CHESTER ASSET MANAGEMENT
2017

Chester High Conviction Fund Quarterly Thoughts January 2025

In partnership with COPIA

The Chester High Conviction Fund Philosophy

Our Key Principles

High Active Share	For active managers to outperform over the long term, the fund has to be truly different than the benchmark. This strategy has had an active share above 80% since inception. Don't follow the crowd.
Mid Cap Bias	Broadly speaking, we find more interesting opportunities outside the large cap universe. Exposure to mid and small caps is essential for long term outperformance.
Cash Flow Growth	We seek to invest alongside companies that either generate predictable cash flows in high quality industries, or determine an appropriate margin of safety where valuation support is paramount, which is in more cyclical sectors of the economy.
Back Owners Of Capital	Allocating capital to management teams that think like owners alleviates the principal-agent problem. "Show me the incentive and I'll show you the outcome" Charlie Munger.
Concentration In Few Ideas	We keep a tight watchlist of stocks that are deemed suitable for investment. Focusing the research effort into fewer ideas provides more opportunity to gain higher conviction views. Too much diversification becomes counter productive.
Focus On Insights	Do we have a different view than the prevailing wisdom of the market? High conviction often comes from a granular understanding of where the market expectations are wrong.
A Contrarian View?	Backing ourselves in unloved, underappreciated or undiscovered stories has been the most consistent source of alpha generation of this strategy.
Keep It Simple	Ultimately, we allocate capital to sectors and companies we understand. The investment thesis needs to be easily articulated for a high conviction idea.
Invest With Humility	All fund managers make mistakes, it's part of the profession. Our tightly knit culture accepts these, tries to learn from them, and keeps making decisions. It is a profession where humility is absolutely essential.
Stay Curious	Fresh ideas or unique insights is critical to ensure the portfolio stays invested with conviction. To consistently generate outperformance we seek to test the investment thesis behind each decision. This requires discipline and a repeatable process in company visitation schedules.

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At 31 December 2024	1 mth %	3 mths %	6 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a	Incep. % p.a. *
Chester High Conviction Fund (after fees)	-1.6	-0.4	5.6	12.7	7.5	12.1	12.1
S&P/ASX 300 Accumulation Index	-3.1	-0.8	6.9	11.4	7.1	8.0	8.5
Outperformance (after all fees)	**+1.5**	**+0.4**	**-1.3**	**+1.3**	**+0.4**	**+4.1**	**+3.6**

* 27 Apr 2017

> *"The nine most terrifying words in the English language are "I'm from the government, and I'm here to help"* — Ronald Reagan

Colonel Mustard. It was the best car we ever owned. A 1972 Toyota Corolla that was a yellow mustard colour, with an orange and brown pinstripe along the sides to give the illusion of speed, despite its top speed of 80kmph. It cost AUD500 in 1994, which even in those days, was not a lot of money. We squeezed 4 years out of it, which was remarkable, given we had to jump start it every morning. By jump start, we mean park the car on a downhill slope so we could run alongside the car to get it moving, jump in and pop the clutch to start the engine. You could see the road through the gear box as the rubber had worn away while the drivers seat had lost a metal bar on the left hand side, leaving the driver steering the wheel on a 30 degree angle tilting towards the passenger seat. It only had AM radio and most often the indicator lights didn't flash, they just stayed on. Heady times. The life of Colonel Mustard came to an unsavory end when pulled over by a police car for the second time, after 3 months earlier having a "canary" sticker placed on the windscreen. A canary was a sticker informing everyone that this car was unroadworthy, which gave you 3 months to make the car roadworthy. Given the 3 months were up, and nothing had changed, we were forced to abandon the car on Beach Rd in Brighton and pay for a tow truck to take it to a wrecker. We received AUD50 for the effort. Only losing AUD450 dollars on a car over 4 years? The best value depreciating asset of all time. Sometimes owning unloved and underappreciated assets really does pay off.

Our strategy has been successful over a long period by focusing on unloved, underappreciated or undiscovered assets. 2024 was a challenging year for this style of investment philosophy given the relentless momentum in the technology sector (+48% return in 2024) and the bank sector (+30% in 2024) which drove the overall index return, while materials (-17%) and energy (-18%) were used as funding sectors. The year could really be described as the US (tech and financials) vs China (commodities) to oversimplify the year in review. So the key question in 2025 is, does this persist? Does momentum continue to be overriding style bias again in 2025? The most surprising (to us) asset price reaction in 2024, has been the move in the US 10 year bond yield, as US cash rates have been cut 100bp. Since September, the US 10 year bond has ***risen*** over 100bp to be 4.65% at the time of writing. Given the equity risk premium (to bonds) has shrunk so materially over the past 4 months, we err on the side of seeing asymmetric risk to the downside for many of the momentum names as we start 2025. The valuation gap is too wide.

What changes the leadership of the market?

Yogi Berra would say that it's tough to make predictions, especially about the future. We are writing this before the inauguration of President Trump, which suggests a period of uncertainty ahead given the incoming administrations focus on significant change to government bureaucracy (DOGE or the Department of Government Efficiency). The recent comments regarding the US interest in Greenland and the Panama Canal suggests that the geopolitical landscape will also be a focus in the first 100 days of the administration. Given the previous 4 years under Trump, we should really expect the unexpected. There is the prospect of the new Trump administration ushering in a new era of deregulation and tax cuts that sees animal spirits return to markets. While this can't be ruled out, in our view such a change in behaviour would still drive a style rotation out of large "Mag7" names into domestically orientated small caps.

We have been consistent in our belief that inflation will be structurally higher over the coming decade than it has been for the past 20 years, given security of supply concerns (semi conductors, critical minerals), an ageing work force (stickier labour costs), embedded rental pressure in developed economies due to housing shortages and given government spending patterns, ongoing tax imposts on business and consumers, which leaves the cost of doing business structurally higher. Given this backdrop, we have been cautious on the speed of rate cuts, given credit spreads are very benign and asset prices are at record highs. This is hardly the backdrop for aggressive monetary policy response, while as per our earlier comment, the valuations across many equities (technology), in our view do not reflect the higher interest rate environment. The only logical answer in our view for rapid interest rate cuts, is that the US Public Debt is actually a far bigger problem than the Fed is wanting to admit. To us, the US deficit remains the most pressing issue in finance through this decade. Interest rates above 4% are very problematic for the US budget deficit. Although from all our reading, it appears Scott Bessent, the incoming US Treasury Secretary, is as well credentialed to tackle the US Public Debt and deficit spending as well as anyone in recent history. The other asset to consider from a macro standpoint is the US dollar. How much does the new administration focus on the USD? Much of the election campaign was based on a weaker USD to help domestic manufacturing. The opposite is currently true.

One of the key variables this year will be Chinese policy (much like the past 2 years). For all the rhetoric about supporting the economy, Chinese data still remains challenging, albeit showing some signs of stabilising. We have been of the view that China hasn't fired all their policy bullets as they have been waiting to see the outcome of the election, and the potential changes to trade deals (tariffs). The willingness of Trump and President Xi to work together or otherwise may signal a change in sector leadership. If a mutually beneficial trade outcome can be reached (Trump did reach a deal in his first term in January 2020, before COVID struck), then it may pave the way for better global growth prospects than the market is currently pricing in. We note the prevailing sentiment at the end of 2024 was for US exceptionalism to continue, with the leadership of US tech and the US economy to lead the way, at the expense of China and every other international market, with Europe considered a basket case. While much of this is true, the dispersion of outcomes and the asymmetry (read crowded positions) suggests to us that not much needs to change to see significant sector rotation. At the very least, the bond market is signaling a return to more value orientated fundamental investing may well pay dividends in 2025. The key question this year lies at the heart of the question, will Trump focus on tariffs and deportations, or deregulation and business?

So what does this mean for positioning?

We try to insulate the fund as much as possible from macro variables by allocating most of the capital (60-70%) to predictable cash generating companies where there is evidence of sustainable cash flow growth. We are happy to allocate capital to cyclical stocks, but with lower weightings given the cycle of cash flows, while a consistent allocation to gold equities tends to assist the fund in times of inherent volatility. **Our philosophy with the Chester High Conviction Fund remains to protect and then grow (what we hope to be) generational wealth. Protecting capital means a rigorous focus on asymmetric investing. This focus on fundamental investment drivers we believe will benefit our fund over the next 2-3 years as we believe the style bias will favour value oriented investing, which hasn't been the case over the last 2 years.**

Portfolio changes this quarter

The portfolio was less active during the December quarter as we consolidated positions and focused on higher conviction ideas leading into 2025. We exited Atlas Arteria **(ALX)** during the quarter. While the initial entry came after the toll road tax was legislated in 2023, the uncertain French political environment and growing budget deficits in the country provide a challenging environment for toll road operators who have seen additional taxes on operations. ALX's primary asset, APRR, concession ends in 2035, and additional taxes have the potential to effect distributions made to ALX as APRR will need to amortise the existing debt within the entity over the remaining concession life. While ALX has challenged the tax, we view an outcome to be both uncertain and lengthy. We also exited Telstra **(TLS)** in December after a period of strong share price appreciation, from our entry price in May TLS' valuation now appears full, trading on 19x FY26 PE, with concerns around a slightly softer outlook for the February 1H25 result. While TLS is the owner and operator of best in class assets, we see better opportunities elsewhere. We also consolidated our gold positions in the quarter, after exiting Evolution Mining **(EVN)** following a strong period of outperformance that left it trading above our valuation, as was Spartan Resources **(SPR),** which was a position we initiated in the first half of 2023, below AUD30c and exited above AUD1.40, making it a strong performer for the fund over that period. We are evaluating several other gold companies that we think may offer strong prospects over the coming 2-3 years. Late in the quarter we re-initiated a small position in Ramsay Healthcare **(RHC)**, which categorically falls into the unloved camp. We previously exited our position in RHC above AUD80/share when private equity group, KKR made a conditional takeover proposal in 2022. RHC is trading well below our valuation, while admittedly there remains industry structure headwinds relating to hospital cost inflation and affordability of private health insurance (PHI). It does appear that volumes have picked up somewhat over the past 3-4 months, while the industry structure does need attention as clearly the number 2 private hospital operator (Healthscope) is facing financial stress. Ultimately though, the sector provides an essential service and RHC has the highest quality assets in the industry, trading at a material discount to our valuation. The wildcard (certainly not our base case) is if RHC is able to exit the underperforming French assets (roughly 25% of our valuation). RHC has a strong mandate to shrink to greatness. A material re-rating would occur on this outcome, in our view.

How is the portfolio positioned?

We remain in the camp that the global monetary debasement issue (printing more fiat currencies because of unrelenting fiscal deficits) will shape the portfolio construction framework over the next decade. Because of this issue, our investment thesis has been focused on structurally higher inflation during this decade, as opposed to the past 2 decades of deflationary forces. We separate near term disinflationary pressures from goods deflation from this structural thesis around monetary debasement. Our focus remains on four key areas of investing, which are listed below and have been consistently applied for the past 5 years.

Gold. We continue to hold a high conviction view that gold equities will perform strongly over the next 2-3 years, given sentiment remains poor, the underlying commodity price has broken out and cash flows will start improving. Gold equities are still trading significantly below the 2011 peak (as per the GDX gold ETF) and as such, we believe as economies slow, and interest rate cuts start being factored in, gold miners will have a very strong period ahead of them. Gold equities currently comprise around 7% of the portfolio with an upward bias.

Real assets. Assets that are very hard to replicate or disrupt indicates a strong starting point. All remain essential services in a modern economy. We would place **AZJ, QUB, EGH, RHC**, **ASK** and **MIN** in this category. We think REITs are interesting when interest rates start falling, while suspect the recent rally in REITs may have jumped the gun on interest rate expectations. Artificial Intelligence will find it hard to disrupt real assets.

Valuation margin of safety. An asymmetric risk profile. We would place **ASB, LLC**, **NUF** and **WOR** in this category. A material discount to book value has provided a strong starting point in many cases with catalysts emerging over the next 12-18 months to see the valuation gap close. We are mindful that several of these positions simply haven't worked as yet, with the catalysts for any re-rating being pushed to the right.

Pricing power, or at a minimum pricing pass through. With cost inflation evident, how likely is a company to be able to at a minimum hold margins, that is, pass through higher costs to their customers without impacting customer engagement? We would place **CSL, RMD, TLC** and **NWS** (through its holding in REA, Dow Jones and Move) in this category. We think margin resilience becomes an important driver of equity returns in the post free money era.

