L1 Capital International Fund (Managed Fund)

Quarterly Report | MARCH 2024

APIR: ETL1954AU ASX:L1IF

Introduction

In this Quarterly Report, we have outlined:

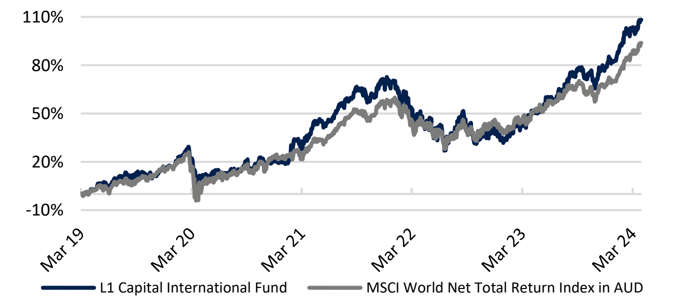
- **Our assessment of the current investment environment including:**
  - **Continuation of overall economic growth exceeding expectations, particularly in the U.S.**
  - **Inflation trending down but staying above Central Bank targets**
  - **Mixed business conditions, with a deterioration evident for lower income consumers**
- **L1 Capital International Fund positioning when it is challenging finding investments offering both Quality and Value**
- **Our review of the last quarter, including key contributors and detractors to the Fund's performance**
- **Recent Portfolio adjustments**
- **Reflections on the 5 years of the Fund since inception.**

Fund performance (Net) (%)	Fund	Index**	Alpha
3 months	14.0	13.9	+0.1
1 year	37.2	28.4	+8.8
3 years p.a.	14.7	14.4	+0.4
Since inception* p.a.	15.5	13.9	+1.6
Since inception* cumulative	108.2	93.8	+14.4

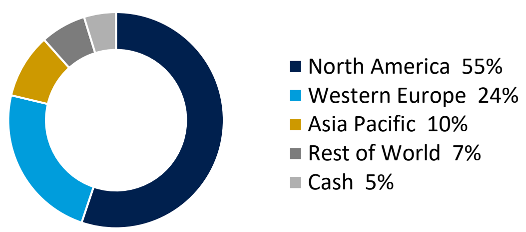
NAV price as at 31 March 2024	$5.8188

** Unit Trust inception is 1 Mar 2019 (returns measured from Index close). ETMF Inception is 22 Nov 2023. Numbers rounded to one decimal place and may not add due to rounding. ** MSCI World Net Total Return Index in A$.*

Fund (Net) and benchmark returns since inception*



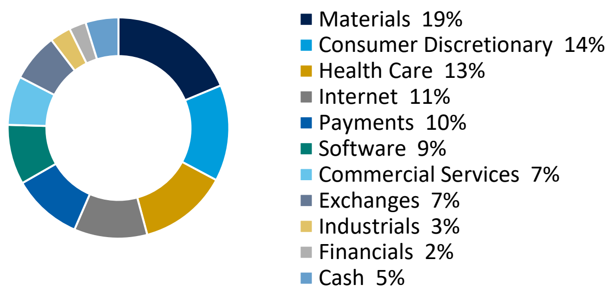
Revenue exposure by region[1]



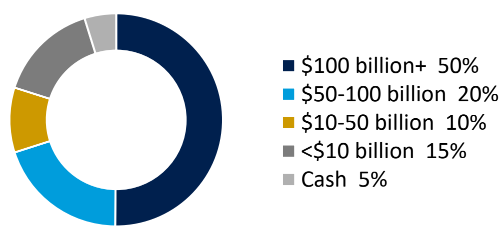
Top 10 holdings *(In alphabetical order)*

	Sector
Amazon.com	Consumer Discretionary / Internet
Booking Holdings	Consumer Discretionary
CRH	Materials
Eagle Materials	Materials
HCA Healthcare	Health Care
Intercontinental Exchange	Exchanges
Mastercard	Payments
Microsoft	Software
Natural Resource Partners	Materials
UnitedHealth Group	Health Care

Sector exposure[2]



Market capitalisation exposure (in US$)



1. Revenue by region is internally estimated on a look through basis based on the underlying revenues of the individual companies held in the portfolio. 2. Sector exposure is defined by L1 Capital International to best describe the nature of the underlying businesses. Past performance should not be taken as an indicator of future performance.

