

Intelligent Investor Australian **Equity** **Growth** Fund (Managed Fund) (ASX:IIGF)

“Nowhere does history indulge in repetitions so often or so uniformly as in Wall Street. When you read contemporary accounts of booms or panics the one thing that strikes you most forcibly is how little either stock speculation or stock speculators today differ from yesterday. The game does not change and neither does human nature.” — Edwin Lefèvre

The fund fell 2.2% in August compared to the market’s nominal gain due to falling commodity prices. Like Warren Buffett, who has been selling his huge stake in **Apple** and buying oil producer **Occidental Petroleum**, we’ve been cashing in some big winners for cheap owner-operated resources and midcap stocks while reintroducing some staples.

Chart 6: Secular bull market in commodities just getting started

Commodities index 10-year annualized returns



Source: BofA Global Investment Strategy, Bloomberg, GFD Finaeon

BofA GLOBAL RESEARCH

Performance (after fees)

	1 mth	1 yr	2 yrs	3 yrs	S.I. p.a
II Australian Equity Growth Fund	-2.2%	7.8%	3.4%	4.0%	11.0%
S&P ASX 200 Accumulation Index	0.5%	14.9%	12.2%	6.7%	12.5%
Excess to Benchmark	-2.7%	-7.1%	-8.8%	-2.7%	-1.5%

Inception (S.I.): 5 October 2020



Fund overview

The Intelligent Investor Australian Equity Growth Fund is a concentrated portfolio of 10 - 35 Australian-listed stocks. The Portfolio invests in a mix of large, mid and small cap stocks, focusing on highly profitable industry leaders that have long-term opportunities to reinvest profits at high rates of return.

5+ yrs

Suggested investment timeframe

10 - 35

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

We'll discuss the changes and reporting season in the quarterly report, but this month let's quickly examine the recent cost of not owning the banks.

The difference between owning our select group of resources stocks and not owning the banks over the past 10 months has cost ~16%, shaving over 4% per year since inception of the fund.

The number increases if you include other big index contributors such as **Goodman Group**, whose valuation includes \$50b for data centres that will take years to build. Unlike the banks, though, we should've bought Goodman in 2020.

We'll regain 10% when bank share prices fall back to fair value and more if other current market darlings sporting divine valuations fall back to earth. Bubbly valuations, falling profits, increased competition, high IT spending and lower interest rates have condemned bank investors to another dismal decade.

Sensible hedging and pragmatism

Value investing requires taking contrarian positions, yet one of the first practical changes I made when I returned to the business in 2018 was having a cornerstone holding in **BHP**.

It's not the type of business we normally look for. It's highly cyclical, has historically blown up shareholder money with dumb acquisitions, doesn't have high insider ownership and is usually fairly valued by the army of analyst's following its every move.

But as a huge dividend payer and given the huge impact the three iron ore majors can have on the index, such as early 2019, it helps smooth our returns vis-à-vis the index and the fund's distributions.

I considered doing the same with the banks, but who would've thought they'd trade at record valuations with stagnant profits? The long-term outlook was grim, competition was increasing, valuations were too high and there were far

better opportunities.

That's why the fund outperformed the market by over 30% between 2019 and 2022. **Pinnacle Investments** was increasing dividends 50% a year, for example, and its shares increased eight-fold from the bottom of the short-lived Covid bear market. **Whitehaven Coal** was similar after coal prices skyrocketed in 2022.

Not owning banks has paid off handsomely until recently, but their recent gains are temporary. Trees don't grow to the sky, bubbly valuations never last, and they're not tech stocks that can surprise with huge growth. They're easy to value, there's no growth and they need to fall at least 30% to approach fair value. Even that's being generous.

While the banks have foiled our recent performance, their falls will become a tailwind again soon enough.

A contrarian alternative

In contrast, our handful of owner-operated resources holdings comprising **Mineral Resources**, coal companies **Newhope** and **Whitehaven** and recent inclusion **Karoon Energy** could double or more.

Mineral Resources potentially trades on a price-to-earnings ratio (PER) of six in the medium term and Karoon currently trades on a free cashflow multiple of nearly 25% with dividends increasing rapidly after the board recently yielded to activist shareholders prompting our purchase.

In addition to the major banks and our resources stocks reverting to average valuations, we'll discuss the third pillar of potential outperformance – our midcap holdings – in the quarterly report.

Two examples are **Aussie Broadband**, which trades at nearly a quarter of what our past similar, largest holding, Uniti Wireless, was acquired for in

2022, and **MA Financial**.

MA Financial is finally showing signs of life after its recent result. It's potentially trading on 10x 2026 earnings, which makes little sense if its profits increase over 50% while **Commonwealth Bank** trades on a PER of 24 despite falling profits. Higher than two of the world's greatest financial creations, **Alphabet** and **Visa**.

The situation couldn't be clearer. With valuations for the most popular stocks the highest of my career, it's time for contrarians to zag.

Two stocks, two very different situations

Now, let's quickly analyse **RPM Global** and Mineral Resources, which produced most of the fund's monthly fall.

