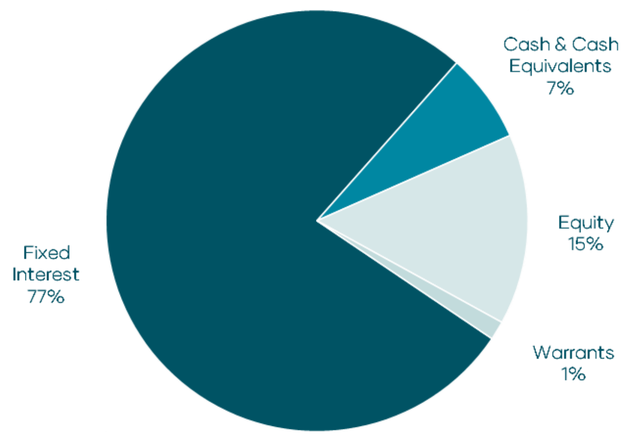
PURE Income and Growth Fund

Foundation Class Portfolio Returns (After Fees)

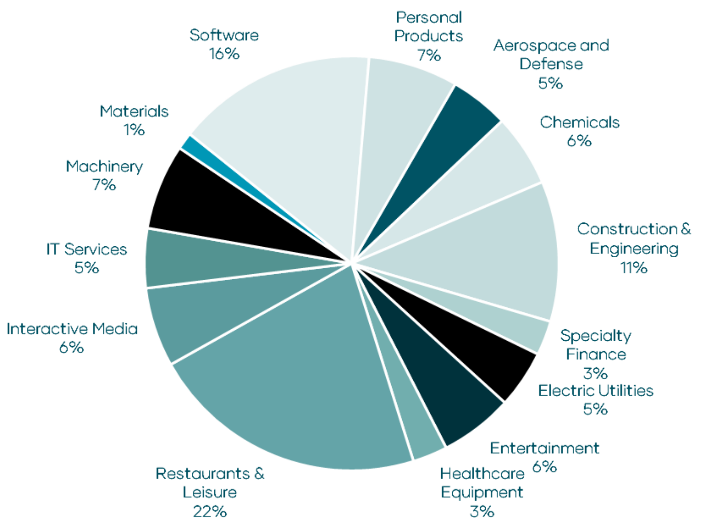
	1 month %	3 Months %	6 Months %	1 Year %	3 Years % p.a.	Since inception* % p.a.
PURE Income and Growth Fund	+1.1%	+1.8%	+3.5%	+5.0%	-1.4%	+10.8%
Standard Deviation (Annualised %)				1.0%	6.0%	11.5%
Sortino Ratio						1.5
Sharpe Ratio						0.6

** Fund inception 21 December 2018*

Portfolio Asset Allocation



Fixed Interest Sector Allocation



PURE online application form

POWERED BY OLIVIA123

Fund Overview

Fund Size (Cum. Dist.)	$120.8m
Foundation Class Unit Price (Cum. Dist.)	$1.1686
Number of Investments	18
Average Loan Size	$5.4m
Weighted Average Interest Rate	10.2%
Arrangement Fees Paid to Investors	$4.0m
Trailing Fund Yield (12m) Est.	~6.2%

Monthly Commentary

Markets continued to recover in December as global inflation expectations moderated, 'soft landing' expectations increased, and the Israel/Hamas conflict was shrugged off. The market cap of the 'Magnificent 7' closed the year at 3x that of the entire US Russell 2000.

Closer to home, larger companies were the best performers, whereas the rest of the ASX All Ords has merely recovered to be flat on the year; outside the top 500, most share prices were hammered…again.

Across the portfolio the Fund had a solid (ish) second half of the year, delivering +3.5% (+7.0% annualised). M&A activity across the portfolio remains buoyant, two facilities were repaid, and two further facilities are likely to be repaid shortly. We are expecting some healthy contracts wins and other catalysts in the first quarter of 2024, so we have reasons to believe we can get back to target returns in 2024.

