FORAGER

CHIEF INVESTMENT OFFICER LETTER

QUARTERLY LETTER DECEMBER 2023

FORAGER FUNDS PERFORMANCE SUMMARY (as at 31 December 2023. Net of all fees and expenses)								
	1 month return	3 month return	6 month return	1 year return	3 year return (p.a.)	5 year return (p.a.)	10 year return (p.a.)	Since inception* (p.a.)
Forager Australian Shares Fund	7.14%	5.00%	10.44%	10.86%	3.18%	6.65%	7.07%	9.30%
Forager International Shares Fund	8.07%	8.14%	8.26%	26.92%	1.54%	12.33%	9.75%	12.02%

Past performance is not indicative of future performance and the value of your investments can rise or fall. Performance in FASF is calculated using Net Asset Value (NAV), not the market price.

*8 February 2013 for FISF and 30 October 2009 for FASF

BLINK AND YOU MISS IN MODERN MARKETS

That was an eventful end to the year. Australia's All Ordinaries Accumulation Index (which includes dividends) jumped 7% in December, taking the year's return to 14%. The S&P 500 rose 4% for a 25% annual return, while the tech-heavy Nasdaq index increased 6%, taking its return for 2023 to a whopping 55%.

Smaller companies finally came to the party as well, albeit not until the final few months of the year, making the prediction that 2023 could be a year for small caps relatively wrong rather than outright foolish. Large cap indices once again outperformed small cap indices in 2023. The MSCI World Small Cap Index underperformed the MSCI World Index by 7%, while here in Australia the Small Ordinaries underperformed the All Ordinaries by 6%. But November and December were good months for small stocks, particularly in the US.

The proximate cause of this dramatic shift in sentiment was a series of welcome inflation statistics released around the world. In the US, November inflation figures showed the lowest annual increase in prices since early 2021. Both headline and core CPI (adjusted for volatile items) fell below 4% and month-on-month increases are now consistent with an annual rate of 2-3%. The rest of the developed world is following, with a lag, including here in Australia.

While central bankers are adamant that the inflation fight isn't over, bond investors are betting aggressively that interest rates will fall throughout 2024. The yield investors can earn on a 10-year US government bond fell from 5.0% to 3.8% between the middle of October and the end of December.

Does all of that justify a dramatic rally in equity markets?

Well, it makes a difference at the margin. All other things equal, stocks should trade relative to the return investors can earn on long-term government bonds. Lower rates should equal higher multiples for equities.

The swings have been extreme, however, and the correlation between bond markets and equity markets suggests plenty of fast money chasing short-term returns. Sure, falling inflation is welcome. Whether it is banished for good is still highly uncertain and labour conditions in many countries remain tight. And whether Fed president Jerome Powell thinks rates will fall or not doesn't make it a certainty. The past few years have confirmed that the central bankers' crystal balls aren't any more reliable than our own.

I don't think any rational person is changing their valuation of the market by 20% based on one month of inflation data. Rather, financial markets are being dominated (more than ever, in my opinion) by money that doesn't care what stocks are worth, only where they are going to trade in the short term. The computer says rates up equals sell. The computer says rates down equals buy.

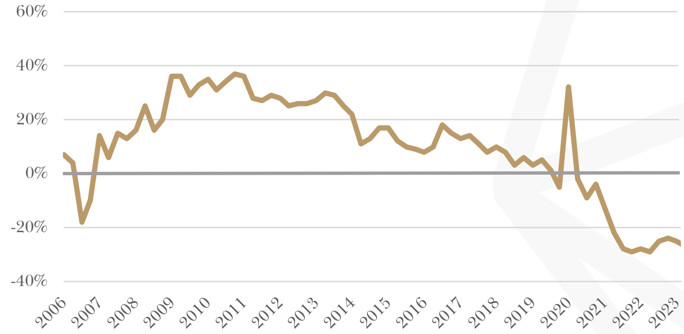
THE LONG GAME IS THE ONLY GAME FOR US

So how should we navigate these significant and rapid moves in equity markets?

First, recognise that neither you nor we can beat the supercomputers at the short-term prediction game. I've spoken to numerous investors over the past 12 months who didn't want to invest in equities until the inflation picture was clearer. While "artificial intelligence" entered the mainstream lexicon in 2023, it has been used in finance for decades. Giant hedge funds and investment banks with supercomputers and billions of dollars to invest dredge the world for data correlations, parse central banker speeches for minute changes in language or tone and execute trades with that information in milliseconds. If you think you are going to win the short-term prediction game sitting at home on the NBN with a laptop, good luck.

Between the middle of October and the end of December, the valuation multiple on the S&P Small Cap Index rose from 12 to 15 times earnings, up 25%. Despite this, the Small Cap Index still trades at a 25% relative valuation discount to the S&P 500, when for the past 20 years, the index has traded at an average 10% premium. Small companies are still a lot cheaper than large companies and there is dramatically more dispersion of opportunity at the smaller end of the market. In the US, though, the opportunity to buy the small cap index cheaply evaporated in just 10 weeks. You have a clearer picture on inflation today, but the bargains are no longer as widespread.

S&P SMALL CAP INDEX VALUATION PREMIUM (DISCOUNT) VS S&P 500 INDEX



Source: Bloomberg

TIME HORIZON ARBITRAGE

All of this focus on the next data point, however, makes the job somewhat easier for the investor with a longer investment horizon. The more the weight of money is focussed on the short-term, the more opportunity there is for those with a longer-term view.

Through all of the volatility and bear and bull markets, the ASX All Ordinaries has delivered a return of 8.1% per annum over the 14 years since we started the Forager Australian Shares Fund. Back out the positive impact from Aussie dollar depreciation, and the MSCI World IMI Index has delivered 9.0% per annum in the almost 11 years that fund has existed. Those returns are roughly in line with historical returns from equities and the sorts of returns you should expect in the future.

The same is true for individual stocks. There is plenty of volatility. And there are times (now being one of them for small cap stocks) when stock prices diverge significantly from their underlying value. But when I look back over the past 10 years, our main successes have been those companies that exceeded expectations on earnings and dividends, and the failures were those that failed to deliver.

Whether interest rates are 5% or 3%, whether inflation is 4% or 2%, the future probably won't be any different. Companies will make profits, pay dividends and grow their collective earnings modestly over time. Long-term returns should be consistent with the past and those that can buy when everyone else is panicking can do a fair bit better than that.

FORAGER BUSINESS UPDATE

Thanks to all International Fund investors who voted to change the Responsible Entity of the Fund in December. The resolution passed with approximately 60% of units voting in favour (less than 1% voted against) and Pepetual's Trust Co should become the responsible entity on 1 February.

The change is part of a number of initiatives to simplify the Forager business. The same responsible entity, registry and administration provider for both funds will make your and our lives simpler. You will receive more information about the Automic registry portal (which will be the same for both funds) in the coming weeks.

We are also progressing with a proposal to delist the Forager Australian Shares Fund from the ASX (if you missed it, here is the original announcement). Fund investors will receive more information on that proposal soon, too, and we still expect to be able to hold a unitholder meeting in the first half of the 2024 calendar year.

Finally, Gaston Amoros left the Forager business in October. Gaston was a Senior Analyst on the Australian Fund and we thank him for his hard work over the past three years. Alex Shevelev and I remain portfolio managers of the Fund and we are excited to have added Nicholas Plessas to the team as a full time analyst.

As always, please get in touch if you have any questions or suggestions.

Kind regards,

Steve Johnson

Steven Johnson
Chief Investment Officer