MARKET MATTERS

INVEST

MONTHLY REPORT | MAY 2022 | 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	9.66%

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 fell 1.80% in May, underperforming its 0.36% absolute return benchmark. The portfolio has returned 10.35% for the rolling 12-months, 17.85% per annum for 2 years & 9.66% per annum for 3 years.

PERIOD	MAY	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	3 YEAR PA
PORTFOLIO %	-1.80	2.28	6.95	10.35	17.85	9.66
BENCHMARK %	0.36	1.04	2.04	4.12	4.14	4.32
RELATIVE %	-2.16	1.24	4.91	6.23	13.71	5.34

In recent months, it has become clear that the Australian economy has started to experience a slowdown at a time when the Reserve Bank has commenced a tightening cycle to combat uncomfortably high inflation. This is generally a poor combination for equity prices and May was another weak month for the market.

The outlook from here now depends on the severity of the slow down and the trajectory of inflation and thus interest rates. If the slowdown builds momentum as confidence deteriorates, and inflation remains persistently high, the shorter-term outlook for the market could be very challenging.

If on the other hand, inflation starts to taper off as pressure on supply chains ease, leaving the RBA with a less onerous job, then confidence will improve, and equities would recover strongly.

In the shorter term, this uncertainty will keep volatility high, although when we stand back and consider the local index, we remain within a ~10% trading range that has held for almost a year: ~7600 on the upside & ~6900 on the downside.

This has us neutral on the broader market, for now, however, we are leaning towards the probability of a tougher period ahead given the backdrop of cost inflation which is likely to impact many industrial businesses.

PORTFOLIO STOCKS

The portfolio holds concentrated positions in 20 securities with a current tilt towards Australian equities, although we have increased the weighting towards fixed income recently. The portfolio has 62% exposure to shares, 31% exposure to fixed income, 4% in property & 3% in cash.

For the month, equities accounted for 1.45% of the portfolio decline while fixed income accounted for 0.26%. Given the backdrop of a weak market, we are pleased with the consistency & defensive qualities this portfolio has shown.

AGL Energy (AGL): We bought AGL when the news flow was a one-way street, a company with massive headwinds as the ESG dynamic built steam. Since then there has been one take-over tilt at a high of $8.25 while Mike Cannon-Brookes of Atlassian fame recently acquired (via derivatives) an ~11% stake apparently around $8.50. Brookfield, who is a very savvy global investor was party to the original bid but is now not involved in the second play, clearly, they saw the merit of the bid up to $8.25, but not at a higher level. While we support Cannon-Brookes and his more noble intentions to wind up coal generation sooner than originally planned, we think at MM it's our job to focus on the economics and act in line with these. We viewed AGL as fully valued at around $8.25 and sold the stock.

Crown Hybrid (CWNHB): Blackstone has recently received approval for its Crown takeover and it now looks likely that the deal will proceed. Once complete, Blackstone will have a decision to make. Redeem the Hybrids paying back the face value plus any accrued interest or leave the Hybrids outstanding. If they leave them outstanding, there is a step up in the margin from bank bills + 4% to bank bills + 9% which is very unappealing for Blackstone. Our view is the notes will be redeemed after the change of control occurs.

BHP Group (BHP): The spin out of their Petroleum division to Woodside (WDS) was completed during the month and the income portfolio is now a holder of WDS stock. We received shares worth $5.38 plus $2.30 in franking with the payment (in WDS shares). The ATO has ruled the sale proceeds are indeed a "dividend", which means it is a taxable event in the current financial year and the franking credits can be applied against this taxable event, while the cost base of the WDS shares passed through by BHP will be set at the price at $29.76 i.e. the close of trade on the 31st of May, while the BHP share cost base does not change as the ATO has deemed this a dividend, not a demerger.

PORTFOLIO STOCKS	
NO. OF HOLDINGS	20
ESTIMATED YIELD (%)	4.71
TOP 5 POSITIONS (% OF AUM)	34.57
TOP 10 POSITIONS (% OF AUM)	60.35

STOCK	CONTRIBUTION (%)
BHP GROUP (BHP)	0.73
G8 EDUCATION (GEM)	0.12
COMMONWEALTH BANK (CBA)	0.03
CROWN HYBRID (CWNHB)	0.02
TRANSURBAN (TCL)	0.01

STOCK	DETRACTION (%)
METCASH (MTS)	-0.62
SMART GROUP (SIQ)	-0.47
TELSTRA (TLS)	-0.29
BANK OF QLD (BOQ)	-0.24
AGL ENERGY (AGL)	-0.24

%	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	YTD
FY22	0.10	3.04	0.58	-1.58	-1.31	3.01	-2.45	4.05	4.25	-0.09	-1.80		**7.80**
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													**38.76**

APA Group (APA): Natural gas pipeline operator and energy infrastructure business APA like all in the space have recognised the deep need to transition towards renewables although they will need further work to grow with competitors on this front. While rising interest rates are not great for APA if they want to raise money for further growth, for now, they are well-positioned as 99% of their contracted revenue is linked to inflation. In other words, they are extremely well-positioned today to maintain their revenue flow and 4.7% dividend but the next growth step will be important to its performance over the coming years. While APA Group is not a cheap stock, quality infrastructure assets are scarce on the ASX and we can see this valuation level being maintained. We continue to like APA and hold it in the Income Portfolio.