2024 Investor Letter

Dear Fellow Investors,

The Totus Alpha Strategy[1] return for the calendar year 2024 was +4.8%, net of all fees. This brings the total return since inception to +391.3%, or +13.3% p.a.

The table below summarises the strategy's performance relative to the ASX 300 Accumulation Index and the RBA Cash Rate. To be clear, we do not manage the strategy to any benchmark but include them as an illustration of broader equity or asset returns.

	1 year	5 years (p.a.)	10 years (p.a.)	Since Inception (p.a.)	Since Inception (cum.)
Totus Alpha Strategy[1]	**4.8%**	**6.9%**	**10.1%**	**13.3%**	**391.3%**
RBA Cash Rate	4.4%	2.0%	1.8%	2.0%	29.4%
ASX 300 Accum. Index	11.4%	8.0%	8.5%	9.4%	214.7%
Beta	-0.05	-0.34	-0.17	-0.15	
Downside Volatility	6.3%	8.0%	7.8%	7.1%	

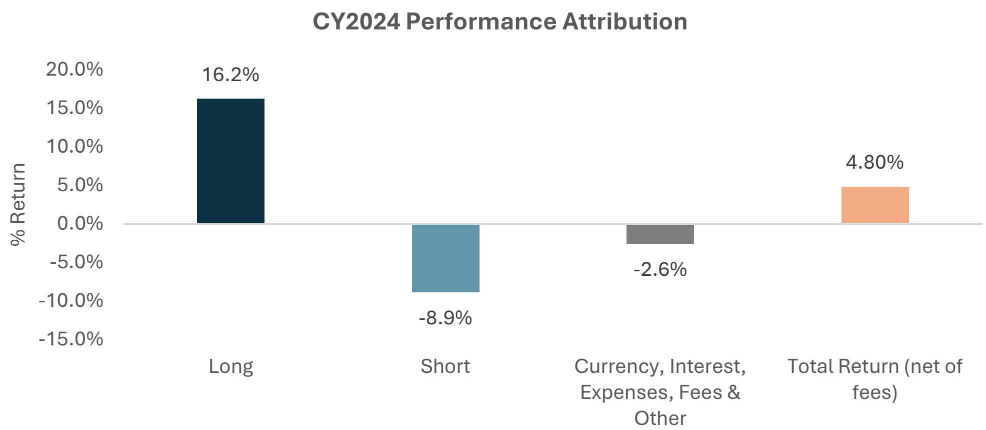
Performance data of the Totus Alpha Fund, inception date 2 April 2012 to 31 December 2024. Source: Totus, Citco, Bloomberg.

Our aim is to generate strong absolute returns (equity-like) over the long term with minimal correlation to broader equity investments. We consider it important to understand the return characteristics, such as beta and downside risk, as well as the absolute return when assessing our performance as this is what makes the strategy a genuine alternative (more on this later).

2024 Portfolio Review

2024 was a very strong year for global equities. The MSCI World Net Total Return index was up 18.7%, the S&P 500 Total Return Index was up 25.0% and the ASX 300 Accum. Index was up 11.4%. In our local market, Information Technology (+48.0%) and Financials (+28.1%) were the best performing sectors while Materials (-17.3%) and Energy stocks (-18.5%) were the worst.

We were pleased to deliver a positive net return in 2024 given the difficult environment for short selling and our long exposure to Resources.