This month we look behind the headlines at the opportunity in *real* smaller companies.

All is not what it seems ...the case for *real* smaller companies.

Investors, particularly those who take the pulse of the market from the US, are perhaps asking themselves why, if the markets were so surprisingly strong in 2023, am I not seeing it in many of my investments.

First let's look at the indices for 2023.

Index	2023 Index Return	Median Price Change	*Cohort*
Australia			
S&P/ASX 50	8.5%	11.7%	*50 Largest Companies*
S&P/ASX Midcap 50	4.4%	6.6%	*50-100 Largest Companies*
S&P/ASX 100	8.0%	9.1%	*Largest 100 Companies*
S&P/ASX Small Ordinaries	4.7%	-1.1%	*300 Largest excluding, ASX100*
S&P/ASX All Ords.	8.4%	0.3%	*Largest 500 Companies*
S&P/ASX Emerging Companies	-2.4%	-5.7%	*200 Companies selected from 300th -650th Largest Companies*
Microcap *(PURE proxy)*	-7.6%	-20.0%	*500th -1200th Largest Companies*
Nanocap *(PURE proxy)*	-12.3%	-29.7%	*Smallest Companies on ASX*
US			
NASDAQ Composite	43.4%	-	*2,500 NASDAQ stocks*
S&P 500	24.2%	-	*500 Largest US Companies*
Russell 2000	15.1%	-	*2,000 Smallest US companies*

The key takeaways are:

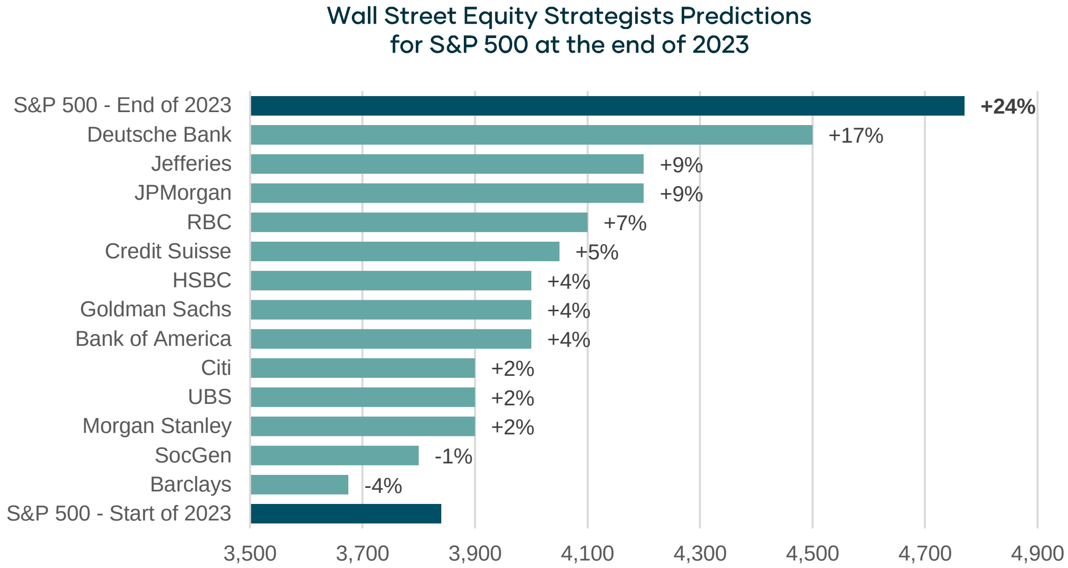
1. Australian indices have underperformed the US. We are not alone in this, almost every country has underperformed the US.
2. The performance of larger companies has materially outperformed smaller companies. This seems so normal now, but over the long-run it has not been the case.
3. The median return of the underlying companies has been materially different from the Index return.
4. Larger companies within their respective Index, have outperformed.
    a. The Magnificent Seven[1] (the seven mega-caps) are responsible for about 60% of the performance of the S&P 500, which means the rest of the S&P 500 delivered 9.5%.
    b. Within the Australian S&P/ASX 100, the top 10 companies generated about half the Index performance.
5. Technology stocks have hugely outperformed.