Current investment environment

"I always like to look on the optimistic side of life, but I am realistic enough to know that life is a complex matter."

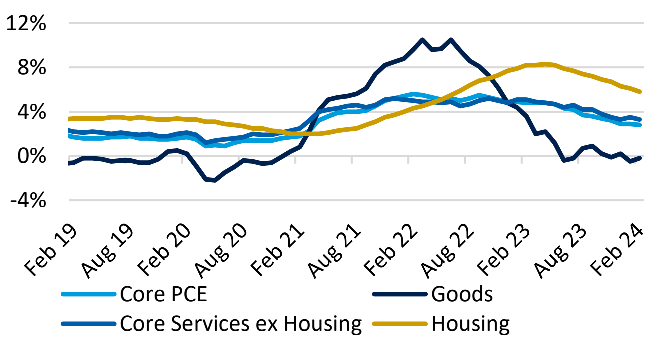
Walt Disney

Over the past three months there have been only modest changes at the macroeconomic level. **The U.S. economy continues to exceed expectations and outperform many regions of the world. Recent inflation data points have been mixed, with some showing a relatively modest uptick in inflation.** Core U.S. inflation has remained a little above expectations, slowing the trend towards the Federal Reserve's targeted 2% core inflation rate and pushing out market expectations for cuts in the Federal Funds Rate.

In his March 2024 Press Conference, the Chairman of the Federal Reserve, Jay Powell, commented "We believe that our policy rate is likely at its peak for this tightening cycle and that, if the economy evolves broadly as expected, it will likely be appropriate to begin dialling back policy restraint at some point this year... [Recent monthly inflation reports] really haven't changed the overall story, which is that of inflation moving down gradually on a sometimes bumpy road toward 2%. I don't think that story has changed."

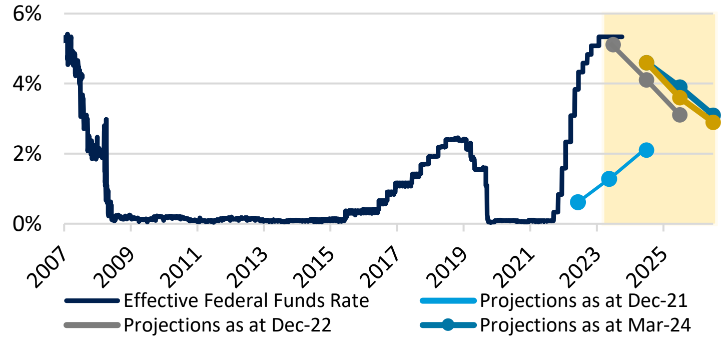
We have long argued that interest rates are likely to stay higher for longer if the economy, particularly labour markets, remain strong, and inflation remains above Central Bank targets (2% in the U.S. and Europe, 2% to 3% in Australia). This is exactly what has been happening. Inflation has been coming down in the U.S., but remains closer to 3% than 2%, while labour markets remain robust, albeit not as hot as they were. Interest rate expectations continue to be pushed 'out and to the right', with the market pricing the probability of a June 2024 U.S. interest rate cut falling to below 35%, compared to a 75% probability one month ago.

Figure 1: Core U.S. PCE growth by category



Source: U.S. Bureau of Economic Analysis

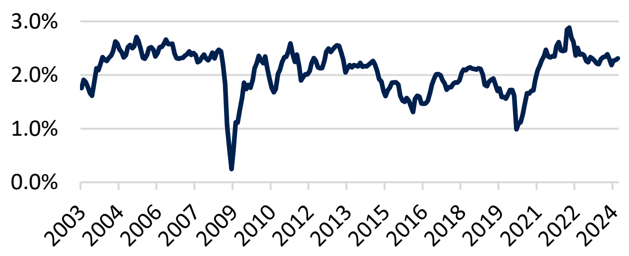
Figure 2: Federal Reserve Funds Rate and expectations



