Cerutty Macro

Cerutty Macro Fund is an independent active manager of global, but predominantly Australian equities. The Manager applies a detailed investment process, using identified macroeconomic trends as the foundation of its allocation. Coupled with analysis of the liquidity cycle and bottom-up research, we aim to deliver attractive returns to investors over a 3-year time horizon.

The Fund's portfolio is a high conviction portfolio ranging from 15-40 positions in equities, to scale between high/low concentration allocations depending on liquidity conditions. It is the Fund's perspective that financial market liquidity has a large impact on asset prices, thus it being a vital component to the investment process. Cerutty's investment process is:

- Macro Themes
- Liquidity Cycle
- Bottom-up

Fund Performance

	Fund %	Index %	Excess %
1 Month	4.01%	7.04%	-3.02%
3 Month	-1.87%	-2.88%	1.01%
1 Year			
Since Inception - 1 June 2023	3.11%	-0.73%	3.84%

Fund Overview

Portfolio Management	Chris Judd
No. Investments	15-40
Type of Investments	Long only Australian listed equities Global listed equities
Time Horizon	3+ years

Past performance is no indication of future performance & returns are post fees with reinvestment of distributions and capital gains.

Monthly Update

In November, the financial markets experienced a notable surge, with the S&P 500 delivering impressive returns of 8.9%, while the Nasdaq displayed positive gains of 10.7%. Closer to home, the ASX Small Ordinaries Accumulation Index saw a return of 7.04%, while the Cerutty Macro Fund managed to secure a gain of 4.01%.

This remarkable performance in the US markets was largely attributed to growing optimism that the Federal Reserve might not only pause, but potentially decrease interest rates over the next 3-5 months. This sentiment was reinforced in a speech delivered by Christopher Waller on November 28th in Washington, D.C. He expressed the following viewpoint: *"Although I am encouraged by early indications of economic moderation in the fourth quarter, based on the available data, inflation remains persistently high. It is too premature to determine if the deceleration we are observing will be sustained. However, I am becoming increasingly confident that our current policy stance is well-positioned to steer the economy towards a slower pace and eventually bring inflation back to the desired 2 percent target."*

Waller went on to acknowledge the possibility of the Fed lowering interest rates if inflation continues to ease in the coming three to five months. He stressed that such a move aligns with established policy rules and isn't an attempt to rescue the economy. Waller's comments carried substantial weight as his views have historically closely mirrored those of Fed Chair Jerome Powell[1] (Danielle DiMartino Booth, 2022).

Furthermore, Powell addressed the issue during a discussion at Spelman College on December 1st and chose not to retract Waller's statements[2]. While he cautioned against prematurely concluding that a sufficiently restrictive monetary stance had been reached, he also hinted at the possibility of policy easing in the future. The market interpreted these remarks as a signal that the Fed is done with rate hikes and may even consider rate cuts within the next 3 to 5 months.

There have been other cues in the market that an easing of liquidity conditions may be on the way. The price action of Gold which reached a new all time high of US$2,150 in early December and Bitcoin which at the time of writing this is up over 160% year to date in USD terms. We view Gold and Bitcoin as offering investors potential protection against monetary inflation, not necessariliy CPI inflation where we feel oil or other growth commodities offer better protection. This nuance sometimes gets missed by market participants and has left some frustrated by the way Gold and Bitcoin performed during the markets recent inflationary episode. When analysed in conjunction with Waller and Powell’s comments, we see a possibility that the relatively tight monetary policy of recent times may soon give way to looser monetary policy as the US jobs market starts to come under pressure and inflation continues to cool.

