PURE ASSET MANAGEMENT

Investor Newsletter
Period to 31 August 2024

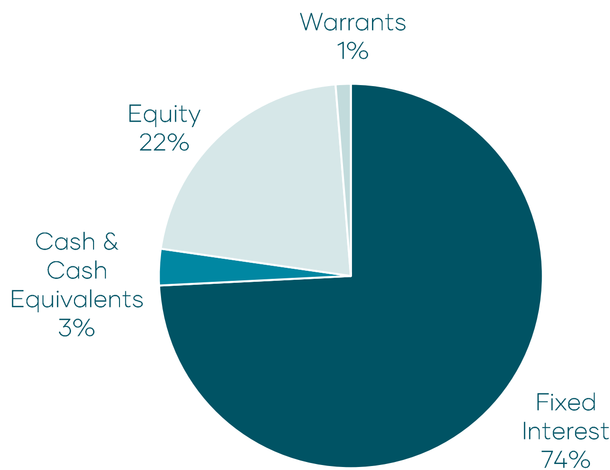
PURE Income and Growth Fund

Foundation Class Portfolio Returns (After Fees)

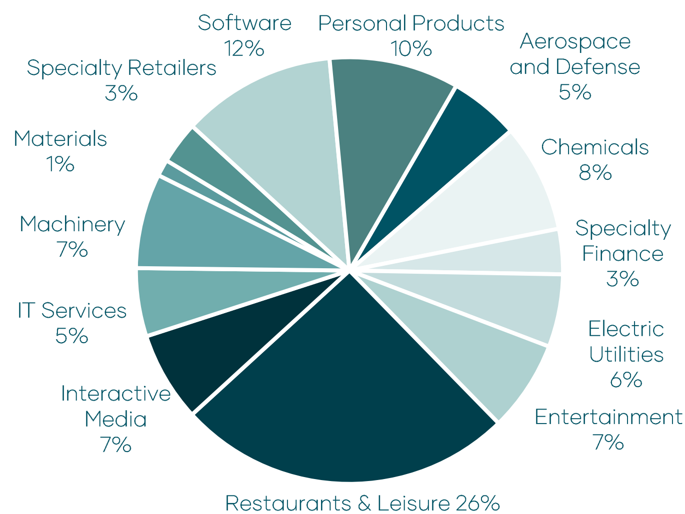
	1 month %	3 Months %	6 Months %	1 Year %	3 Years % p.a.	Since inception* % p.a.
PURE Income and Growth Fund	-0.2%	+0.8%	+5.2%	+7.9%	+1.2%	+10.4%
Standard Deviation (Annualised %)				2.6%	5.0%	10.8%
Sortino Ratio						1.4
Sharpe Ratio						0.6

** Fund inception 21 December 2018*

Portfolio Asset Allocation



Fixed Interest Sector Allocation



PURE online application form

Fund Overview

Fund Size (Cum Dist.)	$108.9m
Foundation Class Unit Price (Cum Dist.)	$1.1723
Number of Investments	14
Average Loan Size	$5.6m
Weighted Average Interest Rate	10.6%
Arrangement Fees Paid to Investors	$4.1m
Trailing Fund Yield (12m) Est.	6.2%

Monthly Commentary

The Fund returned -0.2%, versus a 2.2% decline in the S&P/AS Small Industrials index. August started with a startling market backdrop. Poor US payrolls drove dreadful price action to commence the month, with the ASX All Ords experiencing a 2-day decline of 5.8%. This included a -3.7% move in a single day, the largest fall in four years. By month end, however, bad news had become good news. Bond yields fell 50bps, equities recovered, and all was forgiven, with the market closing flat.

The Fund's performance was due to equity/warrant movements - with Spacetalk (+32%) continuing to rally after its excellent result, but more than offset by falls in DXN (-15%) and Swift Networks (-28%), despite both of which also reporting good results.

Following the success of PURE's DOCA, we are now working closely with each Mighty Craft company to re-establish 'business as usual'. Following the court hearing to approve PURE's s.444GA application and formally transfer ownership (est. October), focus moves to value creation and what augurs as an exciting peak season.

This time ~~it's~~ (it isn't) different

"This time it's different" has been disproven so thoroughly and on so many occasions that the phrase has suffered a semantic inversion such that it's often applied scathingly against making anyone making an emboldened claim.

How often have we looked back with hindsight and wondered "what were they thinking?" From the US sub-prime housing boom, the end of inflation via new monetary stewardship, the Asian miracle, the dot-com boom, the emerging market boom, the Japanese asset bubble, etc, etc, etc, going all the way back to the Nifty Fifty in the 1960s and even the Tulip Mania of the 17th century.

