

# In The Know: Episode 64

## AI disruption, real assets and opportunity in Australian equities

### Announcement ([00:00](#)):

The information contained in this podcast is for general information purposes and does not constitute investment advice. You should seek investment advice tailored to your circumstances before making an investment decision.



### Host ([00:14](#)):

This is In The Know, a monthly investment podcast brought to you by Magellan Investment Partners.

### Joe Wright ([00:20](#)):

As markets become more volatile and in theory more inefficient, that should be pretty good hunting ground for active managers like ourselves.

### Host ([00:27](#)):

That's Joe Wright, deputy portfolio manager at Airlie Funds Management. Welcome to In The Know. How do you invest when markets feel driven by noise, narratives and sudden shocks? In this conversation, deputy head of Australian Equities at Airlie, Emma Fisher, is joined by Joe Wright, discussing how they navigate volatility by staying anchored to process, fundamentals and valuation. They unpack the resurgence of real assets and the sharp selloff in software and classifieds. They also unpack why AI disruption fears may be creating opportunities in quality businesses as well as the outlook for gold and commodities. To kick things off, a welcome from your Host, Emma Fisher.

### Emma Fisher ([01:17](#)):

Hi, my name is Emma Fisher and I am the deputy head of Australian Equities at Airlie and the portfolio manager of the Airlie Australian Share Fund. I'm here today for my very first podcast Hosting with my co-Host, Joe Wright, our deputy portfolio manager.

### Joe Wright ([01:32](#)):

Hi, Emma. How are you going?

### Emma Fisher ([01:33](#)):

So thinking about what we wanted to talk about today, Joe, what really sprung to mind was the saying, "There are decades where nothing happens and then there are weeks where decades happen." And we are now in the middle of March and I think it's fair to say that basically every single month has been a decade happening, a different decade. I feel like I've aged in dog years. And it feels like forever ago where we were standing in January where all the market was talking about was gold and precious metals. And then in February, reporting season, that was completely overshadowed by the SaaS apocalypse. And then now we stand in March and we've got a good old-fashioned hot war on the ground in the Middle East.

### ([02:15](#)):

So there's a lot going on, fair to say, in equity markets, a lot going on in the portfolio as you'd expect and I thought what would be helpful for our listeners today would be to take a step back and talk about how we could

even conceive, I suppose, of how to pick stocks in an environment like this. And I guess the question is, how do you invest in an environment that's incredibly volatile without losing your head and by sticking to your knitting? And for us, the really valuable thing, I guess, is just falling back on our process. I remember years ago working with John Sevier, who founded Airlie, a fantastic investor, and the number one thing that he really drilled into us was this idea that you've got to have an investing anchor.

[\(02:53\)](#):

You've got to have something that you fall back on that really grounds you because there's an incredible amount of noise and volatility in markets. And at Airlie, our investing anchor is obviously our process. So we look at financial strength, first and foremost, so businesses that have good balance sheets and then we look for high-quality businesses that generate high returns, run by good management teams and we're looking for attractive valuations. So those are the four factors that we look at and that really doesn't change depending on what's going on in the world. And in fact, we often take the inverse to the volatility and the inverse to the narrative and really looking for opportunities.

[\(03:28\)](#):

Active management hasn't covered itself in glory in the last couple of years, but ultimately, the reason why active management exists is to exploit the fact that businesses change really slowly in the real world and their share prices are changing all the time in markets. So I wanted to get into some of that stuff today. If we step back and we zoom out the last decade, we have had COVID, we've had the Russia-Ukraine war, we've had now the Iran war, we've had tariffs last year. Over that whole time period, the ASX 200 has returned 162%. And within that, you've got businesses which we own the portfolio like BHP that have returned just under six times over the last decade and not without volatility.

[\(04:13\)](#):

If you think about where BHP was a decade ago, it was coming out of the hangover of the commodity boom in China. Iron ore was 50 bucks a ton. And so it's been a phenomenal rise since then, but not one without volatility. I guess the lesson from all of that is the fact that over the long term, it's really earnings and dividends that drive share prices, not multiples, which definitely drive things in the short term.

