

# WaveStone Dynamic Australian Equity Fund

## Quarterly Fund Report - December 2022

Performance	Quarter %	FYTD %	1 year %	3 years % p.a	5 years % p.a	10 years % p.a <sup>4</sup>	Inception % p.a <sup>1,4</sup>
Fund return (including franking credits)	5.1	7.2	1.7	6.3	8.5	10.4	10.7
Less: Franking credits <sup>2</sup>	0.2	0.8	1.5	1.2	1.6	1.5	1.5
<b>Total Return<sup>3</sup></b>	<b>4.9</b>	<b>6.4</b>	<b>0.2</b>	<b>5.1</b>	<b>6.9</b>	<b>8.9</b>	<b>9.2</b>
S&P/ASX 300 Accumulation Index <sup>4</sup>	9.1	9.6	-1.8	5.5	7.1	8.6	9.0
<b>Active Return</b>	<b>-4.2</b>	<b>-3.2</b>	<b>2.0</b>	<b>-0.4</b>	<b>-0.2</b>	<b>0.3</b>	<b>0.2</b>
Average Daily Net Equity Exposure	82	82	81	81	80	79	81

Past performance is not a reliable indicator of future performance. Numbers may not add due to rounding. Data source: Fidante Partners, 31 December 2022.

<sup>1</sup>The Fund's inception date is 02 July 2009.

<sup>2</sup>Franking credits accrued as received by the Fund.

<sup>3</sup>After all fees and expenses and assumes all distributions are reinvested.

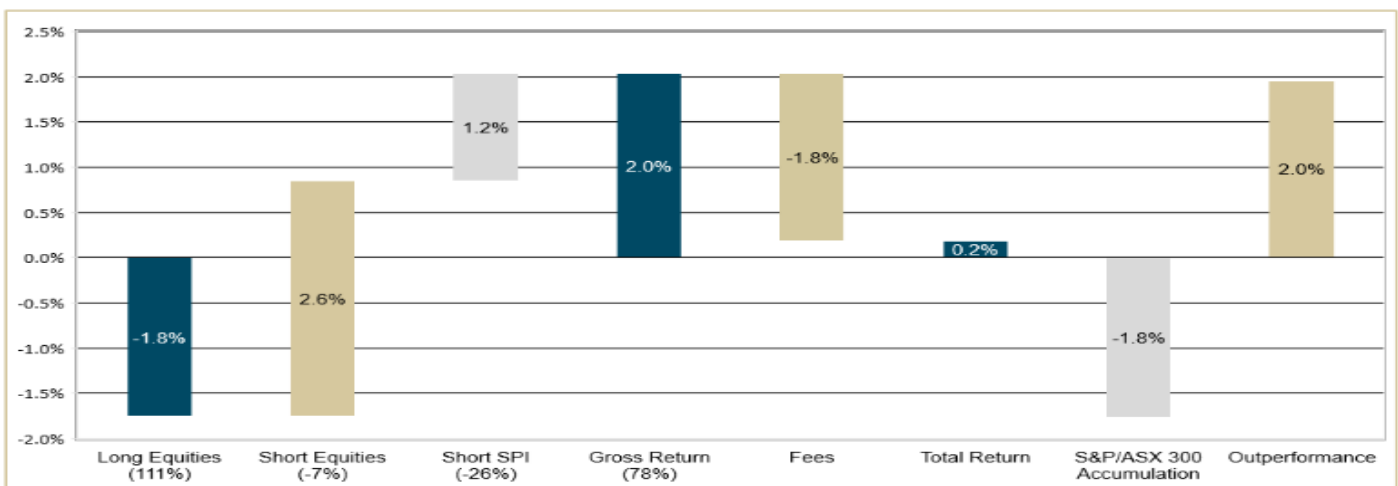
<sup>4</sup>From 1 January 2014, the benchmark of the Fund changed to the S&P/ASX 300 Accumulation Index. Prior to this, the benchmark of the Fund was the RBA Cash Rate.

### Portfolio analysis as at 31 December 2022

Exposure analysis	
Position	% of net invested capital
Long Stocks (39)	111.0
Short Stocks (9)	-7.1
Gross Exposure	118.2
Net Physical Long	103.9
Index Futures/Puts	-25.5
<b>Net effective equity exposure</b>	<b>78.4</b>
<b>Cash/(Borrowings)</b>	<b>-3.9</b>

Largest stock holdings	
Stock net exposure analysis	% of net invested capital
BHP Group Limited	8.5
CSL Limited	8.1
National Australia Bank Limited	5.6
Commonwealth Bank Of Australia	5.2
ANZ Group Holdings Ltd	5.2
<b>Top 10</b>	<b>52.0</b>

### WaveStone Dynamic Australian Equity Fund – 12 month Performance Bridge





The Fund delivered a total return of 4.9% for the December quarter after all fees and expenses. The S&P/ASX 300 Accumulation Index returned 9.1% over the same period. The Fund size was \$175.3m and the unit price was \$1.6111 as at 31 December 2022.

WaveStone is pleased that the Dynamic Fund's net return was 0.2% vs the market return of -1.8% over the 12 months to the end of December 2022, outperforming the ASX300 by 2.0%.

We were pleased with the performance of the short book which contributed 2.6% of alpha which offset a disappointing long book performance especially in the December quarter.

### Quarter in Review

The December quarter saw the ASX300 Accumulation Index returning 9.1%, driven by a broad risk on rally in markets to end a volatile 2022 year. For the year the return including dividends was -1.8% the worst calendar year return for equities since the GFC.

The key drivers of the market were:

**Sector Performance:** All sectors delivered positive absolute performance during the quarter, albeit with Resources up 13% vs Industrials only up 7% boosted by the Banks up 11%. The best performing sectors for the quarter were Utilities (+28.0%), Materials (+14.8%), and Property trusts up (+10.4%). The worst performers featured Consumer Staples (+2.1%), Healthcare (+1.9%), and IT (+1.7%).

**Economic News:** The big news during the quarter was China's widely anticipated reopening following the 20th National Party Congress and sparks of domestic protests following extended COVID lockdowns. This in conjunction with stimulus injected into the troubled property sector not only drove strength in Chinese market indexes, but also equities with China-linked revenues (eg. Australian Miners and export traders).

