MARKET MATTERS
INVEST

MONTHLY REPORT | SEPTEMBER 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	4.04%*

Inception Date 31.01.2020

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.

MARKETS & PERFORMANCE

The Market Matters Emerging Companies Portfolio gained +1.08% in September, strongly outperforming the S&P/ASX Small Ordinaries Accumulation Index which fell -4.04%. The portfolio has returned +8.67% for the rolling 12 months (against the benchmark return of +6.85%) and +4.04% per annum since inception, +3.84% per annum above the benchmark.

PERIOD	1 MONTH	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	3 YEAR PA
PORTFOLIO %	1.08	6.51	5.53	8.67	-10.53	-1.99
BENCHMARK %	-4.04	-1.94	-2.47	6.85	-9.05	2.57
RELATIVE %	5.12	8.45	8.00	1.82	-1.48	-4.56

Benchmark: S&P/ASX Small Ords Accum Index

More broadly, the MSCI Developed Markets Index fell during September (-3.7%), while the S&P 500 also declined (-4.8%) in local currency terms. Australian 10-year bond yields finished the month at 4.49%, up a significant 46bps despite the RBA leaving the cash rate unchanged.

In the US, the Federal Reserve delivered a 'hawkish pause', keeping their target rate unchanged but implied higher rates were a distinct possibility, 10-Year US Treasury yields increased 49bps to 4.57%, having a significant influence on stocks.

Commodity prices were mixed over Sept. Brent Oil rose by US$8.45 to US$95.31/bbl, on a resilient US economy and bullish demand sentiment around China over Golden Week holidays. Iron Ore prices held, rising by US$2.00 to US$119.50/Mt, however depressed rebar prices and spreads signal softening steel demand by China. Gold prices fell on a strong dollar, falling by US$71.80 to US$1,871.

Energy (+1.6%) was the only sector to make gains while Financials (-1.6%), Consumer Staples (-1.8%), Materials (-1.8%) and Utilities (-1.9%) outperformed the benchmark.

Property (-8.6%) struggled most while IT (-7.9%), Healthcare (-6.2%) Consumer Discretionary (-3.7%), Communication Services (-3.5%) and Industrials (-3.2%) all dipped more than the market.

WHAT'S OUR TAKE ON THE MACRO?

Markets have become decidedly more anxious over the past month, but it's important to realise that while the ASX 200 did hit multi-month lows in September and there are legitimate risks to the outlook, underlying fundamentals remain generally robust.

First, while there are reasonable concerns about a future economic slowdown, the latest economic data remains solid. Employment, consumer spending and business investment were all resilient in the first quarter and there simply isn't much actual economic data that points to an imminent economic slowdown. So, while a future economic slowdown is certainly possible given higher interest rates, the actual economic data is clear: It isn't happening yet.

Second, fears that inflation may bounce back are also legitimate, given the rally in oil prices. But the Reserve Bank of Australia, The US Federal Reserve and other central banks typically look past commodity-driven inflation and instead focus on "core" inflation and that metric continued to decline throughout the period. Additionally, declines in housing prices from the recent peak are only now beginning to work into the official inflation statistics, and that should see core inflation continue to move lower in the months and quarters ahead.

Finally, regarding monetary policy, the US Federal Reserve's historic rate hike campaign is nearing an end. And while we should expect the Fed to keep rates "higher for longer," high interest rates do not automatically result in an economic slowdown. Interest rates have merely returned to levels that were typical in the 1990s and early 2000s, before the financial crisis, and the economy performed well during those periods. Yes, the risk of higher rates causing an economic slowdown is one that must be monitored closely, but for now, higher rates are not causing a material loss of economic momentum.

Consistent with what one would expect with the backdrop of rising yields, small caps continued to underperform large-cap indices. Smaller companies are typically more reliant on debt financing to sustain operations and rising interest rates create stronger financial headwinds for smaller companies when compared to their larger peers. We expect a reversal of the trends to be supportive of small caps, which would help to close the ~20% performance gap that has opened up over the last 2 years.

