

# FIRETRAIL ABSOLUTE RETURN FUND

MONTHLY REPORT | JANUARY 2024

## PERFORMANCE (AFTER FEES)<sup>1</sup>

	Month	Quarter	1 Year	3 Years p.a.	5 Years p.a.	Fund inception p.a. <sup>3</sup>	7 Years p.a.	Strategy inception p.a. <sup>5</sup>
Fund <sup>2</sup>	(4.95%)	(7.27%)	(0.85%)	(6.33%)	0.85%	0.42%	-	-
Strategy composite <sup>4</sup>	(4.95%)	(7.27%)	(0.85%)	(6.33%)	0.85%	-	1.88%	6.15%
Benchmark	0.36%	1.07%	3.98%	1.86%	1.39%	1.40%	1.41%	1.48%
Excess Return	<b>-5.31%</b>	<b>-8.34%</b>	<b>-4.83%</b>	<b>-8.18%</b>	<b>-0.54%</b>	<b>-0.99%</b>	<b>+0.47%</b>	<b>+4.67%</b>

1. Past performance is not a reliable indicator of future performance.

## ABOUT FIRETRAIL

Firetrail is an investment management boutique which is majority owned by the Firetrail investment team. Additionally, the investment team is invested alongside clients in the investment strategies.

## ABSOLUTE RETURN FUND

The Absolute Return Fund ("Fund") is a market neutral strategy with minimal correlation to equity market direction. It aims to generate positive returns in all market environments. The strategy is built on fundamental, deep dive research guided by the philosophy that 'every company has a price'.

## INVESTMENT OBJECTIVE

The Fund aims to outperform the RBA Cash Rate over the medium to long term (after fees).

## PORTFOLIO POSITIONING – 31 JAN 2024

Top 3 Overweight Holdings (Alphabetical)
CSL Ltd
Newmont Corp
ResMed Inc

## FUND DETAILS

Unit Prices	31 January 2024
Application Price	\$1.0074
Redemption Price	\$1.0004
NAV Price	\$1.0039
Fund Details	
APIR Code	WHT5134AU
Benchmark	RBA Cash Rate
Inception Date	14 March 2018
Risk/Return Profile	High
Fund Size	\$206mil
Management Fee*	1.28% p.a.
Performance Fee*	20% of outperformance above an annual Hurdle

\*Please read the Product Disclosure Statement for more details

## FUND EXPOSURE – 31 JAN 2024

	Portfolio Exposure
Long Equity	163.5%
Short Equity	-164.0%
Net Equity Exposure	-0.5%

Past performance is not a reliable indicator of future performance.

The Product Disclosure Statement ('PDS') and Target Market Determination ('TMD') of the Fund are available at <https://firetrail.com/firetrail-absolute-return-fund/>.

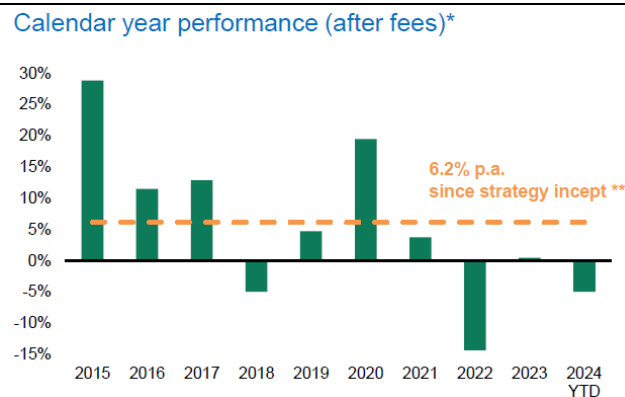
2. Firetrail Absolute Return Fund ('Fund'). Net Fund returns are calculated based on exit price with distributions reinvested, after ongoing fees and expenses but excluding taxation. 3. Fund inception is 14 March 2018. 4. The Fund has been operating since 14 March 2018. To give a longer-term view of our performance for this asset class, we have also shown returns for the Firetrail Absolute Return Strategy Composite ('Strategy') which has been operating since 30 June 2015. Strategy performance has been calculated using the monthly returns (after fees) of the Fund from 14 March 2018 to current date, as well as the monthly returns of the Macquarie Pure Alpha Fund (after fees) between 30 June 2015 to 23 November 2017. The Fund employs the same strategy as was used by the same investment team that managed the Macquarie Pure Alpha Fund as at 23 November 2017. Firetrail has records that document and support the performance achieved as the Macquarie Pure Alpha Fund. The composite returns for the Strategy and the RBA Cash Rate (Benchmark) exclude returns between 24 November 2017 and 13 March 2018. During this period the investment team did not manage the Strategy. As such, the annualised performance periods stated are inclusive of the combined composite monthly returns, and do not include the period when the team were not managing the Strategy. For example, the annualised return over 3 years for the Strategy and benchmark are inclusive of 36 monthly performance periods available in the composite return period, excluding the period between 23 November 2017 and 13 March 2018. For additional information regarding the performance please contact us through the link on our website. Net Fund returns are in AUD terms. Net Fund returns are calculated based on exit price with distributions reinvested, after ongoing fees and expenses but excluding taxation. Past performance is for illustrative purposes only and is not indicative of future performance. 5. Strategy inception 30 June 2015.