Largely this is now all common knowledge and the unprecedented outperformance of the liquidity trade (i.e. the biggest companies) has been covered in our previous newsletters and those of many others.

So, with hindsight, the largest of the US large caps was the place to be, but don't beat yourself up if you missed it, almost every Wall Street equity strategist failed to spot that trade too, with the US market outperforming everyone's expectations.

[1] Apple, Meta (Facebook), Nvidia, Microsoft, Alphabet (Google), Amazon, Tesla

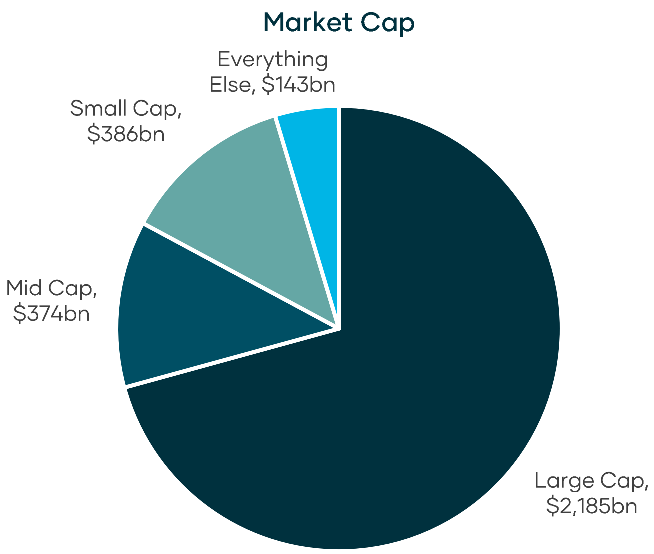
On average, Wall Street was expecting a 4.6% gain for 2023, but the S&P 500 finished the year up 24.2%.



Now turning to the ASX, let's look at the numbers behind the headlines.

Firstly, a disclaimer. Our data analysis isn't perfect, we haven't made allowance for index constituent changes (rebalancing) and free-float and have simply ranked all the companies from largest to smallest, excluding listed funds, ETFs and those companies that are suspended.

As you can see, the market cap of the Australian market is hugely concentrated with the S&P/ASX 100 (Large-cap + Mid-cap), being 83% of the aggregate market cap of ASX. Half the market cap of the entire ASX is just the top 15 companies.

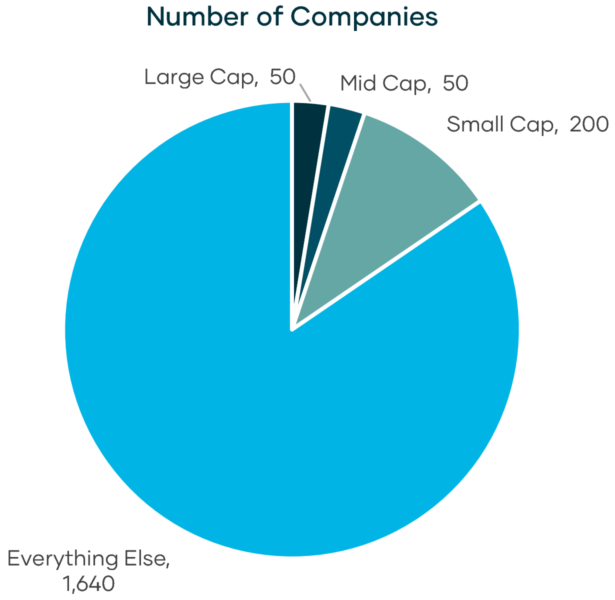


Inversely, the S&P/ASX Small-caps, and everything below, represents, by number of constituents, 95% of all listed companies.

