MARKET MATTERS
INVEST

MONTHLY REPORT | JANUARY 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	9.34%*

**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 advanced 3.49% in January, outperforming its absolute return benchmark of 0.59%. The portfolio has returned 12.53% for the rolling 12 months, 12.62% per annum over 2 years, 10.63% per annum over 3 years & 9.34% per annum since inception.

PERIOD	1 MONTH	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	3 YEAR PA
PORTFOLIO %	3.49	8.68	8.54	12.53	12.62	10.63
BENCHMARK %	0.59	1.74	3.31	5.53	4.79	4.59
RELATIVE %	2.90	6.94	5.23	7.00	7.83	6.04

Benchmark: RBA Cash Rate +4%

A bullish start to the new year with global equity markets enjoying some clear air, at least for now, with stabilising recessionary expectations and easing rate hike fears permeating from softer-than-expected US growth data.

For January, the MSCI Developed Markets Index rose +6.5%, the S&P 500 gained +5.3% in local currency terms, while local stocks did better, the ASX 200 inclusive of dividends up by +6.2%.

Moves such as these highlight the importance of investor positioning in performance outcomes, with bearish rhetoric and defensive asset allocation very evident at the back end of 2022. Simply put, if the majority are underweight equities and overweight cash, positioned for looming economic pain, it leaves a void of natural sellers.

When 'less bad' news emerges then buying becomes amplified, January was certainly a case in point and a lesson to remain open-minded for the year ahead.

The more tepid growth outlook was reflected in bond markets, as the Australian 10-year yield fell by 50bps to 3.55% while US 10-year yield also moved down by 35bps from 3.88% to 3.53%.

Amongst commodities, Brent Oil prices fell US$1.01 to US$84.90/bbl, Iron Ore prices increased US$11.5 to US$129/Mt on optimism around Chinese re-opening, however, it was the gold price that benefitted most from a fall in the USD, adding US$110.35 to US$1,924.

There are growing signs that inflation has now peaked, and the lion's share of interest rate hikes are now in the rearview mirror. This impacts sectors & stocks to varying degrees which sets up more opportunities for actively managed portfolios – we are excited for the year ahead and happy with how portfolios are positioned.

Locally, the consumer discretionary sector was the top performer up (+9.9%) for the month, while Materials (+8.9%) & Property (+8.1%), also outperformed.

Utilities (-3.0%) was the only sector that fell while energy (+1.3%) and Healthcare (+3.9%) underperformed.

PORTFOLIO STOCKS

The portfolio held 20 positions at the end of January with a forecast yield of 6.50% plus franking. 53% of the portfolio was invested in Equities, 35% in Fixed Income (incl floating rate Hybrids) while our cash position was elevated at the end of a positive month, sitting at ~12%.

The portfolio had a position in fund manager **Pendal (PDL)** which was subject to a successful takeover by rival **Perpetual (PPT)** during the month, with the deal structured as part cash, part Perpetual shares. As a result, we now own the larger combined group which has $200 billion in assets alongside an attractive and stable Trust business.

While Perpetual announced further outflows from their funds over the December quarter, the bulk of the redemptions came from one investor and net flows were the lowest in more than a year giving evidence their sales strategy is working. We like the merged entity far more than our standalone position in **Pendal (PDL)**, with this potential outcome forming a large part of our original thesis for buying into PDL. There is clearly some complexity and risk around integration, but if they can successfully achieve the ~$60m p.a. in cost savings as flagged in the deal, the combined entity should trade significantly higher, in our opinion.

Centuria Capital (CNI) is a stock we discussed in a recent Portfolio Positioning webinar, [Watch Here] and a stock we hold in both the Income & Emerging Companies Portfolios. This is at the smaller end of the property spectrum, and they are more leveraged to interest rates given their decision not to 'pay up' to hedge their interest rate risk like many other property companies have done, however, we are backing them to take advantage of this current downturn in the sector. Whilst the position advanced ~10% in January, we remain bullish on CNI for both income & capital growth below $2, initially targeting ~$2.50.

Childcare has proven to be a tough business in recent years and **G8 Education (GEM)** has certainly suffered as a result, however, there are signs emerging that conditions are improving translating into a ~14% increase in the share price through January. In a recent trading update, they showed improving occupancy and enquiry levels, while FY22 earnings (Dec year-end) will at least meet consensus expectations when they report on February 21.

While challenges such as labour shortages remain, GEM has rising occupancy levels, debt levels that remain flat for the year and not onerous, a relatively supportive Govt backdrop that is making it easier / cheaper for consumers to access childcare, a cost-out program on track, a relatively low P/E while paying a dividend yield of ~5% fully franked, plus they also have another $8m of stock to buy-back. We remain optimistic holders of GEM.

One of our concerns leading into 2023 is for retail stocks that have run higher on recently good sales numbers – or at least numbers better than expected – however, interest rates will bite in 2023 and household savings levels will decline. Clearly, there will be some belt-tightening by those rolling off low fixed-rate mortgages into much higher variable rates and this should impact consumption.

PORTFOLIO STOCKS	
NO. OF HOLDINGS	20
ESTIMATED YIELD (%)	6.50
TOP 5 POSITIONS (% OF AUM)	29.35
TOP 10 POSITIONS (% OF AUM)	52.61

STOCK	CONTRIBUTION (%)
PERPETUAL (PPT)	0.68
BHP GROUP (BHP)	0.53
WESFARMERS (WES)	0.51
COMMONWEALTH BANK (CBA)	0.45
STOCKLAND (SGP)	0.38

STOCK	DETRACTION (%)
PENDAL (PDL)	-0.43
NEW HOPE COAL (NHC)	-0.30
NABPF	-0.03
AN3PI	-0.02
CBAPG -0.0086%	-0.01

%	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						**12.43**
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													**44.65**

While this is not a new theme, many retail stocks have bounced strongly in the 2H as results have generally surprised on the upside, however, markets are about looking forward and 2023 could be a different story. **Wesfarmers (WES)** owns Bunnings, Kmart, Catch and Officeworks, with their retail divisions making up around 82% of their earnings before tax in FY22. Clearly, this is a significant component of their business and with the stock trading on an Est PE of 21x next year's earnings versus many retailers trading on ~10x-12x, WES clearly need to grow – a tougher ask in this environment. While their other divisions provide somewhat of a stabilizer, and their Lithium business is tipped to grow (worth around $6.00 per WES share on some estimates), we are becoming more concerned about WES, and this is a position we are likely to exit.

Elsewhere, **BHP Group (BHP)** reported a strong 2Q production update sending the shares up towards ~$50 for the 4th time post-Covid, a level where we 'trimmed' our position. This is undoubtedly a great company but if commodity prices struggle under the weight of a global recession this stock is likely to follow in the downdraft.

We believe in active management for income and will continue to operate a high-conviction portfolio comprised of high-yield equities, fixed-income securities, and a variable cash position, taking opportunities as they arise.

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