1 Danielle DiMartino Booth [@DiMartinoBooth]. (2022, November 14) https://twitter.com/DiMartinoBooth/status/1591913881609568262?s=20&t=knsOOaBZazFNZcG6X7fnKA

2 Fed Chair Jerome Powell (2023, December 1). Opening Remarks, Fireside Chat at Spelman College, Georgia.

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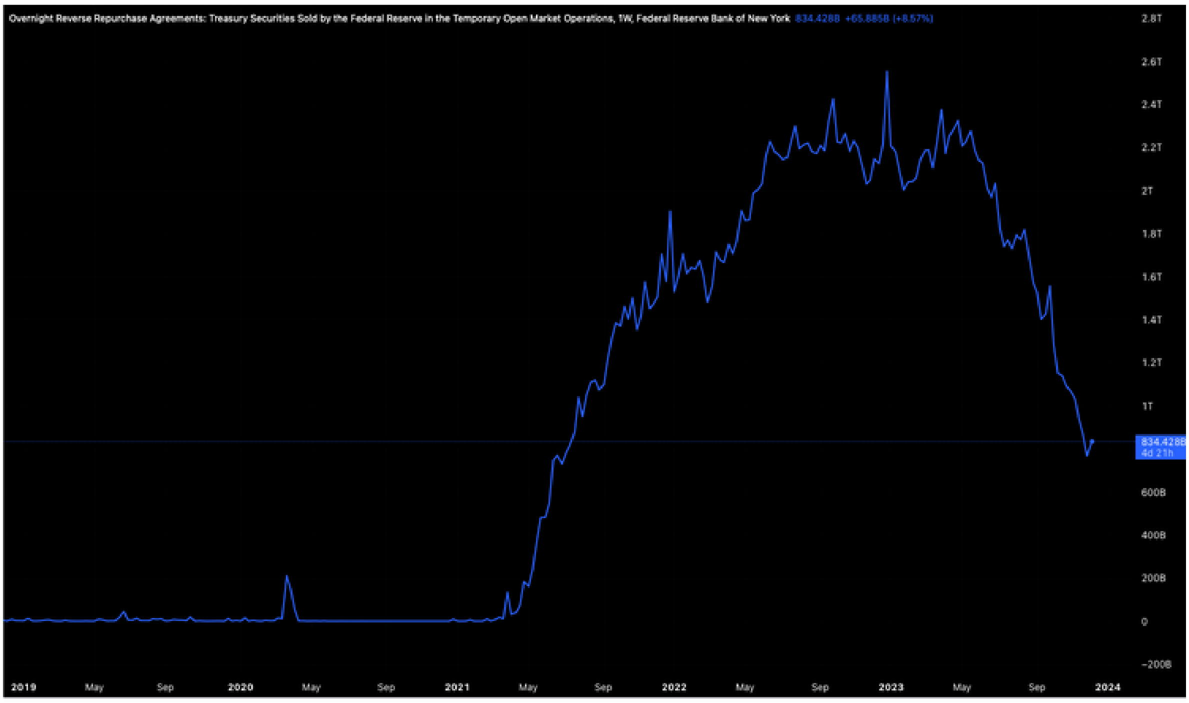
Monthly Update

We continue to closely monitor various liquidity indicators. It's worth noting that despite the Fed's ongoing reduction of its balance sheet and the build-up of the Treasury General Account (TGA), both of which are typically seen as tightening liquidity measures, the Reverse Repo Program (RRP) is rapidly decreasing. This is primarily due to money market funds actively purchasing Treasury Bills, thereby bolstering overall market liquidity.

US Overnight RRP



Source: Trading View, 6 December 2023

Position Spotlight - Vysarn

The WA based hydrogeological business services the drilling and dewatering needs of tier-1 iron ore miners in the Pilbara. The market has historically priced Vysarn somewhat similarly to other Australian listed drilling businesses, some of which are currently priced on multiples in the low single digits. It is the Fund's thesis that Vysarn is much more than a simple drilling business and should be treated accordingly. Over the next few years, Vysarn will significantly outgrow its drilling 'peers', whilst diversifying earnings away from the core Hydro business, which should earn itself a significant rerating.

The group can be divided into five distinct verticals, all of which sit under a broader water management thematic.

PENTIUM HYDRO

PENTIUM WATER

PROJECT ENGINEERING

PENTIUM TEST PUMPING

VYSARN ASSET MANAGEMENT

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Vysarn's core business, Pentium Hydro, is a provider of hydrogeological borefield construction services. With ~65% of the Pilbara's economic resource sitting below the water table, the Hydro business has experienced significant growth since listing in late 2019 and is forecasted to grow substantially via a combination of 'double shifting' rigs and increasingly favourable terms. Management highlighted their expectation that 3 rigs will be contracted on a double shift basis by the end of FY24 in their recent AGM presentation, which alone will contribute an additional ~15% to the unit's top-line performance. It is expected that up to 6 rigs will be double shifting by FY26, offering a fairly straightforward strategy for consistent growth in the near-term.