Source: St Louis Federal Reserve, Federal Open Market Committee

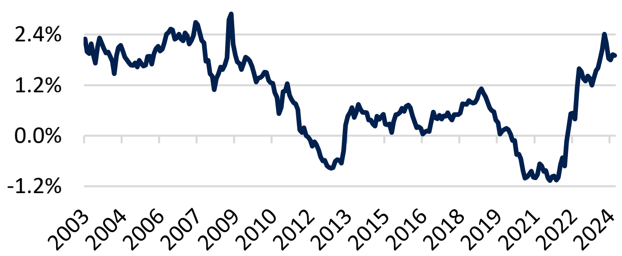
Far too much ink is spilled speculating on near-term fluctuations in cash rates. As outlined in prior quarterly reports, **we remain focused on inflation expectations and the level of nominal and real long-term interest rates. Should inflation expectations or long-term interest rates increase materially from here, there is likely to be pressure on equity markets.** Currently, U.S. inflation expectations remain benign within a 2% to 2.5% range that has persisted for much of the past 20 years. Despite widespread criticism of Central Banks and their inability to foresee and pre-empt the escalation in widespread inflation caused by COVID-19, Central Banks have not lost control of the inflation narrative, and **financial markets have maintained confidence that inflation will be contained to levels consistent with Central Bank targets**.

Figure 3: Expectations for U.S. inflation over next 10-years



Source: St Louis Federal Reserve

Figure 4: U.S. real 10-year interest rates



Source: St Louis Federal Reserve

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"Sometimes the first duty of intelligent men is the restatement of the obvious."

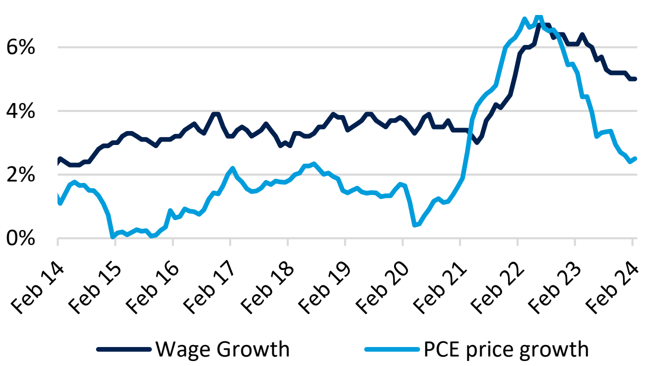
George Orwell

Powell succinctly commented that from a big picture perspective, 2023 had some very favourable dynamics – more people working, people getting paid more when they worked, people spending more money and normalising supply chains. As a result, the economy grew with decreasing inflationary pressures, albeit inflation remained above targeted levels.

U.S. GDP growth accelerated in H2 2023 and was over 3% for 2023. In contrast, Australian GDP growth was only 0.2% for Q4 2023 and 1.5% for 2023, while Australian GDP on a per capital basis was -1% in 2023.

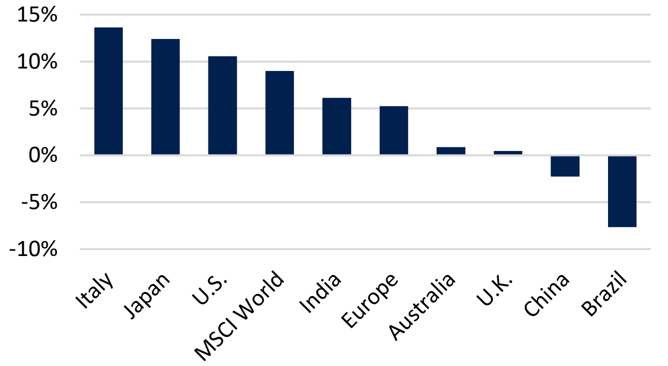
At an aggregate level, wages growth remains well ahead of inflation and employment conditions remain robust. With this generally favourable economic environment, U.S. equity markets have performed strongly, with these trends continuing into 2024.

