MARKET MATTERS

INVEST

MONTHLY REPORT | MAY 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	8.70%*

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 -2.01% in May, underperforming its absolute return benchmark of 0.65%. The portfolio has returned 5.65% for the rolling 12 months and 13.64% per annum over 3 years, outperforming its benchmark by 8.74% per annum.

PERIOD	1 MONTH	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	3 YEAR PA
PORTFOLIO %	-2.01	0.17	3.59	5.65	7.99	13.64
BENCHMARK %	0.65	1.90	3.66	6.66	5.33	4.90
RELATIVE %	-2.66	-1.73	-0.07	-1.01	2.66	8.74

Benchmark: RBA Cash Rate +4%

Australian equities fell through May, as the RBA's hawkish tone resumed, while US lawmakers lingered around the country's debt ceiling. That saw the local market, as measured by the ASX 200 Accumulation Index fall (-2.53%) underperforming other developed markets.

The MSCI Developed Markets Index fell over the month (-0.1%), while the S&P 500 gained (+0.4%) in local currency terms. Bond yields priced in the RBA's more hawkish tone with Australian 10-year bond yields up 26bps to 3.60%, while US 10 years also rose 22bps to 3.64%.

Amongst commodity markets, Brent Oil fell by US$6.00 to US$73.54/bbl, as concerns continued around Chinese oil demand after weaker-than-expected Chinese manufacturing data. Iron Ore prices were soft, down by US$5.00 to US$100.00/Mt while Gold prices fell by US$30.10 to US$1,952 on a stronger USD.

There was significant sector divergence locally, with the IT sector the clear standout up (+11.6%), while Utilities (+1.10%), Energy (+0.2%) and Healthcare (+0.1%) made gains in a soft market.

The Consumer Discretionary sector was the hardest hit during May ending down (-6.1%) while Staples (-4.6%), Materials (-4.4%), Financials (-3.2%), Property (-1.8%), Consumer Services (-1.2%) and Industrials (-0.80%) also fell.

PORTFOLIO STOCKS

The portfolio held 21 positions at the end of May with a forecast yield of 5.88% plus franking. We are defensively set holding 47% in Equities, 36% in Hybrids/Fixed Income, 9% in property and 9% cash (NB: equities equate to 56% if we include the listed property exposure).

We were largely inactive in the portfolio during May, only making one acquisition, entering back into **APA Group (APA)**.

APA is a classic defensive stock with regulated earnings linked to critical energy infrastructure. A lot of talk in the market has been around the high valuations being ascribed to these sorts of stocks as investors look to 'hide' in lower-risk equities, however, APA was trading ~25% below its 12-month high with weak momentum. We suspect the current lack of interest is for a few reasons.

When interest rates (and bond yields) were at rock bottom, fixed income was very unattractive and that led to the term being coined, There Is No Alternative (TINA), meaning that investors were forced into equities. 'Bond-like' equities such as APA benefitted the most and their share prices rallied strongly. We're now in a more 'balanced' environment, where traditional fixed income is back to being a real alternative. This reduces the appeal of stocks like APA, which should theoretically trade back to more normal pricing metrics.

We value APA simplistically based on its yield above 10-year bonds, with recent company guidance implying a FY23 dividend totalling 55c, with market consensus at 58.5c for FY24. Using FY24 assumptions, that puts APA on a yield of 5.82% (unfranked) versus the 3.65% 10-year yield, a spread of 2.17%, which is still below its historical premium of ~2.8%, but well above the ~1% premium where it recently traded. We bought back into APA Group for around $10, having sold out earlier in the year at higher prices.

Telstra (TLS) has proven an excellent defensive income stock through 2023 and we see no reason for this to change. The telco recently hit a new 52-week high, up 10.5% year to date, a great example of the sort of returns that can be achieved from large-cap (safe) stocks with a focus on timing.

