MARKET MATTERS
INVEST

MONTHLY REPORT | MAY 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	5.47%

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 -4.69% in May, underperforming the S&P/ASX 200 Accumulation Index by 2.09%. The portfolio has returned 3.30% for the rolling 12-months, 15.44% per annum over 2 years & 5.47% per annum over 3 years.

PERIOD	MAY	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	3 YEAR PA
PORTFOLIO %	-4.69	-1.75	-1.12	3.30	15.44	5.47
BENCHMARK %	-2.60	3.21	1.44	4.84	15.97	7.85
RELATIVE %	-2.09	-4.96	-2.56	-1.54	-0.53	-2.38

In recent months, it has become clear that the Australian economy has started to experience a slowdown at a time when the Reserve Bank has commenced a tightening cycle to combat uncomfortably high inflation. This is generally a poor combination for equity prices and May was another weak month for the market.

The outlook from here now depends on the severity of the slow down and the trajectory of inflation and thus interest rates. If the slowdown builds momentum as confidence deteriorates, and inflation remains persistently high, the shorter-term outlook for the market could be very challenging.

If on the other hand, inflation starts to taper off as pressure on supply chains ease, leaving the RBA with a less onerous job, then confidence will improve, and equities would recover strongly.

In the shorter term, this uncertainty will keep volatility high, although when we stand back and consider the local index, we remain within a ~10% trading range that has held for almost a year: ~7600 on the upside & ~6900 on the downside.

This has us neutral on the broader market, for now, however, we are leaning towards the probability of a tougher period ahead given the backdrop of cost inflation which is likely to impact many industrial businesses.

PORTFOLIO STOCKS

The portfolio holds concentrated positions in 19 securities from within the ASX 200 and applies specific stock & sector tilts with a focus on risk-adjusted returns over the medium term.

It was a disappointing month from a return perspective with the portfolio down -4.69% - the biggest drag coming from our technology and real-estate holdings which were impacted most by rising interest rates and general risk-off sentiment. We have held the view that interest rate expectations had firmed too much with bond markets pricing in a cash rate near 3% by year-end. That view did not play out during the month which weighed on our positioning. Our short term tactical underweight in resources also hurt, with the materials sector finishing up on the period.

We made a number of changes to the portfolio during the month, cutting both A2 Milk (A2M) and Virgin Money (VUK) at a loss, preferring to allocate funds into Treasury Wines (TWE) which had also been sold down due to Chinese exposure while we transitioned funds from Virgin into an existing position held in Macquarie (MQG). We used excess cash to initiate a position in Nickel & Lithium company IGO Limited (IGO).

Treasury Wines (TWE): It depends on who you ask whether Wine is a 'staple' however history tells us that demand goes up when economic conditions tighten. TWE has had a difficult few years, much of the pain coming from their exposure to China, however, a repositioning of the business and a focus on higher-margin markets has Treasury well-positioned for what comes next. We like this $8bn global wine business and while it doesn't 'scream value' on an Est P/E of 24x, earnings have been depressed and year on year growth from this new base of 20% is very achievable.

PORTFOLIO STOCKS	
NO. OF HOLDINGS	19
ESTIMATED YIELD (%)	2.74
TOP 5 POSITIONS (% OF AUM)	33.92
TOP 10 POSITIONS (% OF AUM)	61

STOCK	CONTRIBUTION (%)
BHP GROUP (BHP)	0.51
IGO LIMITED (IGO)	0.38
TREASURY WINE (TWE)	0.18
ARISTOCRAT LEASURE (ALL)	0.07
COMMONWEALTH BANK (CBA)	0.02

STOCK	DETRACTION (%)
VIRGIN MONEY (VUK)	-1.10
GOODMAN GROUP (GMG)	-0.85
CSR LIMITED (CSR)	-0.81
ALTIUM (ALU)	-0.74
WOOLWORTHS (WOW)	-0.51

%	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		**1.12**
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													**38.18**

IGO Limited (IGO): Lithium ties into the electrification thematic that is taking over the globe. The reason for the hype is lithium has unique characteristics that are difficult to replicate. It is a light metal but can store large amounts of energy and is an excellent conductor of electricity. Furthermore, whilst other minerals used in batteries are subject to uncertainty around different chemistry choices, lithium demand is relatively immune to these risks. Demand for lithium has grown at ~20% compound annual growth rates through 2017-22 and we think that will continue, while Lithium deposits that are technically and economically viable to exploit are rare. This all paints a positive backdrop for the sector, and particularly the higher quality hard rock producers in Australia.

During the month we bought IGO which also has a very solid Nickel business that has been expanded through the sensible purchase of Western Areas (WSA).

Woolworths (WOW): The defensive supermarkets are also having a tough period not helped by poor reports from some US retailers hurt largely by wage pressures and supply chain issues impacting margins/profitability. However, we think it's important to understand the difference between discretionary retailing and non-discretionary retailing, especially in an environment of rising rates – people do have to eat and therefore they have a greater ability to pass on price increases if inflation persists. For some context on Woolworths, during the GFC between 2007 & 2009 WOW fell by 35%, if we see this mirrored through 2022/23 a test of the $30 area would be the result.