Figure 5: U.S. wages growth continues to exceed inflation



Source: Federal Reserve Bank of Atlanta, U.S. Bureau of Economic Analysis

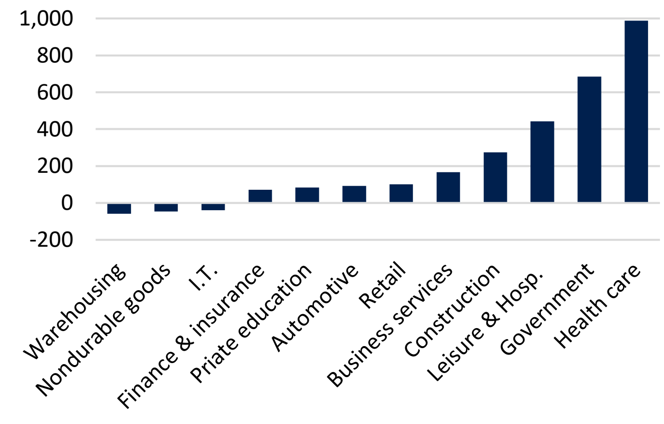
Figure 6: Q1 2024 Global Equity Index Returns in U.S. dollars



Source: Bloomberg

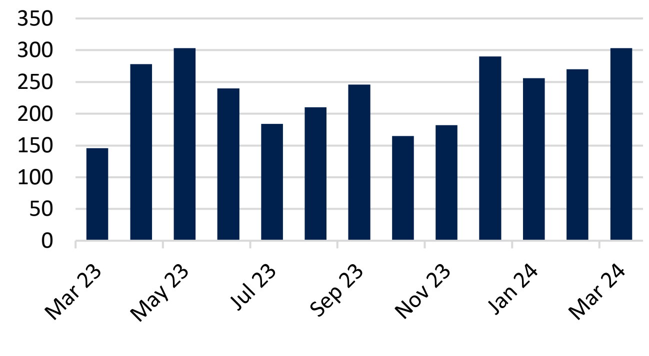
At a U.S. sector level, we see divergence. Net U.S. jobs creation is strongly positive. However, **some sectors** such as Warehousing, Non-durable Goods Manufacturing and Information Technology **have had negative employment trends**, while **jobs are booming** in the Construction, Leisure and Hospitality, Government and Healthcare sectors.

Figure 7: Change in jobs by sector – last 12 months (000s)



Source: U.S. Bureau of Labor Statistics

Figure 8: Aggregate monthly net jobs created (000s)

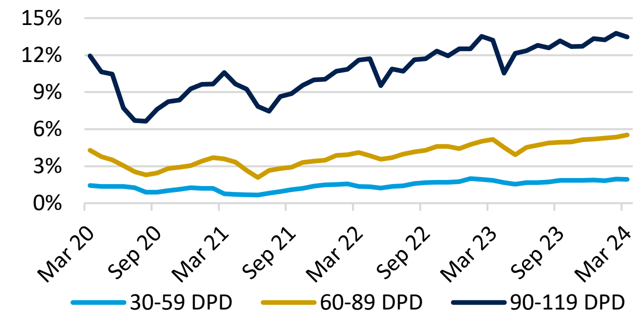


Source: U.S. Bureau of Labor Statistic

The outlook for consumers is also mixed. This continues a long-term trend where **affluent people are doing well, middle-income people are doing O.K., and lower-income people are under increasing pressure.** Affluent people are benefitting from strong house prices, near record equity markets, and are earning yield on their cash and income investments. **Lower socio-economic people are struggling** with cost-of-living pressures and fewer Government benefits than during COVID times. Middle consumers are facing challenges, saving less and reprioritising spending, but are generally doing reasonably well.