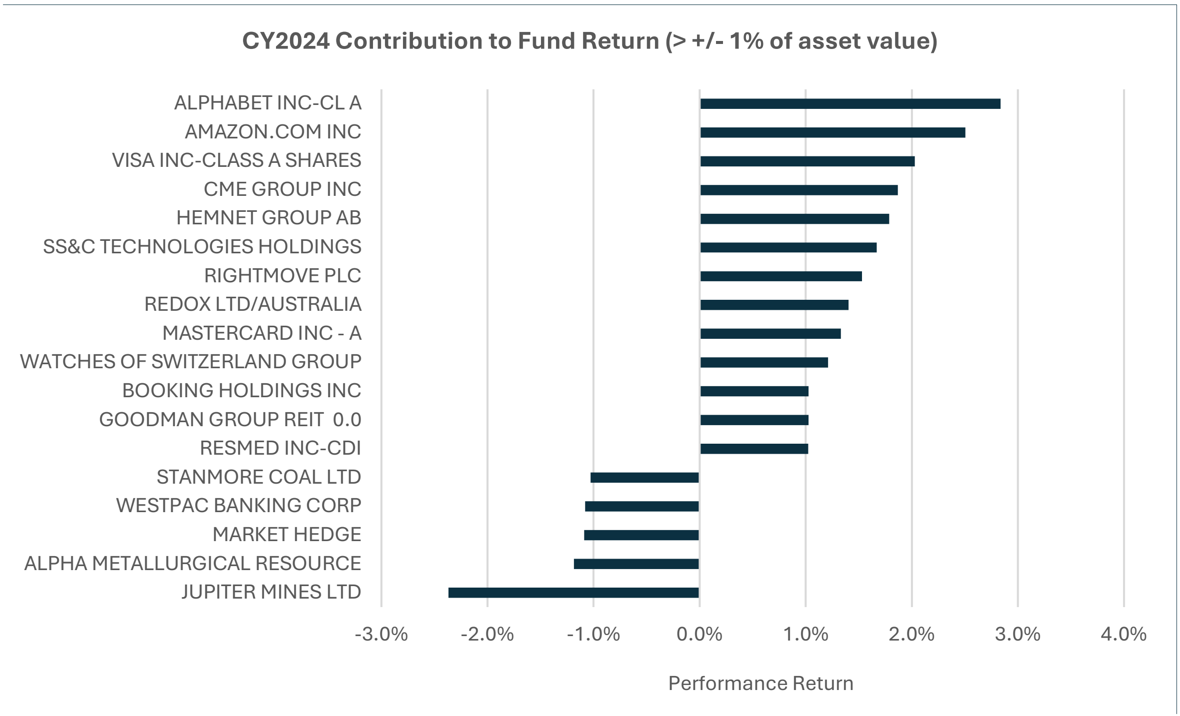


Source: Totus [a]

[1] Performance data is for the Totus Alpha Fund (wholesale unit trust) – see note on page 10. Returns for the Totus Alpha Long Short Fund (retail PDS) will differ due to fees and fund flows – please refer to the relevant monthly performance report for the fund's actual returns data. Past performance should not be taken as an indicator of future performance.

Our exposure to a range of quality growth companies trading at reasonable valuations helped drive the return in the long book. Our core long-term holdings in Visa, Mastercard, Google, Amazon and CME Group drove a significant portion of the long return. We added opportunistically to these businesses throughout the year on what we perceived to be misguided business fears around AI, competitor and/or regulatory threats.

Using knowledge from our learnings in the Australian market and applying it to global peers continues to be a ripe hunting ground. Our investments in real estate portals, Rightmove and Hemnet, continued to deliver and we remain invested, seeing upside to both on an absolute basis and, in particular, relative to REA Group.



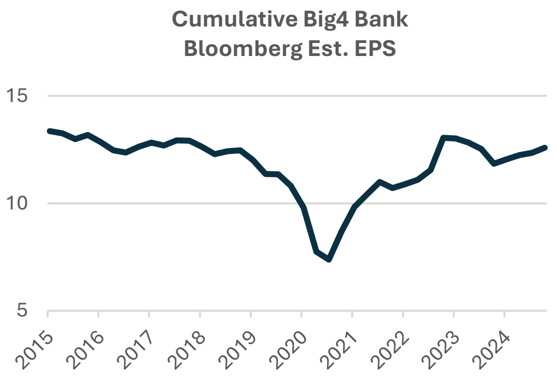
Source: Totus [a]

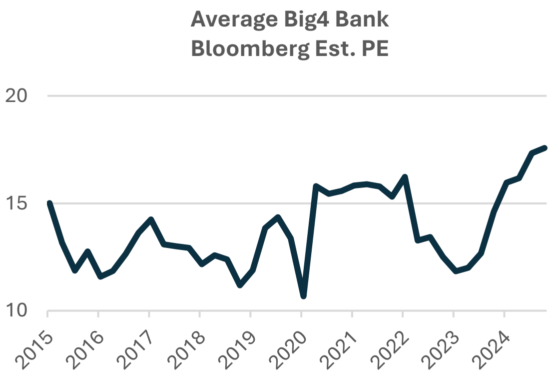
Our exposure to commodities, particularly met coal and manganese, drove the majority of headwinds in our long book. We made the mistake of increasing our exposure to these resource companies upon meaningful global supply disruptions during the middle of the year. Supply disruptions have historically provided good opportunities for the strategy (Vale Dam collapse for iron ore; Russia/Ukraine conflict for coal). Unfortunately, the negative Chinese steel sentiment outweighed these supply disruptions and caused a substantial drawdown across the entire commodity complex, despite spot prices remaining attractive against long-term averages.

