

Intelligent Investor Ethical Share Fund

Active ETF (ASX:INES)

Issued by
InvestSMART Funds
Management Limited
ACN 067 751 759
AFSL 246441

Managed by
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Holdings Pty Ltd
ACN 109 360 983
CAR 1255 838

ARSN 630 396 584
ASX Code: INES

“The most important thing in communication is hearing what isn’t said” — Peter Drucker

“The way to be safe is to never be secure” — Ben Franklin

“Being honest about the odds that your opinions and forecasts will actually come true can be so discouraging and uncomfortable that the warm blanket of denial and overoptimism becomes home to most people’s beliefs” — Morgan Housel

Until the last week of February the quarter was shaping yet another big win for the big banks and momentum. But, as we discussed last month, **Microsoft** boss Satya Nadella’s warning about overbuilding data centres for AI reminded investors that trees don’t grow to the sky.

Throw in fears around tariffs and a dim outlook from US consumers and the banks fell off their highs after reporting dreary results. But as they’re not resources stocks exposed to China, they’ve retained their safe harbour status unlike many growth darlings.

NextDC, for example, has fallen 38% from its high, and **Goodman Group** has fallen 26% after announcing a \$4bn capital raising to fund its massive data centre expansion. **Wisetec**’s share price has fallen 43% after founder Richard White seized control of the board and announced a profit downgrade.

Performance (after fees)

	1 mth	3 mth	1 yr	2 yrs	3 yrs	S.I. (p.a)
II Ethical Share Fund	-2.1%	0.8%	1.4%	9.1%	4.3%	9.3%
S&P ASX 200 Accumulation Index	-3.4%	-2.8%	2.8%	8.5%	5.6%	7.2%
Excess to Benchmark	1.3%	3.6%	-1.4%	0.6%	-1.3%	2.1%

Inception (S.I.): 11 Jun 2019

RIAA’s RI Certification Symbol signifies that a product or service offers an investment style that takes into account environmental, social, governance or ethical considerations. The Symbol also signifies that Intelligent Investor Australian Ethical Share Fund (ASX: INES) adheres to the strict operational and disclosure practices required under the Responsible Investment Certification Program for the category of Product. The Certification Symbol is a Registered Trademark of the Responsible Investment Association Australasia (RIAA). Detailed information about RIAA, the Symbol and Intelligent Investor Australian Ethical Share Fund (ASX: INES) methodology, performance and stock holdings can be found at www.responsiblereturns.com.au, together with details about other responsible investment products certified by RIAA.



Fund overview

The Intelligent Investor Australian Ethical Share Fund is an Active ETF designed for investors seeking a diversified selection of Australian and international companies that produce growing, sustainable profits at low risk of interruption from the increasing threats associated with Environmental, Social and Governance (ESG) factors.

 **5+ yrs**

Suggested investment timeframe

 **10 - 40**


Indicative number of securities

 **Risk profile: High**

Expected loss in 4 to 6 years out of every 20 years

 **S&P/ASX 200 Accumulation Index**

Benchmark

 **Investment fee**
0.97% p.a.

 **Performance fee**
Nil



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Plumbing company **Reece** has almost been cut in half and still looks expensive after a poor result reflecting higher interest rates and intense competition in the US. Ditto for **REA Group**, **Cochlear** and **Pro Medicus** which have fallen 15-30%, while four-wheel drives accessories manufacturer **ARB** is getting closer to a Buy after falling 30%.

These eminent names aren't offering value yet. But thanks to the falls and some good results discussed below, the fund had an excellent quarter showing how quickly things can turn when valuations matter.

Portfolio

We sold our subscale positions in **Audinate**, **Breville**, **Frontier Digital Ventures** and **Digico Infrastructure REIT** bought in the IPO, as we'd rather own parent company **HMC Capital** which earns fees from Digico without the massive investment outlays. We also sold modest positions in infrastructure stocks **Auckland Airport** and **Infratil** to increase our overseas exposure in cheaper stocks such as **Rightmove**.

Unusually, we bought and sold a modest position in **Alphabet** (parent of Google) after worrying its optically cheap valuation of 19x earnings won't compensate for the rapidly increasing threats to the profitability of its remarkable search business.

AI is moving incredibly fast, and a quick ring around the team showed virtually everyone is using alternative search options. A small group of value investing nerds is not a good subset for measuring the power of Google's advertising business, but Search has never faced the threats posed by AI.

It could remain a very profitable business yet make Alphabet a poor investment if its margins decline. It's highly unlikely Alphabet's existing businesses or new ones could ever replace search. The margins would be lower, and they'd require more investment. We've provided more detail in the appendix.