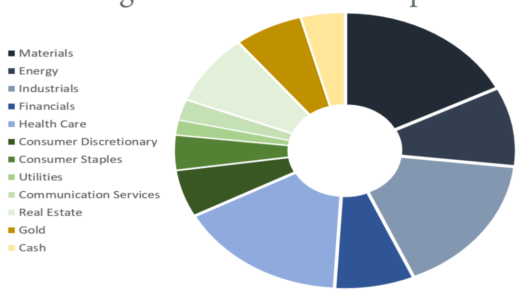
The Portfolio

The CHCF posted a-0.4% fall in the quarter, relative to the-0.8% fall in the ASX300 Accumulation Index. The gold sector had a strong quarter, with both key holdings Genesis **(GMD)** and Westgold **(WGX)** posting strong quarters. The record AUD gold price is providing a strong backdrop for free cash flow growth in 2025 for AUD gold producers. Block **(SQ2)** had a strong November as a perceived beneficiary of the Trump election win, given the expectation of less financial regulation in the US. We remain favorably disposed to the SQ2 business fundamentals, given the likelihood of top line momentum in Cash App as it adds new features (AfterPay) to entice new users into the ecosystem. The detractors from performance included former market darling, Mineral Resources **(MIN)**. The corporate governance issues at MIN have been well publicised. Suffice to say, after a challenging year, we hope the Onslow Iron Ore project ramps up as expected, and the corporate governance at MIN is far better in January 2026 than it has been. The valuation discount in our view remains too wide. Comet Ridge **(COI)** had a soft quarter. Mahalo JV partner and operator Santos (STO) is moving slower than we would like in progressing the Mahalo project towards final investment decision (FID). Patience is a virtue here as this Bowen Basin gas is still a strategic asset.

Top 3 holdings	Portfolio breakdown	
CSL	Materials ex Gold	17.6%
Austal	Industrials	16.7%
Develop Global	Health Care	16.3%

Top 3 portfolio attribution	Bottom 3 portfolio attribution
Genesis Minerals	Mineral Resources
Westgold Resources	Comet Ridge
Block Inc	Aurizon

Fund weights - diverse sector exposure



WHAT ARE WE THINKING ABOUT?

THEME	IMPACT	EQUITY CONSIDERATIONS
TIME FOR A STYLE CHANGE?	It hasn't really paid to be a value manager for most of the last 20 years, with growth and momentum being far and away the most successful style of investing. As we start 2025, we wonder if the crowded trades continue to work or if value, which includes commodities (including energy) actually have a sustained period of outperformance. This is not to say we are pessimistic on markets, our view suggests from this point valuations become more relevant.	We can wrap this up in one big macro trend, but the strength of the USD is ensuring the US stock market retains global leadership and exceptionalism. The rest of the world has clearly lagged US markets over this period, so much so that US markets look very full on most valuation metrics. The contrarian trades become small cap, international and value. Yes, it appears unlikely right now, but positioning is everything.
US DOLLAR	The strength in the USD is showing no signs of weakening, which ties into the style outlined above. The Trump administration philosophically would prefer a weaker USD given the motivation to increase US manufacturing, however this is easier said than done. Given the relative strength in the US economy and the higher US interest projections, the strength in the USD makes intuitive sense.	The strength in the USD creates a headwind for emerging markets (and commodities historically) given the significant USD denominated debt issued outside the US. It may well be the most influential asset price direction of 2025. It, like other trades appears to be very crowded as we start 2025. It is good for Australian companies with offshore revenue, which the portfolio has a material exposure to.
CHINA	In their own words from December the economic priority is "vigorously boosting consumption, improving investment efficiency and expanding domestic demand on all fronts" as the first priority for this year. While "building a modern industrial system" is now the second priority, the reverse of what was the case last year. Given how important stability is, we think the market underestimates any harmonious deal being done between China and the US.	China can't continue to rely on the export driven model that has served them so well since 2001. There is much at stake for Xi to stabilise the economy and pull China out of the deflationary spiral it is currently in. More targeted stimulus is needed, but has to coincide with certainty of the new terms of engagement with the US. Both Trump and Xi deal in negotiating and value reciprocity. It would be favorable for global growth if an agreement was reached early.
ARTIFICIAL INTELLIGENCE	This thematic remains a key influence in markets, where we continue to keep assessing and re-framing our thinking. Our concern currently lies with the extreme exuberance of data centre capital investments, which is the current bottleneck for the future exponential data growth required by AI, according to many forecasts we currently observe. The cycle for new data centres to plan, construct, fit out and grow capacity takes 4-5 years. Our query has always been, what if actual demand isn't as strong as current optimistic forecasts? There is a "build it and they will come" mentality to this investment.	We have watched the lithium market with fascination over the past 5 years. The observation being rarely do optimistic forecasts ever get exceeded, the most likely outcome is project delays, funding issues, capex overruns that make all real world activities harder than an excel spreadsheet. We have watched with great interest the recent funding round of OpenAI (owner of ChatGPT), who as the first mover in open-sourced AI data, is struggling to get investors to stump up the next round of funding for future losses. Most of the key executives of OpenAI have left in the past 6 months. We sense trouble ahead for the AI bubble.
THE BULL CASE?	What if the Trump administration heralds in a new era of deregulation and animal spirits? What happens on January 21st if on day one cutting red tape and taxes and letting the US domestic economy invest with confidence? Given there is a lot of cynicism given the chaos of his first term, maybe the second term is a chance to atone for mistakes the first time around. Trump gets the right people involved? Cutting immigration actually motivates the blue collar work force?	The chance of a complete change in government intervention is higher than zero. Which is also to say that a style rotation into domestic cyclicals and small caps has a high probability of working. Obviously there may be a period of uncertainty given the expectation of material government job losses under the DOGE framework. Trump works on animal spirits, whereby the US economy hasn't had any confidence to deploy capital outside data centres for a significant period.
2025 A STOCK PICKERS YEAR?	While it's possible, it appears unlikely that the ASX Banks index repeats a year like 2024. CBA hasn't grown eps for a decade and is now trading on 25.5x PER and a 3.2% dividend yield. Both metrics that make no sense to any fundamental investment thesis. Hence our view is that in absence of the bank sector doing much of the heavy lifting and technology stocks broadly too expensive, we do think 2025 will be an easier year for bottom up stock picking.	With one eye on the US outlook and another eye on the Australian election, we are hopeful that 2025 could usher in a better time for small and mid cap stocks. The focus on government largesse post the COVID period should be one of the main themes in 2025. An era of deregulation and less government intervention would be welcomed by domestic stocks and small caps. We outline 5 idiosyncratic ideas inside that we believe can generate strong returns in 2025.

Chester High Conviction Fund top 10 holdings

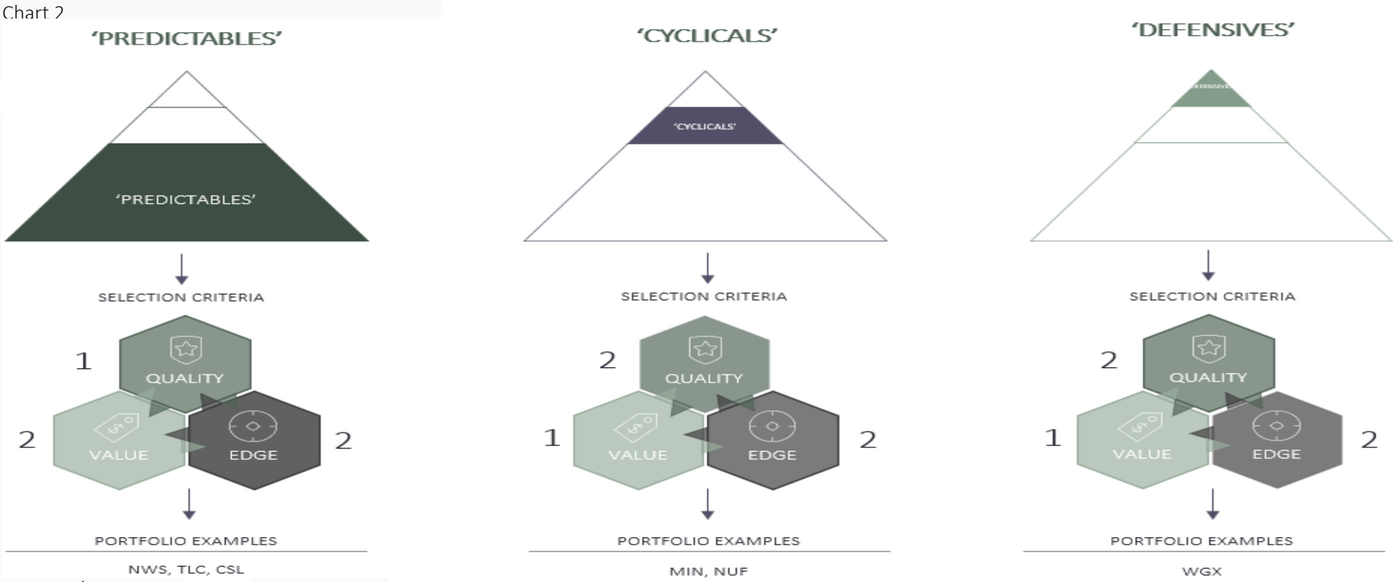
	Cash flow style	FY1 Sales GR	FY2 Sales GR	FY1 Div Yield	FY2 Div Yield	FY1 ROE	FY2 ROE	FY1 BOOK VALUE	FY25 EV/EBITDA	FY1 EPS GR	FY2 EPS GR	FY1 PER	FY2 PER
Abacus Storage King	Predictable	4.0%	10.9%	5.4%	5.5%	5.9%	4.0%	69.1%	19.4	-2.3%	-8.6%	17.6	17.4
Austal	Predictable	4.9%	10.3%	0.0%	0.0%	4.4%	5.5%	1.1	8.2	42.0%	36.0%	25.2	18.6
Aurizon	Predictable	3.9%	2.8%	5.8%	6.4%	10.0%	10.7%	1.3	6.6	-3.6%	9.2%	13.8	12.7
CSL	Predictable	7.1%	6.7%	1.7%	1.9%	17.2%	18.0%	4.3	19.6	12.1%	15.8%	25.5	22.0
Develop Global	Cyclical	51.8%	76.6%	0.0%	0.0%	-0.5%	16.0%	1.9	nm	nm	nm	nm	8.1
Light & Wonder	Predictable	11.0%	5.6%	0.0%	0.0%	40.9%	51.4%	3.7	8.9	38.9%	19.4%	14.9	12.5
Orora	Predictable	-6.4%	25.3%	4.0%	4.6%	11.5%	15.5%	2.8	14.2	-10.1%	16.1%	16.9	14.6
Resmed	Predictable	9.3%	7.5%	1.0%	1.1%	25.3%	23.9%	5.8	19.5	21.2%	10.2%	24.5	22.2
South32	Cyclical	-3.2%	3.6%	3.3%	4.8%	10.4%	11.2%	1.7	4.9	89.4%	33.5%	13.2	9.8
Westgold Resources	Defensive	129.2%	27.8%	2.3%	2.7%	35.3%	29.6%	4.1	3.4	98.5%	30.2%	6.5	5.0

Source: Chester Asset Management, Bloomberg consensus data

We have listed here our top ten holdings at the 1st of January, 2025. Our fund is actively managed and has no position that is simply there to lower the tracking error against the index. It is truly benchmark unaware investing. We broadly hold positions between 1% and 6% depending on our conviction level on the stock and the size of the company. Our conviction level is dictated by the broad art of combining; 1/ the appropriate valuation of the stock, with; 2/ our assessment of the quality of the assets and management team, overlayed by; 3/ our expectations vs the market (or insight/edge) of the earnings projection. I.e. Do we think the market is mispricing earnings? For our thesis to hold, we require at least 2 of these 3 factors to be validated for the investment case.

To explain that in more detail we have used a slide from our presentation material (chart 2 below). The majority of the stocks currently held in the top ten holdings are classified as "predictables" (industrials, REITs or healthcare, etc) while Develop Global (DVP) and South32 (S32) are classified as "cyclicals". Our gold holdings are classified as "defensives", and currently our largest position is Westgold (WGX). When we are allocating capital to those sectors that are more predictable in nature, our primary focus is the quality of the industry position they hold and relative cash flow certainty. We determine this by asking ourselves 7 questions around pricing power, barriers to entry, threat of disruption, etc. We also ask a range of questions around the management incentive structure and track record. Once we decide that a company is well positioned, we then seek at least one other "thesis" to hold true. For predictable companies, we need to be convinced around the quality first, and then valuation or edge. For cyclical or defensive (gold) companies, we need to have a high degree of confidence in the valuation support first (as by definition, we cannot be sure of how predictable the cash flows are). We then seek a degree of conviction around the management team and whether we have a unique insight ("edge") to those particular assets. Thus for the cyclical or gold stocks, it is primarily a valuation driven decision first.

Chart 2



Source: Chester Asset Management

CHCF portfolio construction framework

We have always broken down our portfolio construction into three categories as outlined in chart 3. We think of most sectors in the predictables bucket: healthcare, consumer staples, defence, infrastructure, etc. as, in general, able to offer relatively predictable cash flow profiles from the industry structure they operate in. We are the first to admit this is a relatively primitive exercise given that many stocks have very different cash flow characteristics that may be categorised in several ways. For example, gaming or more specifically casinos have historically been relatively predictable cash flow generators, but COVID derailed many of these formerly "predictable" sectors. We focus heavily on the industry structure and competitive advantages of each company when assessing the investment thesis for "predictable" stocks.