## PORTFOLIO COMMENTARY

The Fund returned negative 4.95% (after fees) for the month ending 31 January 2024, underperforming the RBA Cash Rate by 5.31%.

Fund performance has not been up to our standards in the past 24 months. The underperformance has been driven by 1) our net long exposure to small companies in 2022, and 2) short-term headwinds impacting a number of positions at once in the last 6 months (such as ResMed, Incitec Pivot and Domino's).

**Figure 1: Performance has been disappointing in the past 24 months. We are determined to return the Fund to historical levels of outperformance**



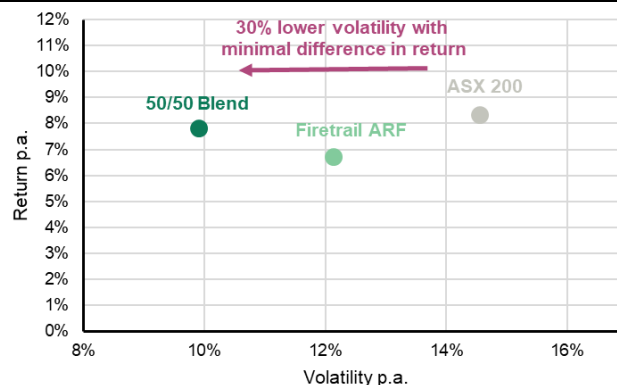
Source: Firetrail, January 2024. Past performance is not a guarantee of future returns

While recent performance has been disappointing, we remain confident that we can return performance to historical levels. There have been no changes to the investment team or the investment process which delivered substantial outperformance in the years prior to 2022. In fact, the team has been strengthened with the additions of Dean Fremder and Matthew Thomson in January 2024. Dean and Matthew bring substantial hedge fund investment experience and are proven alpha generators on both the long and the short side.

In addition, the short-term underperformance of some positions in the last 6 months has presented opportunities to increase high conviction positions at highly attractive prices. We retain high conviction in the current portfolio to outperform over the coming years.

The Fund is designed to provide both portfolio protection during equity market drawdowns and reduce overall equity portfolio volatility without sacrificing returns. Figure 2 below highlights how blending the Firetrail Absolute Return Fund with the ASX 200 (Australian equity market exposure) has reduced overall portfolio volatility by over 30%, with a minimal impact on the long run average return (after fees, since Strategy inception<sup>1</sup>).

