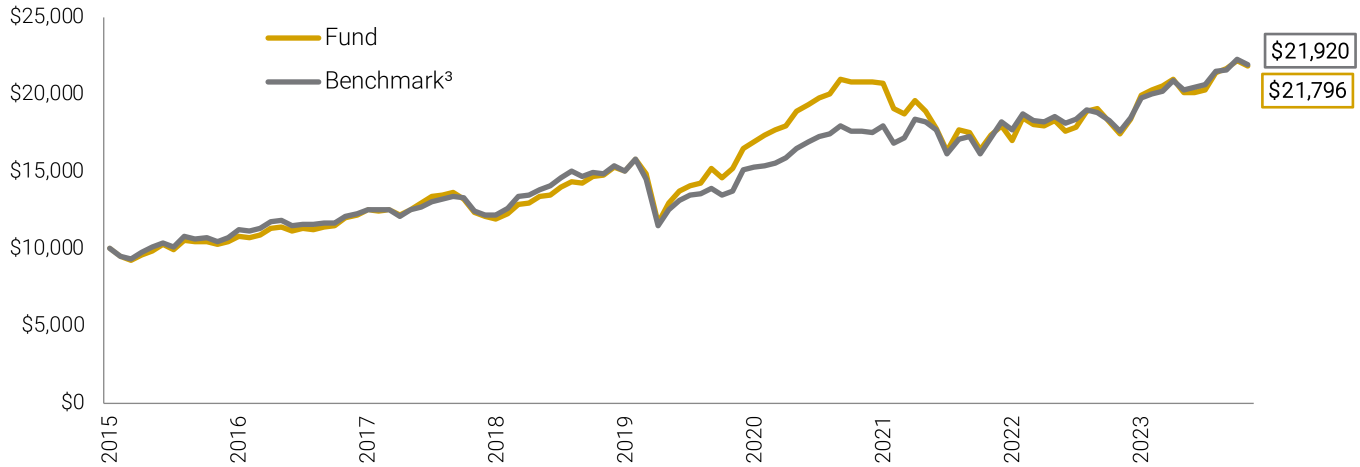
Investor Commentary | 31 October 2024

Bennelong Twenty20 Australian Equities Fund

Long-term Fund performance

Growth of $10,000 since inception[1,2]



Past performance is not indicative of future performance.

Market review

The ASX300 fell by 1.3% in October, dragged down by a 6.3% decline in the ASX100 resources. The ASX100 industrials fell by just -0.2%. This was a sharp reversal from September when the ASX100 resources rose by 9.5% due to expectations that the Chinese government would deliver substantial fiscal stimulus. As we write, the Standing Committee of China's National People's Congress (NPC) has failed to deliver plans to lift China from its deflationary spiral. The bulls are now hoping that December's Central Economic Work Conference may formulate stimulus plans which would be approved and announced at the March 2025 annual NPC meeting. The pressure on China has also intensified as President-elect Trump has discussed plans to place large tariffs on Chinese goods. We continue to have an underweight exposure to the resources sector.

October saw a sharp rise in bond yields as the market became more certain of a Trump victory in the US presidential election. The US 10-year yield rose by 50bp, while the Australian 10-year yield rose by 52bp. The US dollar strengthened significantly in the month with the US dollar index (DXY) rising by 3.2%. The AUD fell by 4.8% against the USD. This combination of a stronger USD and higher interest rates weighed on global equity markets with the USD return for MSCI China -5.9%, MSCI Korea -7.5%, MSCI Europe (ex UK) -6.0% and MSCI Australia -7.0%. The 50bp rise in the US 10-year bond yield in October was the fourth largest monthly gain in the past five years. Despite this sharp rise, the S&P 500 only fell by -1%, a far more muted reaction to past instances when yields rose by c.50bp: April '24 (S&P500 was -4%), September '23 (-5%) and September' 22 (-9%). This muted reaction to higher bond yields reflects the strength of the US economy and prospects for further earnings upgrades by US corporates.