**Rates and Yields:** In mid-December, the Federal Reserve lifted rates by 50bps but officials pencilled in plans to raise the fed-funds rate to a peak level between 5% and 5.5% in 2023 and hold it there until sometime in 2024. Only in September, they anticipated lifting the rate to around 4.6% by the end of 2023. This saw yields end up for the quarter with the US 10-yr bond increased slightly by 5bps to end the quarter at 3.87%; however, there was considerable volatility with a range of 3.4%-4.2%. The RBA lifted rates three times over the quarter to 3.1% and the AUS 10-yr saw relatively higher pressure with yields up 17bps to 4.05%.

**Commodities:** Iron Ore was up 21% during the quarter, buoyed by news of the China reopening and a reversal of the sharp price declines seen in the September quarter. Interestingly, despite the China reopening, Brent Crude was down 2.3% reflective of global economic bearishness heading into 2023. Gold also hit a bottom in November at US\$1620/oz and rallied to over \$1800/oz ending the year roughly where it started. Gold benefitted from a weakening dollar, primarily driven by a strengthening Yen as a result of the BOJ adjusting its Yield Curve Control policy in December.

**Global Markets:** US markets lagged the Australian market in the quarter, with the S&P500 delivering 7.6%; the technology

heavy NASDAQ was a notably laggard as it shed -0.8%. On the other hand, the Shanghai Composite outperformed, was up 21.4% as investor sentiment became more constructive after China commenced its first phases of COVID reopening. Overall, the Australian market fared relatively better, largely explained by sector bias with the Australian market heavier geared to Banks and Resources relative to global indices.

**Corporate News:** Origin Energy received a \$18.4bn bid from Brookfield and EIG which became the key driver of the Utilities sector outperformance over the quarter whilst Perpetual was finally able to draw upon Pandal shareholders' approval to consolidate the two fund managers. The quarter was also riddled with cases of company cyberattacks. Whilst selective in nature (i.e. Optus, Medibank), the inherent risks and ensuing consequences (customer remediation, reputational loss, punished share prices) were showcased on a public stage. With the understanding that all companies are potentially exposed to a potential attack, it forms an increasingly important risk that will likely require increased time, effort and spend to mitigate going forward.

### Fund Performance Summary

The Fund delivered a return of 4.9% for the December quarter after fees and expenses, underperforming the broader ASX300 accumulation index which returned 9.1% over the same period. Top performers over this period included holding Fisher & Paykel, Qantas and Rio Tinto. Bottom performers included holding ResMed, PEXA and Collins Foods.

Fund's best performing investments			
Longs	bps	Shorts	bps
Rio Tinto	+30	Temple & Webster	+17
Fisher & Paykel	+29		
Qantas Airways	+28		

### Major Contributors

#### Rio Tinto

**Rio Tinto (RIO)** rallied hard on the back of higher commodity prices (iron ore up 21% for the quarter). The Chinese government surprised markets in late November with an abrupt end to the Dynamic zero Covid policy. Similar to other countries that have re-opened after Covid, there is an expectation that growth would recover strongly after an initial phase of increased infection rates as the population achieves herd immunity. Following the completion of the 20th National Congress, the government also announced measures to stabilise the property market, a key demand driver for steel. Rio hosted a Capital Markets Day in December which gave investors confidence that operational performance in its key Pilbara iron ore business had strong in the December quarter.



## Fisher & Paykel

**Fisher & Paykel (FPH):** the FPH share price was up significantly on the back of their 1H result, with the management confirming that consumables sales had picked up after a few periods of destocking post Covid. The company also confirmed that 1H was likely the low point in their gross margin, with management guiding to a 200bps improvement in the 2H. Our investment in FPH is based on the premise that during Covid, the company had their installed base pulled forward by almost 10 years and therefore, the consumables-based annuity income going forward was incredibly valuable and the market wasn't recognising that, worrying about short term earnings volatility in the post-Covid destocking period.

## Qantas

The **Qantas (QAN)** share price was up significantly on the back of an update to their guidance for 1HFY23: management expect pre-tax profit for the 1HFY23 to be in the order of \$1.2-1.3B, significantly ahead of street expectations (consensus at \$465m). Air travel demand remained strong – both in domestic as well as international travel – and given the shortages in aircraft, pilots and ground staff, this is expected to persist well into CY23. The strong earnings have meant that QAN's net debt of \$3.2-3.4B at 31-Dec-22 is below the bottom end of their target range. The company continues to buy back shares and we expect if the strong conditions persist, to see further capital management initiatives.

Fund's least performing investments			
Longs	bps	Shorts	bps
ResMed	-52	SPI Future	-179
PEXA	-38	Nufarm	-15
Collins Foods	-37		

## Major Detractors

### ResMed

Our holding in **ResMed (RMD)** detracted from performance over the quarter following a 1Q22 result showing slightly weaker than anticipated device sales in Europe, a (60bp) gross margin impact from adverse FX movements and higher inventory levels. In our view this reaction was overdone with the weakness in RoW flow generator sales reflecting customer preference to wait for connected devices. Importantly, this does not signal a lack of purchasing intent, rather a deferral of a purchase until the desired product is available, which in itself is an endorsement of the product strategy shift to connected devices RMD has made in recent years. It also likely in part reflects management's prioritisation of available product to the more lucrative US market while shortages also exist. Management remains confident in their ability to deliver sequential quarter on quarter growth in device sales given easing chip supply chain constraints and the groups ample production capacity for assembly and components on hand (which was behind the inventory build).

There remains a high unmet need for CPAP which has been exacerbated by the disruption to both sleep diagnosis through Covid and the coincident recall of Philips devices. Philips remains in negotiations with regulators over a consent decree and at this stage there is no evidence they have returned to market. Continued delays are supportive of our investment thesis that the recalls will result in lasting market share gains for RMD.

## PEXA

The Fund's performance was negatively impacted by **PEXA (PXA)**, which sold off on concerns about weaker housing volumes and the Link in-specie distribution overhang, which is a technical factor, not a fundamental one. We expect Australian housing volumes to be weak over the coming 12-18 months as interest rates rise. We do not expect them to be weak indefinitely and see cyclical weakness as an opportunity to buy into a monopolistic, cash generative business like PXA that provides critical infrastructure for Australia. Further, after extensive work on the UK opportunity for PXA, we believe the company can ultimately be successful in this market, which is 3x the size of Australia. We do not believe success in the UK is currently factored into the current share price.