**Figure 2: The Firetrail Absolute Return Fund provides material diversification benefits when blended with ASX 200**

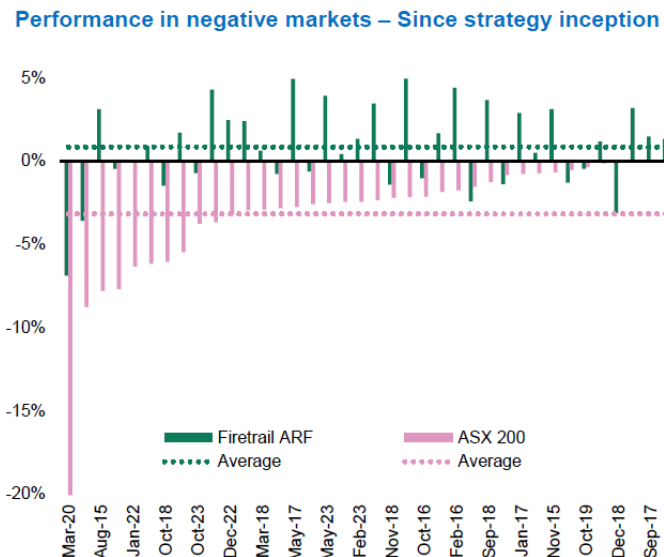


Source: Firetrail, Factset, January 2024. Since Strategy inception<sup>1</sup>  
Past performance is not a guarantee of future returns.

<sup>1</sup> Strategy inception was 1 July 2015

The Fund continues to provide diversification from negative monthly equity market returns. Since inception, the Fund has delivered a positive return in 63% of months where the ASX 200 return was negative. On average, the Fund delivered a positive return of +0.84% (after fees) in negative ASX 200 months, versus the average ASX 200 return of -3.18% in these months. In 2023, the Fund delivered a positive return in 4 of 6 negative ASX 200 months.

**Figure 3: Firetrail Absolute Return Fund performance (after fees) in negative markets since inception. The Fund has delivered a positive return in 63% of negative ASX 200 months**



Source: Firetrail, January 2024

*Past performance is not a guarantee of future returns.*

Key contributors to Fund performance in the month of January 2024 are detailed below:

## CONTRIBUTORS TO RETURNS

Positive contributors included Boss Energy, ResMed and Sigma Healthcare. Negative contributors included Lynas Rare Earths, Domino's Pizza and Newmont. We discuss each further in our commentary below.

### POSITIVE CONTRIBUTORS

#### Boss Energy

Uranium project developer Boss Energy's shares rose in January as the uranium price reached the highest level since 2007 at US\$105/lb. We expect the uranium price to stay elevated over the next few years. The demand outlook is strong, with increasing recognition that nuclear power is essential to meet the world's decarbonisation ambitions. At the same time, supply is constrained with few large uranium deposits currently in development.

#### ResMed

ResMed shares outperformed as the company delivered another strong quarter of sales and began to show a more meaningful improvement in gross margins. Current elevated market share in the US is now also looking more sustainable as major competitor Philips confirmed it was exiting certain product lines. Philips will not start selling its continuous positive airway pressure (CPAP) devices to new patients until it has satisfied a roadmap of requirements set out by the FDA. At a broker conference, ResMed also revealed some data that suggested GLP-1s like Ozempic and Wegovy may actually result in increased use of CPAP devices for some patients.

#### Sigma Healthcare

Pharmacy network provider Sigma Healthcare outperformed in January. No stock specific news was released during the month. In December last year, Sigma announced its plans to merge with Chemist Warehouse Group to create a leading healthcare wholesaler, distributor, and retail pharmacy franchisor. The Chemist Warehouse group currently has 549 stores across Australia and holds 25% market share of the national retail pharmacy market. Concurrent with the proposed merger, the company announced a \$400m equity raise to fund increased working capital requirements and progress other business initiatives. Contingent on ACCC approval, the transaction is expected to close in the second half of 2024.

## NEGATIVE CONTRIBUTORS

### Lynas Rare Earths

Lynas shares underperformed as the price of its main rare earth product, NdPr, remained under pressure. While this is negative for Lynas' short-term earnings, it could be positive for longer-term supply/demand dynamics if it results in the delay or cancellation of new projects from competitors Iluka Resources and Arafura Rare Earths due to poor economics.

### Domino's Pizza

Domino's disappointed the market with an update on H1 FY2024 profitability. While the business has seen promising turnarounds in Australia and Germany, franchisees in France and Japan continue to struggle with minimal sales growth and stubborn inflation. The CEO attributed the majority of the disappointment to management execution. As such, we are looking for a rethought and reinvigorated approach to dealing with problematic markets over the next few months, particularly Japan.

### Newmont

Newmont shares underperformed as Barrick Gold reported disappointing production and cost guidance for two assets that are co-owned with Newmont. These two projects, The Nevada Gold Mines and Pueblo Viejo, account for 20% of Newmont production and have not been immune from cost issues that have plagued the gold sector.