In hindsight, we made the mistake of becoming overweight in a single factor that had a significant headwind. Despite thinking we were managing our risk by diversifying across company, geography and resource, we would have been better concentrating our exposure rather than spreading it across more names. In fact, we made a small collective gain across our key holdings, Whitehaven Coal, Stanmore Resources, New Hope and Yancoal. However, spreading our exposure into US peers, lower-tier operators in Australia, and adjacent resources cumulated to a loss of c.-5%. This was a tough and painful lesson, but one we have learnt from. We have implemented a series of portfolio limits around commodity stocks and are increasingly aware of their correlations as a part of our investment process.

In the short book, our hit rate was only 42% and the average loss was -7bps. Shorting has been difficult over the past couple of years which is typical during strong risk-on markets. We believe we are doing a better job at managing the portfolio through these periods as evidenced by the shallower drawdowns in the strategy over the last several years.

Shorts in Australian domestic banks were the largest detractor from performance, resulting in a cumulative loss of -320bps. Despite their aggregate Earnings per Share (EPS) not growing for over a decade, their multiples have re-rated to a decade high. To us this looks unsustainable, and the risk/reward to the downside has only increased.





Source: Totus, Bloomberg

On a positive note, we introduced several new positions (discussed below) to the portfolio throughout the year that have already contributed positively to returns.

Resmed (RMD AU)

Resmed possesses a lot of qualities we look for in long positions: market leadership; high margins with high returns on capital; a strong balance sheet; good governance. Ongoing fears surrounding the potential impact of GLP-1 weight loss drugs on the sleep apnea addressable market has resulted in a material de-rating of the multiple that Resmed trades on relative to history. We were able to initiate a position on its sell-off late in 2023 following growing adoption of GLP-1 drugs and fears over the terminal value of the business.

Resmed's multiple de-rating has remained despite accelerating earnings growth over the past 12 months. We increased our position as the improving momentum of the business became clear. As more data has come to light, Resmed has seen increased adherence to treatment from combining their products with GLP-1 usage, in line with the standard practice of advocating for combined treatment of both products from initial diagnosis. With Apple and Samsung implementing sleep apnea health warnings into their latest wearable devices late last year, we believe Resmed has strong tailwinds to increase treatment penetration to the 1 billion people worldwide suffering from obstructive sleep apnea.

SS&C Technologies (SSNC US)

Founded in 1986 by Bill Stone (who remains the CEO today), SS&C is a software service provider for the financial services industry and the provider of the trading and portfolio management software which we use to manage and monitor the Totus Alpha Strategy. Our firsthand experience of operating a funds management business has made us privy to just how high the switching costs are for trading/ fund administration as well as the mission-critical nature of service that SS&C provides.

The business was adversely affected by rising interest rates in 2023 following a large-scale acquisition funded via debt at variable interest rates. This increased interest expense created a meaningful headwind to the bottom line as the underlying business continued to organically grow, gain market share, and improve margins. As US interest rates have declined over the last six months, the company's improved earnings power has begun to show, combined with the stock still trading below its long-term average multiple. As a founder-led CEO, Bill Stone has displayed exceptional capital allocation, accelerating buybacks at highly accretive levels. With the ongoing growth in private capital and private markets, SS&C stands to significantly benefit as the fund administrator of choice for the global giants within the sector.

Watches of Switzerland Group (WOSG LN)

Watches of Switzerland is the market-leading luxury watch retailer in the UK, with a significant growing presence in the US. It holds enduring partnerships with global high-end brands, but the jewel in the crown is its partnership with Rolex, the world's leading luxury watch brand. Rolex represents over 50% of revenue with an even greater contribution to earnings for the business. To purchase a Rolex from Watches of Switzerland, a customer must express interest and join a waitlist. The business advises that these waitlists are multiples of annual Rolex sales, providing an elevated level of earnings certainty for the group each year.

Following Rolex's acquisition of Bucherer, along with an earnings downgrade in early 2024, the stock traded down to an all-time low PE multiple of 7x earnings. The group has sold Rolex watches since 1919 and has no exposure to the Chinese luxury slowdown that has evolved in recent years. These factors combined with the unique circumstances around the Bucherer purchase (which ensured the quality of the brand's retail presence was maintained following the third-generation owner's death) meant we felt the risk reward was skewed in our favour.

