Paradice Australian Equities Fund January 2025 Commentary

Market Review

The S&P/ASX 200 Total Return Index and S&P 500 Total Return Index were up 4.5% and 2.7% (in USD) respectively in January 2025.

The Paradice Australian Equities Fund was down 26bps vs the benchmark. Top 3 contributors were Newmont, QBE and ResMed. Top 3 detractors were Alcoa, Treasury Wine Estates and Origin Energy.

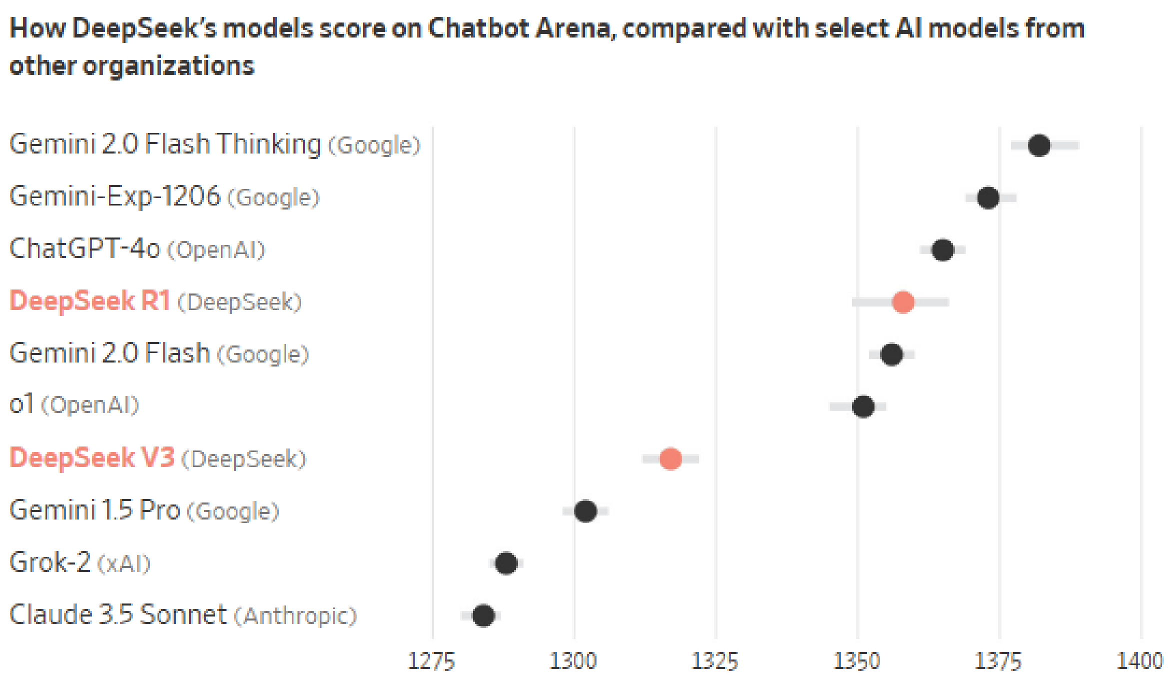
Noteworthy industry / macro developments

#1 Emergence of DeepSeek challenges pre-existing AI investment rationale

The world's largest hyperscale providers (Google, Meta, Amazon, Microsoft) have touted that their vast cloud capex (which have estimated to collectively risen from c$120b in 2023 to c$280b in 2025) affords them a strong competitive moat.

The explosive emergence of DeepSeek, in particular, its superior "reasoning" capabilities developed for a fraction (up to one hundredth) of the cost of the incumbents, has rattled this theory (for now).

In a week post DeepSeek-R1's release, it has leapt up to top 5 in Chatbot Arena, which measures the relative performance of large language models (LLMs).



Note: As of 27 January 2025, Source: Chatbot Arena

Whether DeepSeek used part of OpenAI's intellectual property, or whether it indeed only used 2,000 GPUs[1] (vs Meta training its Llama-4 model on 100,000 GPUs) is still up for debate. However, it is clear that new more efficient technology and competitors disrupts existing incumbents and their capital investment plans. This is expected to lead to LLMs becoming commoditised over time. The need for fewer, and more energy efficient chips also has the capacity to temper the seemingly insatiable appetite to build data centres, with potential impacts on the development pipeline and valuation of companies such as NextDC, Goodman Group, Digico Infrastructure, and Infratil. We are watching these developments with heightened interest.

<u>#2 Trump tariffs key trading partners</u>

On 1 Feb 2025, the White House formally announced a 25% tariff against all imported goods from Canada and Mexico, and a 10% tariff on China. This targets 3 of the 4 largest trade partners for the US representing c40% of US imports.

Source: BEA, Macquarie Macro Strategy

For ASX listed companies, the range of impacts could be fairly broad.

