

# Ellerston Equity Income KIS Fund

Monthly Report as at 31 December 2023

APIR Code: ECL7259AU | ARSN 662 683 123



Concentrated portfolio of 30-40 Australian listed securities that display stable and growing dividend streams.



Looks beyond traditional "income sectors" (e.g., banks and telecoms), recognising "cyclical sectors" are now experiencing structural shifts towards the provision of more reliable income.



Aims to provide investors with returns and income growth greater than the Benchmark over rolling five-year periods.

## Performance Summary

Performance	1 Month	Dec QTR	FYTD 2024	CY 2023	3 Years (p.a.)	4 Years (p.a.)	Since Inception (p.a.) ^^
Fund Net Return <sup>^</sup>	6.36%	10.59%	6.84%	11.68%	10.41%	7.94%	9.29%
Benchmark <sup>*</sup>	7.26%	8.40%	7.57%	12.42%	9.24%	7.23%	8.08%
Alpha	-0.90%	2.20%	-0.73%	-0.74%	1.17%	0.71%	1.22%

<sup>^</sup>The net return figure is calculated after fees & expenses assuming all distributions are reinvested. Past performance is not a reliable indication of future performance.

<sup>\*</sup>S&P/ASX 200 Accumulation Index <sup>^^</sup>Inception date is 1 May 2019.

## Key Information

Portfolio Manager	Chris Kourtis
Investment Objective	To provide investors with returns and income growth greater than the Benchmark over rolling five-year periods.
Benchmark	S&P/ASX 200 Accumulation Index
Liquidity	Daily
Target Number of Holdings	30-40
Number of Holdings at Month End	31
Minimum Investment	Initial investment - \$10,000 Additional investment - \$5,000
Distribution Frequency	Quarterly (where available)
Management Fee	0.70% p.a.
Performance Fee <sup>1</sup>	10.00%
Buy/Sell Spread	0.25% / 0.25%
Strategy FUM <sup>2</sup>	\$64.29m
Platform Availability	HUB24, Netwealth
SQM Rating <sup>3</sup>	Superior / 4.25 Stars

<sup>1</sup>Of the investment return above the benchmark, after recovering any underperformance in past periods.

<sup>2</sup>Funds invested across all Equity Income KIS strategies.

<sup>3</sup>Rating assigned 6 October 2023.

## The Team



### Chris Kourtis

Director & Portfolio Manager

38 years of industry experience.



### Stephen Giubin

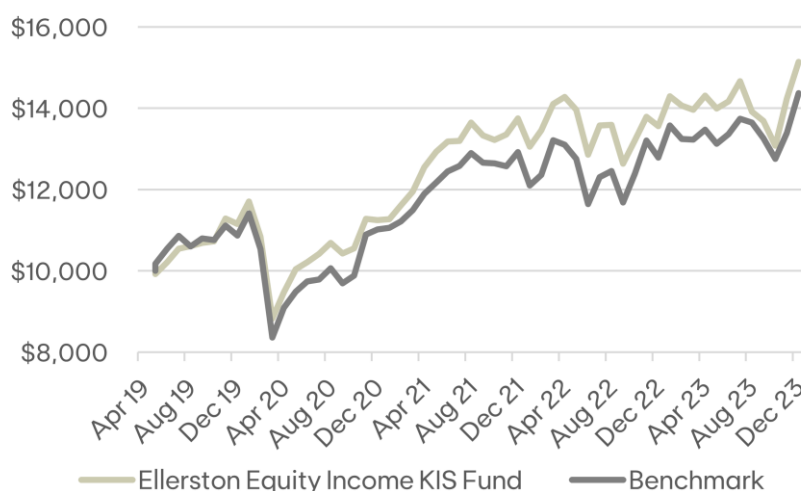
Senior Investment Analyst

35 years of industry experience.

FY24(E) Key Portfolio Metrics	Fund	Benchmark
Grossed Up Dividend Yield (%)	6.4	5.3
Price/Earnings (x)	13.8	16.3
Dividend Yield (%)	5.0	4.0

Source: Ellerston Capital.

## Growth of \$10,000 Investment

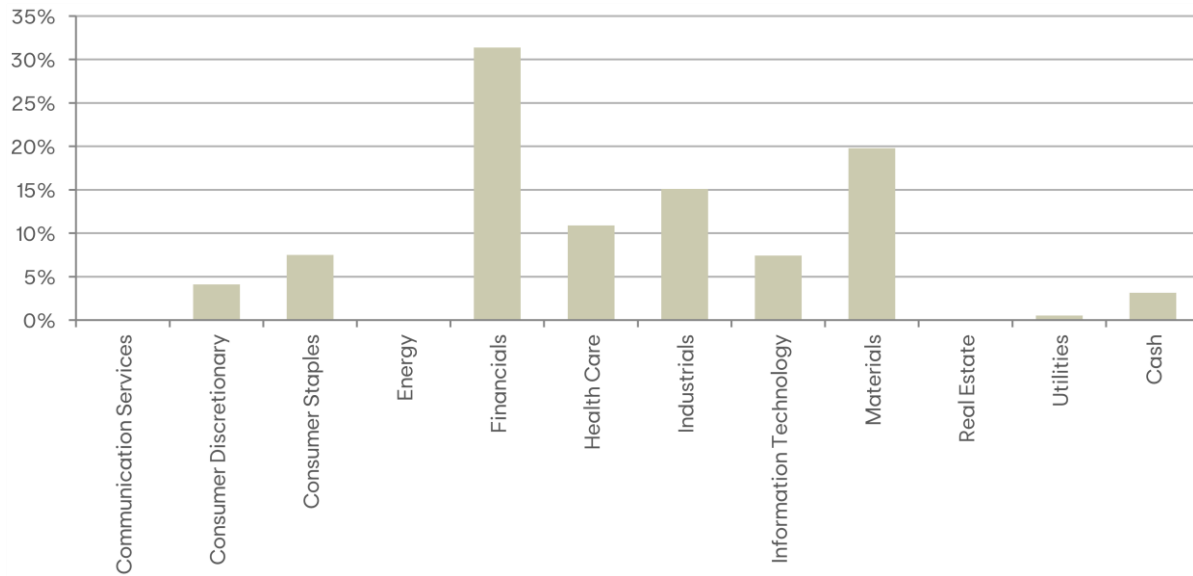


Fund Performance shown is net of fees, assuming all distributions are reinvested.

