2023 in Review

15 CHARTS FROM THE PINNACLE GROUP'S 15 AFFILIATED INVESTMENT MANAGERS

Pinnacle

AIKYA
Antipodes
COOLABAH CAPITAL INVESTMENTS
Firetrail Invest with Conviction
Five V Capital
HYPERION ASSET MANAGEMENT
langdon PARTNERS
LONGWAVE CAPITAL
METRICS
PALISADE
Plato INVESTMENT MANAGEMENT
RESOLUTION CAPITAL
RIPARIAN CAPITAL PARTNERS
SOLARIS investment management
SPHERIA ASSET MANAGEMENT

The significant window of opportunity for life insurers in emerging Asia.

At the 2023 Sohn Hearts and Minds Investment Leaders Conference in November, Aikya Investment Management Portfolio Manager, Ashish Swarup, outlined the investment case for Hong Kong-based life insurer AIA Group – the largest publicly listed life insurance group in the Asia-Pacific region.

"It's quite interesting to see that emerging Asia has a huge protection gap (the shortfall between the amount of life insurance people carry and the amount they need in the event of a death of a primary earner).

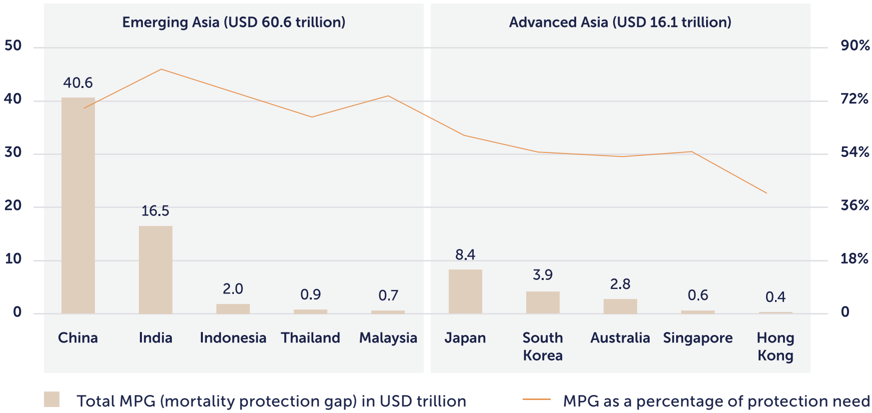
"So, in countries like China and India the protection gap is in the order of trillions of dollars, while advanced Asia is a lot better. Now, you have to just ask the question – why are richer people in emerging markets not saving enough? Why are they not providing for their retirements?

"The answer is actually, they are. Instead of a financial savings products, they're putting their money in assets such as property. And maybe they're just relying on government pensions or they're relying on family to support them once they get older.

"But most of these things are changing – the property market is not as strong, at least in China compared to 10 years back. Government pensions are unreliable, family societal norms are changing.

"So we think there is a significant opportunity for companies to make money selling insurance to these economies."

Emerging Asia has a significant protection gap



Source: Swiss Re
June, 2023

Visit the Aikya website →

US market concentration hits an all-time high in 2023.

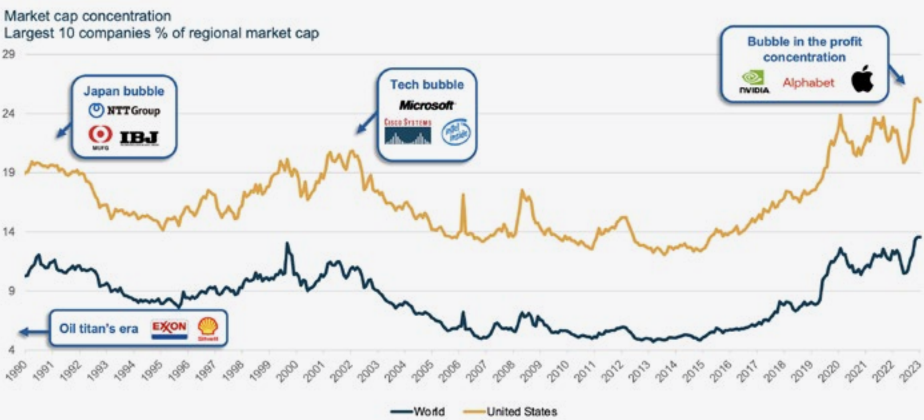
At the 2023 Pinnacle Investment Summit in September, Antipodes CIO, Jacob Mitchell highlighted the extreme market cap concentration present in US markets. He warned investors these periods don't last forever.