We use the word "relatively" predictable, as sectors that are genuinely cyclical in nature (energy, commodities, retail, etc) there is always less certainty over the longevity of a cash flow cycle and sustainability of margins, hence given the uncertainty, we tend to desire much greater valuation support in cyclical sectors.

The "defensive" sleeve is comprised of positions that are historically uncorrelated to the ASX300. We classify gold equities with this lens, as a historical study of large equity market drawdowns highlights how well gold holds up in extremely volatile markets. Cash is often a residual position that we simply state as the option to buy something cheaper in the future.

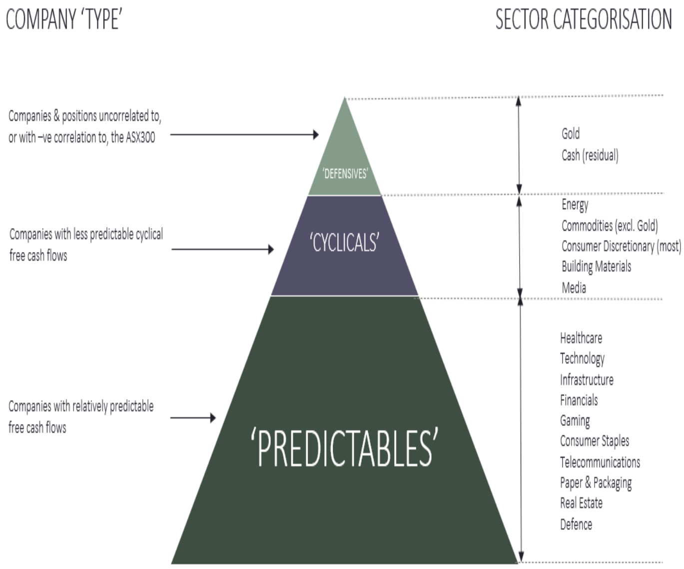
Chart 4 illustrates how these "buckets" have looked over the past 9 years. On average, the allocation to predictables has been 60-70%, while cyclicals have averaged around 18% (10-25%) and defensives have ranged from 10-25% (averaging around 15% of the fund). We have tended to hold an increased cyclical position over the past 6 months, which is predominantly in energy, uranium and select idiosyncratic ideas. The history of the strategy has been successful in delivering alpha, outside FY19, in which the fund was (in hindsight) too cyclical leading into the end of 2018, and then far too defensive during the first part of 2019. We are aware that cyclicals by their nature are higher beta, which means they often appear as the best, or worst performers. Hence the exposure to this part of the market is managed accordingly.

Chart 5 highlights the portfolio characteristics of the CHCF vs the ASX300. We historically find these metrics relatively fluid given the portfolio changes that reflect new weights and new decisions. While these characteristics provide a snapshot of the fund at a point in time, in aggregate, we don't find them particularly insightful.

What this data highlights is that the fund has a value bias, this assisted by stocks such as Westgold (WGX), which is trading on 6.3x PER and should see 111% eps growth in FY25. These types of idiosyncratic decisions can influence the overall shape of the portfolio. But at an aggregate level, the fund has a lower yield than the ASX300, which is primarily a result of no exposure to BHP, RIO or the major banks, which is where the bulk of the ASX300 yield is generated. The fund also shows far superior eps growth relative to the ASX300, with far better valuation support. Bearing in mind, this strategy is designed to be different from the ASX300. The ambition of our strategy is to provide a very different product than the ASX300, as without thinking differently, we would never have achieved the track record over the past 10 years, with lower volatility than the market. It is truly index unaware investing.

How do we allocate capital?

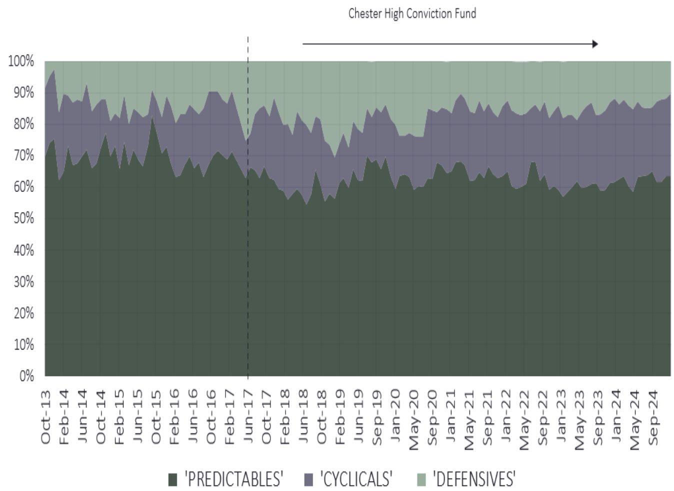
Chart 3



Source: Chester Asset Management

Which has been done consistently over time

Chart 4



Source: Chester Asset Management

Chester High Conviction Fund portfolio characteristics

Chart 5

	CHCF	ASX300 Index
PER FY1	17.3	18.7
PER FY2	15.2	17.8
FY1 EPS growth	30.8%	-2.5%
FY2 EPS growth	13.5%	5.0%
ROE	12.6	12.4
Beta	0.86	1.00
FY25 Yield	2.1	3.4
FY1 DPS growth	22.2%	2.8%

note Chester data excludes non revenue generating companies

Source: Chester Asset Management, Bloomberg, Macquarie research

Stock selection - Resmed (RMD)

Description ResMed (RMD ASX) is a global leader in digital health and connected medical devices, specialising in obstructive sleep apnea (OSA), chronic obstructive pulmonary disease (COPD), and other respiratory conditions. Established in 1989 RMD has since pioneered innovative solutions to improve the lives of millions of patients worldwide. Currently serving 178m patients in 140 countries with a view of increasing that to 250m patients by 2028. RMD's portfolio includes advanced CPAP (continuous positive airway pressure) machines Airsense-11 being the latest model, masks, and cloud-based software platforms (AirView) that enable remote monitoring and personalised therapy management. RMD continually introduces cutting-edge technologies to enhance patient comfort, compliance, and clinical outcomes. Its comprehensive ecosystem integrates hardware, software, and data analytics to optimize therapy delivery and improve patient engagement

Quality RMD benefits from favourable industry dynamics driven by an aging population, rising awareness of sleep disorders, and increasing demand for remote patient monitoring solutions. The company's focus on respiratory care, particularly sleep apnea and COPD, aligns with growing global health concerns, providing a solid foundation for sustained growth. Moreover, RMD's management team, led by CEO Mick Farrell, has demonstrated a keen ability to navigate market challenges and capitalize on emerging opportunities. RMD faces notable rivals such as Philips Respironics, a key player in the sleep therapy market. However, RMD currently commands ~70% market share assisted by Phillips' product recalls. RMD's commitment to R&D, coupled with its comprehensive product portfolio and focus on digital solutions, gives it a competitive edge. RMD remains well placed to maintain its leadership position and drive long-term shareholder value.

Valuation AUD40.00/share DCF derived valuation (WACC 8.5%, 3% TGR), using a AUD0.70c exchange rate. On Chester projected earnings RMD trades on 24x FY26 PER. Historically RMD has traded on 29x 1 year forward PER, hence still trades at a 30% discount to its historical average.

Insight We believe there is still a long runway to treat OSA with sleep devices and masks in conjunction with alternative therapies (GLP-1's). RMD has such a significant market share even though competitor Philips' recall issues came at a time when RMD were somewhat chip constrained, based on pre-recall trends, ~2m patients were untreated for OSA from FY20 to FY24. After a FY24 for RMD that ended with mid-single digit device growth and Philips returning to the market, consensus only has ~3% devices growth in FY25 and FY26. This potentially underestimates "the great untreated". We understand RMD are targeting >6% devices growth in FY25. The top-line difference over 2 years would be meaningful to the bottom line, the direct impact of which is examined below, note this excludes any indirect benefits of enhanced mask sales. Ongoing discussions with US sleep physicians highlight the strong rate of referrals for sleep apnea assessment, with OSA awareness only increasing with the GLP-1 consumer awareness and clinical trials involving weight loss and the decrease in OSA from these trials. There is a longer term risk that significant weight loss does in fact reduce the incidence of OSA to the extent that some patients may no longer need sleep devices, however, we are of the view in the medium term, the uptick in awareness is only driving an increase in OSA diagnosis, whereby RMD and CPAP devices remain the gold standard of care. As per chart 9 below, we can note that even with consensus expecting low single digit device growth in FY25, the downloads of the RMD myAir App are 22% higher than pcp, which provides a positive backdrop for the 2Q result to be released in the coming weeks.

RMD has upside based on a catch up of untreated patients

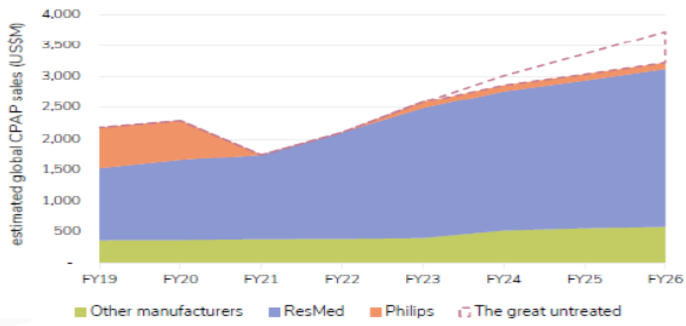
Chart 6

Resmed Potential Topline surprise	Measure	Amount	Comments
RMD Total Devices Sales FY24	USDm	2,444	RMD FY2024 Results
Global Market	USDm	3,000	Refer image across
RMD % of Global Market	%	81.5%	RMD sales / Global sales
Global Market FY26 w/ catch-up	USDm	3,750	Refer image across
RMD % of Global Market	%	78.5%	Assumed RMD retains most market share
RMD Total Devices Sales FY26	USDm	2,944	Market x RMD share, equates to ~9.5% p.a.
Consenus FY26 Devices sales	USDm	2,650	Survey of sell side
Difference GM level	USDm	176	Revenue difference at 60% GM
% of consensus PBT	%	7%	FY26 consensus PBT USD2,670m

Source: Chester Asset Management

RMD should capture the bulk of the catch up in patient numbers

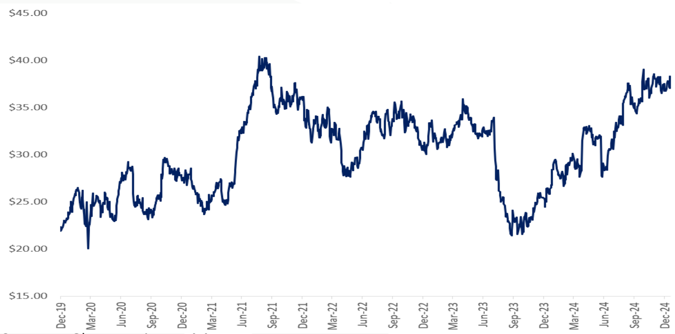
Chart 7



Source: Wilson Advisory

RMD is recovering from the GLP-1 narrative, with strong growth

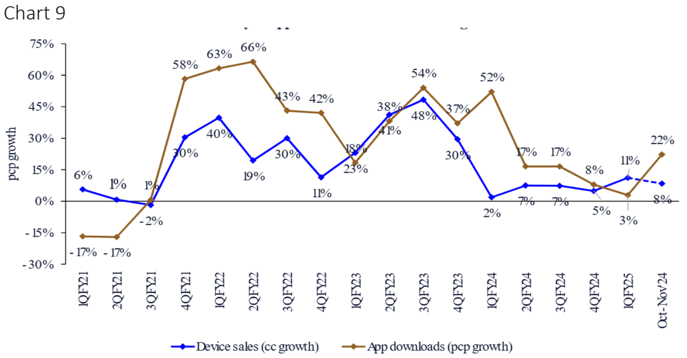
Chart 8



Source: Chester Asset Management

Growth in RMD myAir App downloads vs device sales growth

Chart 9



Source: Citi Research

Stock selection - Botanix (BOT)

Description

Botanix (BOT ASX) is an emerging ASX pharmaceutical company that sits on the cusp of a commercial launch of its leading product in the USA in 2025. Set to be marketed as Sofdra, BOT is the exclusive owner of the global rights to sofpironium bromide gel, the key active ingredient in a new daily treatment of primary axillary hyperhidrosis (PHA = excessive underarm sweating). Having achieved FDA (Food & Drug Administration) approval for the launch of Sofdra in June 2024 BOT will be launching their new therapy into a large and established market with approximately 10 million people in the USA suffering from PHA (Chart 12). Off the back of two large Phase 3 studies that evaluated the effectiveness and safety of Sofdra treating more than 700 patients, BOT looks well positioned to market Sofdra as an effective albeit differentiated treatment from currently approved therapies.