A fundamental characteristic of "new paradigm" thinking is that (at the time) there is a credible thesis to support it. As there is today with the Large Cap boom versus the Small Cap malaise.

The material and global underperformance of small caps - which on the ASX have delivered almost zero return over 14 years, versus large caps which have delivered ~70% - is well recognised and has been discussed by us and others.

What is less discussed is that people have become so conditioned by the underperformance that, just like other new paradigm arguments, it has become counter-consensus to even suggest otherwise.

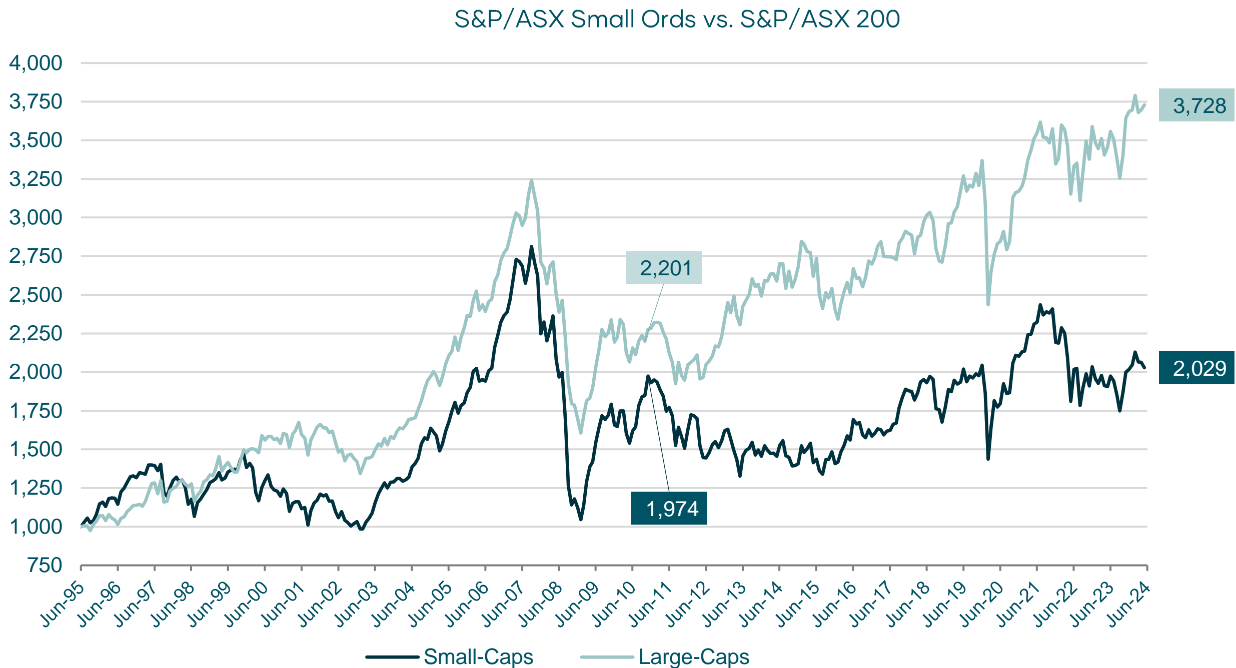
But let's look at the counterfactual.

To believe that the outperformance of large cap is justified, and that there will not be a revision to the mean (i.e. a sustained period of the small-cap outperformance) you must believe:

- That earnings growth isn't the ultimate driver of share prices. That is to say, you must reject Buffett's observation that in the short term the stock market is a voting machine (investor sentiment/popularity), and in the long term it's a weighing machine (earnings). Data from Australia is not available, but over the last 20 years the small cap (Russell 2000) companies have delivered the same earning growth as Large Cap, a little over 6% pa, but have delivered roughly half the stock market performance.
- That the increase in small-cap takeover activity at unprecedented premiums (+80% versus 30% historically) means that corporate acquirers are making the wrong assessment of value and the stock market's assessment is correct.
- That the largest drivers of the Large Cap outperformance will persist at the same rate. These have been:
    - Exchange Traded Funds (ETFs). Large caps been the beneficiaries of the rise of passive ETFs which make investments based on size, rather than an economics. The popularity of ETFs, which almost exclusively invest in large caps, means new investor capital is flowing into large caps and small caps are receiving a diminished share.