"In 1990, the market cap of the world was concentrated in Japanese equities. In 2000 it was concentrated in US tech stocks that were on a really high multiple, and today it's concentrated in the Magnificent 7.

"Everything else is on a lower multiple and the more we move away from the US, the lower that multiple goes. So, arguably, there are many sectors in many regions that are already pricing in a relatively hard landing.

"Why have the Magnificent 7 re-rated? Will Alphabet or Meta sell more digital ads in a recession than they do today? Will Tesla sell more cars in a recession? Investors must be very certain that the high multiple is justified, and we argue conditions will be tougher. Now, we also have companies in that group that are arguably more defensive, such as Microsoft. It has got a great business and AI is giving it more pricing power."

Meanwhile US market concentration is at an all-time high...



Source: FactSet, Antipodes

Visit the Antipodes website →

Unit labour costs are driving inflation and creating a big problem for Central Banks.

At the 2023 Pinnacle Summit Series in July, Coolabah Chief Investment Officer & Portfolio Manager, Christopher Joye explained his view on what is driving inflation, why higher inflation is likely to continue for some time, and the approach he believes central banks are likely to take.

"Unit labour costs – the wage cost of businesses producing products – is running at 8% in Australia, in Europe 6 to 7%, in the US 5 to 6% and this is what is driving services inflation.

"This is why the inflation battle that has been raging since mid 2021 will continue to rage for some time yet. We think this will be an iterative multi-year battle against inflation.

"We are confident that we're going to see recessions. So unemployment will increase and the central banks are going to march forward until they crush inflation. Don't believe this BS around them having dual mandates and being worried about increasing unemployment. They're not worried about increasing unemployment."

Services Inflation Reflects Strong Growth In Unit Labour Costs

Services inflation, excluding rents, reflects strong growth in unit labour costs (labour costs adjusted for labour productivity).

- US unit wages (5.3%) have grown at fastest rate since early 1980s.
- Euro area unit wages (6.4%) have grown at their fastest rate since the global financial crisis (excluding COVID policy distortions).
- Australian unit labour costs (7.9%) have grown at fastest rate since late 1980s due to poor productivity (excluding COVID policy distortions).

Figure 1: Unit labour costs are growing strongly in the US...

US - nominal unit wages (% change on a year ago)*

Figure 2: ... and in the euro area...

Euro area - nominal unit wages (% change on a year ago)*

Figure 3: ... and Australia

Australia - nominal unit labour costs (% change on a year ago)*

*Note: Volatility in 2020 and 2021 reflects COVID policies.

Source: Eurostat, Federal Reserve Bank of St Louis, Australian Bureau of Statistics, CCI, as at July 2023

Visit the Coolabah website →

As the barriers go up to building new things, 'old world' assets become more valuable.

In September at the 2023 Pinnacle Investment Summit, Firetrail Portfolio Manager, Blake Henricks outlined why the Firetrail team believes 'old world' assets are becoming more attractive in the current market and economic environment as higher interest rates and higher inflation compound the barriers to starting new ventures from scratch. At the time both Origin Energy and Newcrest Mining were under takeover offers from offshore players.

"It's getting much harder to build new businesses, from property development to energy and commodities. The increased cost of money makes existing brands and customer bases more valuable and much harder to recreate.

"There's two examples in the Firetrail High Conviction Fund where investors have managed to benefit. Newcrest Mining and Origin Energy – both are seen as old world assets. Both received takeover bids in the past twelve months. Newcrest received a 30% takeover and Origin received a 53% premium.

"The acquirers of these businesses were doing the numbers. 'Should I build it? Or should I buy it?' And our very strong view is as the barriers go up to building new things, old world assets are very, very valuable."

New World? Time for old world assets

NEWCREST MINING LIMITED

✓ Quality, long life growth options
✓ Growing copper production

UNDER TAKEOVER 30% premium

- Old world assets are becoming more attractive
- Building new things is getting harder
  - Increasing expectations
  - Blue collar constraints

origin

✓ 4 million retail customers
✓ Gas and gas-fired power stations
✓ Large renewable portfolio

UNDER TAKEOVER 53% premium

- Areas of interest
  - Energy / Commodities
  - Brands / Customer bases

Old world assets looking more attractive in the new world

Visit the Firetrail website →

Capitalising on a tectonic shift in the Australian business environment.

