MARKET MATTERS
INVEST

MONTHLY REPORT | OCTOBER 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	8.24%*

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 fell by -3.66% in October, underperforming its RBA Cash +4% benchmark which increased 0.68%. The portfolio has returned 9.81% for the rolling 12 months, against the benchmark return of 7.64% and 12.60% per annum for 3 years, 7.20% per annum above its benchmark.

PERIOD	1 MONTH	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	3 YEAR PA
PORTFOLIO %	-3.32	-3.66	-0.91	9.87	6.21	12.60
BENCHMARK %	0.68	2.01	4.02	7.64	6.14	5.40
RELATIVE %	-4.00	-5.67	-4.93	2.23	0.07	7.20

Benchmark: RBA Cash Rate +4%

More broadly, the MSCI Developed Markets Index fell during October (-2.6%), while the S&P 500 also declined (-2.1%) in local currency terms – both outperforming the ASX. Australian 10-year bond yields finished the month at 4.92%, up a significant 44bps, and 82bps above the cash rate, implying further rate hikes are expected – quite an extraordinary move.

In the US, the Federal Reserve kept interest rates on hold while continuing to jawbone the possibility of additional hikes if economic conditions warrant, the rhetoric pushed bond yields higher with the US 10-year yield up by 33bps to 4.90%, but yields remain below the cash rate implying interest rate cuts remain on the agenda.

Commodity prices were mixed over October, Brent Oil fell by US$7.86 to US$87.45/bbl, despite growing tensions in the Middle East. Iron Ore prices held, rising by US$2.50 to US$122.00/Mt, while safe haven demand has continued to drive gold higher, rising by US$127.10 to US$1,998.

Utilities (+1.%) were the only sector to make gains while Materials (-0.80%), Communication Services (-2.9%) and Financials (-3.6%) outperformed the benchmark.

IT (-7.6%) and Healthcare (-7.2%) struggled, while Industrials (-6.4%), REITs (-5.8%), Energy (-5.1%), Consumer Discretionary (-4.8%) and Staples (-4.0%) all dipped more than the market.

PORTFOLIO POSITIONING

The portfolio held 19 positions at the end of October with a forecast yield of 5.93% plus franking. The portfolio is weighted 49% in Equities, 41% in Hybrids/Fixed Income, 6% in property & 4% cash.

We made no changes to the portfolio composition during the month, having been active in September.

AGL Energy (AGL) was flat in a soft market as it continues to consolidate after correcting ~20% from its recent highs. We continue to believe that AGL is well positioned to execute its strategy towards renewable energy, and although there is some risk that pricing dynamics could change, the stock is now forecasted to yield 4.4% over the next 12 months which makes it easier to adopt a patient approach. We have held AGL in the portfolio since February, and the stock has been a strong performer.

Property Fund Manager **Centuria Capital (CNI)** has struggled in line with the underperforming property sector since 2021, but it added to losses in October after it provided soft guidance amid higher interest costs when it reported in August. CNI is one of the most leveraged 'plays' on interest rates given they have lower interest rate hedging in place, a double-edged sword that has worked against them.

However, there are growing signs that bond yields/ interest rates are near a peak and their FY24 guidance may prove conservative, allowing plenty of room for a snapback after such dire price action – plus, CNI is forecast to yield more than 9% plus some franking over the next 12 months, a good return if the stock just treads water.

We remain patient holders of Centuria.

Australia's largest office landlord has been in the vortex of negative sentiment towards property generally, and office specifically as companies continue to struggle with workplace attendance. We added **Dexus (DXS)** to the portfolio back in December 2022 and are down on the holding, offset to a large degree by a strong dividend.

It's not hard to comprehend the weakness in Dexus, commercial property is a relatively illiquid asset class, making marked-to-market valuations estimates at best, with current private sector transactions suggesting some listed companies are being optimistic around their valuations, which throws into question reported NTA, in real terms. While we maintain our bearish outlook on bond yields through correlation, we believe it's worth carrying some property exposure.

The major detractor on performance came from the embattled fund manager, **Magellan Financial Group (MFG)** which took 1.29% from portfolio performance. They flagged the resumption of big outflows exacerbated by weakness across financial markets, while their CEO announced he was leaving.

PORTFOLIO STOCKS	
NO. OF HOLDINGS	19
ESTIMATED YIELD (%)	5.93
TOP 5 POSITIONS (% OF AUM)	32.90
TOP 10 POSITIONS (% OF AUM)	61.63

STOCK	CONTRIBUTION (%)
BHP GROUP (BHP)	0.04
GOVERNMENT BOND (GSBG25)	0.01
AGL ENERGY (AGL)	0.01

STOCK	CONTRIBUTION (%)
NATIONAL AUSTRALIA BANK (NAB)	-1.29
AGL ENERGY (AGL)	-0.46
NEW HOPE CORP (NHC)	-0.41
COMMONWEALTH BANK (CBA)	-0.27
DEXUS (DXS)	-0.22

%	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	YTD
FY24	2.79	-0.44	0.09	-3.32									**-0.88**
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													**45.32**

PORTFOLIO POSITIONING CONTINUED

Our bullish thesis was predicated on improving performance stemming outflows, and in time leading to inflows – which looks wrong. Performance impacts flows and performance fees - it's the lifeblood of an active manager. MFG had turned the performance corner at their last update, however, last month's numbers imply otherwise.

Two parts make up the value in MFG:

1. Cash and investments held on their balance sheet.
2. The fund management business.

Most analysts have a base case for cash and investments worth between $5-6 per share. At the low end, that now implies the funds business is ~$2/sh of the total.

At current prices, investors are buying $35bn of funds under management for ~$300m, or less than 3x earnings. The key for Magellan in our view will be a simplification of the business, a realignment of remuneration to incentivise new management, and a focus on building trust through the products they already have rather than focusing on growth and at the same time, launching a more widespread capital management initiative. We believe the departure of the CEO is a positive step towards this end, and remain holders of MFG.

While performance in October was weak, the portfolio mix continues to deliver lower volatility, higher income, and consistency in returns for Income-focused investors.