**Joe Wright** [\(04:36\)](#):

I think that's right and I think, now investing at this moment in time, not only are things more volatile it feels like from a geopolitical perspective, but market structure, particularly in the ASX has changed with the introduction of more passive money and more short-term money, that that volatility is certainly increased again. And like you said, active management hasn't covered itself in glory over the past few years, but as markets become more volatile and in theory more inefficient, that should be pretty good hunting ground for active managers like ourselves.

**Emma Fisher** [\(05:09\)](#):

No, I totally agree. And ultimately, I think of our job as weighting the portfolio towards businesses that have great long-term earnings outlooks, solid returns, good management teams, good balance sheets. And so to the extent that you can look at this monthly volatility and these narratives that emerge in the market as opportunities to add good businesses, then I think that you are weighting the probabilities in your favor. So I guess what I wanted to get into in this podcast today was to talk about some of these narratives that are dominating markets and pull them apart and really outline, I guess, what we think about them and how we're positioned in the portfolio in relation to them.

[\(05:47\)](#):

So I thought the first one for you, Joe, given not only are you the deputy portfolio manager of the Airlie Australian Share Fund, you also are the mining analyst and the energy analyst and a whole bunch of building materials and cyclical businesses. So one of the narratives that has really come to the fore lately has been the

reemergence or what I might call the rebranding of real assets. Now back in my day when I first started in this industry, we used to just call these value stocks, but they've had a glow up, they've had a PR rebrand and now we're calling them HALO stocks, which stands for hard assets, low obsolescence. So Joe, what are these businesses? Why are they working right now? Let's get into it.

**Joe Wright (06:28):**

Yeah. So I think, as the AI technology, people learn more about it and the disruption risk as a result of this technology started filtering through markets and thesis around certain businesses. A lot of companies that were on extraordinarily high multiples, mainly software stocks, had their terminal value brought right into question. And interestingly, at the same time, the resources required to unlock the opportunities that come with AI and the technology around it increasingly came under the scope of investors as relatively finite or not finite, but they're being large bottlenecks in effectively accessing those resources. And I'm talking about land, energy and raw materials such as copper.

[\(07:16\)](#):

Now, to simply then look at that opportunity and go, "Righto, software's dead," real assets where I need to put my money I think is probably a little too simplistic because there are plenty of hard assets, mines, factories, steelmaking assets, all those sorts of businesses that still aren't good businesses, just even though they are real assets. A good real asset is one where it's difficult to replicate, it has some regulatory protection, it exists as a bottleneck that cannot be easily unwound. There are plenty of mines that no matter where you are in the cycle seem to virtually make no money. And there are plenty of mines that no matter where you are in the cycle always generate a strong profit and that's a function of their cost position and the regulatory environment they live in.

[\(08:05\)](#):

And so I think from a process perspective, our process has always directed us towards those sorts of businesses in the cyclicals, real assets, resources, energy space. In the portfolio, we own BlueScope, we own BHP, we own Santos. These are all businesses that we think are advantaged from a cost position and have asset bases that are incredibly difficult to replicate. So I suppose the point I'm trying to make is you go on Twitter or you listen to other investing podcasts and it certainly feels like there's this, "Real assets are back. Software's dead," all the rest of it. The point I'm trying to make is it's clearly always going to be much more nuanced.

[\(08:44\)](#):

And again, having that process around business quality, management quality has always directed us towards the parts of those sectors where we do think companies have a competitive advantage, and then unfortunately, in this sort of environment that those competitive advantages really come to the fore.

**Emma Fisher (09:02):**

Do you think that these are the sorts of businesses you can happily own through the cycle or is investment timing important here?

**Joe Wright (09:09):**

I think in resources, particularly metals and mining and energy, there's always a trade. There are always going to be better resources businesses than other resources businesses, but if you're able to perfectly pick the direction of the commodity and time it perfectly, you're obviously going to want to be in the most leveraged exposure to that. If you are perhaps less certain around when a commodity might perform, but you have a sort of structural thesis over the medium term, then a way of protecting yourself is to invest in companies that maybe are significantly advantaged from a cost position.