Quality

Since acquiring the global rights to sofpironium bromide gel in mid-2022, the BOT board and management team have successfully cleared the clinical and regulatory hurdles in front of them as they pursued a commercial launch for Sofdra in the world's largest dermatology market, the US. Lead by key executives that possess considerable experience in dermatology product launches management have made a number of decisions over the last couple of years that look set to give Sofdra the best opportunity for commercial success. Given their knowledge of the US healthcare system, together with the fact that PHA is a recognised medical condition, thus making it eligible for reimbursement via the US health insurers, BOT management have been developing a route-to-market strategy that looks set to offer PHA sufferers the opportunity to obtain Sofdra conveniently while minimizing out of pocket costs. In addition, management's decision in 2023 to pay the former owner of the sofpironium bromide asset USD8.25m to buyout the remaining milestone and royalty payments attached to the asset will likely be viewed very favourably if Sofdra gains the market adoption management are anticipating.

Valuation

Recognising the uncertainty that exists around key inputs such as price, reimbursement rates and insurance coverage, our assessed value for BOT is AUD0.78 using a 12.5% WACC and a 3% TGR, with an upside case and a downside case. (Chart 10)

Insight

At its simplest, the success of Sofdra will likely be defined by how many PHA sufferers BOT can engage to try Sofdra and even more importantly, how many of those that try continue to use the treatment because they are satisfied with the overall experience and effectiveness of the treatment. It's Chester's belief that BOT management are developing a distribution model that is most appropriate for the type of condition PHA is and how sufferers will favour sourcing Sofdra. Consistent with the evolving US healthcare system and adoption of new technologies BOT will utilise telemedicine to streamline the prescription and refill process thereby reducing cost inefficiencies inherent in traditional wholesale and distribution channels. Furthermore, consistent with the belief that those impacted by PHA are 'silent sufferers' BOT will lean heavily on digital channels to acquire customers who favour online channels to research possible treatments for their condition.

A wide range of outcomes with asymmetric risk to the upside

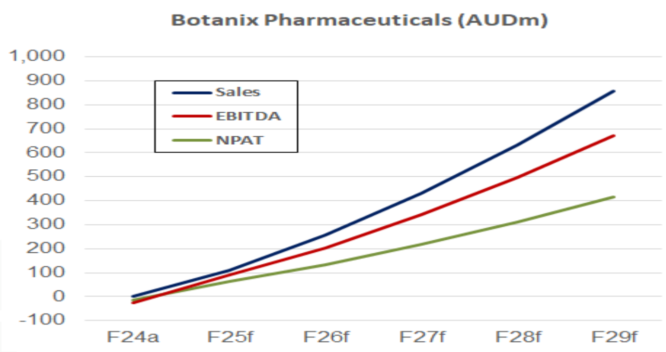
Chart 10

Valuation Scenario Analysis	Low	Base	High	Blue Sky
WACC	12.5%	12.5%	12.5%	12.5%
TGR	3.0%	3.0%	3.0%	3.0%
5 year Valuation				
US Mkt share Terminal Yr	0.5%	1.0%	2.5%	5.0%
US patients treated	23k	50k	115k	230k
Valuation	0.36	0.78	2.00	3.70
10 year Valuation				
US Mkt share Terminal Yr	0.9%	1.8%	4.5%	20.0%
US patients treated	48k	95k	240k	1.1m
Valuation	0.64	1.31	2.95	12.80

Source: Chester Asset Management

Botanix has material growth ahead on a successful roll out

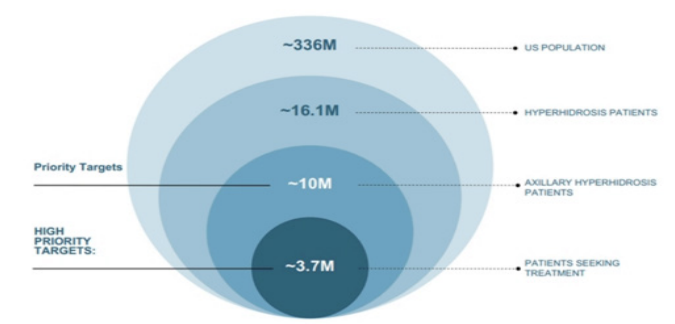
Chart 11



Source: Chester Asset Management

We only assume a small success rate from the addressable market

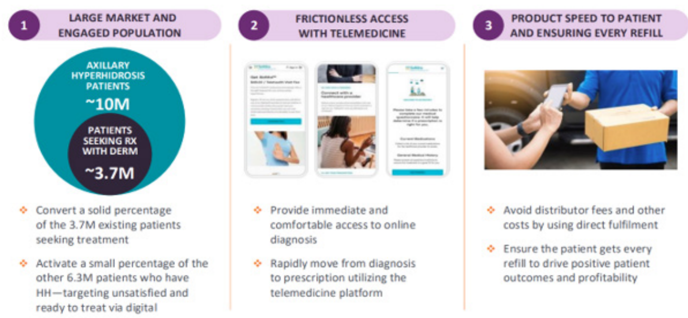
Chart 12



Source: Botanix presentation

Execution depends on patient diagnosis and repeat use

Chart 13



Source: Botanix presentation

Stock selection - Light and Wonder (LNW)

Description

Light and Wonder (LNW ASX / LNW NYSE), is a cross-platform content provider previously known as SciGames. The company is best known for its participation in the Electronic Gaming Machine (EGM) markets in North America and globally. Since 2019 the company has undergone a significant transformation that has seen it: changeover the board and Management team with ex Aristocrat CEO Jamie Odell becoming Chairman in May 2019, shed divisions to reduce its gearing level (from ND >10x EBITDA) and refocus the core of operations to 3 distinct divisions in Gaming, Digital (SciPlay) and iGaming. LNW are targeting USD1.4bn in EBITDA in 2025 a number that was previously dismissed as unachievable by analysts, but to us now looks conservative given the operating momentum LNW are currently achieving. For context, Gaming drives 65% of FY24 revenue, SciPlay 26% and iGaming 9%.

Quality

It is now estimated that ~100 of the senior and mid level management team are ex Aristocrat with LNW poaching some of the brightest talent from the market leader. This includes Chairman Jamie Odell, CEO Matt Wilson and several Game Developers including Ted Hase and Nathan Drain. We believe the track record of this management teams provides them with the greatest odds of history repeating. The business itself is at the forefront of becoming the leading Cross-Platform Global Games Company and the culture they have created enables them to extract synergies in game development and marketing. They enjoy a strong position in a fairly oligopolistic market with over 130 new games launched in FY24 which should enable ongoing market share gains for LNW.

Valuation

AUD184/share DCF derived valuation (WACC 9.0%, 3% TGR), using a AUD0.70c exchange rate. If LNW can achieve FY25 targets and trade to the ALL multiple, the share price would be >220/share. LNW currently trades on 16.1x FY25 PER for 43% eps growth, a 39% discount to the current Aristocrat (ALL) valuation, which we believe far too wide given the strength of the LNW business.

Insight

In September 2024, LNW was issued an injunction on one game that was deemed to have breached ALL intellectual property (Dragon Train). LNW was forced to recall these games off US floors and swap these boxes to new titles. Whilst this was a setback for LNW, the rapid turnover of games and significant number of new titles suggests to us that this game substitution can be relatively seamless. In context, while this game was deemed to be successful, LNW have launched 130 new titles in 2024 with 145 games slated for 2025. Dragon Train had 2200 installed machines in the US, and LNW have replaced 2100 with different titles and lost 100 units. Shenlong Unleashed and Huff n' Even more Puff are two titles well positioned to fill the gap. The company is confident the issue is isolated to this one game and one game developer who has since left the company. Given LNW operate in various segments with gaming operations (managing the installed base on behalf of the casino), which is where Dragon Train was sold, outright sales, international sales, SciPlay (online play) and iGaming, we believe LNW has many levers at their disposal to continue strong growth beyond the initial FY25 USD1.4bn EBITDA guidance they aspired to in 2022. In 2025, we expect LNW to set further medium term targets that should illustrate that the company continues to grow market share and innovate in a growing industry. From an international perspective we see significant opportunity with new regions opening up to casinos, including the Middle East, which might be a 2027 story, but could be material, along with Japan, Thailand and the Philippines to a lesser extent.

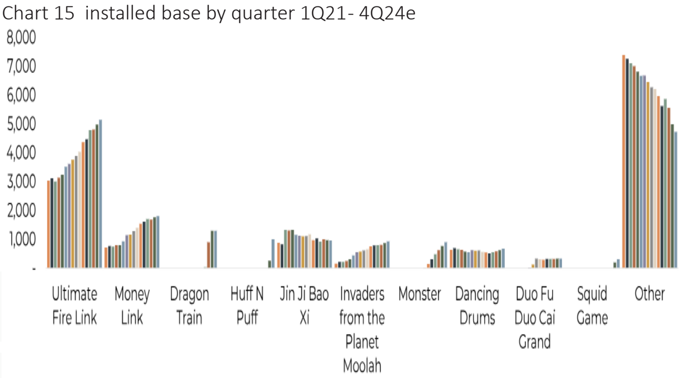
LNW has been a deleveraging story, but remains a growth business

Chart 14 in USD

Source: Chester Asset Management

LNW should be able to replace Dragon Train with other titles

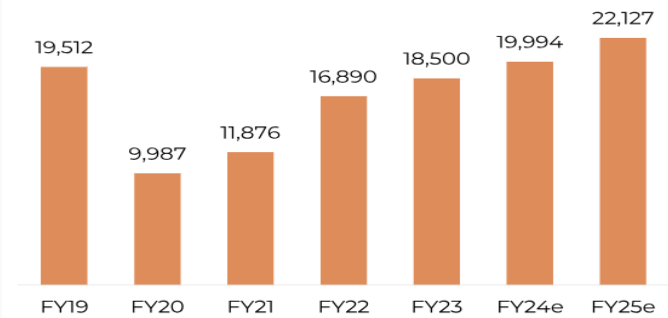
Chart 15 installed base by quarter 1Q21- 4Q24e



Source: Barrenjoey Research, Eilers & Krejcik

LNW seeing market share gains in US outright sales

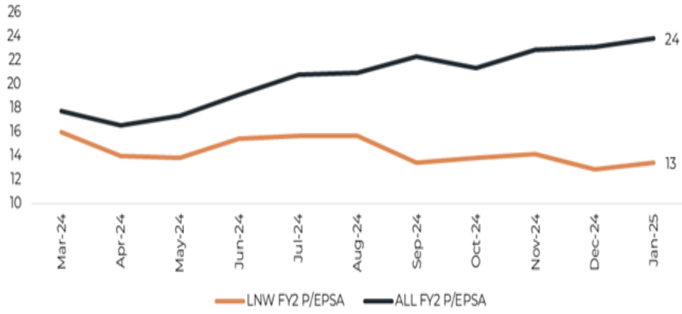
Chart 16



Source: Barrenjoey Research

The LNW FY26 PE discount to ALL is far too wide in our view

Chart 17



Source: Barrenjoey Research

Stock selection - Develop Global (DVP)

Description

Develop Global (DVP ASX) is a mining services company controlled by former Northern Star CEO, Bill Beament. DVP operates under a hybrid model as an underground mining contractor and operator of three mining assets: The Woodlawn Zinc-Copper Mine in NSW; the Sulphur Springs Zinc-Copper project in WA; and post the completion of the Essential Metals acquisition in November 2023 has added the Pioneer Dome Lithium project, located 130km south of Kalgoorlie in WA. DVP has three external underground mining contracts, the first of which is the AUD100m p.a. production and development contract for Bellevue Gold, while in CY24, DVP has also signed an 18 month contract with Mt Marion (MIN) for an underground development, and an initial 18 month contract at the Westgold (WGX) flagship gold asset, Beta Hunt in WA. The Woodlawn project is a restart operation, with FID signed recently, production is expected to commence in mid 2025. Woodlawn has robust project economics with PFS commodity price assumptions well below current spot prices. It is a polymetallic ore body, so will produce payable loads of zinc, copper, lead, gold and silver. It was purchased out of administration in 2021 for AUD100m, while the replacement cost of the plant and mining inventory is estimated at in excess of AUD500m.

Quality

DVP, as an underground miner, forms a critical component of developing new mining districts and is very much a people driven business. A high performance culture is essential in winning tenders profitably. Essentially the business is driven by Bill Beament (CEO and largest shareholder). Bill is well known to the market for taking Northern Star from a AUD100m mkt cap gold explorer, to an AUD5bn mkt cap at the time it merged with Saracen (SAR). So in many ways, an investment in DVP is backing Bill Beament to allocate capital towards the right projects, at the right time in the cycle. We believe DVP has a range of assets, that if executed well, will deliver a material step up in free cash flow over the next 3-5 years. It has strong leverage to a rising copper price, which is one of the key attractions.

Valuation

AUD3.85/share on a risk adjusted basis. This is risking both Sulphur Springs and Pioneer Dome projects heavily as there is an uncertain pathway to project development currently. On an upside case, DVP is worth AUD5.58 using our current commodity price assumptions.