## PORTFOLIO POSITIONING

The Firetrail Absolute Return Fund is a market neutral portfolio (long/short) with zero net market exposure and beta (+/- 0.1) to ensure Fund performance is uncorrelated to the equity market. The Fund is driven by our best long and short ideas.

### The long portfolio can be summarised as:

- 163.5% long exposure across 60-80 stocks with upside based on our medium term earnings forecasts
- Overweights include:
  - Energy companies exposed to commodities where supply is constrained in the medium term, such as Santos and Incitec Pivot.
  - Commodity companies exposed to decarbonisation such as Mineral Resources, NextGen Energy and Lynas Rare Earths with attractive cost positions and strong growth outlooks.
  - Market leaders including CSL, ResMed, and James Hardie who are well placed to strengthen their competitive position through the cycle.
  - Financials with leverage to a higher interest rates environment and better industry outlook including QBE Insurance, Medibank Private and Suncorp.
  - Undervalued companies with quality attributes including Treasury Wine Estates and Domino's Pizza.

### The short portfolio can be summarised as:

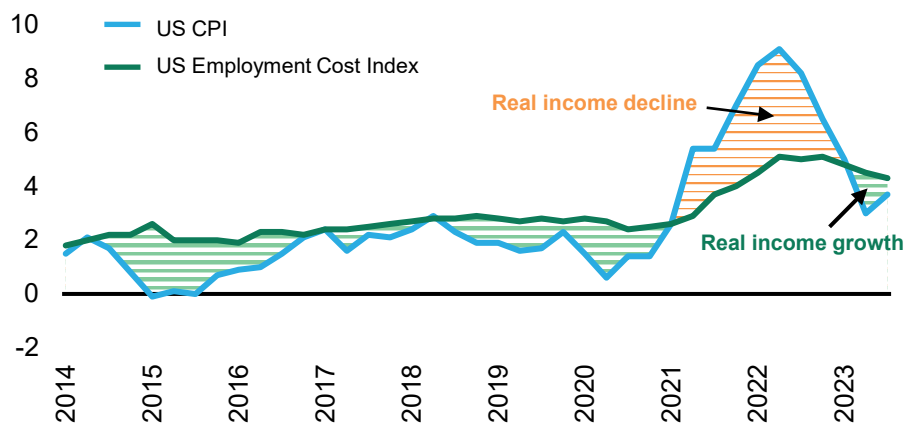
- 164% short exposure across a diversified portfolio of earnings shorts and risk-reducing shorts
- Earnings shorts aim to profit from companies that downgrade near term earnings. We see select opportunities to benefit as companies deal with an environment of rising costs and easing demand at a time of near peak margins.
- Risk reducing shorts offset equity market exposure and control portfolio risk such as style, size, sector and thematic biases to ensure returns are driven by stock specific factors.
- The short portfolio is overweight banks, and bond proxies where we see increasing near term earnings risks.

## ONE INTERESTING THING THAT HAPPENED THIS MONTH...

Expectations for US economic growth have been revised, demonstrating an optimistic outlook for the economy and the strong potential to see the “soft-landing” narrative play out. The successful management of inflation has seen the US Consumer Price Index (CPI) rapidly fall since the high levels experienced after the reopening boom post-pandemic.

Despite falling CPI, wage growth has remained strong and US households are starting to generate real income gains as seen in the US employment cost index below. Increased real income will support consumption, and thereby support US economic growth as consumption represents about 68% of GDP. Prospects for small and medium-sized companies have improved compared to the recessionary expectations from early last year, while growth continues in mega-caps like the Magnificent Seven. As a result, we expect to see the market breadth begin to widen in global equities, particularly in the S&P 500.

**Figure 4: Healthy wage growth and lower inflation means US households are starting to see real income gains (% change, year on year)**



Source: Goldman Sachs, Bloomberg, Firetrail, January 2024

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Links to the Product Disclosure Statement: [WHT5134AU](#)

Links to the Target Market Determination: [WHT5134AU](#)

For historic TMD's please contact Pinnacle client service Phone 1300 010 311 or Email [service@pinnacleinvestment.com](mailto:service@pinnacleinvestment.com)

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