FAWKES CAPITAL MANAGEMENT

20 December 2024

November Monthly Report

Dear Investors

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

(1) Update our performance;
(2) Discuss current investment positions; and
(3) Briefly discuss the macro outlook.

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The Fund delivered a return of 3.6% over the month of November. The majority of the gains over the period were driven by the portfolio's equity exposure, in particular, Argan Inc., Solaris Energy, and GEO Group. A common thread driving performance over the period was the outcome of the US election and its anticipated policy implications. Argan Inc. and Solaris Energy benefited from increased optimism surrounding the incoming administration's energy policies, including plans to expand domestic oil and gas production and accelerate infrastructure projects, which bolstered investor confidence in these sectors. GEO Group also gained as the election highlighted a renewed focus on stricter immigration policies, fuelling expectations of higher demand for its detention services.

Nov-24	1 Mth	3 Mth	1 yr	2 Yrs	3 Yrs	SI (ann)	SI (cum)
Fund (Net)	3.6%	4.9%	25.2%	8.5%	8.4%	8.0%	32.0%
Blended Index	0.0%	1.4%	11.5%	7.1%	5.5%	5.7%	21.4%
All Ords	3.7%	5.8%	23.5%	12.1%	9.0%	9.4%	37.8%
RBA Cash	0.4%	1.1%	4.5%	4.1%	3.1%	2.6%	9.6%

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.

In the following sections we delve into some of the themes underlying our exposures in greater detail.

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Portfolio Positioning

We continue to favour several key investment themes previously discussed, which we believe are at the early stages of long-term trends. Below, we provide updates on these themes and introduce new insights.

- **Immigration policy:** President-elect Trump has reiterated his plan to use the national guard to begin deporting illegal aliens from the US. Greg Abbott, the governor of Texas, has pledged to provide logistical support, signalling strong state-level alignment with federal priorities. Trump has also proposed to get rid of birth-right citizenship. Meanwhile, House and Senate Republicans are debating the best way to pass Trump's policy priorities. This includes navigating the Senate filibuster rule and potentially consolidating key initiatives, such as tax cuts and immigration reform, into a single reconciliation bill targeted for early 2025. Regardless of legislative approach, Republican leadership has pledged to prioritise immigration reform and "drill baby drill" to be part of the first reconciliation bill. In this context, GEO Group, a private operator of detention facilities, is well-positioned to benefit from increased demand and has been one of the Fund's core holding.

- **Tariff beneficiaries:** recently, Trump has proposed a new set of tariffs targeting Mexico, Canada and the BRICS bloc, signalling a renewed focus on trade protectionism. These measures include a potential 25% tariff on Mexico and Canada, contingent on their cooperation in securing U.S. borders and addressing fentanyl trafficking. Right wing media outlets have highlighted Trump's desire to re-negotiate the USMCA since it has proven largely ineffective at improving the plight of US manufacturers. In addition, right wing media outlets have suggested that Trump and incoming Treasury Secretary Bessent are loathe to allow the beginning of the decline in the US dollar's reserve status on his watch. Consequently, the incoming administration threatened a 100% tariff on the BRICS nations if they try to jointly start a new currency and payment system. With Peter Navarro selected as trade adviser, his well-documented hawkish stance on trade with China further underscores the administration's commitment to stricter trade policies. We expect the tariffs that are implemented this time around to be more severe than the last time Trump was in office. The stocks poised to benefit include Whirlpool, ARQ, and domestic furniture manufacturers, which we believe are well-positioned to capitalize on the anticipated shifts in trade policy.

- **Drill baby drill:** Incoming Treasury Secretary Bessent has outlined an ambitious economic strategy inspired by former Japanese Prime Minister Abe's "three arrows," with one arrow dedicated to significantly increasing U.S. energy production. The goal is to boost domestic output by the equivalent of 3 million barrels per day, representing approximately 3% of global oil supply. Given the rising electricity demands driven by AI advancements, it is likely that much of this additional energy production will come from natural gas. Recently, Republicans have laid out some preliminary plans for how they aim to encourage more production. Largely, these plans centre around tax incentives, auctioning or leasing more federal land for drilling and expediting EPA approvals for projects of $1 billion in value or more. These measures are poised to create substantial opportunities for companies supporting oil and gas production infrastructure. Stocks we believe stand to benefit from the policy-driven expansion of the U.S. energy sector include Argan, Solaris Energy, Archrock, SmartSand and other oil and gas field service providers.