[\(09:42\)](#):

So if you're wrong, that upside scenario doesn't eventuate or takes longer to eventuate, you're protected there. You're not at risk of maybe asset underperformance because you're in high-quality assets or capital raisings because businesses are struggling with funding. You're not at risk of companies perhaps having to compromise on their growth ambitions because they don't have the cash flow. That's how I've tended to think about it. And the one thing I know for sure is that I will never ever accurately to the day predict commodity price direction and I don't think anyone probably can regularly.

[\(10:14\)](#):

So that's my philosophy for investing in commodities businesses, but yeah, you still need to have a structural thesis, I suppose, medium term, midcycle on the commodity, why you like it, why you think the supply demand balance looks attractive and then look at the assets that you can get exposure to and pick the ones that you think meet your investment process.

**Emma Fisher** [\(10:31\)](#):

I think it can also be quite dangerous, particularly when you are playing around in the mining space to get too swept up in narratives because a lot of the time ... So for example, one narrative that we've seen play out on the ASX recently has been pure play copper. So copper price is going up, there's all this demand, incremental demand from the AI buildout and investors are falling over themselves to get pure play copper exposure. And the only really semi-decent quality listed exposures on the ASX would be like your Capstone Coppers or your Sandfires.

[\(11:03\)](#):

And so those businesses, for a long time, they were trading at pretty sizable, many multiples higher than the BHP and Rio, the diversified miners that had much higher quality copper businesses, longer life assets, at better points on the cost curve, embedded jurisdictions in most cases, and yet, that copper valuation wasn't really being reflected potentially because investors didn't want exposure to the iron ore side of the business, either way. That's really been the story, I suppose, over the last three months for BHP and Rio, has been this enormous copper-led rerate. How were you thinking about the BHP and Rio results in February in terms of, I guess, the lens through which other investors might've been looking at it for copper exposure?

**Joe Wright** [\(11:44\)](#):

Yup. I think, firstly, just in a more theoretical sense, we base all of our valuations on discounted cashflow analysis, the backbone, I suppose, of how we think about valuation. And the thing about the mining space, inherently, discounted cash flows are the easiest ... If inherently in mining, they're the easiest sector to value on a discounted cash flow basis because you generally have pretty good insight into long-term production profile, mine life. You can put a range of commodity price scenarios over the top of that, you have pretty good insight into the cost structure and there's no terminal value mines and ultimately once the resource body is completely mined through.

[\(12:25\)](#):

And so from that perspective, you look at it and you think, "Oh, okay, well, that should be the source of all truths in the mining space for valuation." What I found is that that seems to be regularly ignored in favor of earnings multiples, short-term earnings multiples and short-term free cash flow yields. And again, that point around pure play significantly rerating always struck me as at odds with the DCF valuations I was getting for those companies, because again, those pure players generally have lower quality assets than some of the diversifieds with shorter mine lives and a higher cost of capital maybe because they're, again, pure plays and they don't have access maybe to diversified stream of cash flows or large amounts of debt funding, say they can be put against multiple assets, all those sorts of things.

[\(13:12\)](#):

And so again, we've always preferred the diversified names for resources exposure because we see them as lower risk entities and again struggle to put a hand up and say, "This is exactly when the copper price is going to perform," or, "This is exactly what the iron ore price is going to be in three months." And so then you bring it back to, say, the earnings results, I suppose, of Rio and BHP and I think the most powerful part of those results was them both highlighting the value that exists in the diversified mining companies that's perhaps not obvious and certainly doesn't exist in smaller pure plays with smaller asset bases.

(13:48):

And I'm talking about things like infrastructure and utilities that are owned say by BHP and Rio. In BHP's instance, they sold a silver stream on the Antamina copper asset for over 4 billion US dollars. I think the consensus valuation for the entire asset was a bit over 4 billion. And the point there is not that BHP has all these secret assets that no one knows about. It's just in that diversified structure, they're incredibly hard to maybe value or pull apart.

