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October 2024 update

Dear Blue Boat Partners,

Set out below are the preliminary estimated portfolio results for the first quarter of the 2025 financial year and since the inception of the fund as usual. Also, for the benefit of our newer investors, we've added annualised returns for the past one, two, three, and five-year periods.

Blue Boat Performance vs Indices Total Returns: April 2017 – September 2024:

	Blue Boat Gross Return	Blue Boat Net Return	ASX 200	MSCI All Country
FY25 YTD (3 months)	19.7%	19.5%	7.8%	6.7%
1-year Return	41.6%	38.4%	21.7%	32.3%
2-year CAGR	28.2%	26.5%	17.5%	26.7%
3-year CAGR	10.2%	9.0%	8.4%	8.6%
5-year CAGR	9.6%	8.7%	8.3%	12.7%
Since Inception Total	108.6%	84.4%	89.3%	125.1%
Since Inception CAGR	10.3%	8.5%	8.9%	11.4%

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.

Momentum in the portfolio continued in the first quarter of FY25 for Blue Boat, during which our portfolio companies reported either quarterly or full-year results. Broadly, these were very pleasing. Whilst some of our companies missed our expectations, on balance, we feel the portfolio outperformed and the future is bright.

Despite bouts of extreme volatility, market conditions have been accommodative for much of 2024. The market has embraced the potential for a 'goldilocks' combination of softer inflation and relatively robust economic activity. Several central banks have cut interest rates for the first time since the aggressive post-Covid tightening began in early 2022, adding weight to the likelihood of this scenario's potential to play out.

The Chinese stock market and stocks in sectors exposed to the Chinese economy surged higher during September. The economy there has been muted for some time due to a weak property market and the associated negative wealth effect weighing on both consumer and business confidence. Throughout 2024, the Chinese government has steadily issued various stimulus measures to address this issue, but the market regarded it as insufficient each time.

That all changed on 24 September when the PBOC announced its most aggressive set of measures, demonstrating a clear intent to support the economy, property, and stock markets. Two days later, this was followed by a Politburo pledge that it would take action to achieve its growth targets and stabilise the real estate market. Just as the downturn in property was manufactured to stamp out rampant property speculation, the recovery plan appears to be underway. The message was clear – 'China means business' – and Chinese markets staged their strongest rally in over a decade. Should the new stimulus measures change the mindset of the Chinese people and give them the confidence boost they need, there is potential for a wave of spending and investment to occur utilising the record savings accrued over recent years. This would have very positive implications for the Blue Boat portfolio.

As value orientated investors we saw potential for tremendous returns in Chinese equities and increased our exposure materially to a small number of high-quality companies in the past two years as the deep bear market dragged on. This detracted substantially from our returns and at times our conviction was tested, so we are pleased to be in what could be the early stages of the turnaround.

Among our portfolio holdings, Alibaba was the most significant positive contributor during the quarter. Alibaba's result showcased the tremendous potential in its cloud division, which is now profitable and showing strong growth. The core domestic e-commerce operation is growing modestly but continues to generate enormous free cash flow. This is being invested in higher-growth subsidiaries such as cloud and international e-commerce while funding Alibaba's on-market buyback, which is running at an impressive US$4bn per quarter.

Alibaba has faced headwinds on multiple fronts in recent years. Fierce competition from rivals and internal missteps have weighed on them simultaneously with intense regulatory pressure and a material downturn in consumer confidence. We now see improvement on all fronts, which augers well for our investment in Alibaba. While the possible range of outcomes for the Chinese economy and Alibaba is broad, we see a reasonable probability of a very positive scenario for Alibaba when we look forward to the medium term.

Alibaba has made some critical improvements to its core e-commerce business, helping to regain lost market share from rivals. With the benefit of a re-invigorated Chinese consumer, we see potential for massive medium-term growth. Aside from e-commerce, Alibaba is rapidly becoming one of the world leaders in AI technology, and its cloud infrastructure business could materially contribute to group earnings. With the added benefit of the ongoing share buyback and the possibility of applying a more appropriate valuation multiple to the stock under this scenario, we remain comfortable with an overweight position in Alibaba.

In our view, the most encouraging results announced during the quarter in the Blue Boat portfolio were from Jackson Financial, Spotify, Tencent, and Step One Clothing.

Jackson's evolving product mix shows healthy growth, and its restructuring delivers material savings in hedging costs. Since spinning off from Prudential in 2021, Jackson has bought back almost 25% of shares on issue and paid rising cash dividends.

Spotify's operating margins have strengthened more than expected, now at +7% versus -8% last year. We believe Spotify's pricing power remains largely untapped. Additionally, TikTok's withdrawal from music streaming is an important win, reinforcing Spotify’s dominance in global audio streaming.

Similarly, Tencent's margins improved enormously, coupled with a resumption of growth in their video games division.

Finally, Step One's earnings defied the notion of a challenging retail environment. They produced an extraordinary result underpinned by returning customers. It's becoming apparent that people really love their products, as do we. An example of the 'word of mouth' led growth in Step One products was shown by the fact that despite having no website in Germany or a dollar of advertising ever spent in Germany, 4% of sales through the UK website were made in Germany. As a result, Step One will test the German market this year as a potential expansion region.

