MARKET MATTERS
INVEST

# MONTHLY REPORT | AUGUST 2023 | ACTIVE HIGH CONVICTION

## PORTFOLIO DETAILS

| | |
|---|---|
| Portfolio Name | Active High Conviction |
| Structure | Separately Managed Account |
| Benchmark | S&P/ASX 200 Accumulation |
| Management Fee | 0.85% incl GST |
| Platform | Open Wealth \| Praemium |
| Included Assets | Equities, ETFs |
| Portfolio Manager | James Gerrish |
| Annual Performance | 8.75%* |

## OBJECTIVE

The objective of the Market Matters Active High Conviction Portfolio is to provide an active exposure to Australian large-cap shares, with reduced volatility. Returns will be achieved through a combination of capital appreciation and income with an overall objective of outperformance of the S&P/ASX 200 Accumulation Index over the medium term, (3 years).

**Inception Date 10.05.2016*

## MARKETS & PERFORMANCE

The Market Matters Active High Conviction Portfolio fell -1.54% in August, underperforming the S&P/ASX 200 Accumulation Index which fell by -0.73%. The portfolio has returned +16.92% for the rolling 12 months (against the benchmark return of +9.56%) and +14.21% per annum for 3 years, outperforming the market return of 10.69%.

| PERIOD | 1 MONTH | 3 MONTH | 6 MONTH | 1 YEAR | 2 YEAR PA | 3 YEAR PA |
|---|---|---|---|---|---|---|
| PORTFOLIO % | -1.54 | 4.98 | 8.08 | 16.92 | 8.38 | 14.21 |
| BENCHMARK % | -0.73 | 3.92 | 3.00 | 9.56 | 2.86 | 10.69 |
| RELATIVE % | -0.81 | 1.06 | 5.08 | 7.36 | 5.52 | 3.52 |

*Benchmark: S&P/ASX 200 Accumulation*

More broadly, the MSCI Developed Markets Index fell over August (-1.7%), while the S&P 500 also declined (-1.6%) in local currency terms. Australian 10-year bond yields were at 4.03%, trading relatively flat as the RBA kept rates unchanged but still retained a tightening bias. That said, we believe the current 4.1% cash rate will be the peak of this RBA cycle.

In the US however, there remains a distinct possibility of one more hike, and this evolving belief pushed up US 10-year yields by 0.14% over the month, to 4.09%, as the Fed continued their hawkish tone.

Commodity prices were mixed across the board in August. Brent Oil rose by US$0.30 to US$85.86/bbl, Iron Ore showed resilient strength to rise by US$6.50 to US$117.50/Mt, while Gold prices fell on a strengthening dollar coupled with higher yields, falling by US$23.10 to US$1,948.

From a sector perspective Consumer Discretionary (+5.7%) and Property / REITs (+2.3%) were the highlights while Energy +0.5% was the only other sector that finished in the black.

Utilities (-3.8%) struggled most while Consumer Staples (-3.2%), IT (-2.1%), Industrials and Materials (-2%), Healthcare (-1%), Financials and Communication Services (-0.8%) all dipped more than the index.

## REPORTING WRAP UP

FY23 results were solid, with earnings (Net Profit After Tax)) beats outnumbering misses by a ratio of 5:3, illustrating the underlying strength of the domestic economy, however, underwhelming guidance for FY24 into a strong market leading into August weighed on confidence and ultimately led to weaker share prices collectively.

Materials (ex-mining) and Communication Services saw the strongest beat rate, while the Consumer Staples and Information Technology stocks saw the biggest skew towards earnings misses. Post results, analysts revised their expectations on FY24 profits at a ratio of 2 downgrades for each upgrade, and now expect ASX200 FY24 profits to decline -5.7% in the year ahead. For comparison, this number was -0.8% just prior to results and +0.7% six months ago, showing downside momentum.

