MARKET MATTERS
INVEST

MONTHLY REPORT | MARCH 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	8.98%*

**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 by 0.06% in March, underperforming its absolute return benchmark of 0.63%. The portfolio has returned 3.54% for the rolling 12 months and 18.68% per annum over 3 years.

PERIOD	1 MONTH	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	3 YEAR PA
PORTFOLIO %	0.06	3.29	12.05	3.54	10.47	18.68
BENCHMARK %	0.63	1.78	3.49	6.07	5.04	4.73
RELATIVE %	-0.57	1.51	8.56	-2.53	5.43	13.95

Benchmark: RBA Cash Rate +4%

Aussie equities tracked sideways in March as moderating inflation strengthened the case for a pause in rate hikes. The S&P/ASX 200 was down (-0.16%), underperforming most other developed markets as the RBA pushed through another 25bps rate hike to 3.60%. Australian 10-year bond yields moved in reaction to slowing inflation, down 56bps to 3.30%. US yields also fell 42bps to 3.49%, amid concern around the stability of US regional banks following multiple failures.

Elsewhere, the MSCI Developed Markets Index advanced (+2.6%), and the S&P 500 increased by (+3.7%) in local currency terms.

Commodity prices saw mixed results. Brent Oil fell by US$4.12 to US$79.77/bbl, on global growth concerns, although it did rally towards the end of the month. Iron Ore prices were unchanged at US$126/Mt while Gold was the big mover, up by US$155.10 to US$1,980, banking volatility and hopes for easing Fed policy pushed the $US lower.

Locally, the Materials sector was the top performer up (+5.9%), while Communication Services (+3.4%), Consumer Discretionary (+1.7%), Utilities (+1.5%), Consumer Staples (+0.5%), Industrials (+0.3%) and Healthcare (+0.10%) all made gains.

The Real-Estate sector was the hardest hit during March ending down (-6.8%) while Financials (-4.9%), Energy (-1.5%) and IT (-0.30%) also fell.

Clearly some significant variance across sectors which lends itself to active portfolio management.

END OF QUARTER

A busy and volatile quarter for markets which included interim reporting for ASX-listed companies, quarterly earnings for US stocks, bank failures, continued cooling of inflationary pressures, lower bond yields and the strong likelihood of a looming pivot by Central Banks on interest rates.

Markets started 2023 with strong gains in January (+6.20%), which were primarily driven by a continued decline in widely followed inflation indicators. February was softer (-2.4%) as growing optimism for an economic soft landing was delivered a setback as economic data implied a still very tight labour market. Additionally, interim results for the 1st half of FY23, which were reported in February, were reasonable, and perhaps "better than feared". The resilient nature of earnings, both in Australia and the US during their quarterly updates stoked optimism that both an economic and earnings recession could be avoided.

March began with investors still focused on inflation and potential interest rate hikes, but the sudden failure of Silicon Valley Bank, at the time the 16th largest bank in the United States, shifted investor focus to the potential for a severe banking crisis. Signature Bank of New York failed just days later, Credit Suisse was forced into a deal with UBS, and concerns about a banking crisis surged.

In response, the Federal Reserve and the Treasury Department acted to prevent a run on the banks by creating new lending programs but concerns about the health of the financial system persisted and those fears weighed on markets through the middle of March. However, while the Federal Reserve hiked interest rates again at the March meeting, US policymakers signalled that they are very close to ending the current rate hike campaign. That admission, combined with no additional large bank failures, eased concerns about a growing banking crisis, and markets recovered to close essentially unchanged for the month, having been down more than 4% at their low point.

In summary, markets were impressively resilient in the first quarter as a looming end to rate hikes, further declines in inflation and quick and effective actions by government officials in response to regional bank failures helped shore up confidence in the banking system. Stocks logged modest gains in Q1, despite the threat of a regional banking crisis in the US and still-elevated market volatility.

PORTFOLIO STOCKS

The portfolio held 21 positions at the end of March 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 remained at ~8%.

We made no changes during the month, a rare period of complete inactivity for our actively managed approach to income.

