FAWKES CAPITAL MANAGEMENT

27 November 2024

October Monthly Report

Dear Investors

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

(1) Update our performance; and
(2) Discuss current investment positions with reference to the recent Republican sweep in the US election.

****

Performance

Fund performance was broadly flat for the month of October. The portfolio's investment positions largely offset one another to produce a small minor return.

Oct-24	1 Mth	3 Mth	1 yr	2 Yrs	3 Yrs	SI (ann)	SI (cum)
Fund (Net)	0.1%	2.8%	18.5%	3.8%	9.5%	7.1%	27.4%
Blended Index	-0.5%	1.8%	14.6%	8.9%	5.5%	5.8%	21.4%
All Ords	-1.3%	2.5%	25.4%	13.6%	7.6%	8.5%	33.0%
RBA Cash	0.4%	1.1%	4.4%	4.1%	3.0%	2.6%	9.2%

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.

Amid the uncertainty leading up to the US election, we proactively reduced risk in the portfolio. Following the election, however, we now have greater clarity and have adjusted our strategy to increase portfolio risk. In our view, the Republican sweep has triggered significant shifts across various industries, setting the stage for transformative trends that could shape the landscape for years to come. This marks an exciting period for investors, and we are positioned to capitalise on many of these emerging opportunities. While we remain focused solely on investment implications in this note, the following section provides a detailed analysis of the significance of these developments.

****

Investment Positioning and Market Views

On 6 November, the US electorate voted for the Republicans to control every level of government. We have written about the election in previous notes. Republicans now control the Presidency, Senate and House. Unified government allows President Trump to pursue his policy agenda with little opposition. It's extremely likely that President Trump will make the changes that he promised.

This event represents a major change that will kick off many long-lasting trends. In many of the trends, we're at the start of them. This makes the risk-reward of investing in these trends extremely attractive.

We categorise the major trends into the following: (i) major changes to immigration policy, (ii) companies that will benefit from increased tariffs, (iii) changes to energy policy and (iv) companies that provide infrastructure for data centres. We focus on the major policies that Trump campaigned on.

We first take a look at each of these segments, before turning our attention to the macro impacts of the Trump presidency on the economy overall.

(i) Immigration Policy

We have previously written about the changes Trump and Republicans intend to make on immigration policy. The southern border was a major issue in the election. Previously, even with a small House majority, Republicans had passed the HR1 bill. This bill told us their gameplan for the changes they'd like to see to the immigration system. Some major changes include increased funding for more private detention facilities, increasing the difficulty of obtaining asylum, automatic shutdown of the border during times of heightened crossing, deportation of illegal aliens and the electronic monitoring of immigrants within the US. All of these changes are set to benefit GEO Group, one of the Fund's holdings, since it will increase the demand for their facilities and services.

Since the election, Trump's rhetoric on immigration policy has only become more hawkish. In public pronouncements, he has pledged to use the national guard to find and deport illegal immigrants currently residing within the US.

(ii) Increased Tariffs

With Republican control of both the House and Senate, it's become clear that President Trump will be able to implement his tariff plan. Throughout the campaign, Trump had noted that implementing major tariffs across the board would make America prosperous. He frequently cited how former President McKinley's tariffs had made America rich before. In the 1980s, Trump had also previous published op-eds about how unfair competition was hurting the US manufacturing base and how he would use tariffs as a remedy.

The plan that Trump has laid out publicly so far comes in two actions. The first is a 60% tariff on all Chinese imports. The second is an across-the-board 10% tariff on imports from all other countries. This would mark a major shift in the current stance of around 25% tariffs on most Chinese imports and no blanket tariff on non-Chinese imports.

It would appear logical to us that companies that manufacture their goods domestically but face significant competition from Chinese imports would benefit. While supply chains may move to Vietnam, Thailand and Mexico, this process will take time and Trump has evinced an intention to place higher tariffs on these secondary countries if they are a conduit for getting around tariffs on Chinese imports.