Recent results have been strong from Telstra and it seems they are finally able to benefit from their extraordinarily strong market position and historical investment in network. Recent years saw TLS lose fixed-line customers to the NBN while facing a price war in mobile services. These trends have changed, particularly in mobile where TLS are increasing prices, telling customers that plans will go up in price annually with some linkage to inflation. They also benefit from NBN contracts that are indexed to inflation.

While Telstra is no longer the portfolio's largest position following a recent reduction, it remains a top 3 holding.

PORTFOLIO STOCKS	
NO. OF HOLDINGS	21
ESTIMATED YIELD (%)	5.88
TOP 5 POSITIONS (% OF AUM)	26.76
TOP 10 POSITIONS (% OF AUM)	49.64

STOCK	CONTRIBUTION (%)
AGL ENERGY (AGL)	0.44
DEXUS (DXS)	0.23
CENTURIA CAPITAL (CNI)	0.17
METRICS CREDIT (MXT)	0.07
PERPETUAL (PPT)	0.04

STOCK	DETRACTION (%)
NEW HOPE CORP (NHC)	-0.58
METCASH (MTS)	-0.47
NATIONAL BANK (NAB)	-0.47
G8 EDUCATION (GEM)	-0.43
WESFARMERS (WES)	-0.38

%	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	2.16	-2.01		**11.03**
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													**43.25**

PORTFOLIO STOCKS CONTINUED

In November last year, a consortium led by the **Regal Partners (RPL)** launched a takeover bid for **Perpetual (PPT)**, who at the time were attempting a takeover of **Pendal (PDL)**. Regal was ultimately unsuccessful with their tilt, however, it's worthwhile revisiting how they thought about the value of the PPT business, in as simple terms as possible.

The consortium bid $1.7bn for Perpetual which equated to $30 per share. PPT said it materially undervalued them despite being a 23% premium to their 30-day average. There was also a curve ball thrown by a legal opinion that related to the potential size of break fees paid to Pendal if Perpetual pulled out – and that in itself may have scuttled the move. Ultimately, the deal was completed and Perpetual took over Pendal, (which is how we became Perpetual shareholders).

As part of the Regal bid, they had lined up the sale of the corporate trust business for ~$1.4bn providing a solid look-through value for that division, which is the largest provider of corporate trustee services and transaction support in the country, with Funds Under Administration (FUA) of $1.16 trillion. So, based on that number, around 50% of the current group's value is underpinned by the $1.4bn value for the trust business.

That leaves the funds and wealth business, and we'll focus on the former which is where the value is. The funds business has over $200bn of FUM, about 5x the amount of Magellan (MFG) and is around 40% more than GQG Partners (GQG) which is capped at around $4.1bn. Regal Partners (RPL) themselves are capped at $935m and have $5.5bn in FUM, although they are an alternative asset manager, so charge more.

Clearly, Regal thought Perpetual was cheap before they took out Pendal, and we think that's still the case now. In our view, PPT is worth well north of $30, or 15-20% higher.

Hybrid Securities feature in the Active Income Portfolio and recent increases in the RBA cash rate flow into higher yields across floating rate hybrids. Spreads have also increased over the past 3 months, from ~2.5% to ~3% over the 90-day bank bill rate. June is a high-income month for Hybrids with many of the bank securities paying distributions. While we continue to like bank hybrids, we do envisage increasing our exposure to fixed-rate securities given the recent uptick in cash rates.

WEBINAR

In association with Ausbiz, **Market Matters hosted a Webinar in May** focussing on portfolio positioning. Lead Portfolio Manager James Gerrish was joined by Nadine Blayney (Host) Head of Content, ausbiz, Ben Clark, Portfolio Manager at TMS Capital, Nick Guidera, Portfolio Manager at Elley Griffiths and Marcus Padley from Marcus Today.

The Webinar covered:

- Where are we in the market cycle; should we be cautious or not?
- Favourite sectors given prevailing macro conditions.
- Highest conviction stocks: two picks from each panellist debated with their peers, just to keep it interesting!) A recording of the 1-hour webinar can be accessed here.

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