OPHIR

Letter to Investors - December 2024

From Andrew Mitchell and Steven Ng
Founders and Senior Portfolio Managers

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Performance Update
Before we jump into the Letter, we've provided a detailed monthly update for each of the Ophir Funds below.

The Ophir Opportunities Fund returned -2.5% net of fees in December, outperforming its benchmark which returned -3.1%, and has delivered investors +22.7% p.a. post fees since inception (August 2012).

Download Factsheet

The Ophir High Conviction Fund (ASX:OPH) investment portfolio returned -5.4% net of fees in December, underperforming its benchmark which returned -3.4%, and has delivered investors +13.5% p.a. post fees since inception (August 2015). ASX:OPH provided a total return of +0.0% for the month.

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The Ophir Global Opportunities Fund returned -0.9% net of fees in December, in-line with its benchmark which returned -0.9%, and has delivered investors +17.4% p.a. post fees since inception (October 2018).

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The Ophir Global High Conviction Fund (Class A) returned -1.3% net of fees in December, underperforming its benchmark which returned -0.9%, and has delivered investors +13.0% p.a. post fees since inception (September 2020).

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The Ophir Global High Conviction Fund (Class B) returned -1.2% net of fees in December, underperforming its benchmark which returned -0.9%, and has delivered investors +26.3% p.a. post fees since inception (June 2023).

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Ho Ho Ho… Hum

- 2024 saw the fifth best year in the U.S. share market in the last quarter century, led by large caps, with material underperformance (albeit still positive) for small caps
- Last year all Ophir Funds delivered strong outperformance and met their long-term investment objectives
- We're particularly pleased that our outperformance in 2024 was driven by our investment process, which focuses on stock selection, rather than other investing "factors"
- The outlook for further U.S. interest rate cuts may be diminishing, but there is renewed optimism in small businesses and a continuing strong U.S. economy should finally deliver the anticipated earnings growth (and share price performance) of small caps

We hope Santa delivered what you wanted under the tree because he didn't deliver what investors were hoping for – a Santa share market rally in December.

Perhaps it was too much to ask for after November's generally stellar gains across the major bourses.

The cause of December's weakness?

The most obvious was the U.S. Federal Reserve. Despite cutting rates by 0.25% during the month, the Fed signalled there may not be many more cuts (with a non-zero chance of no more cuts!) in 2025.

Most share markets fell in December, with the S&P 500, Russell 2000, MSCI Europe and MSCI Australia Indices down -2.4%, -8.3%, -0.5% and -3.1% respectively (local total returns).

Fortunately for unhedged investors, including those in our Global Funds, much of the fall in the U.S. share market was offset by a falling Australian Dollar, which helped protect returns when converted to the domestic currency.

But, overall, 2024 was still a great year for the global share market. Though, admittedly, this was mostly because U.S. large caps had such a stellar year … again!

The S&P 500 ended up +25.7% (total return) in 2024 – the 5th best calendar year return in the last 25 years. You know what beat it out for 4th spot? 2023 – with a return of +26.8%.

And when you consider 2019 (+31.3%) and 2021 (+30.6%) hold first and second place over the last quarter century, it's hard to escape the conclusion that being invested in the biggest companies from the biggest economy in the world has been a great place to be recently.

Share markets rose in 2024 because of several factors:

1. U.S. macro risks, like recession, high inflation and employment worries, generally fell;
2. The Fed started cutting interest rates;
3. Trump was elected, raising economic and market hopes; and
4. The AI train rolled on, boosting the Magnificent 7's earnings and share prices.