Sector performance on the ASX favoured financials (+3.2%), health care (+0.7%) and communication services (+0.6%), while materials (-4.9%), consumer staples (-6.9%) and utilities (-7.2%) lagged. Of the 23 industry groups on the ASX, 17 underperformed in October and 10 fell by more than 4%. ASX200 earnings were downgraded by 1.3% in the month, taking the negative revisions this calendar year to -5%. The ASX200 consensus earnings growth for FY25 is currently just +0.8%, however this is dragged down by materials -11.7%, energy -5.0%, utilities -2.7%, and banks near zero. There is still strong growth in health care +11.5%, industrials +16.5%, technology +26.7% and communications (i.e. the portal stocks such as REA, SEK, CAR) +26.3%. Consistent with this view, October saw many companies provide trading updates at their AGMs. These were generally softer with a few notable exceptions such as HUB24 and Resmed, which the Fund holds.

Highlighting the strength in the US economy, the ISM's Services PMI came in at 56.0 for October (more than 50 shows expansion, more than 55 is a very strong reading), with employment at 53.0, new orders at 57.4, business activity 57.2 and prices paid 58.1. The flipside to this strength is that it's leading to more persistent inflation.

September inflation numbers were reported earlier in the month, with core inflation increasing by 3.3% YoY, well ahead of consensus. The Fed cut interest rates by 25bp at its November meeting and said that further cuts are likely forthcoming, and that the committee intends to "*move towards a more neutral stance over time*". Consistent with our outlook for strong growth and more persistent inflation, over the past six weeks, the bond market has gone from pricing in 9.4 cuts from the Fed by June 2025 to now just expecting 4.0 cuts.

At the time of writing this, the US election has occurred, with the US presidency and senate going to the Republicans and the House undecided, but expected to also be controlled by the Republicans. The key areas of change are expected to be:

1. Tax cuts: existing tax cuts stay in place rather than expiring next year. This could result in analysts upgrading US NPAT by around 5% across the market. There is also potential for further tax cuts.
2. Deregulation: this will lower operating costs and continue to boost productivity growth (driving US corporate earnings upgrades) over time.
3. Lower energy prices: through more acreage being opened up for oil/gas/coal production.
4. Tariffs to potentially increase by 10-20% for most countries and 60% for China. This may see US manufacturing investment boom, but also higher inflation.
5. Lower net immigration: this will tighten the labour market.
6. Tougher foreign policy: this will occur more broadly, which may lessen the risk premium in oil.
7. Finally, Trump has also suggested that there should be greater presidential input into Federal Reserve decisions, challenging the longstanding norm of central bank independence. This will become topical with Powell's term as Chair ending in May 2026.

The policy changes above are broadly positive for company earnings, particularly, more cyclical parts of the market such as consumer discretionary and those sectors exposed to capital expenditure. The caveat is that bond yields may remain higher for longer. This may negatively impact companies with leverage and bond proxies such as utilities, REITS and consumer staples. Finally, Chinese manufacturing will suffer, which will impact China exposures more broadly. Looking at the impact on the ASX of past US elections, the initial market reaction has been more positive following a Republican win, however, longer term, the outcomes are more a product of the economic cycle rather than the election result.

Post month-end, the RBA had its November meeting. In the subsequent press conference, the RBA suggested further stimulus spending by Canberra would be inconsistent with inflation reaching its forecasts. The chances of both parties not promising more spending ahead of the next election is low. The market is now only pricing in the first full cut by the RBA by May 2025. The problem with that is the timing. If parliament goes full term, the election will occur in late May. Cutting rates a few days before polling day would be difficult. After that the next RBA meeting isn't until July. That's a long time to wait when many other central banks are already easing policy. Supporting the RBA's position to hold rates was October data, which showed the labour market remains tight entirely due to the public sector labour growth of over 6% pa. The boom of the public sector has been enormous in recent years. Government's share of GDP has risen from 24% of GDP just prior to Covid to 28% today.

