January 2025

CERUTTY
MACRO FUND

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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	4.65	4.59	0.07
3 Month	5.63	2.71	2.92
1 Year	21.13	12.32	8.81
Since inception (annualised)	19.16	11.91	7.25

Index/Benchmark ASX Small Ordinaries Accum. Index

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
Benchmark	ASX Small Ords Accumulative Index

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

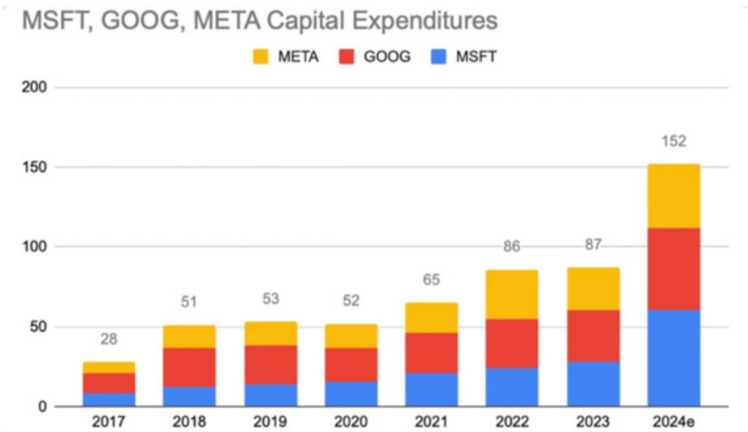
Monthly Update

January was dominated by market reactions to President Trump's policy changes. Leading up to his inauguration on January 20th, the general market response was positive, albeit volatile. The Cerutty Macro Fund had a strong January returning 4.7% for the month and 21.1% over the past year.

President Trump's ability to capture headlines remains unmatched. We've been reminded, particularly since the start of his second term, that overreacting to each individual headline carries the risk of being whipsawed by markets that are prone to prematurely extrapolating events. While the sheer number of headlines emanating from the White House can feel overwhelming, we're trying to pick and choose which headlines to commit a deeper analysis to and which ones we'll wait and see how they evolve. Since the inauguration, three of the key stories we've spent time on are: DeepSeek's AI advancements, the evolving landscape of tariff threats, and the implications of the newly proposed U.S. sovereign wealth fund.

On January 20th, Chinese AI developer DeepSeek surprised markets with the release of their R1 model. The model's performance, coupled with reports that its development cost only US$5.6 million compared to the billions invested by leading American tech companies, triggered a significant market reaction. Nvidia, in particular, experienced a drop of over 17% when markets reopened on the Monday. While the reported cost is likely an underestimation, and some sources suggest DeepSeek had access to Nvidia's H100 and H800 chips, potentially through Singaporean channels, the R1 model still represents a significant breakthrough.[1] It challenges the widely held belief that the U.S. holds an insurmountable lead in AI, prompting, as President Trump reportedly put it, a "wake-up call" to the U.S. tech industry. Regardless of the exact cost of DeepSeek's R1 model, there's growing consensus that it represents a far more economic approach than its rivals, such as OpenAI's ChatGPT.

Tech Capex Boom



Source: Basehitinvesting.substack.com, May, 2024

1. https://www.aljazeera.com/news/2025/1/29/ai-game-changer-or-overhyped-deepseek-faces-scrutiny-over-bold-claims

Monthly Update

Estimates suggest it's 20-40 times cheaper to produce.[1] This is a stark reminder of the deflationary power of technology. The initial excitement around the deflationary impact of ChatGPT, as workers become more productive and companies like Meta envision AI functioning as "mid-level engineers," this year, is now amplified by the potential for even greater cost reductions in AI development.

While Nvidia share price bounced from their initial drop, investor nervousness may persist as alternative approaches to building AI become more apparent. This situation is compounded by the fact that Nvidia already operates in a cyclical industry and faces the challenge of its largest customers designing their own chips. If companies like DeepSeek have discovered a way to achieve comparable or superior results using less powerful chips, the prospect of Google, Apple, or Amazon leveraging their own internally designed chips, in greater quantities, to achieve cost efficiencies becomes increasingly possible.

