F

OPHIR

Letter to Investors - February 2025

From Andrew Mitchell and Steven Ng
Founders and Senior Portfolio Managers

Click to share

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 +1.3% net of fees in February, outperforming its benchmark which returned -2.8%, and has delivered investors +23.0% p.a. post fees since inception (August 2012).

Download Factsheet

The Ophir High Conviction Fund (ASX:OPH) investment portfolio returned -2.5% net of fees in February, outperforming its benchmark which returned -3.7%, and has delivered investors +13.7% p.a. post fees since inception (August 2015). ASX:OPH provided a total return of +5.6% for the month.

Download Factsheet

The Ophir Global Opportunities Fund (Class A) returned -1.9% net of fees in February, in line with its benchmark which returned -1.9%, and has delivered investors +17.4% p.a. post fees since inception (October 2018).

Download Factsheet

The Ophir Global Opportunities Fund (Class B) returned +0.2% net of fees in February, underperforming its benchmark which returned +0.4%.

Download Factsheet

The Ophir Global High Conviction Fund (Class A) returned -2.3% net of fees in February, underperforming its benchmark which returned -1.9%, and has delivered investors +13.1% p.a. post fees since inception (September 2020).

Download Factsheet

The Ophir Global High Conviction Fund (Class B) returned -2.2% net of fees in February, underperforming its benchmark which returned -1.9%, and has delivered investors +25.1% p.a. post fees since inception (June 2023).

Download Factsheet

What causes market corrections – and are we due for one now?

- Trump's policy uncertainty, particularly around tariffs, has soured investor sentiment and helped unwind 2024's market themes including the Magnificent 7
- Small and growth stocks underperformed in February, which our Global Funds offset by getting earnings calls right in the recent reporting season
- With the S&P 500 down -9% (at writing from highs) investors are fretting about whether this is a correction or the start of a bear market
- We examine the history of corrections and find 3 major causes that can help investors define the likely severity of a sell-off
- We also explore which sectors and factors provide investment safe havens for investors during sharp corrections
- Despite the recent sell-off, we find there is some evidence to suggest this 'correction' could be short and shallow, providing investors with a window of opportunity

After January's rally, global share markets (with the notable exception of European and Chinese share markets) took a step back in February, a dynamic that continued into March at writing.

Despite a generally solid February Q4 reporting season out of the U.S., markets are starting to get fed up with the new Trump Administration's policy uncertainty.

