to be "shovel-ready" when the project is approved. The high grade of the deposit, being hard rock, enables NexGen to be one of the lowest cost producers in the world. At US$100/t uranium price, NXG could produce circa C$3.4 billion EBITDA and generate over C$2 billion in free cash flow.

(Photo 3 – NexGen Rook I Project)

In the US, meetings with consumer companies across retail, food & beverages and travel provides a consistent message. The consumer is still spending but more value-conscious and pushing back on price increases. There's a bifurcation between higher end consumers that have fared relatively better from rising rates and the lower end consumer. Yum! Brands, spoke to the consumer bifurcation across its brands. For example, Taco Bell, a more affordable product, is seeing same store sales +2% in the latest trading period, while Pizza Hut, a more expensive offering, is seeing same store sales down 6%.

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Travel spend remains strong, across both leisure and corporate. The Transportation Security Administration (TSA) screened the most people ever over Memorial Day weekend and Delta reported they expect to see a record spring and travel season with their 11 highest ever sales days in history occurring this calendar year. Corporate travel continues to grind higher, with the added tailwind of the tech sector now back to travelling. Delta is seeing business travel demand growing at the mid-teens percentage year-on-year.

Another common thread in our meetings related to labour availability and wages. Following several years of wage pressure and an inability to find staff, the environment for corporates has shifted. Labour availability has improved, and wage pressure is easing.

Beyond labour, supply chain constraints are still causing challenges for some, while benefiting others. For some, it is a mixed blessing. For example, for airlines, Boeing and Airbus's production backlog is crimping capacity growth but perversely keeping yields higher. For the hotel industry. a lack of new hotel supply during covid is also boosting room rates and given the lead time to deliver new rooms, is expected to hold well above the 2019 levels over next year.

Retail REITs faced challenges long before covid and, following a period of rightsizing supply, are in a relatively better position than they have been historically. Retail space per capita in the 45 largest markets in the US has hit a multi-decade low and completions are at the lowest since Q1 2011. Given the increase in construction costs, retail rents would need to increase significantly to drive new supply growth. One of the REITs we met with spoke to occupancy being at record levels, higher annual rent increases and strong re-leasing spreads. While Australia is not entirely comparable to the US, we are positive on Vicinity Centres for similar reasons. Amongst the REIT sector, retail REITs have already taken the cap rate expansion pain and are better placed.

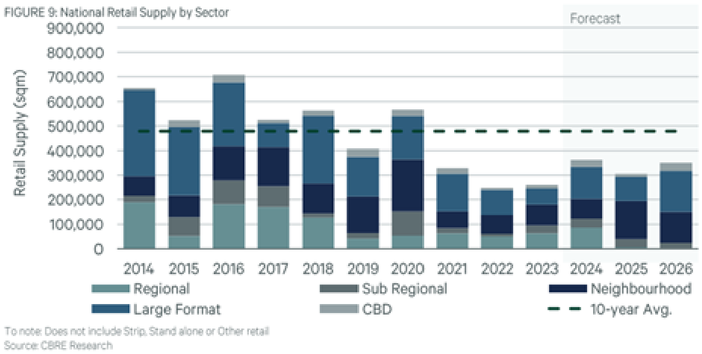
In China, the bifurcation between the lower end and premium consumer was consistent with trends in the US. Unlike most developed economies, there was not a tsunami of stimulus directed at the consumer, which hampered a strong reopening. Our China trip also exposed us to on-the-ground insights into A2 Milk. After years of declining birth rates due to covid and structural challenges, the pent-up demand, an uptick in marriages and the fortuitous "Year of the Dragon" are expected to drive a rise in births in 2024 and 2025. The strength of A2's brand, their market position as a superior quality offering and the strength of the A2 China team's execution came across clearly from multiple perspectives. We came away positive on the further market share expansion outside the Tier 1 cities, an area we had been concerned with previously.

OUTLOOK

The near-term outlook for the Australian economy appears challenged, with softening consumer demand and the prospect of yet another rate hike due to sticky inflation. As mentioned above, the market is pricing in a 50% probability of a rate rise in Australia by September.

Considering the risk of risk of higher-for-longer rates we are being selective with our positioning on REITs and have a relatively positive view on the retail REIT space, owning Vicinity Centres. Despite the soft retail demand environment retail REITs have already been through a cap rate expansion cycle. Balance sheets are in better shape than historically and are trading at relatively attractive valuations.

Australian retail supply by sector – over 50% decline from its peak in 2016 as at 30 April 2024



Trading updates by retailers during the quarter point to a softening consumer. Consumers reluctance to spend on discretionary items was manifested through weaker trading updates from JB Hi Fi, Temple & Webster, Kathmandu, Cettire, and Baby Bunting. Consumers are increasingly seeking value, and a value-conscious consumer is expected to again be a feature during the August reporting season. However, despite this dour current sentiment, the medium-term outlook is more robust, as the prospect of tax cuts equivalent to 1.5% of GDP, and cycling of weak comps, should supporting growth for retail over the next 12-18 months.

Better cost control and deflation in key costs inputs, particularly freight has supported margins. More recently, the cost outlook has since turned less benign, with freight spiking due to the geopolitical disruptions to Red Sea freight and stronger demand. If freight remains elevated this poses a risk to margins. Labour and wage pressure is expected to remain a key focus, albeit improving from what we have seen in the past. Given consumer pricing fatigue we are less confident on companies being able to pass on higher freight in the form of price rises.

Housing construction activity has begun slowing as we have worked through the backlog created from supply chain challenges and covid. Subdued demand conditions are reflective of the slowdown in housing approvals last year, given the lag from approval to commencement to completion. While still early days, we have seen a rebound in housing approval in April and May, likely reflecting a structural undersupply in housing and an influx of migrants over the past two years.

Artificial intelligence (AI) has already catalysed a wave of enthusiasm, backed up by significant investment. As with the internet revolution, the most significant impacts of AI may not become apparent for several years, and they are unlikely to be detected in traditional economic data in the near-term. Constraints on AI adoption include the supply of advanced semiconductors, legal and regulatory issues and limited power. While we are keenly aware of the opportunities, we remain prudent about the costs and time to realise.

On the geopolitical front, tensions are escalating. There continues to be a widespread focus on national security, domestic energy supply, security of supply chains and cybersecurity. Politics is firmly on the agenda with elections in UK, India, France having taken place in the last 3 months. US elections will dominate headlines as we approach the end of 2024, with tariffs, corporate tax, fiscal stimulus and energy key agenda items that will impact inflation and growth in the world's largest economy.

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All up, the market continues to vacillate between soft-landing, no-landing and hard-landing scenarios with each new, conflicting data point. Observing these market fluctuations reinforces our bottom-up approach to investing. We have been busy with company visits and trips during the quarter to build conviction in existing investments and find new ideas. Heading into reporting season, the portfolio remains balanced across sectors and styles, and we remain invested in companies we believe will outperform on individual merits through the cycle.