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Quest Australian Equities Concentrated Portfolio

QUARTERLY REPORT
SEPTEMBER 2023

Australian Equities Concentrated Portfolio

Mr John Citizen
123 ABC Street
Sydney NSW 2000

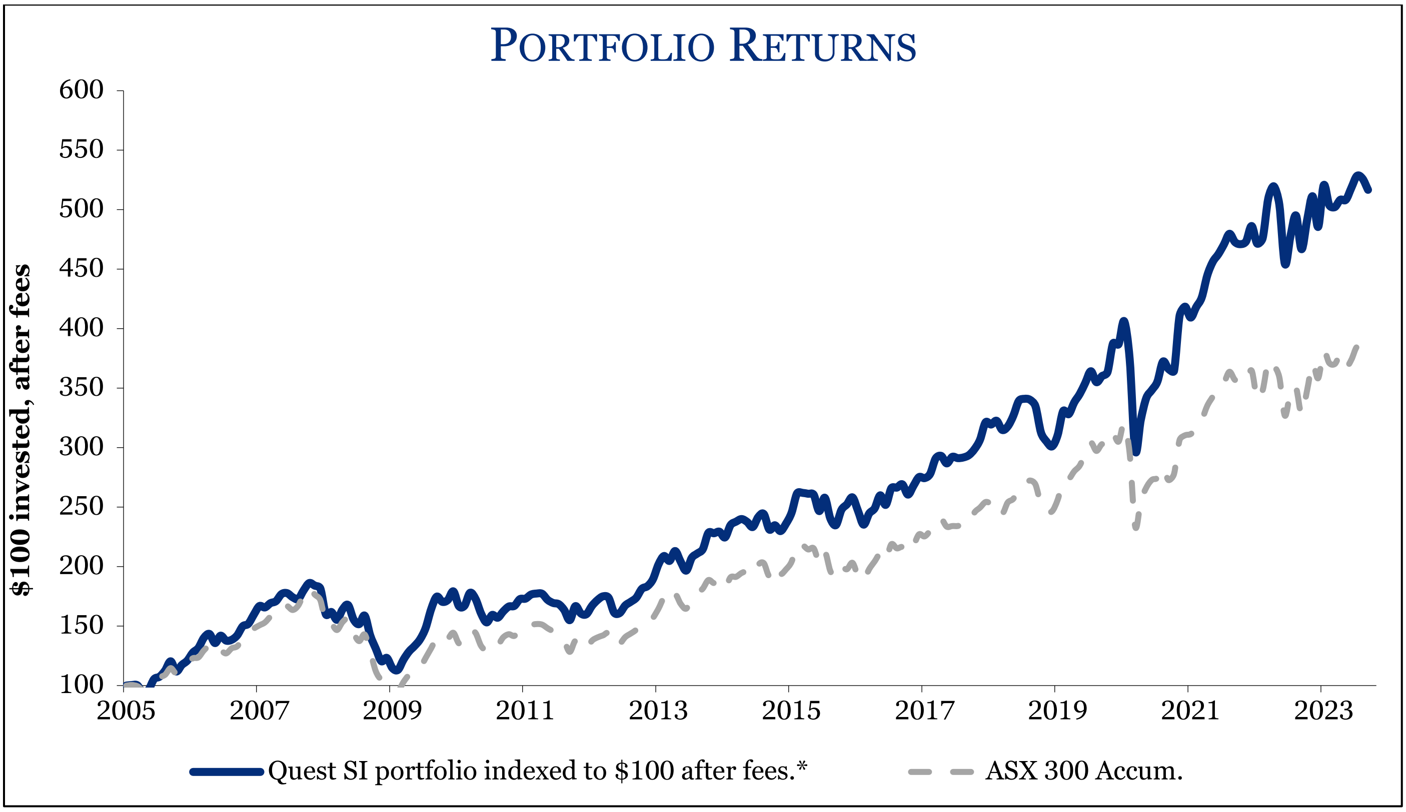
ACCOUNT NAME: Mr John Citizen

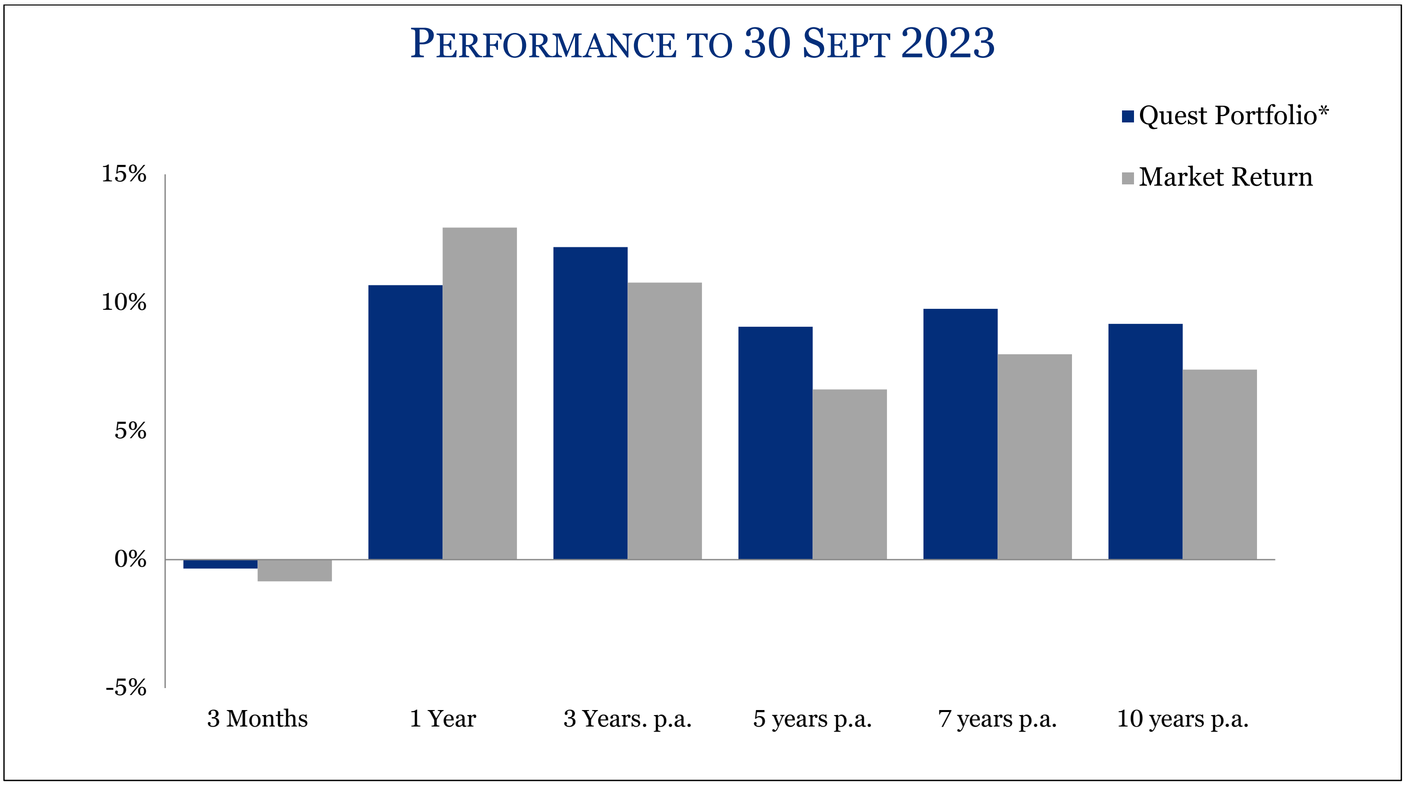
Portfolio Movement	
Previous market value 30 June 2023	
Contributions during Quarter	
Portfolio movement*	
Market Value 30 September 2023	

Your portfolio performance for the quarter*	-0.41%
Market return (S&P / ASX 300 Accumulation Index)	-0.85%
Your portfolio performance for the 12 months*	10.55%
Market return (S&P / ASX 300 Accumulation Index)	12.92%

* Includes fees for the period.

Portfolio Returns





* The portfolio returns shown above are for an actual client portfolio on the JBWere Multi Asset Platform. They demonstrate the returns achieved if invested in the Quest portfolio since inception (February 2005). Individual returns will differ for investors that made an initial investment after this inception date or where additional investments, redemptions or any SPP investments have been made. Quest returns are net of fees. Past performance is not a reliable indicator of future performance.

Market Review

The Australian S&P/ASX300 Accumulation Index was down 0.8% for the quarter. There was however a material change in sentiment which led to a correction late in the quarter.