Past performance is not a reliable indication of future performance.

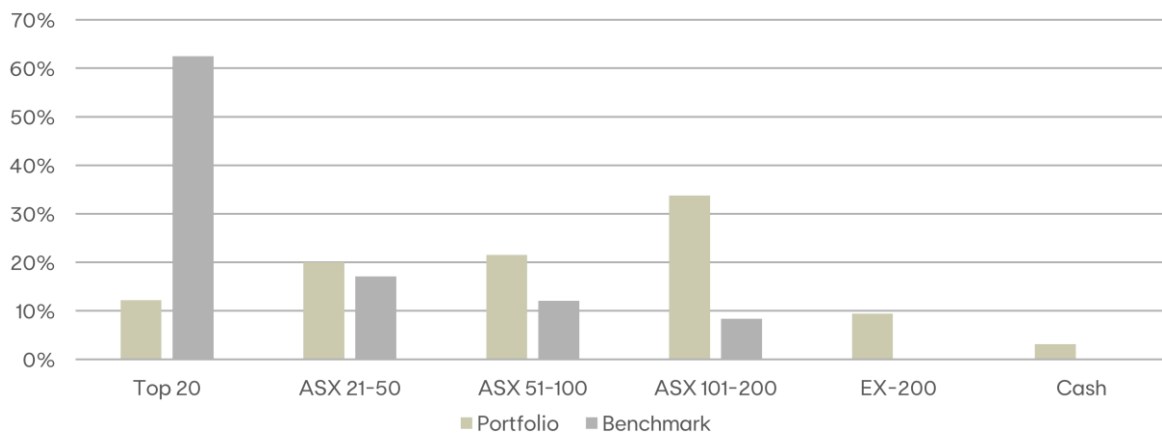
Source: Ellerston Capital.

## Sector Allocation



Source: Ellerstion Capital.

## Exposure by Mark Capitalisation



Source: Ellerstion Capital.