The most acute impact is for companies with a significant portion of their cost base in Mexico/Canada, who then on-sell to the US, as the tariff makes them less competitive. Examples include Fisher and Paykel where c45% of its volume is manufactured in Mexico, and 60% of its US volumes are supplied from Mexico. For Alcoa and Rio Tinto, a significant portion of their aluminium production is in Canada and then exported to the US. For Orora's Saverglass business, tequila is exclusively produced in Mexico and a large portion shipped to the US. The ultimate impact may be partially mitigated by USD strength, price increases, or re-routing of trade.

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[1] Graphics Processing Units

Mexico and Canada are also likely to face significant macro headwinds given the US represents c20% of these countries' exports; as such, companies with material sales exposure to these regions (e.g. Brambles, Amcor) may be adversely impacted.

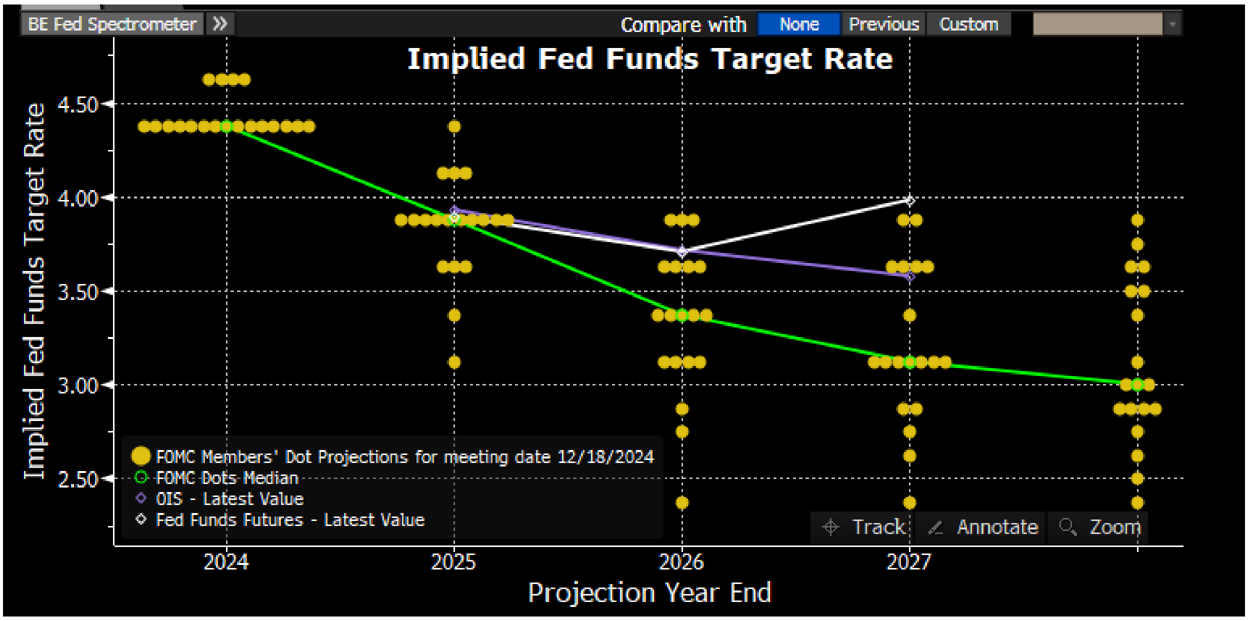
On balance of probability, these measures in isolation are likely to skew the US economy towards higher inflation and lower growth, i.e. they are modestly stagflationary.

#3 Fed keeps rates on hold

As expected, the Fed held rates flat at 4.25-4.50%, unchanged for the first time since July 2024. The Federal Open Market Committee (FOMC) removed a reference from its prior rates decision of inflation making "progress" toward the 2% target, noting unemployment has "stabilized at a low level" and "inflation remains somewhat elevated".

The bond market continues to moderate the pace of rate cuts, with 50bps expected for remainder of 2025 and just 25bps expected in 2026.

Should this transpire, it would suggest a rather healthy and resilient US economy persisting, but where the market multiples could struggle to expand further in anticipation of earnings acceleration. In this environment, high quality companies with strong balance sheets are likely to do well, whilst "bond proxies" (eg REITs, utilities, infrastructure companies) have typically struggled to outperform.



Source: Bloomberg, as at 4 February 2025.

Australian company news of interest

A handful of companies released market updates.

Notable beats included:

- Sigma (SIG) – double digit like-for-like (LFL) growth and margin expansion for the Chemist Warehouse franchisor/supplier
- ResMed (RMD) – posted 10% revenue and 29% EPS growth in 2Q25, beating consensus estimates modestly.

Notable misses included:

- Premier Investments (PMV) - Retail conditions have remained challenging with flat Australian sales and lower margins vs 1H24
- Kogan (KGN) – sales growth accelerated during peak trading period, however profitability was hampered by increased marketing and Mighty Ape re-platforming challenges.

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