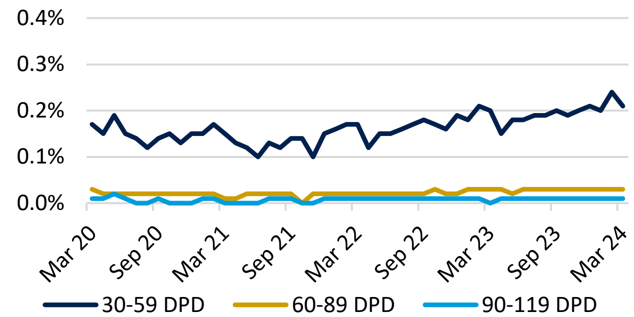
We are seeing **tangible evidence of pressure on more financially disadvantaged consumers**, while the credit performance of middle America remains robust. The charts below illustrate the performance of auto credit for the subprime category, and for prime borrowers. The data reflects similar trends in other asset classes. **Subprime credit performance is worse than pre COVID-19, while credit for prime borrowers remains benign.**

Figure 9: Auto loans – subprime credit



Source: VantageScore Solutions, DPD stands for days past due

Figure 10: Auto loans – prime credit



Source: VantageScore Solutions, DPD stands for days past due

Portfolio positioning

In our **December 2023 Quarterly Report** we outlined why the market's 'Queen mentality' of wanting it all (full employment, price stability and lower interest rates) could be wishful thinking. It is **unlikely that a national or global economy will be in perfect balance**. **Current economic conditions are good**, particularly in the U.S. Yes, inflation is a little above targeted levels and short-term interest rates are reasonably high, but that is countered by overall strong employment and robust economic growth. This environment is **conducive to overall business performance**, but as mentioned earlier, **not every industry or business is equally positioned.**

While we do consider economic conditions to be generally favourable, our central message is that at a business and industry level, conditions are more mixed.

We have seen widespread variance in performance of consumer centric businesses with under-performing companies blaming a range of issues such as weather, pressure on lower income consumers, theft, higher interest rates, geographically regional weakness (particularly China and Europe) and normalisation of spending behaviour post COVID.

Inflationary pressures are not homogeneous either. Overall goods inflation is broadly neutral, but again the detail is mixed. To pick a few commodity examples, oil, uranium, copper and cement prices have been increasing, while natural gas, wheat and coal prices have been falling.

Fiscal and immigration policies remain broadly pro-growth, but again we are seeing **nuanced variations having differentiated business implications.** Geopolitical considerations remain tense.

We are no longer in a TINA or 'there is no alternative' world of investing. **Nor are we in a world of abundant investment valuation support.** In our view there are **pockets of irrational exuberance**, with Artificial Intelligence being the market's current obsession and cryptocurrency markets driven by speculation rather than fundamental analysis.

In our view, most companies operating in an environment of cloudless blue skies are often priced for perfection, with the market assuming the weather never changes for these companies. Equally, not every company that has seen its share price fall considerably is under-valued. Many of the challenges these under-performing businesses face will persist, if not worsen.

We continue to see opportunities in a range of industries and in businesses of varying size. As discussed on page 6 we have made a number of meaningful adjustments to the portfolio, focusing on businesses with favourable long-term drivers of growth, sustainable leadership positions in well-structured industries, demonstrable pricing power, experienced and aligned management, financial strength and valuation support. **Company selection remains critical.**

We believe our unique definition of Quality, prudently and cautiously applied, results in a diversified portfolio of businesses that can deliver strong risk adjusted returns in current mixed economic conditions.

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L1 CAPITAL INTERNATIONAL

March 2024 quarterly review

Performance

In the March 2024 quarter, the Fund returned 14.0% (net of fees), slightly outperforming the Benchmark return of 13.9% by 0.1% (all in Australian dollars). The Australian dollar depreciated 4.1% against the U.S. dollar and depreciated 1.6% against the Euro, increasing the Fund and Benchmark Australian dollar reported quarterly returns.

