

Australian Mid Cap Fund - Class B

Performance Net (%)	1 Month	3 Month	1 Year	3 Year p.a.	Since Inception* p.a.
Australian Mid Cap Fund - Class B	1.92	11.49	11.44	6.21	9.06
Mid Cap Composite Benchmark	3.19	15.99	14.67	8.79	11.18
Excess Return	-1.27	-4.50	-3.23	-2.58	-2.12

* Inception date - 15 May 2017

Investment Objective

The Fund aims to outperform the composite benchmark of 70% of the S&P/ASX Mid Cap 50 Total Return Index and 30% of the S&P/ASX Small Ordinaries Total Return Index over a three to five year period (after management costs and before tax).

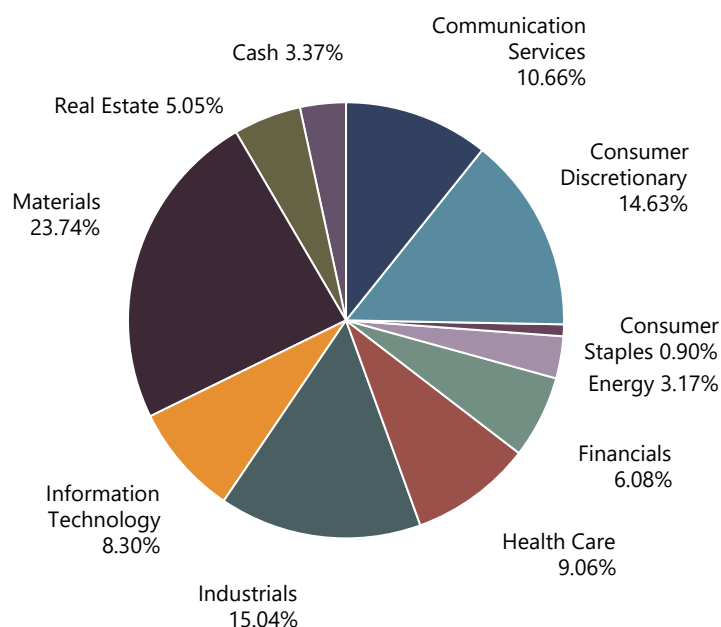
Lead Portfolio Managers

John Lake & Matthew Riordan

Fund Overview

Investing in stocks that are outside the S&P ASX50, this fund uses a detailed fundamental research process to construct a diversified portfolio of stocks. The highly experienced team have a focus on downside protection and are proven to generate consistent outcomes.

Sector Allocation



Key Details

Number of Holdings	54
Portfolio Dividend Yield	1.79%
Fund Size (AUD)	\$87M

Top 10 Positions

	Weight %
Atlas Arteria	3.70
Cleanaway Waste Management Ltd.	3.52
Bluescope Steel Ltd.	3.47
Resmed Inc	3.43
Charter Hall Group	3.40
Northern Star Resources Ltd.	3.32
Seek Ltd.	2.97
Ansell Ltd.	2.93
ALS Ltd.	2.50
Nextdc Ltd.	2.49

Fund Details

APIR Code	ETL8772AU
Distribution Frequency	Semi-Annually
Management Fee ¹	1.10% p.a.
Performance Fee	15% p.a.
Buy Sell Spread	+/-0.25%
Minimum Investment	\$20,000
Stock Range	Typically 40-60
Cash Range	0-10%

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Market Review

For the purpose of comparison, commentary is quoted in AUD terms except where stated otherwise.

The December 2020 quarter was particularly heavy on the news front. COVID-19 continues to rage at unprecedented levels. In the past week alone there have been 650,000 new cases globally and 11,000 fatalities per day with new infections running at record highs in the US and UK. The UK has also gone into a hard lockdown until February and is in the throes of a new, far more contagious strain. Australia has fared better than most with Melbourne coming out of its extended lockdown. Unfortunately, in more recent times new cases have arisen, predominantly in Sydney but also in some other states in a more limited way although protocols do appear to be working. Despite this negativity global growth, whilst slower, is still recovering. On top of this China, which dealt very well with the pandemic, is seeing very strong growth. Also, multiple vaccines have now been approved globally and have started to roll out in many countries. This is expected to accelerate in the coming months. As a result, the equity market is looking through the current crisis to when the World emerges from the pandemic.