      To paraphrase an anecdote from John Templeton, *"Why are large caps outperforming? There are more buyers than sellers."* For small-caps the reverse is true. ETFs now own 35-45% of all equities, for the same impact in the future, you must believe that trend of passive ownership will continue its upward trajectory.
    - Low interest rates. Large caps have considerably more access to debt than small caps; borrowing cheap money enhances return on equity. To believe large cap outperformance will continue, you must believe either that cheap leverage wasn't in fact useful, or that interest rates will go back to the historically low levels of recent decades.
    - Globalisation. Small caps are mainly local; large caps are typically global. Offshoring to cheaper jurisdictions has largely been a large-cap phenomenon. To believe large caps will continue to outperform you must either believe offshoring wasn't productivity enhancing, or that at the current onshoring trend will reverse.

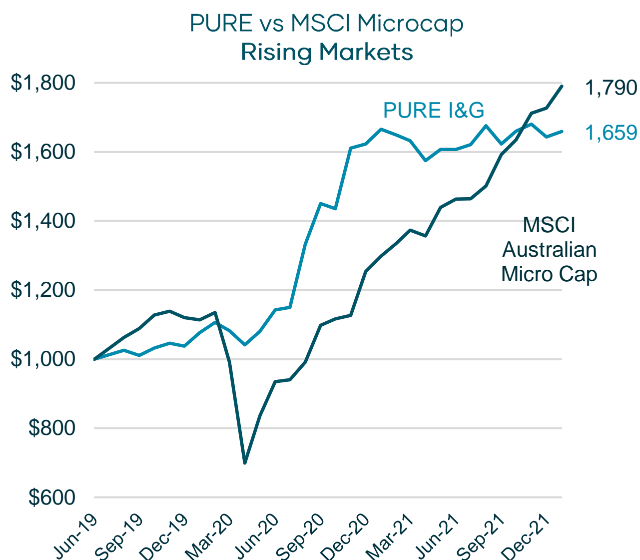
Here is the long-term comparison of Small Caps versus Large Caps, with a comparison over the last 14 years.

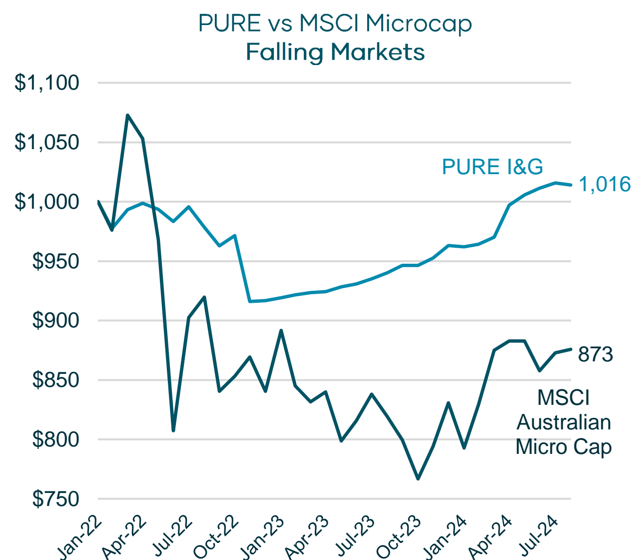


The idea behind our investment approach was to provide a solution to ASX small caps that struggle to find a reasonable cost of financing, and give our investors a superior way of investing, with significant upside, but protection from the downside.

We are not a debt fund, nor an equity fund. Using the uniquely attractive characteristics of hybrid investing our model is designed to exploit the absence of the banks and the failure of the ASX for this part of the market, and in doing so beat both equity and debt strategies over the long run.

In the initial years of the Fund, we underperformed equites but materially outperformed credit. In recent years we have suffered the headwind of equity markets and have underperformed many credit funds, but we have outperformed most small cap equity funds. The combination of those two phases is top quartile performance versus both debt and equity strategies.





DATA REBASED FOR COMPARISON

We are not highlighting this to be defensive of our lacklustre performance in recent years, but rather to say the nature of our Fund is such that a falling market does have repercussion on our performance i.e. to give investors equity upside, we must have a proportion of our assets in equity and equity like instruments, which are subject to the vagaries of the market. Could we, or should we, have done better? Yes.

We launched the Fund nearly six years ago and have suffered a material small cap headwind for the last three. After 14-year underperformance versus large-cap, will this headwind become a tailwind in the years ahead? We believe it will, and furthermore, we believe that this trend has already started.

As we have commented before, due to the strength of our credit position, during the tough times since covid, we have been able to negotiate instruments that will give us material upside from either an individual company's performance, or from the broad-based outperformance of small caps.

Thank you

Nick, Mike, Tim, Dan, Jonathan and Sibghat.

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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%	-0.1%	0.2%	0.6%	2.8%	0.9%	0.6%	8.7%
FY25	0.4%	-0.2%											0.1%

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%	-0.1%	0.2%	0.6%	2.8%	0.9%	0.6%	8.7%
FY25	0.4%	-0.2%											0.1%

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 August 2024

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