MAPLE-BROWN ABBOTT

INVESTMENT MANAGERS SINCE 1984

Maple-Brown Abbott Australian Small Companies Fund

Monthly Commentary – 31 December 2024

Fund performance (%) [1]

	1 month	3 months	1 year	2 years p.a.	Since inception p.a. 24 Jun 2022
Fund [2]	-3.6	0.7	17.7	16.8	18.7
Benchmark [3]	-3.1	-1.0	8.4	8.1	8.7

Market commentary

The typical Santa rally in the December month failed to materialise this year as investors battled with a resilient US economy and more hawkish commentary from the US Federal Reserve with fewer interest rate cuts being forecast (from four to two) in the 2025 calendar year. Interestingly, the US 10-year bond yield continued its upward trajectory to 4.57% at month-end despite another 0.25% interest rate reduction by the US Federal Reserve. This drove the depreciation of the AUD/USD exchange rate to 61.9 cents at month-end. Assuming the current exchange rate level holds, this will have significant implications into the new year with a 'translation' benefit expected for offshore earners, while importers (e.g. retailers, distributors) are expected to face rising input costs with a need to either increase prices or experience a profit margin hit.

Over the month, the top stock performers in the benchmark were skewed to speculative exposed companies (the top 5 performers are currently unprofitable) which don't fit our 'earnings drive share price prices' investment philosophy. These companies included Mesoblast (+75%) which rallied following FDA approval for its Ryoncil drug, and Patriot Battery Metals (+47%) which received a C$69m investment from Volkswagen at a 65% premium to the 30-day volume weighted average price. Notable stock detractors included Clarity Pharmaceuticals (-35%) and Ioneer (-24%) which gave back substantial share price gains from the previous months.

Portfolio commentary

The Fund declined 3.6% over the month, underperforming the benchmark by 0.5%. The Fund continues to generate strong returns since inception (24 June 2022), returning 18.7% and outperforming the benchmark by 10.0% on an annualised basis.

Over the month, key performance contributors included Perenti (PRN) and De Grey Mining (DEG). Perenti announced $185m of new contracts and extensions, including a three-year mining contract at Focus Minerals' Bonnie Vale Gold Project. The company also redeemed US$100m of their outstanding unsecured notes and has been active with their share buy-back. The company's valuation has re-rated over recent months although still trades on a mid-single digit Price/Earnings (P/E) ratio with a strong free cashflow profile expected over the coming years. De Grey Mining agreed to be acquired by Northern Star Mining (NST) in an all-scrip deal at an implied 37% share price premium. We believe the deal makes sense for Northern Star Mining, although we wouldn't be surprised to see competing interest from an offshore tier 1 gold miner given the large-scale gold development opportunity on offer at De Grey Mining.

Over the month, key performance detractors included Mesoblast (MSB – not held) and GQG Partners (GQG). Mesoblast received FDA approval for their Ryoncil drug during the month, and while the initial patient population and addressable market is relatively small, this has the potential to pave the way for broader indicated uses for Mesoblast's stem cell-based therapies. Mesoblast is currently unprofitable and does not fit our investment process. GQG Partners continued to fall during the month as the company disclosed November month-end FUM and net flow figures that were broadly flat on the previous month, representing a significant slowdown in momentum seen during the rest of the year, affected by GQG funds shareholdings in Adani group companies. GQG also cancelled a proposed share buyback due to tax reasons.

Please see next page for Outlook

Notes:

1 Past performance is not a reliable indicator of future performance. Source: Maple-Brown Abbott Ltd, S&P as at 31 December 2024.

2 The Fund's performance is based on the movement in net asset value per unit plus distributions and is before tax and after all fees and charges. Imputation credits are not included in the performance figures.

3 The benchmark is S&P/ASX Small Ordinaries Total Return Index.

Want to find out more?
Contact our Client Service team by:
T 1300 097 995
E mba@unitregistry.com.au
W maple-brownabbott.com

Outlook

Looking to the year ahead, we believe the key drivers for Australian small cap outperformance are in place, including a supportive global stimulatory backdrop and expectations of falling domestic interest rates.