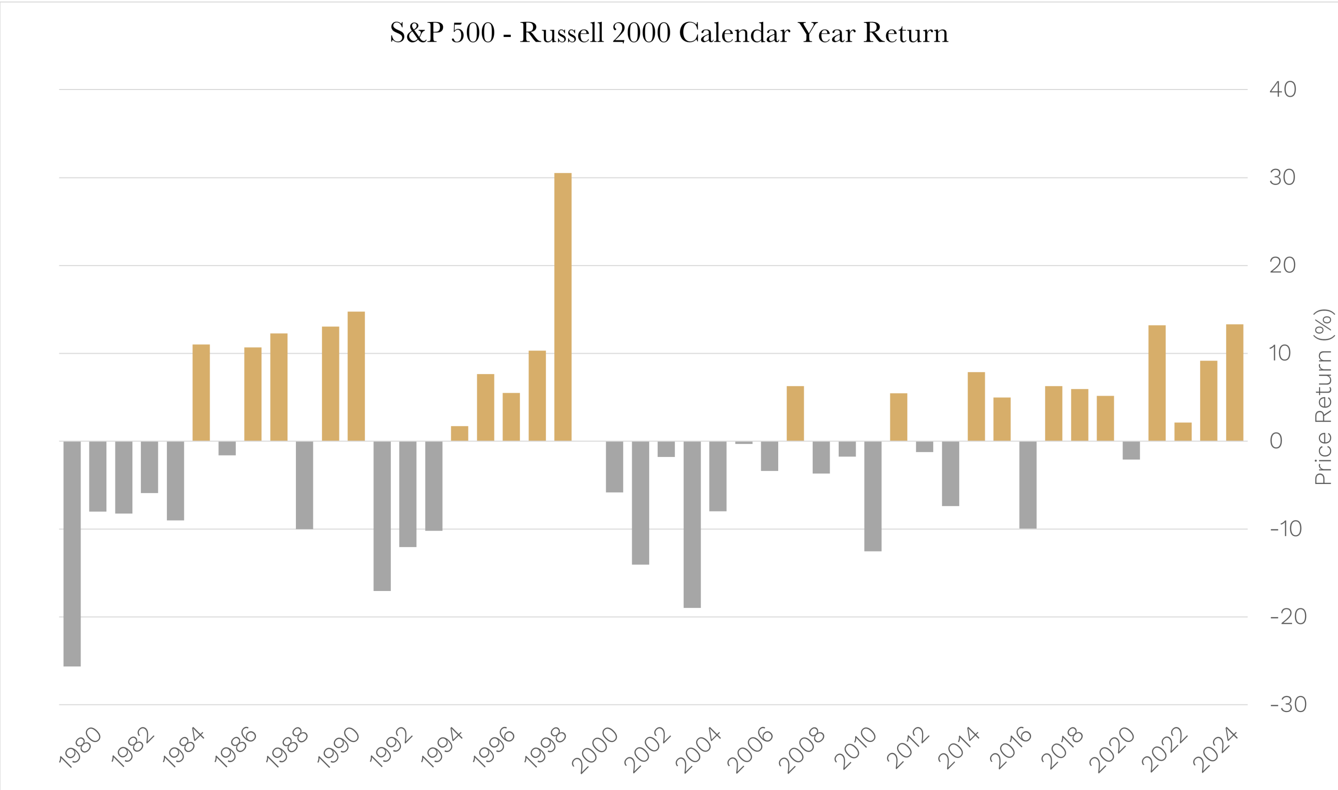
Small cap struggle

Last year small caps continued to underperform large caps, and nowhere was this more evident than in the U.S.

In fact, in 2024, U.S. small caps (Russell 2000) lagged large caps (S&P 500) by +13.3% – the most since 1998.

A good chunk of this came in December just gone, where the almost 6% underperformance delivered the 5th worst monthly underperformance by U.S. small caps to U.S. large caps this century.

Longer term, as seen in the chart below, U.S. small caps have now underperformed for four years in a row.



Source: Ophir, Bloomberg. Calendar year returns are provided for the S&P 500 (U.S. Large Caps) minus the Russell 2000 (U.S. Small Caps) from 1980 to 2024.

But Ophir Funds provided great returns and outperformance in 2024

Whilst one-year returns are too short a period to get overly excited about, we are happy that, despite the small-cap underperformance, the Ophir Funds provided returns between +21% to +45% over 2024:

- Starting off with our **Ophir Opportunities Fund**. Despite operating for more than 12 years now, we've been able to continue with the good results, returning +42.8% last year.
- Not as strong but still a great outcome, our **Ophir High Conviction Fund** provided an investment portfolio return of +21.2%. But based on its ASX listed price, it returned an even higher +26.7%, as its discount to Net Asset Value shrank over the year.

Ophir Australian Funds - Performance to 31 December 2024

	Since Inception p.a.	5 Years p.a.	3 Years p.a.	1 Year	1 Month
Ophir Opportunities Fund (net)^	22.7%	17.8%	13.6%	42.8%	-2.5%
Benchmark*	6.2%	4.0%	-1.6%	8.4%	-3.1%
Ophir High Conviction Fund (net)^‡	13.5%	8.3%	2.7%	21.2%	-5.4%
Benchmark*	9.2%	7.0%	1.4%	10.4%	-3.4%
ASX:OPH total return	N/A	8.8%	-3.0%	26.7%	0.0%

- Turning to our Global Funds, given their high level of stock overlap, they provided very similar returns at +45.1% and +44.7% each for the **Global Opportunities Fund** and **Global High Conviction Fund**.