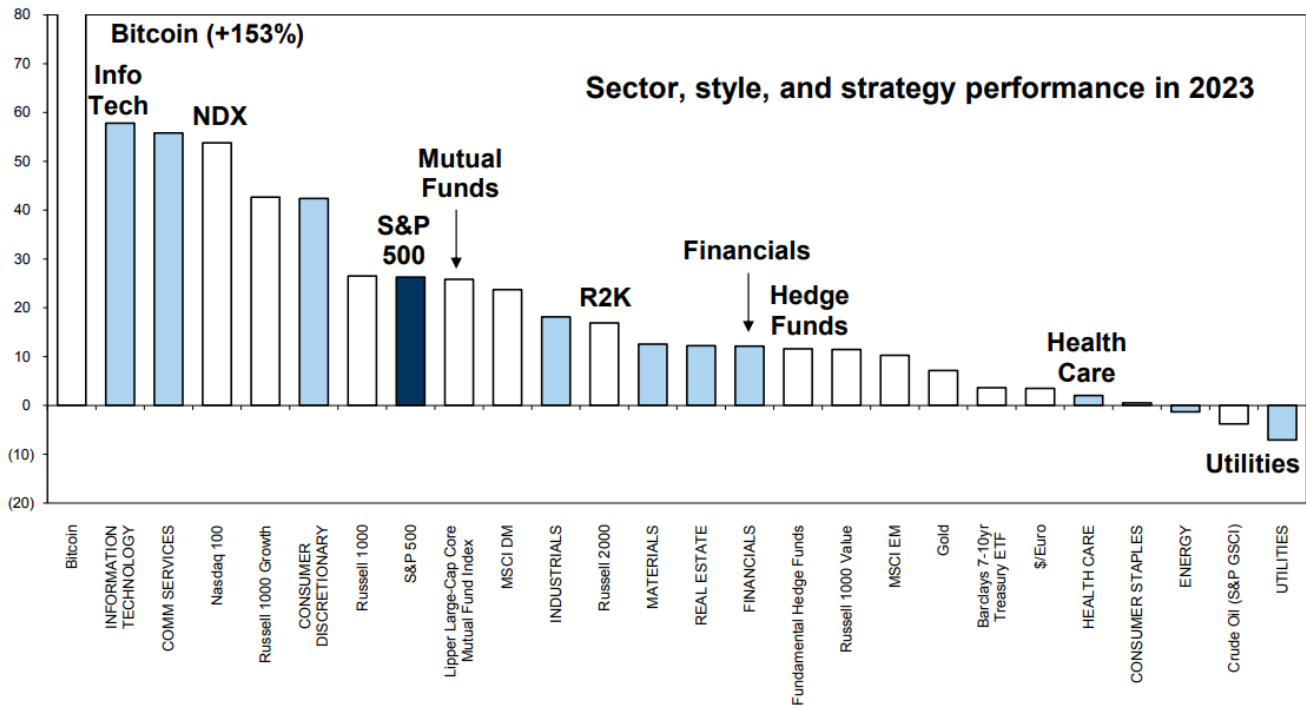
## Top 10 Holdings\*



\* In alphabetical order.  
Source: Ellerstion Capital

## MARKET OVERVIEW

Global equity markets kept rising in December, with the MSCI World Index up 4.2% in local currency terms. Dovish signalling on US interest rates by the Federal Reserve (Fed) sparked a particularly strong run up in stocks, bonds and the Australian dollar. The Fed pivot drove the US 10-year bond yield back to 3.9%, with markets now pricing at least six interest rate cuts in the US and up to three in Australia. The S&P500 rose 4.5% and domestically, the S&P/ASX 200 index closed slightly lower at 7590.8 on the last trading day of the year, flirting with near all-time highs. That was not enough, however, to spoil accumulated monthly gains of 7.3%, the best December rally in three decades. Real Estate (+11.3%) and Healthcare (+9.1%) were the standout performers.



Source: Goldman Sachs

## USA

The Federal Reserve's FOMC meeting on 12/13 December unsurprisingly left the target range for the federal funds rate unchanged. The median dot in the Summary of Economic Projections showed 75bps of cuts in 2024, 25bps more than in the September projections. The Fed moved towards the market's thinking by lowering their core inflation expectations and is now factoring in three rate cuts in 2024. The statement and dot plot screamed of a 'Goldilocks' soft landing, which the market clearly relished.

The S&P 500 and the Dow Jones Industrial Average were up 4.5% and 4.9% respectively, with the NASDAQ Composite Index, rising 5.6% for the month. Way out in front, was the small cap Russell 2000 Index, with an impressive return of +12.2% in December.

## Europe

As expected, the ECB also decided to keep its three key interest rates unchanged in December, but ECB President Christine Lagarde delivered a gentle but resolute pushback against market expectations of policy rate cuts in early March. The BoE, in step, kept rates on hold, singing from the same hymnbook - "the committee continues to judge that monetary policy is likely to need to be restrictive for an extended period of time." Unexpectedly, Norges Bank bucked the trend, with a 25bps rate hike to 4.5% to its key interest rate.

The Euro STOXX50 Index finished the month up 3.2%. Among the major exchanges, UK's FTSE 100 was up 3.9%, whilst both Germany's DAX and France's CAC 40 finished 3.3% higher.

## Asia

China's top leadership held their Central Economic Work Conference (CEWC) in December, explicitly listing the challenges the Chinese economy faces. These included: insufficient demand, overcapacity in certain key industries, weak social expectations, blockages in domestic circulation and rising complexity, difficulty and uncertainty in the external environment. With this frank assessment, the leadership highlighted economic development as the central work of the CPC. It also urged timely policy implementation to achieve sustained high-quality development. Later in the month, the PBOC injected US\$50bn into Policy Banks, the largest since November 2022, suggesting the central bank may be ramping up financing for housing and infrastructure projects to support the economy, with focus shifting from the demand to the investment side.

India's SENSEX was the standout performer in the Asian region, up a solid 7.8%, followed by Korea's KOSPI up 4.7%. The Hang Seng rose 0.2%, the Nikkei closed 0.1% higher and the laggard was China's SSE, down 1.9%. Hong Kong's Hang Seng finished the year down 10.6%, worse than China's SSE, which fell 6.3%.

## Commodities.

Iron ore prices edged higher, rising 6% to US\$140/tonne and coking coal prices marked time at US\$324 per tonne. The base metals complex improved, with aluminium rising 9% and copper up 8%. Crude prices continued to slide, with Brent down 7% to US\$77/barrel, despite ongoing Middle East tensions and the new OPEC+ production cuts expected to kick in for 1Q24, with a headline curtailment of a 2.2Mb/d. The cut in supply included the existing Saudi/Russian voluntary curtailments, plus an addition 0.2Mb/d from Russia and 0.7Mb/d from six other members that have been struggling to meet their existing quotas. Focus remains on compliance. Gold ticked 1% higher to US\$2063/oz, surprisingly less than one would expect given the weaker US dollar and massive move down in bond yields.

The key feature in commodity markets was that lithium carbonate and spodumene continued to sell off in December, falling 16% and 31% respectively. The slump for the year saw lithium carbonate prices down 83% and spodumene benchmark price collapsing by 85%. The destocking in the EV battery supply chain continues!

## Bonds

The US 10-year bond yield was down another 46bps last month to 3.88%, due to the Fed's dovish pivot. On the domestic front, the Australian 10-year bond yield also fell in step with the global trend, falling by 45bps to close at 3.96%. Surprisingly, the US and Australian 10-year bond yields at the start of the year were 3.88% and 4.05% respectively, so virtually no change, but the journey felt like a white knuckle, wild roller coaster ride!

## Australia

The RBA held the cash rate at 4.35%, as expected after November's hike of 25bps. Employment continues to grow at a solid clip, increasing 61k in Nov compared to consensus +11.5k. Despite the strong rise in employment, there was also a material increase in the supply side of the labour market. This came from a lift in the participation rate and upward revisions to the civilian population, which drove an increase in the unemployment rate to 3.9 per cent (from a recent cycle low of 3.4 per cent). For the time being, it appears that the RBA will stay on the sidelines.

The A\$ closed the month up 3% to US\$0.68, a beneficiary of higher iron ore prices, but mainly the weaker greenback which was down 2% on a trade weighted basis, as US Treasury yields fell sharply.

