WaveStone Australian Share Fund

Quarterly Fund Report - March 2024

Portfolio returns

The Fund delivered a total return of 4.9% for the March quarter after all fees and expenses. The S&P/ASX 300 Accumulation Index returned 5.4% over the same period. The Fund size was $618.8m and the unit price was $2.8530 as at 31 March 2024.

Performance	Quarter %	FYTD %	1 year %	3 years % p.a	5 years % p.a	10 years % p.a	Inception % p.a[1]
Fund return (net of fees)	4.9	12.2	14.2	10.4	9.6	9.5	10.0
S&P/ASX 300 Accumulation Index	5.4	13.3	14.4	9.5	9.2	8.3	8.7
Active return[2]	**-0.5**	**-1.1**	**-0.2**	**0.9**	**0.5**	**1.2**	**1.4**

Past performance is not a reliable indicator of future performance. Numbers may not add due to rounding. Data source: Fidante Partners, 31 March 2024.

[1]The Fund's inception date is 01 February 2014.

[2]After all fees and expenses and assumes all distributions are reinvested.

Quarter in review

The March-24 quarter continued a strong rally in equity markets following a record December-23 quarter as consensus priced in diminishing odds of a recession and helped by resilient corporate earnings. This saw growth and rate sensitive sectors dramatically outperform. This was despite meaningful upward movements in yield expectations being priced in by the bond markets.

Global Markets: The ASX300 Accumulation Index rose 5.4%, with the Small Ordinaries Index rallying 7.6%. US indexes outperformed, with the S&P500 rising 10.6% and NASDAQ by 9.3% largely led by the "growth" biased Magnificent Seven stocks. This was despite disappointing first quarter results for Apple (-7.6%) and Tesla (-29.2%) as the Mag 7 was largely buoyed by Nvidia (+82.5%). Chinese equities continued to be sluggish with the Golden Dragon China Index down 2.1%. This reflected weak economic data and exclusions from APAC index flows - we have observed increased demand for Asia-ex China index products.

Sector Performance: March posted a strong quarter with all sectors rallying with the exception of Materials, which was largely hurt by weakening Iron Ore prices. The best performing sectors were IT (+23.7%), REITS (+14.9%) and Consumer Discretionary (+14.0%). With these generally considered rate sensitive sectors, it is interesting to contrast sector outperformance in equity markets against the rise in yields being priced in the bond market. The worst performing sectors were Materials (-5.6%), Communication Services (+1.8%) and Consumer Staples (+2.7%).

Rate and Yields: Movements in the AUS 10-Yr was relatively modest, rising only 1bp to 396bps. However, this reflected a step up in yield expectations in January and February given persistent inflation readings notably in wages. March saw material retracements of 20bps, given softer than expected CPI print of 3.4% yoy (market: 3.5%), marking the equal slowest since November 2021 levels. The RBA remained on pause during the quarter as expected despite this bond markets pushed out the timing of rates cuts to the back half of 2024. In the US, 10-Yr yields rose 32bps to 420bps as bond markets are pricing in a more restrictive monetary outcome in the US driven by more robust inflation and jobs data - US unemployment remains at robust levels at 3.8%.

Commodities: Iron Ore prices fell 26.3% over the quarter, reversing its 17.0% rise in the preceding quarter to US$140.55/tonne. This was largely driven by sluggish economic data coming out of China and build-up of port inventories on the supply side. Conversely, Brent Oil posted strong gains up 13.6% initially driven by concerns over supply tightness caused by the Red Sea conflicts back in January, and later on by market anticipation of a soft landing. Gold was also a notable outperformer commodity, up 8.1% driven through buying activity from global central banks and private Chinese investors seeking a store of value.

Reporting Season: The Feb-24 reporting season looked robust on the headline with twice as many beats than misses, however we note that expectations were lower heading into reporting. We observe cost pressures remaining a topical focus for management teams, despite margins largely holding up given a generally strong demand environment and companies delivering cost rationalisation programs. Outlook sentiment from management teams remain cautious, especially surrounding positive, but slowing top line growth. Overall, FY24 estimates were slightly rebased down 0.6%, with consensus now expecting 5.8% decline in earnings for the year.

