Quarterly Update

31 March 2025

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Intelligent Investor Select Value Share Fund Active ETF (ASX:IISV)

"The most important thing in communication is hearing what isn't said" — Peter Drucker

"The way to be safe is to never be secure" — Ben Franklin

"Being honest about the odds that your opinions and forecasts will actually come true can be so discouraging and uncomfortable that the warm blanket of denial and overoptimism becomes home to most people's beliefs" — Morgan Housel

Until the last week of February the quarter was shaping yet another big win for momentum. But, as we discussed last month, **Microsof**t boss Satya Nadella's warning about overbuilding data centres for AI reminded investors that trees don't grow to the sky.

Throw in fears around tariffs and a dim outlook from US consumers and the Nasdaq and S&P500 fell 15% and 10% from their highs respectively before staging a recovery at the end of the quarter.

Tech stocks were the hardest hit, but it was company specific reasons that did the real damage. **Tesla**'s stock halved as sales expectations cratered while Chinese EV manufacturer BYD announced soaring sales and a leap forward in charging

Performance (after fees)

	1 mth	3 mths	6 mths	1 yr	2 yrs	S.I. p.a
II Select Value Share Fund	-2.5%	-2.7%	4.5%	8.8%	16.9%	16.9%
S&P ASX 200 Accumulation Index	-3.4%	-2.8%	-3.6%	2.8%	8.5%	8.5%
Excess to Benchmark	0.9%	0.1%	8.1%	5.9%	8.4%	8.4%

Note: The benchmark is the ASX200 Accumulation Index. It's one of the world's highest performing indexes, which sets the bar high for the performance fee, and we need to beat our home index to justify investing abroad.

Inception (S.I.): 28 Mar 2023

Fund overview

The Intelligent Investor Select Value Share Fund is an Active ETF designed for investors seeking a diversified selection of International and Australian companies with superior financial metrics and competitive advantages to outperform the S&P/ASX 200 Accumulation Index over five year rolling periods.

5+ yrs
Suggested investment timeframe

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
15% p.a.

times. Meanwhile, **TradeDesk**, a US digital marketing company whose stock had increased 26-fold since 2018 plummeted 60% after announcing a poor result.

Technology is moving faster than ever, and once impregnable competitive moats are at higher risk than they've ever been driven by advances in AI.

Portfolio

We sold a modest position in **Alphabet** (parent of Google) after worrying its optically cheap valuation won't compensate for the rapidly increasing threats to the profitability of its remarkable search advertising business.

AI is moving incredibly fast, and a quick ring around the team revealed virtually everyone is using alternative search options. A small group of value investing nerds is not a good subset for measuring the power of Google's advertising business, but Search has never faced the threats posed by AI.

It could remain a very profitable business yet make Alphabet a poor investment if its margins decline. It's highly unlikely Alphabet's existing businesses or new ones could ever replace search. Success would still likely involve lower margins and higher investment. We've provided more detail in the appendix.

We then bought **ResMed** instead, the global leader in sleep apnoea treatment. Operating in a duopoly with Philips, ResMed runs a razor-and-blade model—selling CPAP machines that need replacing every five years and high margin masks that might be replaced annually.

Nearly half a billion people suffer from severe sleep apnoea, and low diagnosis rates provide a long growth runway. Profits and revenue have tripled over the past decade, while return on equity is routinely above 20%. Yet fears that weight-loss drugs might cure sleep apnoea leave it trading on 23 times earnings despite evidence to the contrary.

The shorts increased their bets that **Mineral Resources** will destroy its value with a highly dilutive capital raising after announcing its key haul road needs a $230m upgrade after cyclone damage. With $10bn of assets, this can easily be avoided by selling assets, starting with its lithium mines.

Stakes in Wodgina and Mt Marion would likely fetch $1-2bn each, and infrastructure such as transhippers and road trains could also raise hundreds of millions of dollars, although lease expenses increase operating costs.

The rest of MinRes' gas portfolio might fetch $200-300m and the rest of the haul road could bring in over $1bn although this, too would add a few dollars a tonne to operating costs. In a fire sale, a combination of lithium sales, gas sales and infrastructure could raise between $3-4bn in desperation with $800m owing from loans to Onslow development partners. Not to mention a stake in Onslow could be sold.

With the company's third transhipper in service and the fourth due in April, the stock should have a meaningful impact on our returns despite its small position size if a capital raising is avoided.