**The S&P/ASX 200 Accumulation Index surged in December, with the ASX 200 rising 7.3% and lifting the 2023 return to +12.4%, including dividends.** This was largely driven by PE expansion, which contributed +16.0% to returns, more than offsetting the 8.1% fall in forward EPS over 2023, with dividends contributing 4.6% to total returns. Real Estate, Healthcare and Materials led the performance charts. The Real Estate sector (up 11.3%), was the best performer, spurred on by Goodman Group (+11.9%), followed closely by Healthcare (+9.1%) driven by CSL's impressive 9.3% gain and Materials (+8.8%). The bottom three sectors were Utilities (+2.5%), dragged down by AGL Energy (+0.5%), Energy (+3.4%) and Consumer Staples (+5.1%).

For the month, the top stocks that made a positive contribution to the Index's return were BHP (+99bps), CBA (+57bps), CSL (+56bps), NAB (+35bps) and Fortescue (+32bps). Conversely, the bottom five stocks detracting from the Index's performance were QBE Insurance Group (-5bps), IDP Education (-4bps), IAG (-3bps), Evolution Mining (-1bps) and De Grey Mining (-1bp).

The ASX Small Ordinaries rebounded very strongly in December and closed up 7.2%, just pipped by the broader benchmark at 7.3%. Within the ASX Small Ordinaries, the Small Industrials did much of the heavy lifting +8.5%, versus the Small Resources, which struggled and closed up 3.7%.

## COMPANY SPECIFIC NEWS

### The Market Hits

**Neuren Pharmaceuticals (NEU +61.1%) and in fact, was the best performing stock in the ASX200 for 2023, + 214%**

NEU develops new drug therapies to treat multiple serious neurological disorders that emerge in early childhood and have no or limited approved treatment options. DAYBUE™ (trofinetide) is approved by the US Food and Drug Administration (FDA) for the treatment of Rett syndrome in adult and paediatric patients, two years of age and older. NEU granted an exclusive worldwide licence to Acadia Pharmaceuticals, Inc. (ACAD) for the development and commercialisation of DAYBUE. In November 2023, NEU reported highlights from its partner ACAD Q3 earnings announcement, which showed strong sales of DAYBUE in the US of US\$67m. Forecast sales of US\$80-87m for 4Q (incurring a 10% royalty for NEU) also buoyed sentiment. Importantly, apart from the annualised royalties of A\$50m+ to NEU, pleasingly for investors, operational metrics exceeded expectations. NEU then followed this up in December with the announcement of positive top-line results from the completion of its Phase 2 clinical trial of NNZ-2591 (treating Phelan-McDermid syndrome - PMS), which is a five times larger opportunity than DAYBUE. Based on the reported safety and tolerability profile, development progression for NNZ-2591 was deemed warranted and whilst NNZ-2591's mechanism of action is not as specifically defined as receptor or gene-targeted drugs, the in vivo preclinical data from genetic models was solid. Investors have concluded that overall, the probability of success for NNZ-2591 in PMS has increased and this confidence pushed NEU'S stock price up 30% on the day, clocking 61% for the month and an impressive 214% for the year, right at the top of the charts.

### **HMC Capital (HMC +27.8%)**

HMC has outperformed the Real Estate sector by 30% this year, driven largely by former investment banker David Di Pilla. HMC has successfully raised capital for new funds, acquisitions and capped off the year with the company transforming Sigma Healthcare (SIG) transaction. SIG confirmed plans to "merge" with Chemist Warehouse to create a \$8.6bn Australian healthcare juggernaut. This is the most significant transaction in the pharmacy space in decades and if approved by regulators (big if), will see the creation of an entity of a similar scale to medical consumer supplier EBOS, competing directly in its core healthcare business. As part of the transaction, SIG undertook a capital raise of \$400m at \$0.70 per share. HMC, which held 19% of SIG, participated in the capital raising and saw SIG's stock price rise an astonishing 44%, post raise.

### **Lovisa Holdings (LOV +27.5%)**

LOV is Australia's leading specialist fast fashion jewellery retailer, with over 700 stores across 30 countries globally. The company has developed a vertically integrated business model, through which it develops, designs, sources and merchandises 100% of its LOV branded products. LOV announced that it had opened its highly anticipated first store in China, in the Guangzhou Po Park Mall during the month. CEO, Victor Herrero Amigo who joined LOV 2 years ago, has deep experience and relationships in that market, having been instrumental in rolling out 600 Zara stores across China. LOV will start with a small handful of test stores, before committing to a full-scale rollout. Victor is noted as one of the highest paid CEO's in the country, bagging \$21m last year, so China expectations are high and there is little margin for erroneous execution for a retailer trading on 32 times. Time will tell whether he succeeds, meanwhile, investors propelled the shares on the news.

### **Credit Corp Group (CCP +25.3%)**

CCP bounced as bond yields fell amid dovish expectations of US rate cuts in early 2024, raising hopes that CCP's previous guidance of a sustained deterioration in collection conditions for FY24 would abate.

### **Magellan Financial Group (MFG +24.7%)**

The rise in MFG stock price during the month was driven by two key factors. First, global equities performed strongly, with the listed fund manager's equity business leveraged to higher share markets. Second, MFG agreed to buy \$65 million worth of options over its flagship ASX-traded global shares strategy, putting its battle with the activist Nick Bolton to rest. The options allowed unit holders to buy units at a 7.5% discount to NTA and given the share price was much lower at the time, there was a risk that a hedge fund could come over the top and promote a large scale buy back, or force a closure of the fund, which was deemed not to be in the interest of shareholders. The imbroglia was a hurdle for MFG to undertake a more aggressive capital management strategy by mid-2024.