Corporate News: Corporate takeovers were highly featured, largely from strategic than financial sponsors. This was especially the case in the Building Materials sector where CRH's $2.1bn bid for Adbri finalised in February, France based Saint Gobain bid $4.3bn for CSR, and Seven Group bid $1.9bn to acquire their remaining 28.4% stake in Boral. Furthermore, software design vendor Altium also received a $9.1bn bid from Japanese buyer Renesas, which was a partial contributor behind the IT sector's outperformance for the month. Finally, after 2 years since the initial announcement, ANZ received

approval for the proposed merger with Suncorp following a successful appeal to the Australian Competition Tribunal.

Fund Performance Summary

The Fund delivered a gross return of 5.1% for the March quarter slightly underperforming with the broader ASX300 accumulation index which returned 5.4% over the same period. Top contributors included owning Goodman Group and Resmed and not owning Fortescue. Top detractors included owning Rio Tinto and not owning QBE and Westpac.

Fund's best performing investments	
Company	**bps**
Goodman Group	+35
Fortescue	+28
Resmed	+21

Major Contributors

Goodman Group

Goodman Group (**GMG**) contributed to Fund performance during the quarter as the February results saw GMG upgrade FY24 EPS guidance from 9% to 11%. Moreover, GMG also benefitted from its inclusion in the NAREIT index which saw passive inflows into the stock. We are still encouraged by the improvement in fundamentals shown at the 1H24 result. Importantly, the data centre power bank was upgraded from 3.7GW to 4.0GW, with around half of this already contracted for power. 1H24 saw a welcome rebound in commencements and management is suggesting data centres could soon grow from 37% of its workbook mix to ~50% by FY25. Industry trends remain robust underpinned by a step change in capex spend by hyperscalers whereby the company is strategically positioned to benefit, given their existing relationships with the cloud providers and the existing availability of power and land secured. Hyperscalers are extending contract length (i.e. 5 years to Microsoft offering 15-year terms with 5-year + 5-year renewal options) as well as increasing yearly escalators in a bid to secure capacity. Moreover, our industry conversations suggest that despite GMG's legacy as an industrial developer, they have impressively been able to build capability in data centre development in a reasonably short timeframe. Ultimately, having the right assets and the technical knowhow should position GMG as a preferred developer of these centres.

Fortescue

Fortescue (**FMG**) (not held) contributed to the Fund performance, with the stock declining 11% over the quarter & underperforming both Mining peers (by 4%) and the wider market (15%). The main driver was a weaker iron ore price, which fell from >US$130/t at the start of the year to <US$100/t as at end-March. The real estate segment continued to be a drag, highlighted by new starts (proxy for steel demand into property) tracking down 30% YoY in Jan-Feb (last available data point). More broadly, the momentum in steel intensive sectors underwhelmed following the Chinese New Year in early-Feb, with pig iron production weaker YoY and iron ore inventories >140Mt which is elevated compared to prior years. We also note that FMG has had an operationally challenging quarter given a train derailment late in CY23 impacting January production, coupled with wet weather meaning current FY24 guidance of 192-197Mt will be a stretch.

Resmed

Resmed (**RMD**) outperformed the market after management (CFO and IR) meetings with analysts and investors gave greater confidence in the demand drivers and gross margin outlook for the business. Near term the greatest driver of gross margin will be product mix (masks are sold on better margins than devices), with cost headwinds, such as freight and inventory costs, also abating. Management noted their new mask launch (F40) had been going well, supporting their expectation of share gains in future quarters. Longer term moving to a single device product line should deliver solid gross margin benefits. Until that time the AirSense 11's higher price point and slight COGS advantage will be supportive as will some of the recent work undertaken on manufacturing optimisation. The disruptions in the Red sea have seen freight costs rise again and are adding to shipping lead times but at this stage Management expect gross margins can continue to improve provided Red Sea issues (more of a Q4 impact) do not deteriorate further.