Telstra (TLS) is the largest position in the Market Matters Active Income Portfolio with a ~7% weighting, and it is trading at new 52-week highs, up over 6% year to date, about twice the market's gain. This has been a longer-standing position in the portfolio, having bought it at ~$3.25 back in mid-2021 while we've collected some strong income along the way, driving a 30% return in less than 2 years. This is an example of the sort of returns that can be achieved from large-cap (safe) stocks with a focus on timing – no need to venture into the risker end of the market! Recent results have been strong from Telstra and they are well on their way towards their T25 strategy, a great example of a company executing on their well-laid out plans.

Banks were in focus during the month following the regional banking crisis in the US and forced takeover of **Credit Suisse** by **UBS**, but despite consistent comparisons in the financial media between what happened in March and the 2007-2008 financial crisis, there are important differences between the two periods and regulators have already demonstrated their commitment to ensuring we do not experience a repeat of those difficult days, and we believe these comparisons will prove off the mark. Regulators and government officials have proven they are ready to use current tools (or create new ones) to prevent a broader spread of the US regional banking crisis, and that's an important, and positive, difference from 2008. While we are still underweight the sector given some earnings headwinds, we now have a more positive bias after their meaningful pullback.

During the month, **New Hope (NHC)** reported a strong 1H net profit of $668m vs $330m this time last year while delivering an interim dividend of 30c fully franked plus a special dividend of 10c fully franked, putting it on a 7.5% yield for the half (15% annualised) plus franking. They also restarted a $300mn buyback with everything sounding very supportive of a stock trading on a valuation of just 3.6x.

PORTFOLIO STOCKS CONTINUED

The dividend equates to a ~10% grossed-up return for the half, which is the reason we hold a 4.2% position in the Income Portfolio. importantly the company suggested demand is continuing to outstrip supply, with future growth expected from South-East Asia.

The Swiss Government orchestrated deal pushing UBS to buy Credit Suisse saw equity holders receive shares in UBS at a level 89% below where they were trading just 12 months ago, however, this is more than holders of Credit Suisse Hybrids (called 'Cocos' in Europe which stands for Contingent Convertible Capital Instruments) will receive – they get zero in the deal. i.e. Hybrid holders book a 100% loss. Securities that sit higher in the capital structure rarely get a worse outcome, however, there are some important aspects to note in this scenario:

Government bailouts of high-risk European banks are common. In a government bailout scenario in Europe, hybrids must be written off to zero. This is not the case in Australia where they would be converted to equity in extreme circumstances.

The CS Hybrids were very risky securities, carrying a very low credit rating, they were not listed, instead being traded in the Over-The-Counter (OTC) market which can be very grey – before the restructuring of CS, they were trading down ~70%.

In the US/Europe, banks typically skip distributions and or treat first-call dates as truly optional. In Australia, if an Australian bank stops paying distributions on Hybrids, they cannot pay out dividends on the underlying shares, initiate buy-backs or even pay staff bonuses.

Importantly, and this is the key, Australian banks are safe, incredibly well capitalised, and not involved in the business of risk that was obvious at Credit Suisse, while they are also traded on a transparent exchange which is not the case in Europe.

We do hold Hybrid securities, but these are limited to the highly rated, well-capitalised, and safe institutions of ANZ, CBA, NAB and SUN. Hybrid prices fell during the month, pushing yields higher, but there were no signs of stress. The Average spread on ASX major bank 5-year hybrids has moved from a very low 2.2% out to around 3%. Yields on risker issuers like Macquarie and Challenger have moved out by more. MM believes the current weakness in Australian Hybrids is presenting better value for income-focused investors.

PORTFOLIO STOCKS	
NO. OF HOLDINGS	21
ESTIMATED YIELD (%)	6.40
TOP 5 POSITIONS (% OF AUM)	28.76
TOP 10 POSITIONS (% OF AUM)	51.88

STOCK	CONTRIBUTION (%)
AGL ENERGY (AGL)	0.66
BHP GROUP (BHP)	0.49
TELSTRA (TLS)	0.09
WESFARMERS (WES)	0.24
NEW HOPE CORP (NHC)	0.19

STOCK	DETRACTION (%)
CENTURIA CAPITAL (CNI)	-0.45
DEXUS (DXS)	-0.44
NATIONAL BANK (NAB)	-0.28
METCASH (MTS)	-0.26
PERPETUAL (PPT)	-0.21

%	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	0.06				**10.88**
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													**43.10**

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