### **Alumina (AWC +24.0%)**

The WA Government finally approved Alcoa's 2023-27 mine plan and issued a conditional exemption to allow Alcoa to keep mining, even if the EPA undertakes a further assessment. While Alcoa will still be mining lower quality bauxite until at least 2027, the potentially fatal risk of an immediate halt to mining and refining has been removed. AWC holds 40% of the joint venture company AWAC with Alcoa, so the ability to keep operating also reduces the need for AWC to raise capital for the time being. This good news for a change (after a string of negative announcements) was well received by investors, which saw the share price perk up during the month, but still down 40% for the year overall.

### **Block, Inc. (SQ2 +21.1%)**

After last month's guidance for 4Q adjusted EBITDA of US\$430-450m, 10-14% ahead of consensus and FY24 guidance of US\$2.4b adjusted EBITDA, again - well ahead of sell-side estimates at US\$1.94b, the SQ2 stock price continued to rally. This was helped by a month of "risk on" behaviour and short covering, together with the US\$1bn buy-back announcement.

### **Polynovo (PNV +20.4%)**

PMV is a medical device company, focused on advanced wound care that designs, develops, and manufactures dermal regeneration solutions (NovoSorb BTM, NovoSorb MTX) using its patented NovoSorb biodegradable polymer technology. PNV announced their first \$8m sales month for November, up 22% from October and \$29m for the FYTD. The stock price moved in line with the November sales growth, but even after annualising their highest month to date, this places PNV on 12 times revenue, which certainly requires investors to maintain the faith!

### **Liontown Resources (LTR +20.0%)**

LTR's volatile price move during December was more of a "dead cat" bounce following the aborted Albemarle takeover at \$3.00 per share, which initially drove the shares to a low of \$1.35. By month end, the stock closed at \$1.65. Given the continued weakness in lithium prices, which hit a low of US\$970/tonne for spodumene, the LTR price action had more to do with a takeover arrangement that Hancock Prospecting carried out with Chile's SQM in December, whereby Hancock was aiming to acquire Azure Minerals, after it accumulated a large equity position, stymieing SQM's initial offer. Hope that something similar could happen to LTR, given that Hancock is still its largest shareholder, got the short sellers nervous, sparking a relief rally.

### **Centuria Capital Group (CNI +23.2%)**

Property investment manager, CNI caught the tailwind of the rapid fall in global bond yields during the month, which saw the Real Estate sector as the top performer, rising 11.3% and outperforming the ASX200 by 4.0%.

## The Market Misses

### IDP Education (IEL -11.6%)

IDP has been a crowded consensus long among growth investors for some time, however a number of headwinds for its student placement and English language testing have emerged. Tensions between Canada and India continued to rise post the killing of a Canadian Sikh activist back in June of 2023, which has not been helpful for IEL's placement business. During the month, our home affairs minister Clare O'Neil, unveiled a new migration plan, which entails stronger integrity measures to reduce net overseas migration from 510,000 last financial year to an estimated 250,000 in the year to June 2025. Australia's commitments with India under the current ECTA, somewhat limit the impact on IEL's placements locally, although this remains unclear. Given IEL's high earnings multiple of 32x, investors needed more clarity. A further curve ball was thrown with the surprise announcement that its CFO would be departing after 13 years, leaving the relatively new CEO on his Pat Malone.

### Core Lithium (CXO -10.7%)

The 31% slump in benchmark spodumene during the month of December, chalking up an 85% decline for the year, was the nail in the coffin for CXO. The company announced a strategic review of operations, investigating a range of options to lower costs and increase productivity. Given the difficulties associated with mining and construction in the wet season and the focus on reducing capital expenditure, BP33 early works were suspended. The future of the company and its operational viability beyond 2025 hinges on its ability to make the BP33 underground operation economic, a challenge which has become considerably more difficult given its processing plant is only recovering ~50% of the lithium units fed to it. CXO won the wooden spoon, down 79% for the year!

### De Grey Mining (DEG -8.4%)

Little news on DEG during the month, although after the recent \$300m capital raise at \$1.05 per share, the share price bounce to \$1.40 looked very enticing and punters took profits.

### Light & Wonder, Inc. (LNW -7.4%)

NASDAQ listed, LNW is a leading cross-platform global games company with a focus on content and digital markets. It develops technology-based products and services, and related content for the gaming, lottery, social and digital gaming industries globally. North America is its largest geographic market and land-based gaming accounts for 2/3 of sales. LNW had a secondary listing on the ASX in May 2023 and the shares performed strongly. However, LNW gave back nearly half of its run in November, after an upbeat 3Q result, on no particular news, but the stronger \$AUD certainly acted as a translation headwind.

### PEXA Group (PXA -7.3%)

Digital property settlement platform, PXA provided a very soft trading update in December, resulting in FY24 EBITDA guidance of \$109-115m, below consensus of \$120m. The local business was in line, but the international business continued to disappoint. Investors don't like downgrades in the week before Christmas and they didn't like this one. As a result, the stock fell 12% on the day, erasing previous gains.

### IPH (IPH -6.1%)

IPH is an intellectual property (IP) advisory offering IP and Trademark services spanning the patent/trademark life cycle. It has a leading market share in ANZ and Singapore and is seeking to expand further into new markets. The stock continued to de-rate and is now down 27% for the year. IPH is currently trading in line with the market at ~15x PE, but a meaningful discount compared to its long-term average of 20x. IPH has historically delivered consistent and defensive earnings, but with modest overall organic growth, somewhat boring in the current environment. Even a \$124m acquisition in Canada failed to get investors' pulse racing.

### Megaport (MP1 -5.4%)

No news on MP1 in December, but the stock continued to slide since their 1Q FY24 result, where KPI's were on the softer side. Services net additions growth was slower than in Q4 FY23 and it was well flagged that services growth will likely only step up from 3Q/4QFY24, once new sales staff kicked in. Whilst guidance was unchanged, the rebuild and recovery of momentum is expected to take time. Investors are still waiting!