Insight

DVP has significant portfolio optionality with its range of projects, although the market will not reward DVP until there is evidence of a commercial ramp up at Woodlawn (their first project to come on stream in mid 2025, after FID was announced in September). Our positioning in DVP is early as we believe Bill Beament has both the historical track record as an owner/operator and the incentives in place to ensure the Woodlawn ramp up is a success. Once DVP confirms strong cash flow growth out of Woodlawn, it may be in a position to sell-down a small percentage of the project to an offtake partner (historically, Japanese and Korean entities are happy to invest minority stakes in projects for guaranteed offtake). A project level sell-down would then enable DVP to recycle this capital into either Pioneer Dome or Sulphur Springs, depending on the macro landscape at the time. Whilst not a base case, it is something DVP is exploring, which would enable an acceleration of their portfolio development. The Chester approach (which differs from most generalists) is to value the assets in the ground and invest on that basis, while most investors will wait for confirmation of the production ramp up, which will drive the earnings uplift. We forecast DVP to be generating just under AUD200m EBITDA in FY27, based on the Woodlawn ramp up. If the successful execution of Woodlawn occurs, DVP will be materially higher in 12 months time.

DVP has a suite of assets that are materially undervalued

Chart 18

Risked DVP Valuation at 10% Discount Rate

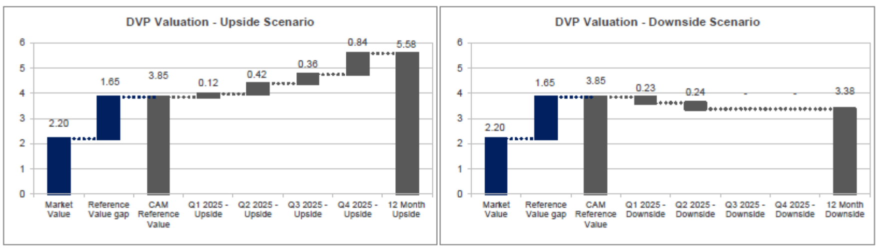
Asset	Unrisked NAV (AUDm)	Risking	Risked NAV (AUDm)	Per Share (AUDps)
Producing & Near Production Assets				
Woodlawn	681	80%	545	1.90
Sulphur Springs	351	30%	105	0.37
Underground Servic	358	75%	268	0.93
Pioneer Dome	180	60%	108	0.38
Key Assets	1,570		1,027	3.57
Development and Exploration Assets				
Whim Creek	20	40%	8	0.03
Exploration	165	*20%*	33	0.11
Other	185		41	0.14
Corporate/ Other				
Cash / (Net Debt)	14	100%	14	0.05
Ongoing Exploration	-	50%	-	-
Corporate G&A	(45)	100%	(45)	(0.16)
Investments / Other	70	100%	70	0.24
Corporate	39		39	0.14
Total	1,794	6.24	1,107	3.85

DVP Intrinsic v Market Value

	NPV Valuation	Market Price
Amount	3.85	2.20
Valuation Gap		75.07%

DVP's market price is below our Valuation. Material contributors to performance include:
- Commodity Prices. High leverage to copper and zinc prices;
- Coverage. Lack of coverage is impacting interest in the stock; and
- Complexity. Some are scared off but small degree of complexity in DVP.

DVP Valuation Timeline



Item	Description	Q1 2025	Q2 2025	Q3 2025	Q4 2025
Woodlawn	A high-grade zinc-copper-lead-gold-silver project in New South Wales, Australia, with a JORC-compliant resource of 7.3 million tonnes grading 13.2% zinc-equivalent.	Early ore on the ROM pad	Commissioning	Ramp-up of Woodlawn	Regional exploration
Upside Scenario		0.12	0.24	0.12	-
Downside Scenario		(0.12)	(0.24)	-	-
Mining Services	Provides underground mining services, contributing to DVP's revenue and supporting its mining operations and those of 3rd parties	Woodlawn and Bellevue ops	New Contracts - Havieron?	Woodlawn and Bellevue ops	New Contracts - Beta Hunt?
Upside Scenario		-	0.06	-	0.13
Downside Scenario		-	-	-	-
Sulfur Springs	A zinc-copper project in Western Australia's Pilbara region, with a mineral resource estimate of 13.8 million tonnes at 5.7% zinc and 1.1% copper.	Review of exploration opportunity	Woodlawn sell down to unlock capital for decline?	Update on exploration program potential	Underground Exploration
Upside Scenario		-	0.12	-	-
Downside Scenario		-	-	-	-
Pioneer Dome	A lithium project in WA, featuring the Dome North Lithium Project with a JORC Mineral Resource Estimate of 11.2 million tonnes at 1.16% Li_2O	Limited work expected at Pioneer Dome as Management waits for the lithium market to show signs of positivity. Potential engagement with MIN RE Bald Hill			
Upside Scenario		-	-	0.24	0.71
Downside Scenario		(0.11)	-	-	-
Scenario Totals					
Upside Scenario	Total Upside Scenario	0.12	0.42	0.36	0.84
Downside Scenario	Total Downside Scenario	(0.23)	(0.24)	-	-

Analysis is absent any movements in macroeconomic assumptions, and Valuation roll-forward.

Other Material Share price influences	
Management	Bill Beament is a larger than life character, there could be some things in his personal life or people that invest or don't invest in DVP because of Bill
TCRCs	Have the potential to surprise in terms of cash flows during the year
Commodities	Commodities and China in particular are on the nose, DVP will benefit from any shits in changes in attitude towards China

Source: Chester Asset Management research

Stock selection - Worley Limited (WOR)

Description

Worley (WOR ASX) is a leading engineering, procurement and construction (EPC) provider, delivering project and asset services globally. The WOR business is broken down into 3 segments, Energy (48% of sales), Chemicals (30%) and Resources (22%). Across the business, services range from project management for oil & gas majors such as Saudi Aramco, to full EPC services for carbon capture facilities.
The business has undergone meaningful change in recent years, shifting from a pure oil and gas contractor to a business with a global earnings base and broad end market diversification. Importantly, WOR has focused on winning a high degree of 'energy transition' work, for which the pipeline is significant (a fourfold increase in decarbonisation and green energy projects are projected to come to market in the medium-term). This, in combination with the continued recovery in traditional oil and gas capex and low competitive intensity, puts WOR in a position to grow earnings at a double digit CAGR over the next 3 years.

Quality

The majority of projects WOR works on are large and complex leaving only 2 other major competitors to complete a significant pipeline of globally available contracts. CEO, Chris Ashton was recently quoted, "From a competitive intensity perspective, is the lowest it's been in my career, in 35 years in the industry." This lack of competition means WOR can selectively work on high quality and low risk contracts, with 84% of WOR's work contract being reimbursable. Additionally, the favourable supply/demand dynamic means WOR can continue to lift contract pricing above inflation – positive for growing margins. Perhaps most importantly, a focus on energy transition has diversified WOR's earnings base from being reliant on highly cyclical oil and gas capex, to one that is leveraged to more steady sustainability work.

Valuation

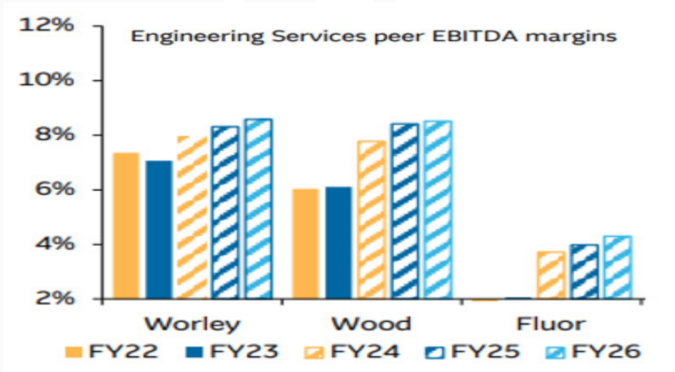
Our assessed value for WOR is currently AUD18.60 using a 10% WACC and a 3% TGR. On Chester projected earnings WOR trades on ~12x FY26 EPSA.

Insight

We believe the market is assuming little chance of Venture Global's CP2 contract ramp up (given perceived uncertainty surrounding final project approvals) and therefore see an asymmetric opportunity in WOR. Should full CP2 ramp up occur, we believe market expectations of FY26 earnings are likely to increase 10%+, given the chunky nature of contracts at high single digit EBITA margins. In our opinion, CP2 is likely to move full steam ahead, noting WOR is already on-site and part way through engineering/procurement work. We also believe the market is underestimating WOR's progression in shifting to a higher degree of sustainability work and as such are still valuing WOR like an oil proxy. Given the business is no longer a pure oil & gas contractor, and as the proportion of sustainability work increases (management are targeting 75% by the end of FY26), we believe the market will change its view of WOR. We also see the prospect of a pick up in projects being announced/approved once the Trump Inauguration is out of the way. Companies can then plan with more certainty, hence the order backlog should recommence post this lull over the past 6-12 months.

WOR delivers strong margins on higher value added work

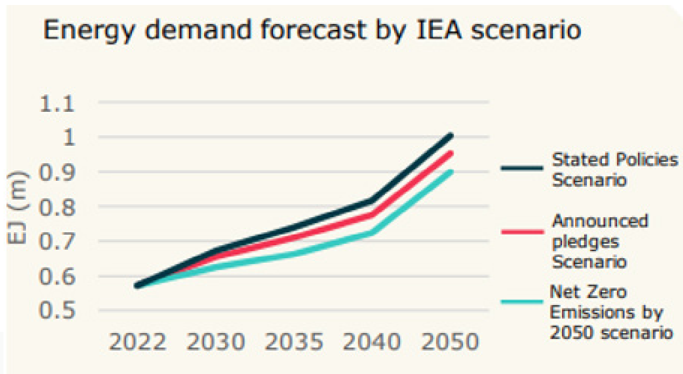
Chart 19



Source: Macquarie Research

WOR is a strong beneficiary of this tailwind over the next 2 decades

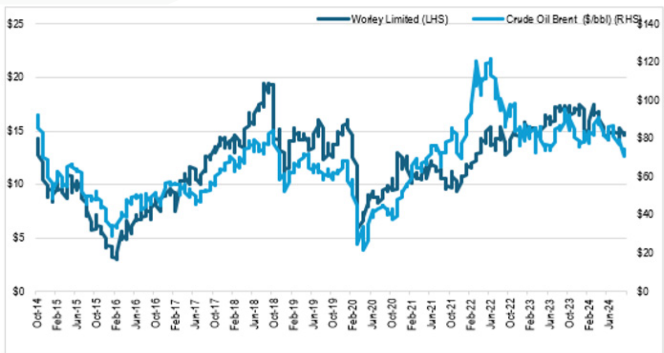
Chart 20



Source: IEA World Energy Outlook

WOR still trades in line with the oil price as a legacy relationship

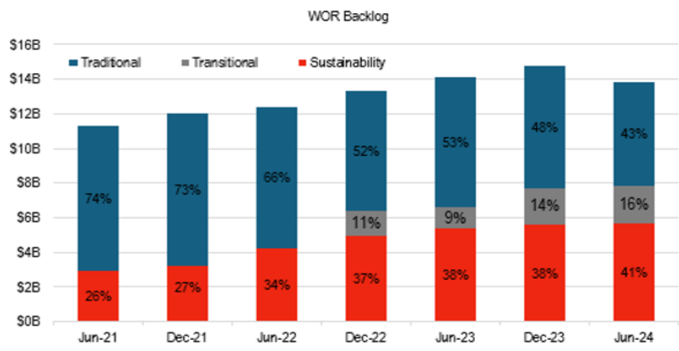
Chart 21



Source: Chester Asset Management

Sustainability work has grown to 41% of the backlog

Chart 22



Source: Worley, Chester Asset Management

US exceptionalism

We enter 2025 with the US as the overriding consensus trade. These charts outline how we have arrived at this juncture. Chart 25 highlights just how much better US eps growth has been than the rest of the world for the past decade. Clearly the earnings growth has led to the US outperformance and the record share of the global market (67% as per chart 27) and the ongoing dispersion of valuations afforded to specific markets. There is no question the US deserves a higher multiple than other global markets, but the magnitude of the rerating since the end of COVID leaves us concerned as to how much investors are paying for the privilege of owning US assets.

In our view much of the US strength has been due to the combination of the rise of the AI narrative, where undoubtedly the US tech sector leads the world, but also the sheer magnitude of the deficit spending (as per chart 26 below). Never has a country operated with such a deficit during times of economic expansion. Incoming Treasury Secretary, Scott Bessent said recently that the US doesn't have a revenue problem, it has an expenditure problem. The deficit is unsustainable, which may impact the profit margins that corporate America is currently operating with (chart 24), which have never been higher. Our view suggests there is a lot of good news priced into the US stock market, while the incoming Trump administration wants to slash government spending. That suggests to us uncertainty lies ahead.