CME Group benefited from the market volatility recording a record annual result. The derivatives exchange operator also launched credit futures and its Google partnership is creating new data-driven revenue streams. Increasing US deficits are fuelling hedging demand, helping support the company's fortress-like balance sheet and 4% dividend yield.

Allfunds' share price increased 5% after increasing annual revenue and net profit 16%. Yet the European wealth platform operator's share price is below what we paid two years ago. The company launched an intelligent €250m buyback and raised the full-year dividend to 13 cents. At just 12 times earnings, the company should be a huge beneficiary of investment flows from the US to Europe.

After taking some profits alternative asset manager **KKR** fell 21% despite an excellent result and outlook, as investors fret over fundraising and performance fee delays given the current market uncertainty. We started buying those shares back as the asset-gathering machine could make US$8-9 of earnings per share in 2026 with years of double-digit growth ahead.

MA Financial had almost doubled over the past year before dropping 20% despite profits poised to double over the next three years. **RPM Global** announced a solid result and the sale of its consulting business for a good price making it a more attractive takeover target. The proceeds will be returned to shareholders.

If history repeats, avoiding the market darlings will blow a tailwind lasting years. As their price-to-earnings ratios deflate, unpopular companies that can steadily increase profit and dividends, join or rejoin the major indexes and potentially become takeover targets as corporate activity increases, have a huge amount of outperformance to reclaim.

Please get in touch if you have any questions

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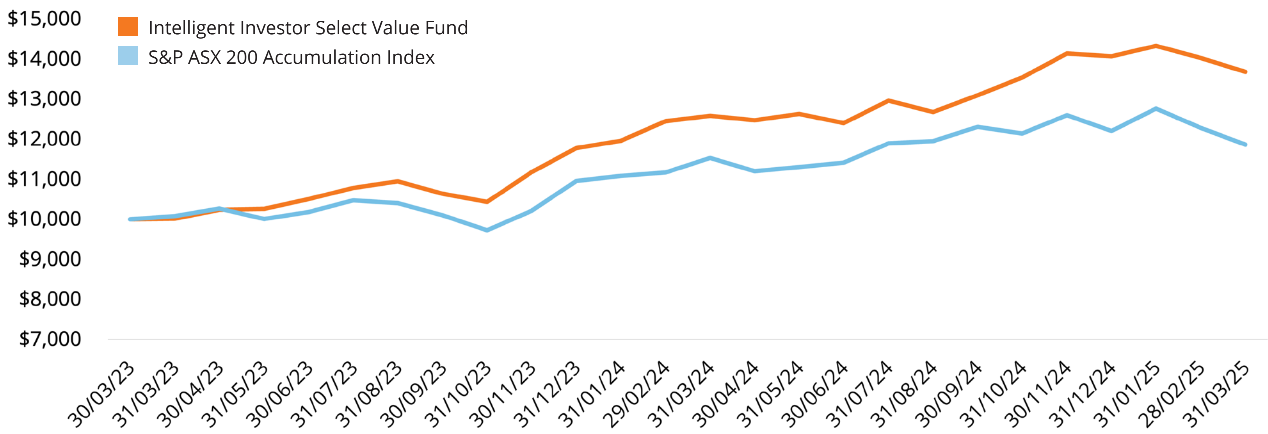
Performance since inception



Inception (S.I.): 28 Mar 2023

Asset allocation

Financials	36.0%
Information Technology	15.1%
Communication Services	13.2%
Cash	11.6%
Consumer Discretionary	9.3%
Health Care	6.7%
Real Estate	3.7%
Materials	3.2%
Industrials	1.3%

Top 5 holdings

Fairfax Financial Holdings (FFH.TSX)	7.3%
Rightmove PLC (RMV.LSE)	6.1%
CME Group (CME.NAS)	5.7%
Visa (V.NYS)	5.3%
MA Financial (MAF.ASX)	4.5%

Fund Stats

Distribution yield	0.33%
Net asset value	$3.41

All tables and chart data is correct as at 31 March 2025

Appendix

Alphabet faces its Uber moment

Before an early flight or after a late night out, taxis were the transport mode of choice. Assuming the cab turned up, passengers were often greeted by a pungent smell, Alan Jones, a slow route home and a scrabble for change.

This experience was normalised until Uber's arrival forced passengers to confront their misery. The Uber app made it immediately clear. Here was an easier, faster, safer, cheaper, more reliable way to get about.

Taxis had become a sector run not for the benefit of passengers or cabbies but the owners of the licences, which had become an asset class all of their own. Uber proceeded to smash their investment thesis. Now Alphabet, owner of a near global monopoly in search, faces its Uber moment.