Fund's least performing investments	
Company	**bps**
Westpac	-29
Rio Tinto	-27
QBE	-19

Major Detractors

Westpac

Westpac (**WBC**) bounced in line with ANZ and NAB (owned by WaveStone) up 14% for the quarter. WBC announced its Q1 result was $1.8bn ex-notables with a return to loan growth in line with system which the market liked as WBC has lost significant mortgage share over the last decade. However, in order to do this WBC discounted pricing below the other major banks and we note that ROE declined 61bps to 8.9% annualised in the quarter. During March the new Chairperson met with sell side analysts and indicated he will be looking to put new CEO in the next 12 months and is actively looking offshore! Despite this current CEO Peter King announced a new technology programme called Unite which aims to spend within the $2bn investment envelope by spending less on regulatory spend and more on technology. Given where CBA, NAB and Macquarie are at, we believe that WBC needed to announce a more ambitious technology plan but the business can only cope with so much change internally.

Rio Tinto

Rio Tinto (**RIO**) was not immune from weaker iron ore pricing over the March quarter. RIO's stock fell 10% over the period, underperforming the wider market (by 14%) and Resources peers (3%). Iron ore fell from >US$130/t in early January to

underperforming the wider market (by 14%) and Resources peers (3%). Iron ore fell from >US$130/t in early January to <US$100/t at quarter-end. China's real estate segment continued to be weak, with new starts tracking down 30% YoY (Jan-Feb), pig iron production weaker and iron ore inventory at levels that are historically elevated pointing to muted demand. High levels of rainfall in the Pilbara will likely show some weakness in the March period for the iron ore miners, including RIO although given this is the first quarter of RIO's financial year we see little risk to guidance (323-338Mt on a 100% basis).

QBE

QBE's (**QBE**) share price rallied over the quarter mainly on the back of running yields improving, as the expectation of rate cuts subsided - especially in the US where the market was pricing in 6 rate cuts in January-24 versus the current expectation for less than 3 cuts. This was the case for all three listed General insurers - our preferred exposure remains IAG which we like because of the market structure for personal lines insurance - home and motor. Commercial insurance pricing remains buoyant and there is an expectation that as claims inflation moderates, underlying margins across the insurance industry will improve - leading to better earnings.

Fund Activity

New Stocks Added	Stocks Exited
	• Qualitas • Telix Pharmaceuticals

Increases	Decreases
• Treasury Wine Estates • IDP Education	• ANZ

Key Additions

None.

Notable Increases

The Fund increased its holding in Treasury Wine (**TWE)** over the quarter. The wine category has been volatile post-Covid especially in the US and market expectations were for TWE to report a weak result. The company's result came in better than expected, helping the share price recovery. This was particularly important given that the investors were sceptical of their acquisition of DAOU Vineyards last year, especially the full price paid. Whilst early days, it is pleasing to see DAOU performing to its business case. Through the quarter, there was growing expectation that the China tariffs were going to be removed. This came to fruition in late March.

TWE now has the opportunity to rebuild its business in China, its biggest organic growth opportunity in the luxury Penfolds business. John Mullen has taken over as Chairperson of TWE and this should bring greater focus on capital allocation going forward.

IDP Education (**IEL**): Despite a very strong 1H24 result, the stock has been hit by poor sentiment surrounding tighter regulatory screws and the potential impact on its Student Placements division. We acknowledge the uncertainty in industry conditions in recent months but believe that this is largely cyclical and IDP, given the strength of its franchise in core source and destination markets, is well positioned to emerge with a stronger market position. The Fund used the weakness in the share price to increase its holding in IDP Education over the quarter.

Notable portfolio exits and reduction

We reduced ANZ Bank (**ANZ)** on valuation grounds (PE 13.2x FY25, 10% ROE) as the share price was up 13% over the quarter. The news during the quarter was that the Australian Competition Tribunal (ACT) decided to authorise the proposed acquisition of Suncorp Bank. ANZ now requires the Queensland government and the Treasurer to approve its acquisition. We continue to believe that ANZ has overpaid for SUN. We will watch the merger of the two retail banks to see if there is a loss of market share to competitors due to the internal focus of ANZ management to achieve the synergies.

The Fund exited its position in Qualitas (**QAL**) as it hit our price target, on the back of its strong operating result. The private credit space is increasingly a hunting ground for global competitors such as Apollo, Ares and Blackstone - not to mention local competitors now entering the space given the demand from an asset allocation standpoint. Whilst QAL is a very good and disciplined operator, we are wary of exposure to large residential development projects when the cost of labour, materials and funding are still elevated and make project economics quite weak.