Australia fared better than most other global markets. The S&P500 and NASDAQ indices in the U.S. fell 3.7% and 4.1% respectively and both Germany and Japan fell by more than 4%. The UK was the only positive major market, up 1.0%.

Markets entered the quarter in an optimistic mood, sensing that the Federal Reserve in the US was engineering a soft landing and that the recent incoming tide of higher interest rates would soon reverse. Tech stocks moved higher. The energy sector also began to move early in July.

The Fed and the ECB raised rates in July by 0.25% with the ECB raising again in September. The U.S. labour market remained strong and the economy appeared resilient.

Sentiment turned based on concerns that interest rates had not peaked and would remain higher for longer. The key development was the revised Fed "dot plot" which highlights each Fed member's view of the path for future interest rates. A correction followed with small falls in August followed by a heftier drop in September.

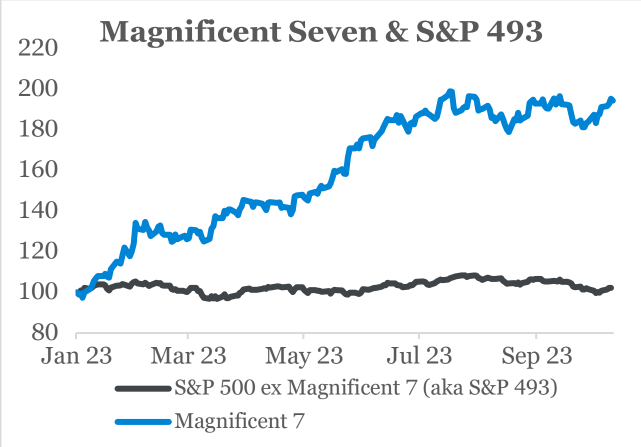
Yields on the all-important US 10-year Government bond surged. The yield was 3.9% at the start of the quarter and ended September at 4.6%. The last time we saw these levels was in mid-2007. This increase was partly due to the high levels of Government debt issuance in the U.S. (topping US$3 trillion).

Australian 10-year yields also jumped 0.5% to end the quarter at 4.5%. This is terrific for those with deposits.

Higher rates matter for stock valuation particularly when you consider that real yields were negative during the pandemic period (as rates were so low), which super-charged stock prices. Real yields are now spiking well above 2% and stock valuations are lower.

Despite this valuation headwind, large highly priced growth stocks in the U.S. have been conspicuously strong.

The so-called *Magnificent Seven*, comprising Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta and Tesla are buoying the performance of the U.S. market. These stocks have still massively outperformed the rest of the market. The chart below highlights the divergence of returns during 2023.



Source: Bloomberg, E&P

Note from the table below that a few did not fall back during the latest quarter. Investor focus on anything to do with Artificial Intelligence was the key factor here.

Magnificent Seven – returns (in order of market capitalization)			
	Mkt cap US$	Sept quarter	Calendar 2023
Apple	$2.8bn	-12%	+32%
Microsoft	$2.4bn	-7%	+33%
Alphabet	$1.8bn	+9%	+48%
Amazon	$1.4bn	-2%	+51%
Nvidia	$1.2bn	+3%	+198%
Meta	$840bn	+5%	+150%
Tesla	$835bn	-4%	+103%

Source: Iress

The global commodities index rose sharply during the quarter, driven by higher energy prices that resulted from cuts in oil production from Russia and Saudi Arabia. WTIS crude was up +29%, natural gas climbed +20% and thermal coal popped +25%. Other strong commodities included coking coal +31%, Aluminum +10% and iron ore +7%. Precious metals were down with both gold and silver falling -3%.

The Chinese economy remains under pressure. The property sector remains a concern with two large developers in a dire financial state. Investors expected a stronger response from authorities in Beijing who have not thrown the usual stimulus at the weakening property market. Beijing has had enough of speculative property bubbles.

Locally, the best sectors were Energy and Consumer Discretionary, the latter benefiting from surprisingly strong earnings during reporting season. Banks also performed well. Technology, Health and Real Estate posted poor returns in the September quarter.

The IPO scene remains very quiet with our team seeing only a couple of potential floats before Christmas. There are a number of corporate transactions underway, particularly relating to commodities.

Firstly, the merging of lithium producer **Allkem** with **Livent** (NYSE:LTHM), will see merger documents released later than expected in November. Quest owns Allkem shares. The deal seems likely to go ahead unless a third party were to emerge.

