Quarterly Update

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InvestSMART Funds Management Limited
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Managed by
Intelligent Investor Holdings Pty Ltd
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Intelligent Investor Australian Equity Growth Fund (Managed Fund) (ASX:IIGF)

"Some things you cannot explain because they are too simple." — **Bernard Moitessier**

"When momentum is on your side, people focus on your strengths and forgive your weaknesses. When the momentum stops, they scrutinize the whole thing." — **Packy McCormick**

"We are built with an almost infinite capacity to believe things because the beliefs are advantageous for us to hold, rather than because they are even remotely related to the truth." — **Dee Hock**

Trump's election victory has been euphoric for everything from stocks to Fartcoin and art, which includes 'Comedian'. A US$6.2m banana that a crypto bro paid to duct tape to a wall before eating it.

No one rings a bell at the top of the market, but Fartcoin's multibillion dollar valuation and unofficial slogan that 'hot air rises' is a warning to make sure you know exactly what you own and why.

According to one broker, the index's expected return has fallen to a miserly 3% p.a. That's hardly surprising when the banks would need to fall over 40% to offer a 10% return (much more for CBA) and a new contract signed by Pro Medicus that added $20m to operating earnings boosted its market value by $2.5bn.

Performance (after fees)

	1 mth	3 mth	1 yr	2 yrs	3 yrs	S.I. p.a
II Australian Equity Growth Fund	-1.8%	-6.3%	2.9%	2.6%	3.2%	10.0%
S&P ASX 200 Accumulation Index	-3.2%	-0.8%	11.4%	11.9%	7.4%	12.0%
Excess to Benchmark	1.4%	-5.5%	-8.5%	-9.3%	-4.2%	-2.0%

Inception (S.I.): 5 October 2020

Fund overview

The Intelligent Investor Australian Equity Growth Fund is a concentrated portfolio of 10 - 35 Australian-listed stocks. The Portfolio invests in a mix of large, mid and small cap stocks, focusing on highly profitable industry leaders that have long-term opportunities to reinvest profits at high rates of return.

5+ yrs
Suggested investment timeframe

10 - 35
Indicative number of securities

Risk profile: High
Expected loss in 4 to 6 years out of every 20 years

S&P/ASX 200 Accumulation Index
Benchmark

Investment fee
0.97% p.a.

Performance fee
Nil

Chart 1: ASX Financials vs Resources

If you think 3% is bad, spare a thought for US large cap investors who must suffer seven years of over 6% annual falls to return to fair value according to investing great Jeremy Grantham.

Avoiding the bubbly areas of the market is why we outperformed by over 35% between 2019 and 2022. Though the market dynamics are different, we believe a similar period is brewing. But waiting doesn't get easier.

This is my fourth episode of raging animal spirits. The first climaxed with the GFC. In 2006 I was finally realising my dream as a professional investor when I was nicknamed 'Short sell Bell' given how worried I was about valuations and other crazy behaviour.

Back then there was a clear date for Ninja loans (no income, no job and no assets) and other subprime loans to revert from introductory repayments to regular mortgages, which triggered the GFC.

Studying the *Chartered Financial Analyst* and learning about Collateralised Debt Obligations and other highly leveraged financial Frankenstein creations every fortnight in *Grant's Interest Rate Observer* meant I was prepared.

Today's market echoes the tech boom and Nifty-Fifty bubble where an AI, growth stock and momentum boom sits oddly alongside a bank bubble.

There's no obvious ticking time bomb, but valuations broadly have never been higher, there's been a relatively small number of huge winners, individuals have never owned more stocks and passive investing and animal spirits are dominating markets.

Thankfully we're not weighed down by having half a trillion dollars to invest like Warren Buffett. So, given the bar for beating the index has never been lower, let's review the investment case for some of our largest and most prospective positions that we expect to outperform long after the euphoria fades.

Australia's mining giant

2024 was reportedly the worst year for the resources sector in almost a decade and is responsible for this quarter's underperformance.

This year we added **BHP** but it's a much smaller position compared to the index as Chinese iron ore demand is moderating after massively overbuilding apartments and other developments while supply is increasing. But on 12x earnings and a 5% dividend yield, it's far cheaper than the banks, for example, and leaves room for iron ore miner **Mineral Resources** while remaining underweight the iron ore sector.

Mining software company **RPM Global** has more than doubled after doing everything we'd hoped, but it had to as we initially had to hold cash against the position due to its sub $500m market value and our strict liquidity constraints.

We've taken profits but still think it's worth between four and five dollars depending on the success of its new software and recently signed general framework agreements with some of the world's largest miners.

It's been a classic *Intelligent Investor* pick. An insider with skin in the game and excellent track record transformed a small, obscure company into a subscription as a service business over many years of investment and hard work that's recently been rewarded with inclusion in the ASX300 index.

We've discussed Mineral Resources in depth in previous reports, but having likely avoided a dilutionary capital raising with asset sales the stock is likely worth between two and three times its current price once Mt Onslow reaches nameplate capacity in June and depending on future lithium prices.

The formidable Mining Services business is worth more than the company's current market value in our view, which suggests you're getting the lithium and oil and gas assets for free.

New Hope Corporation is currently yielding around 10% grossed up, nearly three times what the market is likely to return according to the forecasts discussed above. Normally 10% dividend yields suggest the dividend is about to be cut, but in this case, it could increase materially if/when coal prices increase and once current mine expansions are complete.