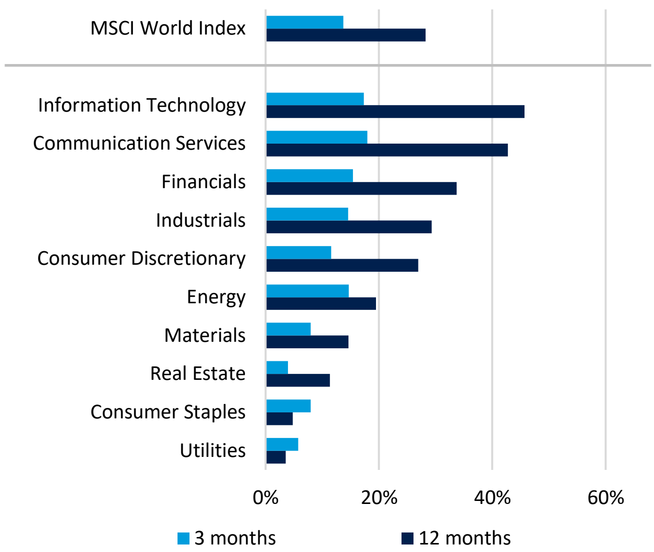
Key contributors and detractors

The contributors to the market's performance were quite broad during the March 2024 quarter, with the share price of almost 75% of the companies making up the S&P500 Index increasing. Information Technology and Communication Services were the leading sectors for the March 2024 quarter, but Financials, Industrials and Energy all increased at a greater rate than the market average. Only the Real Estate sector made a slightly negative contribution when measured in U.S. dollars, with Utilities and Consumer Staples making subdued contributions.

The narrative around the Magnificent 7 and their outsized contribution to market returns continued but morphed into a discussion of the 'Gang of 4', namely Amazon.com, Meta, Microsoft and Nvidia. Apple and Tesla have lost some of their lustre and Alphabet has traded more in line with the market.

We find these retrospective discussions of the companies driving market returns as simplistic. Cloud computing, Artificial Intelligence, software and online advertising are key growth areas of the modern economy, with some of these sectors highly consolidated and led by some of the largest, most successful businesses in history.

Figure 11: MSCI World Index (in A$) – Sector Performance



Source: Bloomberg

It should not surprise anyone that if you single out the large businesses which have an increasing share price you will identify the largest contributors to index performance. While many of these businesses are in the technology sector, broadly defined, it does not follow that all technology companies did or will continue to perform strongly, as evidenced by the most recent three months.

Microsoft and **Amazon.com** were two of the six companies which each contributed over 1% to the Fund's returns for the March 2024 quarter. The others (in alphabetical order) were **CRH**, **Eagle Materials, HCA Healthcare** and **Mastercard**. **The Fund's returns were again diversified across different sectors, as well as companies with a wide range of market capitalisations**. Another five companies each positively contributed over 0.5% (in AUD) to the Fund's quarterly returns.

There were no companies which detracted from the Fund's performance by 0.5% or more (in AUD) in the March 2024 quarter. However, during the quarter the share price of **UnitedHealth** fell around 10% from its mid-January price and has fallen a further 10% in April. UnitedHealth's share price has been under pressure for three reasons:

- A cyber-security breach at its subsidiary, Change Healthcare, a business intricately involved in payments within the U.S. healthcare industry,
- Near term pressure on profitability as a result of an uptick in people receiving medical treatments, and
- Lower than expected reimbursement from the Government, particularly under the Medicare Advantage regime.

All of these factors are real and will have a negative impact on UnitedHealth's near-term profitability. However, we believe UnitedHealth has a highly experienced management team and scale, diversity and financial strength second to none in the industry and will be able to address these issues and remain well positioned over our longer-term investment horizon. We have taken advantage of the fall in UnitedHealth's share price to increase our investment in the business.

Portfolio adjustments

We made a number of adjustments to the Portfolio in the March 2024 quarter, totalling around 15% of the Fund's investments.

The most significant change to the Portfolio was the sale of our entire investment in **Graphic Packaging**, a business that has been a stalwart in the top 10 for the past few years. Graphic Packaging has been a very profitable investment for the Fund, being a top ten contributor to the Fund's since inception performance. Heading into Graphic Packaging's 2023 final quarter results and 2024 outlook we were concerned by our ongoing research that suggested continued destocking of packaging by consumer customers, weak demand in some segments, such as beer, and increased industry supply including the threat of imports from Europe combining to pressure pricing for paperboard. These concerns proved to be largely correct. In addition, Graphic Packaging's free cashflow generation was weaker than we expected, an issue we continue to monitor closely.