Ophir Global Funds - Performance to 31 December 2024

	Since Inception p.a.	5 Years p.a.	3 Years p.a.	1 Year	1 Month
Ophir Global Opportunities Fund (net)^‡	17.4%	13.7%	1.0%	45.1%	-0.9%
Benchmark*	9.0%	9.6%	6.4%	20.7%	-0.9%
Ophir Global High Conviction Fund (net)^‡	13.0%	N/A	-1.2%	44.7%	-1.3%
Benchmark*	13.0%	N/A	6.4%	20.7%	-0.9%

^Net performance figures are after fees and including reinvestment of distributions calculated using the net asset value of the funds. Inception dates: Ophir Global Opportunities Fund – October 2018, Ophir Global High Conviction Fund – October 2020, Ophir Opportunities Fund – August 2012, Ophir High Conviction Fund – August 2015. *Benchmarks: Ophir Global Opportunities Fund – MSCI World SMID Index TR (Net) (AUD), Ophir Global High Conviction Fund – MSCI World SMID Index TR (Net) (AUD), Ophir Opportunities Fund – S&P/ASX Small Ordinaries Accumulation Index, Ophir High Conviction Fund – 50% S&P/ASX Small Ordinaries Accumulation Index (XSOAI) 50% S&P/ASX Midcap 50 Accumulation Index (XMDAI). ‡The Trust Company (RE Services) Limited (ABN 45 003 278 831, AFSL 235 150) is the responsible entity of, and issuer of units in, the fund. Ophir Asset Management Pty Ltd (ABN 88 156 146 717 (Ophir) is the manager of the fund.

Source: Ophir. Bloomberg. Data as of 31 December 2024. Past performance is not a reliable indicator of future performance.

These numbers mean that the Ophir funds even outperformed the Australian and global large cap Indices in 2024.

While we would never want investors to extrapolate those sorts of one-year numbers into perpetuity, or think we are going to repeat them year in and year out, they have comfortably met our long-term goal of 5% outperformance versus our market benchmarks, and the 15% absolute return per annum we target over the long term.

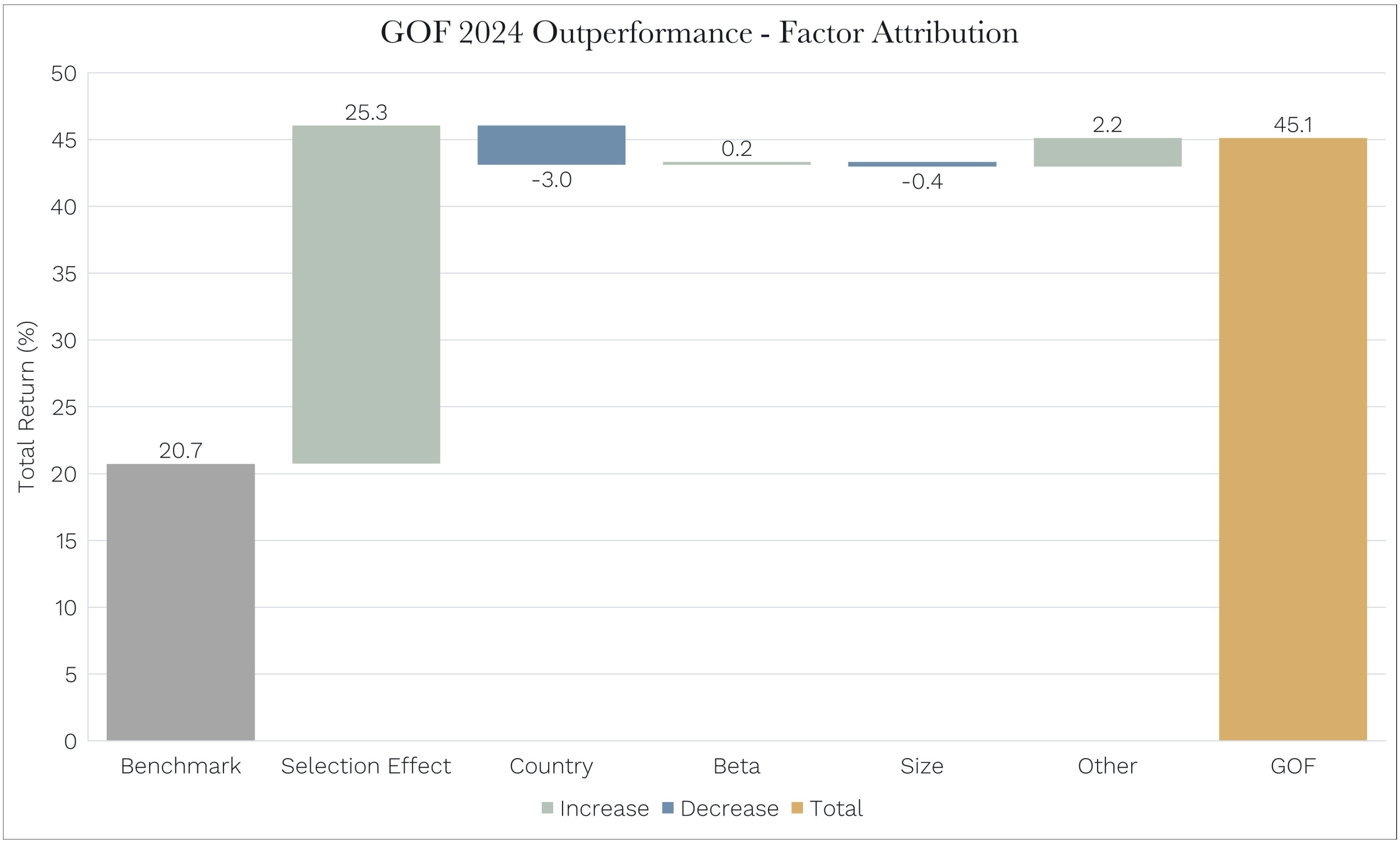
It was stock picking that drove Ophir's 2024 outperformance