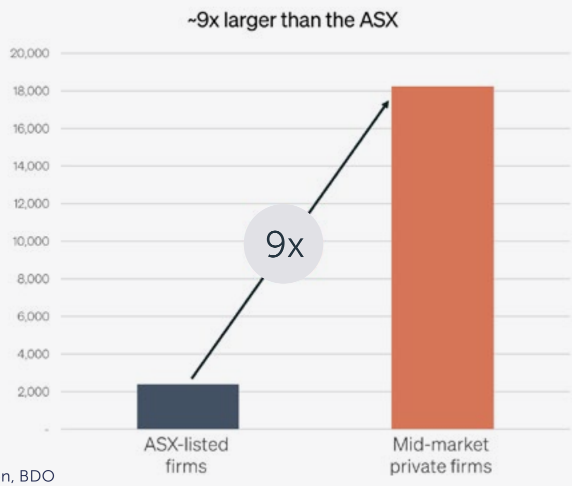
Tim Cooper from the Five V Investment Team presented on private equity opportunities at the 2023 Pinnacle Investment Summit in July. Tim outlined the major opportunity for private equity investors stemming from baby boomers transitioning into retirement.

"The mid-market opportunity is huge and by BDO's estimate there are approximately 18,000 of these businesses in Australia. You're looking at an opportunity set that is approximately 9x larger than the entire public universe.

"We often say at Five V that Australia is a big country but made up of lots of small businesses and that's what we're focused on. Importantly the ability to transact with these businesses is rapidly accelerating – we're at the start of a tectonic shift taking place in Australian society with the transition of the baby boomers into retirement.

"Off the back of that, approximately $4 trillion worth of family and private business wealth will transfer. Some of those businesses will obviously transition within families, but many will seek new owners."

The private mid-market opportunity is huge...



Source: S&P Capiq, Illion, BDO July, 2023

Visit the FiveV website →

Three key benefits of artificial intelligence and machine learning.

Jolon Knight, Investment Specialist at Hyperion Asset Management spoke about the three key benefits from AI and Machine Learning at the 2023 Pinnacle Investment Summit in September.

"The first is productivity benefits – you will be able to run your business smarter, harder, and faster. Maybe you've got some coders in your business – one guy codes, the other checks the codes. If you have an AI machine learning bot off to the side, the bot can check the code – you don't need that duplication anymore.

"Then there's incremental revenue opportunities – being able to monetise your customer base more. Microsoft said they'll be able to get incremental revenue increases with their Copilot product. ServiceNow already has a customer service bot that's been used very well – and can't be identified as a bot. Workday has a lot of machine learning within their HR product. We're seeing it here in Australia as well; ML has been core at Xero for many, many years.

"Finally, when you're actually embedded within those businesses there is no cost of acquisition for that customer. Your competitive advantage within that business becomes stronger and stronger. The risk of you being shaken out becomes less and less.

"So three really positive signs that we like to see coming forward for AI and ML. And this is a multi-decade opportunity – we're still in its infancy."

Artificial Intelligence & Machine Learning Insights

Hyperion believes there are three key benefits from AI/ML usage:

1. Productivity benefits.
    - Automating processes.
2. Incremental revenue opportunity.
    - Monetise AI/ML capabilities with additional pricing tiers.
    - Low or no customer acquisition costs.
3. Strengthen their sustainable competitive advantages.
    - Stronger offerings with imbedded optionality.

Any reference to a specific security should not be construed as a recommendation to buy or sell this security. Please note that portfolio holdings and positioning are subject to change without notice.

Visit the Hyperion website →

Fishing in the right pond – smaller companies can help effectively fight inflation.

During a video interview for clients in August, Greg Dean, Founder and Lead Investor at Langdon Equity Partners discussed the opportunities in global small caps and explained how Langdon's approach to investing helps protect against inflation shocks.

