8th December

Defying Gravity; Aussie residential property.

As interest rates rise, asset values fall. That's just a law of economics based on the higher cost to buy/hold the asset and the relativity of yield required from that asset to be an investable instrument.

But not Australian residential dwellings for some reason.

In November, our dwelling prices lifted 0.6% month on month (m/m) and +8% since Jan-23, to a record high level.

The reason behind this anomaly is another economics standard rule; the supply/demand ratio. The November sales volumes slumped -28% m/m & -38% y/y. That's a big decline. This is the lowest level since the COVID lockdown in 2020. There is no supply.

SA (unless noted)	Dwelling prices											Sales (NSA)	
	Australia			Houses		Units		8 capital cities		Regional		Australia	
	% m/m	% m/m (NSA)	% y/y (NSA)	% m/m	% y/y	% m/m	% y/y	% m/m	% y/y	% m/m	% y/y	% m/m	% y/y
Sep-23	0.8	0.7	4.1	0.9	4.1	0.4	3.8	0.6	5.0	0.3	0.2	-5.5	0.2
Oct-23	0.7	0.8	5.7	0.8	5.9	0.6	4.9	0.7	6.8	0.3	1.7	-10.4	-11.5
Nov-23	0.6	0.6	7.0	0.7	7.5	0.4	5.8	0.5	8.2	0.1	3.1	-28.3	-38.5

The lack of supply is keeping the housing market 'tight', proving a significant offset to the RBA's rate hikes, which are reducing borrowing capacity and demand.

Also, renovations approvals, which remains remarkably resilient, only eased modestly from a record high too.

Our research partner UBS believes housing prices are still trending up, and surveys suggest expectations of ongoing strong growth (even towards ~10% annualised). This likely reflects very low supply of established housing, combined with record migration lifting demand, which is more than offsetting the RBA's rate hikes. Meanwhile, the outlook for new housing supply is also deteriorating.

While residential building approvals bounced in Oct-23, the trend remains close to ~160k, which is around a decade low. Reflecting this, the residential rental vacancy rate at a non-existent ~1% is still near a record low, and hence is pushing up rents by close to 10% annualised. Hence, this mix of housing dynamics is still inflationary.

Looking ahead, the RBA's rate hikes will work with a lag on borrowing capacity and household cash flow. The fixed-rate mortgage reset will continue over 2024 and it should result in an increase in 'stressed sellers'. However, the impact so far on home prices (& sales) has been minimal with mortgage arrears remaining extremely low.

The question now remains what happens with the RBA cash rate and unemployment. Is there another rise ahead or are we done? Will another rise be the straw that broke the camel's back, or will the low unemployment number allow employees to continue to demand higher wages, offsetting the higher interest cost (ultimately creating further inflation)?

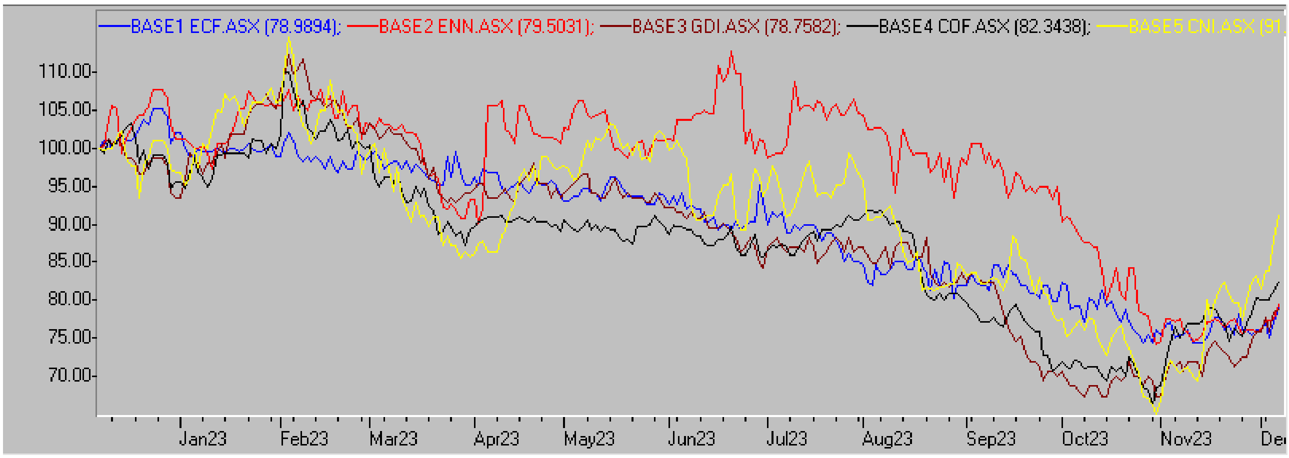
REIT's

After enduring an indiscriminate sell down in all thing's property related, our property picks are slowly peeling themselves off the floor and dusting themselves off. Still, a long way to go to reverse the adverse sentiment of interest rate rises.

As mentioned above, when interest rates rise, asset values fall; but we had selected a small number of REIT's that were trading at such a steep discount to asset value and paying such strong distributions that we thought we could hide in these names. Wrong. The baby was thrown out with the bathwater.

Regardless, a recovery is underway, presumably due to the expectation of peak rates being where we currently are, or not far from it.

A long way to go but the early moves have been more than welcome.



Carbonxt (CG1)

- On Monday this week CG1 announced a capital raise comprising a placement to professional investors and a non-renounceable pro-rata entitlement offer to existing shareholders for approximately $2.94m.
- Key terms of the Offer: 1 for every 9 shares at $0.06 per share to raise approximately $1.84 million.

- The Offer is fully underwritten.
- The proceeds raised under the Offer will be used to:
    1. provide funding to the Company for the development of the Kentucky Facility; and
    2. provide working capital to the Company.

- Based on the rapid completion of the KCP facility, the potential for a major asset sale and rising demand for the suite of Activated Carbon products CG1 produces, I would expect this to be the very low point and potentially last capital raise undertaken by CG1. Could be an interesting coming 12 months.

Woodside Petroleum (WPL)/ Santos (STO)

Speculation of a merger between Woodside and Santos has now progressed to the aforementioned companies confirming they are in discussions regarding a merger.

From a strategic and valuation perspective this makes a lot of sense. Both companies are very under-valued by equity markets which apply an 'ESG discount' to fossil fuels. Despite this, these companies are going to be generating huge amounts of cash in coming years as declining supply crashes into the rock of resilient demand.

The market's focus on short term commodity price weakness is rather myopic; the medium-term game is not just in tact but getting stronger.

The biggest issue may end up being the ACCC – these are the two biggest suppliers of gas into the Eastern Australia gas market. Woodside from Bass Strait and Santos from the Cooper Basin and Qld coal gas.

Gas customers are already complaining about the lack of available supply (not WDS and STO fault – blame government for that), but it will be an issue. Any merger will need to satisfy the ACCC that gas markets will remain competitive – which will be tricky.

Have a good weekend,

Ben and the team.

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