The fund also exited its position in Telix (**TLX)** over the quarter as the stock traded closer to our valuation and we became less convinced shareholders would see the benefits of the approval of the companies diagnostic products in the near term. The appeal of TLX for us was the depth of the R&D pipeline and potential forthcoming approval of TLX's kidney diagnostic, building on the recent approval of ILLUCCIX for prostate cancer diagnosis. However, with management increasingly intent on reinvesting these profits to prove out the therapeutic portfolio, it could be some time before shareholders see this benefit of the near term approvals in the diagnosis channel.

Outlook & Strategy

Global growth so far in 2024 has been resilient, with the United States as the beacon. Inflation is receding at the same time, giving the Federal Reserve (Fed) the room to cut interest rates. Given the strength in the US economy, market expectation for almost 6 rate cuts at the start of the year has shifted closer to the Fed's view of 2-3 cuts this year. The US unemployment rate has stayed low at 3.8%, with continuing strong growth in payrolls.

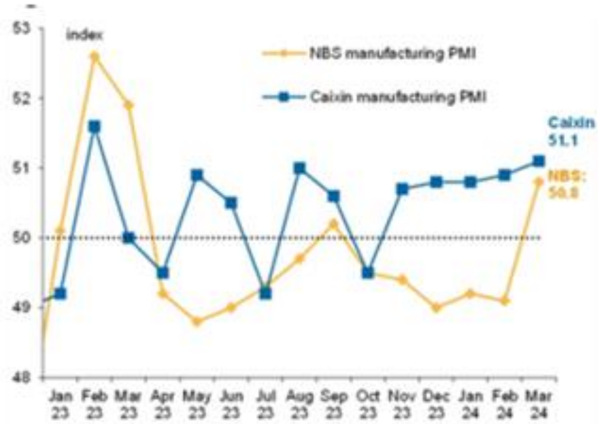
Evercore ISI Company Surveys (above) shows that activity levels in the US are lifting, implying resilience is set to continue.

Source: Evercore ISI

Given the strength of the US, Global PMIs (above) are recovering too – implying that the recovery is spreading to the rest of the world and becoming more broad-based.

The Chinese Government set a GDP growth target of 5% for 2024 which looks like a high hurdle given the absence of any large stimulus – we were expecting more fiscal support. However, the strength of the Western economies, especially the US, is having a positive impact on the external sector in China, as reflected by the China PMIs in March.

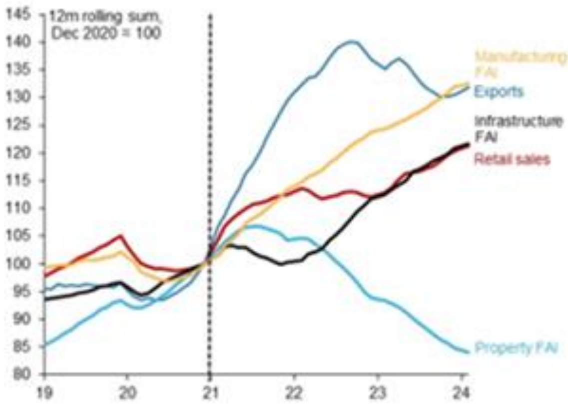
PMIs Improved in March



Source: NBS, WIND, Macquarie Macro Strategy

The recovery of the export sector gives the government some additional room whilst trying to stabilise the property sector. President Xi remains focused on shifting the emphasis in China to advanced manufacturing production and in high tech dominance.

