MEREWETHER CAPITAL

Merewether Capital Inception Fund Performance Summary (at 30 September 2023 net of fees and expenses)					
1 Month	3 Months	6 Months	1 Year	2 Years (p.a.)	Since Inception*
-0.23%	1.40%	10.22%	4.60%		-25.91%

Indicative performance is reported net of all fees and assumes reinvestment of distributions. Past performance is not a reliable indicator of future returns. * Inception Date 26 November 2021

Dear Investor,

The Merewether Capital Inception Fund (the "Fund") began the month with an indicative unit price of $0.7426 and ended the month with a unit price of $0.7409 for a -0.23% return.

September was marked by falling equity markets globally as the "higher for longer" mindset for interest rates entrenched itself led by a sharp rise in the benchmark US 10-year treasury yield. The US yield curve has been inverted for over a year, but the spread between the 2 and 10-year treasuries fell to its lowest point in early July, with the 2-year yielding more than 1% over its longer dated counterpart.

Many pundits expected that the yield curve inversion would be rectified by a pivot at the front end of the yield curve as central banks would be forced to begin cutting rates (or at least hinting that it may be necessary), bringing them in line with longer dated yields. However, the sharp 70bps rise in the 10-year treasury yield from 4.08% to 4.78% in a month is perhaps the market throwing in the towel on it's bet against the strength of the US economy and the Federal Reserve.

We had very little portfolio news after reporting season, with only **Austco Healthcare** (AHC) announcing they had tacked on an extra $1m to their order backlog and **Global Health** (GLH) announcing they had won a contract to provide their patient administration software MasterCare to another small private hospital.

With AGM season rolling around in October/November I expect we will get more updates from companies to get a feel for how the new financial year has begun.

With little else to write about I thought I would take the time to pen some broader investment thoughts. For some time, I have believed that in the short term it is often the price movement of a stock that drives the narrative of the business behind it. I think it is natural to expect it is the other way around, because the times that the opposite is true it is usually so obvious.

For example, broad narratives like artificial intelligence, energy transition/electric vehicles and cyber security are likely to experience strong structural growth in the future that people seek out businesses exposed to those themes, driving up share prices in response. That sort of behaviour can lead to irrational prices and bubbles as the fundamental performance of businesses cannot live up to the narrative around them.

However, in most cases I think it is the other way around and the market searches out a narrative as a reason to explain the movement of share prices. This thought re-surfaced in September as I watched the share price of **Resmed** (RMD).

When RMD reported earnings on the 4th of August, shares fell roughly 20% on a clean earnings miss. I happened to be on ausbiz's The Call that day (https://ausbiz.com.au/media/the-call-friday-4th-august?videoId=30820) where I commented that despite the magnitude the share price reaction actually felt quite rational based on the valuation and the issues with a weakening gross margin.

However, shares continued to slide in the following days, and another bogeyman needed to be found to explain why. The market quickly settled on the emergence of weight loss GLP-1 drugs which were seeing some successful results and rapid uptake internationally.

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There is truth that an effective obesity treatment will have some impact on RMD as sleep apnoea is more prevalent among the obese, but of course that is the case because the whole point is to find the narrative to explain the share price movement.

Ironically, the emergence of GLP-1 drugs has now evolved into a broader market theme like those examples given above, and any business related to obesity (no matter how tangential) has seen share price weakness.

While an interesting case study, it is hard to find actionable ideas in the ASX small and micro-cap space to take advantage of a price dislocation based on the emergence of GLP-1 drugs. However, the phenomenon of price driving narrative creates ample opportunities in our hunting ground, generally in two ways.

The first is when a share price has traded sideways or down for a long time (often years) and creates the narrative that the underlying business must be failing or stagnating. Over the longer term, it is true that a company's share price tends to reflect the operating performance of the business, but it isn't always the case especially in the more illiquid pockets of the market. The inherent belief in the "weighing machine" of long-term markets means people may not look past the price chart to the fundamental business.

I believe a potential example of this is **Prophecy International** (PRO) whose share price is trading at a similar level to where it was nearly seven years ago in 2017. Given the business embarked on a strategy change back then to shift to recurring revenue, the easy analysis is to look at the long-term price chart and deem the strategy shift a failure. But that would overlook the 40% CAGR in recurring revenue since then that has left the business trading at a recurring revenue model well below industry peers.

Underneath the stagnating share price (albeit with a few rises and falls along the way, the operating business has moved from strength to strength.

The recent blog post of PRO goes into the investment case further (https://www.merewethercapital.com.au/blog/are-profits-foretold-in-this-prophecy/), and as the business executes, grows and generates profits I expect the share price will catch up to the fundamental execution.

The other way price drives narrative is the movement of a share price in reaction to trading updates or financial reports. Very often the impression of the result is based on the share price reaction to it, but where it gets most interesting is when impressions change over time.

An example of this was the recent financial result for **Rectifier Technologies** (RFT) which I wrote about last month saying it was by far the best report in our Fund. It ticked almost every box for growth, margins, returns on capital and the outlook in a rapidly growing industry. Even better it traded on roughly 11x earnings.

The early discourse with the result was extremely positive in investment forums (as it should have been). However, when the price didn't rise and steadily fell, the perception of the result began to change. The small negatives with the result such as cash conversion and the contracted backlog of work were put into focus to try and explain why Mr. Market didn't like the result, while the glaring positives were ignored.

As a small and micro-cap fund, we are staunch opponents to the efficient market hypothesis that says all known information is reflected in a share price. It is clear that the more you remove liquidity the less signal can be taken from the share price to try and assess the fundamental performance of a business and it can create great opportunities for those willing to look past the share price chart.

Thanks for your on-going support.

Luke Winchester (Portfolio Manager)