**Emma Fisher (14:19):**

So we ignore them. It's fair to say from-

**Joe Wright (14:21):**

Well, equity markets have certainly and you can see that from the multiple they've put on them, I suppose. Whereas you look at like a Sandfire, two decent-ish assets, you can certainly quite easily figure out exactly what they own. And the harder part with both of those assets is maybe trying to quantify the extent to which mine life can be extended or costs can be held or even reduced. And so that's what I liked about the results. I think they finally managed to shine a light on the value that is embedded in some of these diversified companies as a function of their scale and as a function of their complexity almost.

**Emma Fisher (14:58):**

We have been joking internally though that probably to the day that the copper price peaked in the last couple of weeks, Joe had gone on the AFR website, and obviously, the AFR website, they're serving you banner ads all the time. And we took a screenshot of BHP had taken out a banner ads saying, "Over half of our earnings today come from copper," which surely marked a short-term top for the copper price. We were joking only a few weeks later when the iron ore price ripped and copper price fell. They'd probably be taking out ads to remind everyone they're actually half iron ore as well.

(15:31):

But it just goes to show that even though diversifieds aren't immune from chasing narratives in the market in order to rerate their script, I suppose, which makes ... Given BHP and Anglo, given the broader context of miners tend to get their checkbooks out at the top, I suppose we did feel a little nervous that BHP's, to their credit, selling assets at the top of the cycle, so they have a phenomenal balance sheet, but equally, it was very clear to me in the presentation that they put together for their results that they were trying to get the equity markets to accurately value the copper part of their portfolio.

(16:10):

Now, that may be sensible to get the share price up, but I guess the conspiracy theorist in me, given that backdrop of recent attempts of M&A, make me wonder, "Why do they want their share price up so bad?"

**Joe Wright (16:27):**

Yeah, I know what you mean. BHP have probably spent five or six years pivoting the business towards base metals. They sold the petroleum business, they collapsed the dual listed structure. By far, the lion's share of the growth pipeline is copper and potash. And it certainly felt like, for a long time, the multiple was basically

unchanged despite there being a material shift in which commodities were generating the earnings. And it doesn't help when iron ore sits consistently in backwardation.

[\(16:59\)](#):

I think investors really struggle with that part of the thesis, but it certainly felt like, yeah, at this last result, not only did it come through that, "Yes, there's growth here in copper and we have a fantastic copper business that's the biggest in the world and growing over the next decade, but also we have the balance sheet to execute that growth and plenty of optionality in the asset base far above perhaps what consensus is modeling." And the interesting dynamic that's now taken place, I suppose, in some of these copper names more recently is, despite the war in the Middle East, the copper price, it's come off a little bit, but it's still very healthy in the context of history and certainly would be above most analysts' estimates, I suspect.

[\(17:47\)](#):

But the stocks have derated pretty quickly with the view that, ultimately, the longer this war goes on, the worse it is for global growth and the more likely that that eventually hits copper demand in the short to medium term. And it's hard to pull that apart in any great detail, so where do you get comfort? Well, you look at the balance sheet and you look at the assets cost curve position and you think about, "Okay, well, where is their upside and where is their downside on relative and absolute sense in this company?" And again, that always tends to steer us to the less high beta resources names, I suppose.

**Emma Fisher** [\(18:23\)](#):

Exactly. And not to put words in your mouth, but I guess my takeaway from this discussion with respect to this narrative is that we're really talking about a narrative wrapper on a very cyclical part of the market that is benefiting from supportive end market conditions with a question mark, I guess, about the sustainability of that given some of these geopolitical turn of events. That said, at Airlie, we just take a step back. We want to own high-quality businesses in that part of the market. We are happy to own "real assets", but we want them to have rock-solid balance sheets, really good positions on the cost curve, great management teams.

