MARKET MATTERS
INVEST

MONTHLY REPORT | DECEMBER 2023 | EMERGING COMPANIES

PORTFOLIO DETAILS

Portfolio Name	Emerging Companies
Structure	Separately Managed Account
Benchmark	S&P/ASX Small Ords Index
Management Fee	0.85% incl GST
Platform	OpenInvest
Included Assets	Equities
Portfolio Managers	James Gerrish & Harrison Watt
Annual Performance	4.96%*

OBJECTIVE

The objective of the Market Matters Emerging Companies Portfolio is to provide an active exposure to Australian emerging companies defined as all listed stocks outside the S&P/ASX 100. Returns will primarily be achieved through capital appreciation rather than income with an overall objective of outperformance of the S&P/ASX Small Ordinaries Index over 5 years.

**Inception Date 31.01.2020*

MARKETS & PERFORMANCE

The Market Matters Active Emerging Companies Portfolio added 5.16% in December, underperforming the S&P/ASX Small Ords Accumulation Index which advanced 7.23%. The portfolio has returned 8.11% for the rolling 12 months against the benchmark return of 7.82% and -1.26% per annum for 3 years, slightly underperforming the small gain in the benchmark of 0.95%.

PERIOD	1 MONTH	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	3 YEAR PA
PORTFOLIO %	5.16	1.17	8.09	8.11	-6.8	-1.26
BENCHMARK %	7.23	8.52	6.42	7.82	-6.2	0.95
RELATIVE %	-2.07	-7.35	1.67	0.29	-0.6	-2.21

Benchmark: S&P/ASX Small Ords Accum Index

Calendar 23 was a solid but not spectacular year for the portfolio, outperforming the benchmark in what was a choppy period for the small-cap area of the market. The portfolio's macro-overlay alongside a catalyst-driven strategy has yielded solid results over the long term with the portfolio up +4.96% p.a. since inception, more than double the return of the benchmark which is up +2.3% p.a.

This month we're stepping back and looking at CY23 for markets and how the Market Matters Portfolios performed throughout.

Locally, stocks had a solid but not spectacular calendar year when compared to other major benchmarks, with the ASX 200 advancing by 12.42% net of dividends versus the US S&P 500 which logged a more substantial gain of over 20%, largely thanks to the higher proportion of technology stocks in that index. The less-tech-stock-sensitive Dow Industrials (16.18%) and Russell 2000 (16.93%) also enjoyed strong returns in 2023, but relatively underperformed the Nasdaq (55.13%) and S&P 500 (26.29%). Notably, the index performance for the calendar year 2023 was the opposite of 2022, where we saw the Nasdaq and small caps decline substantially more than the ASX 200 and S&P 500.

MARKETS & PERFORMANCE CONTINUED

By market capitalization, small caps outperformed large caps towards the end of the year thanks to those surging rate cut expectations, as lower rates are typically most beneficial for smaller companies. For the year, however, large caps handily outperformed small caps as the higher rates for the majority of 2023 weighed on smaller company performance.

From an investment-style standpoint, growth significantly outperformed value, with the reasons being familiar ones: Artificial intelligence enthusiasm powered tech-heavy growth funds early in 2023 while in the December quarter expectations for rate cuts were seen as positive for growth stocks. Growth outperforming value is also the opposite of 2022, where higher rates and recession fears resulted in value outperforming growth.

All ASX sectors ended 2023 with gains, not surprisingly, the influence of expected lower rates was dominant towards the end of the year with Real-Estate being the best-performer in the December quarter, although for the full year, Technology (31.43%), Consumer Discretionary (23.85%) and Materials (18.27%) were hard to beat as expectations for stable economic growth rose on telegraphed future rate cuts.

Looking at sector laggards, defensive sectors including Consumer Staples (2.60%) and Utilities (4.04%) lagged as economic growth was more resilient than expected while higher rates (for most of 2023) reduced the demand for high dividend paying areas, while Healthcare (3.96%) was hit by sector-specific concerns over weight loss wonder drugs.

The December rally was clearly a significant one and accounted for over half of the yearly gain for local stocks thanks to a surprise dovish pivot by the US Central Bank, which combined with solid economic activity and declining inflation to push stocks sharply higher both here and abroad.

Internationally, overseas markets were generally strong headed by the US, although stellar gains were also achieved from stocks in Europe. Emerging markets lagged as increased geopolitical tensions in the Middle East and on continued lacklustre Chinese economic growth which saw mainland Chinese equities actually down over 12% for the year – proving a tough place to be again in 2023.

Commodities were a mixed bag during the year as weakness in oil, which was driven by reduced geopolitical fears and rising global economic growth worries, offset a solid gain in gold. Gold rallied on a falling U.S. dollar and hit a new all-time high in early December. Iron Ore was a standout rallying more than 16% in CY23 on robust Chinese steel production and generally bearish investor sentiment and positioning, while Copper prices remained resilient to mildly positive for the period.

In fixed-income markets, the Bloomberg AusBond Composite Bond index had a positive year, up 5.06% as falling inflation and expectations for rate cuts in 2024 pushed bonds higher.

Longer-duration bonds outperformed those with shorter durations in the final 3 months as bond investors reacted to lower-than-expected inflation and priced in future Fed rate cuts, however, for the full year, shorter-duration debt outperformed longer-term bonds as high inflation readings through much of 2023 weighed on the long end of the yield curve.

2023 was ultimately a year of surprises for the markets as the expectations for a recession never materialised, inflation fell faster than forecasts, corporate earnings proved resilient and central banks surprised markets by pivoting to a more dovish future policy. The result was solid gains for equities broadly, with some pockets of substantial gains, particularly from US technology stocks that rebounded from a weak 2022.

