MARKET MATTERS
INVEST

MONTHLY REPORT | FEBRUARY 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	7.96%*

**Inception Date 10.05.2016*

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).

MARKETS & PERFORMANCE

The Market Matters Active High Conviction Portfolio declined by -1.93% in February, outperforming the S&P/ASX 200 Accumulation Index which declined by -2.45%. The portfolio has returned 9.08% for the rolling 12 months & 10.01% per annum over 3 years.

PERIOD	1 MONTH	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	3 YEAR PA
PORTFOLIO %	-1.93	2.70	8.17	9.08	10.30	10.01
BENCHMARK %	-2.45	0.30	6.37	7.16	8.68	7.93
RELATIVE %	0.52	2.40	1.80	1.92	1.62	2.08

Benchmark: S&P/ASX 200 Accumulation

February was a weak month for equities, as company results illustrated waning earnings momentum. The S&P/ASX 200 was down (-2.4%), as the RBAs 25bps rate hike to 3.35% placed pressure on the already decelerating economy. Australian 10-year bond yields moved in reaction to tightening monetary policy, selling off 30bps to 3.86%. US yields also sold off 39bps to 3.92%, in reaction to stronger-than-expected economic data.

Elsewhere, the MSCI Developed Markets Index fell (-1.5%), and the S&P 500 also lost momentum (-2.4%) in local currency terms. Commodity prices fell across the board. Brent Oil lost US$2.04 to US$82.45/bbl fuelled by a stronger USD. Iron Ore prices also declined US$3.00 to US$126/Mt on flat demand and a soft Chinese property market. Gold prices were hit hard, down by US$105.25 to US$1,819, hindered by the strength of the Greenback.

Locally, the Utility sector was the top performer up (+3.4%), while IT (+2.7%), Industrials (+1.5%), Consumer Staples & Property (+1.1%) all made gains.

The Materials sector was the hardest hit ending down (-6.6%) while Financials (-3.1%) and Energy (-0.8%) also fell.

When the two most influential sectors on the ASX (Financials & Materials) fall an average of 4.85%, it's always going to be a tough month at the index level.

PORTFOLIO STOCKS

The portfolio held 18 positions at the end of February with our main sector tilts being towards technology & gold while we continued to raise cash, sitting at ~18% by month end, inline with our commentary in January, where we took the opportunity to sell into the prevailing strength.

We made multiple changes during the month, the most notable being the sale of **Commonwealth Bank (CBA)** ahead of their results, switching to **ANZ Bank (ANZ)**. We also trimmed **Macquarie Group (MQG)** and sold **Seek (SEK)**.

CBA is often described as the world's most expensive bank, but it keeps delivering having rallied to all-time highs ahead of its report. Our motive was simply driven by price with CBA trading ~9% above its long-term average valuation and a big premium to the broader sector. While this is not a new theme for CBA, and there are reasons why it should garner a higher multiple, the valuation gap to ANZ, which was trading ~10% cheap versus its historical average, was compelling.

We saw no reason for this effective 19% variance, and we switched. We are now more optimistic about ANZ's relative prospects given their asector-leading growth rates and the looming acquisition of Suncorp's (SUN) banking division.

Recruitment platform **Seek (SEK)** traded to our $25 target after rallying 38% from its September low. 1H23 results were inline from a revenue and profit perspective while they tightened guidance to be more towards the bottom end of the previously guided range for the full year. While we like SEK, and will likely re-enter at some point, we elected to lock in our gains.

Newcrest (NCM) was the target of a takeover attempt during the month with the $55bn US-based **Newmont Corp (NEM US)** making a conditional bid of 0.38 shares for each Newcrest (NCM) share, a bid which at the time was worth $27.40. We believe the logic and synergies for the NEM-NCM tie-up make perfect sense as does the timing for the US suitor with NCM searching for a new CEO and the relative weakness of the share price.

NEM is the largest global producer of gold with the smaller $22bn NCM coming in 5th with less than half of the production. We remain bullish on gold and its producers over the coming years.

Macquarie Group (MQG) has outperformed its peers in 2023 and after delivering a strong Q3 result during the month, the risk of negative news is theoretically in the rear-view mirror. It can be a tricky job picking the revenue drivers for MQG, but they have a habit of pulling the correct levers at the right time, today it's the Commodities Division but history says they will pick an excellent route both into and out of the tougher economic times which lay ahead.

While we trimmed MQG during the period, we remain positive about its prospects.

PORTFOLIO STOCKS	
NO. OF HOLDINGS	18
ESTIMATED YIELD (%)	3.61
TOP 5 POSITIONS (% OF AUM)	30.6
TOP 10 POSITIONS (% OF AUM)	54.97

STOCK	CONTRIBUTION (%)
SEEK (SEK)	0.37
NEWCREST MINING (NCM)	0.32
MACQUARIE (MQG)	0.12
ALTIUM (ALU)	0.10
XERO (XRO)	0.08

STOCK	DETRACTION (%)
BHP GROUP (BHP)	-0.68
EVOLUTION MINING (EVN)	-0.63
WHITEHAVEN COAL (WHC)	-0.38
NATIONAL BANK (NAB)	-0.37
IGO LIMITED (IGO)	-0.33

%	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	YTD
FY23	8.16	2.80	-5.71	3.68	7.75	-3.20	8.18	-1.93					**19.73**
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													**43.22**

REPORTING

As always, there are a lot of moving parts when it comes to reporting and these interim results were no different. Overall, it seems likely earnings have peaked and we're now in for a tougher period, however, it's not all bad news. It fits with our thinking that the RBA is too positive in their assumptions around the health of the Australian economy and as a result, far too hawkish on interest rates. While earnings may have peaked overall, pockets of the market are still performing while rates in our view will not reach the height that markets are currently pricing in, so the headwind on valuations from sharply higher yields may ease.

- More companies missed expectations than beat, but it wasn't by a lot. While the companies that missed saw ongoing underperformance i.e., the strong became more highly valued than the weak.
- Ahead of reporting, analysts were expecting earnings growth year on year of +7.3%. As we exit reporting, that number sits at +6.6%, a reduction of 0.7% – down but not a disaster.
- Resources companies battling with higher costs were the main drag here, and while it's a negative, we can't help but think these pressures will improve as tightness in the labour market ultimately eases.
- We saw some pockets of consumer strength, so instead of all retailers struggling, there was a greater divergence of outcomes. Big ticket items, lounges, white goods etc are a tougher ask, but smaller items, or retailers that give options to trade down, did well.
- Extrapolating CBA's results across the banks, they are in very good shape, although there were signs that intense competition was eroding the benefit of higher rates on margins.
- More broadly, there was clear caution on what comes next and an acknowledgment that the next six months will be tougher, although it wasn't the case across the board implying more of a 'patchy' slowdown than a deep and wide recession.
- Labour shortages were the No 1 issue in FY22 results six months ago, but for the most part, this has improved, though wage pressure is still bubbling away, more so in some sectors like mining.
- Inflation is there for all to see, but many companies are having success passing on price rises to protect margins, although that is a blanket comment, and some companies would disagree.
- The housing market is weak, and that's flowing into weakness more broadly, but some areas have remained immune, like travel.
- Companies are still planning to spend, with capex intentions remaining robust.

In summary, a patchy period rather than a universally weak one, the 2H will be very important and we need to be on our toes, but it would be a mistake to think a hard economic landing is a fait accompli.