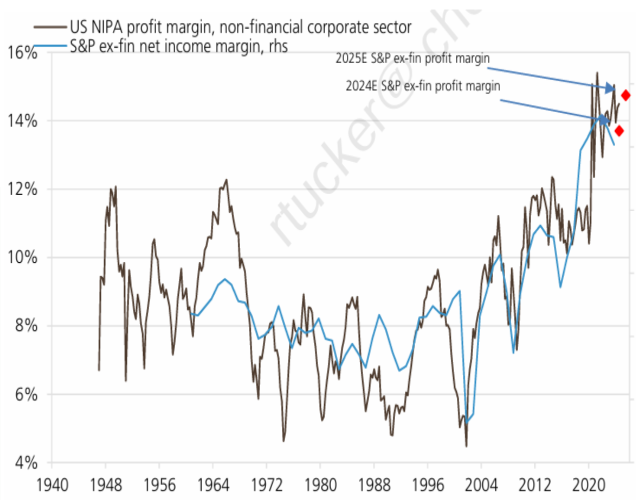
The US market is priced for ongoing growth

Chart 23

Source: UBS

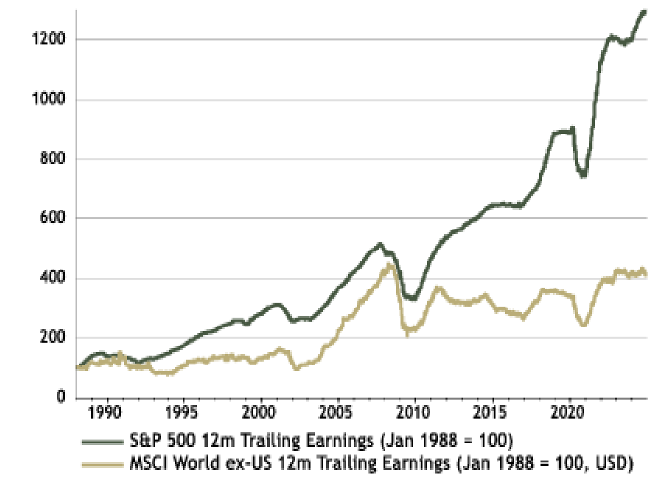
US profit share of GDP is at record highs

Chart 24



Which it has delivered relative to the rest of the world

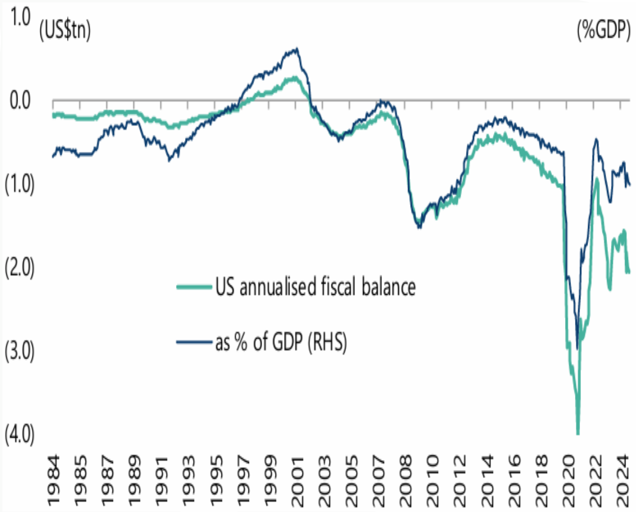
Chart 25



Source: ASR research

US annualised fiscal balance - unsustainable

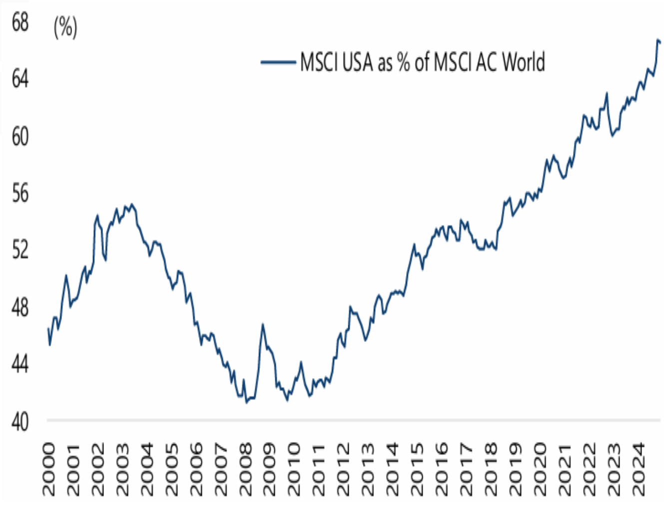
Chart 26



Source: Jefferies Research

US is now a record high as a % of the world stock market

Chart 27



Source: Jefferies Research

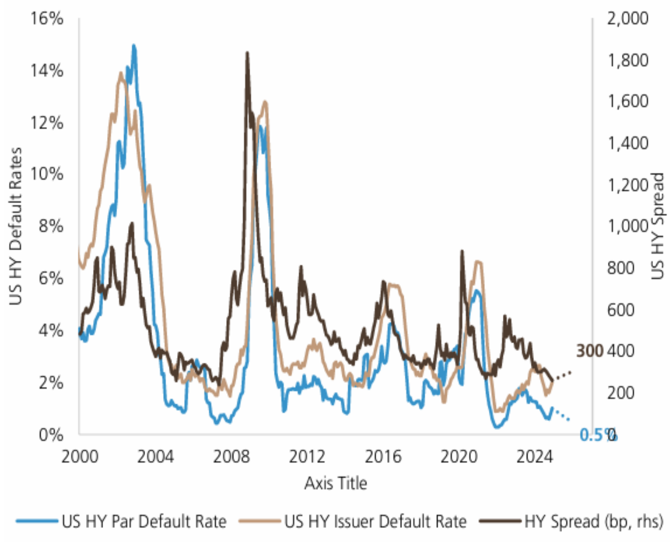
US Thoughts on DOGE

Much of what we write here will be outdated by the time the Trump inauguration takes place, given the speculation that he has over 100 executive orders to unveil on day one. We really wanted to focus on the Department of Government Efficiency (DOGE) given it is likely to have significant ramifications on both the size of the deficit going forward, but what it could mean for both the unemployment rate (1m ex government employees looking for work?) and the inflation outlook given material changes to social security or medicare could have ramifications for household spending and the price of goods and services (do we see a deflationary period?). As a side note, the launch of the $TRUMP meme coin that is (at the time of writing) now a US76bn asset reminds us that, for all the optimism of a conservative, private sector friendly president, things are unlikely to be smooth sailing and never far from controversy. Always back self interest etc etc...

In a letter published in the Wall Street Journal in November, Elon Musk and Vivak Ramaswamy authored an op-ed piece with the ambition of cutting US2Tn from the US budget deficit. In 2025, it is estimated (Congressional Budget Office) that US spending will be US7.0Tn with US receipts of US5.1Tn for a budget deficit of US1.9Tn in 2025. Our problem is outlined in chart 31 below. 95% of US receipts are outlays on either Social Security, Medicare, Medicaid, Veterans Affairs or net interest expense. All non discretionary items. Musk will view the waste and bureaucracy of government inefficiency as something he can attack. But this is easier said than done. Of the US2Tn of spending that is discretionary, US900bn is on defense spending, which Trump is supportive of increasing (particularly shipbuilding, which augurs well for our position in Austal). Thus the easiest path to cut spending is attacking the US1.1Tn of discretionary spend. The federal government employs around 3m people, across the various agencies and departments. If Elon Musk was successful in cutting 50% of the US government work force (1.5m jobs), it might save the US government a maximum of US300bn per annum (1.5m jobs at US200k p.a.). All else being equal this would increase the unemployment rate by almost 1% (161m total labour force) and cause significant dislocation to many government agencies. We think it is highly likely that if something of this magnitude is embarked on, it would act as a deflationary shock for equities, while also being positive for the US Treasury market (not having to issue as many new bonds) and arguably the USD would rally further. The curious thing about the magnitude of such a grand change to government spending is that Trump views the stock market as a real time indicator of his popularity.

The credit market is not worried about the US economy

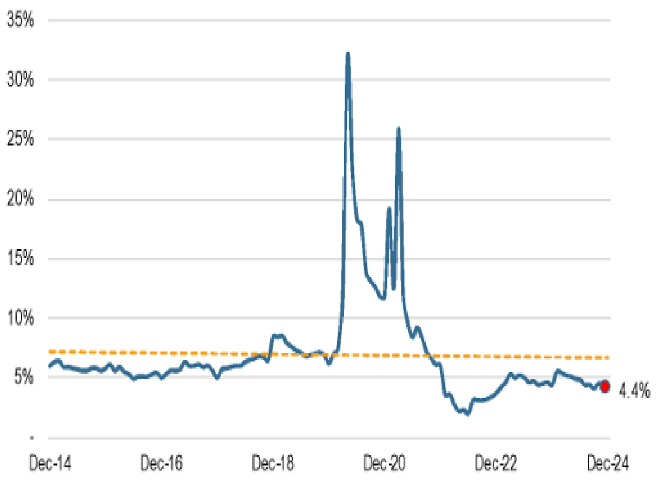
Chart 28



Source: UBS Research

US household savings is below the long term trend

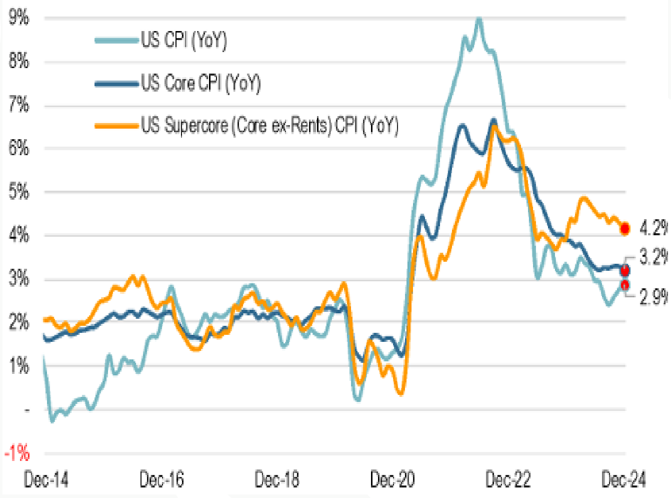
Chart 29



Source: JP Morgan

US inflation is subdued, but not yet beaten

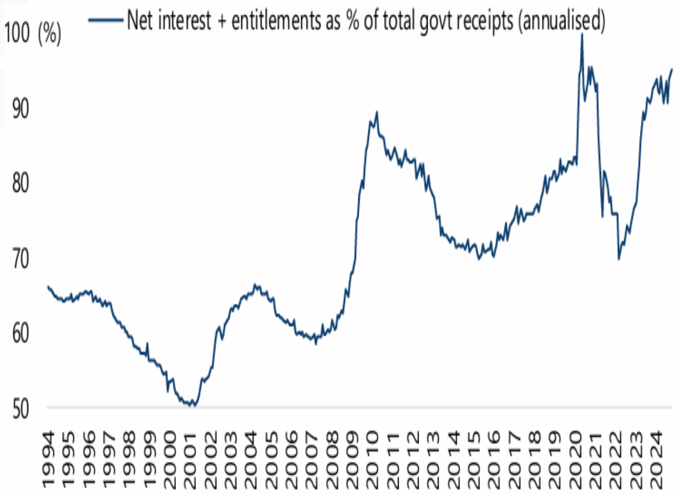
Chart 30



Source: JP Morgan

95% of government receipts are spent on non discretionary items

Chart 31



Source: Jefferies Research

China

Chinese policy holds one of the keys to the 2025 outlook in our view. The global view has been one of disappointment regarding the lack of a big bazooka style stimulus thus far, while domestically, mainland investors were more constructive on the various measures so far announced. Asset stabilisation has been the focus, particularly around house prices. Domestic consumption has been poor given confidence has been so weak, but there is US8.9Tn of deposits sitting in bank accounts that can be deployed if more consumers start spending with renewed confidence in the economic outlook. Confidence plays a large part in this, although confidence can only really exist if China knows what size of the tariffs they are dealing with as Trump starts his new administration. Chart 36 highlights just how poor sentiment is towards China from an investment standpoint, while clearly the Chinese 10 year bond yield (chart 33) is highlighting a deflationary spiral is underway, although 4th quarter property sales rose almost 10% yoy as easing measures were introduced. More property easing measures are expected post Chinese New Year and there is a material pick up in Chinese bonds being issued in 2025, which should allow uncompleted projects and vacant land to be bought back from developers, to clear the backlog of unsold inventory. Given how despised Chinese property is, maybe not much needs to go right in 2025?