## Collins Foods

**Collins Foods (CKF):** Despite posting an in-line 1H23 result, CKF was down 19% in November after lowering its FY23 and FY24 EBITDA margin guidance in KFC by 100-150bps which led to consensus earnings downgrades of ~20% for FY24. We were surprised and disappointed by the downgrade given the strong brand position and the value menu pricing advantage that KFC Australia has against other QSR peers, especially after the company expressed confidence in its ability to manage the cost inflation headwinds at the September AGM. We overestimated the company's ability to increase price to offset inflation and this was evident at the result with transaction volumes flat yoy following low single digit % menu price rises. Further, the company took a non-cash impairment of \$11.9m (post-tax) to 8 Taco bell restaurants and new restaurant builds have been paused as the brand struggles to generate same-store sales growth.

## Fund Activity

New Stocks Added	Stocks Exited
<ul style="list-style-type: none"> <li>ASX</li> </ul>	<ul style="list-style-type: none"> <li>The Lottery Corp</li> </ul>

Increases	Decreases
<ul style="list-style-type: none"> <li>James Hardie</li> <li>Endeavour Group</li> <li>Domino's Pizza</li> </ul>	<ul style="list-style-type: none"> <li>Qantas Airways</li> </ul>



## Key additions

**ASX (ASX):** During the quarter we began accumulating a position in ASX following a cascade of negative media headlines regarding its botched back-end clearing technology (CHESS) replacement project. ASX is a high quality business with a monopoly position in Australian financial markets, extremely high operating margins and almost 10% of its market cap in net cash. Historically seen as a stable and defensive business, this is coming under question for ASX as it faces several headwinds, including softer equity trading and capital markets volumes, elevated cost growth and the aforementioned tech upgrade issues. We believe most, if not all, of these issues are temporary and new management can hopefully bring a fresh perspective to technology and operating expenses. Further, ASX stands to benefit in several ways from higher interest rates ushering in more rate volatility. Now trading at 5 year lows from a multiple perspective, we see emerging value.

## Notable increases

**James Hardie:** We had significantly reduced our holding in James Hardie (JHX) at over \$50/share, mainly on the back of the change in senior management, the valuation and likely headwind for the housing sector as the Fed increased rates. We continue to like JHX's fundamental position in the US housing market - its exterior siding product we believe will continue to win share and whilst high interest rates have impacted housing demand in the short term, there is a large underbuild in housing stock that will likely resume once interest rates stabilise. Moreover, two thirds of JHX's siding demand come from the repair and remodel market which will likely be more resilient. Short term earnings will be volatile as we expect the environment to stay choppy for a while, allowing us to increase our holding at attractive prices.

**Endeavour Group:** After selling the majority of our Endeavour Group (EDV) position in August, we began adding to the position in December after a meaningful stock price decline. One of the best performing stocks for the first half of 2022, EDV's share price has come under pressure recently due to a small miss to FY22 earnings and potential reforms to electronic gaming machine (EGM) regulation proposed by NSW Premier, Dominic Perrottet. We believe this share price reaction is overdone. We expect strong earnings momentum for EDV's Hotels business following reopening, while the Retail business, after cycling difficult COVID comps, should see margin expansion due to several initiatives, most notably the growth of private label. With respect to changes to EGM regulation, we see a minor impact to overall group earnings, even if they are passed in their currently proposed form, which we view as an unlikely outcome. Following a material de-rating, we have increased our position.

**Dominos Pizza (DMP):** We increased our holding in DMP after participating in the \$165m equity raise. We believe the raise was prudent following a ~30% increase in the share price post its August result, and alleviates concerns around potential gearing issues. The proceeds of the capital raise will be used to fund payment of the option to acquire Domino's Pizza Group plc 50% interest in the German JV (~A\$130m), with additional proceeds used to pay down debt (A\$35m). Consensus EPS expectations were downgraded 2% on the back of the equity dilution, slightly offset by lower interest costs. The company

also reaffirmed its FY23 guidance and we remain attracted to Dominos long term store rollout opportunity.

## Notable portfolio exits and reduction

**The Lottery Corp (TLC):** We exited our position in TLC during the quarter on valuation grounds. The share price rallied after a positive AGM trading update which saw group revenues up 11% yoy for the first four months to October 2022 (aided by a \$120m Powerball draw in late October), as well as the surprise announcement that Powerball's ticket price will increase by 9% towards the end of FY23. Powerball represents around 40% of overall lottery turnover and is the largest game within the TLC portfolio. This change was unexpected given Powerball had a significant game change back in 2018 (29% price increase and change in Div 1 odds from 1/77m to 1/135m). However, the trading update wasn't all positive - digital lottery turnover remained flat on the 2H22 exit rate at 39% of total turnover, which suggests digital penetration may have peaked in the short term and benefitted from COVID lockdowns. The migration from retail to digital sales has historically driven TLC's margin expansion as it effectively bypasses the 9.3% retail commission. Further, we remain concerned that the market underappreciates the potential cost pressures on the horizon for TLC following the expiry of the Transitional Services Agreement with Tabcorp ending on August 2023 which will see TLC add an additional 10% to its total headcount.

**Qantas (QAN):** QAN has benefited immensely from the recovery in air travel in the near term. As articulated, we were very attracted to the improvement in the industry structure since the collapse of Virgin (and now, private equity ownership) as well as the tailwinds to travel from the consumer shifting to higher consumption of services (away from goods). That has largely played through resulting in QAN experiencing very strong profit and cash flow this year. The stock has moved closer to our valuation and hence the reduction in our holding.