In our view, the term "Small-caps" is a misnomer. Only those operating within the ASX large-cap could draw such an inappropriate appellation.

Two things seem absurd to us.

Firstly, a market that is largely categorised into three areas: Large; Mid; and Small, has a distribution of listings that looks like this:



Secondly, the actual S&P/ASX Small Cap Index, against which most small-cap investors are benchmarked, is largely made up of companies that are not, in our view, "small" at all.

It includes companies like Nufarm, CSR, Tabcorp, Boral and Sigma. The average market capitalization is about $1.7bn… compared to BHP and CBA yes, they are "small", but the average "Small-cap" in the index is bigger than 90% of the companies listed on the ASX.

In our view, most investors invest in small companies because they think of them as agile, faster growing, and disruptive or innovative. S&P/ASX Small Cap Index does include companies like this, but many (most?) are large, stable companies that have been around for a long time and unlikely to provide much more then GDP+ growth.

At PURE we focus on companies with $20-200m market capitalisation, which straddles the S&P/ASX Emerging Companies Index and what we call *Micro-caps*. This is a cohort of 700 companies, with an aggregate market cap of ~$56bn.

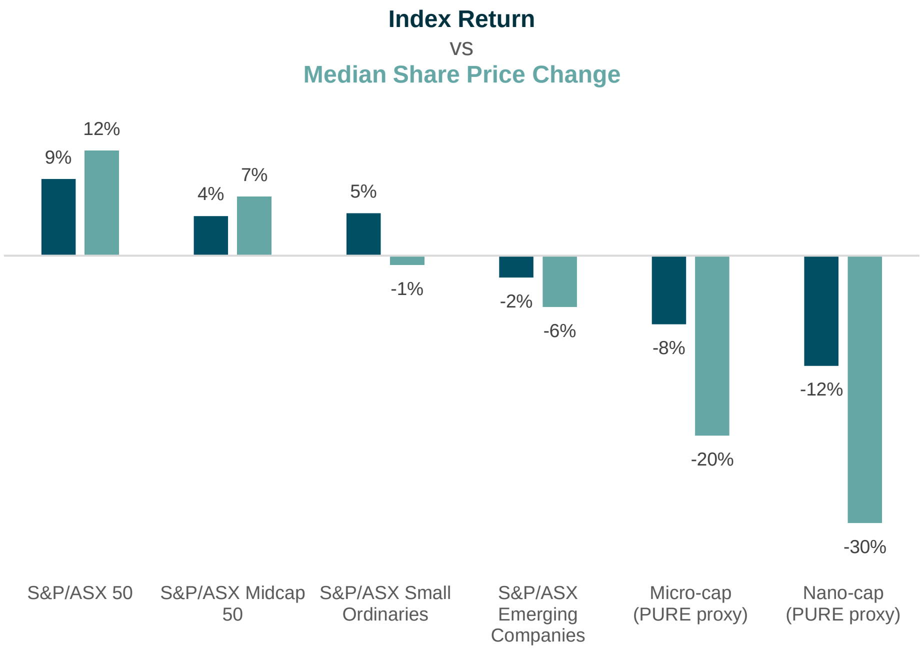
Investors choose to deploy capital outside the large caps for growth – typically a modest allocation to boost portfolio returns. To find these companies, in our opinion, you need to look outside the top 300 companies. Multiple billion-dollar companies success stories, like TELIX, Pro Medicus, Dicker Data, Lovisa and Macquarie Telecom, were all too small for the S&P/ASX Small-cap index just five years ago.

So, what has happened to the real smaller companies?

For this we need to look at the S&P/ASX Emerging Companies Index, which is made from 200 constituents. and selected from companies ranked between the 300th and 650th largest in terms of market capitalisation.

We have also built two simple indices for the smaller constituents (Micro-caps and Nano-caps) the former are companies between $250m and $25m in market cap, and the latter is everything else.