Newmont Corporation, based in Denver, has bid for **Newcrest** with all approvals now obtained. The Scheme meeting is to be held in October. Newcrest will remain listed as Newmont and trade as a CDI with the head stock being listed on the NYSE. Quest does not own Newcrest.

Lithium miner **Liontown** is constructing the Kathleen Valley underground project near Kalgoorlie and is now the subject of a $3 bid from **Albemarle** (NYSE: ALB). Lithium bearing rock is the source of lithium battery power and assets are both rare and valuable.

Gina Reinhardt has spoilt the party by buying 19% of the stock on market at $3 and is positioned to derail the shareholder's vote on the Albemarle takeover. Liontown may remain in Aussie hands! Quest does not hold Liontown shares.

Qantas continued their reputational Stuka dive in September with CEO Alan Joyce retiring early and a swag of customer service improvements announced. Quest is not fond of airlines and has never owned Qantas.

Origin Energy received notice that the ACCC had granted authorisation for the Brookfield and Mid Ocean Energy consortium to acquire the company subject to shareholder approval. The ACCC have decided the deal is in the public interest because of the staggering amounts of money that our energy transmission will cost. Quest does not hold Origin shares but invested in **AGL** earlier this year.

Quest Achievements

The Quest **Concentrated** SMA was the best performing Australian Equities portfolio over both 5 and 10 years to 30th June 2023 in the Morningstar Survey.

Financial Newswire/SQM awarded the Quest Concentrated portfolio **Fund Manager of the Year** 2023 in the Australian Equities SMA category.

In October Lonsec lifted the rating of Quest's Concentrated and Ex20 portfolios to the highest possible rating of **Highly Recommended**.

Quest was again a finalist in the 2023 Lonsec Fund Manager Awards.

Portfolio Review

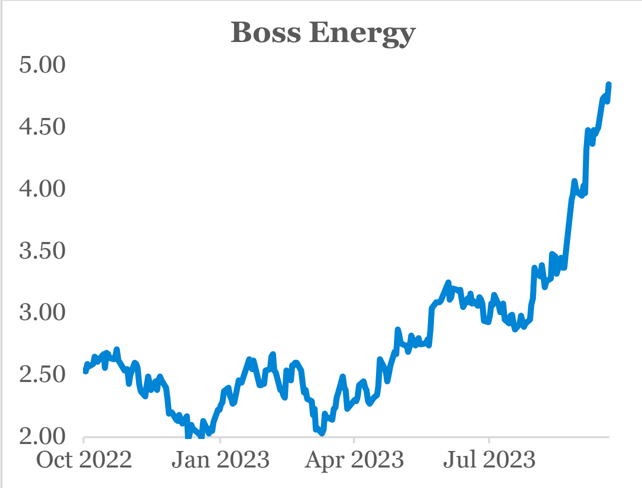
The Quest portfolio was flat in the September quarter and outperformed the index which fell 0.9%. The best stocks for Quest were **Boss Energy, Stanmore Coal, MAAS Group** and **Computershare**.

Boss Energy was the subject of a stock review in the recent Quest June 2023 Quarterly. The timing was good with Boss adding 56% in the quarter so someone obviously read it! The company is about to restart mining at the remote Honeymoon mine in South Australia.

Our original investment at $2.15 to fund plant rebuild and commissioning was followed by a lift in the uranium spot price from circa USD$30 to above USD$60 per pound. Uranium has done very little in the last decade but the market is springing back to life.

Boss is yet to commit to an offtake contract but we sense it is close with first production due early in 2024. We are aware of utilities now bidding for uranium pounds in the market. Boss shares now trade at $4.50, more than double our initial purchase price..

There are already 436 nuclear reactors in the world with many more planned. The World Nuclear Association is pushing for recognition by COP 28 (Dubai November 2023) that nuclear power should be recognized as a green energy source.



Source: Iress

Stanmore Resources is a met coal supplier from Queensland. We have held the stock for years with the stock more than doubling as coal prices have firmed. Stanmore has returned to Christmas levels after a slump that had more to do with a rumored acquisition than any operational issue. It now seems that this acquisition will not occur. Stanmore is well run, delivers very strong cash flow and sells into a willing Asian market.

MAAS Group moved up 25% after a solid result with good cash flow. It is an integrated property developer based in Dubbo with interests from south-east Queensland down to the Victorian border. There are four divisions including construction materials, civil construction and hire, residential and commercial real estate and manufacturing. Housing affordability near the coast provides a natural pull into inland areas while government spending on roads, wind farms, solar arrays and the inland rail provides plenty of work. MAAS is still below our target price.