In The Innovator's Dilemma, Harvard Professor Clayton Christensen proposes a framework to understand why successful companies struggle to adopt disruptive technologies that threaten their core business. Think Blockbuster versus Netflix, Spotify versus record stores and Fairfax Media versus REA.

It's important to understand that the dilemma is faced by the incumbent, not the many smaller companies chipping away at its market share.

Blockbuster became the largest video chain store on the planet. Responding to the disruptive technology of streaming entailed cannibalising the substantial profits late rental fees delivered. Instead, it decided against buying the company, failed to pivot when Netflix launched a streaming service in 2007, and entered bankruptcy in 2013.

Disruptive innovation

Christensen's model describes how disruptive innovation incrementally kills market leaders; the only way to compete with an upstart technology is to copy it, with no guarantees of success, often whilst suffering an accelerating decline of the incumbent, profitable business.

Let's step through the nature of Alphabet's innovator's dilemma.

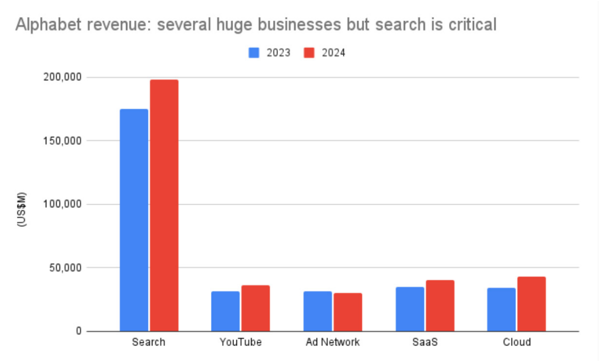
Alphabet has several business segments. Advertising generates about 75% of revenue, the bulk of which comes from search, but also YouTube and its ad marketplace.

Google Cloud, a competitor to Amazon Web Services (AWS) and Microsoft Azure, the company's cloud computing platform, delivers about 12% of revenue and 5% of profit. Several businesses, including moonshots like self-driving technology, are loss making.

The company doesn't break out the profit contributions of its businesses like Gmail, Google Docs or YouTube, but search is believed to contribute as much as 80-90% of profit.

From an investment perspective, we can ignore almost everything other than search for the reasons shown in Chart 1. If this business were to be disrupted, the investment case would break down as it did with taxis.

Chart 1: Reliance on Search Revenues



Source: Company accounts

Given this dependence on search, a second issue arises—is the company willing to cannibalise the profits it makes in order to avoid disruption?

This remains an open question. With DeepMind and Gemini, Google long led the field in AI research. Indeed, as noted in our special report The New Great Game: Machines, Empires, and AI, in 2017 the company produced the breakthrough Transformer model, since seen as AI's great leap forward.

The fact that it has been superseded by the likes of Open AI, DeepSeek and Perplexity points to the problem. Despite leading technology, the company does not lead the field in products. Instead, a raft of new competitors are fighting for market share.

Table 1: AI Products by Monthly Active Users (Estimated, Circa 2025 - sources: company announcements, DeepSeek, Grok)

AI Product	Monthly Active Users (M)	Owner
MetaAI	500	Meta
ChatGPT	400	OpenAI
Gemini	300	Alphabet
Apple Intelligence	250	Apple
Ernie	200	Baidu
CoPilot	150	Microsoft
Doubao	150	Bytedance
DeepSeek	80	DeepSeek (open source)
Qwen	50	Alibaba (open source)
LLaMA	40	Meta (open source)
Claude	22	Anthropic
Grok	50	xAI
Hunyuan	20	Tencent
Alexa	15	Amazon

Two years ago, Google search didn't have much in the way of competition in western markets. Its product was the undisputed champion of finding information. Now it is a laggard. Despite 300m Gemini users, Google faces a fearsome horde of tech competitors invading its critical business.

Without any marketing, DeepSeek overtook TikTok and Instagram to become the US's most downloaded app for several days. It's hard to think of a faster collapse in the barrier-to-entry in the history of technology. Networks usually have a tipping point. When they reach critical scale, users tend to migrate en masse, with Uber a prime example.