- **Suppliers to data centres:** The rapid development and adoption of AI technology continue to impress, with its integration driven less by immediate profitability and more by the imperative of institutional survival and competitive parity. While sceptics point to challenges such as negative returns on investment, the necessity of adopting AI to avoid losing market share is undeniable. A prime example is Google's introduction of AI-generated summaries at the top of search results – a costly move aimed at countering competition from emerging players like Perplexity. The infrastructure required to support such initiatives is immense; if Google were to generate AI summaries for every search query, the number of chips and data centres needed would far exceed current capacities. Increasingly, corporations across industries are rolling out AI products. To provide a sense of how widely this technology is being explored and used, we list some use cases here:

  - SAP is now using AI to better plan supply chains.
  - According to CEO Jensen Huang NVIDIA's latest generation of chips could not have been designed without AI running 24 hours a day.
  - BigTech companies are racing to create an AI agent that can interact with technology on your behalf (for example, Google's Project Mariner or Apple's recently upgraded Apple Intelligence).
  - Coca-Cola now uses AI to make its TV ads
  - AI agents can be used to hack websites or personal accounts. Subsequently, AI will likely be needed to defend against these attacks.
  - Inditex, who owns the Zara fashion brand, invested in Epoch Biodesign, a startup that uses artificial intelligence to design enzymes that allow the cycling of mixed plastic and textiles
  - Samsara is embedding AI into its IoT devices.
  - Workday is using AI to help businesses make recruitment decisions.
  - Serve Robotics is using AI to allow its autonomous sidewalk robots to make deliveries for Uber.
  - Leading tech companies are now working out how they might be able to combine multiple large language models together to provide them with the ability to reason.

  Overall, the more we've considered developments in the technology, we believe we're still quite early in its rollout. Companies we favour in this segment include Aehr Testing, Celestica, Innodata, Credo Technology and the DAPP ETF. While the potential is vast, we remain cautious of, and continue to closely monitor

potential risks, including the exponential relationship between compute power and token generation, which could challenge the scalability of this transformative technology. Nonetheless, we believe we are still in the early stages of AI's broader rollout, offering substantial upside potential for well-positioned companies.

- **Antimony:** We have recently established a position in the antimony industry, recognising its growing strategic importance. Antimony is a rare earth metal that is increasingly being used in essential services such as coating for artillery and ammunition, as a fire retardant and within solar panels. What we had initially anticipated happening in the graphite market is instead playing out in antimony. China, which mines approximately 60% of the world's antimony, has recently banned its export. Unlike graphite – where a ban could cripple China's battery industry – restricting antimony exports aligns with several of China's strategic objectives. These include accelerating its renewable energy transition, bolstering Russia's position in the war in Ukraine, and preserving domestic antimony reserves amid reports that its largest antimony mine is nearing depletion. Together, China, Russia, and Tajikistan account for 90% of global antimony production, while the U.S. and Europe, with no active mines, consume about 25% of the world's supply each.

  The export ban has created a significant supply-demand imbalance, resulting in antimony prices tripling within a short period. However, this could mark the beginning of a much larger price surge. Based on historical supply shocks and the projected 50% reduction in global supply, we estimate that antimony prices could rise more than tenfold, which we view as a conservative projection given the metal's inelastic demand. To capitalize on this opportunity, we have invested in several strategic areas of the antimony value chain. This includes an American refining business—home to the U.S.'s only antimony smelter—which operates on a cost-plus pricing model and has mining interests in the U.S. We have also taken positions in an Australian antimony producer and companies specializing in antimony recycling, as the metal can be recovered from lead batteries. With almost all new antimony projects in developed markets at least three years away from production, we see significant potential for established producers and recyclers. Key stocks in this segment include U.S. Antimony Corporation, Mandalay Resources, and Campine.

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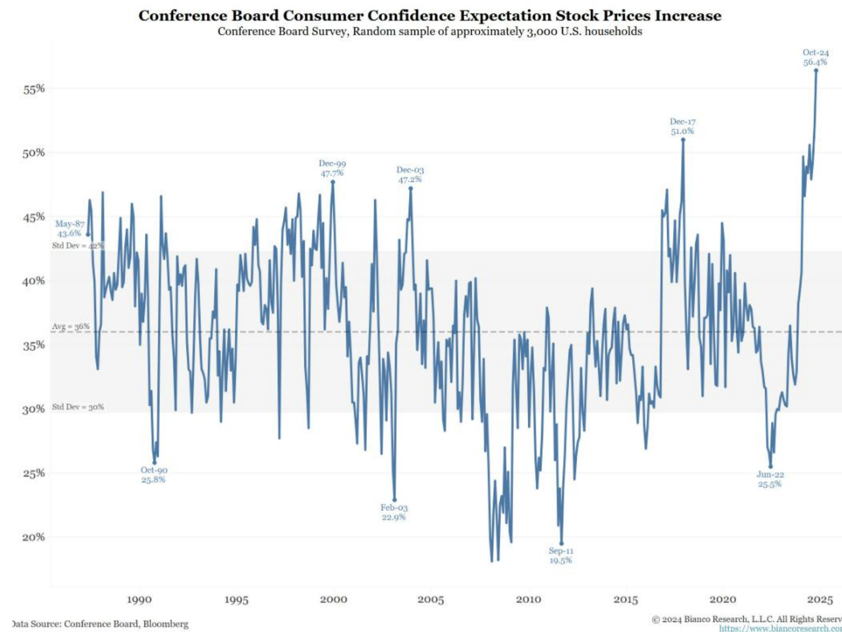
Macro Outlook

We've written less about the macro-economic outlook recently. The reason is because the situation, as we monitor it, is stable and shouldn't significantly influence our investment theses. The US economy remains stable and there is no suggestion of the labour market cracking in the data that we monitor. Inflation is coming down slowly.