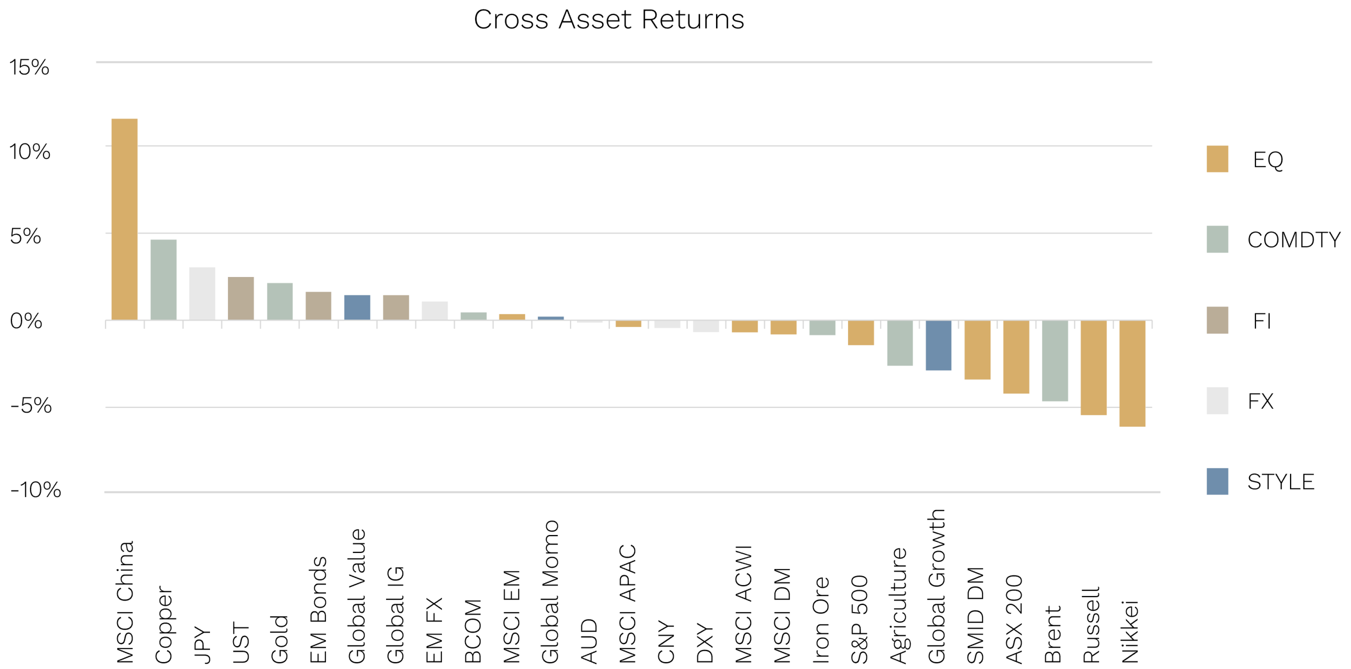
Tariffs remain front and centre here with everyone still guessing about their ultimate motivation and extent. Are they to stem illegal immigration and fentanyl? To raise U.S. government revenue to pay for tax cuts? Are they just on Canada, Mexico and China? What is the tariff rate? When do they take effect? The possibilities go on and on!

When these questions go unanswered, or are changed or delayed daily or weekly, companies and consumers unsurprisingly respond by reducing their activity until uncertainty is resolved.

The changing political and policy uncertainty has soured investor sentiment and helped turn many of the market themes from 2024 on their head in 2025. Last year's outperformance of the Mag7, U.S. share market, and momentum and growth factors have now given way to European, value and defensive stock leadership.

Small cap underperformance has continued, though, with the Russell 2000 down over -5% in February, only edged out by the Japanese share market (Nikkei) as the worst performers in the month.