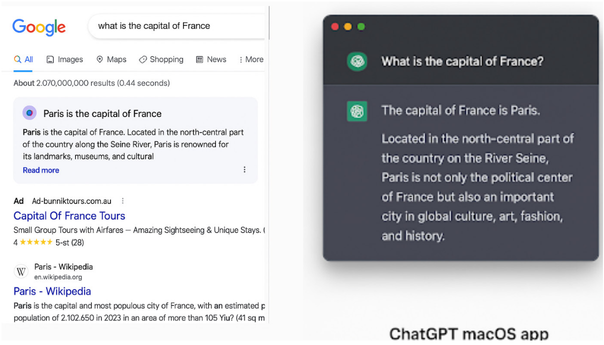
Not only that, the pace of development is breathtaking and costs are tumbling. In just five years, the cost of building a custom AI model has fallen from tens of millions of dollars to a few thousands. A conversation with an AI is up to 100 times cheaper to run than a Google search.

Dilemma writ large

Google employees saw the threat coming. In 2021, reports Bloomberg, Google's web search team proposed a chatbot where visitors could ask questions directly rather than serving the typical list of links. According to a former employee involved in the conversations, management was unimpressed. 'It was self-regulation. People just weren't daring to think the thoughts,' said the former employee.

This is the innovator's dilemma writ large. Providing a better user experience to Google users would have entailed fewer opportunities to sell ads. Understandably, Google wasn't willing to consider cannibalising its search business. Instead, it took the path of least resistance, incorporating Gemini into its typical results page. The image below shows how this is working out.

Image 1: Query response ChatGPT v Google



Source: ChatGPT. Google.

Google's page rank system delivered superior search results and its simplistic, user orientated, search page encouraged repeat visits. Note the similarities in the ChatGPT interface above with the current Google search page.

The problem is in the results rather than the queries. The more that Google's Gemini product improves and is incorporated into ever more searches, the more Google weakens its core product as users learn new ways of doing things.

Google's search management team wasn't wrong—a chatbot is a better user experience—but every improvement risks the revenue that made the company successful in the first place.

Last year we called the company 'a profoundly good business trading at a sensible price'. Since then, competition has emerged at an unimaginable pace.

Google will probably survive the innovator's dilemma. It is laden with AI talent, has money to burn and a vast ecosystem of four billion users. The company has successfully pivoted before, from desktop search domination, for example, to mobile, and is integrating AI results with search advertising.

Not life threatening

It is also the owner of probably the deepest data lakes on the planet. That and long-established user habits mean it is far from death's door. If Gemini is good enough and ads can be integrated, today's price might be a bargain. But why take the risk?

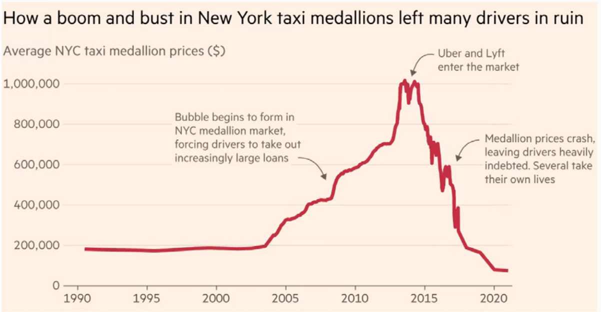
Google already takes 40 cents of every digital advertising dollar spent, and credible rivals like Meta, Amazon and TikTok are all fighting for market share. Google's moat isn't growing; it's shrinking.

Even with generous valuation multiples applied to YouTube and Cloud, search still needs to account for about a trillion dollars of Alphabet's US$2tn market cap. (Moonshots like quantum computing and self-driving software have dollar potential but it's tough finding a trillion of them.)

In 2024, search likely contributed around US$100bn in profit. Applying a multiple of ten doesn't seem a stretch, until one considers what happened to taxis.

In 2011, Uber entered the New York taxi market, the same year a taxi medallion—a license to operate—sold for US$1m. Three years later, the average New York medallion was still worth US$1m but the number of Uber drivers had reached 10,000. This was a tipping point.

Chart 2: The Uber moment



Source: Financial Times

New York still has plenty of taxis but the value of licences has crashed. Companies, like taxis, can survive the innovator's dilemma but a lot of capital can be lost in the process.

With its leading models and technical and financial resources, Alphabet could compete for users with the likes of OpenAI and Perplexity. What it likely cannot do is maintain the astonishing margins in its search business while doing so.

In 2005, US newspapers made a combined US$49bn in revenue from advertising. By 2016, that figure had fallen to US$18bn. Alphabet and Facebook, meanwhile, booked combined advertising revenue of US$106bn.

Alphabet's search business is one of the world's best. But AI is now threatening to do to Google search what Google did to newspapers. This is the opposite of Buffett's one-foot hurdles and handicapping the future of technology businesses means jumping at shadows. But the cost of being wrong is mitigated by the number of high quality, more predictable businesses listed overseas.