Quarterly Report

Antares Ex-20 Australian Equities Shares Fund – March 2024

For adviser use only

Highlights for the quarter

Performance: The Fund returned 8.7% (net of fees) for the March quarter, compared to its benchmark return of 8.3%.

Contributors to performance: Positive contributors – Megaport, Ventia Services, Telix Pharmaceuticals, Sandfire Resources, Judo Bank; Negative contributors – APM Human Services, Nine Entertainment, Seek, QBE Insurance, Tabcorp

Stock activity: Buys/additions – Iress, Mineral Resources, Neuren, Resmed; Sales / reductions – Wisetech, Lynas, Champion Iron Ore, The Lotteries Corporation

Fund snapshot

Inception date	1 October 2019
Benchmark	S&P/ASX 200 Total Return Index excluding the S&P/ASX 20 Total Return Index
Investment objective	The Fund's objective is to outperform the Benchmark over rolling 5 year periods.

Investment returns* as at 31 March 2024

Period	3 months	1 year	2 years pa	3 years pa	Since inception pa
Net return[2] %	8.7	10.9	3.7	7.3	8.4
Benchmark return %	8.3	15.4	5.9	8.4	6.3
Net excess return %	**0.4**	**-4.5**	**-2.2**	**-1.1**	**2.1**

**Past performance is not a reliable indicator of future performance. Returns are not guaranteed and actual returns may vary from any target returns described in this document. The value of an investment may rise or fall with the changes in the market.
[2] Investment returns are based on exit prices, and are net of management fees and assume reinvestment of all distributions.

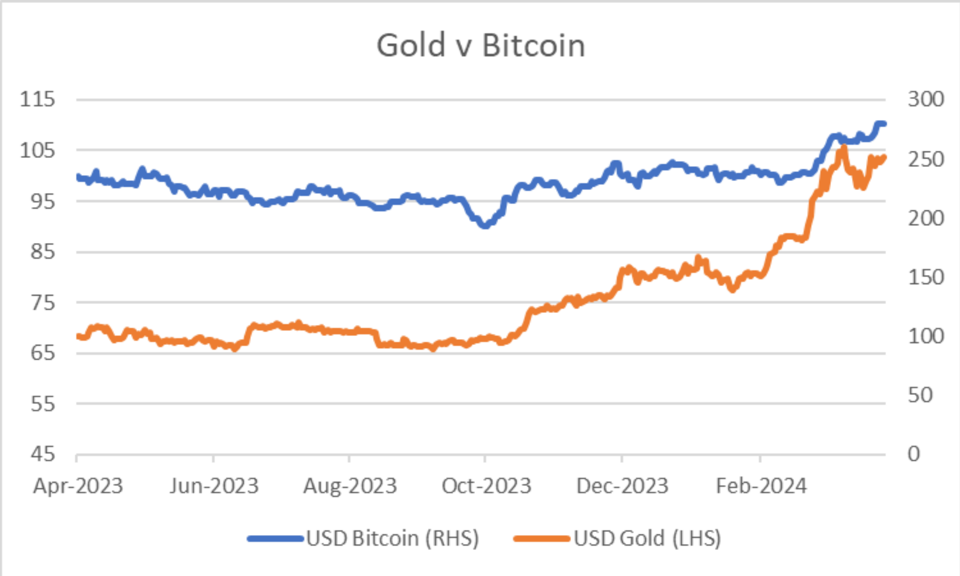
The March quarter saw stocks continue to benefit from the market's expectation of declines in rates over the rest of the year; this is despite data in March suggesting that US inflation may be more sticky than previously thought. As a result, we saw market leadership over the quarter shift from long duration growth towards commodities and value oriented equities as long bond rates shifted upwards.

The Fund delivered a return of 8.7% for the March quarter compared to the benchmark return of 8.3%. The strategy's exposure to healthcare, tech and resources assisted this performance while consumer discretionary and communication services were a drag.

Quarterly Update, Outlook and Positioning

In trying to think where the portfolio should be positioned, we feel there is a very loud and clear voice in the market offering a very clear signal – gold. As Chart 1 highlights, the gold price has been rallying strongly. It is a very clear signal. But what, exactly, is it signifying?