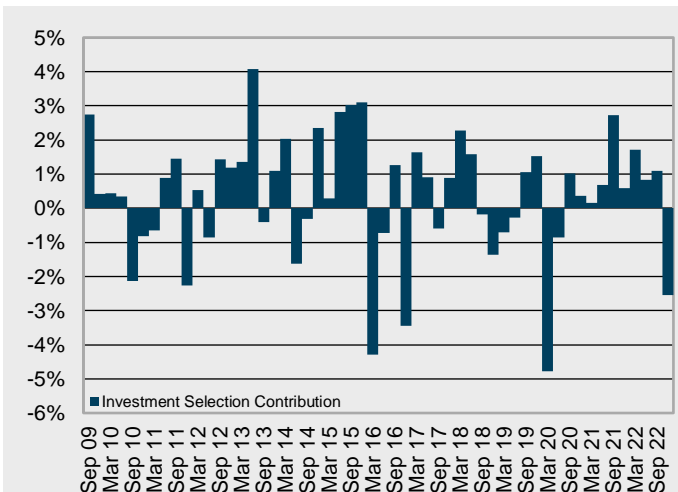
## Fund Statistics

<b>Best month <sup>1</sup></b>	10.5%	<b>Worst month <sup>1</sup></b>	-20.0%	<b>Fund volatility</b>	11.7%
<b>Sharpe Ratio</b>	0.6%	<b>Positive months</b>	69%	<b>S&amp;P/ASX300 volatility</b>	13.9%

<sup>1</sup> Based on monthly returns since inception. After all fees and expenses and assumes all distributions are reinvested.

## Quarterly investment selection contribution

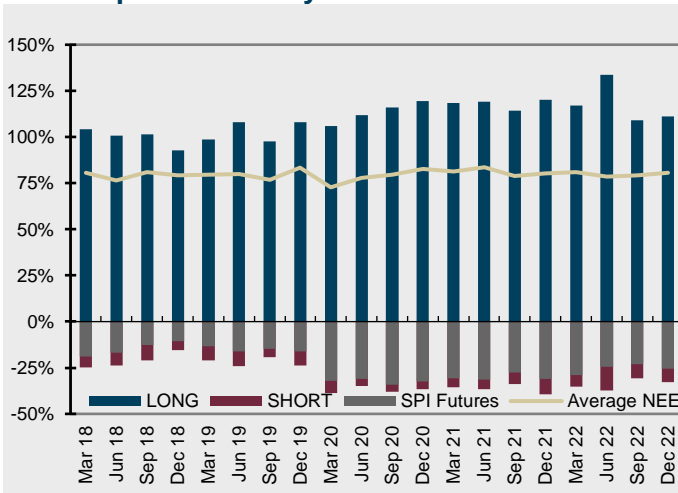
Market return x NEE = Mkt Contribution + Investment Selection Contribution = Total Return				
Market return	x NEE	= Market contribution	+ Investment Selection contribution	= Total return
9.1	81.6	7.4	-2.5	4.9



### Past performance is not indicative of future performance

This table represents the part of the Fund's Quarterly Total Return (after all fees and expenses and assumes all distributions are reinvested) that is attributable to WaveStone investment selections. Investment selection contribution is defined as Total Return (after all fees and expenses and assumes all distributions are reinvested) less market benchmark adjusted by the Funds Average Net Equity Exposure (NEE).

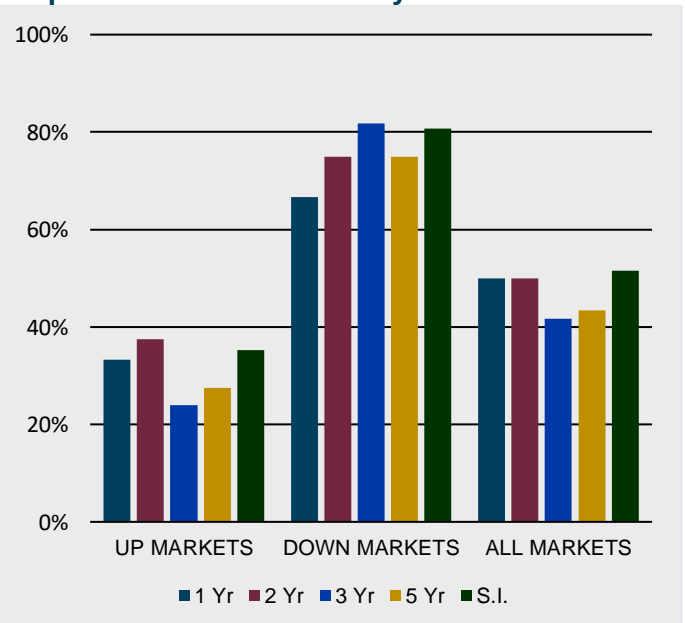
## Fund exposure history



## Sector exposure analysis as at 31 December 2022

	Long	Short	Net	Index	Diff
Consumer Discretionary	9.2	-4.0	5.2	6.2	-1.0
Consumer Staples	8.8	-2.2	6.6	4.7	1.9
Health Care	16.5	-3.1	13.3	9.9	3.4
Energy	4.8	-1.6	3.2	6.2	-3.0
Utilities	1.1	-0.4	0.7	1.4	-0.8
Industrials	9.9	-1.5	8.5	5.9	2.6
Materials ex Metals & Mining	1.1	-0.6	0.5	2.2	-1.7
Metals & Mining	20.7	-5.7	14.9	22.5	-7.5
Non-bank Financials	7.0	-2.4	4.6	7.8	-3.2
Banks	20.1	-6.1	14.0	20.4	-6.4
Property Trusts	4.6	-2.5	2.1	6.1	-4.0
Telecoms	4.3	-1.0	3.3	3.8	-0.5
Information Technology	2.9	-1.5	1.4	2.9	-1.5
<b>Total Exposure</b>	<b>111.0</b>	<b>-32.6</b>	<b>78.4</b>	<b>100.0</b>	<b>-21.6</b>

## Outperformance Consistency



### Past performance is not indicative of future performance

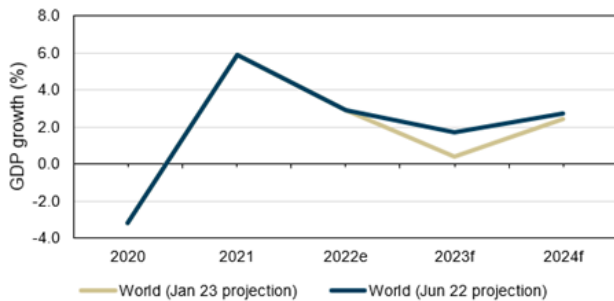
After all fees and expenses and assumes all distributions are invested. The Fund's inception date is 02 July 2009. From 1 January 2014, the benchmarks of the fund charged to the S&P/ASX 300 Accumulation Index. Prior to this, the benchmark of the fund was the RBA cash rate.



