MARKET MATTERS

INVEST

MONTHLY REPORT | FEBRUARY 2024 | 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	8.95%*

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.

**Inception Date 05.07.2017*

MARKETS & PERFORMANCE

The Market Matters Active Income Portfolio declined by 1.45% in February, underperforming its RBA Cash +4% benchmark which increased 0.65%. The portfolio has returned 8.12% for the rolling 12 months, against the benchmark return of 8.08% and 10.64% per annum for 3 years, 4.81% per annum above its benchmark.

PERIOD	1 MONTH	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	3 YEAR PA	5 YEAR PA
PORTFOLIO %	-1.45	3.94	3.30	8.12	8.00	10.64	9.43
BENCHMARK %	0.65	2.05	4.07	8.08	6.81	5.83	5.23
RELATIVE %	-2.10	1.89	-0.77	0.04	1.19	4.81	4.20

Benchmark: RBA Cash Rate +4%

More broadly, the MSCI Developed Markets Index rose (+4.6%), while the S&P 500 also strengthened (+5.3%) in local currency terms highlighting the underperformance of Australian stocks.

Commodity prices were mixed in February. Brent Oil rose by US$1.97 to US$83.68/bbl, whilst Iron Ore prices fell by US$15.50 to US$117.50/Mt. Over the month, Gold fell by US$20.80 to US$2,032 as bullion markets recalibrated Fed expectations.

On a sector basis in Australia, IT (+19.5%) was a standout driven primarily by corporate activity, Consumer Discretionary (+9.1%), Real-Estate (+5.1%), Financials (+3.5%) and Industrials (+2.7%) all outperformed, more than offsetting the weakness seen in Energy (-5.9%), Materials (-5.0%) and Healthcare (-0.27%).

REPORTING- WHAT WE LEARNT

February results saw almost twice as many earnings beats versus misses, but this is somewhat misleading given analysts entered the period with unusually low profit expectations.

ASX200 FY24 earnings growth slipped by 0.6% overall and now sits at -5.5% year on year, although this is driven primarily by weakness in the energy sector. Cost-cutting was a dominant theme and the primary talking point, though most companies still highlighted sticky input prices. That said, the peak rate of upward momentum in cost growth looks to be over, with roughly 30% of reporting companies saying cost pressures have now passed peak intensity.

Profit margin improvements were the key to results, and the ability to pass costs onto the consumer remained robust. This is underpinned by a fully employed economy combined with significant investment from governments, meaning that for most companies, end demand remains solid. Combined with a focus on companies managing internal costs, this meant that around 75% of the companies that reported were able to expand or maintain profit margins, which is the main takeaway in our view.

Top-line growth does appear to be slowing though, with evidence of a decelerating sales trajectory coming through in forward guidance, with cost-of-living pressure and higher rates still to blame.

All in all, a solid results period, and when combined with easing pressure from a macro perspective, we came out the other side feeling more confident about the outlook from here.

PORTFOLIO POSITIONING

The portfolio held 18 positions at the end of February with a forecast yield of 5.38% plus franking. The portfolio is weighted 47% in Equities, 38% in Hybrids/Fixed Income, 7% in property & 8% in cash.

We made no changes to the portfolio during the month, which proved a tough one from a performance perspective.

Centuria Capital (CNI) detracted from returns despite results that were 'as expected' in terms of financial metrics. Like all positions, we continue to question our thesis, more so when we can't pinpoint the reason for a particular share price reaction. On a PE of 12.4x for FY24 and a yield of 7% (part franked), it remains appealing on face value. As we've written recently, the movement lower in bond yields in aggregate over the last 6 months has been a big beneficiary to the high operating leverage fund manager REITs, including CNI, so they enjoyed a run-up into their results, and while they were in line, the underlying trends still show some challenges. Raising new money is tough, capital inflows into their unlisted platform remained subdued at $300m for the half, which shows no real improvement on the run rates of FY23. Transaction volumes are subdued, and they still have a decent exposure towards office, which remains on the nose.

