MARKET MATTERS

INVEST

MONTHLY REPORT | AUGUST 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	9.16%*

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 -0.44% in August, underperforming its RBA Cash +4% benchmark which increased +0.68%. The portfolio has returned +12.96% for the rolling 12 months (against the benchmark return of +7.37%) and +13.30% per annum for 3 years, 8.10% per annum above its benchmark.

PERIOD	1 MONTH	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	3 YEAR PA
PORTFOLIO %	-0.44	4.46	4.64	12.96	7.41	13.30
BENCHMARK %	0.68	2.01	3.93	7.37	5.82	5.20
RELATIVE %	-1.12	2.45	0.71	5.59	1.59	8.10

Benchmark: RBA Cash Rate +4%

More broadly, the MSCI Developed Markets Index fell over August (-1.7%), while the S&P 500 also declined (-1.6%) in local currency terms. Australian 10-year bond yields were at 4.03%, trading relatively flat as the RBA kept rates unchanged but still retained a tightening bias. That said, we believe the current 4.1% cash rate will be the peak of this RBA cycle.

In the US however, there remains a distinct possibility of one more hike, and this evolving belief pushed up US 10-year yields by 0.14% over the month, to 4.09%, as the Fed continued their hawkish tone.

Commodity prices were mixed across the board in August. Brent Oil rose by US$0.30 to US$85.86/bbl, Iron Ore showed resilient strength to rise by US$6.50 to US$117.50/Mt, while Gold prices fell on a strengthening dollar coupled with higher yields, falling by US$23.10 to US$1,948.

From a sector perspective, Consumer Discretionary (+5.7%) and Property / REITs (+2.3%) were the highlights while Energy +0.5% was the only other sector that finished in the black.

Utilities (-3.8%) struggled most while Consumer Staples (-3.2%), IT (-2.1%), Industrials and Materials (-2%), Healthcare (-1%), Financials and Communication Services (-0.8%) all dipped more than the index.

REPORTING WRAP UP

FY23 results were solid, with earnings (Net Profit After Tax)) beats outnumbering misses by a ratio of 5:3, illustrating the underlying strength of the domestic economy, however, underwhelming guidance for FY24 into a strong market leading into August weighed on confidence and ultimately led to weaker share prices collectively.

Materials (ex-mining) and Communication Services saw the strongest beat rate, while the Consumer Staples and Information Technology stocks saw the biggest skew towards earnings misses. Post results, analysts revised their expectations on FY24 profits at a ratio of 2 downgrades for each upgrade, and now expect ASX200 FY24 profits to decline -5.7% in the year ahead. For comparison, this number was -0.8% just prior to results and +0.7% six months ago, showing downside momentum.

While the index itself was weak, it was also an unusually volatile reporting period with a high proportion of outsized share price moves on company results (+ or - 10% on the day). This is indicative of crowded trades at a time of unpredictability from an economic standpoint, while another observable outcome has been the continuance of trends, on the upside or downside.

A major surprise was the contrasting performance in consumer sectors pre- vs. post-results. In the months leading up to reporting investors had been buying staples, on expectations that the discretionary names would suffer as householders struggled against cost-of-living pressures and higher interest rates. Instead, discretionary retailers saw that consumer spending was slowing (but not collapsing), whilst staples suffered under cost and operational challenges.

Cost pressures across the mining industry was another notable trend, and while not as surprising, they were more extreme and coincided with an uptick in planned capex over the coming years.

PORTFOLIO POSITIONING

The portfolio held 19 positions at the end of August with a forecast yield of 5.56% plus franking. The portfolio is weighted 47% in Equities, 40% in Hybrids/Fixed Income, 7% in property and 6% cash.

We experienced a solid rather than spectacular reporting period for the income portfolio with shares and property both down, while fixed income was largely flat for the month.

Wesfarmers (WES) was the standout in the period contributing +0.47% to portfolio returns, up on the back of a solid FY23 result, led by Bunnings, while they said trading conditions to start FY24 have been resilient.