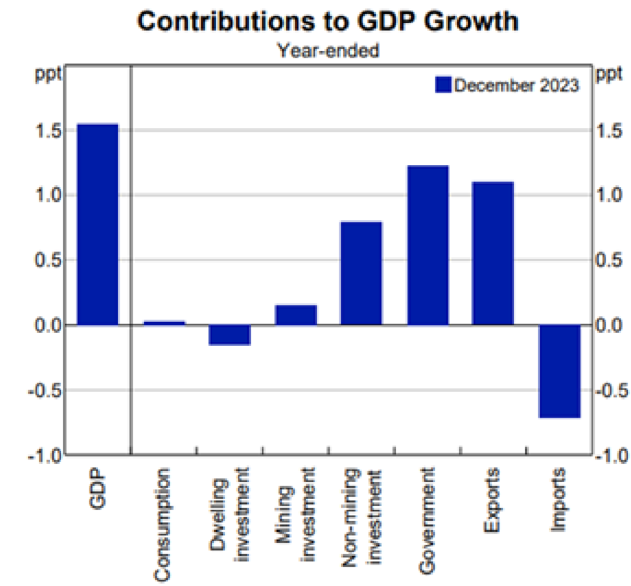
Two Speed Recovery since 2021



Source: China Customs, NBS, WIND, Macquarie Macro Strategy

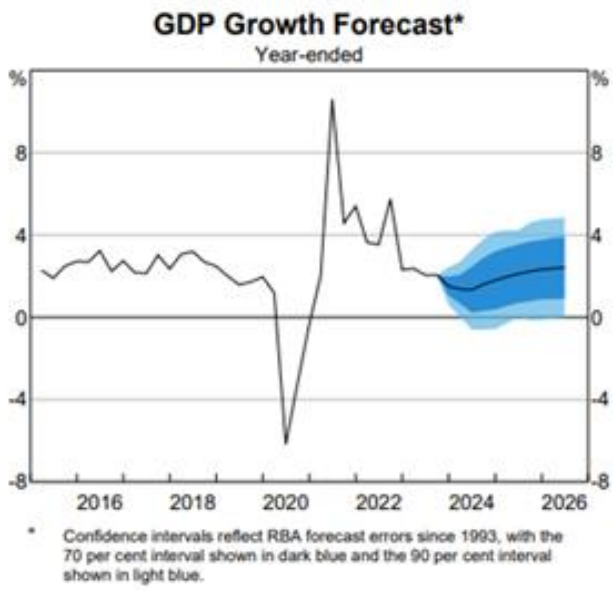
The China housing market remained weak, with likely more defaults by the large developers. If the global economy remains resilient, we expect the Chinese to hold their ground and try and rebalance the economy without being forced into significant fiscal stimulus that creates more imbalances longer term.

Source: WIND, Macquarie Macro Strategy



Source: ABS, RBA

The RBA expects Australian GDP growth to pick up gradually through the course of the year, largely reflecting stronger public demand and improving household consumption. Moderating inflation will help improve real income growth and aid with household consumption.



Source: ABS, RBA

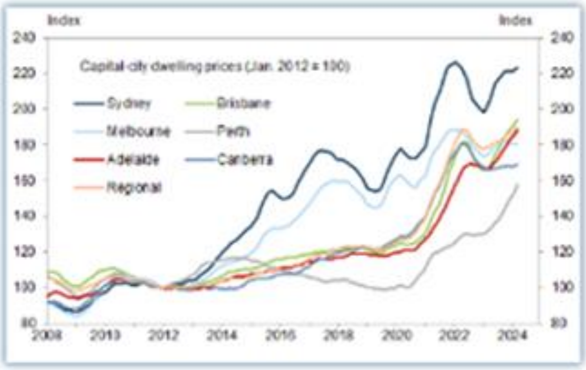
We continue to expect strong public spending in infrastructure in the medium especially given the investments required for the energy transition as well as in residential construction.

The high cost to build has meant that housing approvals are very weak, with completions exceeding approvals. This means that housing construction will likely hit an air pocket in the short term (see below). Given the large shortfall in housing and surging rents, we expect a pick-up especially in multi-family construction towards the latter part of this year and into CY25/26 as the RBA moves to cut rates and construction costs (labour and materials) start to level off.

Source: Barrenjoey Research

House prices continued their uptick in the March quarter (the highlight being Perth) and with interest rates having likely peaked, the positive wealth effect will allow the consumer to further draw down on savings – cushioning domestic consumption till the tax cuts mid-year. It is also expected that wages will increase by around 4% in FY25, with the Fair Work decision likely in June.

House prices continue to climb



Source: CoreLogic, Goldman Sachs Global Investment Research

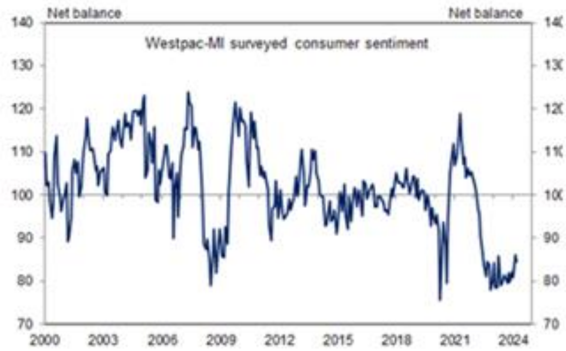
Whilst business conditions have remained resilient, business confidence remains weak. Our expectation that the economy will recover in the second half should mean that business confidence will likely have bottomed and should improve from here.