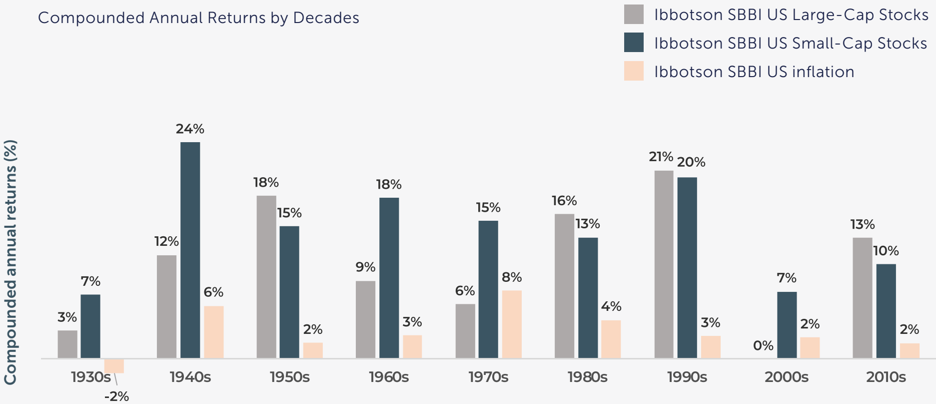
"It's a misconception that smaller companies are perilously capitalised and much more sensitive to economic shocks and periods of stress like the one we are in at the moment.

"When you look to the types of businesses we want to own (low leverage, high rate in which they convert accounting profits into cash flow) we tend to not see those periods of stress correlate to periods of stress for our portfolio.

"Inflation is still everywhere and very topical but we've actually seen it probably more as a benefit to a lot of our businesses that have pricing power and are able to charge further for the goods that they provide to their customers. And because they don't have the really aggressive balance sheets – we call leveraging the 'performance enhancing drug' – we just haven't seen the negatives, but we've actually benefited from a lot of the positives that inflation has bought."

Large Cap vs. Small Cap vs. Inflation

Compounded Annual Returns by Decades



Ibbotson® SBBI® 1926-2021 is a 96-year examination of past capital market returns that provides historical insight into the performance characteristics of various asset classes. Stocks in this example are represented by the Ibbotson® Small Company Stock Index & Ibbotson® Large Company Stock Index, and inflation is represented by Ibbotson ® SBBI ® US Inflation. *Ibbotson® SBBI® US Small-Cap Index is a proxy for small caps to reach farther back in history than the Russell 2000 goes (CPI)

Visit the Langdon website →

Within the same small cap sectors, investors can find stark divergences in company earnings outcomes.

Longwave Capital Partners CIO, David Wanis highlighted the importance of fundamental analysis and company research at the 2023 Pinnacle Investment Summit in September.

"What do we mean by focusing on companies and not Macro? Well, we've got some charts here of earnings forecasts for a range of small caps clustered into the sort of sectors and markets that are similar in which they operate. They show the earnings expectations that the market had for these businesses at the end of December last year – and where we've got to at the end of reporting season.

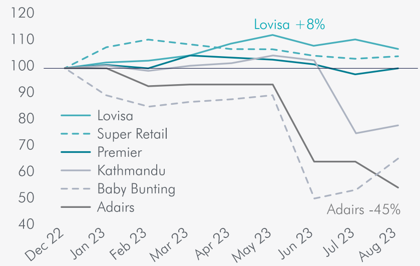
"Within the same sectors you're seeing very large divergences in the earnings outcomes for these businesses. Retail has been tough but there are a couple of retailers who have executed very well. Tourism and leisure has been a very strong sector. With Star Entertainment it's really a company specific issue that has caused their grief. In Small Financials there's big divergences between the winners and the losers.

"The magnitude of difference over eight months is quite surprising. But that's not unusual in small caps.

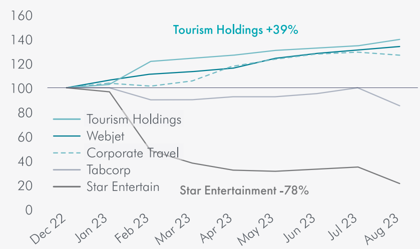
"It's always, we believe, incumbent on us as investors to focus on the businesses we own and the opportunities in front of them and not get too caught up in the macro forecasting of what may or may not happen across the board economy."