## Outlook & Strategy

**Global growth will continue to be quite weak in 2023, given the lagged impact of interest rates, the Russian invasion of Ukraine and the continuing US-China conflict.** More recently, the reopening of the Chinese economy, the warmer winter in Europe (less damage as gas prices have fallen) and the slightly better news on inflation has meant that the odds of a recession has likely fallen somewhat. The trajectory of growth from here will depend on the Chinese economy recovering post their New Year holiday period.

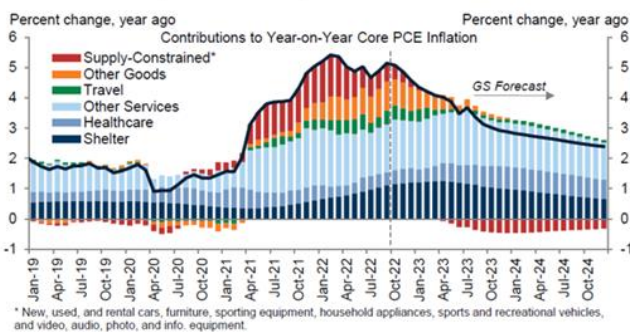
**World GDP Forecast**



Source: World Bank

**The inflation debate is more nuanced now, with the peak behind us.** This has meant that the market's expectation of interest rates is at odds with the Fed's own forecasts. The discussion is now less about how much more rate hikes need to happen versus how long the Fed funds rate needs to be in restrictive territory to get inflation back to their target of 2%.

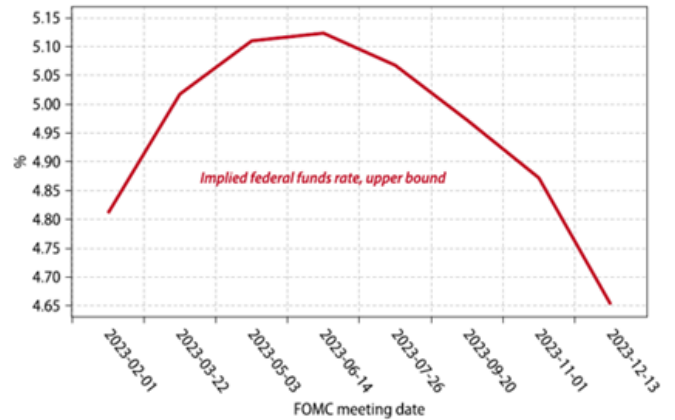
**Inflation has peaked in the US but path to 2% less clear**



Source: Haver Analytics, Goldman Sachs Global Investment Research

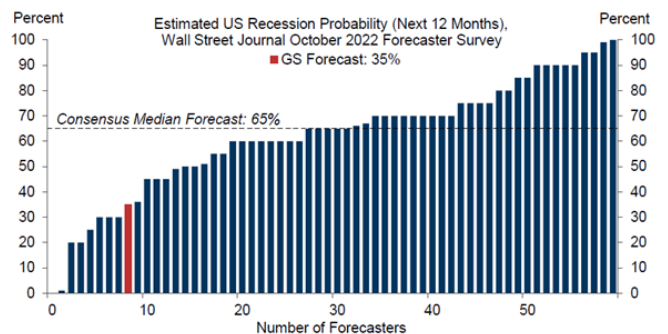
Market pricing has the Fed cutting rates mid-year which seems aggressive given the current tightness in the labour market.

**Federal funds futures imply 50bp of rate cuts starting in July**



Source: GaveKal

**The path for US economic growth – whether there is a recession or not – will be determined by the path of inflation and in turn, interest rates (higher for longer).** An October 2022 survey by the Wall Street Journal put the estimated probability for a US recession within the next 12 months at 65%.



Source: The Wall Street Journal, Goldman Sachs Global Investment Research

**The warm winter has given Europe a positive boost in recent weeks.** Despite severe weakness in the business surveys until very recently, the hard economic data held up surprisingly well in 2022 given the massive terms-of-trade shock resulting from the natural gas crisis. Now, the economy is experiencing two positive shocks, namely the warm winter (which has pushed wholesale natural gas prices below pre-war levels) and China reopening (which should disproportionately benefit export-oriented economies such as Germany). Consequently, the recent bounce in business expectations in the PMIs may have further to run and the Euro area economy may well avoid a recession after all.

**With the exit from zero-Covid policy much faster than expected, we expect Chinese growth to improve sequentially over the course of 2023 and into 2024.**

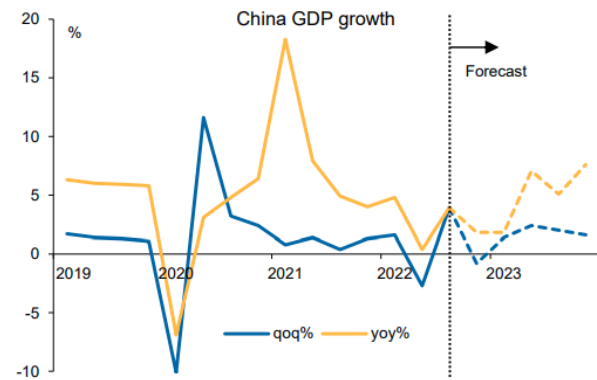
Following the leadership changes at the 20th Party Congress, the government has signalled for a return to growth. Macquarie forecast 5.5% growth in 2023 – with recent data on the impact of the virus, we think that this will be exceeded. The growth will be led by consumption given the low base and the significant savings build up (see below). We expect stability in the property



sector and more modest growth in investments. Given the state of the global economy, exports will likely be a drag.

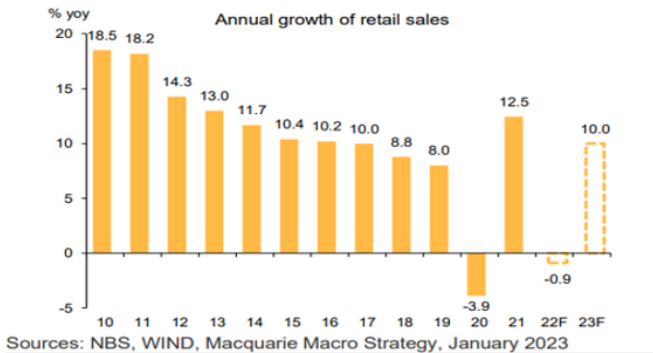
The long-term goal to double GDP per capita by 2035 remains which means that annual GDP growth will need to average almost 5% per annum from the period 2021-2035.