[\(18:56\)](#):

Happily, there are a few stocks that fit that bill in the Australian market. As you mentioned, BHP, Rio, IGO, they own a quarter of the lowest hard rock lithium asset, lowest cost hard rock lithium asset in the world in Greenbushes, and even Ampol and Santos, our energy exposures, which have done nothing really for us for a long time, but are now really benefiting from the current environment.

**Joe Wright** [\(19:21\)](#):

Yeah. And I think that question you asked earlier, "Can you own these businesses through a cycle or do you trade them?" the reality is we will always adjust position size to reflect relative valuations, yeah, no matter how much we like the assets or how much we like the management team.

**Emma Fisher** [\(19:38\)](#):

Yeah. And just to give you an example of that, we were trimming BHP in the high 50s. Now that it's fallen below 50 only a couple of weeks later, we're adding again. So we are totaling our position size up and down to take advantage of market extremes. The next narrative I think that's worth discussing is the inverse of the real asset narrative, which is the SaaSocalypse. So again, I think it makes sense in a world where the first order impact of AI progress is that no one really knows what's around the corner. It makes sense that the market is then shrinking the terminal values of businesses that look like they may be in the firing line of AI disruption.

[\(20:15\)](#):

And so it's not only SaaS businesses, it's in the Australian market we've seen the classifieds, the digital classifieds. So REA, Carsales, Seek have all gotten smoked over the start of this year and even some leftfield victims like insurance brokers and even the insurers themselves. It's interesting to me firstly, maybe this is a bit

tangential, but the market is not applying this disruption thematic equally. If you take the insurers, for example, it seems like the worry is that you get some agent scraping of pricing that leads to an erosion of this front book, back book dynamic where the insurers are taking advantage of the fact that the typical back book insurance contract is pretty lazy, rusted on, "I'm happy to just keep paying whatever price increase each year." And so that price discovery erodes margins.

[\(21:04\)](#):

And I think, first of all, I'd say, "Okay, well, that's a logical fear, but ultimately for the insurance manufacturers like an IAG or Suncorp, to take that fear to its logical conclusion, you're saying that these businesses will be willing to accept a lower return to bring that product to market and they wouldn't just reprice for that changing dynamic." And I would find it difficult to accept that thesis. And so we've lent into the fear in adding IAG to the portfolio on the back of this selloff. And yet, if you look at a sector like the banks, which have the exact same dynamic where you're taking advantage of inertia in the back book in terms of your pricing, particularly on deposits as well, there's been no fear priced into the market that you get some agent constantly trawling, moving your deposit from low cost, sorry, the best return, which would probably be Macquarie.

[\(21:51\)](#):

An enormous amount of CBA's profit is underwritten by their very low-cost, sticky retail deposits. And they've now seen the first credible competitor emerge, for as long as I can remember, in banking in the form of Macquarie who were going after that deposit base. And I would argue that AI probably accelerates that, but we can leave that aside, I suppose. We don't even really need to go down that particular rabbit path. I think there are enormous opportunities in the market in terms of the extreme fear that you can see going on.

[\(22:23\)](#):

I've noticed over my career that whenever entire sector gets repriced down at the same time, that's usually a really good signal that you should be doing the work on that sector because every business is different. And yet they often, when they're swept up into narrative, get repriced as though they're all the same. So if we look at the SaaS sector, for example, we didn't own any of these SaaS businesses in our portfolio for many years, despite the fact that they were phenomenal performers. We felt that they were too expensive. Now you've had this enormous derate and I think they're looking interesting again.

[\(22:55\)](#):

There's probably an argument that most of these businesses are buyers at the current valuation, but when we look at the entire sector, the whole sector's been smoked. And when you get into the nitty-gritty, I think that Xero probably stands out as one amongst the pack that theoretically should be less disrupted by the advent of AI for a number of reasons. I think, with enterprise software, you've got large businesses on the other side of your contract. And even if they aren't going to vibe code and inverted commerce your SaaS product, the threat that they have the resources to be able to do that at the very least is likely to keep a dampener on price.