So what drove the outperformance in the Ophir funds last year?

As we highlighted in our Investment Strategy Note last month (link) it has continued to be stock picking.

We show this below for our Global Opportunities Fund (which is mirrored very closely with outperformance from our Global High Conviction Fund).

When we look at the 'factors' (see article linked above for further details) or common characteristics that might have caused this outperformance, we see things like our allocation to different countries, the market sensitivity of the companies we held in the portfolio ('beta'), or the size of those businesses, amongst other things, made very little contribution to our outperformance.



Source: Ophir. Bloomberg. Data as of 31 December 2024. Benchmark is the MSCI World SMID Cap Index NR (AUD). Factor analysis uses proxy of Bloomberg Global Developed Mid Small Index.

Ultimately, it was good old fashioned stock picking (here formally called "selection effect").

This is great news because that is what our investment process targets.

If it was exposure to some other factor – like being overweight U.S. stocks when the U.S. share market did well (which would show up as a positive "Country" factor attribution) – we'd be worried (and so should you!) because it's not a sustainable way to outperform with our investment process. We don't try to invest based on factors other than stock picking because a) it's very difficult to do; and b) we have no skill in it.

We are happy our hard work finding mispriced companies that are growing faster than the market expects has been rewarded in 2024.

Of course, the work doesn't stop. We need to keep "pounding the rock" (see link to this great motto from the NBA San Antonio Spurs Hall of Fame coach Greg Popovich here).

We are acutely aware new investors are coming on board all the time and for you our very long-term returns are just numbers on a page, not tangible results.