While the index itself was weak, it was also an unusually volatile reporting period with a high proportion of outsized share price moves on company results (+ or - 10% on the day). This is indicative of crowded trades at a time of unpredictability from an economic standpoint, while another observable outcome has been the continuance of trends, on the upside or downside.

A major surprise was the contrasting performance in consumer sectors pre- vs. post-results. In the months leading up to reporting investors had been buying staples, on expectations that the discretionary names would suffer as householders struggled against cost-of-living pressures and higher interest rates. Instead, discretionary retailers saw that consumer spending was slowing (but not collapsing), whilst staples suffered under cost and operational challenges.

Cost pressures across the mining industry was another notable trend, and while not as surprising, they were more extreme and coincided with an uptick in planned capex over the coming years.

## PORTFOLIO POSITIONING

The portfolio held 20 positions at the end of August with cash finishing the month at ~7.5%.

As we wrote last month, we started to tentatively add more value-orientated stocks to the portfolio with three new positions that had struggled during FY23 but have a credible road to redemption mapped out into FY24. These included **Elders (ELD)**, **Magellan Financial Group (MFG)** and **Lendlease (LLC)**. Results gave us a better handle on these three companies, with one firmly disappointing (Elders), so we cut it, one showing good progress towards improvement (Magellan) and one that was okay, but questions remain (Lendlease).

| PORTFOLIO STOCKS | |
|---|---|
| NO. OF HOLDINGS | 20 |
| ESTIMATED YIELD (%) | 4.14 |
| TOP 5 POSITIONS (% OF AUM) | 28.83 |
| TOP 10 POSITIONS (% OF AUM) | 53.57 |

| STOCK | CONTRIBUTION (%) |
|---|---|
| NORTHERN STAR (NST) | 0.34 |
| MAGELLAN FINANCIAL (MFG) | 0.29 |
| XERO (XRO) | 0.28 |
| NATIONAL STORAGE REIT (NSR) | 0.24 |
| TREASURY WINES (TWE) | 0.23 |

| STOCK | DETRACTION (%) |
|---|---|
| RESMED (RMD) | -1.20 |
| RAMSAY HEALTHCARE (RHC) | -0.58 |
| LENDLEASE (LLC) | -0.40 |
| ELDERS (ELD) | -0.29 |
| SEEK (SEK) | -0.20 |

| % | JUL | AUG | SEP | OCT | NOV | DEC | JAN | FEB | MAR | APR | MAY | JUN | YTD |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **FY24** | 4.82 | -1.54 | | | | | | | | | | | **3.82** |
| **FY23** | 8.16 | 2.80 | -5.71 | 3.68 | 7.75 | -3.20 | 8.18 | -1.93 | 2.08 | 2.63 | -1.72 | 1.71 | **24.43** |
| **FY22** | 0.25 | 2.53 | 0.78 | 1.75 | -3.49 | 2.72 | -4.00 | 2.06 | 5.51 | -2.30 | -4.69 | -7.70 | **-6.58** |
| **FY21** | 0.27 | 4.94 | -4.10 | -1.07 | 14.87 | 1.34 | -0.50 | 3.08 | 0.66 | 4.10 | 1.17 | 2.70 | **27.46** |
| **FY20** | 1.21 | -2.16 | 3.75 | -1.55 | 0.80 | 0.34 | 2.06 | -10.25 | -24.12 | 12.66 | 5.30 | 2.02 | **-9.94** |
| **FY19** | 1.11 | 1.64 | -0.77 | -2.16 | -1.22 | -1.94 | 3.39 | 4.98 | -1.00 | 2.39 | 1.72 | 4.41 | **12.55** |
| **CUMULATIVE** | | | | | | | | | | | | | **51.20** |

## PORTFOLIO POSITIONING CONTINUED

We hold two healthcare positions in the portfolio that when combined detracted 1.78% from portfolio performance in the month – in other worlds, the rest of the portfolio was solid, but these were a real disappointment. The biggest drag was **ResMed (RMD)** -1.2% while **Ramsay Healthcare (RHC)** -0.58% was down, although some of its negative influence was born in prior months.