Computershare was added to the portfolio in May. A well-known provider of shareholder services globally, the stock was up 12% in the quarter. The company benefits from higher returns on cash deposits. They have some strong operating divisions and have announced a simplification strategy to boost exposure to their core strengths. We believe the strategy will be good for shareholders. Subsequent to the end of quarter, they announced the sale of the US Mortgage Services business for $US720m. The balance sheet is strong with a buyback now underway.

Allkem fell 26% this quarter as the lithium price fell on lower demand. Allkem fell more than the other lithium miners as a delay and cost over-run was confirmed at the Sal de Vida brine project in Argentina. There is also an upcoming election in Argentina.

Earlier in the year Allkem announced a "merger of equals" with **Livent Corporation** (NYSE: LTHM). The merger documents have been delayed and are now due in November. This has been tedious and may have contributed to the poor performance. Note however that Allkem was our best performer in the June quarter and is more than 400% up for our early investors.

Material Stock Contributions September Quarter 2023			
Best		**Worst**	
Boss Energy	+56%	Allkem	-26%
Stanmore Coal	+43%	Resmed	-18%
MAAS Group	+26%	Qualitas	-13%
Computershare	+12%	IGO Ltd	-12%
NAB	+10%	Charter Hall	-11%

Source: Iress

Laboratory testing business **ALS Limited** was added to the portfolio. ALS is the global leader in commodities testing for the exploration market and through all aspects of the mining life cycle. Its scale, expertise and relationships provide an advantage over peers particularly for more complex multi-element minerals analysis. When conditions are buoyant it has been able to maintain better turnaround times than competitors which has led to market share gains. Commodities exploration is cyclical but ALS has demonstrated the ability to scale its business up and down and manage margins. Whilst ALS has been historically strong in commodities, in recent years the life sciences business (environmental, food and pharmaceutical testing) has grown to dominate revenue through a combination of organic growth and acquisitions. The higher portion of life sciences revenue makes the overall business more predictable.

ALS has good long term growth prospects in our view. Growth in testing requirement in life sciences will be driven by increasing regulatory standards and heightened consumer expectations. Commodities demand will be underpinned by decarbonisation and historical underinvestment in some of the key minerals that support it. Strong gold prices are also a helpful tailwind for exploration. The lab testing industry is still relatively fragmented and ALS has a good track record in making accretive acquisitions. We rate ALS as a high B grade under our Q stocks process. The share price has pulled back recently due to concerns around the short term outlook for exploration and we saw this as an opportunity to establish a position. Our entry price implies a forward earnings multiple of around 17x which we see as reasonable value for a good quality business.

Steadfast was sold above target have performed strongly for clients over several years. **Ramsay** was sold prior to reporting results in August. The stock fell after the result and our sale. The company has become an exercise in frustration for our team with overdue improvements in operating performance continuing to be delayed.

We chose to exit our small holding in **Resmed** which was added to the portfolio following the dramatic price fall in August. We concluded that the long-term impact from GLP-1 obesity drugs is too significant to ignore. This drug class appears set to have broad impacts on society and widespread adoption is likely over time. The key question is therefore the impact on long-term earnings. It will be difficult to see evidence to counter this concern in the short-term and we chose to move on, despite the valuation appeal.

The portfolio continues to hold only two banks being National Australia Bank and Macquarie Bank. NAB rose 10% in the quarter. It is our preferred play in a big sector. We see ongoing margin and cost pressure for major banks although a soft landing locally may limit or more likely delay the bad debt cycle.

Our enthusiasm for lithium miners continues with holdings in **IGO Limited** (reduced this quarter), **Mineral Resources** and **Allkem**. Lithium chemical prices have fallen from very high levels and further softness is possible. Lithium miners are still selling product at high margins and the move to lower emissions is unstoppable now. The last two years have been excellent in these stocks. We acknowledge that they cannot go up every day and remain convinced the energy transition is a lengthy process. See our December 2022 quarterly article on lithium and EV's at https://www.questap.com.au/funds/quest-australian-equities-concentrated-portfolio-sma

Our stock number limit of 35 stocks results in a sectoral exposure often being made up of a single stock. **Woolworths** is our only retail investment while **Santos** is our sole oil and gas exposure. **CSL** is currently our only healthcare holding.