We recall how much more profitable Australian steelmakers became after significant tariffs on Chinese imports. It completely changed the economics of that industry. We've invested in a number of companies that we believe stand to benefit. We've invested in domestic furniture manufacturers, domestic household goods manufacturers, domestic manufacturers of industrial goods, domestic producers of pharmaceutical products and domestic producers of activated carbon. Aided by technology, we continue our search for unfound businesses whose economics will change in a major way as a result of forthcoming tariffs.

(iii) Drill baby drill

The Trump campaign pledged to make "America the dominant energy producer in the world by far." In order to achieve this end, we believe the Trump administration is very likely to pursue the following policies: (i) auction off more onshore and offshore federal land for oil and gas exploration and production, (ii) reverse President Biden's executive order that bans new LNG export facility construction, (iii) provide tax incentives for oil and gas producers to drill new wells, (iv) encourage more fossil fuel use to meet America's growing energy demand and (v) reverse some of President Biden's EPA edicts on limiting inter-state pollution from power plants.

We're particularly focused on the natural gas element of this policy change. Like in 2018 during Trump's previous term, we believe natural gas will be the favoured way to meet the fast-growing demand for electricity. We are invested in companies that should benefit from increased exploration activity. This includes companies that provide compression equipment, sand for fracking, drilling equipment and engineering businesses that build natural gas power plants.

(iv) Suppliers to data centres

Artificial intelligence is already increasing the need for the number of data centres. Utility companies across America have already seen increased demand flow through their revenue. Trump's policy of promoting the use of cryptocurrency is likely to only increase the need for data centres and energy. The reason is because cryptocurrencies are mined via solving tough computation problems.

Trump's policies on cryptocurrency mark a major change from those of the previous administration. So far, Trump is considering: (i) creating a department that would oversee the creation of a government-issued digital currency, (ii) rolling back the Biden's administrations regulation of the industry, (iii) create a US strategic reserve of Bitcoin, (iv) giving cryptocurrency companies access to the conventional banking system. President Trump owns and has issued many of his own coins and he is connected to the industry.

We believe that companies that provide datacentres with the equipment and energy they need will continue to benefit. After these changes are enacted, the pace of these businesses' growth will likely increase even further.

(v) Macro

We begin by discussing what is more obvious before venturing into a discussion about what's more dubious. What's obvious to us is that a Republican sweep is good for stocks. There are many reasons for this. The main reason is that Republicans will seek to extend and increase tax cuts for individuals and companies. While Trump will create a government efficiency department, our tracking of his spending priorities suggest that he is very likely to increase the federal deficit even further. A strong economy is very likely to support stock growth. A Trump administration may also encourage speculative behaviour, fostering the animal spirits that may cause a circular loop between economic activity and investment speculation. Given the similarities to 1997-2000, we're open to the idea that we are at the inception of another asset bubble.

What happens to interest rates is less clear. The Trump administration has pledged to bring inflation down. We believe where interest rates end up going will depend largely on what happens to the price of energy. If Trump passes legislation that encourages exploration and development, then lower petrol, gas and electricity prices may allow the Fed to keep interest rates low. The Saudis have already expressed concern, leaking to major newspapers around the world that they may pursue a policy of strategic market share to discourage American production. If energy prices remain stable, then fiscal stimulus and significant reductions in the labour force will likely produce inflation like we saw in 2018.

Finally, the US dollar should appreciate. It should appreciate for a few reasons. The first is that if Trump places significant tariffs on countries across-the-board, then in a freely floating exchange rate regime, the US dollar should adjust by appreciating. The second is that, with significant fiscal loosening in the US but tightening or an absence of stimulus in other developed countries, the US economy should outperform. Lastly, a trade war against China will likely engender a flight of capital away from Asia.

(vi) Overall Assessment

We are excited by the financial changes a Trump presidency is likely to bring to the world. We believe these trends are in their infancy and will very likely last a long time. The economics of many businesses will be turned upside down. In our conception of value, change brings about significant opportunity. We continue to monitor the course of events, research further opportunities and remain invested in the trends we foresee.

Please click *here* to subscribe to receive future Fund or market updates.

Fawkes Capital Management Disclaimer