We have high regard for Graphic Packaging's management and were once again reminded that **strong management teams make their own luck**. Graphic Packaging announced the divestment of one of the group's weaker businesses in conjunction with the 2023 results. This divestment was positively received by investors, us included. While likely to be modestly earnings dilutive, the divestment improves the quality of the business and reduces near term market risks. Graphic Packaging has moved from the Portfolio to our 'Bench' of potential future investments should the valuation become more attractive.

Other portfolio changes were less dramatic, but still meaningful on a collective basis.

We added to our investment in **Intercontinental Exchange** (ICE) which has now entered the Fund's top 10 holdings. We have held an investment in ICE since inception of the Fund and have actively followed the business and management team for well over a decade. ICE is a leading global provider of data services and technology solutions, operating through three divisions.

The Exchanges division (around two-thirds of ICE's earnings) operates a global network of exchanges and clearing services across major asset classes, including operating leading derivatives exchanges with a particular strength in energy derivatives (where market participants can hedge or trade their exposure to oil and gas prices). ICE also owns the flagship New York Stock Exchange.

The Fixed Income and Data Services division (around 20% of ICE's earnings) provides a wide range of essential financial industry data and analytics as well as some behind the scenes financial plumbing services such as CDS clearing. These businesses provide steady growth and strong free cashflow generation.

The Mortgage Technology division (around 15% of ICE's earnings) is the Group's newest division, built over recent years through a series of industry acquisitions. ICE management is attempting to digitalise the U.S. mortgage origination and servicing industry, delivering a range of efficiencies, new value-add services and over time additional revenue opportunities through the provision of data and derivatives trading solutions. The business is currently under-earning due to low activity levels in the U.S. mortgage industry, as existing home sales and refinancing activity are low due to the rapid increase in mortgage rates. We believe ICE is uniquely placed to add value in this industry, but change will be measured over years, not quarters.

ICE's financial leverage is high following recent acquisitions, but management has committed to reducing leverage and has a track record of delivering on commitments. In our view, the current share price provides an attractive investment opportunity given our longer-term investment horizon.

We added to a number of existing investments, in addition to the aforementioned UnitedHealth. We are particularly excited by the long-term prospects of **Amazon.com** and look forward to a meaningful upward inflection in earnings and free cashflow.

Outside of the top 10, initial investments were made in a few businesses, including from our Bench of 'ready-to-go' investment opportunities. **While the broader market is reaching record highs and many companies are trading at or near record share prices, this is not universal**. As discussed earlier, the operating environment for many companies is choppy, and we are **starting to see better value in consumer-facing businesses where near-term performance is subdued and share prices have fallen significantly**.

The share price of some companies in the Portfolio have continued to appreciate, and we have maintained our valuation discipline and **trimmed investments when the share price reaches or exceeds our view of fair value, including but not limited to the technology sector**.

5-Year reflections

Meeting Fund objectives

During March 2024, the L1 Capital International Fund reached its 5-year anniversary since inception, a 'coming of age' moment for investment funds. The past 5 years have been exceptionally eventful. To be brief, back in March 2019 no-one would have imagined a global pandemic, the largest war in Europe since World War II, other regional conflicts, broad-based elevated inflation and a rapid rise in interest rates in most global markets as well as the birth of commercialised Artificial Intelligence, to name a few global events.

Yet, over that time, the Fund's Benchmark, the MSCI World Net Total Return Index, has increased by around 94% or nearly 14% p.a. in Australian dollars. It is trite but still appropriate to quote Ken Fisher's adage, "Time in the market beats timing the market".

The Fund aims to deliver attractive risk adjusted returns while reducing the risk of a permanent loss of capital by investing in a Portfolio of businesses that meet our definition of Quality supported by our assessment of valuation. Specifically, the object of the Fund is to outperform the Benchmark net of fees and expenses over rolling 5-year periods.

We are pleased that the Fund has met its objectives over its initial 5-year period since inception.