Rolex has entrusted Watches of Switzerland to be its expansion partner throughout the US (a significantly under-penetrated luxury watch market) with extensive showroom openings occurring in New York, Texas, Florida, and Atlanta. As the market grows more confident of the durability of the group's Rolex relationship and the ongoing store rollout across the US, we believe the stock price should benefit from an acceleration in earnings growth in 2025 with real potential for a simultaneous multiple re-rate.

Why use the Totus Alpha Strategy as an Alternative?

Equities have been one of the best long-term asset classes over the last 100 years. However, due to their liquid nature and daily pricing they are subject to the emotion of investors which can make them very volatile. Volatility is not necessarily a long-term risk for the patient investor; however, it is a danger to the investor who has shorter timeframes, is leveraged, or emotionally influenced by price.

We view equities as the best vehicle for compounding your wealth over the long term, but the ability to preserve capital during tough times reduces emotional stress and increases an investor's staying power to enjoy the benefits of compounding.

This is why we are advocates for alternative investments. Alternatives vary across asset class and style, but the key to be truly considered an alternative is its uncorrelated[2] and low-beta characteristics compared to traditional assets (i.e. long-only public equities or bonds). There are many investment products that are labelled as an alternative but realistically are not. Examples include high-beta hedge funds which are, essentially, levered long equities, and private credit/equity where mark-to-market pricing is opaque and volatility is suppressed (until it isn't). We are not saying that these are bad investments and shouldn't play a role in your portfolio - we are only highlighting the need to be aware of whether a product is a true alternative and if you are using it for the right purpose. For instance, using a high-beta hedge fund will amplify returns on the upside but have a higher chance of larger drawdowns during market downturns. Using private credit as an equity alternative to reduce portfolio volatility may look great on paper but what happens in a recession? Can you liquidate your exposure at face value? Are the assets marked correctly?

Alternatives are not a replacement for your equity exposure, but they can act as a sensible complement to a core long equity exposure. By diversifying into alternatives, investors can reduce portfolio volatility and downside risk, and by helping investors to hold on during volatile periods, generate outperformance over the long term.

The Totus Alpha Strategy applies a fundamental equity long short investment approach that aims to deliver equity-like returns over the long term with very low correlation to traditional asset classes. To generate a return profile like this, the portfolio cannot look anything like the underlying equity market (i.e. broad market indices). Inevitably this can, and will, lead to periods of underperformance relative to equity markets.

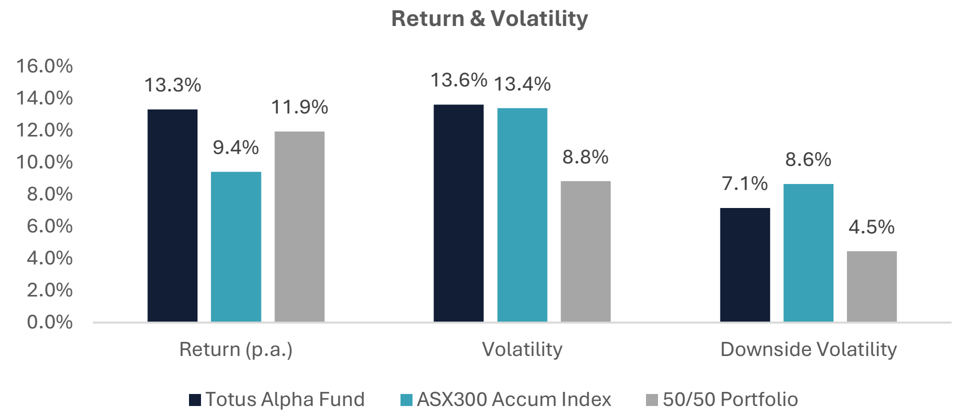
We aren't big believers in market timing and don't expect our investors to be either. Investors tend to focus on investment performance relative to the equity indices but not necessarily how and when a manager generated the return and the risk taken. Typically, this leads to investors allocating to alternatives like the Totus Alpha Strategy after periods of strong outperformance and redeeming during bouts of underperformance. One way to avoid this is for investors to allocate a portion of their overall portfolio that they are comfortable with and hold it for the long term rather than trade in and out of the funds. There is no point buying your insurance when the house is already burning.

