25 October 2024

September Monthly Report

Dear Investors

We are pleased to provide you with the September 2024 Monthly Report for the Fawkes Capital Fund ("Fund"). In this monthly report, we:

(1) Update on Fund performance; and
(2) Provide an overview of investment positioning.

Performance

The Fund generated a net return of 1.13% for the month of September, primarily driven by our strategic macro positioning. Key contributors included anticipating higher interest rates relative to the steep cuts priced in by the market, as well as gains from long positions in S&P 500 futures. As of this writing, the Fund has continued to grow in October, supported by both our macro positioning and select stock-specific investments. In the following section, we provide an overview of the rationale behind some of the stock-specific positions in the portfolio as well as touch on some of the macro exposures.

Sep-24	1 Mth	3 Mth	1 yr	2 Yrs	3 Yrs	SI (ann)	SI (cum)
Fund (Net)	1.1%	0.3%	12.7%	1.7%	8.9%	7.3%	27.3%
Blended Index	1.9%	4.4%	13.1%	10.7%	5.7%	6.1%	22.0%
All Ords	3.4%	7.9%	22.2%	17.5%	8.1%	9.1%	34.8%
RBA Cash	0.4%	1.1%	4.4%	4.0%	2.8%	2.5%	8.8%

Returns are calculated net of fees and represent the combined income and capital returns over the specified period.
All returns provided are in AUD. Blended Index returns are composed of 50% All Ords / 50% RBA Cash.

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Portfolio Positioning

While many of our positions are now expressed in macro format, we continue to hold a handful of stock-specific investments from before. We run through those here.

Argan

Argan is an engineering firm that designs, builds and / or installs gas power plants and renewable energy farms. Both the movement towards more renewable energy in the US and AI's need for more data centres is increasing the demand for electricity. As one of only a handful of companies with the capability to build gas power plants in the US, Argan is capturing the benefit of these structural tailwinds.

We believe these are longer-term trends that will benefit the business for many years to come. In the shorter-term, our tracking of completed data centres and those currently in construction points towards increased energy needs. While nuclear energy is the favoured source of non-interruptible energy supply for data centres, it takes many years to build a new plant. Small, modular reactor technology is still in its infancy. In the interim, gas power plants are the only option to fill the void when energy demand pressures are forecast to be most acute.

GEO Group

We believe GEO Group stands to benefit from the likely forthcoming changes to US immigration policy following the election as well as from lower interest rates. GEO Group owns and operates various prison and immigration centres mainly in the US but also in other parts of the world. Both Trump and Harris have committed to fixing the immigration problems on the Southern border. If elected president, Harris committed to signing the bipartisan Senate border bill into law. Trump has pledged to fix the border crisis by putting in place as stronger measures as possible. A significantly increased amount of electronic monitoring of immigrants, which is included in the bipartisan Senate bill, could cause GEO Group's operating earnings to skyrocket. GEO Group is the dominant supplier of this service and access to the high-margin technology benefits from scale. Even without a major change in policy, reduced interest rates alone would justify a higher capitalisation factor. Given the low valuation with which GEO Group trades, we believe the risk-reward is skewed.

Celestica

Celestica is a contract manufacturer of electronic components. In particular, Celestica manufactures various data centre components for hyperscaler customers. They provide solutions for storage, compute and connectivity. Despite doubling earnings, generating a 20% return on equity (which is growing) and having long-standing relationships with their hyperscaler customers developing data centre products at a time of scarcity, the stock trades at a valuation far below its peers.

Centrus Energy

As at the time of writing, we've recently reduced a significant portion of our Centrus Energy holdings as the uranium sector becomes over-hyped. Centrus Energy does 3 main things. The company imports enriched uranium and on-sells it to utility customers, its engineers help to build, restart and maintain nuclear power plants and it is currently piloting the enrichment of uranium with the US government to very high levels for small modular reactors (SMRs). While Big Tech's recent announcements of using uranium to power data centres is positive for the future of the sector, many of the revenues from these contracts won't be seen until 2030 at the earliest. As such, we've used the rally in the stock to reduce our positioning.

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In addition to these stock specific positions, we also maintain some macro positions.

S&P 500 Futures

As explained in our last monthly update, we believe that a continuation of the economic cycle will support equity prices. While we continue to monitor the situation closely and early company reports of this earnings season have reported further deceleration in spending growth, a soft landing appears to be the most likely scenario to us. However, we continue to track the economy, and in particular layoffs, closely.

Gold

We will explain in greater detail our thesis for owning gold in a forthcoming research note. We believe gold exhibits highly skewed risk-reward characteristics given the likely future economic environment. When the unemployment rate rises, spending growth slows and interest rates begin to fall, gold prices have risen every time in this part of the economic cycle. Even in soft landings, gold tends to rise in price. Additionally, the war in Ukraine has created a large change in gold demand. According to the data we see, Russia uses gold as a medium for payment now that it has been shut out of the international payments system. The emerging countries that provide Russia with the goods and services it needs to wage war with Ukraine are happy to be provided with an appreciating hard currency. We estimate that this new-found demand for gold from these countries amounts to around 12% of global supply. This is set to increase because the Russian government recently increased its military budget by 30%. We believe that the large supply-demand imbalance due to the buying of sovereign nations that comes at a time in the economic cycle when private-sector buying has almost always increased makes this investment opportunity asymmetric.

Thailand

The new Thai government is seeking to bring itself into favour with the electorate to sure up its legitimacy. To do so, the government is trying to get the economy going. The new Prime Minister of Thailand is the daughter of a real estate billionaire. Her economic policy, which is already in train, is to lower interest rates, maintain a weak currency and to provide 3% of GDP worth of unrestricted cash handouts. This is more fiscal stimulus than Kevin Rudd introduced during the height of the GFC. The scale of the fiscal policy is comparable to what some countries did to fight Covid. And yet the economy is still growing at the moment and there is no GFC or Covid. Thailand is doing the kind of stimulus that China needs to do but it doesn't have the same population growth or real estate problems. In our view, this macro-economic set up will significantly benefit Thai stocks and a liquid ETF listed in the US exists to take advantage of this major change.

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We continue to vigilantly monitor how each of these investment concepts evolves and won't hesitate to change our view if the facts change in a determinative way.

Kind Regards,
Fawkes Capital Management

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