What could shock the system? We do see some concern around Trump's impending imposition of tariffs. While the impact on the S&P 500 earnings should be small (perhaps say -1.5% year over year), it could give rise to another bout of inflation. As an example of what could happen, in 2018 Whirlpool successfully lobbied the Trump administration to impose 25% tariffs on imported washing machines and dryers. As a result, the price of washing machines and dryers rose by around 10% in the US inflation data. If tariffs were imposed in a pervasive way, it's possible that the economy could experience another inflationary shock. Such developments could unsettle equity markets, potentially mirroring the volatility seen in 2022. This remains a key risk to watch.

We're also open to the possibility that the Federal Reserve keeps rates steady at current levels for an extended period. A historical precedent for this can be found in the late 1990s, when the Fed paused rate hikes and inflation fell sharply following the Asian Financial Crisis. This decline in inflation provided U.S. consumers with significant savings, which fuelled a wave of investment and speculative growth, particularly in the tech sector. This time, however, the dynamic is slightly different. The excess savings available to U.S. consumers were primarily built up during the COVID-19 pandemic, driven by stimulus measures and reduced spending opportunities. While these savings are gradually being depleted, there remains the potential for speculative bubbles to form in certain asset classes, especially if economic stability and lower inflation reignite consumer and investor confidence. If such bubbles emerge, the Fed's future policy decisions could shift abruptly, particularly if market exuberance begins to spill over into inflationary pressures or systemic risks. This possibility warrants close attention as the economic landscape evolves.

We have also become increasingly cautious about the widespread bullish sentiment surrounding equities.



Source: Bianco Research, Bloomberg and Conference Board

Historically, when market participants exhibit such uniform optimism, reversals often occur – though not always.

Turning to the currency markets, we maintain a bullish outlook on the U.S. dollar, particularly relative to the Australian dollar and Brazilian real. In large part, we believe the reason is a combination of impending tariffs and trade war between China and the US, as well as US economic outperformance. The troubles that were once at the periphery of Europe have spread to the centre. The lack of a first-past-the-post voting system in countries like Germany and France has made consensus building increasingly difficult. While the Australian economy looks much healthier than most, the currency is unlikely to swim against the global tide.

We should also touch on what we're seeing in the Brazilian economic situation because it's very unique. We had previously predicted the course of events during Turkey's economic implosion accurately, and what we're seeing in Brazil shares many similarities. At the heart of Brazil's challenges lies an unsustainable government debt burden. With a debt-to-GDP ratio of approximately 80% and an effective interest rate of around 8%, the country is dedicating nearly 7% of its GDP solely to servicing debt. This burden is poised to grow due to several compounding factors. First, the central bank's commitment to raising short-term interest rates to around 15% will result in higher rates on rolled-over government debt. Second, much of Brazil's liabilities are tied to inflation, exacerbating the problem as inflation rises. Third, the left-leaning government's reluctance to reduce its 3.5% budget deficit – for fear of losing the next election – further entrenches fiscal imbalances.

In addition, much of the pricing in the Brazilian economy is linked to inflation. The situation is untenable. This is a rare situation in that the way in which the markets move can, rather than just reflecting the outcome, actually determine the outcome. If the currency continues to weaken at roughly the pace that it has been, then inflation may rise even faster than before. More interest rate hikes to counter such inflation would make the budget situation even more untenable and likely lead to a recession. The country's current account balance has been hit badly and any further tariffs could cause a run on the currency. When the central bank raised interest rates by 1% and threatened more rate hikes, the prevailing bias of investors to judge that such an action would only make the debt situation worse and the economy weaker was reinforced. It's a unique and rare situation that could easily give rise to a large one-sided market move.

Looking top-down, we remain open to a broad spectrum of potential market outcomes in 2025. The evolving economic and geopolitical landscape presents both challenges and opportunities, reinforcing the importance of staying agile and responsive. As always, our focus will be on closely monitoring the outlook and positioning our

portfolio to capitalise on asymmetric opportunities, where the potential upside significantly outweighs the downside risk.

Kind Regards,

Fawkes Capital Management

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