Chart 1: Gold and Bitcoin Price Indices

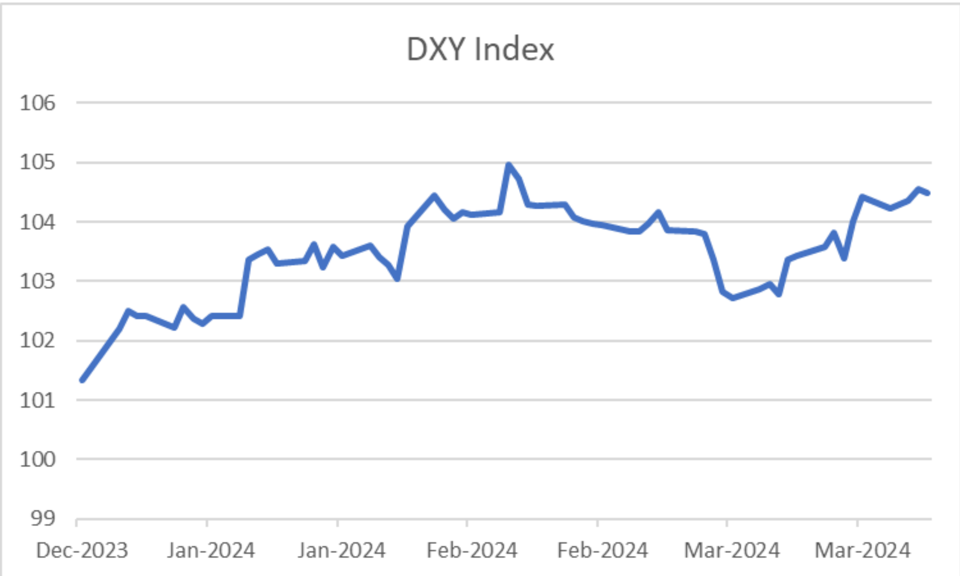


Source: Bloomberg and Antares Equities; April 2024

In Chart 1 we have also included the Bitcoin price as a reference. We have done this to examine one thesis that may explain the strength in gold – namely a currency alternative. Bitcoin has played the role of a virtual currency at times, as gold has traditionally done. But as we can see from Chart 1 the relationship between the two is not that strong at present, and the correlation between the two has been breaking down in recent weeks.

Likewise, gold is often seen as an asset that is negatively correlated with the US dollar, being an alternative form of reserve currency – when the USD loses favour, gold usually finds it. As Chart 2 below shows, there is a long history of negative correlation between the two. Yet as the chart shows in the part circled, more recently, both the gold price and the US Dollar have been rallying in tandem. This is unusual and suggests that US dollar weakness is not the signal.

Chart 2: USD index



Source: Bloomberg and Antares Equities; April 2024

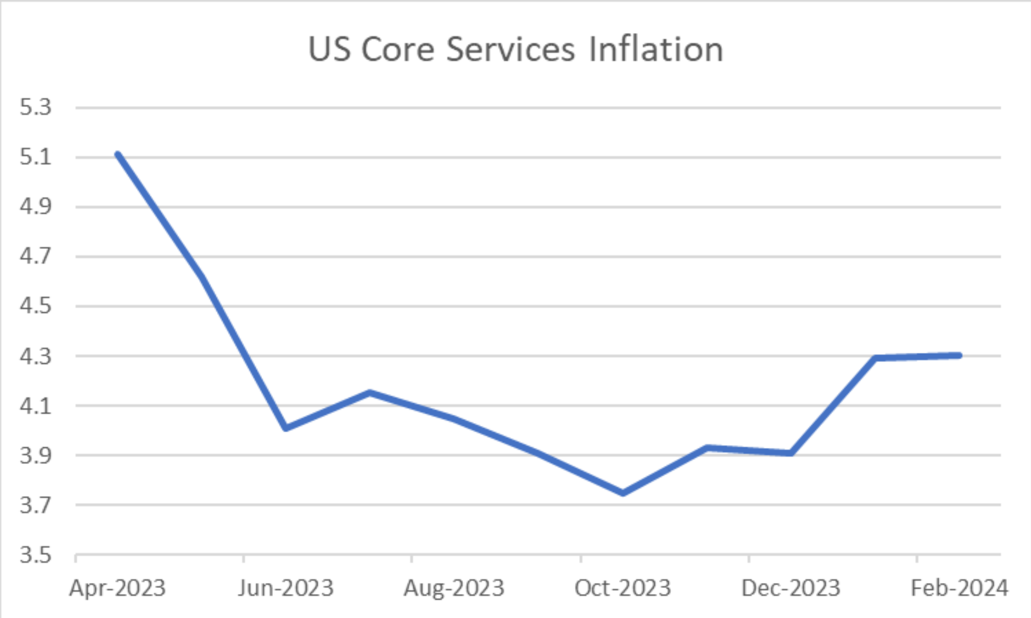
We note that gold can also act as a hedge against geopolitical risks. This a material consideration. The war in Ukraine seems to be grinding to halt which may favour Russia's superior resources over Ukraine. Such an outcome would indeed be unsettling. A Trump presidency would add to that risk. Yet this is at the margin, and while the Israeli conflict has the potential to broaden regionally, to-date such things have been contained, as seen with the Houthi rebels. So, while we don't say absolutely no, we don't think the gold price is speaking to materially increased geopolitical risk, concomitant with the magnitude of its rally.

Thus remains gold's traditional role as a hedge against inflation. And it is this signal that looks to us to be the one the gold price is sending to the market.

The fall in the US Federal Reserve's preferred inflation measure, Core PCE, has begun to stall in recent months and indeed, is beginning to tick back up. We will discuss the US predominantly here as its central bank was sooner to act on inflation than many others and can be seen as something of a lead indicator for other economies.

The reason is a persistently strong core services inflation (Chart 3) which has strengthened again in recent readings. This is consistent with the performance of the US economy generally, and it is worth noting that Services compromise over 70% of US GDP.

