



BKI INVESTMENT COMPANY

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QUARTERLY REPORT

What goes around comes around – an update on the Investment Clock

Welcome to the latest edition of the BKI Quarterly Report, prepared by Contact Asset Management (“Contact”).

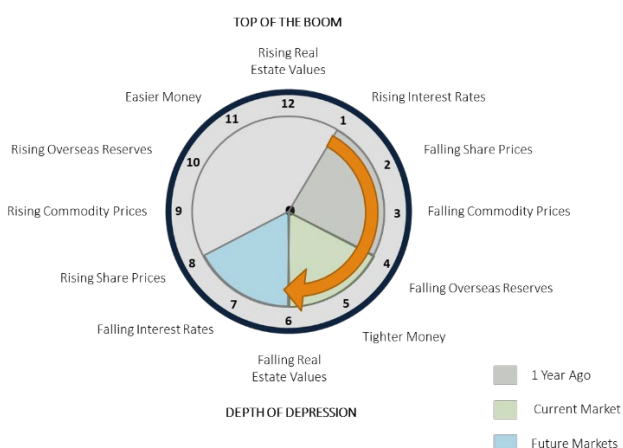
We often consult the Investment Clock, which was first shown in London’s Evening Standard newspaper in 1937. It shows various parts of the economic cycle from peak to trough. While it's not perfect, it's a decent indicator of seeing where we are by matching up current events to the clock face. We last shared our thoughts on what we thought the “time” was in June 2023. Following a strong performance by global equity markets over the past twelve months, we thought it appropriate to revisit. The biggest debate with the clock is not the model itself but what “time” we are at this particular moment. This is not an exact science but an exercise that we consider both interesting and useful.

Our view on the Investment Clock 18 months ago

In the BKI Quarterly Report from June 2023, we made the following comments:

“Over the last year, we’ve been watching the Investment Clock with interest. We believe we are almost through the cycle and while the term “Depth of Depression” sounds a little overcooked, this point in the cycle should provide the long-term investor with a significant opportunity.”

Our assessment of the Investment Clock in June 2023 and subsequent market performance



The S&P/ASX 300 Accumulation Index has increased by 24% since June 2023



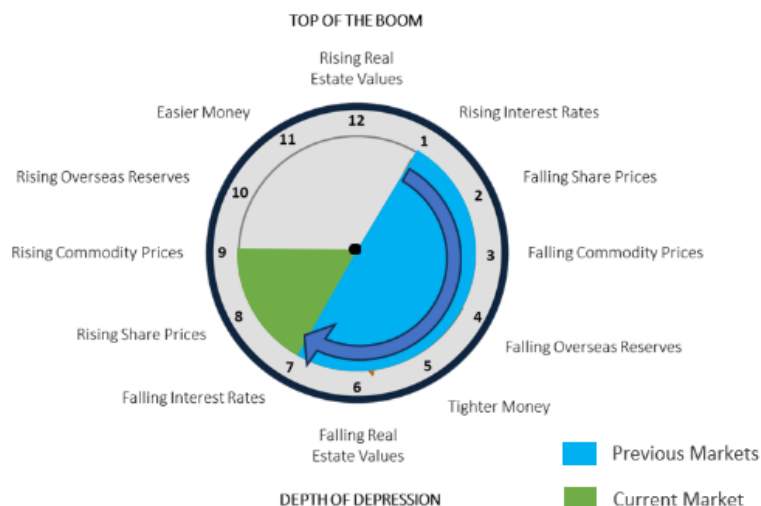
Source: The Investment Clock, Factset, Contact Asset Management

We remained optimistic on markets during that period and, as depicted in the chart on the right above, the subsequent increase in Australian Equity markets has rewarded investors.



Our view on the Investment Clock now

The tricky part is where are we now?



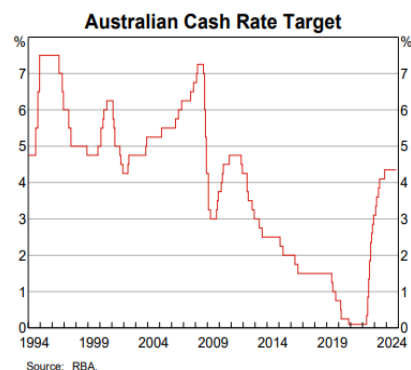
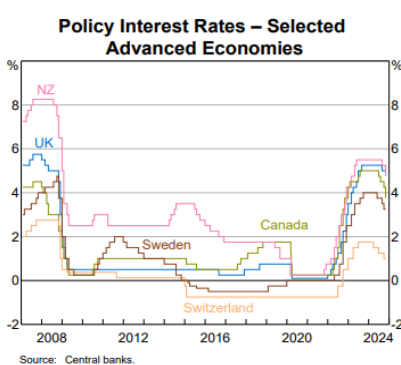
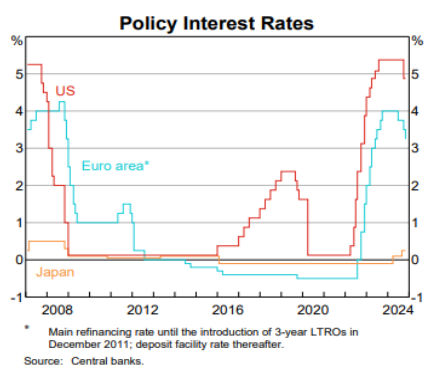
According to the Investment Clock, equity markets typically enter a period of appreciation following tighter global monetary policies, falling real estate values, and declining interest rates. We have started to see those factors pass, which has boosted global equity markets. We expect equities markets to continue to be supported, albeit we may experience increased volatility in the near-term as geo-political factors remain