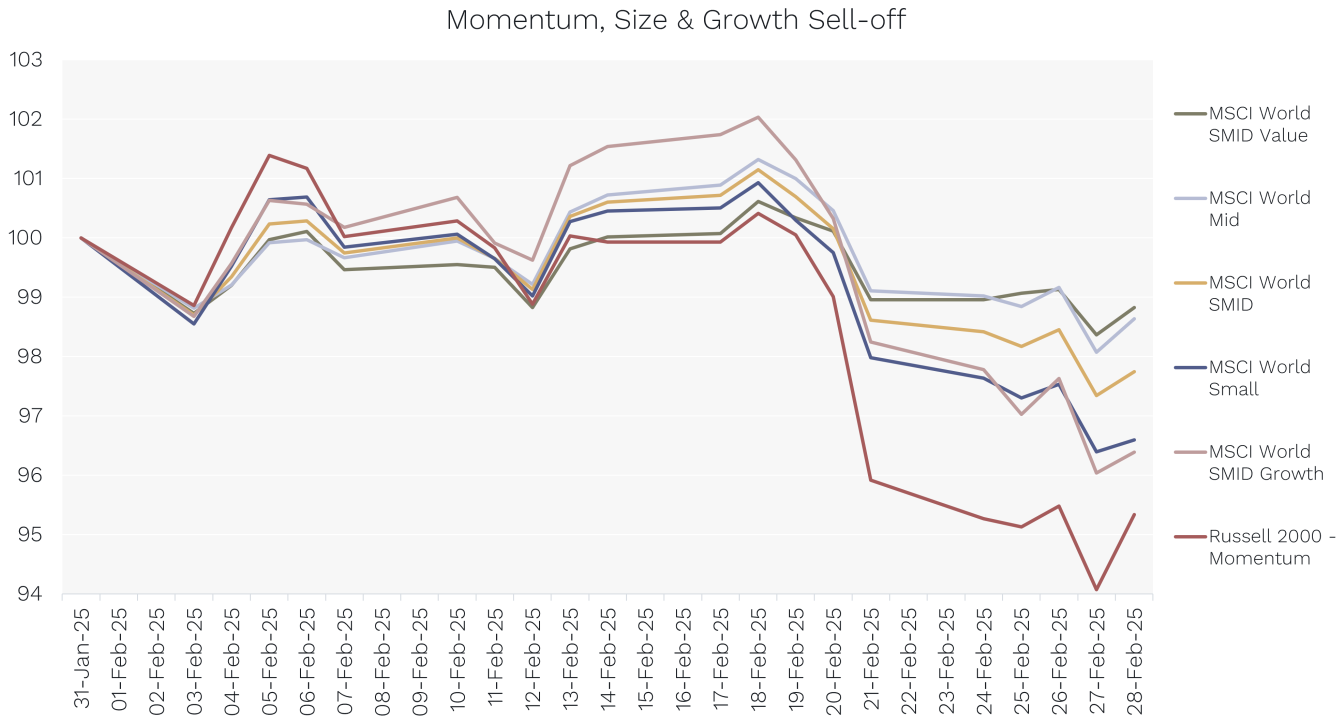
Asset Returns – February 2025



Source: JP Morgan

Despite the Ophir team having a great Q4 reporting season, with our Global Funds in February getting our earnings calls right, it didn't really show up on the scoreboard for the month, with both funds down around -2%, similar to our benchmark.

As a small cap growth-orientated investor this was because, within our SMID (small/mid) cap benchmark, mid-caps outperformed small caps, and value stocks outperformed growth stocks during the month.



Source: Bloomberg. Data as of 28 February 2025.

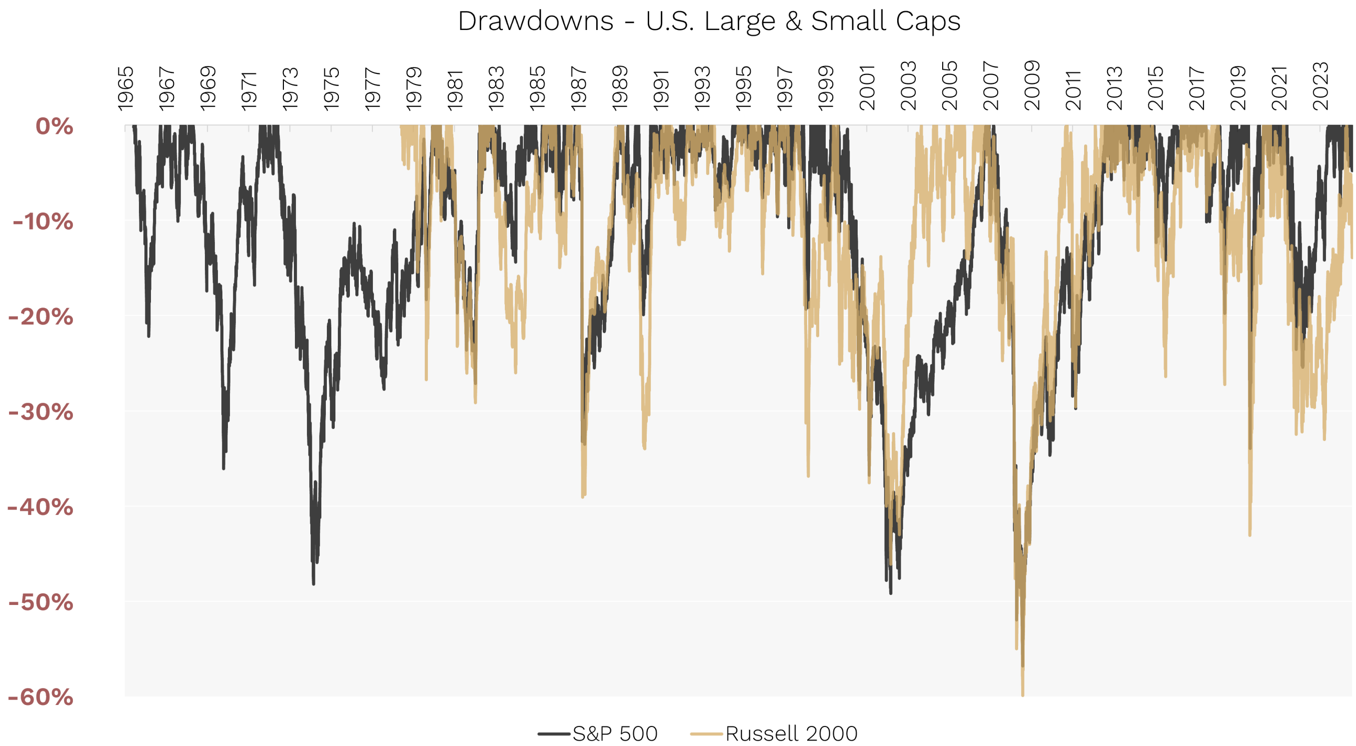
Those stocks with price momentum – which we typically have some exposure to as we're looking for those companies doing well and outperforming the market's growth expectations – were sold off hard, too, in February.

