MARKET MATTERS
INVEST

MONTHLY REPORT | JUNE 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%*

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 added +2.07% in June, outperforming its RBA Cash +4% benchmark which advanced +0.65%. The portfolio has returned +15.36% for the rolling 12 months (against the benchmark return of +6.93%) & +13.68% per annum for 3 years.

PERIOD	1 MONTH	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	3 YEAR PA
PORTFOLIO %	2.07	2.17	5.54	15.36	7.82	13.68
BENCHMARK %	0.65	1.92	3.72	6.93	5.33	5.00
RELATIVE %	1.42	0.25	1.82	8.43	2.49	8.68

Benchmark: RBA Cash Rate +4%

June saw investors shrug off domestic recession fears amid a local retail spending rebound; and easing of inflation, although local stocks underperformed most other global markets with the MSCI Developed Markets Index up sharply (+5.7%) while the S&P 500 gained (+6.6%) in local currency terms. Australian 10- year bond yields ticked marginally higher to 4.02%, as the RBA's Jun-23 meeting saw the cash rate hike by 25bps, to 4.10%. US yields also rose with the 10-year up 18bps to 3.81%, on concerns of further Fed tightening.

Amongst commodity markets, Brent Oil rose by US$2.24 to US$74.90/bbl, trading on tighter market fundamentals over the driving season, coupled with political uncertainty in Russia. Iron Ore prices rose by US $13.50 to US$113.50/t on demand growing slightly more than supply and inventories falling. Gold prices fell by US$52.15 to US$1,912 as Fed and ECB hone in on inflation.

There was significant sector divergence locally, with the Materials sector bouncing back from recent weakness, up (+4.8%), while IT (+3.5%), Financials (+3.1%), Utilities (+2.9%), Consumer Staples (+2.9%), Consumer Discretionary (+1.8%) and Energy (+1.8%) outperformed the broader index.

The Healthcare sector was the hardest hit during June ending down (-6.6%) while Communication Services (-1.0%), Real-Estate (-0%) and Industrials (+0.20%) underperformed.

FY23

The portfolio has a primary focus on income and holds high-yielding equities, property and fixed income securities including ASX listed Hybrids. The portfolio composition at the end of June stood at approximately 50% equities, 40% fixed income (incl Hybrids), 7% property and 3% cash. As a guide on the returns from each asset class, equities returned ~18%, fixed income ~7% and property ~11%.

Active management for income has been pivotal to this return and we believe the backdrop has improved dramatically as central banks reduced liquidity and tightened financial conditions.

As economic conditions change in the real world, some companies will be in sweet spots where they can take advantage of that, while others will face headwinds, improving the backdrop to add value through active portfolio positioning.

Recently, the $250bn Future Fund recognised this changing dynamic as they restarted their allocation to active investing, away from passive mandates that were put in place 6-years ago. The move is driven by the likelihood of more volatility, higher inflation, challenges to corporate profits, deglobalisation, populism and greater coordination between fiscal and monetary policy.

In this annual update for FY23 we'll attempt to make sense of the current economic climate, what may come next and how we'll be managing your portfolio through the period ahead.

Firstly, a look back on FY23 where the market experienced its 3rd strongest year in the past decade, however, the ultimate return overshadows the challenges that played out. Central banks hiked interest rates at an unprecedented speed taking them to fresh 11-year highs, the US experienced a Banking Crisis, China's economy was buffeted by aggressive COVID lockdowns and war was waged on Ukraine, to name just a few of the headwinds for equities.

LOOKING AHEAD

As we begin the new Financial Year, the outlook for stocks and bonds is arguably the most positive it's been since late 2021, as inflation tapers off recent highs, economic growth and the labor market remain impressively resilient, Central Banks are at or near a pause on their historic rate hiking campaign, the US debt ceiling extension is resolved, China looks poised to stimulate and we've seen no significant contagion from the US regional bank failures from earlier this year.