[\(23:30\)](#):

And we've talked to a number of AI experts and a number of CTOs at companies and things and even the large banks, for example, are telling us that there are SaaS providers that they think they could develop a competing product internally and bring that cost inhouse. So I think it is real. And then when I look at Xero, you see they've got an SME subscriber base and they don't charge very much, their up who is sub 50 bucks a month. So you don't stand to save a lot of money by doing it yourself or going to an alternative AI native provider and there are hurdles in terms of learning a new system.

[\(24:08\)](#):

So it's not that this business is not disruptable, it's that I think it sits at the less disruptable end of an entire sector that's been smoked as a pack. And equally, I think without a doubt in an AI world, one portion of Xero's moat has been eroded and that is the advantage of legacy code base that they've developed over the years. In a world where code is essentially free and very easy to come up with a product, then I would argue that the moat then shifts to sales and distribution. I don't think there's much analysis going on in the imputed share price

moves, but when you start to think about it, "Who are these AI native competitors? How are they being funded, right?"

[\(24:48\)](#):

So if sales and distribution becomes the moat, Xero's cumulatively spent like \$3 billion in sales and distribution over the years, really boots on the ground talking to accountants, getting them trained on the program, using accountants as a channel to push the product to the end users. And so you have to go to accountants who are so busy and pretty happy on Xero and you have to come up with your AI native version of it, at a same time where presumably the whole thesis is there are no barriers to entry now, so at the same time as everybody else is developing an AI native version and who's funding this?

[\(25:21\)](#):

Is local VC going to fund all these startups when we've just been told there's absolutely no moat anymore or any pricing power in this industry? So I think when you start to work through some of the second and third order implications, I actually think there's a world in which it might enhance the moat, certainly that portion of Xero's moat.

**Joe Wright** [\(25:38\)](#):

I think the interesting part of this AI disruption narrative that's affected the technology companies, and as you said, is also impacting companies that you think would be less affected like the insurance businesses is the classifieds. And that, in my mind, is potentially now the cheapest and most exciting part of the market that's been, I think, unfairly derated on the back of these disruption concerns. Any perspectives on some of the portfolio holdings there?

**Emma Fisher** [\(26:05\)](#):

Yeah. Well, I guess I was at pains to say that, given the starting valuations and the level of uncertainty, we put Xero in that high-risk, high-reward portion of the portfolio and reflected in a smaller position size. But where we do have larger exposure, it's the classifieds. So going into this SaaSocalypse, we had a very large position ... Sorry, one of our top three positions was News Corp. Now News Corp in reporting season had a belter. They grew earnings in the teens. It was like 7% ahead of consensus. They have no debt. In a normal environment, you would've seen the share price handsomely rewarded, but because of this backdrop of disruption risk, the share price fell 12% in February, which was from a short-term perspective, very disappointing obviously, but we've taken advantage of the lower crazy share price, in my view, to add to our position

[\(26:52\)](#):

And really, the narrative that's swept up the classifieds and has also given us the opportunity to add CAR Group to the portfolio in reporting season is this idea that our search journey will change in a way that is to the detriment of the existing classifieds. And I think again, there's an element of maybe fighting the last war here where the last time there was this generational disruption, it was the advent of the internet and people saw that the digital classifiers themselves disrupted the old mode of newspaper advertising. And so I think there's a shoot first, ask questions later of, "Well, they're going to be disrupted again."

[\(27:25\)](#):

Again, on the work that we've done today and the facts that we can see today, we believe that this is likely to be a bit more like the shift to mobile. That was a different mode of search. We were searching predominantly on desktop, now we're searching more on our mobile and that's led to the rise of the app for REA. Potentially, we do start to use a chatbot to begin our search, but equally, REA has agreements with the frontier models and you're able to access REA listings via those search, plus there's a very small portion of search today. Could that change in the future potentially? I keep coming back to the fact that it's solving a problem that doesn't exist in the sense that you sell your house so infrequently that it's not as though it's a massive timesaver if you can search more efficiently during the process. And in fact, you like doing it, right?