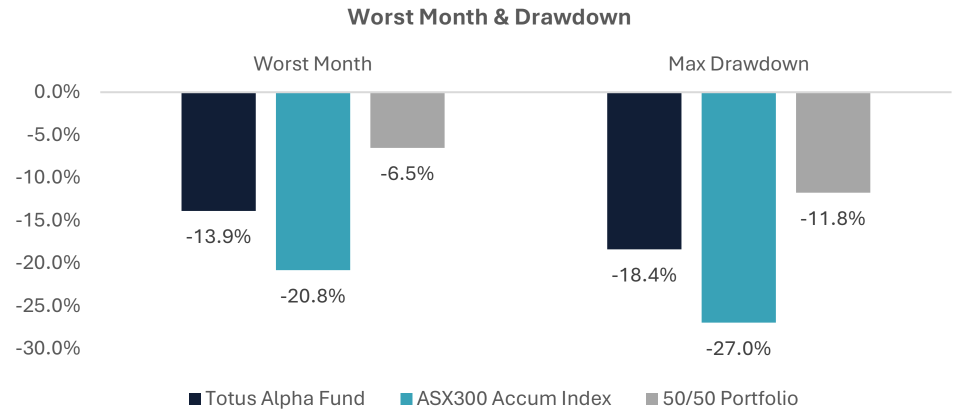
Investors who have retained their investment in the Totus Alpha Strategy over a reasonable time frame (*in our view 7+ years)* have all enjoyed a solid equity-like return delivered with minimal market risk (average net exposure of 36%) and minimal correlation to the overall market (correlation -0.14, beta -0.15[3]). In terms of our absolute return objective, this has been a good outcome for every investor and an excellent one for those who have been brave enough to allocate after periods of underperformance.

[2] Correlation measures the extent to which investments move in the same direction as one another. c = 1 is perfect positive correlation; c = -1: perfect negative correlation; c = 0: No correlation.
[3] Compared to the ASX 300 Accumulation index.

For an investor who owns unhedged equity longs alongside the Totus Alpha Strategy, the experience has been even better due to the diversification benefits delivered by the low correlation of a true alternative fund. Taking an example of a 50/50 portfolio that has allocated 50% to the Totus Alpha Fund and 50% to the broader Australian market such as the ASX 300 Accumulation Index (reweighted monthly), the benefits are illustrated in the charts below.

Firstly, looking at the returns since inception, blending the Totus Alpha Strategy with a long equity index has led to less volatility (with significantly less downside) whilst still delivering an attractive portfolio return and avoiding the deep drawdowns of equity-only investments.





Data from 2 April 2012 to 31 December 2024. Source: Totus, Citco, Bloomberg

Sharpe and Sortino Ratios are measures of risk-adjusted returns. The Sharpe Ratio is a measure of excess return (return of the portfolio versus the risk-free rate) for every unit of risk taken (volatility). The Sortino Ratio is a similar measure but isolates for downside volatility[4]. The higher the Sharpe and Sortino, the better the risk-adjusted return is.

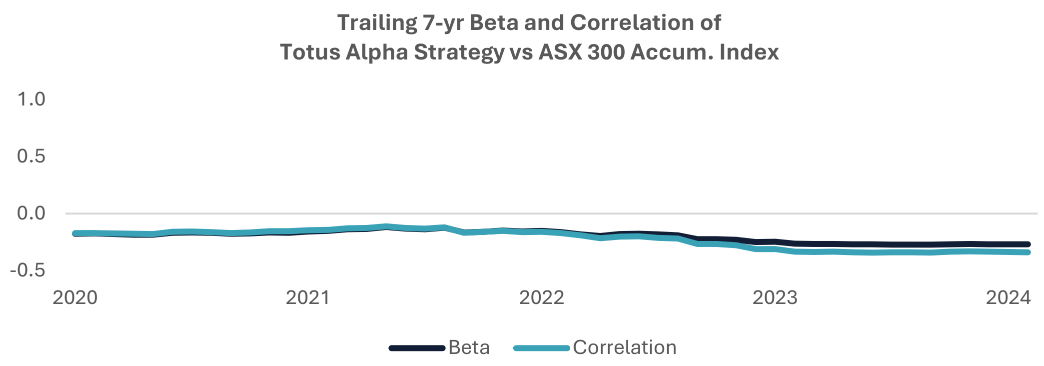
	Totus Alpha Strategy	ASX 300 Accum. Index	50/50 Portfolio
Return (p.a.)	13.3%	9.4%	11.9%
Volatility (p.a.)	13.6%	13.4%	8.8%
Downside Volatility (p.a.)	7.1%	8.6%	4.5%
Sharpe Ratio	0.83	0.55	1.12
Sortino Ratio	1.57	0.85	2.22
Beta	-0.15	1.00	0.43
Correlation	-0.14	1.00	0.65

Data from 2 April 2012 to 31 December 2024. Source: Totus, Citco, Bloomberg

[4] Volatility refers to the dispersion (or swings up or down) of returns of an asset or portfolio, measured using standard deviation of returns. Downside volatility/risk is the potential loss that can result from a fall in the price of an asset or portfolio, measured by the standard deviation of the downward movements of an investment in excess of the risk-free rate.

