MARKET MATTERS
INVEST

MONTHLY REPORT | JUNE 2022 | 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	4.61%

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 fell -7.7% in June, outperforming the S&P/ASX 200 Accumulation Index which fell by -8.77%. The portfolio has returned -7.15% for the rolling 12-months, 9.8% per annum over 2 years, 1.22% per annum over 3 years & 4.61% per annum since inception.

PERIOD	JUNE	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	3 YEAR PA
PORTFOLIO %	-7.7	-14.05	-11.15	-7.15	9.80	1.22
BENCHMARK %	-8.77	-11.90	-9.94	-6.47	9.34	3.32
RELATIVE %	1.07	-2.15	-1.22	-0.68	0.46	-2.10

One of the most common questions I am asked is – *"what's your outlook for the next 12 months"* and my honest answer is always, *"it depends"*, however, at no other time in memory does it depend on so many complex and interrelated economic circumstances as it does today. As Charlie Munger, Vice President of Berkshire Hathaway said at the company's last AGM, *"If you are not a little confused by what's going on, you don't understand it."*

In this annual update for FY22 we'll attempt to make sense of the current economic climate, what may come next and how we'll be managing your portfolio through the period ahead.

Firstly, a look back on the year where the market enjoyed a solid 1H fuelled by vaccines allowing economies to re-open, unprecedented fiscal expenditure and aggressive monetary policy, however, the 2H was more challenging. A 'shot across the bow' came in January with the local market falling around 12%, while US stocks fell more, and while a sharp recovery ensued propelling stocks back near highs, the die had been cast, and volatility was back in town.

The final quarter of the year saw the Australian market fall 12%, the lion's share of the declines occurring in June (-8.8%). For the 12 months, the ASX 200 was down over 10% excluding dividends, however, the divergence in sectors was quite extreme. The Technology sector down 38% was the starkest of stats, while Consumer Discretionary (-23%) and Real-Estate (-16%) also fell sharply i.e. the sectors most influenced by interest rates.

On the flip side, a lot of joy came from Energy (+29%) and Utilities (+24%), while the Industrials (+0.8%), Staples (-2%), Materials (-9%) & Telcos (-9%) all outperformed the broader market to varying degrees.

In the US, the S&P 500 fell 11% while the bond market provided little protection against the decline, our preferred measure being the Bloomberg AusBond Composite Index was down by 10.5% for the year as interest rates moved sharply higher (and bond prices lower). Not even gold (-0.6%) or Silver (-11.2%) attracted a safety bid while Bitcoin, which in 2021 was touted as the 'new Gold' is now down ~70% from its highs.

It's probably not surprising, but writing this update was more difficult than usual, in fact, it was probably the most difficult since Q1 2020 when the world was gripped by COVID. Certainly, dark days, however, one must appreciate that the market will overcome these challenges, as it has with all others, and staying the course, holding the line into market weakness remains as important as ever.

THE ECONOMIC BACKDROP

Think about a pendulum swinging back and forth, oscillating around a midpoint – the point of equilibrium where it's in absolute balance. From an economic standpoint, this would be characterised by trend growth, low & stable unemployment, moderate inflation and interest rates. Covid saw the pendulum swing sharply to one side, pushing it to an extreme, economies contracted, and share markets fell sharply before huge levels of government and central bank intervention stabilised its movement.

As the recovery took hold, economies reopened, growth surged and so too did inflation and the pendulum swung the other way – again to an extreme – prompting the aggressive removal of intervention. The desire of central banks and governments around the world is to ease the pendulum back to its midpoint, the risk being that when economies are at extremes, when they have been out of balance for a period of time, it is a much harder task to land the pendulum back at its point of natural rest without overshooting on either side – we're simply dealing with greater levels of momentum.

This is the challenge that now faces those managing economies globally as we move into the new financial year and beyond.

Inflation: The dominant economic driver in FY22 with domestic inflation at 5.1% while in the US prices increased by more than 8% leading central banks globally to embark on aggressive tightening of monetary policy. This included rate hikes and a sharp reduction in bond holdings, known as quantitative tightening (QT) – both measures reduced liquidity in financial markets.

Liquidity is important and has a major impact on asset prices, and just as quantitative easing (QE) had a huge bearing on valuations coming out of the GFC and more recently, COVID, so too has QT as the cost and availability of capital has turned from a clear tailwind to a headwind.

Interest Rates: Have moved significantly higher, the global benchmark rate being the US 10 Year Treasury has moved from ~0.50% to a peak in June of 3.47%. In Australia, 3-year government bonds were trading ~0.30% 12 months ago, hitting a June high of 3.7%. The official cash rate in Australia bottomed at 0.10% and remained at that record low level for more than 2 years before a flurry of recent hikes now has the cash rate at 1.35%. The forward-looking futures market expects cash rates to be 3.2% by December 2022.

Economic Growth: Has been strong and unemployment is at very low levels, however, the war in Ukraine has not only triggered a costly humanitarian crisis, but it has also created economic damage, contributing to a slowdown in global growth in 2022 while adding significantly to inflation. Global growth is now projected to slow from above 6% in 2021 to 3.6% in 2022 and 2023, with the backdrop for inflation prompting more aggressive interest rate hikes than central bankers would normally target.

Corporate Earnings: Overtime, share prices follow earnings and for now, at least, earnings have remained robust, particularly in some areas such as energy, resources, many industrials and some technology providers. Further insight into how sustainable current earnings are will be garnered during full-year results next month. If earnings prove resilient, the market will be confirmed as too cheap and a strong rebound will ensue. We will await this important period before making any large changes to portfolio dynamics.

PORTFOLIO POSITIONING

The portfolio holds a collection of strong or strengthening ASX listed companies, many are well-known brands, priced reasonably that we believe will help the portfolio achieve its specific objectives.

Top contributing stocks over the year came primarily from the resource sector, with the portfolio holding meaningful positions in Whitehaven Coal (WHC), Fortescue Metals (FMG) and Oz Minerals (OZL. On the flip side, the biggest detracting securities came from the technology sector headlined by Xero (XRO), which took ~2% away from overall returns.

We enter FY23 maintaining our technology exposures (although we are looking to lighten into strength), a below-average allocation to banks, an inclination to rebuild our weighting towards resources and an open mind towards pockets of the market that may get oversold as the pendulum swings, retail & property are two such areas that we believe may offer opportunity in the year ahead.

PORTFOLIO STOCKS	
NO. OF HOLDINGS	18
ESTIMATED YIELD (%)	3.96
TOP 5 POSITIONS (% OF AUM)	35.66
TOP 10 POSITIONS (% OF AUM)	64

STOCK	CONTRIBUTION (%)
WOODSIDE ENERGY (WDS)	0.32
RESMED (RMD)	0.27
TPG TELECOM (TPG)	0.22
ARISTOCRAT LEISURE (ALL)	0.07
WOOLWORTHS (WOW)	0.14

STOCK	DETRACTION (%)
QANTAS (QAN)	-1.37
XERO (XRO)	-0.91
NEWCREST (NCM)	-0.84
MACQUARIE GROUP (MQG)	-0.82
IGO LIMITED (IGO)	-0.76

%	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	YTD
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													**23.49**

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