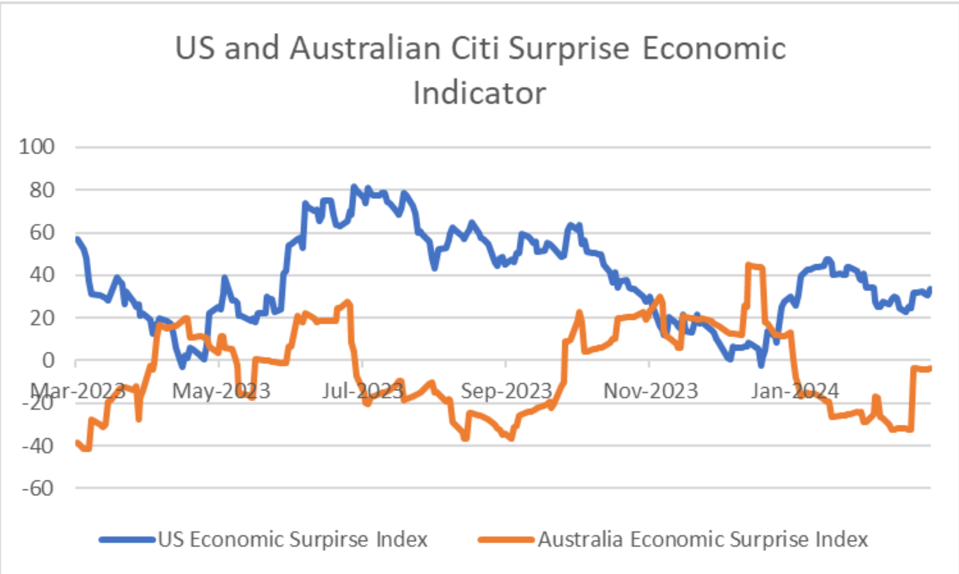
Chart 3: US Core Services Inflation (%)



Source: Bloomberg; April 2024

As Chart 4 highlights, the US economy has continued to positively surprise predictions, even as these predictions have been revised up. Typically, this surprise index is very cyclical as forecasts adjust to recent data thereby reducing the "surprise" element in time. Good data means forecasts are revised up making forecasts harder to "surprise" to the upside and vice versa. As the chart shows, however, the US is actually going the other way, implying it is strengthening above recent expectations. This is not consistent with a moderation in underlying inflation.

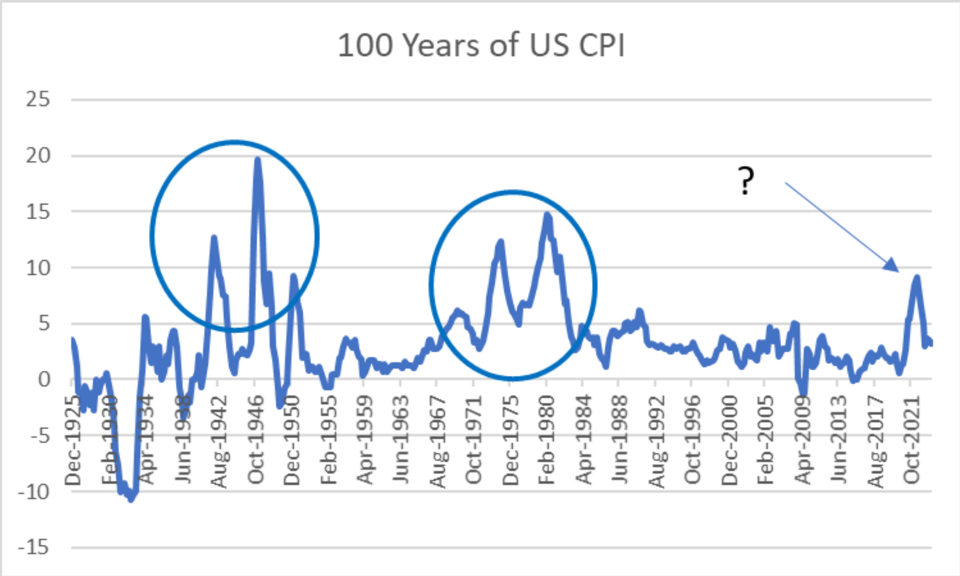
Chart 4: Citi Surprise Economic Indicators



Source: Citi Research, Bloomberg; April 2024

We will not comment on why the US is now expanding. It is sufficient to note merely that it is and this is occurring at a time when monetary tightness should be applying downward pressure to demand and therefore ultimately to inflation. It is not; and suggests to us, taking the gold price as a guide, that there is upside risk in the months ahead to inflation. History suggests that battles with inflation are not simply over in a short market cycle of two to three years – eg in the 1970's there were three distinct peaks to inflation as there were in the 1940's and earlier (Chart 5).