Fund performance

	Fund	Benchmark[3]	Value added
1 mth	-1.58%	-1.30%	-0.29%
3 mths	2.02%	2.19%	-0.17%
CYTD	9.42%	10.84%	-1.42%
1 year	25.39%	24.86%	0.54%
3 years p.a.	1.60%	7.62%	-6.02%
5 years p.a.	8.13%	8.10%	0.04%
10 years p.a.	na	na	na
Since inception[1] p.a.	9.36%	9.30%	0.06%

Performance figures are net of fees and expenses. 'Value added' calculation does not use rounded performance figures.
Past performance is not indicative of future performance.

Portfolio characteristics

	Fund	Benchmark [3]	Profile
Return on Equity	13.7%	11.2%	Premium Quality
Debt/Equity	28.0%	42.7%	
Sales Growth	3.4%	4.7%	Typically More Growth
EPS Growth	0.9%	3.1%	
Price/Earnings	20.6x	18.4x	Reasonable Valuation
Dividend Yield	2.8%	3.5%	
Beta	1.09	1	
Active Share	34%	na	Genuinely Active
No. of Stocks	40	299	

Source: broker consensus estimates for the next 12 months

Portfolio review

The Fund delivered a return of -1.58% for October, which was -0.29% below the -1.30% benchmark return. The Fund's primary contributors in the month were CCP, HUB and REA. The primary detractors this month included ARB, IEL and JHX.

At a sector level, the Fund benefited from the underperformance of financials which contributed +48bp in performance. This was offset by the underweight position in gold miners detracting -30bp in performance.

Top five active holdings

At month end, in alphabetical order

Company
ARB Corporation Limited
CAR Group Limited
Credit Corp Group Limited
Fisher & Paykel Healthcare
James Hardie Industries PLC

Top three contributors

To monthly relative performance, in alphabetical order

Company	Avg active position
Credit Corp	Overweight
HUB24 Limited	Overweight
REA	Overweight

Credit Corp (CCP)

CCP held its AGM, during which it re-affirmed FY25 guidance. CCP reported US 1Q25 cash collections up 12% YoY which was a solid outcome. Management continued to sound confident in the outlook and the operational improvements that they have made in the US business. The Australian performance was also strong, with collections up 15% QoQ. At the end of the month, CCP's two US debt buying competitors, PRA Group and Encore Capital also reported 19% YoY and 22% YoY collections growth respectively in 3Q24.

HUB 24 (HUB)

HUB reported 1Q25 net inflows of $4.0bn which was up 44% on pcp. Platform funds under administration (FUA) increased by 8% in the quarter to $91.6bn (up 41% on pcp). The strength in flows was across the board and didn't include any large transitions. HUB signed 195 advisers in the quarter and 44 licensees which was a quarterly record. Consensus earnings expectations for FY25 increased by 2-3% following the update. More importantly, the confidence in the longer term growth profile has increased which is driving the rerating in the stock.

REA Group (REA)

REA reversed its September underperformance as the market endorsed management's decision to withdraw its bid for UK business, Rightmove. REA maintained that the deal made strong commercial sense. The intention was to combine two number one real estate classifieds for global diversification, leveraging REA's significant scale in product investment, applying REA's experience in growing adjacent revenue streams like commercial and mortgages, and enhancing the UK property buying experience. REA initially offered a 27% premium to Rightmove's pre acquisition price, but this was quickly rejected. REA bid three more times, ultimately reaching a 45% premium (inclusive of the dividend) for Rightmove, but all bids were rejected. REA ended up withdrawing the offer to maintain financial discipline. In Australia, listings remain strong, up 10-14% YoY in Sept/Oct and REA continues to execute well on product driving double digit yield growth.