While this might have seen us 'swimming upstream' during the month, as we've stated many times before: if you get the earnings right – which we did during the reporting season –the share price performance will ultimately look after itself long term.

A history of U.S. drawdowns

With the S&P 500 down just over -8% from its all-time high in February, many investors are asking whether this is a correction (a >10% fall), or is there a bear market (a >20% fall) around the corner for the U.S.? And given the U.S.'s dominance, a bear market for global shares?

As we show below for the S&P 500 (since the mid 1960s) and the Russell 2000 (since the late 1970s), there have been plenty of falls greater than -10% and -20%, with even the odd fall of more than -30% or -40%. The only fall greater than -50% during this period was the gut-wrenching GFC.



Source: Ophir. Bloomberg.

Many of the biggest drawdowns (peak-to-trough falls) were associated with U.S. recessions, including those in the early and mid 70s, the '81/82 recession, the '90/91 recession, the Dot.com Bubble with its early 2000s recession, and of course the 2008/09 GFC, as well as the brief Covid-19 recession in 2020.

The benefits of understanding corrections

Why care about understanding market corrections in the first place?

One obvious answer is: knowing what tends to cause corrections might help you avoid them. But, despite thousands of studies and books trying, it is very difficult, or perhaps even impossible, to identify corrections ahead of time with sufficient accuracy to be useful.

While you may not be able to time a correction by going into or out of cash, if you understand what causes corrections you can identify when you are in the 'danger zone'; where a correction is more probable. You then may be able to mitigate some of the fall by skewing your portfolio to companies with stronger fundamentals and less risk.

Knowing what caused a correction can also help you can understand what will likely stabilise it and trigger a market rebound.

The three causes of corrections

In the table below our friends at Piper Sandler have categorised every U.S. share market correction greater than -10% going back to 1964. There have been 27 of them! Or about one every 2.2 years. (Get used to them long term investors!)