Chinese GDP growth will accelerate sequentially in 2023



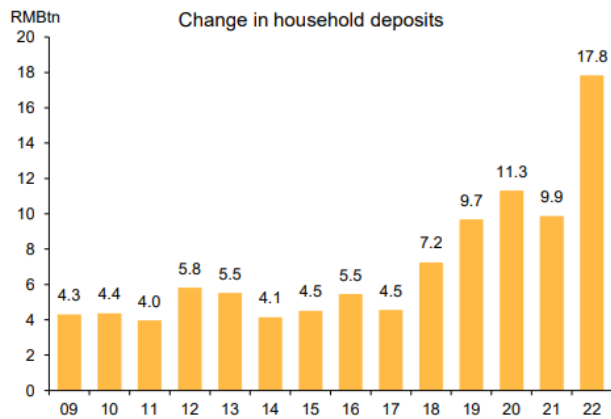
Sources: NBS, WIND, Macquarie Macro Strategy, January 2023

The economic recovery will be driven by the consumer



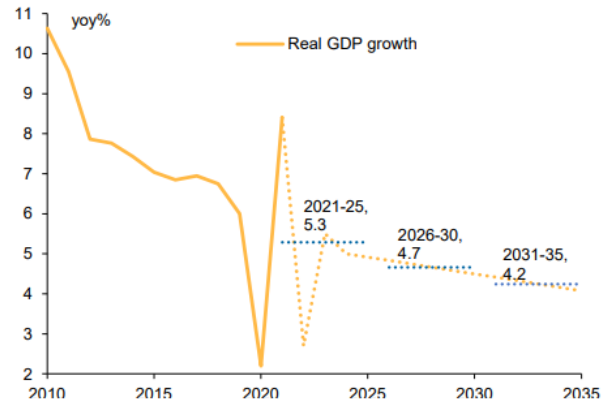
Sources: NBS, WIND, Macquarie Macro Strategy, January 2023

There is a large accumulation of savings which will support the recovery



Source: PBoC, WIND, Macquarie Macro Strategy, January 2023

A potential growth trajectory to double GDP in 2021-2035



Source: NBS, WIND, Macquarie Macro Strategy, January 2023

**Australia's economic growth is expected to slow on the back of a weaker consumer.** The deceleration is mainly driven by a slowdown in household spending. The consumer is expected to be under cash flow strain as higher interest rates (fixed rate loan expiry) will significantly impact debt-servicing costs. An adverse wealth effect through lower house prices will be an additional headwind.

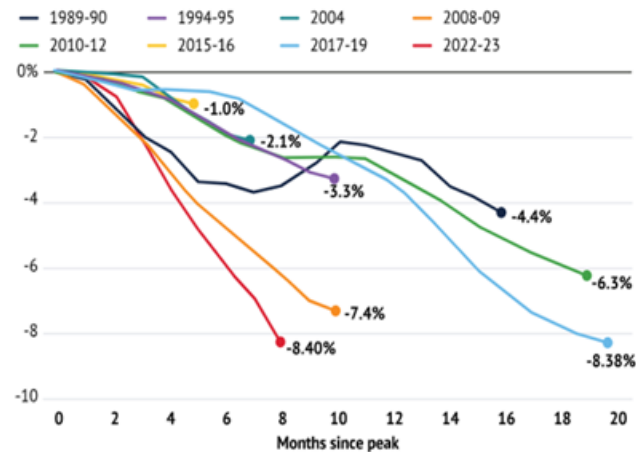
GDP growth is expected to slow materially in 2023



Source: ABS, Bloomberg, RBA, Macquarie Macro Strategy



### Australian home values mark the largest decline on record



Source: CoreLogic

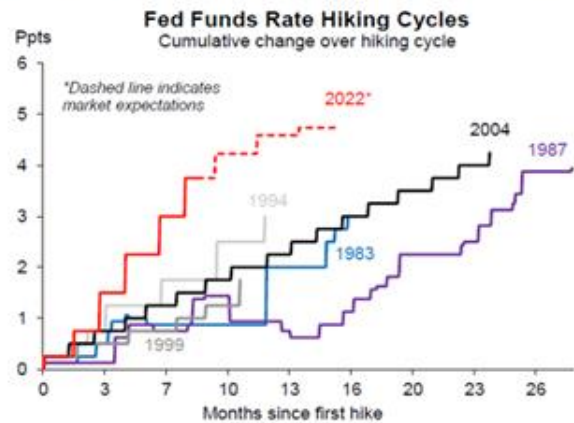
Inflation could turn out to be stickier in Australia given our wage-setting process (Fair Work Commission setting the minimum wage). This could be problematic for the business sector, especially as consumer demand falls. **The earlier than expected reopening of China is a clear positive for Australia, with trade exposed sectors such as tourism and education as well as the commodity sectors benefiting from the uplift in Chinese growth.** There appears to be some positive movement on removal of tariffs as well which augurs well for the agriculture sector.

**Decarbonisation and deglobalisation will continue to be dominant themes for the foreseeable future.** There has been wide recognition of the need to move away from fossil fuels and the Russian invasion of Ukraine has propelled energy security as a key driver for economic and political stability. This is particularly true in Europe which has been in the eye of the storm. Despite recent attempts by China to re-engage with the West, we continue to expect a slow decoupling and a move to deglobalisation – with reshoring and friend shoring still the way forward. This will be a drag on Chinese economic growth over the longer term.

### Market Outlook

Plenty was thrown at markets in the last twelve months – the fastest increase in interest rates (chart below) alongside QT, the invasion by Russia of Ukraine and the attendant energy and food crisis, China's zero-Covid policies and the continuing US-China conflict. Despite that, global markets have been resilient and more importantly, we haven't observed large dislocations or significant stresses in asset markets.