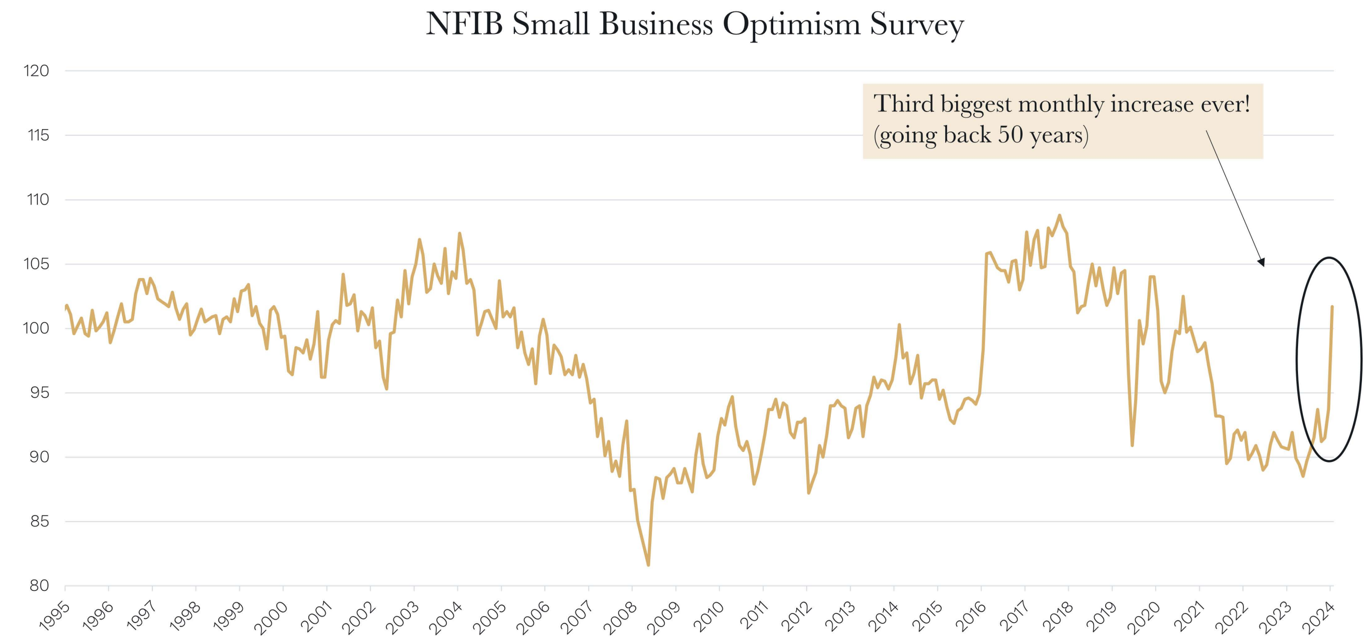
U.S. small business gets excited about Trump 2.0 from 2025

Returning to U.S. small caps, one thing holding back the relative performance of U.S. small caps over the last few years is that their earnings have not been growing as fast as their larger brothers and sisters, such as the Magnificent 7.

When may that change?

We were encouraged in December when the NFIB (leading U.S. small business association) Small Business Optimism Index – closely followed by economists – jumped 8 points in November after Trump's election win.

This was the third-biggest monthly jump in U.S. small business optimism in the last half century! It also took the reading back above its 50-year average of 98, a level it had been below for the last almost 3 years.



Source: Bloomberg. Data to 31 December 2024.

As NFIB Chief Economist Bill Bunkelberg wrote at the time:

"The election results signal a major shift in economic policy, leading to a surge in optimism among small business owners. Main Street also became more certain about future business conditions following the election, breaking a nearly three-year streak of record high uncertainty. Owners are particularly hopeful for tax and regulation policies that favor strong economic growth as well as relief from inflationary pressures. In addition, small business owners are eager to expand their operations."

*At writing the December data for the NFIB Small Business Optimism Index was released, showing another gain, and the highest reading since late 2018. Interestingly, the net percent of owners expecting the economy to improve rose to a net 52%, the highest since the fourth quarter of 1983!

We are hearing this from the coal face from our portfolio companies too. Optimism is up. Hiring and capex intentions have increased. We'll be keeping a keen eye on how this translates to company guidance for revenues and profits this year that will be provided at full-year 2024 results in late January and February.

This optimism needs to be tempered with the more recent news that potentially little further rate cut relief is ahead in the U.S., which may limit further valuation increases.

But here too we may have a silver lining.

U.S. rates may not come down much from here, simply because the U.S. economy is in such strong health. And that bodes well for small cap earnings too – especially if we see a friendly Trump 2.0 policy mix for domestically orientated U.S. small-cap businesses.

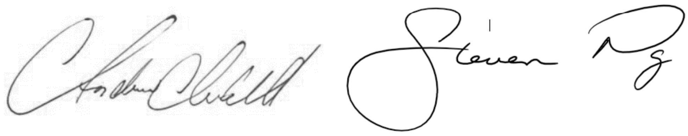
We are excited about the new year ahead having returned from a brief break and raring to go. The investment team is in a great place, and we can't wait to get stuck into reporting season for our portfolio companies that starts later this month. We think we own some great businesses that should pleasantly surprise the market and help build on 2024's investment returns.

As always, thank you for entrusting your capital with us.

Kindest regards,

Andrew Mitchell and Steven Ng

Founders and Senior Portfolio Managers
Ophir Asset Management



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