Every 10%+ Market Correction Since 1964 (S&P 500)

	Start	End	Drawdown	% Chge P/E	Duration (Wks)	Catalyst			
						Higher Rates	Job Losses	Global	
1	1966	1966	-22.2%	NA	34	×			
2	1968	1970	-36.1%	NA	78	×	×		Recession
3	1971	1971	-13.9%	NA	30	×			
4	1973	1974	-48.2%	NA	90	×	×		Recession
5	1975	1975	-14.1%	NA	9	×			
6	1976	1978	-19.1%	NA	61	×			
7	1978	1978	-13.6%	NA	9	×			
8	1979	1979	-10.2%	NA	5	×			
9	1980	1980	-17.1%	NA	6	×	×		Recession
10	1980	1982	-27.1%	NA	89	×	×		Recession
11	1983	1984	-14.4%	NA	41	×			
12	1987	1987	-33.5%	-38.1%	14	×			1987 Crash
13	1990	1990	-10.2%	-10.2%	4	×			
14	1990	1990	-19.9%	-20.0%	12	×	×		Recession/ Persian Gulf
15	1997	1997	-10.8%	-10.8%	3			×	Asia Financial Crisis
16	1998	1998	-19.3%	-20.0%	6			×	Russia/ LTCM Crisis
17	1999	1999	-12.1%	-15.0%	13	×			
18	2000	2002	-49.1%	-44.8%	133		×		Recession
19	2007	2009	-56.8%	-32.6%	74		×		Recession
20	2010	2010	-16.0%	-22.2%	10			×	Euro Debt Crisis
21	2011	2011	-19.4%	-23.2%	22			×	U.S. Debt Downgrade
22	2015	2016	-14.1%	-14.2%	29			×	China, Oil Collapse
23	2018	2018	-10.2%	-14.3%	2	×			
24	2018	2018	-19.6%	-20.2%	12	×			
25	2020	2020	-33.9%	-34.1%	5		×		Recession/ COVID-19
26	2022	2022	-25.4%	-30.1%	40	×			
27	2023	2023	-10.3%	-13.2%	13	×			

Source: Piper Sandler.

As you can see, most of the deepest falls are associated with recessions. The 1987 Crash, and the 2022 fall courtesy of the rapid hiking of interest rates by the U.S. Fed, are key exceptions.

Importantly, most corrections are driven overwhelmingly by valuations (price to earnings ratios) shrinking as risk aversion increases, rather than corporate earnings falling off a cliff.

Each correction can be grouped into three main causes:

1. High interest rates
2. Higher unemployment
3. Exogenous global shocks (such as the Asian Financial Crisis or Euro Debt Crisis)

Of course some of these can overlap and have other intertwined causes, but there is usually one of these three causes that stands out as the major reason the correction starts and ends.

History shows that not all correction causes are created equal

The most important insight history tells us is that the cause of the correction will go a long way to explaining how deep and long it is.

The six charts below are great ones to commit to any investor's memory bank.

S&P 500 Drawdowns Peak to Trough

S&P 500 Drawdowns Duration (Weeks)

Source: Piper Sandler.

They tell us that:

1. Higher rates have historically caused, and lower rates ended, the most corrections (52% of them), followed by higher unemployment (30%) and global shocks (18%). However, since inflation targeting was introduced in the U.S. in the 1990s, inflation and hence interest rates have been less volatile and caused fewer market corrections.

2. Those corrections associated with job losses should be the most feared because they typically see the largest falls (-36% on average) and last the longest. This is probably because they are the most likely to see corporate earnings fall the most, alongside valuation falls.

3. Those corrections based on exogenous global shocks tend to be the 'best', with similar average falls to those caused by higher rates (around -16%), but global shock corrections tend to be shorter lived.

While rising interest rates or unemployment might indicate a correction is ahead, getting the timing right is always difficult because markets are forward looking and the correction may begin when market participants EXPECT rates or unemployment to increase, before they actually do. It can still be useful though to understand the cause, because when rates or unemployment stabilise that can signal that the correction may be coming to an end, with a rebound to follow.

Almost by their very definition, exogenous global shocks are unpredictable, but at least their resolution can provide some guidance on what the market needs to see before it recovers.