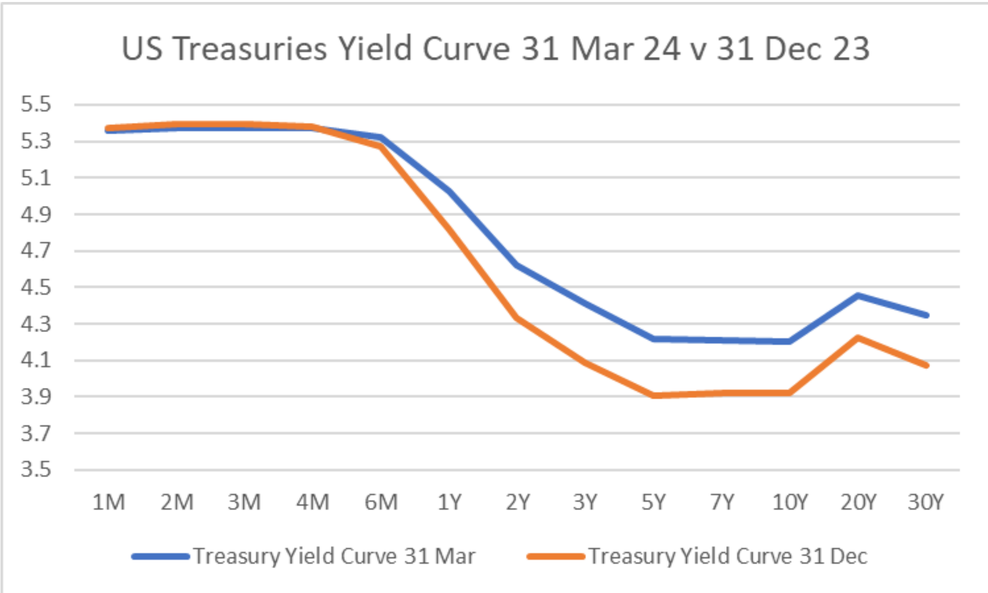
Chart 5: US CPI (%)



Source: Bloomberg and Antares Equities; April 2024

What would this mean? The obvious implication would be for interest rates. We will discuss in a little more detail below, but in a nutshell, the equity markets are increasingly pricing for a so-called “no landing” whereby there is no economic slowdown and Central Banks cut rates regardless. The rally from late November has been broad based showing confidence in the outlook. Bond markets have been less enthusiastic but still supportive, although the yield curves have been flattening suggesting higher near-term rates (Chart 6).

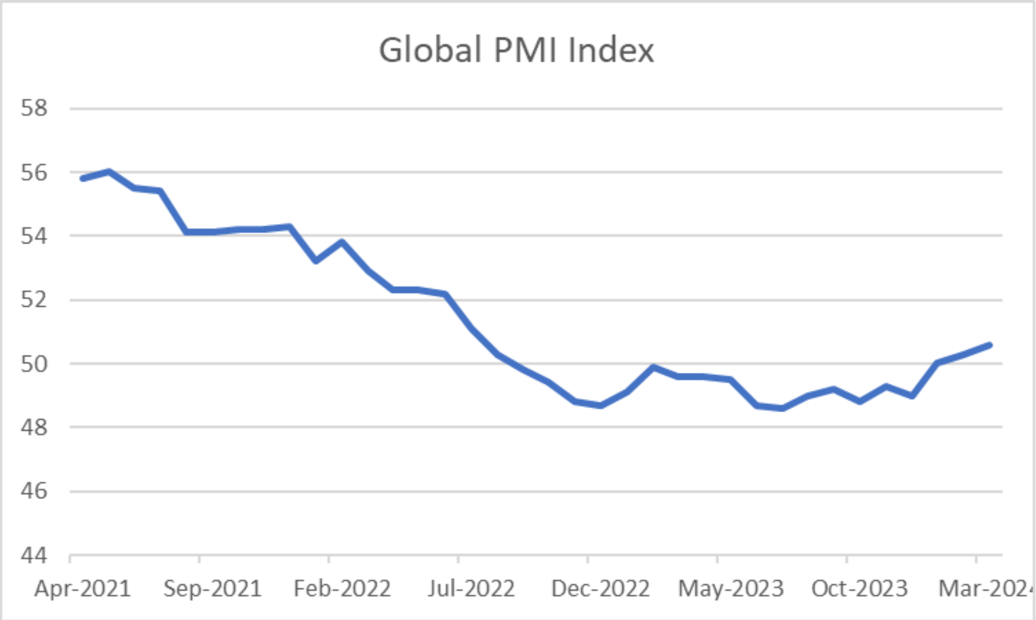
Chart 6: US Yield Curve (%)



Source: Bloomberg and Antares Equities; April 2024

Further, global manufacturing indices seem to have bottomed and are turning positive. This indicates that manufacturing activity is expanding globally. Chart 7 highlights this inflection point in the world’s major manufacturing economies. Post the supply chain disruptions, we have seen a major destocking event globally. As this runs its course, manufacturing is beginning to recover as retailers look to resume normal inventory conditions.