Beyond the core business sits Pentium Water, Project Engineering, Pentium Test Pumping and the recently added, Vysarn Asset Management. Pentium Water was founded out of management's initiative to capitalise on their unique water management skillset, creating a consulting arm that grew from near zero revenue in FY22 to $4.1m in FY23.

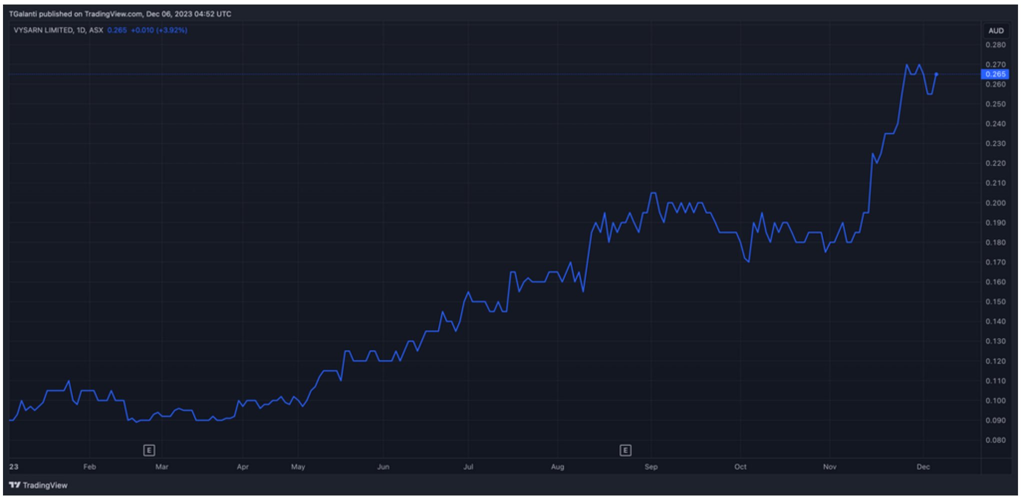
The Project Engineering business was acquired in July of 2022. It develops and installs Managed Aquifer Recharge (MAR) units for resource companies, local municipalities, and governments. After growing ~20% in FY23, the company is looking to effectively double productive capacity by the start of FY25 with the establishment of a new production facility. Management have noted the demand for MARs is quickly growing amongst current tier-1 clients to meet sustainable water disposal standards by the end of the decade. They suspect this business will reap most of that growth as Australia's definitive leader in MAR technology.

Pentium Test Pumping provides test pumping and injection testing, collecting live data from wells, borefields and aquifers. Management have noted the cross selling they've experienced with the rapidly growing MAR business, although have recently been constrained with only one advanced test pumping unit in FY23. In September of 2023 an additional, and more advanced unit, was deployed, quickly growing in its utilisation. It is expected that effectively doubling the business' capacity and opportunities to double shift, similar to the Hydro business, offers some fairly low capex growth over FY24 and FY25.

The Vysarn Asset Management (VAM) business was announced in October of 2023 and won't likely attribute material results in FY24. Management have brought in former Executive Director of JP Morgan Securities Asia, Richard Lourey, who recently ran a separate water investment company in Australia to head operations. Whilst we don't have a firm view on future contribution from this business unit, it should be fairly capital-light and acts as potential further diversification on group earnings.

The average forward EBITDA multiple attributed to Australian drilling companies is ~3.15x, Vysarn (after some recent success) trades at ~4.2x. Whilst the market is currently pricing Vysarn on more favourable terms, it is the Fund's view that it still presents significant asymmetric return potential.