Lastly in the resources sector, **Karoon Energy** is trading at around four times earnings due to lower oil prices, hurricanes and operational issues. The board could easily approve dividends that would yield double digits and the stock could conservatively be worth more than three times its current price.

We don't normally own many resources companies. But as you can see, our basket is unusually cheap.

Industrial holdings

Despite increasing 50% since August, **MA Financial**'s share price is languishing nearly 40% below its high from a few years ago due to a slump in corporate activity, higher interest rates and heavy investment.

With these trends reversing, earnings could increase 50% over the next two years putting the stock on 2026 price-to-earnings (PER) ratio of just 13. That's half Commonwealth Bank's ratio. MA Financial's fully franked dividend yield is also higher and dividends could increase rapidly with earnings. MA Financial shows the general discrepancy between small and large cap stock valuations.

Despite **Resmed**'s share price recovering 80% since fears peaked about the potential impact of new obesity drugs on sleep apnoea sufferers, the stock trades on a modest forecast PER of 25. Again, well below Commonwealth Bank's multiple despite a long history of double-digit earnings growth and expectations that the new group of GLP-1 drugs may produce more sleep apnoea diagnosis and more patients for ResMed, not less.

Eagers Automotive's share price can be volatile, but its earnings and dividends have increased consistently for decades. Sporting a 6% fully franked yield and PER of 13, expectations for this business are low despite continuing to gradually increase its market share with an expanding range of automative brands.

CSL's share price is stuck where it was five years ago due to a combination of over-valuation, Covid's impact on margins, and a poor acquisition. Yet despite much lower expectations and double-digit earnings growth, it's forecast PER of 28 is well below most high-quality businesses listed on the ASX.

Either CSL's earnings aren't going to increase as expected, or Australia's current market darlings are overvalued. Clearly, we're betting on the latter.

Aussie Broadband isn't as high quality as Uniti Group, which was our largest position when the small telco was taken over three years ago at around three times Aussie's current valuation. But Aussie has excellent management with skin in the game, a clear growth strategy and recently paid its first dividend.

Although owning large telcos has generally been a losing bet due to low margins and intense competition, owning niche telcos can be extraordinarily profitable particularly when they're eventually acquired.

Summary

While the market is possibly priced for its lowest ever returns despite falling earnings, your portfolio is cheap with two thirds of the holdings boasting management with skin in the game reinforced with some of Australia's best healthcare companies and monopolistic businesses like **The Lottery Corporation**. More importantly, several holdings are nearing step changes in their earnings and/or dividends.

In a market increasingly dominated by momentum, the key to high and safe returns is finding value before the algorithms almost instantly incorporate the latest reported numbers into share prices.

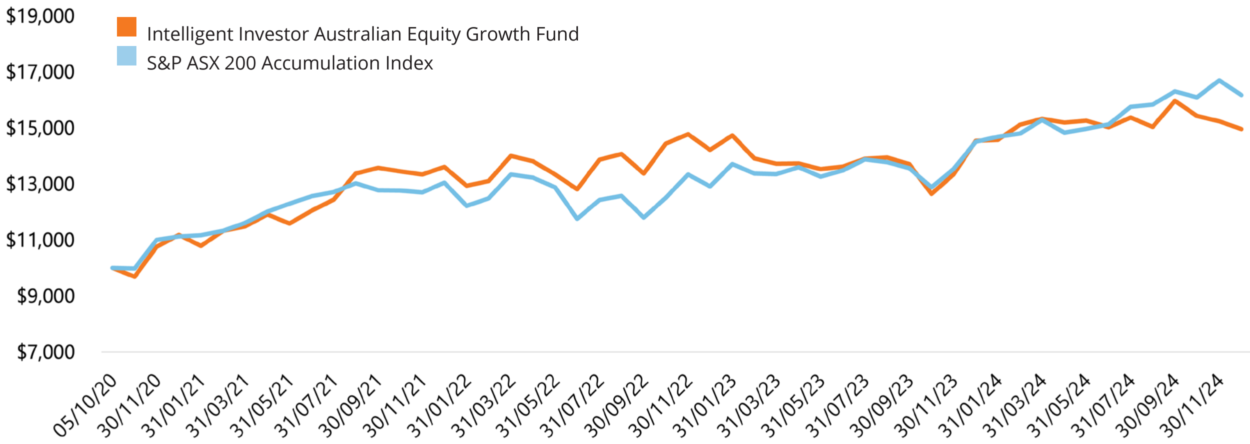
Environments where algorithms increasingly decide which stocks are in or out can be frustrating when far less deserving stocks are soaring, but value will always be rewarded eventually and those that overpay will be punished faster than ever when the momentum changes direction. That will provide plenty of opportunities in the years ahead as more investors learn old lessons like price always matters.

Please get in touch if you have any questions

info@intelligentinvestor.com.au

1300 880 160

Performance since inception



Inception (S.I.): 5 Oct 2020

Asset allocation

Materials	22.2%
Health Care	17.0%
Consumer Discretionary	15.6%
Information Technology	11.4%
Financials	7.3%
Consumer Staples	5.9%
Industrials	4.4%
Energy	4.2%
Communication Services	3.9%
Cash	3.2%
Utilities	3.1%
Real Estate	1.8%

Top 5 holdings

BHP Group (BHP)	7.3%
CSL (CSL)	7.1%
New Hope Corporation (NHC)	6.4%
RPMGlobal (RUL)	6.2%
ResMed (RMD)	6.2%

Fund Stats

Distribution yield	1.36%
Net asset value	$2.93

Important information

All tables and chart data is correct as at 31 December 2024