Fortunately, we were able to replace it with private equity giant **KKR**, whose share price had conveniently fallen 20%. KKR has a far more predictable future, albeit potentially a more cyclical one that will hopefully provide an opportunity to increase our position.

CME Group benefited from the market volatility recording a record annual result. The derivatives exchange operator also launched credit futures and its Google partnership is creating new data-driven revenue streams. Increasing US deficits are also increasing demand for hedging, helping support the company's fortress-like balance sheet and 4% dividend yield.

Allfunds' share price increased 5% after increasing annual revenue and net profit 16%. Yet the European wealth platform operator's share price is below what we paid two years ago. The company launched an intelligent €250m buyback and raised the full-year dividend to 13 cents. At just 12 times earnings, the company should be a huge beneficiary of investment flows from the US to Europe.

MA Financial had almost doubled over the past year before dropping 20% despite profits poised to double over the next three years.

RPM Global announced a solid result and the sale of its consulting business for a good price making it a more attractive takeover target. The proceeds will be returned to shareholders.

Eagers Automotive also beat expectations due to the popularity of electric BYD vehicles, triggering a 20% share price rise. The share price has increased ~50% since last year's purchase and it was an excellent result in a tough market that has hammered its smaller rivals, yet it remains heavily shorted.

New Zealand fibre network company **Chorus** increased its dividend by 10% despite reporting a soft result as customers choose cheaper broadband plans during recession. We're happy owning a virtual monopoly trading on a sustainable ~6% dividend yield with some growth when New Zealand's economy should improve with lower interest rates. **Telstra** also increased its dividend and finally offers some decent, albeit low, growth.

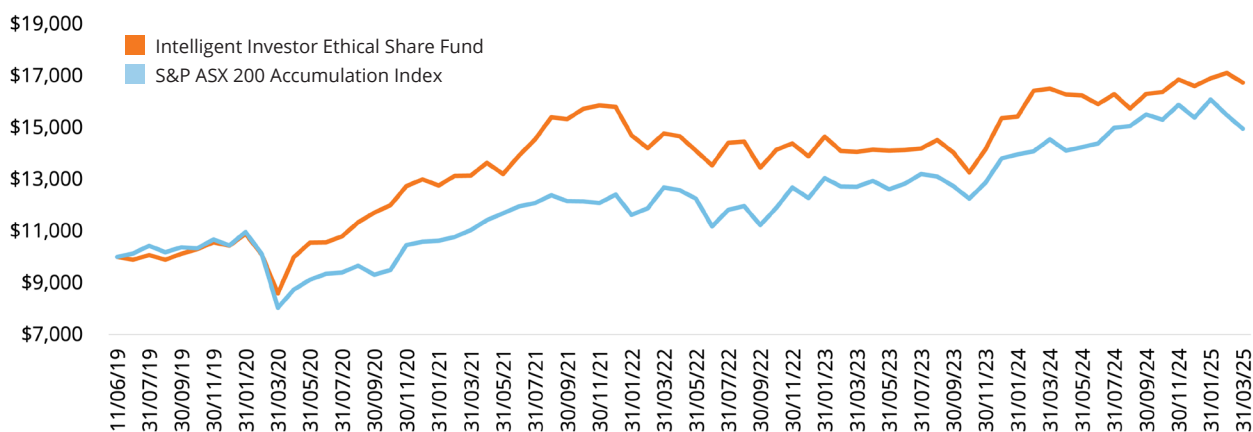
If history repeats, avoiding the market darlings will blow a tailwind lasting years. As their price-to-earnings ratios deflate, unpopular companies that can steadily increase profit and dividends, join or rejoin the major indexes and potentially become takeover targets as corporate activity increases, have a huge amount of outperformance to reclaim.

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Please get in touch if you have any questions

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Performance since inception



Inception (S.I.): 11 Jun 2019

Asset allocation

Financials	32.07%
Communication Services	21.29%
Information Technology	15.39%
Health Care	14.79%
Consumer Discretionary	7.67%
Cash	7.65%
Materials	1.14%

Top 5 holdings

Visa (V.NYS)	6.6%
Fairfax Financial Holdings (FFH.TSX)	6.4%
CME Group (CME.NAS)	5.9%
CSL (CSL)	5.6%
Rightmove PLC (RMV.LSE)	5.3%

Fund Stats

Distribution yield	4.20%
Net asset value	\$3.43

Important information

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All tables and chart data is correct as at 31 March 2025

Appendix

Alphabet faces its Uber moment

Before an early flight or after a late night out, taxis were the transport mode of choice. Assuming the cab turned up, passengers were often greeted by a pungent smell, Alan Jones, a slow route home and a scrabble for change.