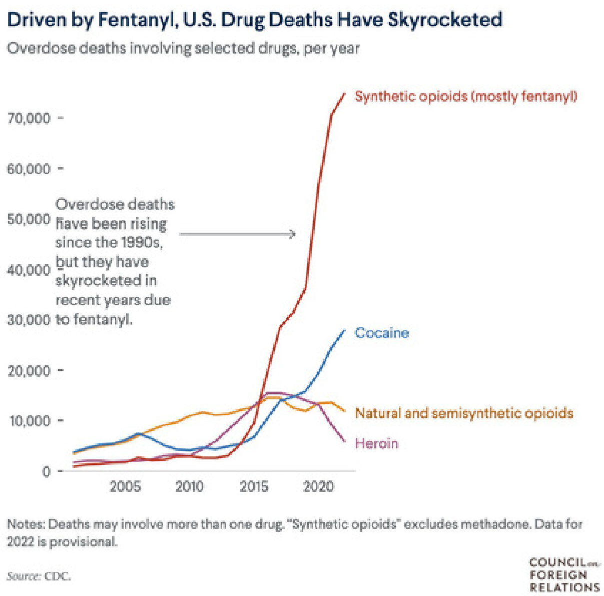
Looking ahead, we continue to believe that access to high-quality data represents a significant and defensible moat in the AI landscape. Beyond this, we maintain our investments in the broader theme of electrification and companies exposed to data centre capex, as these areas remain critical components of this incredibly important thematic.

The issue of tariffs is clearly a priority for President Trump. We witnessed this with the tariffs imposed on Colombia on January 26th, followed by the announcement of tariffs on Mexico, Canada, and China on January 31st. Colombia's cooperation in taking back prisoners, and the commitments from Mexico and Canada to assist the U.S. in addressing illegal immigration and the fentanyl crisis, resulted in the postponement, and potential avoidance, of these tariffs.

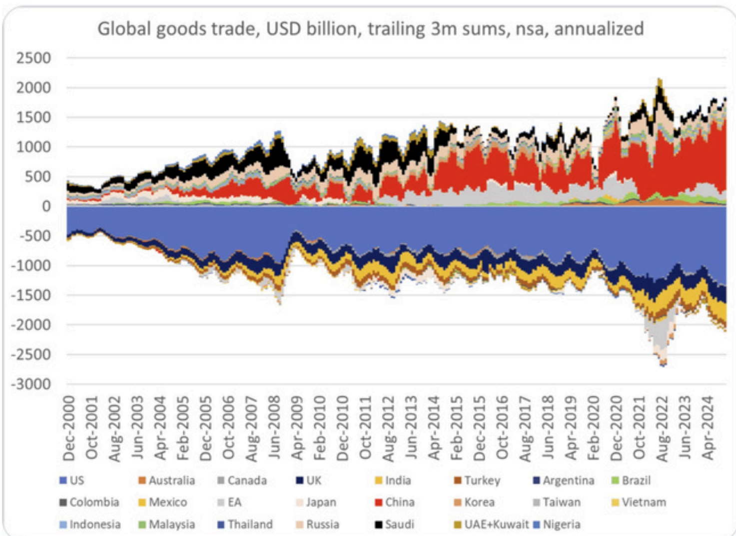
China responded with its own retaliatory tariffs on U.S. goods, including coal, LNG, and crude oil, as well as export controls on critical minerals and an antitrust investigation into Google.[2] Analysing the underlying motivations behind Trump's tariff strategy, we believe several key objectives are at play.

First, he likely seeks an appreciation of the Yuan against the USD, thereby reducing China's manufacturing advantage. Secondly, he aims to reduce the trade imbalance between the U.S. and various countries, believing that a significant trade surplus held by a geopolitical rival poses a strategic risk. Finally, we believe Trump is genuinely committed to addressing the devastating impact of fentanyl on American communities, where drug overdoses now claim over 100,000 lives annually, with fentanyl being a primary driver.