Chinese steel production still resilient

Chart 32

Source: JP Morgan

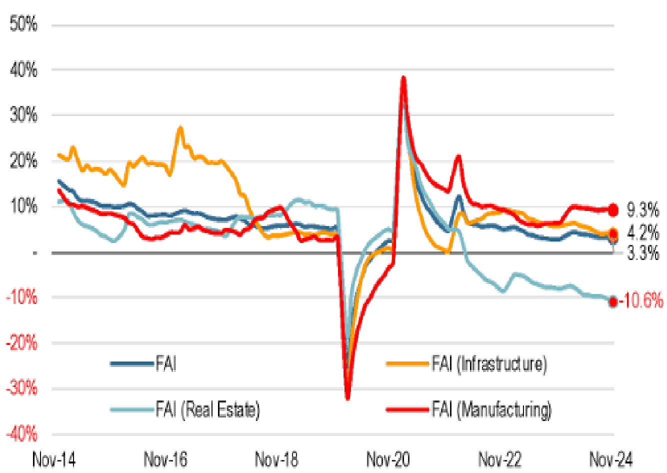
Chinese 10 year bond - priced for deflation

Chart 33

Source: Jefferies

Real Estate investment still recessionary

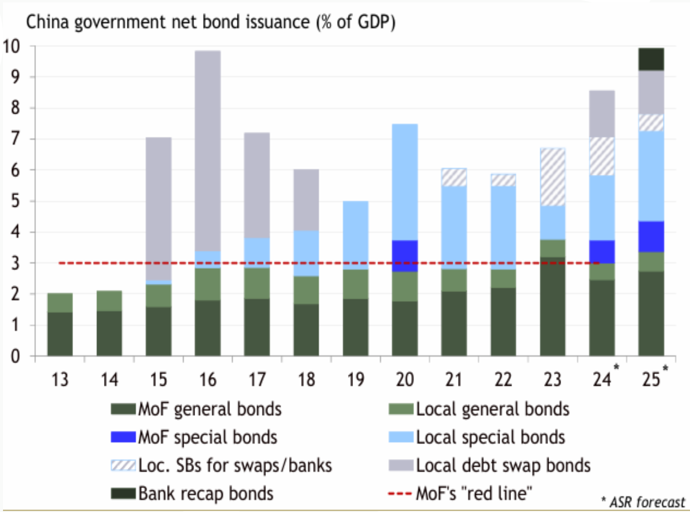
Chart 34



Source: JP Morgan

Chinese credit growth will accelerate in 2025

Chart 35



Source: ASR Research

While sentiment is absolutely appalling

Chart 36

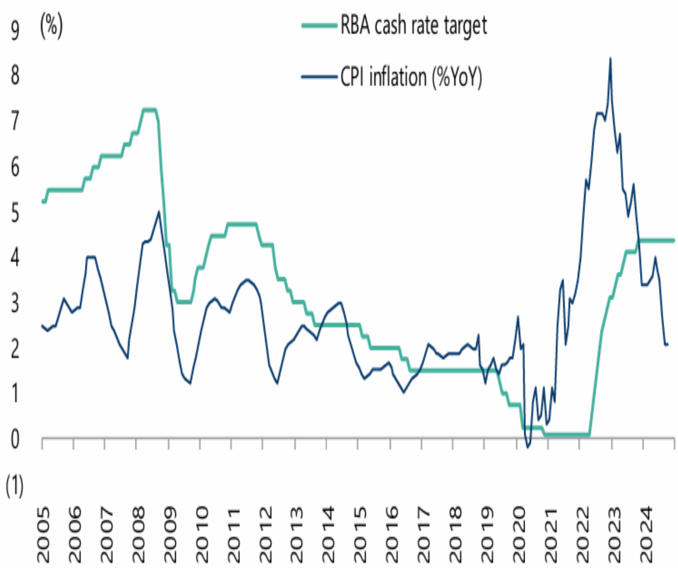
Source: UBS

Australia

Australia still seems stuck in the no landing camp, albeit inflation (as per chart 37) has fallen back far enough for rate cuts to be coming into view. Chart 41 is a significant impost on consumer confidence in our view, given the mortgage belt is facing a significant drag on discretionary income. Fortunately everyone still has a job, thus mortgages in aggregate are still being paid off. If we look at the ASX Bank performance in 2024, there are no signs of mortgage stress anywhere, potentially ever again (based on the valuations afforded the bank stocks). For the domestic cycle to improve, we need to see housing approvals (and then starts) re-accelerate from the decade lows we are witnessing. This, combined with the pent up demand for housing (immigration on chart 40 remains stubborn) suggests rental pressure will continue, making the mortgage belt and renters (under 35s) struggle with any savings. It doesn't augur well for the transfer of households assets outside estate planning and inheritance. One of our biggest concerns has been the job creation in Australia that has been highly geared towards the public sector (blue bars on chart 39). This public job creation has masked the underlying challenge for wage pressure to ease (that is fiscal policy is making it very difficult for monetary policy to work). To this end, we are watching the trends in the US closely, as to how successful Trump is in removing government largess. So is Peter Dutton.

2025 might see interest rates in Aust follow global rates

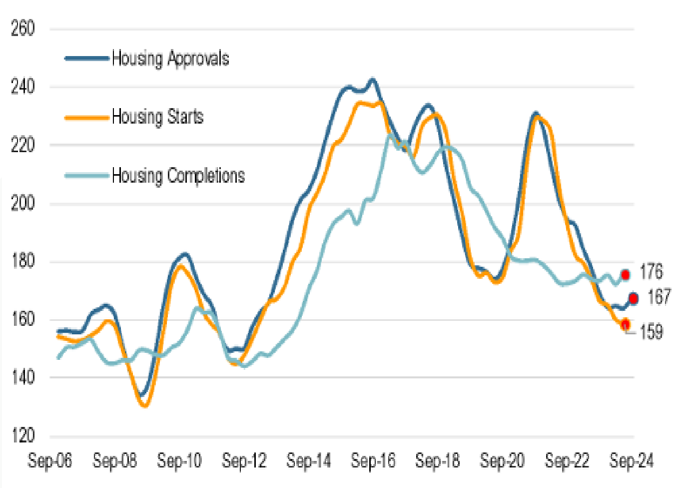
Chart 37



Source: Jefferies

The housing cycle remains stuck with a cost of supply issue

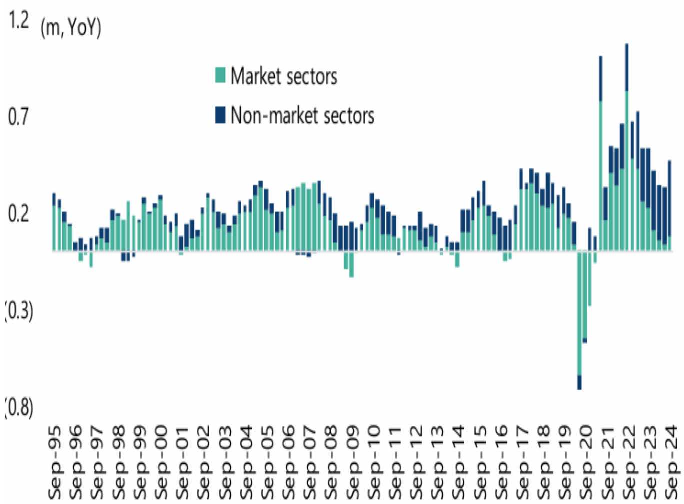
Chart 38



Source: JP Morgan

Most jobs created have been in the public sector

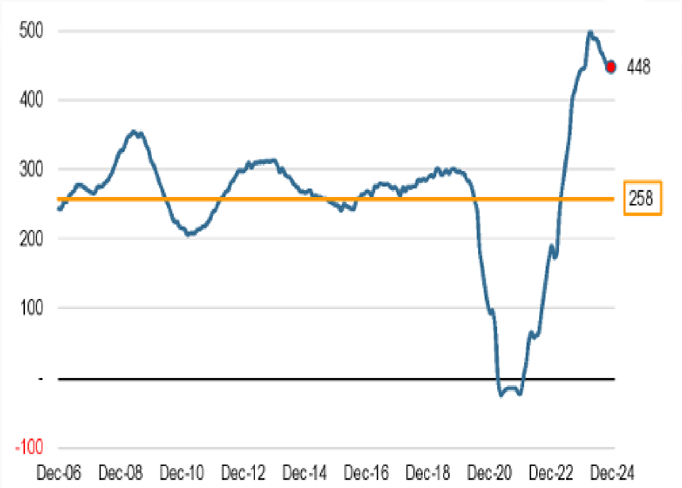
Chart 39



Source: JP Morgan

Immigration remains the key reason for housing shortages

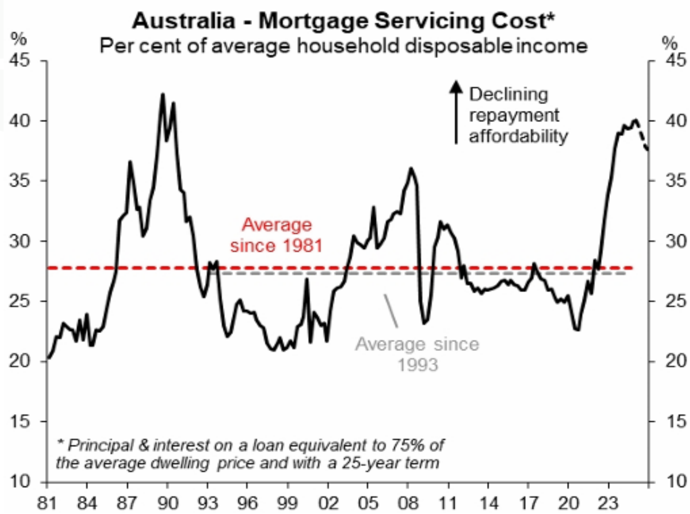
Chart 40



Source: JP Morgan

Wages and rents are the main pain points for inflation

Chart 41



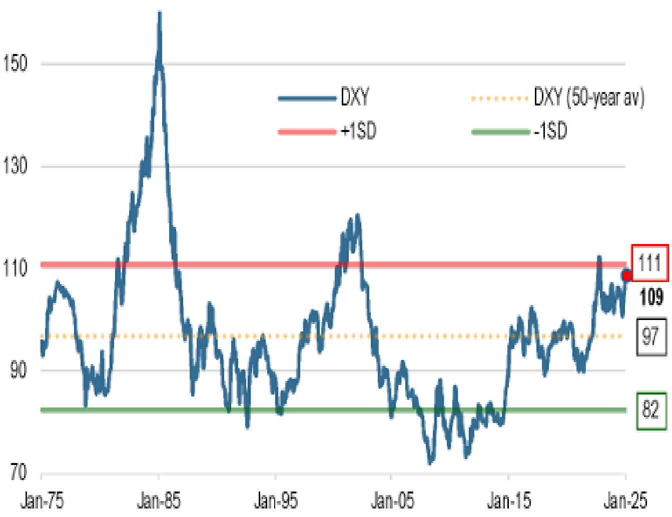
Source: Macquarie Research

Charts that make you go hmmm...

We often simply post some charts in the quarterly as we tend to think that sometimes, a picture is worth 1000 words. This is a collection of charts that help us make sense of what is happening. Chart 42 highlights the strength in the USD (DXY) against other currencies. It is a significant drag on returns for international markets. The strength owing to the current narrative around US exceptionalism (earnings growth and interest rate outlook attracting foreign capital and demand for USD). A very popular trade currently. Chart 43 highlights where much of the US earnings growth is coming from, namely capex spend on data centre roll out and an insatiable demand for chips that go into the AI infrastructure. While we don't disagree that the AI wave is a significant transformation, we disagree with how much we are being asked to pay for that exposure. The contrarian in us is waiting for (we believe) the period of over-investment and the inevitable disappointment of high expectations not being met. Chart 44 just reiterates how expensive Australian banks are, which gave the ASX 7.8% of the 11.4% total return in 2024. We don't believe this is sustainable. Given the hype of technology and growth stocks, value managers have had a particularly challenging time over the past 2 years. We believe that given the interest rate setting and Trump's focus on domestic growth, the set up for value to outperform is compelling in 2025.