How different sectors perform in corrections

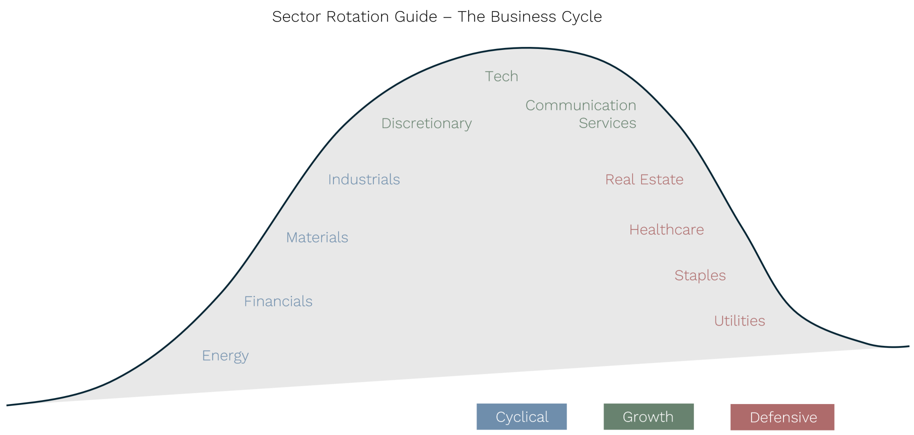
Perhaps the most useful part of this history lesson is understanding which parts of the market do better when staying invested during a market correction. (And staying invested will be the best outcome for most investors.)

Here the evidence is pretty clear, though not infallible. First, at a sector level, during a market correction the sectors that tend to perform better provide more stable, reliable and defensive revenue and earnings.

Which ones are they? Typically, Real Estate, Health Care, Consumer Staples and Utilities.

Each has, on average, outperformed the U.S. share market as a whole during the 15 market corrections that we have data for going back to 1990. Each also has an 80% or better 'Hit Rate' – that is, they have outperformed the market in at least 4 out of every 5 corrections.

What do these sectors have in common? Their revenues and earnings tends to fluctuate less, generally because consumers don't cut spending on them easily (everyone has to pay their utilities, grocery or doctors bills). They can therefore provide something that is prized in market uncertainty: more certain returns to their shareholders.



Source: Piper Sandler.

The type of stocks ('factors') that outperform in sell-offs

But investment 'factors' are better guideposts for investing during corrections than Sectors. (Factors is just a fancy investment term for common characteristics of different stocks.) So, what are the best and worst factors during market corrections?

S&P 500 Factor Returns (High Relative to Low, Sector Neutral)

			Risk	Variance	Deep Value	Size	Quality Value	Coverage	Profitability	Stability
Peak	**Trough**	**S&P 500 Decline**	**Beta**	**Sales Variance**	**Sales Yield**	**(Small to Large)**	**FCF Yield**	**Interest Coverage**	**ROE**	**Low Volatility**
1987	1987	-34%	-10.3%	-10.1%	-3.4%	-6.0%	5.0%	1.6%	4.8%	8.9%
1990	1990	-10%	-1.7%	-1.2%	-0.3%	-1.8%	0.7%	1.6%	2.6%	2.4%
1990	1990	-20%	-17.5%	-10.3%	-10.5%	-8.3%	3.9%	3.0%	8.3%	15.1%
1997	1997	-11%	-3.0%	-2.2%	0.1%	-0.6%	0.3%	1.7%	1.0%	4.2%
1998	1998	-19%	-3.1%	-5.5%	-4.2%	-5.5%	9.5%	0.8%	4.7%	9.0%
1999	1999	-12%	-0.9%	-0.6%	-9.3%	-2.3%	-3.6%	2.7%	3.0%	1.1%
2000	2002	-49%	-54.0%	-59.3%	24.2%	25.8%	87.0%	54.5%	25.9%	91.8%
2007	2009	-57%	-32.3%	-30.6%	-31.7%	-22.5%	6.0%	30.4%	45.7%	42.1%
2010	2010	-16%	-11.2%	-6.7%	-6.6%	-4.4%	-3.1%	8.3%	8.8%	12.3%
2011	2011	-19%	-21.4%	-15.8%	-16.0%	-13.0%	2.3%	15.2%	18.8%	24.0%
2015	2016	-14%	-17.2%	-14.0%	-9.5%	-7.7%	0.0%	4.9%	8.2%	18.2%
2018	2018	-10%	-3.2%	0.0%	-0.5%	-0.8%	1.0%	0.1%	-0.1%	1.5%
2018	2018	-20%	-10.6%	-5.7%	-1.9%	-1.2%	0.4%	1.0%	1.9%	8.6%
2020	2020	-34%	-15.0%	-3.3%	-17.7%	-15.4%	-3.4%	11.1%	14.1%	17.9%
2022	2022	-25%	-13.7%	-6.0%	12.0%	4.7%	5.2%	-2.8%	-1.8%	10.6%
2023	2023	-10%	-12.2%	-9.8%	1.0%	-5.5%	5.5%	4.2%	5.0%	14.5%