It is worth considering some of the key factors above in more detail.

Tighter Money – we believe we have passed this part of the cycle

The global monetary landscape experienced significant tightening as central banks adopted restrictive policies to combat persistent inflation. Elevated interest rates and reduced quantitative easing measures have curtailed liquidity, raising borrowing costs for businesses and consumers alike. This environment had the desired effect on dampening investment activity, slowed credit growth and created headwinds for economic expansion. The stronger U.S. dollar, a byproduct of tighter U.S. monetary policy, has further strained economies with dollar-denominated debt, increasing financial vulnerabilities. While the restrictive stance aims to anchor inflation, it does seem that many Central Banks are more comfortable with inflation rates, and many have started to cut. It is a delicate balancing act to tame inflation yet avoid the risk of a prolonged economic slowdown, particularly as geopolitical tensions and fiscal pressures weigh on recovery prospects.

Many Central Banks have cut Interest Rates. We expect the RBA to keep rates flat in the near term but the next move will be down





Falling Real Estate Values - we believe we are near the end of this part of the cycle although the performance between different segments of Real Estate is nuanced

Industrial assets remain well supported as vacancy rates remain very low. We think it more interesting to discuss both the Residential and Office markets to gauge current sentiment.

Residential Auction Clearance Rates: Some interesting developments in Australian real estate has emerged recently with some weak auction clearance rates being posted over the last couple of weekends. Australia's auction clearance rates over the last weekend of November fell to their lowest level this year, reflecting weak buyer demand and growing expectations of house price declines in 2024. The weekend was seen as a key test for the market, with over 1,000 auctions scheduled in Sydney and Melbourne and more than 2,600 nationally. However, preliminary data from CoreLogic showed only 63.4% of homes sold under the hammer, down from 65.3% last week. This matches the early November clearance rate, which was the lowest recorded so far this year. Final clearance rates, which typically adjust downward as additional results are tallied, are expected to fall below 60% for the seventh consecutive week.

The slowdown in demand is evident in auction withdrawals. According to Ray White, Australia's largest real estate agency, 51% of Sydney vendors withdrew their homes from auction last week. Of these withdrawals 18% involved homes sold prior to auction as sellers opted for pre-auction offers to avoid the risk of no-shows. Nationally, 35% of Ray White's scheduled auctions were withdrawn. These figures show to us a challenging environment for sellers as the market adjusts to weaker buyer sentiment and rising interest rate pressures.

SQM Research forecasts a 5% decline in Sydney and Melbourne house prices next year as the Reserve Bank of Australia maintains higher interest rates for longer.

The Office market: Contact's analyst Rob Horne recently attended a tour of the REITs around Sydney with a focus on the office segment. His feedback from the day showed that Sydney's "Core Premium" office market is demonstrating strong fundamentals, with effective rents growing by 10% and incentives beginning to tighten. Demand is primarily driven by major legal, consulting, and banking tenants seeking high-quality, amenity-rich spaces. There continues to be limited supply in this space, with over 60% of new developments pre-committed through 2027, further bolstering confidence in this segment. Leasing activity in Core Premium is robust, supported by a "flight to quality." Developers face headwinds due to the economic rent gap for new builds, but the constrained supply pipeline is expected to support rents and stabilize the market.

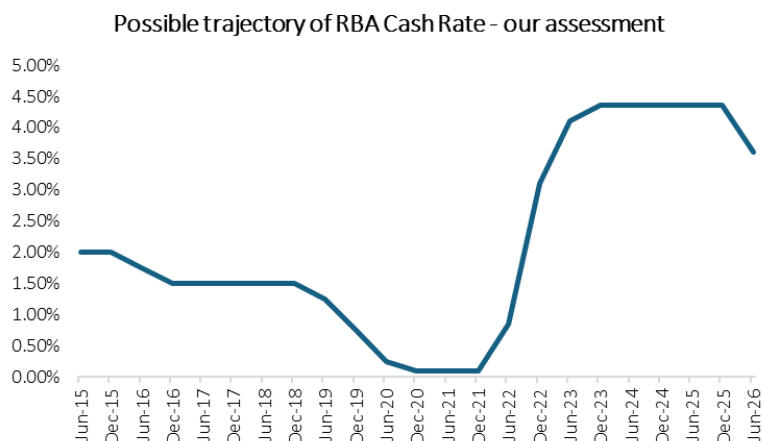
However, outside of the core premium segment, challenges persist. Sublease availability has decreased as tenants "right-size," yet vacancy rates remain high, with Sydney's Western Corridor at 30%. Melbourne continues to struggle with demand and oversupply, while Brisbane's "golden triangle" is seeing improvement. Global and domestic capital shows interest primarily in derisked Sydney assets, though capital deployment remains cautious. Sustainability is a key factor, with tenants increasingly prioritizing ESG-compliant buildings. Despite ongoing difficulties, market sentiment reflects optimism, with major players pointing to a gradual normalization of occupancy and stronger leasing conditions compared to last year.