Top three detractors

To monthly relative performance, in alphabetical order

Company	Avg active position
ARB Corporation Limited	Overweight
IDP Education	Overweight
James Hardie Industries PLC	Overweight

ARB Corporation (ARB)

ARB's 1Q25 trading update was softer than expected, with 1Q25 group sales growth of 6.5% slightly below consensus expectations. Management commented that gross margins "remain healthy with a small price increase on 1 Oct 24". Profit before tax was "modestly down vs pcp" vs consensus expectations for mid-single growth. Part of the lower profit was due to the one-off costs associated with the 4 Wheel Parts acquisition. While the 1Q numbers were softer, the outlook for FY25 and longer term remains positive. Management said that the order book in Australia and the export business remains strong, and new contracts with Toyota USA will be announced during FY25. The acquisition of 4WP will also give ARB substantial ownership in the largest footprint of specialist 4WD accessory retailers in the US, and therefore the opportunity to drive more ARB product sales. For more details on ARB, refer to the stock anecdote section of our September Quarterly investor commentary.

IDP Education (IEL)

IDP held its AGM during the month. There was nothing new in the management commentary, they reiterated that they expect the markets they operate in to be down 20-25% in FY25 but for IDP to outperform with further market share gains. However, Canada continues to make changes to its international student program, changing post-study work right requirements. There have also been concerns around renewed tension between the Canadian and Indian governments and how that could impact student sentiment.

James Hardie (JHX)

The stock gave back some of the gains made in the September quarter. This was primarily due to concerns that the recent increase in interest rates may drive affordability issues for US households. Our industry feedback has pointed to continued softness in housing demand as consumers defer decisions due to uncertainty from interest rate volatility and the US election. Hurricanes in the south east of the US may also impact volumes in the December quarter. While housing activity has been slow, there are a number of signs that pent up demand is strong. Builders have reported that enquiry levels have picked up when mainstream media talk about the potential for further interest rate cuts. There has also been commentary that there has been a large rise in the number of Home Equity Line of Credit (HELOC) accounts that have been opened, but not yet drawn. This again suggests that many homeowners are preparing to undertake repair and remodelling work on their homes. This optimism is supported by the fact that the median age of a house in the US is now 42 years versus 32 years in 2005, and there are 35 million homes aged 20 to 40 years old. This is the prime age at which houses need re-siding. The National Association of Homebuilders also estimate that there has been at least a 1.5 million home underbuild since the GFC, which should support new construction activity over the next three to five years.

Outlook

While economic growth is slowing, it remains at a reasonable level, particularly in the US, which is growing strongly. Inflation is slowly moderating, which provides room for central banks to reduce interest rates. Fiscal policy should remain supportive, with Trump elected in the US and the Australian election to be held by May 2025. This provides an economic backdrop for well-run companies that have reinvested in their business to continue to grow earnings.

The cumulative forecast three-year earnings growth for the portfolio using market consensus forecasts is 14.9%, which is similar to the ASX300's growth. This similar growth is explained by the Fund's index position in the ASX20. The portfolio is higher quality, however, with an ROE of 13.7% versus the ASX300 of 11.2%. This higher ROE also comes despite lower levels of debt. The portfolio's gearing of 28.0% compares to the ASX300 at 42.7%. Over the long term, we expect the high quality to drive superior returns.

BAEP's investment philosophy and approach remains unchanged. We invest in high-quality companies that are global leaders in their niche and can sustainably compound their earnings at above market growth rates, over the medium to long term. They do this by investing in R&D to develop a superior product or service which enables them to take market share and grow earnings largely irrespective of the cycle. We take a bottom-up research approach driven by extensive company and industry contact to deepen our understanding of the companies we invest in and where earnings prospects may be under-appreciated by the market. Over the long term we believe earnings delivery drives company share prices. So, investing in quality companies delivering sustainable compound earnings growth is what will drive attractive returns for our portfolios over the medium and long term.

About the Fund

The Bennelong Twenty20 Australian Equities Fund provides a cost-effective exposure to the S&P/ASX300 universe through a combination of actively managed ex-20 securities and a passive exposure to the top 20 securities. It typically holds 40-55 names.