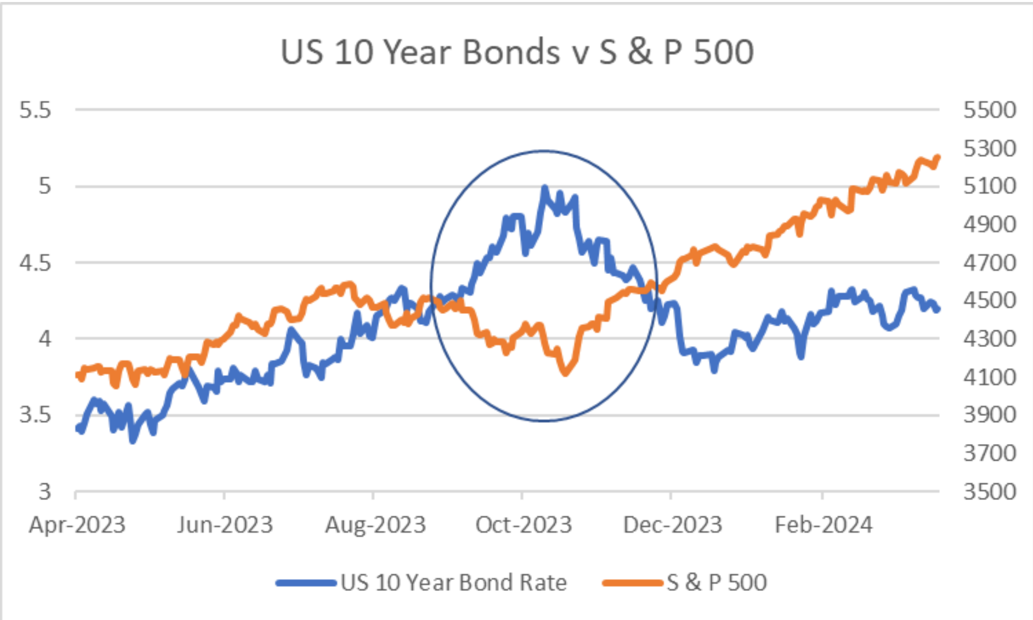
Chart 7: Global PMI Index



Source: Bloomberg; April 2024

This strengthening is occurring as inflation stays high reducing the chances (and quantum) of rate cuts. Indeed, if economies accelerate, then such positioning around lower rates would be mistaken. This seems to us to be a growing risk. As Chart 8 shows, even as recently as mid last year, the equity markets didn't pay a great deal of attention to rates as they climbed on the back of increasing inflationary pressures. Until they did and we saw a significant drawdown in equities.

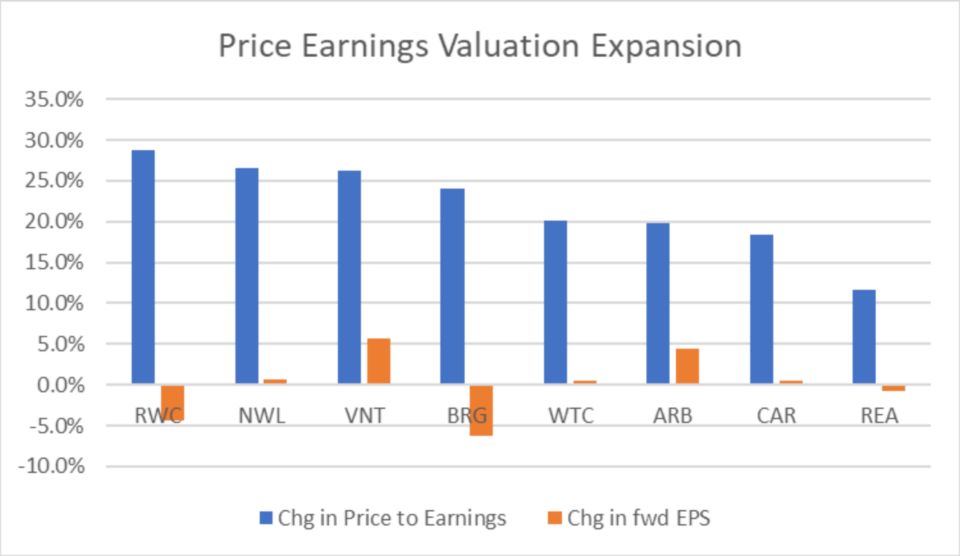
Chart 8: S&P 500 v 10 Year Bonds (%)



Source: Bloomberg and Antares Equities; April 2024

In particular there have been stocks that have seen their PER's re-rate upwards on the back of the perception of rate cuts with only limited upwards earnings revisions. The market has been increasingly prepared to pay for "quality", perhaps on the assumption that falling rates would reduce valuation headwinds. These include stocks that have been in our portfolio like Wisetech (see discussion on our decision to exit below) as well as Carsales, HUB24, Netwealth and REA. Even if rates do fall, these stocks have largely benefitted from the expected valuation uplift.

Chart 9: PER Expansion



Note: (RWC) Reliance Worldwide, (NWL) Netwealth, (VNT) Ventia Services, (BRG) Breville, (WTC) Wisetech, ARB, (CAR) Carsales, REA
Source: Antares, Bloomberg; April 2024

To summarise, we think the gold price is telling equity markets that the battle with inflation is not over. The timing of the rally and its robustness have coincided with stronger economic outcomes in the US and increasingly, globally. While Federal Reserve guidance remains for cuts, the number expected is falling. The situation is not the same here in Australia as Chart 10 highlights. Our economy is not gathering strength but is rather languishing. Nevertheless, with tax cuts from mid year expected to be mildly inflationary, and the prolonged wage setting cycle here, inflation risks abound.

We are therefore positioning the portfolio around this risk, trimming or exiting longer duration growth stocks and favouring commodities given strengthening global manufacturing, especially those in structurally short supply (copper) or shorter duration earnings streams from staples, eg Brambles and Metcash, as well as idiosyncratic healthcare exposures.