Focus on companies not macros

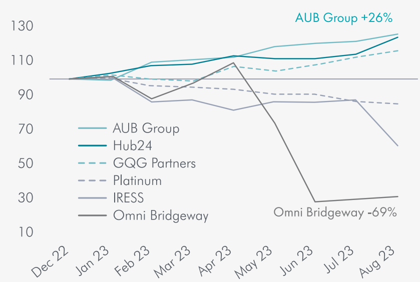
Small Retail 12M FWD EPS (100 = Dec 22)



Small Tourism & Leisure 12M FWD EPS (100 = Dec 22)



Small Financials 12M FWD EPS (100 = Dec 22)



Source: Bloomberg Consensus EPS estimates: 31 Dec 2022 to 31 Aug 2023

Visit the Longwave website →

Structuring loans to mitigate risk.

Metrics Credit Partners Managing Partner, Andrew Lockhart shared insights into how private debt can assist in providing investors reduced capital volatility, during the 2023 Pinnacle Investment Summit in September.

"Unlike other public markets investors, our role is to originate transactions directly with companies. We need to ensure that equity wears the risk of volatility, equity wears the risk of deterioration in credit quality, and you structure a loan to look through the cycle.

"So, we want to understand what are the key drivers of cash flow that are going to sustain the company's capacity to service and repay its debt and then we will structure appropriate terms, conditions and covenants. The biggest driver in a credit decision isn't the security, the biggest driver, the decision to lend, is the company's capacity to generate cash flow to service and repay its debt.

"Relationships with borrowers are very important because it is what allows us to gain access to private information to be able to assess and manage the risk of providing financing to that company and allows us to move to take corrective action if there was a deterioration.

"Another thing that's important to think about in terms of capital stability is the skill set around lending to good quality counterparties. And those counterparties that you believe have good businesses, good projects, and a demonstrated track record of performance."

Private Debt For Reduced Capital Volatility

In Australia, Private Lenders Benefit From A Range Of Protections

Structural Protections in Australia

Australian corporate insolvency regime assists lenders to protect capital

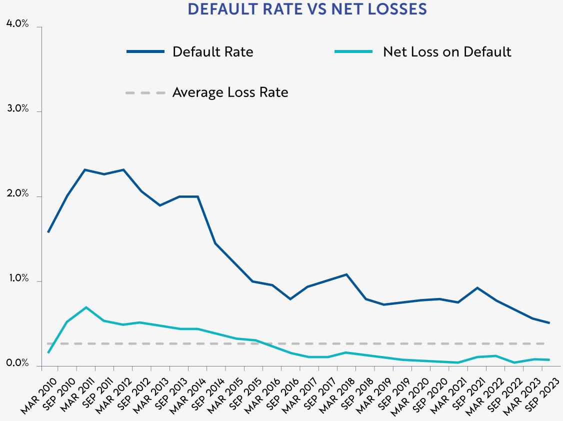
Relationships with Brokers

Regular communication with borrowers ensures the private debt manager can more effectively manage risk

Financial Contracts

Covenants are negotiated & documented in loan agreements to assist in controlling risk. These include Controls, Security, Pricing & Reporting obligations

AUSTRALIAN CORPORATE LENDING – DEFAULT RATE VS NET LOSSES



Source: APRA APS 330, Metrics.

The benefits of investing in mid-market infrastructure.

At the Pinnacle Summit Series in July, Palisade Investment Partners' Executive Director, Andrew Killesteyn, explained how a focus on mid-market infrastructure is a defining feature of the Palisade Group. He outlined two key reasons the investment team focusses on this segment of the unlisted infrastructure market.

"The first really centres around supply and demand. So, from a demand perspective we don't see the big walls of capital that you see in the large cap space – we're not competing against the likes of the Australian superannuation funds, many of whom are now investing directly into the asset class. We don't compete against the Canadian pension funds, the Middle East sovereign wealth funds, so there is not that same level of capital pressure.

"Then on the supply side, in terms of executing transactions, we're not necessarily beholden to the next asset a government has decided to privatise, which is where a lot of the deal flow in large cap sector comes from in Australia.

"In the mid-market there is more ability to go out there and generate opportunities, work with vendors and execute deals on a bilateral basis and we've secured about 75% of the assets in our portfolio on a bilateral basis and all this points to, in our view, better risk adjusted returns available in the mid-market."

Why Invest in Mid-Market Infrastructure with Palisade?

