MARKET MATTERS
INVEST

# MONTHLY REPORT | JANUARY 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 | 9.36%* |

## 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 advanced by 0.80% in January, outperforming its RBA Cash +4% benchmark which increased 0.70%. The portfolio has returned 7.95% for the rolling 12 months, against the benchmark return of 7.98% and 11.55% per annum for 3 years, 5.82% per annum above its benchmark.

| PERIOD | 1 MONTH | 3 MONTH | 6 MONTH | 1 YEAR | 2 YEAR PA | 3 YEAR PA | 5 YEAR PA |
|---|---|---|---|---|---|---|---|
| PORTFOLIO % | 0.80 | 8.31 | 4.36 | 7.95 | 10.99 | 11.55 | 10.60 |
| BENCHMARK % | 0.70 | 2.07 | 4.10 | 7.98 | 6.65 | 5.73 | 5.19 |
| RELATIVE % | 0.10 | 6.24 | 0.26 | -0.03 | 4.34 | 5.82 | 5.41 |

*Benchmark: RBA Cash Rate +4%*

More broadly, the MSCI Developed Markets Index rose (+1.8%) over January, while the S&P 500 also rose (+1.7%) in local currency terms in a strong month for equities.

Commodity prices were mixed, Brent Oil rose by US$4.67 to US$81.71/bbl, while Iron Ore prices fell by US$9.50 to US$133.00/Mt. Gold also slipped over the month, falling by US$25.15 to US$2,053.

On a sector basis in Australia, Energy (+5.2%), Financials (+5.0%), and Health Care (+4.3%) all outperformed, more than offsetting the weakness seen in Utilities (-1.5%), and Materials (-4.8%), the only two sectors to lose ground.

## PORTFOLIO POSITIONING

The portfolio held 18 positions at the end of January with a forecast yield of 5.38% plus franking. The portfolio is weighted 48% in Equities, 38% in Hybrids/Fixed Income, 7% in property & 7% in cash.

We made only one change to the portfolio in the month, taking profit on **Magellan Financial Group (MFG)** as we moved towards a more defensive stance into prevailing strength, with cash increasing to ~7%.

While we are positive on the embedded value in the Magellan franchise when we aggregate the sum of the parts (SOTP), the share price was starting to factor this in, and the risk / reward became unappealing, particularly as we gravitated to a more defensive stance following a strong rally in the market.

An area we like currently for defensive income is infrastructure and the Income Portfolio has exposure in this space. There are a few key reasons why we currently like infrastructure:

- They generally have stable customer demand often as a provider of essential services.
- High barriers to entry, usually because of a high amount of capital required for physical assets and the long-term contracts or regulations involved.
- Economic hedging, which is essentially how the pricing of a service works; for example, prices are often linked to CPI, or earnings are often countercyclical, i.e. they do well when the economy struggles.

The upside here is that stocks generally have a lower-than-average beta (i.e. less volatile), but, the cost of capital is influential because they generally borrow a lot to own assets, and their earnings are longer-term in nature. Higher interest rates are, therefore, a headwind.

| PORTFOLIO STOCKS | |
|---|---|
| NO. OF HOLDINGS | 18 |
| ESTIMATED YIELD (%) | 5.38 |
| TOP 5 POSITIONS (% OF AUM) | 33.12 |
| TOP 10 POSITIONS (% OF AUM) | 59.87 |

| STOCK | CONTRIBUTION (%) |
|---|---|
| NATIONAL BANK (NAB) | 0.49 |
| COMMONWEALTH BANK (CBA) | 0.36 |
| ORORA (ORA) | 0.34 |
| 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 | | | | | | **7.22** |
| **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** | | | | | | | | | | | | | **52.54** |

## PORTFOLIO POSITIONING CONTINUED

When we think about infrastructure, we break it into two key areas. Pure play infrastructure stocks where most of their earnings come from the infrastructure assets, examples include **Transurban (TCL)** and **APA Group (APA)**, and Infrastructure Industrials which own some infrastructure but also have meaningful exposure to operating businesses, examples here include **Telstra (TLS)** and **AGL Energy (AGL)**.

Interest rates/bond yields materially increased during 2023 and that provided a clear headwind for the bulk of these stocks. However, since the 30th October 23, bond yields have pulled back, particularly at the long end of the curve (US 10-year yields peaked at 5%, they are trading at 4.10%, having been as low as 3.8% at the end of December) – this macro trend is incredibly important for this sector.

If we are correct and yields track lower in 2024, the headwind that played out last year will become a tailwind this year.  At the same time, inflation looks set to remain somewhat sticky, which is important when thinking about pricing mechanisms that are linked to CPI, in other words, they have a clear advantage in maintaining pricing power. There is also the prospect of more deal flow if funding pressures ease.

We like a combination of pure infrastructure and infrastructure industrials into 2024, particularly for income-focused / defensive portfolios.

Focusing on Telstra as an example of an Infrastructure Industrial, if the collective of analysts (consensus) proves correct, Telstra is set to grow its profits by 8-9% pa for the next 3 years, leading to higher dividends and likely a higher share price.

Several factors will drive the growth, but primarily, it's mobile business, which is tracking at high single-digit growth with looming price rises (inflation-linked), set to benefit the Telco during 2H24.

We were disappointed that TLS shelved plans to hive off infrastructure, as it took away the chance for a short-term re-rate of the stock, however, we can see their rationale for sitting pat, and they still have this optionality in the future. Their enterprise business does need to improve, which is the area that provides business customers with technology solutions, while the headwinds facing fixed broadband seem to be easing.

We like the combination of Telstra's divisions, which underpins a defensive earnings stream.

While Telstra is not 'cheap', it's trading on its average multiple over the past 5 years (EV/EBITDA) of 7.5x; however, we argue that the outlook over the next couple of years is better than the recent past, implying that earnings growth could be accompanied by a slightly higher multiple, which would drive a higher return, north of 10% pa.

We expect to have a high allocation to infrastructure as/when interest rates decline.

## DISCLOSURE

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