Falling Interest Rates – we have started to see evidence that we are in this part of the cycle

As depicted above, several Central Banks globally have cut rates. The RBA in November reaffirmed its stance of maintaining the cash rate at 4.35%, signalling a "cautious" approach to monetary policy as it juggles persistently high inflation, full employment and an emerging two-speed economy. In its November 2024 statement, the central bank highlighted progress in bringing headline inflation down but emphasised that restrictive monetary settings would remain until there is clear evidence that inflation is moving toward its 2-3% target range.



The RBA outlined in February 2024 that they projected the cash rate will hold steady through mid-2024 before entering a period of gradual easing, potentially falling to 3.25% by mid-2026. Looking forward, we believe that the cash rate will now hold steady until mid-2025 before possibly entering a period of gradual easing, potentially falling three times to 3.60% by mid-2026.



Source: RBA, Contact Asset Management estimates

Predicting the cash rate and when it falls is obviously speculating and fraught with danger. However, the broader picture to us reveals deepening challenges for many Australians. Rising borrowing costs and stagnant wages have created an increasingly stark divide between the "haves" and "have-nots." As some demographics maintain resilience amid high asset values, yields, rental income and savings buffers, others are feeling the strain of significantly elevated living costs and reduced disposable income. This widening gap poses risks to the economy's long-term cohesion. While stability at the macro level (moving toward its 2-3% target range) may be on the horizon, governments face a growing obligation to address the disparities within the population, one that could hinder broader economic recovery and social wellbeing.

Rising Share Prices – we are in this part of the cycle

According to the investment clock, equity markets typically enter a period of appreciation following tighter global monetary policies, falling real estate values, and declining interest rates. However, in November 2024, global equities have continued to leap ahead of the cycle, buoyed by investor enthusiasm in the wake of Donald Trump's victory in the U.S presidential election. U.S indices, including the Dow Jones, S&P 500, and Nasdaq, reached record highs as markets priced in expectations of tax cuts, tariffs, and other pro-growth policies promised by the President-elect. This "Trump Trade" also fuelled a surge in the U.S dollar, a rally in Bitcoin, and a sell-off in U.S. bonds, as investors recalibrated their portfolios in anticipation of these shifts.

Momentum was not confined to the U.S, with key indices across Europe and Asia finishing November at or near record levels. Germany's DAX, the UK's FTSE 100, India's S&P BSE 100, and Japan's Nikkei 225 all surged, reflecting broad-based optimism in global equities. Closer to home, Australia's S&P/ASX 300 Accumulation Index also capped off an amazing period of performance, posting a 23.2% gain for the year ending 30 November 2024. Meanwhile, China's CSI 300 Index and Hong Kong's Hang Seng Index lagged, struggling to regain traction as investors await signs of confidence, clearer guidance, and upward momentum from these key markets. While global equities appear buoyant mixed performances between China and the rest of the world highlight to some extent the uneven sentiment in global markets.



Conclusion

While we remain optimistic on the long-term, valuations are certainly more stretched and the bountiful opportunities available in the pessimism of June 2023 are harder to find. The market's valuation (PE multiple approaching 20x) suggests that while it trades near record highs, it remains competitive compared to global benchmarks. Local investor sentiment has been buoyed by declining inflationary pressures and although delayed compared to earlier original forecasts, the continued anticipation of easing monetary policy.

Unfortunately, as we see a continued rally in the market, we also experience downward pressure on dividend yields - dividend payouts aren't keeping pace with share price appreciation. The Australian market yield is now below 3.2%. We have been actively investing the BKI portfolio to attempt to optimise dividend income as well as capital appreciation for our fellow shareholders.

We have been long-term investors at BKI for 21 years and are willing to be patient to seek opportunities. We expect periods of volatility in 2025. We will continue to focus on investing in quality companies. As it stands, the portfolio demonstrates a good mix of income and growth with much of the yield coming from those companies associated with Infrastructure or having hard assets.

Finally, we would like to wish all BKI shareholders and clients of Contact Asset Management a safe and enjoyable Christmas and New Year Period. We look forward to working with you and investing alongside you all again in 2025.

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