[\(28:12\)](#):

REA has some extraordinary stats around the millions of people in Australia that have registered their home on the REA app. And actually, they can map out the way that you're behaving when you're using the REA app and predict the likelihood of you selling your home soon and then effectively sell you as a lead to your local real estate agent because you start to behave in a manner that suggests you might be looking. You start to search comps in your local area. You start to maybe search another suburb, that sort of thing. So they have a lot of really valuable proprietary data that an LLM will never be able to amass. So again, I think it stands to reason that they'll be able to enhance the value of their business through the application of AI in a way that subverts the narrative which is being priced into the equities.

[\(28:54\)](#):

Now, the reason I'm talking about REA, when we started talking about NewsCorp is obviously NewsCorp owns 65% of REA. It's about 60% of NewsCorp's group earnings, so it really does dominate the sentiment for that stock. And equally for CAR Group, I think CAR Group was probably one of the standouts when we had all of our company meetings through reporting season. They are probably at the forefront of investing in AI, investing in tools to enhance the value of their business. I thought they were really impressive. And so we see so often in markets that narratives follow share prices. So because the share prices of these sectors have all been smoked, it's like everyone's falling over themselves to create.

[\(29:32\)](#):

At post hoc, this bearish narrative about how their business models are disrupted by AI, equally, you could have constructed a scenario where, say, SaaS business valuations all rose, the classifiers' share prices all rose and we'd be falling over sales to be talking about the many ways in which AI benefits their business. They're going to be able to pull costs out of their business, they're the ones that have the distribution, they're the ones that have the market positions, and as a result, they'll be able to have this golden age of margin expansion. And so it's just so interesting to me how these narratives can construct themselves.

[\(30:06\)](#):

Ultimately, a share price, it doesn't tell you anything about the future trajectory of a business, but it tells you a lot about the embedded expectations. So when a share price is low for a business that has a good balance sheet, expectations are low. It's that simple. And the extent to which a business that has a long track record of exceeding expectations than has very low embedded expectations in the share price, then I think there could be a lot of future performance embedded in those low share prices. So we are tilting the portfolio towards businesses like News Corp, like Carsales and even like Xero because we think we're happy to take the other side of this disruption narrative that's emerged.

[\(30:44\)](#):

Back to you, Joe, the final topic that I wanted to talk about in terms of narratives in the market is one that really dominated markets in January. And again, it's coming to the fore during this crisis, although probably not performing the role that people might think that it would and that would be the gold sector.

**Joe Wright** [\(31:00\)](#):

Yeah, gold had an extraordinary run in January and obviously took all of the equities with it, like price ended up topping out over US \$5,500 an ounce. It's one thing to try and forecast, I suppose, commodity prices where there is supply and demand based on return on equity and return on invested capital and get a sense for ... And genuine, I suppose, resource scarcity like maybe copper, it's another to try and forecast the gold price where it's effectively a currency and certainly put my hand up and had virtually no success doing that. On top of that, gold miners are just such frustratingly imperfect vehicles, I suppose, to express a view on the gold price.

[\(31:44\)](#):

They are businesses that typically have relatively short mine lives. The barriers to entry particularly in WA are certainly not nearly as high as something like copper or iron ore. They're incredibly energy intensive from a

diesel perspective. They do a lot of M&A with highly varying levels of success. I suppose what I'm trying to say is, historically, we've found most of the businesses in the gold sector to not meet our standards of quality. That being said, there are management teams that have extraordinary track record of success in this space that know the sorts of assets they like and know the sorts of assets they can run and do a very good job of finding those assets, building them, and again, redeploying that cash.

(32:26):

Guys like Mark Clark at Capricorn, guys like Raleigh Finlayson, Bill Beament had an extraordinary amount of success at Northern Star when he was there. So it's certainly not a sector we want to dismiss entirely because there are management teams that we really love. I suppose what's been interesting is the heat has really come out of that market, the gold price, despite ... And again, this is a very short-term view, despite some serious uncertainty emerging from a geopolitical sense.

