January 2024 update

Dear Blue Boat Partners,

This half the portfolio registered a net gain of 5.6%.

Blue Boat Performance vs Indices Total Returns: 3 April 2017 – 31 December 2023:

	Blue Boat Gross Return	Blue Boat Net Return	ASX 200	MSCI All Country
FY24 YTD (6 months)	5.8%	5.6%	7.6%	7.5%
Since inception	50.7%	36.0%	68.5%	89.0%
CAGR	6.3%	4.7%	8.0%	9.9%

Source: Bloomberg. The returns for Blue Boat and ASX are presented in AUD, MSCI in USD. Index returns include net reinvested dividends. CAGR is the compound annual growth rate since fund inception 3 April 2017.

2023 was an unusual and challenging year for markets. For much of the year, investor sentiment was deeply bearish, with pessimistic financial media focussed on a complex macroeconomic environment. However, we observed an apparent softening of the negative headwinds from inflation, supply chain disruption, tight labour markets and energy prices. A nascent bull market took shape in the USA, led by a handful of mega-cap technology companies that outperformed expectations throughout the year. During this latest quarter, global stock markets have turned positive, as if investors simultaneously recognised all the abovementioned easing.

In 2021, companies publicly stated that inflationary pressures were building everywhere long before the economists declared it a problem. Again, in 2023 markets have moved sharply, long after the winds of change were felt. In the year's final two months, leading indices in the USA and Australia have each gained over 10%.

Whereas gains previously had been highly concentrated among a selection of mega caps, the recent strength has been much broader. We see this in the relative outperformance of smaller companies. We also note a significant pick-up of Merger and Acquisition activity which had been very subdued since 2022. M&A is an important channel for unearthing undervalued companies, so we welcome its return.

This episode demonstrated the market's schizophrenic tendency to jump from wildly bullish to bearish and back again. Three years ago, all were assured that COVID-19 stimulus would only have a limited, temporary inflationary impact that would wash out once supply chains normalised. In early 2022, the market was rocked by a sudden jump in inflation and the ensuing interest rates that rose at the fastest pace in history. As they tend to do, the pundits proclaimed rates would be 'higher for longer' merely two years since 'lower forever' was the consensus narrative, and all interest-rate sensitive assets were hit. Now, markets have been surprised in the

other direction as inflation has come down faster than expected. Will we see cries of 'lower for longer' interest rates again soon?

The regime change that has occurred with a shift in the outlook for interest rates is an important moment for equities as it removes the most significant headwind that has weighed on stocks since 2022. With the outlook now for falling rates, we have potential tailwinds in sectors that were priced for long-term impairment from the impact of inflation and rising interest rates.

At Blue Boat, this serves as yet another reminder to focus on evaluating companies and ignore the macroeconomic noise.

Blue Boat’s portfolio results were mixed. During the half our consumer-facing businesses, including Beacon Lighting, Unibail Rodamco Westfield, Lovisa and Spotify, have all performed strongly. Each of these businesses have been making good progress towards their strategic objectives, and a more benign environment is helping them to be recognised in the market. The absurd shifts in sentiment towards rate-sensitive companies allowed us to buy and add to these positions in 2022 and 2023.

Another strong performer has been US listed annuity provider Jackson Financial, whose results have been deeply unappreciated since being spun out from Prudential in 2021. Even though its share price has doubled since June, it trades with a dividend yield of circa 5% and annually buys back a further 6% of the shares on issue. In the two years since gaining independence, Jackson has paid out $4.56 per share in dividends, a 16% cash return on our investment. At the same time the company has repurchased 19% of its shares via buybacks. Together these represent exceptional returns of cash to shareholders.

This quarter Jackson received regulatory approval to effectively change how it reports to present a more accurate, more stable view of the business from 2024. Demystifying the accounting and continued exemplary results should significantly improve its appeal to investors.

Meanwhile, our China-related positions have detracted from the portfolio's gains. The Hang Seng Index (HSI) has now fallen -14% in 2021, -15% in 2022, and 14% in 2023. Remarkably, the HSI is now back to the level it reached in August 1997, just as Hong Kong returned to China and the Asian Financial Crisis began. During the 26 years since, China's GDP increased 20-fold from US$0.96tn to US$18.9tn. This market is priced for a major economic crisis, which is not remotely the reality we observe. The IMF's latest forecast is for China's GDP to grow by 5.4% in 2023 and 4.6% in 2024, ranking it second only to India among the world's major economies. At a time when most other major global stock exchanges have turned strongly bullish, China's stark underperformance is one of the most significant market disparities we have ever seen.

The de-rating in Chinese stocks has been staggering. In December 2019, before the COVID-19 pandemic, Alibaba traded on a forward PE of 29x, and now it is down to 8x PE. Likewise, Tencent traded on 34x PE, now 17x; Anta Sports was at 31x, now 20x; and BYD was at 49x, now 18x.

The most acute example of this de-rating from our portfolio has occurred for Ping An, the world's 2nd largest insurance business after Berkshire Hathaway. Since 2016, Ping An has generated an operating return on equity of between 17-20%, and in turn, until the onset of the pandemic, its shares traded fairly at a Price-to-Book (P/B) ratio of around 2x. Today, they're trading at circa 0.6x P/B, representing a significant discount to the company's equity, which they've proven to deploy very profitability. This price corresponds to a PE of 5x and pays a dividend yield of 8%.

As China-related stocks currently represent about one-third of the Blue Boat portfolio, the underperformance of this market has been disappointing. It has weighed substantially on the overall Blue Boat results. However, as value-orientated investors, we must maintain sight of the

attractiveness of the opportunity offered here, particularly from these depressed levels of valuation. We have seen how quickly and materially markets in the USA, Europe and Australia strengthened in late 2023, and we are confident that there is a significant re-rating ahead for our blue-chip Chinese companies.

Finally in November we were saddened to hear of the death of Charlie Munger. Time and again he gifted the world with straight-shooting sage advice. In October he gave a rare interview leaving us with several gems of wisdom such as this:

> *"My position in China has been that: (1) the Chinese economy has better future prospects over the next 20 years than almost any other big economy. That's number one. (2) The leading companies of China are stronger and better than practically any other leading companies anywhere, and they're available at a much cheaper price. So naturally, I'm willing to have some China risk in the Munger portfolio."*

Yours sincerely,

David Nelson and Tim Evans