Stock Story: Treasury Wine Estates

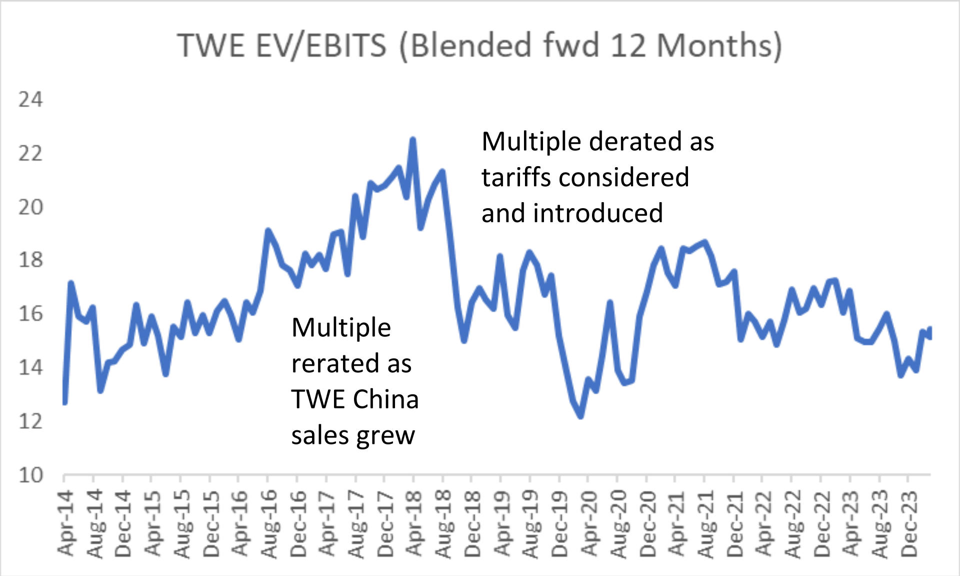
Treasury Wine Estates (TWE): Lifting of tariffs on Australian wine opens the door for a rerating
At the end of March, it was announced that punitive 200% tariffs on Australian wine put in place in 2020 by the Chinese government had been lifted following a review. The news has been widely anticipated over the past 12 months after talks of an early end to the tariffs were tabled. The Chinese market had previously been a major export market for Treasury Wine Estates (TWE). When tariffs were first initiated, TWE was able to successfully reroute much of the product previously sold in China into other Asian markets. Observing TWE's understanding of these markets and the potential for them to absorb some of the previous demand from China was a key reason for Antares re-initiating a position in TWE back in 2021.

Near term pricing uplift drives modest earnings upgrades
On our estimates, the news will result in modest uplifts to pricing given a tighter demand/supply environment from the reintroduction of Chinese demand. In response, TWE plans to announce global price increases in June this year. The quantum is not yet known, however we estimate this could be 3-5% across the Penfolds portfolio. While this drives modest earnings upgrades in the near term, the more significant impact will be over the medium to long term if TWE is able to increase production of Penfolds wines to meet increased demand from the Chinese market in addition to the new demand that has been stimulated in Asia.

Long term increase in production the key value driver
We visited Penfold's winemaking facilities in the Barossa in December 2023 to gain a better understanding of the winemaking capacity available for increased production if China were to reopen. Prior to the introduction of tariff's TWE had committed $165m to upgrading its facility in the Barossa, with the project completed in 2022. We found that the winery is operating at two thirds capacity, so as long as TWE is able to source enough quality grapes, the company can theoretically ramp up Penfolds production by as much as 50%. The winery has quite a high level of automation and flexibility built into it, enabling both better conversion, reduced costs and better safety. Given the age release profiles of luxury wines such as Penfolds, it generally takes about three years for an Australian vintage to be released. As such, for TWE, any increased intake in vintage 2024 will only be released in 2027 and so a commensurate increase in wine sold is a more medium-term prospect.

However, our analysis of the impact is that TWE will move from being a mid to high single digit earnings growth company into a double-digit earnings growth company which we expect to drive a rerating in the stock. Further, given the reallocation of Penfolds into Asia ex China over the past few years, the business is now more diversified than it was previously which arguably should also attract a higher multiple.

Chart 10: TWE Enterprise Value (EV)/EBITS (x)