### Insurance Australia Group (IAG -4.7%)

General insurers, including IAG shares, sold off due to the combination of three key factors - poor weather, which played havoc over the Christmas period, the recent sharp fall in Aussie 2-3yr bond yields and finally, ongoing claims inflation. The severe storms along Far North Queensland and the east coast over Christmas and Boxing Day, which continued into the year-end, look likely to potentially trigger a "major cat event". So despite premium rates hardening and potentially going even higher (depending on cost of current weather and reinsurance outcomes), investors feared that IAG's FY24 Natural Peril allowance of \$573 would be at risk, and accordingly, dumped the shares. As a reminder, IAG experienced \$75m of peril claims in the Sep quarter (leaving around \$500m remaining for Dec 23 quarter), so given its main per cat event retention of \$169m (net of reinsurance quota share), this should still leave the company within their 1H24 limit. However, the previous anticipated upside might now be removed, and skittish investors headed for the exit.

**Iluka Resources (ILU -4.5%)**

ILU provided a disappointing update on its Eneabba Rare Earths Refinery project. Capex is now expected to be ~\$1.8bn, 20% above market consensus of \$1.5bn and commissioning of the refinery has been delayed to 2026 (was 2025). No update was issued as to whether further government funding beyond the existing A\$1,050m non-recourse loan and \$200m cost overrun facility will be provided. Investors were already expecting capex to rise given the tight Western Australian labour market, but not by 20%. Regardless, there was only a minor fall in the stock price.

**Perseus Mining (PRU -4.1%)**

PRU underperformed the gold sector, which rose 1.0% for the month and also underperformed the ASX200, which was up 7.3%. No particular news from PRU in December, but being an African gold producer, this makes it higher risk and African producers/explorers typically fare worse when gold fever slows.

## FUND PERFORMANCE

Despite being massively underweight the REIT sector (but where we held a small residual position in GPT), which was the best performing sector in the market (+11.5%) and coupled with not owning any of the high-flying shares during the "dash for trash", the Fund returned +6.42% during the month.

This brings the tally for the 2023 calendar year to +12.46%, bang in line with the benchmark return of +12.42%. The best performers in 2023 were Technology (+27.9%, no dividend yield to speak of here), Consumer Discretionary (+21.7%) and Real Estate (+15.6%), as the widely anticipated US recession failed to eventuate, interest rates peaked towards year end and Fed pivot messaging drove investors back into these cyclical sectors after their poor performance in 2022. Large-Cap stocks, up 13.6% (where the Fund retains a material underweight) outperformed, with Mid-Caps and Smalls finishing as the worst performers in calendar 2023, materially lagging by 4.7% and 4.6% respectively.

Against this backdrop and given our selectively contrarian Value bias, the Fund's yearly return of +12.42% did well to keep up with the market.

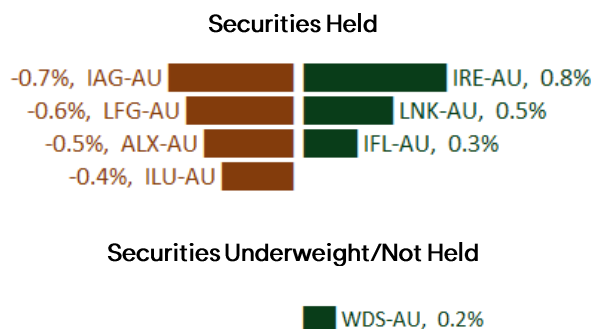
Materials, which rose 8.8%, posted the largest contribution (+218bps) to the market's return during the month (led by BHP which was up 8.9%), followed by the Financials and Healthcare (CSL +9.3%) sectors.

Utilities (AGL Energy +0.5%), Energy (Woodside Energy +0.2%) and Information Technology (Technology One -2.0%) weighed on the broader market in the month of December.

Returns (%)	Gross	Benchmark	Excess	Net
1 Month	6.42%	7.26%	-0.84%	6.36%
December Quarter	10.78%	8.40%	2.38%	10.59%
FYTD 2024	7.21%	7.57%	-0.36%	6.84%
Calendar Year 2023	12.46%	12.42%	0.04%	11.68%
3 Years (p.a.)	11.49%	9.24%	2.25%	10.41%
4 Years (p.a.)	9.00%	7.23%	1.77%	7.94%
Since Inception (p.a.)	10.38%	8.08%	2.30%	9.29%

*"The return figures are calculated using the redemption price and on the basis that distributions are reinvested. The Gross and Excess return figures are before fees and expenses whereas the Net Return figures are net of fees and expenses. Returns of the Fund may include audited and un-audited results. Past performance is not a reliable indicator of future performance."*

### Month of December Attribution



Source: Ellerston Capital.

In the month of December, the main positive contributors to the Fund's performance was its sizeable overweight positions in IRESS (IRE, +15.9%) which followed through and continued to rally, even after its 40.9% surge in November, Link Group (LNK +59%), which received a takeover proposal from Mitsubishi UFJ Financial Group, and Insignia Financial (IFL +10.9%), as well as not holding any Woodside Energy (WDS +0.2%).

The detractors during the month were overweight positions in Insurance Australia Group (IAG -4.7%), Liberty Financial Group (LFG -2.7%), Atlas Arteria (ALX -0.3%) and Iluka (ILU -4.5%).