PORTFOLIO STOCKS	
NO. OF HOLDINGS	19
ESTIMATED YIELD (%)	5.56
TOP 5 POSITIONS (% OF AUM)	31.34
TOP 10 POSITIONS (% OF AUM)	58.87

STOCK	CONTRIBUTION (%)
WESFARMERS (WES)	0.47
MAGELLAN FINANCIAL (MFG)	0.26
NEW HOPE CORP (NHC)	0.23
METCASH (MTS)	0.19
NATIONAL BANK (NAB)	0.15

STOCK	DETRACTION (%)
CENTURIA CAPITAL (CNI)	-0.43
APA GROUP (APA)	-0.41
AGL ENERGY (AGL)	-0.27
DEXUS (DXS)	-0.23
TELSTRA (TLS)	-0.15

%	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	YTD
FY24	2.79	-0.44											**2.35**
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

Earnings were up and ahead of expectations, and they declared a final dividend of $1.03 putting the FY payout to $1.91, which was above our expectations. Quality has risen to the top this reporting season, and WES was another demonstration of that. We remain comfortable holders.

Magellan Financial Group (MFG) delivered their much-anticipated FY23 results mid-month that came in largely as expected from an earnings perspective while they announced a final dividend of 39.8¢. What drove the positive reaction was a 30cps special dividend along with cost guidance for FY24 that was pleasing. That dividend equated to a ~10% grossed return based on our original purchase price of ~$8.

As we've suggested previously, better performance is important to drive flows, and in the 6-months to June, their global equity strategy outperformed for the first time in multiple years. This better performance should stem outflows (seems to be happening) and while they are not yet at the point of attracting inflows and launching new products, this is a natural progression over time. Capital management (given strong balance sheet) provides optionality for management in the meantime, and we saw this lever being pulled at these results. We believe Magellan is worth ~$12 if they get the turnaround even partially right. MFG rallied strongly post results.

It wasn't as positive over at **Dexus (DXS)** with the shares down following their FY23 results. They booked Funds from Operations (FFO) ahead of consensus and a dividend of 51.6cps, inline with expectations. FY24 guidance is for FFO to be broadly inline with FY23, which is slightly better than the current consensus (50.5cps) implies, while they have guided to a DPS of 48cps versus 50.5c consensus. Assets were revalued (lower) by ~6.9% which led to a net loss of $752.7m. Putting that number into perspective, it took 11.4% off the NTA, which declined to $10.88 per share, which as at the end of August, places the stock at a ~28% discount to NTA.

Coming into this result we were aware of likely asset revaluations lower, soft earnings and a tough outlook, our premise for owning Dexus is that the discount to NTA is too great, for the quality of their underlying asset base, solid balance sheet (gearing 27.9% /84% hedged), while we can pick up a 6% (unfranked) yield while we wait for global office fundamentals to turn.

Energy infrastructure company **APA Group (APA)** is looking to raise a total of $750mn at $8.50, $675m was placed very quickly with institutions while there is a share purchase plan available for retail investors. APA are paying $1.8bn for Alinta power assets in the Pilbara, slightly below the expected price tag of $2bn.

We are positive about APA's East Coast pipeline network over FY24-26 and while being conscious that the VIC Gov ban on new gas connections will have little near-term impact it must be considered longer-term while we could see renewed regulatory focus on APA's QLD to NSW/VIC gas pipeline route.

Despite some near-term uncertainty, we believe the likely share price decline from this raise, now presents a good entry point into APA ~$8.50, with an estimated yield over the coming year now likely to be above 6%.

G8 Education (GEM) is one of Australia's largest childhood education and care providers with over 430 /centres with a particular focus down the East Coast, although they also have some centres in WA. They operate under brands such as Jellybeans, Greenwood, Kool Kids, Bambinos and more, and while the last few years have been very challenging, to say the least, they are in a lot better position than they were 2 years ago.

They are a December year-end so reported 1H23 results in the period that showed occupancy remains too low (67.4%) and the improvement from the same time last year (+0.6%) is too benign. They continue to be constrained by ongoing labour shortages while the staff they have are being paid more through a recent award increase of 5.75%. New centre supply across the sector has also ticked up meaningfully, with the highest rate of new centre supply since 1H21, which adds competition for both staff and children. Adding further complexity, there are results due from an ACCC review targeting fee increases of providers across the industry which adds another layer of uncertainty to the already challenging backdrop, plus a declared dividend for the half of 1.5c fully franked was too low.

While we think GEM is doing a good job turning around, a lot of external challenges remain that create a higher degree of uncertainty in the near term, prompting us to cut the position.

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