Portfolio turnover remains low. However, we did lighten our exposure to some of our ASX-listed consumer companies, exited our position in Unibail Rodamco Westfield, and added a new position in Mineral Resources, a Western Australia-based diversified miner and contractor we had long admired but never owned.

From its 2006 IPO to its high in 2023, Mineral Resources was a 'hundred bagger'. The share price then fell 70% from its 2023 high due to declining lithium and iron ore prices, presenting the opportunity to invest. Their balance sheet position is stretched, but we believe Founder/CEO Chris Ellison, who owns 11% of the stock, has options available and will fight through this difficult period for the company.

At Blue Boat, we do not consider ourselves trendsetters or style pickers when it comes to fashion, but we have taken note of the long-term shift in apparel toward comfort and performance. Looking back at the past few centuries, clothing, particularly female clothing, has evolved constantly through the eras and has sometimes gone in some unexpected directions. The one constant has been the gradual relaxation of dress codes and the prioritisation of feeling good while looking good.

There are many drivers of fashion, but 'aspiration' is a common theme, with consumers dressing like the type of person they want to be. In recent times, we have seen a surge in people prioritising healthy living and wellness. This was accelerated by the pandemic, where the barriers between work, social activity, and exercise faded. The boom in 'athleisure' ensued, making activewear suitable for all the abovementioned activities in many cases.

Today, we observe that an aspirational life is typically presented as wealthy, healthy, and relaxed and portrayed in settings where people are wearing comfortable clothes. In eras gone by, the aspirational fashion goal may have been that of a tailored suit. Today, it seems the opposite, where a life free of suits is the goal of the masses.

'Ultra luxury' has been considered a secular growth industry for decades. The wealthy buy the highest-end fashion brands and sales have proven immune to economic downturns. The main driver of sales growth for ultra-luxury brands has been China, validating the consensus narrative that ultra-luxury is not cyclical. We are not suggesting this will change; instead, we observe a change in what is proving to be most resilient to economic challenges in leading economies, including China.

Take the results of Lululemon, Anta Sports, and Step One Clothing, for example. Lululemon's China sales are up +34% year on year for the past quarter. This was achieved in a depressed consumer economy, growing faster than the rest of the world (+24%) and North America (+1%). Anta's sales in China increased by +14% this year. Compare these figures with Louis Vuitton in China (-13%), Kering (-22%) and Richemont (-18%). These luxury goods giants have ridden the boom in Chinese demand for two decades. What if the Chinese appetite is changing, and a healthier, more active fashion aspiration is taking the mantle for what is desirable?

Looking closer to home, we see a similar trend. Lululemon's 'rest of the world', including Australia, is growing rapidly as consumers prioritise clothing performance and comfort. Step One

Clothing sells underwear at a premium to its peers, but customers are voting with their wallets that the product is so good it is worth it.

When Lululemon changed the mindset of buyers of yoga pants to the view that paying a hefty premium for quality was worth it, it brought on a wave of lookalikes. Perceived initially as a risk, it was, in fact, a positive as it drove more people to see the benefits of such quality products at a premium price. Today, we notice copycats of Step One popping up, which normalises the price point and the idea of paying for a quality staple product that performs better than the alternatives.

Step One grew revenue by +30% and profit by +50% last financial year, during a time when apparel companies in Australia have said conditions are as hard as they've ever been. Hanes Brands, the owner of Bonds, called out Australia as their weakest region globally, citing a very value-conscious consumer environment, which is at odds with what Step One is achieving.

We will leave the fashion tips to the experts, but we will follow the data, and this trend of health, wellness, comfort, and performance is one we believe is sustainable. Lululemon shares are down 50% in 2024, and Anta Sports is down 50% from its 2022 highs. The market is currently dismissing the sales trends we mentioned above, but how long will they keep ignoring them? With very healthy operating margins of 23% & 25% and return on capital of 44% & 23% respectively, we feel comfortable with exposure to both stocks in our portfolio along with Step One, which rivals Lovisa, also held in Blue Boat, as the highest-margin retailer on the ASX with gross margins over 80%.

Finally, a term we came across recently is the idea of '*pronoia*.' Pronoia is a kind of anti-paranoia where the subject has a genuine belief that things will turn out fine. Moreover, the research suggests that those with pronoia tend to have greater success in life. It's speculated that this might be because they are free from the burden of anxiety and stress or because confidence tends to invite support from enablers who can help on one's journey.

This has parallels when it comes to investing. We once heard that to be 'lucky,' one must constantly have their radar on alert for opportunities wherever they may appear. Secondly, one must boldly seize those opportunities when they appear. This second part requires inherent optimism, as one will often have to look through a scenario of doubt and uncertainty to mentally align with a positive outcome that is not obvious or remotely certain.

Generally, being a bit pessimistic sounds judicious and intelligent, but how does it work out in the long run? The stock market has a well-established record of producing sound returns for long-term investors. Market upswings tend to be far harder to predict than downturns, yet the crowd obsesses over the latter. A promotor who claims to be able to foresee 'the next big market downturn and how to avoid it' may sell out an auditorium. Meanwhile, someone who offers a competing lecture on the statistical benefit of being fully invested, regardless of what is forecast for the markets or the economy, would almost certainly attract a smaller crowd despite the latter having a near certain probability of creating more wealth for the listeners.

We want to be lucky, take advantage of opportunities, and deliver strong results for our investors, so you'll forgive our optimism.

Yours Sincerely

Tim Evans & David Nelson