**Emma Fisher (32:55):**

If it's not a store of value during a hot war in Middle East.

**Joe Wright (32:59):**

Yes, value.

**Emma Fisher (32:59):**

When is it going to be a store of value?

**Joe Wright (33:01):**

I agree. And the lines outside the ABC Bullion shop in Martin Place have certainly vanished. And I think it speaks to probably the risk on that formed in that sector. As it was running, you certainly couldn't escape any single pundit or investor with a microphone, talking up the exposure to gold they had in their portfolio.

**Emma Fisher (33:22):**

We had an intern who told us all his university mates that the year before were all punting crypto coins were suddenly all in physical gold-

**Joe Wright (33:32):**

That's the goal.

**Emma Fisher (33:33):**

... and junior gold miners.

**Joe Wright (33:35):**

Yeah, and I suppose relative to its history, it certainly didn't feel like an environment where the gold price should have outperformed as much as it did, conscious that obviously there's a debasement argument, but at the same time, yields were reasonably strong and gold is typically unperformed in those sorts of environments. Again, it felt like it got incredibly speculative. There were certainly companies that had ... Any company with assemblance of a gold project was getting ascribed at pretty incredible valuation it felt like. And now that risk-off environment, which has historically been very favorable for gold, is actually seeing the gold equities basically derate quite significantly.

(34:15):

And again, I don't have the answer as to where the gold price is going next. All I can say is costs are going up for the mining companies, particularly as the energy, as oil and gas prices rise significantly. And at the same time,

this sentiment shift from risk on, risk on, risk on to risk off has certainly, I suppose, validated part of our thesis that the recent run into gold equities was perhaps overstated and definitely speculative. And now at more reasonable valuations, some of those companies are looking really interesting, particularly when there are excellent management teams with long track records of creating value in the space.

**Emma Fisher (34:53):**

Yeah. Well, I think we've rabbitied on for long enough, but if I had to summarize our view on a lot of these dominant narratives that tend to move markets in the short term, it's that, if you take a step back and you focus on the earnings growth and the capital returns of businesses, then a lot of this stuff just disappears into the wash. The interesting thing about narratives, I suppose, is there's always a kernel of truth in them. I think it's fair to say that AI has shrunk the terminal value of a lot of businesses. And probably we've seen a repricing in businesses that were just far too expensive to begin with, which doesn't make them cheap. Equally, hard assets, real assets were probably undervalued by the market for a very long time, a market that was just chasing high-returning businesses that could grow year in, year out without any capital invest in the business.

**(35:41):**

And I think, again, we're seeing a reemergence buoyed by cyclical factors of real businesses seeking to earn a return on pretty unique asset bases. And equally with gold, there is an argument that it's difficult for countries to get on top of their fiscal deficits. There certainly has been central bank buying, particularly since the freezing of Russia's assets during the Ukraine war. So all of these factors ... The market is right to identify them as factors, but I think that they get priced ... There's often situations where it's too extreme to the extent to which they get priced into equities and that's when you can find quality businesses on sale. Because ultimately, that's what we're trying to do with a quality and a value focus at Airlie, everyone can see the quality businesses on the ASX. It's pretty obvious.

**(36:28):**

There's not many instances where you get a chance to buy them at a good price. And I guess the really exciting thing about the market right now is I've never seen a time in my career where so many quality businesses are available at such attractive prices. So essentially, that's what we're trying to exploit in terms of how we're positioned in the portfolio. And even though it's a very tumultuous time to be an investor, I think it is also a very exciting time. So thank you everyone for listening.

**Host (36:51):**

That was Emma Fisher, deputy head of Australian Equities at Airlie Funds Management, in discussion with deputy portfolio manager, Joe Wright. We trust you've enjoyed this episode. For more information on previous episodes, visit [magellaninvestmentpartners.com/podcast](http://magellaninvestmentpartners.com/podcast) where you can also sign up to receive our regular investment insights program. Thanks for listening.

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