4Q revenue for ResMed came in below expectations and it was also accompanied by weaker margins when the market was looking/positioned for expansion. However, the real selling pressure gathered momentum as investors focused on the rise of weight loss drugs, particularly in the US, and their potential impact on sleep apnea, given the known linkage between obesity and sleep disorders.

The burning question being, how could this impact the demand for ResMed's products and what type of revenue hit could ensue?

These weight loss treatments are known as GL1's because they mimic the action of a hormone called glucagon-like peptide 1, in simple terms, it sends signals to the appetite centre in the brain to reduce hunger and increase fullness. The most widely known drug is Ozempic which is currently used to treat people with diabetes while Wegovy is approved for weight loss. While these drugs are FDA approved, most insurance companies do not cover the cost of weight loss treatments, but that could change.

The connection between body weight issues and sleep apnea is clear. If the funding mechanism for weight loss medication does change, the impact on ResMed could be significant, although the quantum is unknown at this stage. We have held our position in RMD for now, given our view that the stock is oversold, however, ultimately this could have a reasonable impact on the long-term earnings profile of RMD and as a result, they will likely trade on a lower multiple relative to history. We are still working through these issues, but are very cognisant of this negative, and potentially significant headwind.

Chinese economic growth has stalled creating a headwind for commodities. We do anticipate further stimulus from Beijing and when combined with our bullish assumptions around some key resources, we have a bias for adding to positions into prevailing weakness. We started by increasing our position in **BHP Group (BHP)**, taking it towards a market weighting into weakness.

Decarbonization is a theme with decades of runway ahead and remains a major input into our positive thesis on 'future facing' commodities. **Worley (WOR)** is a global contracting business that has positioned itself with a first mover advantage in this space, and their results in August confirmed a growing push into sustainability related work which now accounts for 41% of aggregated revenue, up ~40% on FY22. We remain optimistic on how their changing book will drive margin expansion over the coming years, underpinning a big uplift in earnings.

Aligned with this theme is a recent tilt into Uranium via the purchase of **Paladin Energy (PDN)**. Put simply, we believe the uranium sector is entering the next phase of its recovery after the major downturn post-Fukushima back in 2011. There's been a distinct lack of investment in new mines over the past 12 years which has resulted in a structurally undersupplied market with the subsequent drawdown of inventories leading to a meaningful commodity price recovery – the spot uranium price has increased to around US$60/lb and in our view is heading significantly higher over the next two years. Nuclear Energy is recognised by many countries as an essential element of the clean energy mix, which should enable nuclear power to increase its current footprint from ~10% of global electricity. Given its volatile nature, our position is relatively small, however we will build on this over time if our views prove on point.

**Magellan Financial Group (MFG)** delivered their much-anticipated FY23 results mid-month that came in largely as expected from an earnings perspective while they announced a final dividend of 39.8¢. What drove the positive reaction was a 30cps special dividend along with cost guidance for FY24 that was pleasing.

As we've suggested previously, better performance is important to drive flows, and in the 6-months to June, their global equity strategy outperformed for the first time in multiple years. This better performance should stem outflows (seems to be happening) and while they are not yet at the point of attracting inflows and launching new products, this is a natural progression over time. Capital management (given strong balance sheet) provides optionality for management in the meantime, and we saw this lever being pulled at these results. We believe Magellan is worth ~$12 if they get the turnaround even partially right. MFG rallied strongly post results.

**National Storage REIT (NSR)** is the largest supplier of self-storage in Australasia and a recent addition to the portfolio. They reported FY23 results at the end of August that were ahead of expectations by ~4% and showed their defensive, resilient (and now undervalued asset base) continued to perform well. The catalyst for weakness in the NSR share price was the listing of competitor, Abacus Self Storage (ASK) which came on at a steep discount to the value of its assets, weighing on NSR that was trading at a premium. That premium turned into a discount which allowed us to buy NSR at ~$2.21, a ~10% discount to its current NTA of $2.48.

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