### The fastest and largest Fed hiking cycle in decades



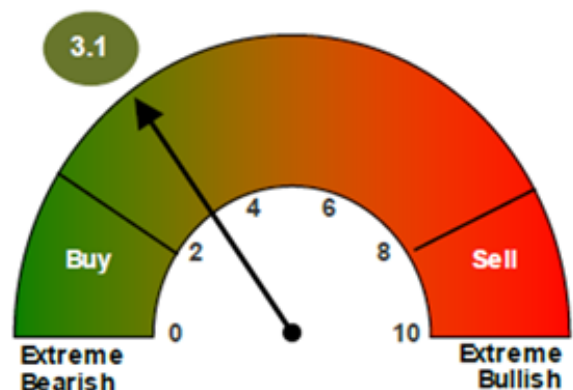
Source: Bloomberg, Macrobond, Macquarie Macro Strategy

Into the new year, there have been a few significant positives namely, the sudden reopening of China as well as an unseasonably warm winter in Europe. Headline inflation has also come off – giving markets some respite as investors eye off a Fed pause in interest rate increases; and maybe even cuts later in the year.

Investors have been sitting on the sidelines, waiting for the clouds to clear. This can be seen in the average cash weightings of active managers as well as Merrill Lynch's Bull & Bear Indicator (below).

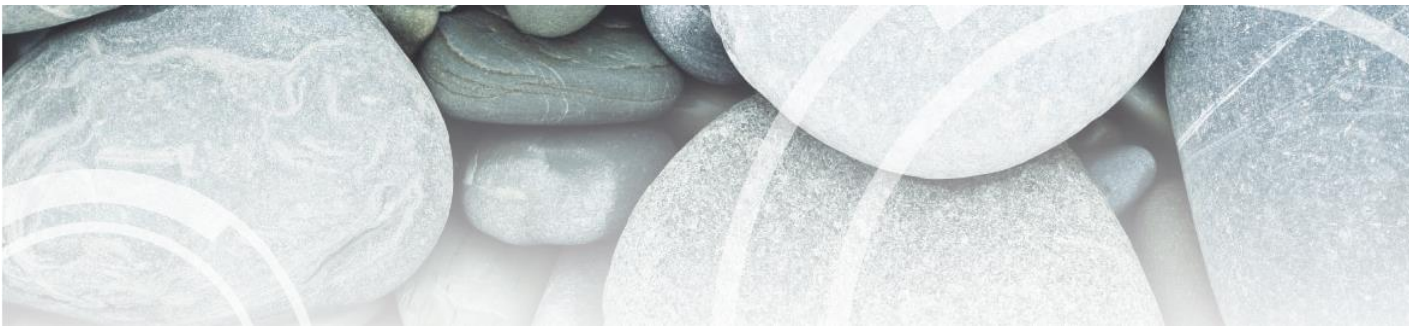
### Bull & Bear Indicator

Rises to 3.1

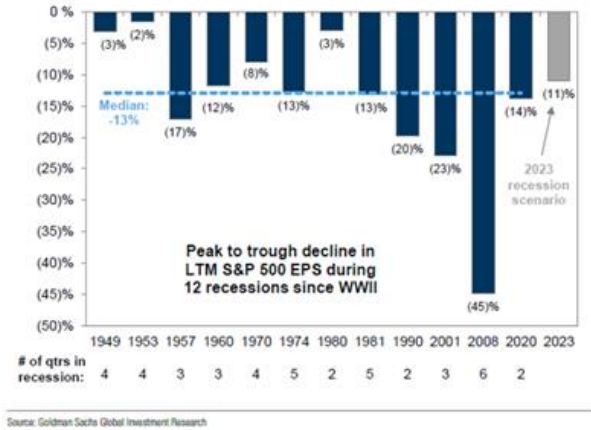


Source: BofA Global Investment Strategy

**Having said that, the rapid increase in interest rates, in our view, will start to impact the real economy.** US net profit margins are still at peak levels. GS expects a reversion in margin to pre-pandemic levels which will likely result in double digit EPS downgrades in S&P earnings.



### Peak to trough decline in S&P500 EPS during historical recessions



The Australian market has been resilient in 2022, given the uncertainties around global growth and China. The resource sector has done well (chart below) despite the China slowdown, helped by the inflationary environment and more recently, the prospect of China's reopening positively impacting demand. Bank earnings have been buoyed by rising interest rates.

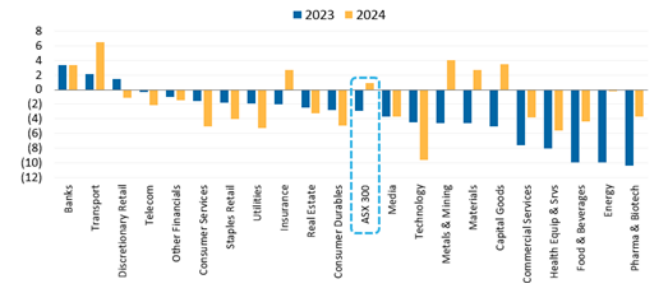


**Earnings resilience will be key to future share price performance.** We anticipate that earnings will be under pressure for industrials in 2023 and the market is still too optimistic (see below). The abnormal nature of this episode given the vast amounts of fiscal and monetary stimulus has meant that activity levels have stayed strong even as business conditions have deteriorated. We think this is more of a timing issue and expect more downgrades to come through. This will likely be more acute for businesses that have large workforces as wage costs will likely be quite sticky in the short term.

Market and sector EPS growth (%) (pro-rated to June)	FY21A	FY22A	FY23E	FY24E	FY25E	Current 1 yr fwd	Forecast 2 yr Fwd
All Companies	28.8	22.7	2.6	9.1	2.1	5.0	6.6
Banks	31.8	14.3	11.7	(0.3)	0.2	7.4	(0.1)
Property Trusts	(13.0)	15.8	4.6	1.3	6.4	3.4	3.2
Resources	58.3	38.5	(12.2)	11.2	(3.9)	(3.8)	5.8
Industrials (All Cos ex Res, LPTs, Banks)	7.7	8.2	21.5	15.0	10.6	19.1	13.4
S&P/ASX 100	29.2	20.0	2.8	8.8	0.6	4.9	5.9
Small Companies	17.0	33.8	0.8	12.7	16.9	5.1	14.2
Small Industrials	9.5	25.2	(4.3)	8.0	11.0	0.1	9.0
Small Resources	46.4	53.2	11.8	21.2	26.5	15.1	23.1
Domestic Industrials	2.6	(3.5)	10.5	16.2	13.1	12.6	15.0
International Industrials	15.0	23.3	33.1	13.9	8.1	26.2	11.8