Portfolio activity in the quarter included increasing the **BHP** position cum dividend which secured more of the 6% franked annualised yield that was paid in late September. We also increased our **Macquarie Bank** holding in July.

A new addition to the portfolio is gold miner **Genesis Minerals.** Based in Perth, Genesis sees the previous **Saracen Minerals** team re-form to deliver a roll up of gold assets in the Leonora region north of Kalgoorlie in Western Australia.

Saracen merged with Northern Star and the team is now working the development of a new asset base.

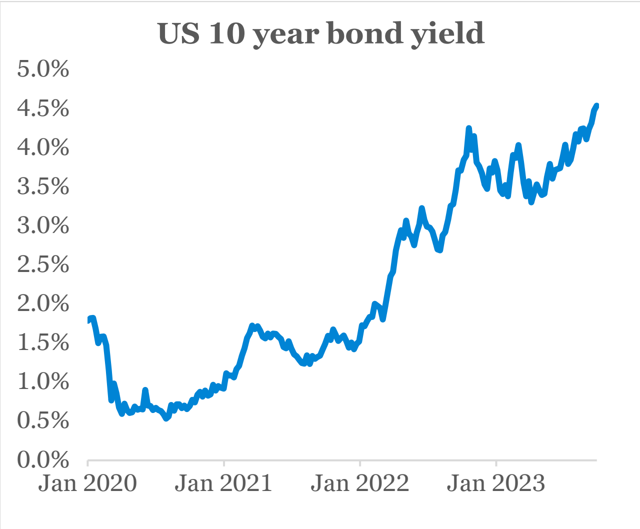
Genesis raised $470m in 2023 to buy 80% of **Dacian Gold** and assets from **St Barbara Mines** including the Gwalia gold mine and Leonora mill with associated development areas. Gwalia is already producing 30,000 oz gold per quarter and supplementing feed from other areas will lift productivity at the mill. The aim is to mine more efficiently, lift gold production and deliver nearby prospective areas to increase mill utilisation.

The team are well known operators with a proven record. We see the opportunity to lift gold ounces to 300,000 oz per annum in a few years and the potential for cost synergies from delivering ore from surrounding areas. Genesis is not well known in the market but has recently been included in the ASX300 index.

Outlook

We remain cautious given the persistent upward move in bond rates. Our expectation has been that the strength of employment, fixed rate mortgages and energy tightness would make inflation difficult to contain. The US 10 year bond bottomed at a yield of 0.05% in July 2020 and recently hit 4.8%. This is a massive and rapid move that has held us back from any dramatic portfolio moves.

The recent lift in bond yields mentioned early and shown in the following chart has surprised many. There are a number of drivers, including shorter term issues relating to US economic strength & political turmoil, OPEC supply reductions and the scale of government bond issuance to fund deficits. There are also more structural issues relating to the end of QE, the shift to QT and the loss of the US Govt AAA credit rating. Many economies are not well positioned to cope with higher interest rates.



Source: Iress

Market sentiment has been somewhat dismissive of this bond weakness until September when yields popped from 4.1% to 4.8% in a matter of weeks. This saw the S&P500 fall 4.8% in September while the Nasdaq lost 5.6%.

Collective sentiment swings are not unusual but often taking the opposite position to consensus is worth considering. Clients have benefitted over many years from Quest following our Investment Philosophy of *Investing because opportunity exists not because cash is available.*

The sudden rush to be bearish has led us to consider sectors that have done poorly as rates have risen. There are many: REIT's, utilities, gold as the US dollar may be near a high, retail, tech, bond proxies and some industrial small caps.

The following chart details the remarkable lack of interest in ASX listed smaller industrial companies relative to their larger counterparts.

Source: Iress

There are a number of reasons for this lack of interest.

Small caps are generally more exposed to the underlying economic conditions. Investors should tread carefully when the RBA is tightening. The Quest founders started Australia's second Small Cap fund in the early 1990's. Generally, small caps trade at a discount to the larger companies due to this relative volatility.

The proliferation of managers with a Small cap benchmark in the last decade propelled stocks to unsustainable levels. The number of small cap funds is now in decline while consolidation of super funds (forced by regulator APRA) has pushed portfolios toward larger index stocks. Smaller caps appear to be the cheapest in a decade.

Quest own a number of small caps including ALS discussed above, Catapult, Maas Group and Credit Corporation.

Performance Fees

There is no performance fee due for the September quarter.