The USD Index might be the most influential asset currently

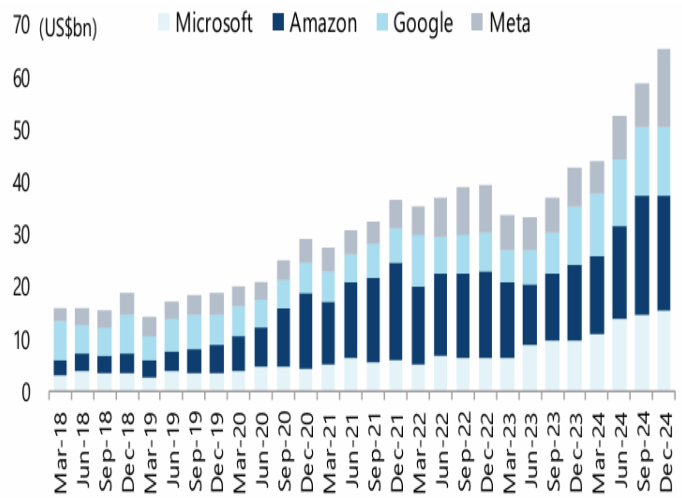
Chart 42



Source: JP Morgan

US hyperscalers' quarterly capex - all in on AI

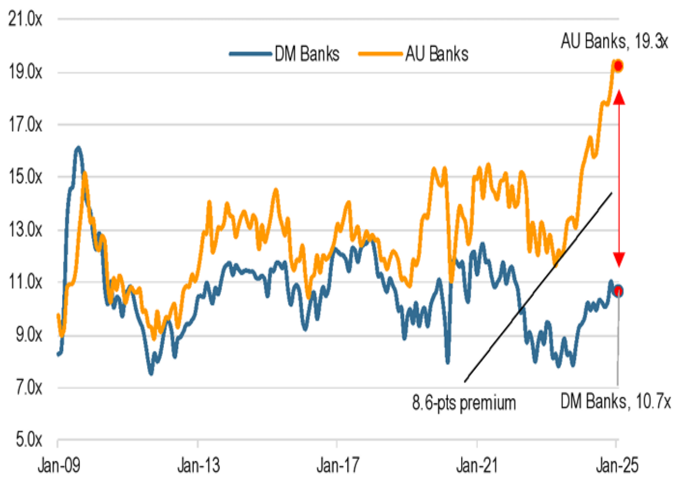
Chart 43



Source: Jefferies

Reinforcing how expensive Aust banks are to global banks

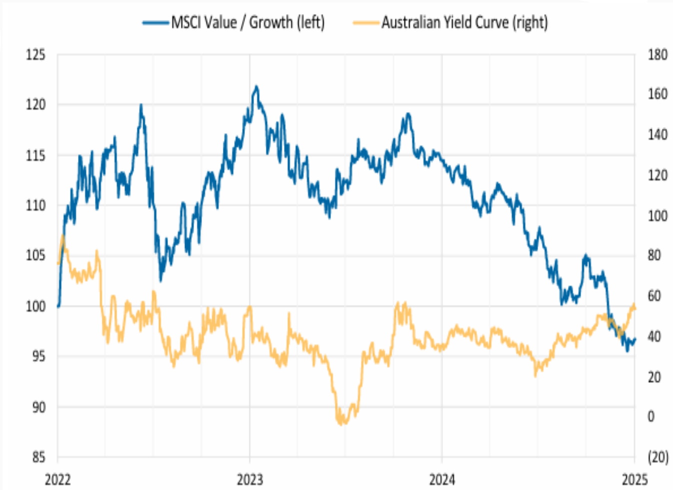
Chart 44



Source: JP Morgan

Value Managers have had a challenging 2 years

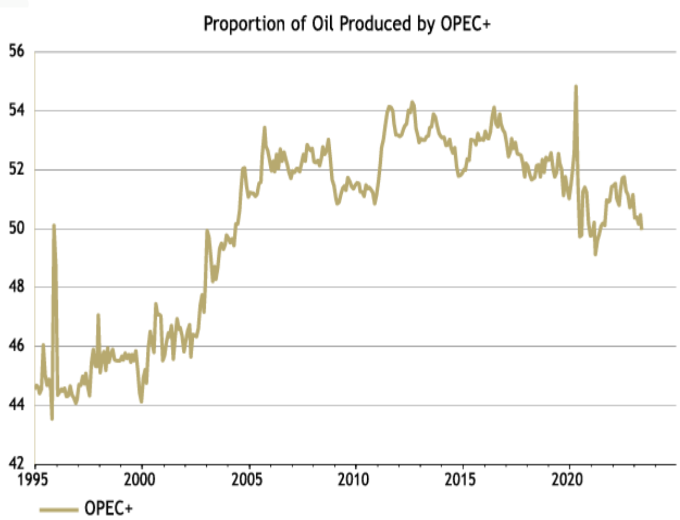
Chart 45



Source: Macquarie Research

Is OPEC becoming less influential?

Chart 46



Source: ASR Research

Executive summary

Equities

It is hard to start 2025 without trying to understand the policies of the new Trump administration. How much energy is devoted to tariffs and deportations (arguably both inflationary) versus a pro growth, deregulation stance that lets animal spirits loose (it has worked in crypto currencies). All this overlaid with the Department of Government Efficiency (DOGE) ambitiously aiming to cut US2Tn from the US outlays in 2 years. Which could be significantly deflationary. Then how does Trump influence geopolitical outcomes in 2025? On one hand it feels like we are closer to ending conflict in the Middle East and hopefully Russia/Ukraine, while on the other hand, sweeping comments around the Panama Canal and Greenland may keep global tensions high. All this suggests to us that volatility will increase in 2025. We believe Scott Bessent will make a sensible Treasury Secretary, who combined with Elon Musk, should ensure that US deficit spending is reigned in (as much as possible under Trump). We approach China with curiosity given how despised the market sentiment currently is. The banking system leverage, high property prices, soft real estate investment and an ageing demographic are well understood issues. Aggressive stimulus will be needed given the current deflationary forces are showing no signs of abating, while we still believe China is waiting to understand the new rules of engagement (tariffs) in order to proceed with confidence with new fiscal policy initiatives.

Given our view of investing leans towards unloved and underappreciated assets, we look for reasons why the current growth and momentum trade will change styles towards a more valuation driven approach in 2025. It has been a challenging 2 years for value managers. We believe the bond market (US 10 year yield at 4.7%) is signaling that inflation is far stickier than it has been historically, as do 5 year forward inflation expectations. Simply speaking, the valuation of high growth equities is (in our view) signaling an asymmetric outcome. There is far more risk to the downside than the upside. If the bond market is correct, valuations will matter again in 2025, and value will be a far stronger style than it has been. If Trump is successful in sweeping deregulation, then the most successful assets will be US domestic cyclicals and small caps, which again, suggests that 2025 will most likely see a style rotation at some stage.

Our view remains that real assets (property, infrastructure, agriculture, commodities, gold etc) will outperform capital light or long duration assets over the coming period, where we still see a wide valuation dispersion that needs to unwind. We believe inflation stabilises over the next 12 months, but remains somewhat embedded due to localisation of supply chains, decarbonisation, capital investment and a reversal of cheap labour arbitrage from emerging markets over the past 20 years.

We believe Australia is well placed to benefit from this trend over the coming decade, with an enviable lifestyle and strong (if not somewhat flawed) democracy. As a primary producer of agriculture and commodities, we are well set up to continue to prosper as a nation, which should all else being equal, attract global capital and labour via both skilled and unskilled migration. Whilst this may appear contradictory (relative to our positive stance on Australia), we remain cautious on China. Hence our commodity exposures are energy, base metals and agriculture over iron ore. At a sector level, we see merit in the idea that select industrials look attractive from a valuation perspective, energy and healthcare should see earnings resilience in this environment while gold equities look fascinating from a sentiment perspective. Bull markets historically follow bear markets and in that context, small caps tend to perform better as risk appetite increases. From a strategic perspective, as more dovish interest rate policies come into view (Australia appears at least 6 months behind the US), we may start to see some rotation from growth into value as a style, given many value driven stocks provide cyclical exposure to domestic economies. For the same reason, it would be a reason why small caps finally start outperforming large caps with higher domestic exposure. The Australian banks are priced as though there will never be another bad debt cycle. We remain very cautious towards the banking sector should we see unemployment pick up. We are also of the view that PE re-ratings are a thing of the past, hence earnings will be the only driver of stock prices going forward, meaning we believe a far more fundamental investment process will provide superior returns over the next 2-3 years.

By and large, our stock selection framework continues to focus on:
Real assets - **AZJ, S32, QUB, AGL, STO**
Valuation margin of safety - **CGF, LLC, ASB, WOR**
Pricing power - **CSL, RMD, NWS, TLC**
Gold - **WGX, GMD**

As we have demonstrated over the past 10 years with this strategy, the returns we generate do deviate significantly from the benchmark, where we are proud of the track record of the strategy, delivered with lower volatility than the ASX300.

Government spending and bond yields

Interest rates are under enormous strain with the amount of debt issuance by central banks, and we still wonder how ongoing US deficit spending is financed outside the Fed Reserve embarking on QE, which is potentially what the US bond market is pricing in. With this backdrop, the only way the debt burden to society gets repaid, is through asset reflation, or in some cases, debt forgiveness. Central banks (led by Japan) have had no other playbook since the GFC, and will continue to issue new bonds to finance the deficit spending of governments and the debt burden, which becomes debt monetisation. Since Alan Greenspan, Fed governors have always issued a “put” on the stock market with new easing policies, which in the next sharp downturn, eventually becomes yield curve control, and ultimately direct equity purchases, if needed. Jay Powell may well have “blinked” recently with his relatively dovish language, despite the fact that inflation remains well above trend.

Chester High Conviction Fund

Quarterly Thoughts

December 2024

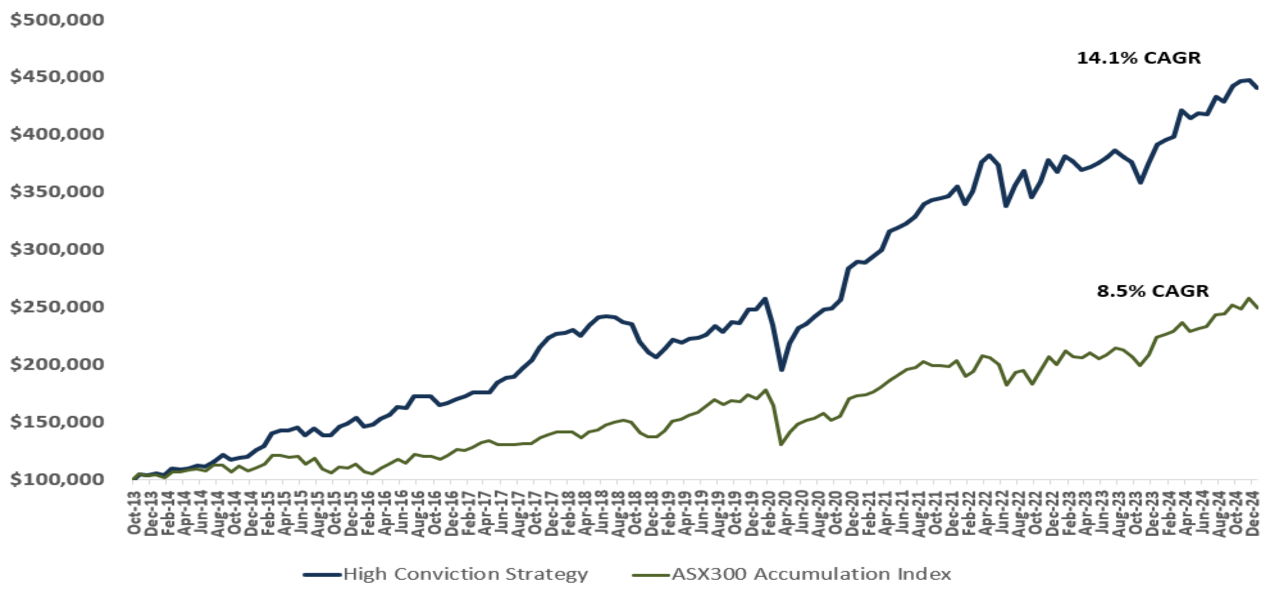
APIR OPS7755AU
ARSN OPS7755AU

Accumulated Performance by Financial Year - Same Strategy

	FY14 (%)#	FY15 (%)	FY16	FY17 (%)*	FY18 (%)	FY19 (%)	FY20 (%)	FY21 (%)	FY22 (%)	FY23 (%)	FY24 (%)	FY25 (%)	Since Incep (%)
Same Strategy (after MER)	+11.2	+24.5	+17.4	+11.2	+28.3	-6.4	+3.9	+37.2	+4.8	+12.5	+9.7	+5.6	+14.1
S&P/ASX 300 Accum Index	+7.8	+5.6	+0.9	+9.1	+13.2	+11.4	-7.7	+28.5	-6.8	+14.4	+11.9	+6.9	+8.5
Value added (after MER)	+3.5	+18.9	+16.4	+2.1	+15.1	-17.8	+11.6	+8.7	+11.6	-1.9	-2.2	-1.3	+5.6

Per Annum. The inception date of SGH Australia Plus was the 8th of October, 2013, where Rob Tucker was the sole Portfolio Manager, until his departure on February 28th, 2017.
* The inception date of the Chester High Conviction Fund was April 26th, 2017, hence FY17 reflects 8 months of SGH Australia Plus and 2 months of the CHCF.
We note this is a statement of fact of the performance achieved by the fund during the time which Rob Tucker was the sole Portfolio Manager making active decisions on the SGH Australia Plus portfolio. We note performance is the record of the firm not the individual however past performance has been constructed from publicly available unit price data. Past performance is not necessarily indicative of future performance and should not be relied upon in making investment decisions.

High Conviction Strategy - accumulated performance



Note this graph is representative only of the combination of the same Portfolio Manager running the same strategy, and would only represent actual returns for unit holders that invested money at inception of SGH Australia Plus, withdrew those funds at the end of February 2017 and then invested all those initial funds again at inception of the Chester High Conviction Fund in April 2017. Note, this depicts returns after fees.

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