The quarter also witnessed the most controversial US election in recent times, which led to unprecedented scenes of protestors storming the Capitol building in early January. The final result is a Biden / Democrat win including the Democrats also taking control of the Senate. The market has taken this positively believing it will lead to further stimulus and infrastructure spending. It should also be expected to lead to higher taxes although the market is currently discounting this. In the meantime additional stimulus was approved in the US coming into the end of the Calendar year and various measures remain in place in Australia although they are slowly being eased back (despite this all signs are that the economy is holding up better than expected).

Australia saw its relationship with China hit new lows in the quarter with bans or tariffs being put on a variety of Australian products from wine and beef to barley and coal. Fortunately, it has not impacted our most important export (iron ore). It will be interesting to see how a change in US leadership flows through to the Australia/China relationship.

In the face of all these events, markets over the quarter focused on the positives and surged with the Nasdaq Composite Price Index returning +15.4% (USD) and the S&P500 Price Index returning +11.7% (USD). In Australia, the S&P ASX Mid Cap 50 Total Return Index and S&P ASX Small Ordinaries Total Return Index ending up 16.9% and 13.8% respectively, whilst the broader S&P ASX200 Total Return Index returned 13.7%.

The prospect of rebounding growth and sustainably higher US fiscal spending have had other flow on effects driving a reflation trade. This kicked in strongly after initial reports of success with vaccine trials. It has seen the AUD rally another 7.4% to 76.9c (following a 4% rally last quarter) relative to the USD, the AU10yr bond yield rise from 79bps to 97bps whilst the US10year bond yield firmed from 68bp to 91bps. Commodities continued their stunning run with iron ore rallying a further 44%, Nickel up 50% and Copper up 17%. Gold bucked the trend remaining relatively static, in part reflecting its defensive status.

From a sector point of view the Paradise Mid Cap composite index (70% ASX Mid Cap 50 / 30% ASX Small Ords) reflected the reflation trade with Energy and Financials being the best performers. Surprisingly, Information Technology and Communication Services (also tech heavy) were also very strong. Defensives suffered with Utilities and Healthcare underperforming. Interestingly Consumer Discretionary was also weak (despite numerous profit upgrades in the sector) as was Materials, although this was solely due to gold underperforming.

From an economic and corporate perspective, things continue to tick along far better than might be anticipated given the circumstances. Apart from the aforementioned strength in the retail sector, banks have seen loan deferrals come back significantly, job ads have now returned to pre-COVID levels and residential property prices and activity actually rose during the Calendar year. Many companies have also upgraded profits in recent times as their revenue line has held up whilst their cost bases have fallen due to COVID induced lower spending (eg – less travel, marketing, hiring, etc); certainly not your typical crisis.

We continue to see strong capital raising activity including in the resources space (e.g. Independence Group and Nickel Mines), strong IPO activity (although outside of stocks like Nuxit most have been at the smaller end including a lot of speculative companies) and in the Mid Cap space we saw takeover bids for Coca-Cola Amatil and Link Administration, although the outcome of these bids remains uncertain.

Performance

The Paradise Mid Cap portfolio had a difficult quarter relative to its index. We suffered from being underweight the strong reflation sectors such as Energy, Financials and non-gold resources. We were also overweight more defensive sectors such as Healthcare. We were underweight technology stocks which (as mentioned in the previous section) counter intuitively outperformed in the quarter despite their "long tail" valuations. From a stock point of view the attribution indicated a few "mistakes" (in terms of companies within the portfolio not hitting their financial targets) but was more a reflection of the macro rotation we have described, with a number of the stocks that served us well during the earlier stages of COVID, underperforming.