Globally, we have seen an acceleration of liquidity injected into financial markets given moderating inflation growth back to within central bank target ranges. In addition, the Trump presidency's pro-growth stance with tax cuts and reduced regulation is expected to be stimulatory for economic activity. There are also hopes that geopolitical tensions with Russia/Ukraine and the Middle East may be showing signs of easing.

Domestically, the RBA has been uncoordinated with other central banks, remaining more hawkish given stickier inflation. However, the December meeting has recast a more dovish tone with interest rate cuts expected to start early in 2025 with the market factoring in close to 0.75% reduction by year-end. This compares to the US which has already cut interest rates by 1.0% in 2024 with the US Federal Reserve flagging at the most recent FOMC meeting that the trajectory of interest rate cuts into 2025 is expected to slow with only an additional 0.5% reduction expected by year-end. This set-up is expected to be supportive and renew investor interest for Australian small caps. US equity markets have seen the smaller end start to outperform the larger end in the second half of 2024 as the US Federal Reserve flagged and subsequently reduced interest rates which is a precedent for what may happen domestically in 2025.

2025 is expected to be another interesting year for Australian small cap investors with the following key themes investors should be looking out for:

- **Stock performance broadening**: Given a more favourable domestic macroeconomic backdrop, we expect a better earnings outlook at the smaller end of the market (relative to large caps) over the next couple of years, resulting in a broadening out of stock performance across the index. We continue to see structural growth and Information Technology exposed companies delivering on earnings although many now are being priced for perfection. We no longer expect a 'earnings scarcity' premium going forward (unlike what we experienced over the 2023 and 2024 financial years) as investors may look to recycle capital into under-appreciated Australian small cap companies with more attractive valuation metrics and strong earnings outlook that are less crowded
- **Onshoring/defence exposures**: A key trend post-COVID has been companies seeking greater supply chain security via on/near-shoring. In addition, we are seeing heightened geopolitical tension and de-globalisation with increasing global defence spending being a structural growth thematic which we expect to escalate under the next Trump presidency
- **Election uncertainty**: The 2025 calendar year is expected to be particularly interesting given the upcoming Federal election, which must be held by May 2025. We expect cost-of-living measures and fiscal spending to continue which should be supportive for our holdings in the aged care and childcare sectors. However, investor attention is now focusing on the potential for a minority government and/or change in government (Coalition currently drawing ahead now) outcome which will provide a level of uncertainty for equity markets for the first half of the year.
- **Rising industrial action driving stickier wage inflation?**: A key surprise from 2024 has been the strength in the labour force despite forward indicators having softened. Whilst the major driver has been public sector linked jobs growth, there are risks to the wage inflation environment being stickier given the following: (1) cost-of-living pressures have eroded real wages with the Fair Work Decision looking again set to increase minimum wages by in excess of 3.5%; (2) new union delegate rights and enforced negotiations are driving a wave of employee strikes across select industries; and (3) recent trends in Enterprise Bargaining Agreements (EBA) outcomes look to have re-accelerated. We continue to focus on companies with pricing power that can pass through potential cost increases or have cost levers to pull to protect margins.
- **Corporate activity**: Given the lower Australian dollar, improving earnings outlook and attractive valuations on offer, we expect increased M&A interest from offshore players for growing domestic small and nimble businesses.

In summary, we have been underwhelmed with the performance of the Australian small caps market relative to their larger counterpart given the number of tailwinds as risk appetite returns to the space after a challenging few years. We believe 2025 has all the hallmarks of being 'the year of the Australian small caps'.

The Fund remains well positioned with regards to its core pillars of earnings delivery and sustainability factors. Going forward we see solid earnings potential, better than benchmark sustainability characteristics and a superior risk profile for the stocks held in the Fund.

For latest Fund factsheet click here.

Want to find out more?

Contact our Client Service team by:

T 1300 097 995

E mba@unitregistry.com.au

W maple-brownabbott.com

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PRI Principles for Responsible Investment