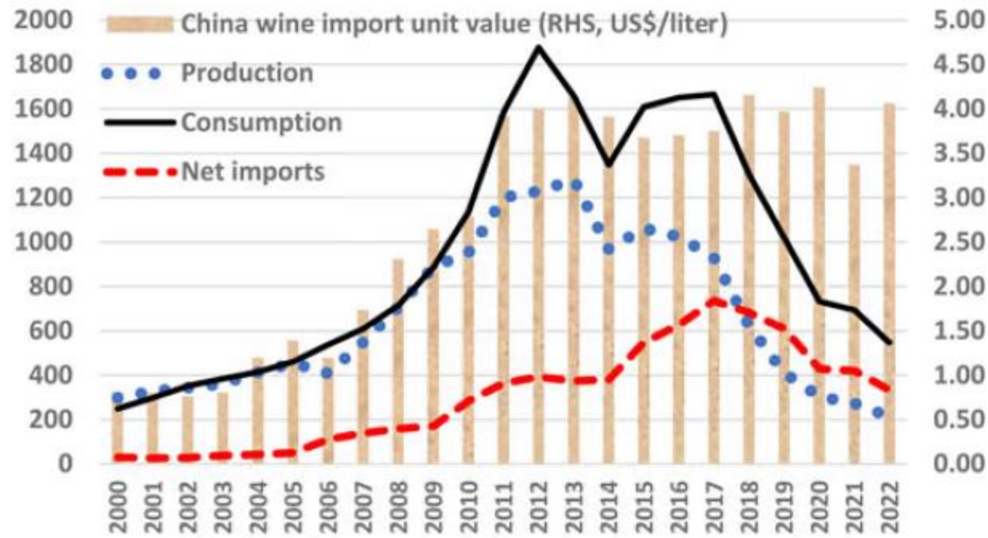
Source: Bloomberg; April 2023

The Chinese market has changed and will require investment

A lot has changed in China since the introduction of the tariffs. The consumer is still reeling from the aftermath of COVID-19, and well publicised turmoil in the local property and stock market has impacted business confidence. The hero Penfolds SKUs of the Chinese market pre-tariffs were the iconic Bin 389 and 407 wines, which were heavily sought after for business dinners, banquets, and for gifting occasions. With business confidence now low, we believe it will take some time to rebuild this segment of the market. We do not expect TWE to achieve the same level of sales and profitability that it previously did over 2017-2019, however even capturing a portion of this has a material impact on earnings.

Chart 11: Chinese wine consumption vs Australian wine imports

Chinese wine consumption has fallen in line with the shrink in Australian imports



Source: Professor Kym Anderson, *What's Happened to the Wine Market in China, Journal of Wine Economics (2023)*

Prior to the introduction of tariffs, Penfolds accounted for nearly two thirds of all Australian wine by value being sold into China. In the absence of Australian wine over the past few years, only a small amount of the market previously held by Australian imports has been absorbed by European wine and the local Baijiu market with consumption falling in line with the drop in Australian imports. As such, TWE will need to invest to reinvigorate demand for Australian wine amongst the Chinese consumer and generate new demand through on premise trade at wine clubs and restaurants. Encouragingly our channel checks indicate that because TWE had the foresight to maintain investment and people in China, the Penfolds brand is still very strong and sought after in the Chinese market, with the news of tariffs lifting generating excitement amongst distributors and consumers.

As such, we believe the elements of a strategy to capitalise on China re-opening are in place and see an opportunity for the stock to rerate and grow above recent year trends due to a resurgence of a stronger Penfolds business.

Portfolio activity

We added **Iress** (IRE) back to the portfolio in March in a switch with **Wisetech** (WTC). We see management executing well on its plans to turn the business around with strong prices realised in its non-core businesses disposals, such as UK Mortgages. We are attracted to IRE's strong cashflows, and its unique market position. With focus back on its dominant market, now that asset sales have been completed, we see a compelling valuation and turnaround story emerging.

We sold WTC in the period. This was not a decision taken lightly given the great growth prospects of the business, its unique global opportunity set and excellent track record of execution. Everything, however, has its price. We saw WTC trading at a near record market valuation to forward revenue ratio. This we cannot justify when the core Cargowise engine within WTC has begun to slow consistently over the last three reporting periods. Hence we see the valuation at risk with the market enthusiasm pushing the price to overly stretched levels. Hence our decision to exit, for now.

We sold out of our positions in **Lynas** and **Champion Iron Ore** in order to finance our re-entry into **Mineral Resources** (MIN) While we remain sceptical about the near term prospects for the lithium market, we like the Onslow iron ore project for MIN as well as its production discipline in the weaker Lithium market.

We also opportunistically added **Neuren** (NEU) to the portfolio. NEU is the developer of the neurological drug Daybue which targets the rare Rett Syndrome. It is marketed by US pharmaceutical company Acadia which specialises in neurological medicines. Acadia was the target of a short selling report questioning its strategy. This saw a precipitous fall in the NEU share price. Our internal work has long investigated Acadia and the deal and so we were comfortable that the report is incorrect, thereby providing an opportunity to invest in NEU.

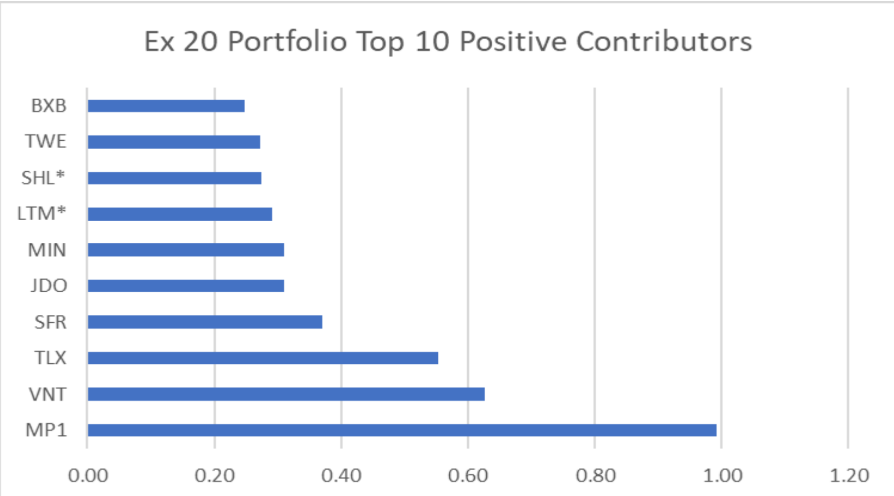
Resmed (RMD) was added back to the portfolio following share price underperformance vs the broader health care sector. Our analysis suggests the potential impacts of GLP-1 drugs on RMD's are more than reflected in the share price, and in the near term RMD remains well positioned versus competitors struggling with the ongoing impacts of product recalls.
The portfolio exited the position in APM Human Services (APM) following a third earnings downgrade in 5 months. While the stock appears prima-facie cheap following the sell off, the last downgrade confirms our ongoing governance concerns and concerns around the balance sheet.