Favourable risk-return characteristics

- **Greater supply of assets** and **less competitive market environment** allows for more attractive entry pricing
- Typical entry multiples for mid-market of **12-15x** EBITDA (compared with 20-25x for large-cap infrastructure)
- Palisade has generated a 10 year gross total return for its flagship fund (PDIF) of **11.3% p.a.**, comprised of **6.0% p.a. yield**

Ability to execute on a bilateral basis

- Palisade has been investing in mid-market infrastructure **since 2008**
- **Development of extensive network of market participants** including developers, corporates and local government / municipalities
- Palisade has acquired **over 30 assets** since establishment, **75%** of which have been on a **bilateral** basis

Sector diversification

- Mid-market allows for greater ability to **build a diversified portfolio** across multiple infrastructure sub-sectors
- Flexibility to work with vendors on an opportunistic basis and **target sub-sectors** that offer **better relative value**
- Palisade's existing portfolio has exposure to **all major infrastructure sub-sectors**

Value creation through majority control

- Size of assets in the mid-market means that Palisade can acquire **majority / controlling interests** in assets
- Control over portfolio companies allows Palisade to **work with asset management teams closely** to drive alignment and shareholder value
- Palisade works with **experienced operating partners** across industry sectors who act as directors on asset boards

Visit the Palisade website →

The importance of franking credits in generating stronger income.

At the 2023 Pinnacle Investment Summit in September, Plato Investment Management Managing Director, Dr Don Hamson outlined Plato's focus on generating high levels of fully franked income and why this is critical for retirees.

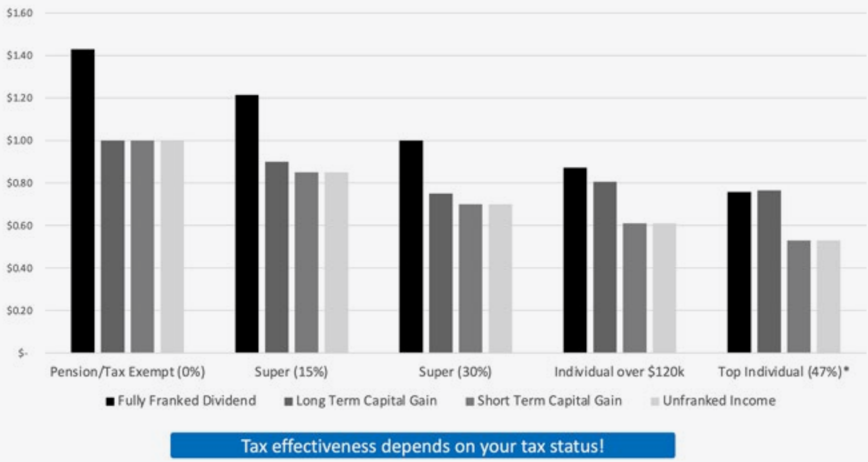
"Retirees are different – they're living now off the income from their investments. They're worried about longevity risk.

"They do have one thing on their side though, they still are tax free, at least for the first $1.9 million and we try and take advantage of that.

"This chart highlights why we focus on retirees and why retirees are different. We're looking here at the after tax value of $1 of pre-tax income and the first set of lines are for retirees and the black line is the value of a fully franked dividend. If you get $1 fully franked dividend is worth over $1.40 when you get the franking credit refund.

"That's what we focus on – generating high levels of fully franked income so that our investors can hopefully live largely off the income from their investments rather than have to draw down on capital."

Pension phase super tax rates are different



Source : ATO, Plato using 1 July 2023 tax rates including Medicare levy. After tax value of $1 of pre-tax return)
September, 2023

Visit the Plato website →

Rising replacement costs underpin rents.

At the 2023 Pinnacle Investment Summit in September, Resolution Capital Portfolio Manager, Julian Campbell-Wood expands on how the current trend of rising replacement costs underpin rents in a couple of different ways.

"Another factor which is a key underpinning at the moment is the rise in replacement costs. We've seen an extraordinary increase in replacement costs and the cost to develop new buildings.