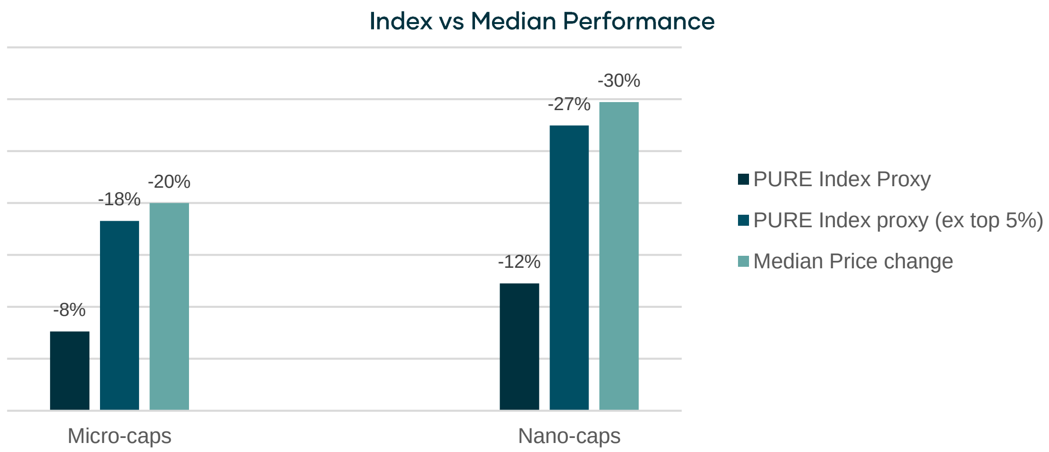
Looking at 2023 this is how the different indices and companies have performed.



The first thing to note is there is a near perfect correlation between size and performance. This is not unusual (and a natural reaction to the nervousness people have experienced), but it is extreme.

The second thing to note is that Index performance and the median price performance can differ substantially. This is a function of outliers and weighting. It has been easier to beat the Index in the larger indices than smaller ones. In the ASX100 the median price is higher than the indices, whereas at the smaller end, when any performance that has been obtainable, it has been very narrowly based.

Looking at our calculated proxies for Micro-caps and Nano-caps, if we exclude the top 5% of performers, our Indices and the Median price are more closely aligned.



What does all this mean?

What it means is that in the real-world of smaller company investing, 2023 was far more difficult than the headline data may suggest. Only 13% of companies outside the main indices (Emerging, Micro-cap and Nano-cap) have outperformed the large caps benchmark.

Faced with this evidence it is clear that the wholesale underperformance is driven by liquidity and sentiment. This may be the right call, but flawed thinking to conclude it an objective assessment of the operational performance and economics of investing in these businesses.

In 2022, the median price fall for companies outside the S&P/ASX 300 was -35%, so bear in mind this year's weak performance comes on the back a very poor prior year for smaller companies. The value proposition in front of investors today is better than they may appreciate from looking at the headlines.