The position in **The Lotteries Corp** (TLC) was exited during the month to fund the new position in Resmed, with the stock approaching our valuation following its share price appreciation in recent months.

Stock attribution

We have introduced a new component into this quarterly report providing more granularity into the drivers of our quarterly performance. This is to provide the Top 10 Contributors and Detractors. We provide a short comment on the Top 5 of each.

Chart 12: Positive Contributors



*denotes not held by the portfolio
Source: Antares Equities; March 2024

Megaport (MP1) was our best contributor for the quarter. The company provided an upbeat outlook in January when it pre-released its first half 2024 results which showed a pleasing uptick in annual recurring revenue and encouraging news on major contracts. MP1 also benefitted from its association with AI (it provides virtual links between data centres as a core offering) and from the general enthusiasm for the sector.

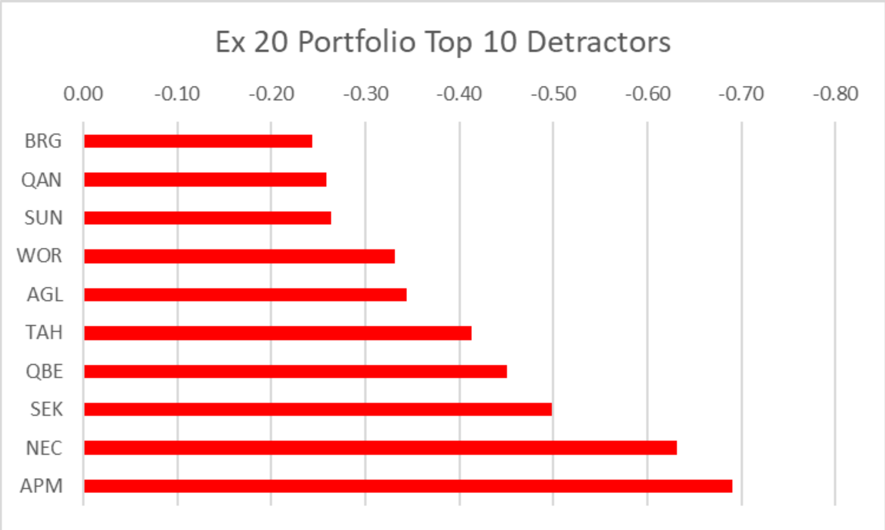
Ventia Services (VNT) shares rallied on the back of a solid calendar year 2023 result which beat expectations and guidance for 2024 which was ahead of the market.

Telix Pharmaceuticals (TLX) was strong in the March quarter on the back of promising sales results from its Illucix kidney cancer drugs. Further, the market is beginning to look forward towards some upcoming Phase 3 trial results for TLX591 which will open a new vertical in prostate treatment for the company.

Sandfire Resources (SFR) delivered a strong operational update as it ramps up its operations at its Botheo copper mine in Botswana. It also enjoyed the rally in the copper price in the latter part of the quarter as supply shortages in the physical copper market became increasingly apparent.

Finally **Judo Bank** (JDO) rallied in the quarter after providing a reassuring operational update in January which showed stability in net interest income margins combined with well-controlled bad and doubtful debt exposures.

Chart 13: Negative Contributors



Source: Antares Equities; March 2024

APM was sold off heavily following another earnings downgrade only two months after its AGM update due to the impacts of prolonged unemployment, higher interest costs and tax leading to a greater than expected decline in 1H24 earnings only two months after the company's AGM update. We exited the position.

Nine Entertainment (NEC) shares slid after it provided a downbeat outlook for the advertising market in the remainder of financial year 2024. Despite the cyclical headwinds, we note that TV audiences have actually grown in late 2023 and early 2024 for the first time in over a decade. We think NEC is very well-managed and will benefit from its leadership position when the advertising cycle turns.

Seek (SEK) was very similar to NEC in that it slightly downgraded its earnings outlook based on weaker than expected job ad listings. With job listings now below levels last seen in 2019, despite a larger economy and working population, we see SEK as well-placed to make progress towards its target of over $2bn in revenue in 2028 given the underlying improvement in its revenue generation, excluding cyclical factors.

QBE Insurance was exited in the previous quarter and continued to rally. We saw QBE as fully valued in the medium term and instead focused on longer term opportunities with SDF.

Finally, **Tabcorp** (TAH) saw a weaker result as the wagering market cycled out of its COVID induced highs. The stock was also impacted by the resignation of its Managing Director over inappropriate behaviour. We note that TAH has been taking share in digital for the first time since competition emerged as tax changes across states even the wagering playing field and like the position over the medium term for this reason.

DISCLAIMER

Get in contact

antarescapital.com.au

Phone: 1300 738 355
Email: investorservices@antaresequities.com.au
Mail: PO Box 200, North Sydney NSW 2059