To be clear, there are real risks to both the markets and the economy as we move deeper into FY24. But these are largely the same risks that markets have faced throughout FY23 and over that period the economy and markets have remained impressively resilient. So, while these risks and others must be monitored closely, they don't present any new significant headwinds on stocks that haven't existed for much of the year. We intend to remain invested, holding stocks that we believe offer good risk/reward dynamics, that align with our broader macro views. We don't believe now is the right time to significantly increase cash, or turn aggressively defensive (via hedging), although we continue to monitor the ever-evolving investment backdrop and set the portfolio accordingly.

PORTFOLIO POSITIONING

The portfolio held 22 positions at the end of September with cash sitting at ~4%. We made no changes to the portfolio in the month, having cycled through some positions in August, moves which have broadly supported continued outperformance through September.

PORTFOLIO STOCKS	
NO. OF HOLDINGS	22
ESTIMATED YIELD (%)	1.96
TOP 5 POSITIONS (% OF AUM)	30.73
TOP 10 POSITIONS (% OF AUM)	51.17

STOCK	CONTRIBUTION (%)
PALADIN ENERGY (PDN)	2.88
AUSSIE BROADBAND (ABB)	1.11
BOWEN COAL (BCB)	0.67
SILEX SYSTEMS (SLX)	0.29
READYTECH (RDY)	0.11

STOCK	DETRACTION (%)
FINEOS (FCL)	-1.20
GOBAL LITHIUM (GL1)	-0.59
SILEX SYSTEMS (SLX)	-0.51
CALIX (CXL)	-0.48
CENTURIA CAPITAL (CNI)	-0.32

	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	YTD
FY24	-1.16	6.67	1.08										**6.59**
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													**30.30**

PORTFOLIO POSITIONING CONTINUED

Our exposure to uranium through **Paladin Energy (PDN)** was supportive of performance in September. We have held Paladin on and off since May 2021 with the current up ~45%, including a 30% gain in the month. The Uranium price has increased on the back of supply issues and low inventory levels while a wave of Uranium ETF volume last month created significant buying across the sector. The ETF volume also supported uranium enrichment company **Silex Systems (SLX)**.

The weakest position on an outright basis was green industrial technology company **Calix (CXL),** which has rolled off substantially since mid-August. There is no one reason for this ~40% drop – no broker downgrades or company news flow at least, so we have put this down to two primary reasons:

Government focus: The UK has walked back on carbon-neutral targets, and there is concern that other countries may follow this popularist change of tune. While the company has a low exposure to the UK, much of Calix's value relies on companies and countries investing in ways to reduce carbon emissions, with Calix targeting high-emitting processes (cement and lime manufacturing, lithium processing and the like). There is some risk around US elections and the priority voters have for environmental outcomes at a time when the cost of living has been climbing substantially.

Cash burn: They finished FY23 with ~$70m in cash which is expected to nearly halve in FY24. Investment in research and development, pilot projects and upfront capex for long-term projects is taking its toll on the balance sheet, while major revenue sources seem at least two years away. In the forecasting period, CXL continues to burn money in an environment where the market is shying away from these types of stocks.

We continue to see Calix's technology as game-changing for a number of industries, and have retained the position.

Another detractor on performance came from the contracting business **SRG Global (SRG),** which has struggled since reporting. The FY23 result was a strong one in our view with the company posting a small beat to guidance at the EBITDA line, a number that was regularly revised higher throughout the year. The issue was softer cash conversion though we expect this to improve in FY24 given the amount of spending that went into winning new work. They won $1.1b worth of work last year and have started FY24 on the same footing with a pipeline of $6.5b worth of contracts to bid on. There is some concern about a potential slowdown in Government work, however, SRG has a small exposure to it and we view the stock as inexpensive given it is trading on a single-digit PE with conservative guidance for 20% EBITDA growth.