As noted above, Vysarn is not a traditional drilling business and should not be treated as such. Their core business is not subject to the cyclicality of the broader resource market, instead it services operating tier-1 iron ore producers with production costs ~$20/tonne (which would make them profitable at any point in the history of a freely floated iron ore price). From a growth perspective, the aforementioned drilling peers will average FY25/FY26 EBITDA growth of ~2.85%, internal modelling forecasts indicate Vysarn will grow ~20%. VYS' EBITDA CAGR between FY24-FY26 is expected to be ~16%. Combining their far more predictable cash flows (less cyclical) and growth profile, with their efforts to diversify earnings away from their core Pentium Hydro business, should make Vysarn deserving of that rerating.



Source: Trading View, 6 December 2023

Position Spotlight - Close the Loop

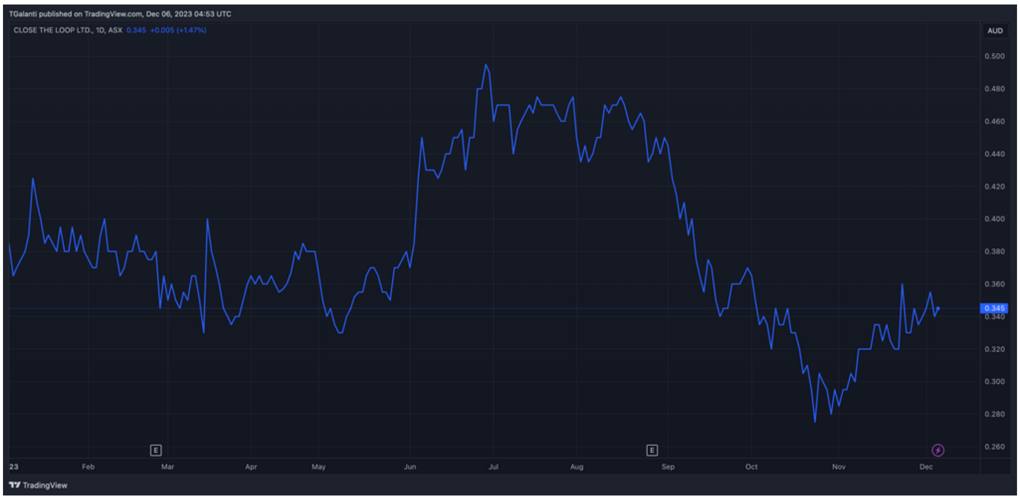
CLG is not a recent addition to the Fund, being a staple to the portfolio since inception. We thought it would be worth readdressing given some recent significant updates to the story, affirming our positive views on management, and building momentum in FY24.

Close the Loop is a 'circular economy' recovery, refurbishment, and reuse play, collecting from 260k sites globally and re-manufacturing 500k electronic consumables per year. In the early parts of 2023, CLG acquired ISP Tek Services a U.S. based electronics refurbishment business. On a pro-forma basis, assuming no growth, the newly combined business will generate $200m revenue and ~$43m in EBITDA. On current valuation, the market is pricing CLG on a ~5x EV/EBITDA multiple and 8.5x NPATA. It is important to note the conservative nature of these numbers, given the assumption of no growth over the FY24 period. We believe that to be wrong for a number of reasons:

- In the 2-months of ISP Tek Services contribution in FY23, NPAT from the new business grew ~35% pcp or ~27% on a constant currency basis.
- Management noted in their AGM that they delivered a strong Q1FY24 and as a result are confident of "achieving guidance greater than the $43m EBITDA." This leaves open the possibility for a full-year guidance upgrade as early as Q1 should Christmas trade be sound.

Whilst the transaction was initially welcomed by the market, some investors expressed concerns surrounding ISP's significant key client risk, with HP making up ~80% of total revenue along with the contract initially being a 1-year rolling agreement (standard for HP and other OEM's when dealing with external service providers) . Prior to their recent AGM, management successfully renegotiated the terms of the HP contract, converting the existing rolling one year to an exclusive 3-year contract and gaining exclusivity across key product lines. We view this to be an important de-risking event and may lead previously hesitant investors to reassess this opportunity.

Future growth for the ISP Tek Services business is likely to come from improved volumes with additional OEMs, replicating the business model into Europe and expansion of their offerings into warranty product refurbishment.



Source: Trading View, 6 December 2023

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