This experience was normalised until Uber's arrival forced passengers to confront their misery. The Uber app made it immediately clear. Here was an easier, faster, safer, cheaper, more reliable way to get about.

Taxis had become a sector run not for the benefit of passengers or cabbies but the owners of the licences, which had become an asset class all of their own. Uber proceeded to smash their investment thesis. Now Alphabet, owner of a near global monopoly in search, faces its Uber moment.

In *The Innovator's Dilemma*, Harvard Professor Clayton Christensen proposes a framework to understand why successful companies struggle to adopt disruptive technologies that threaten their core business. Think Blockbuster versus Netflix, Spotify versus record stores and Fairfax Media versus REA.

It's important to understand that the dilemma is faced by the incumbent, not the many smaller companies chipping away at its market share.

Blockbuster became the largest video chain store on the planet. Responding to the disruptive technology of streaming entailed cannibalising the substantial profits late rental fees delivered. Instead, it decided against buying the company, failed to pivot when Netflix launched a streaming service in 2007, and entered bankruptcy in 2013.

Disruptive innovation

Christensen's model describes how disruptive innovation incrementally kills market leaders; the only way to compete with an upstart technology is to copy it, with no guarantees of success, often whilst suffering an accelerating decline of the incumbent, profitable business.

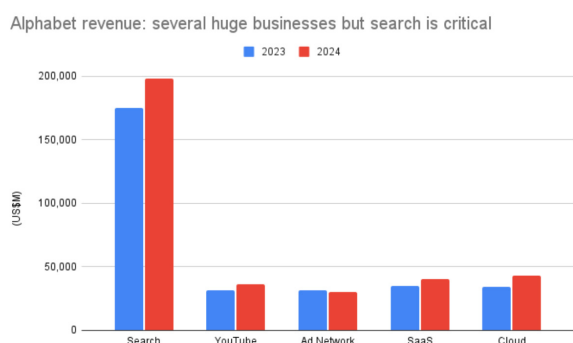
Let's step through the nature of Alphabet's innovator's dilemma.

Alphabet has several business segments. Advertising generates about 75% of revenue, the bulk of which comes from search, but also YouTube and its ad marketplace.

Google Cloud, a competitor to Amazon Web Services (AWS) and Microsoft Azure, the company's cloud computing platform, delivers about 12% of revenue and 5% of profit. Several businesses, including moonshots like self-driving technology, are loss making.

The company doesn't break out the profit contributions of its businesses like Gmail, Google Docs or YouTube, but search is believed to contribute as much as 80-90% of profit.

From an investment perspective, we can ignore almost everything other than search for the reasons shown in Chart 1. If this business were to be disrupted, the investment case would break down as it did with taxis.

Chart 1: Reliance on Search Revenues

Source: Company accounts

Given this dependence on search, a second issue arises—is the company willing to cannibalise the profits it makes in order to avoid disruption?

This remains an open question. With DeepMind and Gemini, Google long led the field in AI research. Indeed, as noted in our special report *The New Great Game: Machines, Empires, and AI*, in 2017 the company produced the breakthrough Transformer model, since seen as AI's great leap forward.

The fact that it has been superseded by the likes of Open AI, DeepSeek and Perplexity points to the problem. Despite leading technology, the company does not lead the field in products. Instead, a raft of new competitors are fighting for market share.

Table 1: AI Products by Monthly Active Users (Estimated, Circa 2025 - sources: company announcements, DeepSeek, Grok)

AI Product	Monthly Active Users (M)	Owner
MetaAI	500	Meta
ChatGPT	400	OpenAI
Gemini	300	Alphabet
Apple Intelligence	250	Apple
Ernie	200	Baidu
CoPilot	150	Microsoft
Doubao	150	Bytedance
DeepSeek	80	DeepSeek (open source)
Qwen	50	Alibaba (open source)
LLaMA	40	Meta (open source)
Claude	22	Anthropic
Grok	50	xAI
Hunyuan	20	Tencent
Alexa	15	Amazon

Two years ago, Google search didn't have much in the way of competition in western markets. Its product was the undisputed champion of finding information. Now it is a laggard. Despite 300m Gemini users, Google faces a fearsome horde of tech competitors invading its critical business.

Without any marketing, DeepSeek overtook TikTok and Instagram to become the US's most downloaded app for several days. It's hard to think of a faster collapse in the barrier-to-entry in the history of technology. Networks usually have a tipping point. When they reach critical scale, users tend to migrate en masse, with Uber a prime example.

