MARKET MATTERS
INVEST

MONTHLY REPORT | FEBRUARY 2023 | ACTIVE INCOME

PORTFOLIO DETAILS

Portfolio Name	Active Income
Structure	Separately Managed Account
Benchmark	RBA Cash +4%
Management Fee	0.85% incl GST
Platform	Open Wealth | Praemium
Included Assets	Equities, Hybrids, Trusts, ETFs
Portfolio Manager	James Gerrish
Annual Performance	9.13%*

**Inception Date 05.07.2017*

OBJECTIVE

The objective of the Market Matters Active Income Portfolio is to provide a high level of regular tax-effective income with lower volatility than the underlying share market. This is achieved by actively managing a portfolio of high-yielding equities combined with ASX listed income securities that offer diversification benefits to both Australian equities and cash or term deposits.

MARKETS & PERFORMANCE

The Market Matters Active Income Portfolio declined by -1.61% in February, underperforming its absolute return benchmark of 0.55%. The portfolio has returned 7.87% for the rolling 12 months & 12.15% per annum over 3 years.

PERIOD	1 MONTH	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	3 YEAR PA
PORTFOLIO %	-1.61	3.42	7.94	7.87	11.94	12.15
BENCHMARK %	0.55	1.74	3.37	5.78	4.91	4.26
RELATIVE %	-2.16	1.68	4.57	2.09	7.03	7.89

Benchmark: RBA Cash Rate +4%

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 21 positions at the end of February with a forecast yield of 6.4% plus franking. 56% of the portfolio was invested in Equities, 36% in Fixed Income (incl floating rate Hybrids) while our cash position was elevated at the end of the month, sitting at ~8%.

We made two changes during the month, selling **Stockland (SGP)** ahead of their results and buying back into **AGL Energy (AGL)** after they reported.

Stockland (SGP) had been an underwhelming position since it was acquired in April last year, and while it has enjoyed a strong recovery in the past six months, hindsight tells us our entry-level was too high. SGP generates their earnings from property, broadly split evenly between commercial and what they term communities, which include their residential developments & retirement living business.

We think 2023 will be another tough year for property and while Stockland seems inexpensive trading on an Est PE of 12.25x while yielding 6.5% (unfranked), they are unlikely to grow their earnings this year. With no earnings growth and a multiple slightly expensive relative to their own history, we think the dividend, which is sustainable, would have been the extent of returns for the next 12 months. An expected yield of (6.5%) versus the cash at 3.60% equates to a 290bps margin, simply not enough in our view for the underlying risks.

There is a very real chance that **AGL Energy (AGL)** will double earnings in FY24 and grow them by another 20% in FY25, all while paying 75% of profits out as dividends, which based on the currently depressed share price under $7, will equate to a yield of ~8% and ~10% respectively.

During the month, they reported earnings that were ~30% below consensus expectations and while that's not great, a lot of this was around timing. They also outlined their ambitious targets for decarbonization, and these targets drove a big statutory loss of over ~$1bn, an eye-watering number however it was a non-cash write-down of their coal-fired assets given they will now close earlier than previously planned.

If we think about the 'new AGL' which starts to sell the vision of renewables and makes very tangible steps towards making that a reality, while growing earnings strongly, and perhaps leveraging their ~4.5m strong customer base into other areas, the narrative could change very quickly.

BHP Group (BHP) was the largest negative influence on the portfolio in February after falling short of expectations in its recent 1H23 results. While a very slight miss, the stock had been strong, so it provided a reason to rake some 'off the table'. More importantly for income investors, it seems to us the company is pivoting more towards growth, both organic (higher capex) plus M&A (OZ Minerals) which will lead to lower dividends and buybacks. While we believe the direction makes 100% sense, we have lowered our expectations around future income.

Core portfolio holding, **Telstra (TLS)** delivered a solid 1H23 earnings result while the dividend was in-line with expectations at 8.5c fully franked. The company largely reiterated guidance and at this stage, we believe they are making good progress on their T25 strategy. We are expecting a 9cps 2H dividend putting it on a yield of 4.25% plus franking (~6% inclusive). We aren't expecting fireworks from TLS but a test of $4.50 feels likely.

PORTFOLIO STOCKS	
NO. OF HOLDINGS	21
ESTIMATED YIELD (%)	6.50
TOP 5 POSITIONS (% OF AUM)	28.35
TOP 10 POSITIONS (% OF AUM)	51.81

STOCK	CONTRIBUTION (%)
TELSTRA (TLS)	0.15
DEXUS (DXS)	0.10
TRANSURBAN (TCL)	0.09
STOCKLAND (SGP)	0.08
METRICS CREDIT (MXT)	0.06

STOCK	DETRACTION (%)
BHP GROUP (BHP)	-0.56
COMMONWEALTH BANK (CBA)	-0.37
CENTURIA CAPITAL (CNI)	-0.29
NATIONAL BANK (NAB)	-0.24
NEW HOPE COAL (NHC)	-0.24

%	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	YTD
FY23	4.22	0.30	-3.64	3.31	4.82	-0.07	3.49	-1.61					**10.82**
FY22	0.10	3.04	0.58	-1.58	-1.31	3.01	-2.45	4.05	4.25	-0.09	-1.80	-6.54	**1.26**
FY21	1.16	2.22	-1.21	-0.17	9.29	1.46	0.47	0.96	2.73	2.79	1.91	2.39	**24.00**
FY20	1.54	-0.57	2.90	-4.54	1.16	-0.51	1.78	-3.97	-15.53	7.33	6.24	1.94	**-2.23**
FY19	1.35	0.76	-0.62	-3.09	-0.61	-0.40	2.42	3.92	-0.21	1.17	3.13	1.37	**9.19**
CUMULATIVE													**43.04**

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.