Business conditions have been fairly resilient

Source: Haver Analytics

Consumer sentiment as measured by the Westpac Melbourne Institute Consumer Sentiment Index remains subdued. It dipped in March as consumers are still pessimistic about any immediate relief from interest rates as well as continuing cost of living pressures.

Consumer Sentiment still weak



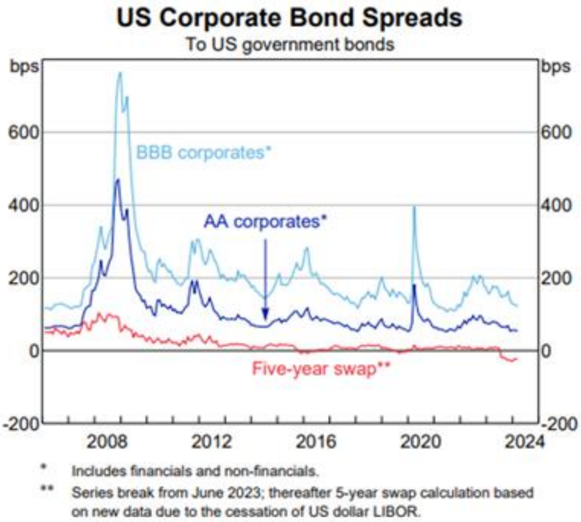
Source: Haver Analytics

The sharp rally in equity markets since October last year has meant that investors are pricing in a strong cyclical rebound in earnings. In the US, the relative performance of cyclical stocks vs. defensive stocks has surged in recent months as investors have become more confident in the strength of the economy. This has meant that despite the US 10-year rate moving from 3.9% to 4.4%, a relatively large move since late December 2023, equity markets have continued to rally.

Equities are pricing optimism about growth backdrop

Source: Goldman Sachs Global Investment Research

We can similarly observe the optimism in the US corporate bond market where the spreads for riskier corporates (BBB) are trading at very low levels compared to history.



Source: Bloomberg, ICE

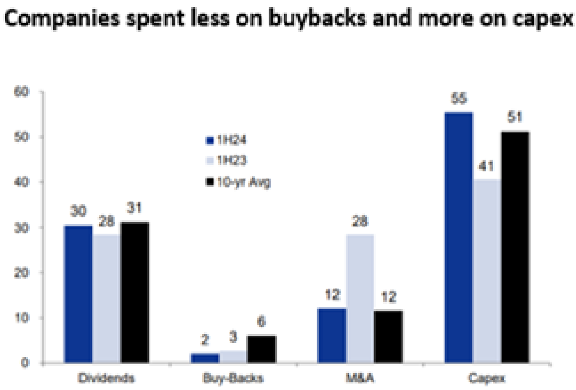
In Australia, the February reporting season was better than expected. Sales growth, as evidenced in the chart below, has slowed significantly as inflation has moderated – reducing the need for price increases. Given the ~2.5% population growth experienced, volumes appear to have recovered slightly.

Source: Goldman Sachs Global Investment Research

Companies (especially B2B) that have failed to price the additional inflationary pressures in costs have seen margin headwinds, resulting in downgrades. This was particularly evident in the health services sector such as pathology and hospitals. Companies like Cleanaway who rely on pass through of their costs have also seen a significant lag in margin recovery. Discretionary retailers had a very good reporting season as they managed their inventories well resulting in improvement in gross margins (little or no discounting) that helped offset labour cost increases (cost of doing business).