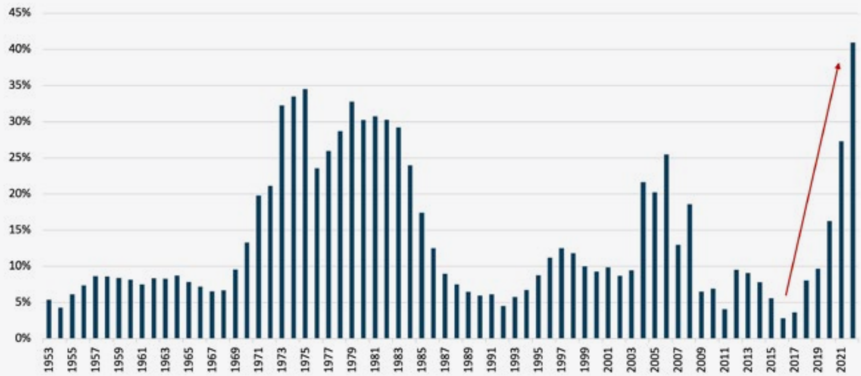
"The chart shows the rolling replacement cost trend over three years as assessed by Zurich Insurance in North America. And really, we haven't seen this level of increase in cost for decades, not since the 70s and 80s.

"This supports the underlying rental dynamics for landlords in a couple of ways. Firstly, if developers have to absorb this increase in cost, they need higher rents to maintain the same economic return. So that helps to underpin the rents for existing landlords.

"If landlords can't get those higher rents development starts will decline, supply will decline, and over time that underpins the pricing power for existing landlords. So this increase in replacement costs again is a supportive underpinning for the sector in the years ahead."

Rising replacement costs underpins rents

Rolling 3 Year Real Property Replacement Cost Trend



Source: ResCap, Zurich Real Property Replacement Cost Trend. Jan 2023

Visit the Resolution Capital website →

Irrigator confidence buoyed by record water storage levels.

During Riparian Capital Partners' End of Water Year Investor Update in August, Managing Partner, Nick Waters, explained how the volume of water held in the major storages in the Southern Murray Darling Basin region had reached multi-decade highs in July 2023.

"The volume of water in major storages is still at very high levels, this has really allowed for quite strong opening allocations to be issues to pretty much all entitlement holders and these strong allocations are really expected to provide increased levels of confidence to the irrigation sector which will encourage the sector to increase production and therefore water use later this season.

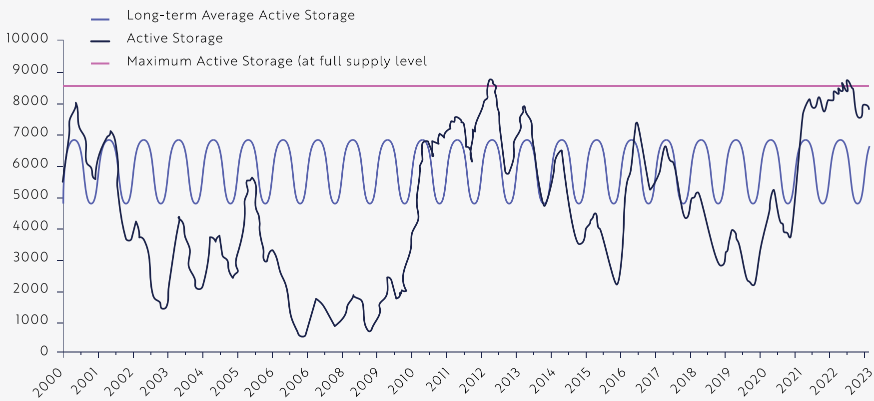
"It really should be no surprise that over the last few years increasing water supply conditions and strong commodity prices have resulted in the two highest agricultural production years on record and ABARES (Australian Bureau of Agricultural and Resource Economics and Sciences) is expecting the current water year that ends in June 2024 to be third highest on record.

"This really illustrates how farmers respond to supply conditions by ramping up production and water use."

Storage levels at record highs

Highest July storage levels for over 2 decades, supporting irrigator confidence

MDBA Active Storage: June 2000 to end July 2023



Source: Murray Darling Basin Authority, August 2023

Visit the Riparian website →

What really drives share prices in the long term?

In September, at the 2023 Pinnacle Investment Summit, Solaris' Chief Investment Officer, Michael Bell shared this chart which demonstrates long term quality earnings drive share prices and why Solaris believes this is one of the keys to investing.

"It's fair to say that trying to pick the markets in the short term is a mugs game. From January to July 2023, 95% of the movement in the S&P 500 has come from noise – that might be AI, short-term interest rate moves, it might be wars – and only 1% from earnings upgrades.

"The point is its very hard to predict short term moves in the market. Fortunately for investors the long term is a little bit easier than that and it comes down to fundamentals.