Agriculture is a growth area for them, and they have a focus on owning high-quality agricultural real estate with solid tenants, an example being the 20-hectare glasshouse they own in Guyra NSW leased to Tomato Exchange, a subsidiary of ASX-listed Costa Group (CGC). Centuria is actually now the largest owner of glass houses in Australia, along with other protected cropping assets. One positive they did stress when we met them post results, was investor interest in agriculture remains strong, and we think they'll continue to grow this area as a proportion of their business.

Ultimately, nothing has materially changed around our thinking on CNI, and we continue to believe that patience will, in time, be rewarded, and we're happy to pick up a solid ~7% yield while we wait.

PORTFOLIO POSITIONING CONTINUED

Metcash (MTS) announced the acquisition of three additional businesses for ~$578m that we think complement their existing operations and are consistent with their strategy in food and hardware. The purchases are being funded by a combination of debt ($278m) & equity ($300m) issued at an 8% discount to the pre-deal market price ($3.35).

The biggest is Super Food Service, where Metcash paid $390m upfront + some earnouts for a well-established, incredibly well-run food wholesaler that sells into restaurants, cafes, canteens, caterers, schools and universities, healthcare and aged care facilities and a variety of other food service operations. While they have paid a full price (9x EV/EBITDA), this is a faster-growing business than their existing food operations, where they supply the likes of IGA and Foodland.

In hardware, they've bought construction and industrial supply business Bianco for $82m and Alpine Truss for $64.0m, which manufactures and supplies roof trusses, wall frames and flooring systems to builders. The three deals are aligned with their strategy of powering independents under strong brands, and importantly, they fill geographic and product gaps in their current operations.

Synergies is a buzzword used in acquisitions, and these come on two sides. Cost synergies, which means the businesses bought can be run more efficiently within the MTS structure, and revenue synergies, which means the company can benefit from more sales given a wider group and more cross-sell opportunities.

MTS think they'll get $19m in synergies leading to mid-single digit earnings accretion – in other words, the acquisitions will be a positive on their earnings growth from the get-go. We remain holders of MTS in the Income Portfolio.

PORTFOLIO STOCKS	
NO. OF HOLDINGS	18
ESTIMATED YIELD (%)	5.38
TOP 5 POSITIONS (% OF AUM)	33.42
TOP 10 POSITIONS (% OF AUM)	60.73

STOCK	CONTRIBUTION (%)
NATIONAL AUSTRALIA BANK (NAB)	0.32
COMMONWEALTH BANK (CBA)	0.13
METCASH (MTS)	0.10
NEW HOPE CORP (NHC)	0.23
METCASH (MTS)	0.21

STOCK	DETRACTION (%)
BHP GROUP (BHP)	-0.50
AGL ENERGY (AGL)	-0.37
MAGELLAN FINANCIAL GROUP (MFG)	-0.12
CENTURIA CAPITAL (CNI)	-0.04
APA GROUP (APA)	-0.03

%	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	YTD
FY24	2.79	-0.44	0.09	-3.32	2.67	4.63	0.8	-1.45					**5.77**
FY23	4.22	0.30	-3.64	3.31	4.82	-0.07	3.49	-1.61	0.06	2.16	-2.01	2.07	**13.10**
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													**51.09**

PORTFOLIO POSITIONING CONTINUED

APA Group (APA) has also been under some pressure after reporting a 1H24 result that was in line with expectations while they maintained guidance. 1H24 earnings (EBITDA) of $840m was solid as was the 26.5cps dividend. The regulated utility said they were on track to deliver full-year underlying EBITDA of $1.87-1.91bn versus the current consensus of $1.876bn, along with a FY24 dividend of 56cps, putting it on a 7% yield. Now trading at a 3% premium to 10-year bond yields, we think APA remains a compelling income investment.

There was a very mixed reaction to **Orora's (ORA)** 1H24 results in the month, the stock initially rallied then fell away. The decline in share price mirrored the miss of revenue (around 7% below consensus), however, earnings were resilient/solid, particularly in the newly purchased Saverglass business which had a month of contribution and beat expectations, while the Australian operation was in line, the US was a tad light on. All in all, earnings (EBIT) was in line with consensus and given the miss on the revenue line, that implies margins were stronger. They said volumes still struggling amid high inventory at customers persist, however, they maintained FY24 guidance.

We're surprised about the share price performance from ORA during the month, the market treated them very harshly on what we thought was a solid result (meet) and guidance (maintained).