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The top relative contributors to performance for the quarter are as follows:

Evolution Mining (EVN) – Underweight Weak performance of gold stocks in general during the quarter in a risk on environment.

Mesoblast (MSG) – Underweight/Not held Biotech that failed in multiple clinical trials of its products during the quarter.

Nuix (NXL) – Overweight Strongly performing IPO that the portfolio participated in during the quarter. Nuix offers a platform for searching, analysing and extracting knowledge from unstructured data for use in such industries as the legal and law enforcement professions as well as forensic accounting.

The top relative detractors from performance for the quarter are as follows:

Ansell (ANN) – Overweight The stock underperformed despite upgrading F21 guidance during the period. This would seem to relate to USD weakness (ANN's functional currency) and its perception as having been a COVID beneficiary in its Healthcare division, noting that the company is also exposed to rising industrial production through its Industrial division.

Chorus (CNU) – Overweight Yield sensitive stocks underperformed in the quarter.

Saracen (SAR) – Overweight Weak performance of gold stocks in general during the quarter in a risk on environment.

PORTFOLIO CHANGES

The December quarter saw one of the most significant index changes we have seen in a number of years with both Afterpay (APT) and Xero (XRO) exiting into the ASX 50 Leaders to be replaced by Oil Search (OSH) and Vicinity Centres (VCX). The sheer size of APT and XRO saw a significant change in the relative weights of all stocks in the index and, as they were both in the Information Technology Sector, also saw a significant change in the sector weightings of the portfolio's benchmark. The majority of the proceeds from selling holdings in APT and XRO have now been reinvested.

ESG

The Paradise ESG effort has been greatly assisted by the hiring of Nick Varcoe who commenced at the start of September as Head of ESG. Since that time the following tools have been adopted:

- Engagement tool –financially material, sub-sector specific question bank for companies
- Modern Slavery tool – determines companies with exposures to locations with a higher risk of modern slavery.
- Climate Change Risk Analysis tool – in the process of constructing, it is based on analysing 3 key risks: 1. The transition to a low carbon economy, 2. Physical climate change risk, 3. Management capability and willingness to adapt.

Outlook

As we alluded to in the opening comments the market has very much taken an optimistic view of recent developments such as the initial days of a vaccine rollout and a Democratic clean sweep in the US despite the current turmoil around both factors. Interestingly, the emergence from the Spanish flu almost a century ago saw a period of strong economic growth and strong equity market performance. The key question here is to what extent will history repeat and how smooth will the process be. In this regard it is worth considering a number of factors.

On the vaccine front we still do not have absolute clarity as to how long a rollout might take and what it might mean in terms of a return to "normal". We are also not certain to what extent the vaccine is capable of dealing with the new strains appearing currently or for that matter, in the future. Hopefully it will be effective.

The outcome of the US election has also spurred numerous trades based on advocated policies such as higher infrastructure spend, more stimulus and a move towards greener energy which has seen EV and battery related stocks soar. History has shown that it is often very difficult to turn policies into practice. The last time we saw a surge in US infrastructure stocks was after Trump was elected and this ultimately led nowhere. We also need to consider the consequences of long term high debt levels in both the USA and globally.

We are also currently experiencing a period of rising bond yields and USD weakness. Interestingly while these are both currently in train, they have also been a consensus view in recent years but have not come to fruition over the course of those years.

In the near term our focus will switch to the reporting season for the period ended 31st December, which will kick off later this month. Key areas of focus here will be what "normalised" earnings might look like both for companies that have benefited from as well as suffered from the implications of COVID and what a trajectory to normal might look like. We will also be looking for indications of what the slow withdrawal of stimulus means and to what extent it is being offset by an economic recovery. We also have a number of companies in our sector with a reasonable component of USD earnings so we need to consider the implications of the reasonably sharp movement that we have seen here.

In the meantime we continue to remain focused on company fundamentals and to investigate pockets of opportunity that are developing in a market that is trading close to record highs.