Source: Macquarie

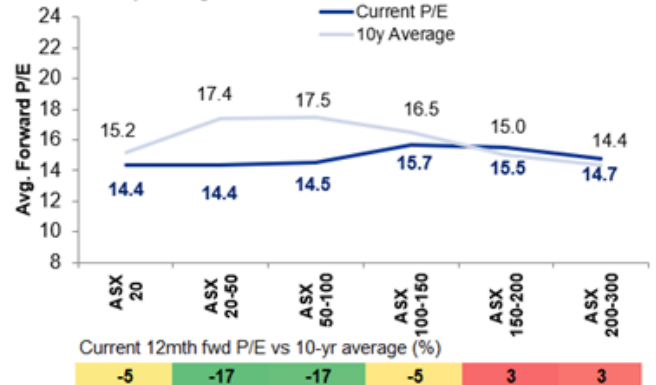
### ASX 300 - Change in Consensus EPS Over Last 3 Months



**Valuations have retraced significantly, especially in smaller companies.** Given that we still anticipate downgrades to earnings, the lower multiples to some extent reflect market pricing of earnings risks.

### Valuation Depending on Firm Size

Current vs. 10 yr-averages.



**We consider bottom-up stock picking as the key ingredient to long term portfolio outperformance.** WaveStone follows its 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](http://www.fidante.com/WaveStoneESGreport)



## ASIC Periodic Reporting Requirements

The WaveStone Dynamic Australian Equity Fund (Fund) is classified as a hedge fund in accordance with the Australian Securities and Investments Commission Regulatory Guide 240 *Hedge funds: Improving disclosure*. We are required to provide this additional information to you on a quarterly basis.

### Asset Allocation (as at 31 December 2022)

Exposure analysis	
Position	% of net invested capital
Australian listed equities	103.9
International listed equities	-
Exchange traded derivatives	(25.5)
Over-the-counter derivatives	-
Cash equivalent investments	(3.9)
Net equity exposure	78.4
Gross equity exposure	143.7

### Liquidity profile

The table below demonstrates the liquidity profile of the Fund as at 31 December 2022.

In summary, 100% of the Fund's assets can be liquidated within 10 days.

Time to liquidate	% of assets
Within 1-10 days	100%
>10 to 21 days	0%
> 21 days	0%

### Maturity profile

As at 31 December 2022, the Fund does not have any material liabilities.

### Derivative counterparties engaged

The derivative counterparties engaged for the period 1 October 2022 to 31 December 2022 are provided in the table below.

#### Derivatives counterparty

UBS AG, Australia Branch

### Leverage ratio

WaveStone uses leverage to increase the exposure of the Fund to investment markets. Leverage can be obtained by either of the following methods:

- Using derivative instruments to increase the Fund's investment exposure beyond the net asset value of the Fund; or
- Borrowing a share to sell on the market (short selling); or
- Borrowing cash to invest.

WaveStone will use leverage as an investment strategy predominantly through short selling and using derivatives.

Short positions are taken on particular stocks where WaveStone believes a security is overvalued and it is expected that these stocks will fall in price, or for hedging purposes. Short selling will also increase the Fund's total gross effective exposure to the share market above 100% of its net asset value.

The Fund may have gross exposure of up to 250% of net asset value (NAV), including up to 100% in short positions and 150% total in long positions.

The Fund has the ability to borrow up to a maximum of 50% of the Fund's net asset value. The level of borrowings employed by the Fund have historically been and is anticipated to continue to be around 0-20% of the net asset value of the Fund. Borrowings undertaken by the Fund may be undertaken through the prime broking relationship with UBS AG, Australian Branch. The Fund must provide collateral to secure its obligations under the relevant Customer Documents.

As at 31 December 2022, the Fund is long 111.0% and short 7.1%; gross leverage is 118.2% and net leverage is 78.4%.



## Fund Facts as at 31 December 2022

<b>APIR Code</b>	HOW0053AU
<b>Inception date</b>	02 July 2009
<b>Management fee + (Performance Fee)</b>	1.10% p.a. + (15% of the Fund's daily return (after fees and expenses and after adding back any distributions paid) above the Fund's Performance Benchmark.) <sup>1</sup>
<b>Buy/sell spread</b>	+0.20% / -0.20%
<b>Fund size</b>	\$175.3M
<b>Exit price</b>	\$1.6111

Data source: Fidante Partners.

<sup>1</sup>The performance fee is applied on the outperformance over the benchmark after deduction of fees and expenses and after adding back any distributions paid.

During the period there have been no changes to key service providers for the Fund including any changes to any related party arrangement. Additionally, there have been no material changes in the Fund's investment team, risk profile, or strategy, nor to the individuals who play a key role in the investment decisions for the Fund.

### 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](http://www.wavestonecapital.com)

This material has been prepared by WaveStone Capital Pty Ltd (ABN 91 092 873 160, AFSL 232379) WaveStone Capital, the investment manager of the WaveStone Dynamic Australian Equity Fund. Fidante Partners Limited ABN 94 002 835 592 AFSL 234668 (Fidante) is a member of the Challenger Limited group of companies (Challenger Group) and is the responsible entity of the Fund. Other than information which is identified as sourced from Fidante in relation to the Fund, Fidante is not responsible for the information in this material, including any statements of opinion. It is general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. You should consider, with a financial adviser, whether the information is suitable to your circumstances. The Fund's Target Market Determination and Product Disclosure Statement (PDS) available at [www.fidante.com](http://www.fidante.com) should be considered before making a decision about whether to buy or hold units in the Fund. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information. Past performance is not a reliable indicator of future performance. WaveStone and Fidante have entered into arrangements in connection with the distribution and administration of financial products to which this material relates. In connection with those arrangements, WaveStone and Fidante may receive remuneration or other benefits in respect of financial services provided by the parties. Fidante is not an authorised deposit-taking institution (ADI) for the purpose of the Banking Act 1959 (Cth), and its obligations do not represent deposits or liabilities of an ADI in the Challenger Group (Challenger ADI) and no Challenger ADI provides a guarantee or otherwise provides assurance in respect of the obligations of Fidante. Investments in the Fund are subject to investment risk, including possible delays in repayment and loss of income or principal invested. Accordingly, the performance, the repayment of capital or any particular rate of return on your investments are not guaranteed by any member of the Challenger Group.