Secondly, looking at rolling returns to assess the consistency of this outcome is important. Are the absolute returns of the alternative reasonably steady and, more importantly, have the returns consistently been generated in a non-correlated way?

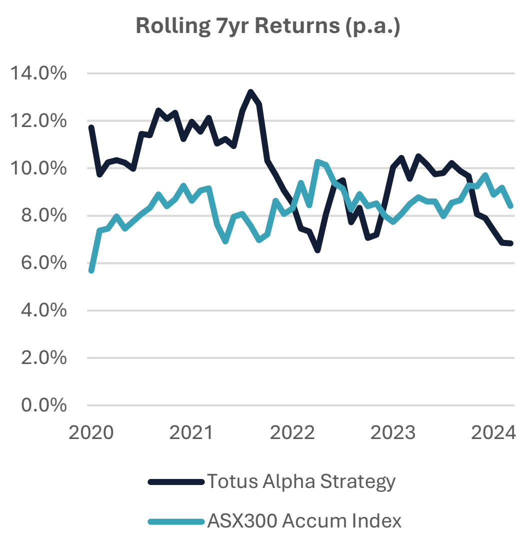
Beta is the measure of a portfolio's volatility relative to the market's volatility. A beta of 1 infers that the portfolio moves in line with the market; the lower the beta the less systematic risk in the portfolio. Since inception, the Totus Alpha Strategy has had a historical beta of -0.15 versus the ASX 300 Accum. Index. Correlation measures the directional relationship of the portfolio versus the market. A correlation of 1 means that prices move in tandem, -1 indicates that they move in opposite direction and 0 means that the price movements are uncorrelated. On a 7-year rolling basis the strategy's beta and correlation has consistently been low to negative (as shown below). This is reassuring when assessing an alternative strategy as it is evidence that the strategy has different return drivers to headline equity indices.

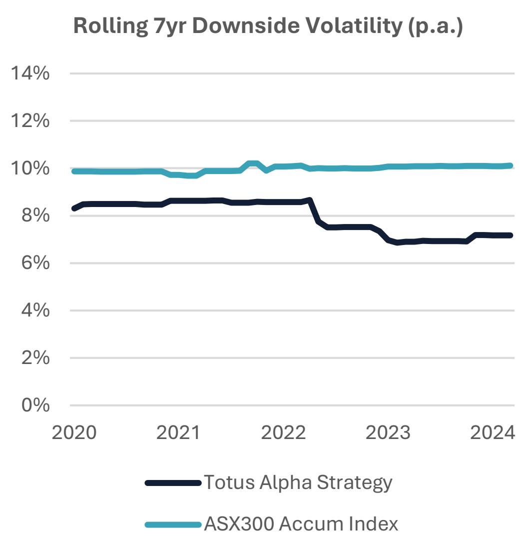


Data from 1 November 2020 to 31 December 2024. Source: Totus, Citco, Bloomberg

Despite having minimal correlation with the broader equity market, the Totus Alpha Strategy has delivered positive equity-like returns in all rolling 7-year periods, with outperformance in 80% of those periods. Additionally, the return has been delivered with consistently lower risk, particularly downside risk.

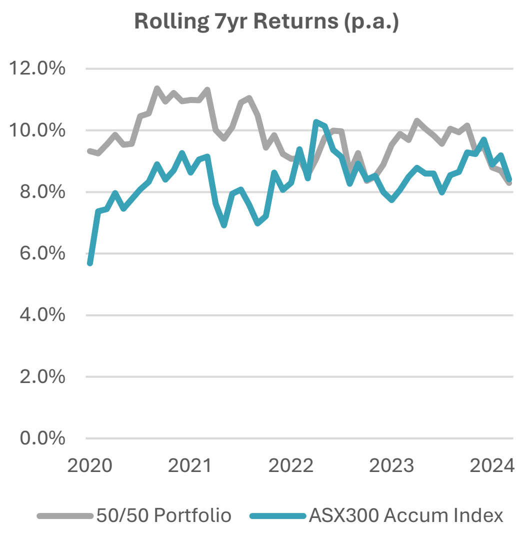
Periods of underperformance for the strategy have tended to come in strong risk-on markets where equity returns are elevated versus history (what we believe we are currently experiencing). While this can be frustrating to live through, it is inevitable to have these tough periods. Historically, these have been the best times to allocate to the strategy.