## FUND ACTIVITY

The Fund capitalised on the strong market conditions in December to take profits in Bega Cheese, Cleanaway Waste Management and exited Orora, where we were disappointed with management's flat profit guidance in their trading update. ORA noted FY24 Saverglass EBITDA to be broadly in line with €168m Pro Forma FY23 EBITDA. Prolonged customer destocking and softness in consumer demand as the major cause of volume reductions beyond early CY24 were called out as risks to this outlook. We used the proceeds to buy back the Atlas Arteria stock that we trimmed at higher levels (when IFM crept up the register in November) during the toll-road operator's brief intra-month period of weakness. We also strengthened the existing holdings in Link Group and Perpetual.

NEW STOCKS ADDED	STOCKS EXITED
<ul style="list-style-type: none"> <li>None</li> </ul>	<ul style="list-style-type: none"> <li>Orora</li> </ul>
INCREASED	DECREASED
<ul style="list-style-type: none"> <li>Atlas Arteria</li> <li>Link Group</li> <li>Perpetual</li> </ul>	<ul style="list-style-type: none"> <li>Bega Cheese</li> <li>Cleanaway</li> </ul>

## FUND STRATEGY AND OUTLOOK

### Summary of the Year in Review

It was certainly a tale of halves for the share market and broader risk assets (huge rally in the December quarter). Who would have thought that US10 Year Treasury yields would end the year where they started, Bitcoin would be up +156%, Iron ore would be over US\$140/t, US house prices would be down -10%, yet the Home builders would rally +68%, just to mention a few highlights. This drove share markets to or at near all-time highs globally and breadth was also beginning to return to markets. Over 20% of S&P500 constituents hit 52-week highs on the last trading day of the year and over 30% were flirting with all-time highs.

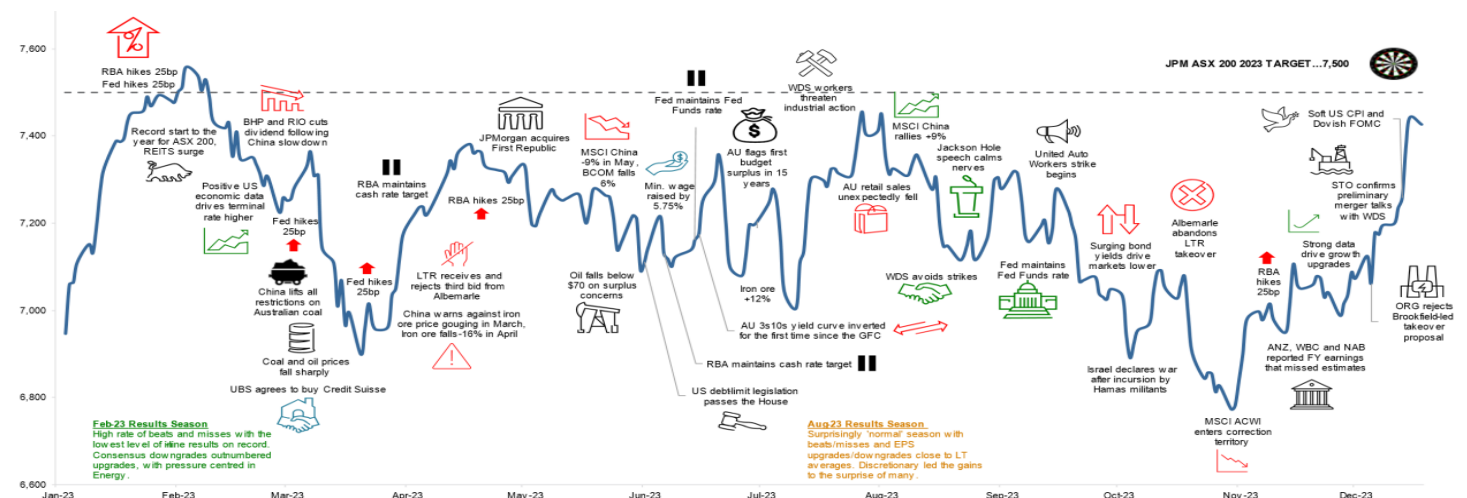
The S&P 500 returned 26.3% in 2023, clocking up a sizzling +11.7% in 4Q23 alone. Growth (+42.7%) significantly topped Value (+11.5%) as a factor and Small Caps (+16.9%) dramatically lagged. Technology (+57.8%) and Communication Services (+55.8%) led the charge, while Utilities (-7.1%), Energy (-1.3%), and Staples (0.5%) were left behind.

The NASDAQ Composite rose 44.6%. Led by the market darling Nvidia, the biggest US tech stocks rallied between 50% and 239% in 2023, whilst the small cap Russell 2000 was at the other end of the scale, up 16.9%.

Japanese shares outperformed due to their relatively high-tech weighting, with the Nikkei 225 up 30.4%.

China was one of the worst performing stock markets globally. The end of Covid-19 restrictions failed to ignite consumer confidence in the face of depressed property values and residential construction activity, amid ongoing debt headaches for China's biggest property developers. China's SSE fell 6.3% and the Hang Seng was worse, down 10.6%.

### 2023 Pictorial Review



Source: JP Morgan

In Australia, the best performers in 2023 were Technology (+27.9%), Media (+23.7%) and Consumer Discretionary (+21.7%) as the widely anticipated 2023 US recession did not happen, and investors rotated back to these cyclical sectors after a poor showing in 2022.

The best ASX Top 100 performers had a materials/housing flavour, the likes of James Hardie (+114%), Seven Group (+79%), REA Group (+68%) and Reece (+64%). Tech fared really well too, with REA (again), Xero (+63%), NEXTDC (+54%), WiseTech Global (+50%), SEEK (+31%) and Block, Inc. (+27%) outperforming significantly. The bottom performers had a resources flavour, with Alumina (-41%), IGO (-27%), Iluka (-29%), Incitec Pivot (-20%), South32 (-13%) and Whitehaven Coal (-12%) significantly underperforming the broader market.