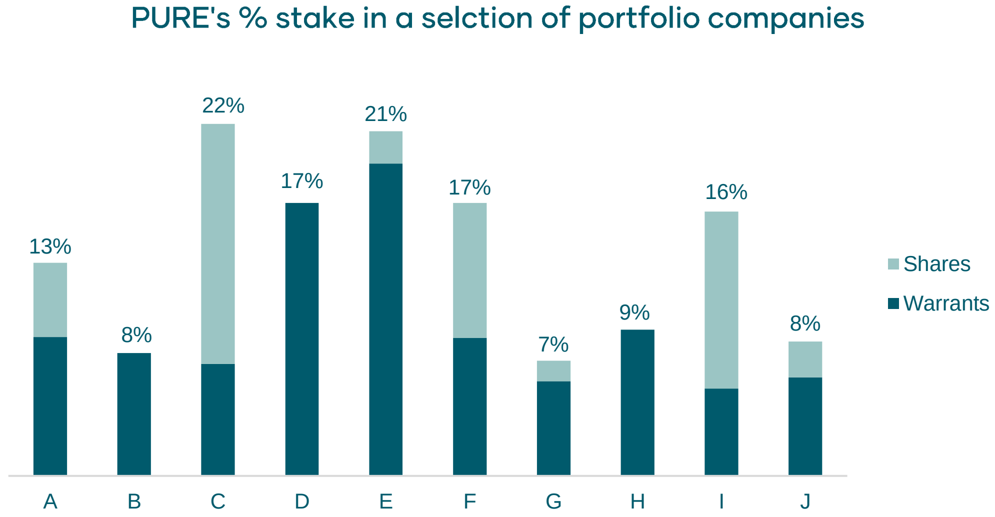
When markets are rising investors have a tendency to look for the reasons to be bullish and when markets are falling the commentary tends to argue the bearish case for further declines. But the narrative is a **lagging**, not a **leading** indicator. The Wall Street strategists are a perfect recent exemplar of this momentum groupthink.

The same inclination applies to companies. Investors have a tendency to extrapolate that a poor share price, equates to poor business, but this is not always the case, because sentiment and liquidity play a huge part in defining the share price of a company in the short-term.

Many of the companies in our portfolio, and many of those we review, are well run by professional, experienced executives, that have executed well in challenging circumstance (Covid, supply chain issues, cost inflation, limited access to capital).

When investors catch-up to how oversold *real* small-caps are, this won't be a normal recovery, the upside is exceptional. Over recent years we have helped many companies in our portfolio navigate the challenging circumstances. The *quid pro quo* has been to reset our economics, so when the recovery inevitably happens, the Fund is well placed to capture it.

Below is an anonymised chart showing the funds top 10 economic exposures to companies in the portfolio. The aggregate carrying value of these stakes today is <5% of funds under management.



Thank you

Nick, Mike, Tim, Dan, Jonathan and Jean-Luc

Monthly Returns – After Fees

The Income and Growth Fund – Foundation Class													
Year	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Fin YTD
FY19						2.4%	-1.8%	1.2%	0.3%	-1.0%	2.5%	1.7%	5.4%
FY20	2.6%	-1.4%	2.1%	1.4%	-0.8%	3.8%	2.8%	-2.2%	-3.8%	3.8%	5.7%	0.7%	15.0%
FY21	15.9%	8.8%	-1.0%	12.2%	0.7%	2.6%	-1.0%	-1.0%	-3.5%	2.1%	0.0%	0.8%	40.9%
FY22	3.4%	-3.2%	2.3%	1.2%	-2.2%	1.0%	-0.1%	-2.3%	1.6%	0.5%	-0.5%	-1.0%	0.5%
FY23	1.3%	-1.7%	-1.6%	0.9%	-5.7%	0.1%	0.2%	0.3%	0.2%	0.1%	0.4%	0.3%	-5.3%
FY24	0.5%	0.5%	0.7%	0.0%	0.7%	1.1%							3.5%

The Income and Growth Fund – Platform Class (APIR: PUA7226AU)													
Year	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Fin YTD
FY21	16.0%	8.9%	-0.9%	12.4%	0.7%	2.7%	-0.9%	-1.0%	-3.5%	2.1%	0.0%	0.8%	41.8%
FY22	3.4%	-3.2%	2.3%	1.2%	-2.2%	1.0%	-0.1%	-2.3%	1.6%	0.5%	-0.5%	-1.0%	0.5%
FY23	1.3%	-1.7%	-1.6%	0.9%	-5.7%	0.1%	0.3%	0.3%	0.2%	0.1%	0.5%	0.3%	-5.3%
FY24	0.5%	0.5%	0.7%	0.0%	0.7%	1.1%							3.5%

Unit Price Data Download

Please click on the link below to download the updated unit price data for each unit class.

The Income and Growth Fund – unit price data to 31 December 2023