(Q1 vs Q5 Factor Returns, Sector Neutral)

	Beta	Sales Variance	Sales Yield	Size	FCF Yield	Interest Coverage	ROE	Low Volatility
Average	**-14.2%**	**-11.3%**	**-4.6%**	**-4.0%**	**7.3%**	**8.6%**	**9.4%**	**17.6%**
Hit Rate	**0.0%**	**6.3%**	**25.0%**	**12.5%**	**81.3%**	**93.8%**	**87.5%**	**100.0%**

Most Consistent Underperforming Factors | Most Consistent Outperforming Factors

Source: Piper Sandler.

The table above shows that during corrections there are a few types of stocks that tend to underperform: Those with more volatile share prices compared to the market (so called higher Beta), those with volatile revenues; and smaller stocks.

By contrast, stocks with higher-quality cash flows, less debt and less volatile prices outperform .It's perhaps unsurprising that when markets are falling a lot, investors favour those businesses they can be more certain of their fundamentals and their share prices.

Important Point: While smaller companies tend to fall more during market corrections, the key exception to this in the table above is the 2000 to 2002 Dot.com-related market falls, where smaller companies significantly outperformed. This period shares some similarities to today where U.S. small caps have been the cheapest compared to large caps since the Dot.com Bubble. This was a key reason 25 years ago U.S. small caps fell less – they started from much cheaper valuations.

Where does that leave us today?

With the U.S. share market on the precipice of a correction (>-10% fall), it seems U.S. tariffs are the most likely cause of the drop and would fall in the 'global exogenous shock' bucket.

Neither interest rates nor unemployment has moved higher in the last few weeks to cause the sell-off. In fact, the most recent move in both short and long-term interest rates in the U.S. has been down.

It remains a risk, though, as tariffs are inflationary. So, it can't yet be ruled out that the Fed may need to reverse course and hike rates as a result.

The U.S. unemployment rate has been moving up from its low in 2023, but this isn't a new occurrence, and it is still near multi-decade lows. If history is any guide this is good news because, as we've seen, exogenous shocks tend to see smaller market falls that recover more quickly.

Investors need to watch, however, that tariffs and policy uncertainty in general in the U.S. don't morph into something more sinister like a recession, which would see job losses and a likely further fall in the share market. For now, though, this doesn't seem the most likely outcome as the typical recession precursors like rising interest rates and lax credit conditions are absent.

We don't even know if the U.S. share market will enter a correction at this stage.

At Ophir, we always remain bottom-up stock pickers first and foremost.

This is ultimately where our 'edge' lays, and what has driven the vast majority of our outperformance over the long term. Though from a portfolio management perspective we are not ignoring the lessons of history about what sectors and factors tend to do well during share market sell-offs.

We see this as just part and parcel of prudent management of ours, and our investors' capital.

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

Investor Services
Automic Group | 02 8072 1478
ophir@automicgroup.com.au

Investment Enquiries
Brendan Carrig (Chief Executive Officer)
+61 405 175 549| brendan.carrig@ophiram.com