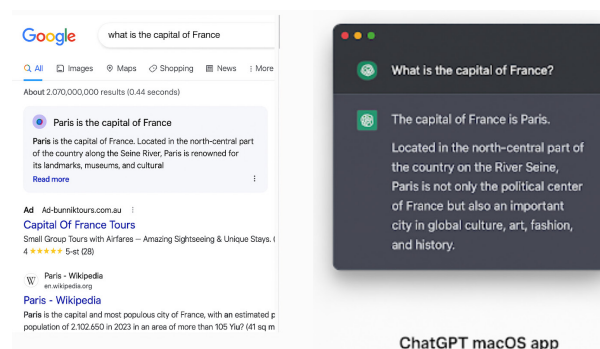
Not only that, the pace of development is breathtaking and costs are tumbling. In just five years, the cost of building a custom AI model has fallen from tens of millions of dollars to a few thousands. A conversation with an AI is up to 100 times cheaper to run than a Google search.

Dilemma writ large

Google employees saw the threat coming. In 2021, reports Bloomberg, Google's web search team proposed a chatbot where visitors could ask questions directly rather than serving the typical list of links. According to a former employee involved in the conversations, management was unimpressed. 'It was self-regulation. People just weren't daring to think the thoughts,' said the former employee.

This is the innovator's dilemma writ large. Providing a better user experience to Google users would have entailed fewer opportunities to sell ads. Understandably, Google wasn't willing to consider cannibalising its search business. Instead, it took the path of least resistance, incorporating Gemini into its typical results page. The image below shows how this is working out.

Image 1: Query response ChatGPT v Google



Source: ChatGPT. Google.

Google's page rank system delivered superior search results and its simplistic, user orientated, search page encouraged repeat visits. Note the similarities in the ChatGPT interface above with the current Google search page.

The problem is in the results rather than the queries. The more that Google's Gemini product improves and is incorporated into ever more searches, the more Google weakens its core product as users learn new ways of doing things.

Google's search management team wasn't wrong— a chatbot is a better user experience— but every improvement risks the revenue that made the company successful in the first place.

Last year we called the company 'a profoundly good business trading at a sensible price'. Since then, competition has emerged at an unimaginable pace.

Google will probably survive the innovator's dilemma. It is laden with AI talent, has money to burn and a vast ecosystem of four billion users. The company has successfully pivoted before, from desktop search domination, for example, to mobile, and is integrating AI results with search advertising.

Not life threatening

It is also the owner of probably the deepest data lakes on the planet. That and long-established user habits mean it is far from death's door. If Gemini is good enough and ads can be integrated, today's price might be a bargain. But why take the risk?

Google already takes 40 cents of every digital advertising dollar spent, and credible rivals like Meta, Amazon and TikTok are all fighting for market share. Google's moat isn't growing; it's shrinking.

Even with generous valuation multiples applied to YouTube and Cloud, search still needs to account for about a trillion dollars of Alphabet's US\$2tn market cap. (Moonshots like quantum computing and self-driving software have dollar potential but it's tough finding a trillion of them.)

In 2024, search likely contributed around US\$100bn in profit. Applying a multiple of ten doesn't seem a stretch, until one considers what happened to taxis.

In 2011, Uber entered the New York taxi market, the same year a taxi medallion—a license to operate—sold for US\$1m. Three years later, the average New York medallion was still worth US\$1m but the number of Uber drivers had reached 10,000. This was a tipping point.

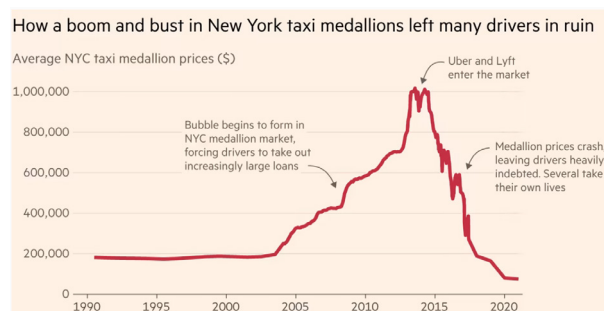
New York still has plenty of taxis but the value of licences has crashed. Companies, like taxis, can survive the innovator's dilemma but a lot of capital can be lost in the process.

With its leading models and technical and financial resources, Alphabet could compete for users with the likes of OpenAI and Perplexity. What it likely cannot do is maintain the astonishing margins in its search business while doing so.

In 2005, US newspapers made a combined US\$49bn in revenue from advertising. By 2016, that figure had fallen to US\$18bn. Alphabet and Facebook, meanwhile, booked combined advertising revenue of US\$106bn.

Alphabet's search business is one of the world's best. But AI is now threatening to do to Google search what Google did to newspapers. This is the opposite of Buffett's one-foot hurdles and handicapping the future of technology businesses means jumping at shadows. But the cost of being wrong is mitigated by the number of high quality, more predictable businesses listed overseas.

Chart 2: The Uber moment



Source: Financial Times