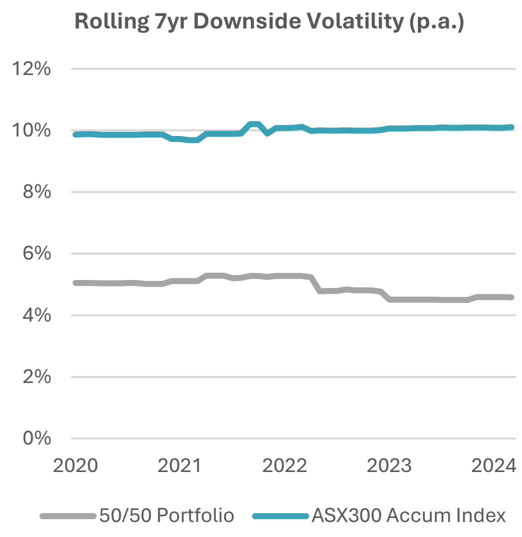




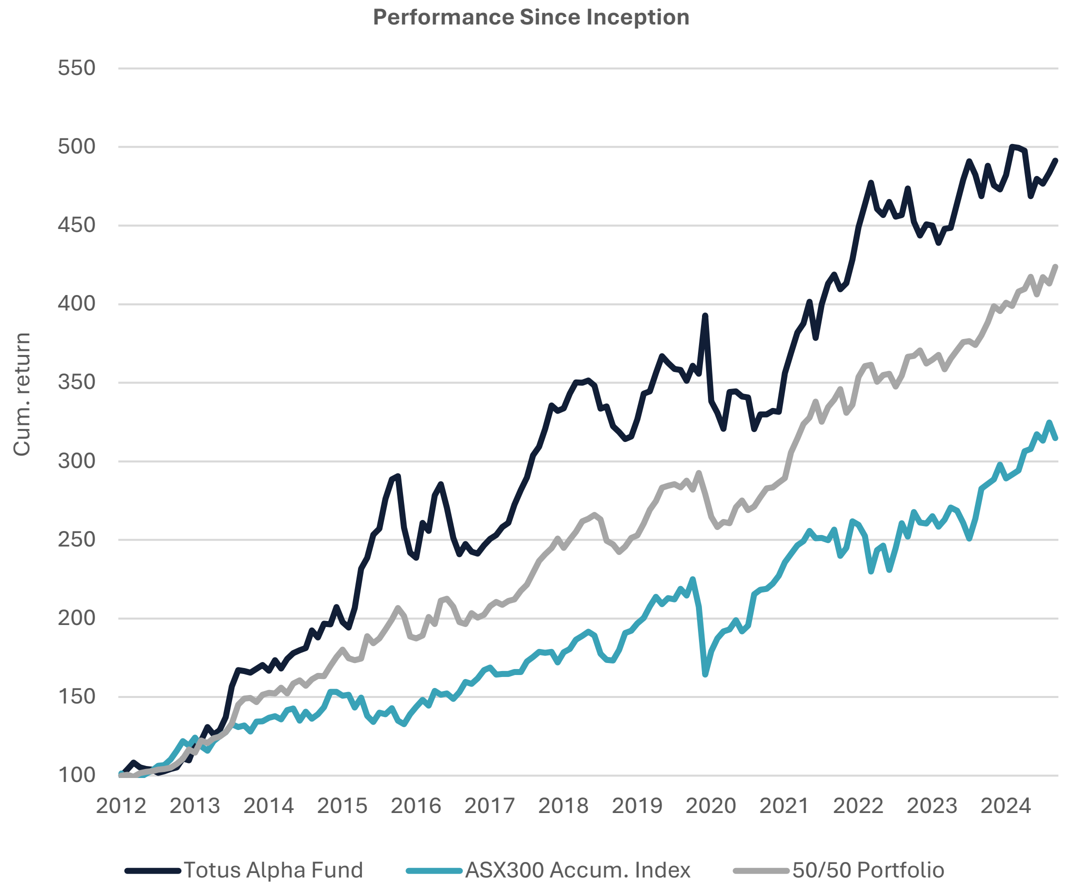
Data from 1 November 2020 to 31 December 2024. Source: Totus, Citco, Bloomberg

Looking at the 7-year rolling returns and downside risk of the 50/50 portfolio, the benefits of using the Totus Alpha Strategy as an alternative within an overall equities portfolio becomes clear. The 50/50 portfolio return stream is smoother, has outperformed the market 87% of the time (on rolling 7-year returns) and downside volatility is halved.