U.S. Fentanyl Crisis



Global Trade Surplus v Deficit Nations



Source: Brad Sester, X

2. https://apnews.com/article/china-us-tariffs-timeline-trump-xi-08b5d468e61ba15e760563ef0186b2bb

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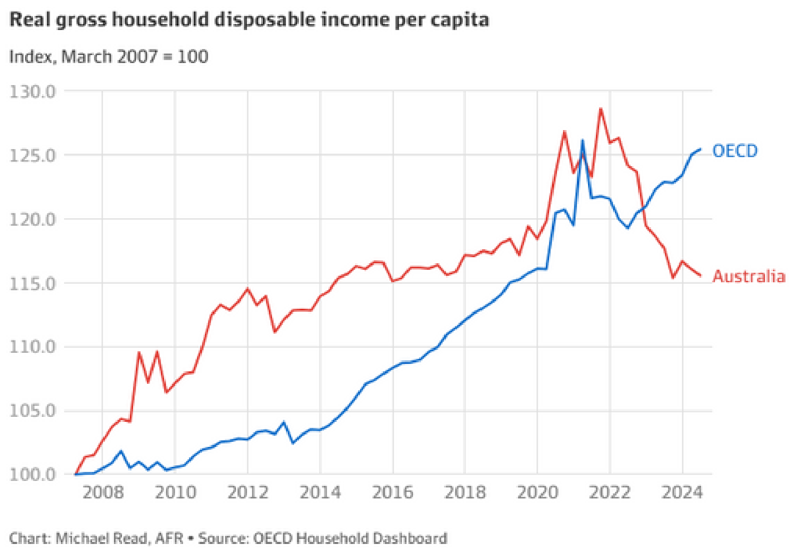
Lastly, the announcement of the U.S creating a Sovereign Wealth Fund in the next 12 months feels like a significant announcement that due to the sheer volume of announcements isn't being fully appreciated by the market currently. Treasury Secretary Scott Bessent has said he wants to "monetise the asset side of the U.S balance sheet for the American people". It's not clear which assets he has in mind, but with the U.S Gold reserves currently being valued at $42 per ounce, revaluing this alone would add hundreds of billions of dollars to the asset side of the balance sheet. [3]

Position Spotlight - Cash Converters (CCV.AX)

As we've all read in the AFR, Australia is experiencing one of the worst GDP per capita recessions in its history. Living standards are declining and household real incomes have retraced to 2014 levels. Whilst we're hopeful of an economic rebound, we're confident that demand for short-term loans and second-hand goods will be likely benefactors of this macro backdrop. Broadly, we positioned the portfolio away from Australian discretionary and included Cash Converters (& others) as a potential winner.



It is our view that whilst Cash Converters offers a unique positioning for a key economic trend, it also offers plenty of company specific upside under a strategic shift that occurred in 2023. The company announced they would start to roll off their high-yield small loan book (SACC) and auto finance business, redirecting focus on their medium amount credit contracts (MACC) and Line of Credit (LoC) offerings. We believe the stock had been perpetually trading at a discount due to potential regulatory risk associated with shot-term consumer loans and an unclear growth strategy – both of which have been addressed in their strategic review.

Cash Converters trades at ~7.5x forward earnings, whilst paying a 2c (8% fully franked) dividend and in our opinion, setting itself up for material growth in the short term. If management can successfully execute their loan book rebalancing (i.e. improve quality, whilst maintaining size) and reduce their net loss rate, we believe the market will rerate the stock accordingly. Encouragingly, in the September quarter, we observed a material reduction in the Net Loss Rate (NLR) to 3.7% (4.8% pcp) and a relatively flat loan book, suggesting management's efforts are so far yielding positive results. This development not only derisks the business but also potentially serves as evidence of their successful loan book rebalancing initiative. Whilst we expect the loan book yield to fall as they shift to higher quality products, the ~23% reduction in NLR pcp should result in a net positive to the bottom line.

Management have identified >200 franchise locations they could potentially buy/corporatise (mainly in the UK and Australia), with a pipeline of 12 in the UK and 39 in Australia. Our conversations with management indicate they've identified many 'low hanging fruit' opportunities, where they believe they can improve profitability in short order. If successfully executed, this strategy could not only drive higher earnings growth but also enhance operational control, improving margins across their expanded corporate store network. With a clear pathway for growth and improving fundamentals, we believe Cash Converters is well-positioned for a market rerating.

3. https://www.reuters.com/markets/wealth/trump-signs-executive-order-create-sovereign-wealth-fund-2025-02-03/

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There are risks involved in investing in the CAR's strategy. All investments carry some level of risk, and there is typically a direct relationship between risk and return. We describe what steps we take to mitigate risk (where possible) in the Fund's Information Memorandum. It is important to note that despite taking such steps, the CAR cannot mitigate risk completely. You should obtain a copy of the Product Disclosure Statement before making a decision about whether to invest in this product.

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