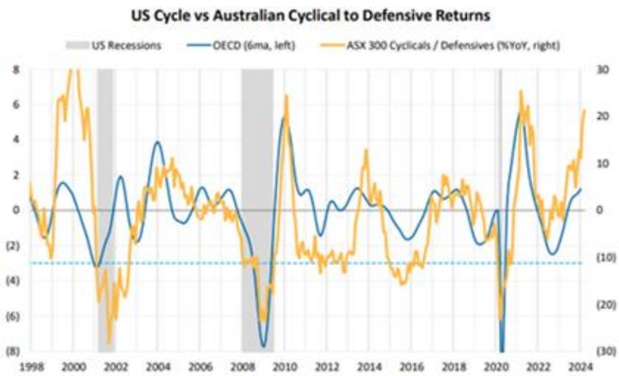
Source: FactSet, Goldman Sachs Global Investment Research

Capital spending has definitely increased, with dividend and buybacks impacted somewhat. This will likely persist given that corporate spending on Tech/AI appears to have just started.



Source: FactSet, Goldman Sachs Global Investment Research

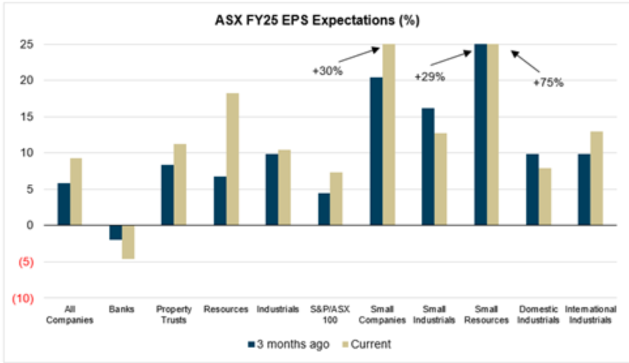
Similar to the US experience mentioned above, we have seen a re-rating especially of cyclical companies in anticipation of an earnings recovery.



Source: FactSet, Macquarie Research, March 2024

The overall market multiple (PER) has gone up despite the increase in the risk free rate, a reflection of better overall expectations for EPS growth in CY24 and beyond.

Source: Goldman Sachs



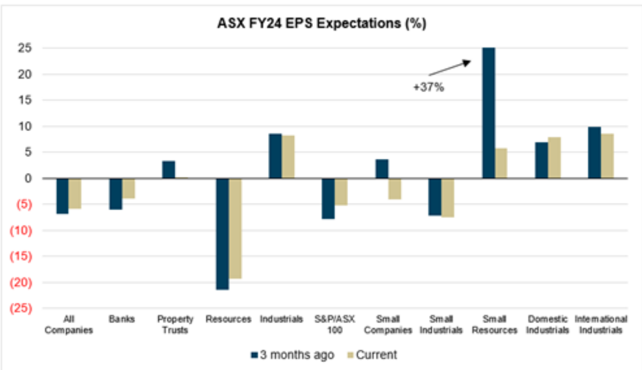
Source: Macquarie

Earnings expectations for the market in FY24 (below) remain reasonably subdued, mainly because of lower commodity prices. Expectations of a household consumption led recovery in FY25 is slowly being reflected in the earnings outlook for small and domestic industrials.

Market and sector EPS growth (%) (pro-rated to June)	FY24E	FY25E	FY26E	Current 1 yr fwd	Forecast 2 yr Fwd
All Companies	(5.8)	9.3	(3.8)	3.3	1.4
Banks	(3.9)	(4.6)	1.7	(4.3)	(0.8)
Property Trusts	0.1	11.3	7.6	6.9	9.1
Resources	(19.3)	18.3	(20.3)	3.4	(5.0)
Industrials (All Cos ex Res, LPTs, Banks)	8.2	10.4	7.9	9.5	8.9
S&P/ASX 100	(5.3)	7.4	(4.6)	2.3	0.2
Small Companies	(4.1)	29.8	3.0	16.3	13.6
Small Industrials	(7.5)	12.8	11.8	4.8	12.2
Small Resources	5.7	75.0	(12.2)	47.5	22.4
Domestic Industrials	7.9	7.9	6.3	7.9	6.9
International Industrials	8.5	13.0	9.3	11.2	10.7

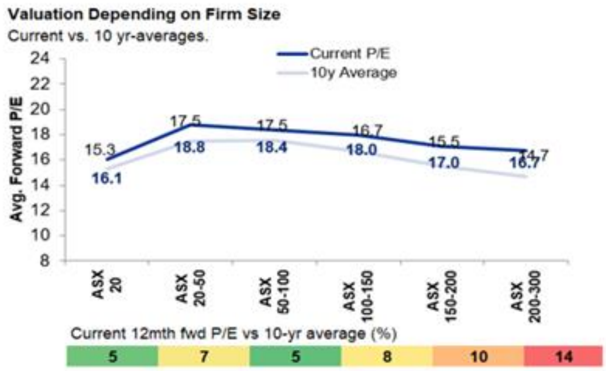
Source: Macquarie

Some early signs of an improvement EPS expectations can be seen in the charts below – a comparison of FY24 and FY25 EPS across sectors from three months ago to now.