Data from 1 November 2020 to 31 December 2024. Source: Totus, Citco, Bloomberg



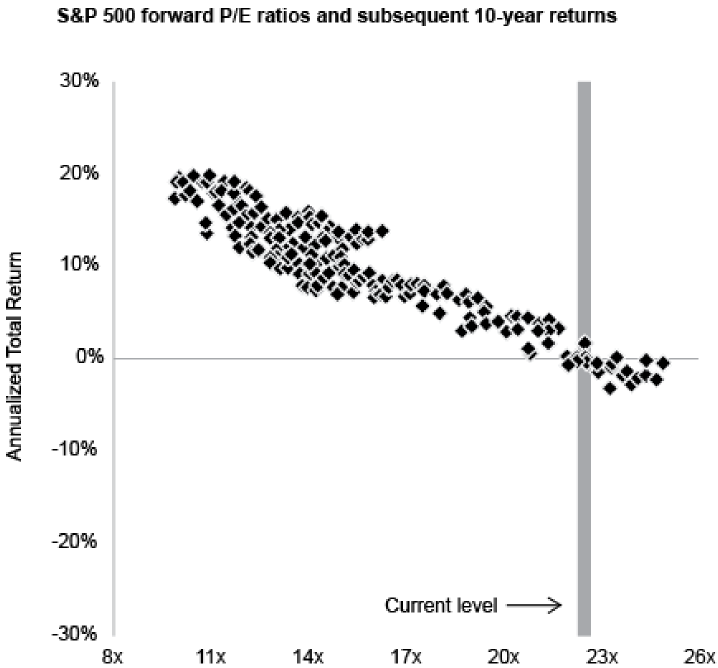
Data from 2 April 2012 to 31 December 2024. Source: Totus, Citco, Bloomberg.
Past performance should not be taken as an indicator of future performance.

Summary

In summary, despite the Totus Alpha Strategy having underperformed equity markets over the last two years, we are delivering on our long-term objective of delivering equity-like returns with minimal to no correlation to the broader equity investments. These characteristics are what makes this alternative product valuable in providing meaningful diversification benefits within your portfolio, especially during tougher periods.

Equity markets have had a strong run and investment sentiment is bullish. For investors sitting on strong 2-year returns from equities, is it time to start thinking about risk management?

The famous investor, Howard Marks, recently highlighted in his memo, "On Bubble Watch" [5], when investors have historically bought the S&P 500 on a PE ratio in line or greater than today's 22x, the forward 10-year returns have been lacklustre.



Source: Oaktree Capital Management, January 2025

We are not suggesting you liquidate all of your equity exposure based on this data and we certainly don't know what the future holds. But we do think it is a sensible time to consider allocating to, or increasing investments in the Totus Alpha Strategy.

Totus Capital
23 January 2025

[5] "On Bubble Watch" - Memos from Howard Marks, Oaktree Capital Management, L.P., January 7, 2025

Notes

Totus Alpha Fund performance returns - Post the unit conversion and removal of series performance accounting that took place on 1 November 2019, all performance numbers from 30 November 2019 are for Platform Class (APIR TOT7316AU) units, net of all fees. All performance numbers quoted prior to this time are for Founder Series Main (APIR TOT0006AU) units, net of all fees. Past performance should not be taken as an indicator of future performance.

[a] Performance attribution data is estimated and unaudited, sourced by Totus Capital.

ASX 300 Index is a stock market index that measures the performance of the top 300 companies listed on the Australian Securities Exchange (ASX). RBA Cash Rate is figure set by the Reserve Bank of Australia (RBA), representing the interest that banks and lenders have to pay on the money they borrow (the base interest rate). MSCI World NTR Index captures large and mid-cap representation across Developed Markets countries.
Indices are included for illustrative purposes only, are not available for direct investment and do not reflect the deduction of fees or expenses, which would reduce returns.