Since inception, the Fund has returned 15.5% p.a. exceeding the Benchmark by 1.6% p.a. net of all fees. Both the Fund and Benchmark returns include around 1.5% p.a. contribution from the depreciation of the Australian dollar over the past 5 years. **The Fund's returns rank in the top decile of investment funds in its category as measured by independent databases.**

We view the absolute returns achieved by the Fund as reasonable given the high quality of companies in the Portfolio and our measured approach to investment risk. We are less satisfied with the relative outperformance of the Fund compared to the Benchmark and will aim to continue to deliver capital growth to investors in the Fund over time.

Contributors to Fund performance

Pleasingly, contributors to the Fund's performance since inception have been broad based across industries, internal Quality rating assessment and market capitalisation.

19 companies have each positively contributed over 2% to the Fund's returns since inception, while a further 11 have each positively contributed over 1% to the Fund's returns. Only 3 companies have each detracted from the Fund's performance by more than 2%, and just one additional company detracted by more than 1%. We view risk as a permanent loss of capital as opposed to volatility in share prices. While some investment losses are inevitable, we have taken learnings from each of these 4 loss-making investments and improved our investment assessment and decision processes.

The Magnificent 7 (of which we have invested in 4 since inception) have accounted for around 23% of the Fund's total returns since inception. The Fund's returns have not been overly dependent on the contribution of any one business or sector.

L1 Capital International business

The senior members of L1 Capital International and L1 Capital have significant personal investments in the Fund and the experienced L1 Capital International team is well aligned with investors in the Fund. The L1 Capital group continues to provide strong operational, compliance and business development support.

The Fund is available on most investment platforms and since November 2023 is available on the ASX as an Exchange Traded Managed Fund (ETMF) with the ASX ticker L1IF.

We are pleased to announce that a currency-hedged version of the Fund will be available both as an unlisted Fund and as an ETMF later this year.

The L1 Capital International team would like to express our appreciation for your continued interest in the L1 Capital International Fund.

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Fund Information

Name	L1 Capital International Fund (Managed Fund)
Portfolio management	David Steinthal, Chief Investment Officer
Types of investments	Listed securities globally. Developed market focus. No shorting, no leverage
Number of investments	20 to 40
Cash weighting	0% to 25%
Minimum initial investment	$25,000
Hedging	Unhedged
Structure	Dual Registry
Domicile/Currency	Australia/A$
Inception	1 March 2019
Management fee	1.2% p.a. inclusive of GST and net of RITC
Expenses	Nil (included in Management Fee)
Benchmark	MSCI World Net Total Return Index in A$
Performance fee	15.38% over Benchmark inclusive of GST and net of RITC*
High watermark	Yes
APIR / ISIN / ASX Ticker	ETL1954AU / AU0000302960 / L1IF
Platform availability	Asgard, Australian Money Market, BT Panorama, CFS Firstwrap, Hub24, Macquarie Wrap, Mason Stevens, MLC, Netwealth, North, Powerwrap, Praemium

* There must be positive absolute performance (adjusted for distributions) in the performance period. Otherwise, positive relative performance carries forward to next Period.

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L1 CAPITAL INTERNATIONAL

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L1 Capital International overview

L1 Capital International is an independent active manager of global equities established as a joint venture with L1 Capital. We apply a detailed investment process built on a fundamental assessment of Quality and Value. We aim to deliver attractive risk-adjusted returns by investing in high-quality companies that have favourable cashflow-based valuations in well-structured industries. Capital preservation over the investment horizon is central to our investment philosophy and process. We view risk as the potential for a permanent loss of capital as opposed to volatility in share prices.

L1 Capital is a global investment manager with offices in Melbourne, Sydney, Miami and London. The business was established in 2007 and is owned by its senior staff, led by founders Raphael Lamm and Mark Landau. L1 Capital's clients include large superannuation funds, pension funds, asset consultants, financial planning groups, family offices, high net worth individuals and retail investors. Additional information on L1 Capital International and L1 Capital is available at **www.L1.com.au**.

Key service providers for the Fund are: Responsible Entity – Equity Trustees Limited, Fund Administrator and Fund Custodian – Apex Group, Fund Auditor – EY, Legal Advisor – Hall & Wilcox. There have been no changes to key service providers since the last report.