Source: Macquarie

We need to see further upside to corporate earnings for the stock market rally to be sustained. There remains considerable uncertainty for the rest of the year – foremost is the outcome of the US election and its implications for further geopolitical uncertainty in Russia-Ukraine, the Middle East and China.



Source: Goldman Sachs

Whilst we are cautiously optimistic given the slightly more favourable outlook, we are very focused on our defined investment approach to identify high quality business franchises that have built and demonstrated a Sustainable Competitive Advantage (SCA). We continue to focus on companies offering valuation upside with effective capital allocation.

The WaveStone Capital Investment Team

ESG Activity

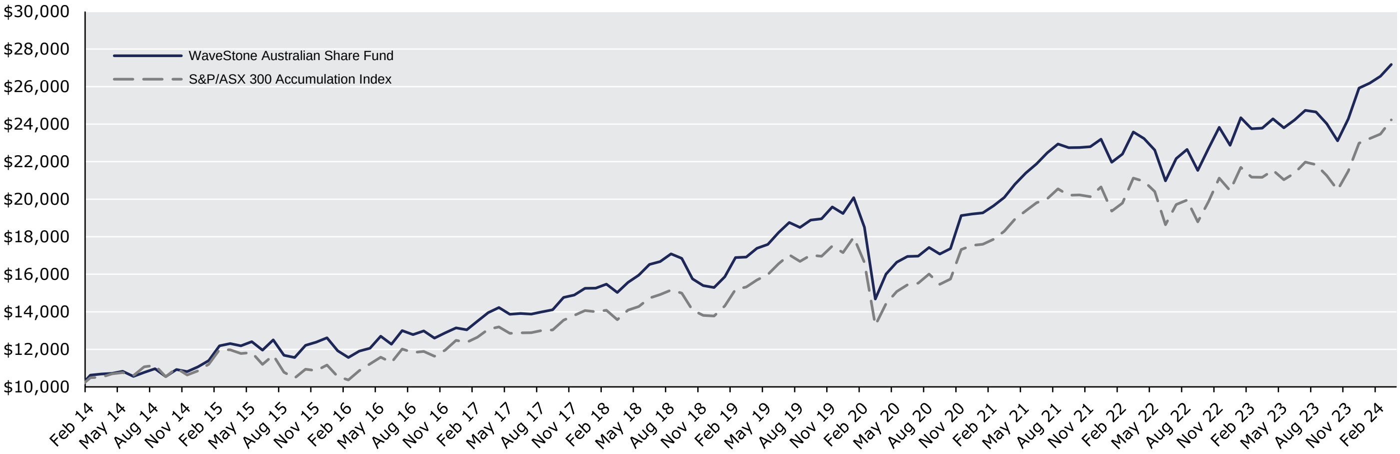
Our most recent report on ESG activity can be found here: www.fidante.com/WaveStoneESGreport

Fund Facts as at 31 March 2024

APIR Code	HOW0020AU
Inception date	01 February 2014
Management fee + (Performance Fee)	0.97% p.a. of the net asset value of the Fund + (Nil)
Buy/sell spread	+0.20% / -0.20%
Fund size	$618.8M
Exit price	$2.8530

Data source: Fidante Partners.

Growth of $10,000



Past Performance is not indicative of future performance. **The Fund changed investment manager on 1 February 2014, at which time Wavestone Capital commenced managing the Fund. The transition was completed on 31 January 2014. Therefore, the inception date for the Fund returns shown above is 1 February 2014. For performance relating to previous periods please contact the Fidante Partners Investor Services team on 13 51 53 (during Sydney business hours).**

Contact us

For more information, please contact Fidante Partners Adviser Services on 1800 195 853 or Fidante Partners Investor Services on 13 51 53, or visit www.wavestonecapital.com