RPM Global's share price has risen rapidly over the past year and no doubt attracted its share of momentum investors, which fled recently when the company announced a tiny profit downgrade for 2024. The company has since announced 2025 expectations showing every metric heading in the right direction.

Falls like this are part and parcel of owning highly valued stocks, but with \$160m in pre-contracted revenue – more than double the company's current annual revenue and nearly four times its subscriptions revenue – profits should grow consistently with Global Framework Agreements recently signed with three of the world's largest mining companies making future sales easier and faster.

The company's finances are in rude health and buying back shares at lower prices will add more value until a likely takeover that would be at least 50% above the current share price based on similar industry multiples. More if the company continues growing sales quickly, helped by recent software releases XECUTE and to a lesser extent ShiftManager.

In short, nothing has changed.

In contrast, the iron ore price breaching US\$100 triggered the recent painful slide in Mineral Resources' share price after falling lithium prices had already halved the stock. We considered cashing in when the share price neared \$100 but we aim to be long term shareholders and drastically underestimated the lithium price collapse.

In addition to falling iron ore and lithium prices, high debt from its massive investment in the low-cost Mt Onslow iron ore mine that will transform the company's profitability next year has created panic, fuelling the short sellers. But the company's iron ore business makes good money at US\$80 and breaks even at US\$40.

The jewel remains the Mining Services division, which earns excellent, consistent returns based on iron ore volumes rather than prices. Its current operating earnings of \$550m could exceed \$1bn in just two years with plenty of growth to come and the company has other assets it could sell if desperately needed. Unfortunately, we can't buy more shares as we already have a full position.

In two years, the Mining Services division alone should put the stock on an EV/EBITDA ratio of 11, which still undervalues the division given it has contracts that are decades long and for 'life-of-mine'.

It's essentially a high growth, highly predictable infrastructure business that investors normally drool over valued as a highly cyclical resources business with no control over its prices, which means you get the lithium, iron ore and potential gas export business for free.

In similar situations, Australian companies are forced by their bankers to raise capital. But the company's intelligently arranged US borrowings have no covenants, fixed interest rates and provide nearly three years for Mt Onslow to maximise production and reduce debt.

There are no free lunches in the stock market, and the price for potentially making three times our money from here or more is enduring falling lithium and iron ore prices while the

market is rewarding less-cyclical businesses with increasingly dangerous valuations.

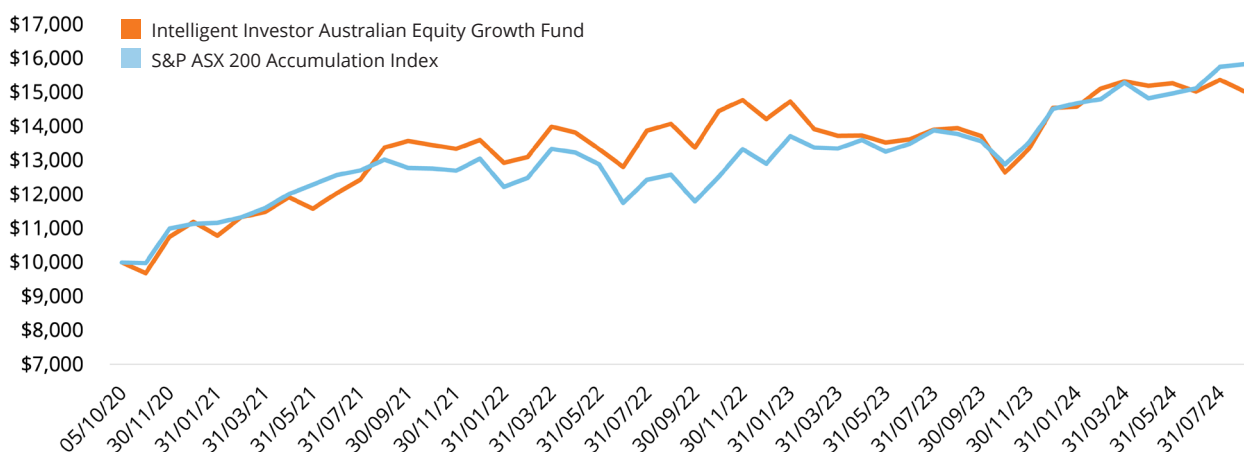
Even if we're only half right on Mineral Resources and our other key holdings the potential rewards are large, and it's much better waiting for your shares to increase than fall. The timing, however, remains as hazy as ever.

Please get in touch if you have any questions

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Performance since inception



Asset allocation

Health Care	17.1%
Materials	14.3%
Cash	14.0%
Information Technology	13.8%
Consumer Discretionary	11.8%
Consumer Staples	6.8%
Financials	5.0%
Energy	4.9%
Utilities	4.0%
Industrials	3.8%
Communication Services	3.5%
Real Estate	0.9%

Top 5 holdings

RPMGlobal (RUL)	8.3%
CSL (CSL)	7.3%
ResMed (RMD)	6.2%
New Hope Corporation (NHC)	5.4%
MA Financial	5.0%

Fund Stats

Distribution yield	1.12%
Net asset value	\$2.98

Important information

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All tables and chart data is correct as at 31 August 2024