"Over the last 20 years we can see the markets are up 310%, so big move in the market. Over the same time earnings were up 270%. So, 90% of the move in the S&P over the long term is from earnings fundamentals – only 10% this time, from noise.

"So what does that tell us? That long term quality earnings drive share prices – and at Solaris we believe that's the key to investing."

Fundamental Analysis wins in the long term

Fundamental analysis wins in the long term

Source: Bloomberg. Reflects S&P 500 Index. The graph does not reflect costs. Past performance is not a guarantee of future results.

Visit the Solaris website →

SPHERIA ASSET MANAGEMENT

Lithium stocks: Over-hyped & over-priced?

In September at the 2023 Pinnacle Investment Summit, Spheria Portfolio Manager, Marcus Burns warned of a bubble in Australian-listed lithium stocks.

"Everyone knows lithium is a hot topic and there's a huge demand for lithium, no doubt. But what's interesting is that there's been a big decrease in the lithium carbonate price.

"So that orange line there (below) shows you the lithium carbonate price over the last couple of years and you can see there's been a massive fall in the price. Yet the blue line (below) which is a weighted average market cap of Australian lithium stocks is still trading at high levels, not far off its peak.

"What's interesting is if you look globally lithium stocks have sold off materially in line with the lithium carbonate price, but in Australia the stocks have held up with a lot of money crowding into the space. We think there's a real risk here for investors."

Lithium "Bubble" Deflating

Domestic share prices have held up relatively well

Chart Source: Bloomberg. *Stocks include: PLS, AKE, LTR, GL1, AVZ, CXO, LKE, VUL, PSC, AGY, SYA.

Visit the Spheria website →

PINNACLE DISTRIBUTION TEAM

Kyle Macintyre
HEAD OF WHOLESALE AND RETAIL DISTRIBUTION
+61 2 8970 7926
kyle.macintyre@pinnacleinvestment.com

Mark Cormack
DIRECTOR | RETAIL DISTRIBUTION (QLD & NSW)
+61 417 412 524
mark.cormack@pinnacleinvestment.com

James Archer
BUSINESS DEVELOPMENT MANAGER (QLD)
+61 432 273 335
james.archer@pinnacleinvestment.com

Gerald Willeston
DIRECTOR | RETAIL DISTRIBUTION (NSW)
+61 404 123 490
gerald.willeston@pinnacleinvestment.com

Emily Pearson
BUSINESS DEVELOPMENT MANAGER (NSW & ACT)
+61 449 611 002
emily.pearson@pinnacleinvestment.com

Adam Allcock
BUSINESS DEVELOPMENT MANAGER (NSW)
+61 418 119 500
adam.allcock@pinnacleinvestment.com

Andrew Reidy
DIRECTOR | RETAIL DISTRIBUTION (VIC & SA)
+61 449 202 249
andrew.reidy@pinnacleinvestment.com

Darcy Graham
BUSINESS DEVELOPMENT MANAGER (VIC & SA)
+61 451 659 951
darcy.graham@pinnacleinvestment.com

Olivia Northwood-Blyth
BUSINESS DEVELOPMENT MANAGER (VIC & TAS)
+61 432 458 108
olivia.northwood-blyth@pinnacleinvestment.com

David Batty
DIRECTOR | RETAIL DISTRIBUTION (NZ)
+64 212 288 0303
david.batty@pinnacleinvestment.com

Chris Meyer
DIRECTOR | LISTED PRODUCTS
+61 414 951 344
chris.meyer@pinnacleinvestment.com

James Dawson
ASSOCIATE DIRECTOR | LISTED PRODUCTS
+61 435 719 998
james.dawson@pinnacleinvestment.com

Jamie Mimis
ASSOCIATE | LISTED PRODUCTS
+61 428 229 661
jamie.mimis@pinnacleinvestment.com

Callum Evans
BUSINESS DEVELOPMENT MANAGER (WA)
+61 431 872 044
callum.evans@pinnacleinvestment.com

DISCLAIMER

GET IN TOUCH

For retail distribution enquiries:

P 1300 010 311

E distribution@pinnacleinvestment.com

For institutional distribution enquiries:

P 1300 737 240

E insto@pinnacleinvestment.com

Pinnacle

P 1300 010 311
E distribution@pinnacleinvestment.com