PORTFOLIO STOCKS

The portfolio held 21 positions at the end of December with cash finishing the month at ~3%.

Having been active in prior months, we took a more wait-and-see approach in December having minimal portfolio turnover. The low cash position supported returns with our view of strong equity markets playing out into year-end.

While the Small Cap Accumulation index posted a high single-digit gain for the year, this hides the fact that there were two periods of extreme weakness where the market fell more than 10% and a maximum drawdown of more than 15% from a high set in January.

What we got wrong...

Given the nature of Small Cap stocks and their tendency to be more volatile than their larger-cap counterparts, staying away from disastrous positions is a focus in this portfolio. While this isn't always possible, only four positions detracted more than 1% from performance in the portfolio in 2023.

The frustrating position of **Bowen Coking Coal (BCB)** detracted -2.71% from performance, a position that hasn't been able to capitalize on strong coal markets. **Praemium (PPS)** took -1.87% from returns, **Capitol Health (CAJ)** -1.25% and **Calix (CXL)** -1.19%.

What we got right....

Key contributors to alpha in the portfolio came from several holdings, though six positions added more than 1% to performance in the year. No surprise that our position in **Audinate (AD8)** was the key contributor, adding 4.94% to the portfolio with the stock more than doubling in 2023. Elsewhere, **Paladin Energy (PDN)** added 3.15%, **Aussie Broadband (ABB)** 2.59%, **Sandfire Resources (SFR)** 2.29%, **NextDC (NXT)** 1.21% and **Centuria Capital (CNI)** 1.04%.

PORTFOLIO STOCKS	
NO. OF HOLDINGS	21
ESTIMATED YIELD (%)	2.35
TOP 5 POSITIONS (% OF AUM)	33.47
TOP 10 POSITIONS (% OF AUM)	56.45

STOCK	CONTRIBUTION (%)
CENTURIA CAPITAL (CNI)	1.34
SANDFIRE RESOURCES (SFR)	1.14
SILEX SYSTEMS (SLX)	1.04
SILVER LAKE RESOURCES (SLR)	0.54
PREMIER INVESTMENTS (PMV)	0.44

STOCK	DETRACTION (%)
PEXA GROUP (PXA)	-0.37
CALIX LTD (CXL)	-0.17
PRAEMIUM (PPS)	-0.14
EML PAYMENTS (EML)	-0.11
GLOBAL LITHIUM RESOURCES (GL1)	-0.09

	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	YTD
FY24	-1.16	6.67	1.08	-7.77	4.24	5.16							**8.22**
FY23	14.48	3.07	-9.21	0.87	5.76	-6.42	8.36	-4.24	-2.29	2.33	-5.22	1.47	**8.96**
FY22	2.97	1.17	5.91	1.13	2.19	-2.47	-10.29	-5.93	6.68	-5.19	-7.80	-15.25	**-26.88**
FY21	10.92	17.19	-10.89	0.63	0.58	0.57	-0.86	5.91	-7.10	4.38	-3.81	2.37	**19.89**
FY20								-16.09	-27.07	37.98	21.26	5.66	**21.74**
CUMULATIVE													**31.93**

LOOKING AHEAD

What a difference a year makes.

At this time last year, the market was struggling as central banks globally were in the midst of the most aggressive rate hike campaign in decades, inflation was above 7% and concerns about an imminent recession were dominating the news flow.

Now, as we begin 2024, the market outlook couldn't be much more positive. Central Banks look done with rate hikes and cuts are on the way, likely in early 2024 for the US and later in the year locally. Economic growth has proven more resilient than most could have expected and fears of a recession are all but dead. Inflation dropped substantially in 2023 and is not far from central bank targets while corporate earnings growth is expected to resume in the coming year.

Undoubtedly, that's a more positive environment for investors compared to the start of 2023, but just like overly pessimistic forecasts for 2023 proved incorrect, as we look ahead to 2024, we must guard against complacency because at current levels both stocks and bonds have priced in a lot of positives in the new year.

Starting with the most important macro-economic influence globally, Fed policy. Fed officials are forecasting three rate cuts in 2024 but investors are currently pricing in six rate cuts in 2024 with the first one occurring in March or May. That's a very aggressive assumption and if it is incorrect, we should expect an increase in volatility in both stocks and bonds.

Regarding economic growth, it's foolish to assume just because the economy was resilient in 2023 that it will stay resilient. Obviously, that's the hope, but hope isn't a strategy. The longer rates stay high (and they are still high) the more of a drag they create on the economy. Meanwhile, all the remnants of pandemic-era stimulus are gone and there is some economic data that's starting to point towards reduced consumer spending. Point being, it is premature to believe the economy is "in the clear" and a slowing of growth is something we will be on alert for as we start the new year, because that would also increase market volatility.

Inflation, meanwhile, has declined sharply but it still remains above central bank targets. Many investors expect inflation to continue to decline while economic growth stays resilient, a concept traders coined "Immaculate Disinflation." However, while that's possible, it's important to point out it's extremely rare as declines in inflation are usually accompanied by an economic slowdown.

Finally, corporate earnings have proven resilient but companies are now facing margin compression as inflation declines and economic growth potentially slows. Earnings results and guidance have not been as strong as earlier in 2023 and if earnings are weaker than expected, that will be another potential headwind on markets.

Bottom line, while undoubtedly the outlook for markets is more positive this year than it was last year, we won't allow that to breed a sense of complacency because as the past several years have shown, markets and the economy rarely behave according to expectations, and the influential macro-economic environment is a fluid one.

As such, expect a greater level of activity around portfolio positioning to start the year, and while we are prepared for the positive outcome currently expected by investors, we are also conscious of the many risk factors still permeating through markets and we will not hesitate in playing a more defensive stance should it be warranted.

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