The Fund is a single portfolio made up of two parts:

1. **An indexed position in the S&P/ASX 20 Index ('the top 20')** – The Fund has a position in each top 20 security in the same weight it has in the S&P/ASX 300 index. This means the Fund's largest positions are the largest companies on the ASX. For example, if Commonwealth Bank has a weight of 7% in the index, it will also have a weight of 7% in the Fund.
2. **An active position comprising BAEP's best picks from outside the top 20 ('the ex-20')** – The Fund is also invested in a selection of ex-20 securities we believe will outperform, which in turn allows the Fund to outperform the benchmark. These securities are chosen using our proven approach that focuses on fundamental factors such as earnings, growth and valuations.

Benefits of the Fund

- Cost-effective, with a low management fee (plus a performance fee where applicable)
- Provides broad exposure to the Australian market via a combination of passive and actively managed securities
- The Fund's ex-20 exposure is managed as per the Bennelong ex-20 Australian Equities Fund's strategy. which has a track record of adding value by outperforming the market over the long term
- Managed in accordance with BAEP's robust, disciplined and proven investment philosophy and process

About BAEP

Bennelong Australian Equity Partners (BAEP) is a boutique fund manager investing in Australian listed equities. It was founded in 2008 by Mark East, in partnership with Bennelong Funds Management.

BAEP is a genuinely active, award-winning and highly-rated fund manager with an experienced and performance oriented team. Its investment philosophy is to selectively invest in high quality companies with strong growth outlooks and underestimated earnings momentum and prospects. Its investment process is research-intensive, with a focus on proprietary field research, and is supported by macro-economic and quantitative insights.

Portfolio sector allocation

Sector	Fund Weight	Benchmark Weight[3]	Active Weight
Discretionary	19.3%	7.4%	11.8%
Communication	8.5%	3.7%	4.7%
Health Care	11.7%	9.8%	1.9%
Financials	32.4%	32.6%	-0.2%
Liquidity	-0.7%	0.0%	-0.7%
Consumer Staples	2.4%	3.6%	-1.2%
IT	2.0%	3.3%	-1.3%
Utilities	0.0%	1.3%	-1.3%
Energy	2.7%	4.0%	-1.3%
Industrials	3.3%	6.9%	-3.6%
REIT's	2.6%	6.9%	-4.3%
Materials	15.8%	20.4%	-4.6%

Get in touch

baep.com.au

client.experience@bennelongfunds.com

1800 895 388 (AU) or 0800 442 304 (NZ)

The Fund at a glance

Feature	Fund facts
APIR code	BFL0017AU
Benchmark	S&P/ASX 300 Accumulation Index
Investment objective	2% p.a. above benchmark measured over rolling 3-year periods
Active stock limit	± 5%
Cash limit	0 - 10%
Inception date	02 December 2015
Recommended investment period	Long term (five years plus)
Buy/sell spread	+/-0.20%
Entry/exit fees	Nil
Management fees and costs[4]	0.44% p.a. of Net Asset Value of the Fund
Performance fee	15% of any amount by which the Fund's return is greater than the return generated by the S&P/ASX 300 Accumulation Index

How to invest

The Fund is open to investors via the PDS (available on our website), mFund (code: BAE04), or the following platforms.

- AMP (Elements Investment, Elements Pension, iAccess, My North, North, Portfolio Care, Portfolio Care eWrap, PPS, Summit, Wealthview eWrap Inv)
- BT Asgard (Master Trust, Employee Super, Infinity eWrap)
- BT (Panorama)
- CFS (FirstWrap)
- Dash
- Hub 24 (Super, IDPS)
- Macquarie Wrap (IDPS, Super)
- Mason Stevens
- Netwealth (Super Service, Wrap Service, IDPS)
- Praemium (Non Super, Super)

1 Inception date is 2 December 2015

2 Calculations are based on net returns (after fees and expenses) and assume the reinvestment of distributions.

3 S&P/ASX 300 Accumulation Index

4 Management fees and costs consist of annual management fee rate and capped recoverable expenses. For a detailed split of the fees and costs, please refer to the fund(s) PDS.