The Top 5 ASX 200 Stock performers for 2023

Security	Description	2023 Performance
NEU	Neuren Pharmaceut.	214%
EMR	Emerald Res NL	154%
JHX	James Hardie Indust	114%
BOE	Boss Energy Ltd	89%
BLD	Boral Limited	87%

The Worst 5

CXO	Core Lithium	-76%
CHN	Chalice Mining Ltd	-73%
SGR	The Star Ent Grp	-66%
SYA	Sayona Mining Ltd	-63%
HLS	Healius	-42%

While the 2023 returns in the US equity market were extremely robust, investors need to be reminded that stocks delivered a 2-year return of only +3.4% (or +1.7% annualized). Over this period, EPS improved 6%, while capital values declined 17% (2.9x multiple points). The largest 7 companies currently (AAPL, AMZN, GOOGL, META, MSFT, NVDA, TSLA) returned +75.6% in 2023, versus -39.9% in 2022.

Contrary to conventional expectations at the start of last year, the US economic backdrop was surprisingly resilient in 2023. At the start of the year, consensus GDP forecasts for 2023 stood at 0.3%, versus 2.4% today. The most recent unemployment reading of 3.7% is only 10 bps above year-ago levels. While credit availability still remains tight, it is showing signs of improvement.

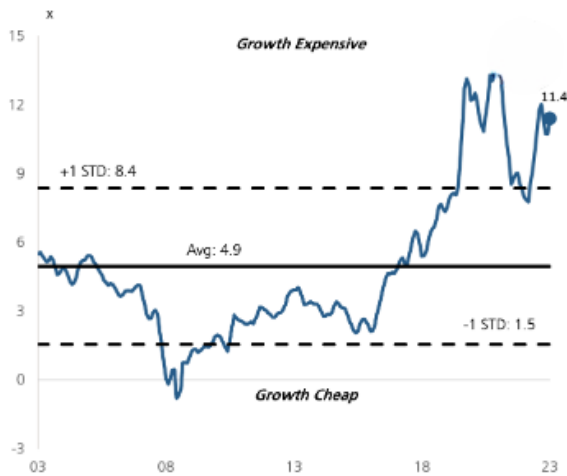


Source: UBS

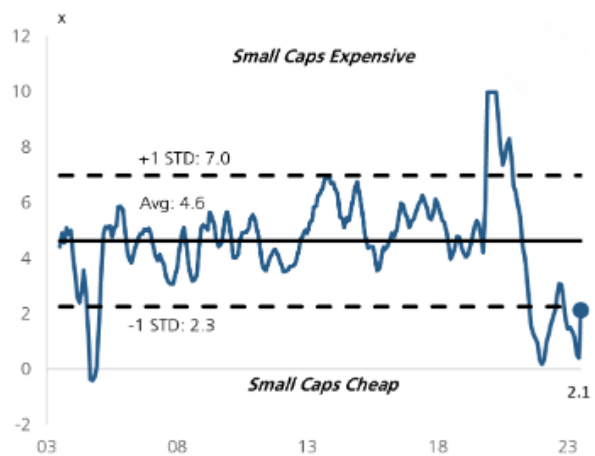
The 12MF PE of the S&P500 is currently 19.5x. If we strip out the Magnificent 7, it falls to 17.3x which is ~2 PE points lower ... which looks more reasonable.

The Valuation of US growth stocks including the Magnificent 7 looks quite extended vs historic levels, whereas the Small Cap sector remains at a huge discount. With increasing liquidity and given its deep discount versus historical levels, Small Caps, even despite their run in the month of December, look very attractive heading into CY24.

**P/E: Growth minus Value Benchmark**



**P/E: Small- minus Large-Caps**

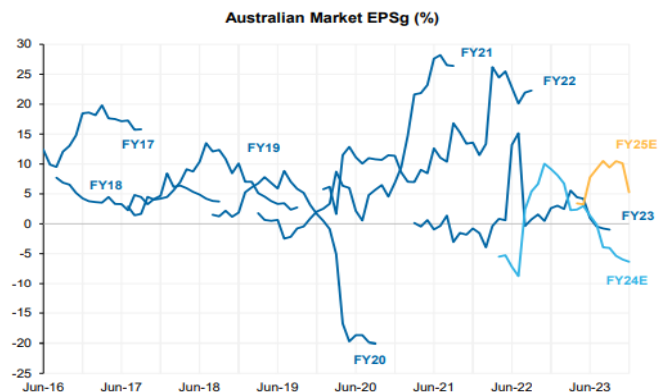


Source: UBS

The domestic market 12MF P/E now stands at 16.0x, which is 11% above the 20-year average. The ASX 200 consensus FY24 earnings have stabilised at -6.3%, with outer year earnings growth remaining anchored in low-single-digit territory.



Source: Goldman Sachs



Source: Macquarie

With several months until the next Fed meeting, outside of overheated conditions, or the "tram had a flat tyre", the equity market shackles which were released late last year, may well continue into 2024, albeit at a slower pace, but with a better environment for IPO's, placements and especially M&A. What could possibly go wrong.....

Following the up crash in the last two months of 2023, we would expect the market to consolidate its recent gains and we would not rule out a short-term pull back, considering the short covering rally in the US, which started in late October, was the largest since 2018.

Mid and Small caps are now representing the best value that we have seen for a long while and an area where we think we are very well placed. We would expect to see future alpha generation in our sweet spot, Mid-Cap segment and apart from the adjustments in the activity section, our strategy remains unchanged.

The grossed-up dividend yield on the portfolio for FY24 now rests at 6.4%, which remains superior to the market dividend yield, despite owning no Banks and many other conventional traditional income payers.

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