That improvement in the fundamental outlook has been reflected in both stock and bond prices so far this year as more cyclically focused sectors led markets higher late in the quarter on rising hopes for a broad economic expansion.

However, while clearly, the latter part of the year brought positive developments in the economy and the markets, it's important to remember that potentially significant risks remain. Put more bluntly, the market has taken a decidedly positive view on the ultimate resolution of multiple macroeconomic unknowns, but their outcomes remain very uncertain and thanks to a strong rally in stocks, there is now little room for disappointment.

First, the economy has not yet felt the full impact of the RBA's historically aggressive hike campaign, and while the economy has proved surprisingly resilient so far, we know from history that the impacts of rate hikes can take far longer than most expect to impact economic growth. Put in plain language, it's premature to think the economy is "in the clear" from recession risks, and we should all expect the economy to slow more as we move into the first half of FY24. The key for markets will be the intensity of that slowing, as at these valuation levels stocks are not pricing in a significant economic slowdown.

On inflation, clearly, there's been progress in bringing inflation down, as year-over-year CPI has fallen from 8.4% in December 2022 to 5.8% in May. However, CPI remains far above the RBA's 2-3% target. If inflation bounces back or fails to continue to decline, then the RBA could easily hike rates further, like the Bank of Canada and Reserve Bank of New Zealand, following pauses of their own. Those higher rates would weigh further on economic growth.

Furthermore, the impact of sharply higher rates is unlikely to have been felt in full across the economy. We saw the impact on some US regional banks of this tectonic shift in the cost of capital. While markets have taken the regional bank failures in stride, it's likely premature to consider the crisis "over" and at a minimum, reduced lending by banks poses an additional threat to the commercial real estate market and small businesses more broadly.

LOOKING AHEAD CONTINUED

Finally, markets are trading at above-average valuations, as investor sentiment becomes more optimistic. The Volatility Index, which is a widely used measure of pricing risk is at historical lows, while Investor Sentiment Indicators have risen to levels not seen since November 2021, right before the market collapse started in early 2022. Positive sentiment does not automatically mean markets will decline, but the sudden burst of enthusiasm needs to be considered in the context of what is a still uncertain macroeconomic environment and markets no longer have the protection of low expectations and valuations to cushion declines.

Clearly, there have been positive macro developments so far in 2023 that have helped the stock market rebound. However, it's important to remember that multiple and varied risks remain for the economy and markets. We believe this creates an ideal backdrop for active rather than passive portfolio management, and we expect favourable conditions to add 'alpha'.

PORTFOLIO STOCKS

Returns get their relevance from the risk taken to achieve them. There are many ways to measure risk, however a simple measure relevant for this portfolio is maximum drawdown, or in other words, the biggest decline the portfolio experienced in the period, which stood at just ~4.8%.

We added new positions in APA Group (APA) and Magellan Financial Group (MFG) while we also increased our holdings in existing Hybrid securities. We reduced positions in AGL Energy (AGL), Telstra (TLS) and Wesfarmers (WES) to varying degrees.

We start FY24 with ~20 positions and a small cash allocation, while our attention moves to the outlook for interest rates and how this may impact fixed-income markets.

PORTFOLIO STOCKS	
NO. OF HOLDINGS	20
ESTIMATED YIELD (%)	5.40
TOP 5 POSITIONS (% OF AUM)	30.24
TOP 10 POSITIONS (% OF AUM)	57.49

STOCK	CONTRIBUTION (%)
AGL ENERGY (AGL)	0.52
BHP GROUP (BHP)	0.37
METSCASH (MTS)	0.30
COMMONWEALTH BANK (CBA)	0.23
PERPETUAL (PPT)	0.20

STOCK	DETRACTION (%)
CENTURIA CAPITAL (CNI)	-0.17
METRICS CREDIT (MXT)	-0.09
OZ BOND ETF (OZBD)	-0.09
DEXUS (DXS)	-0.09
TELSTRA (TLS)	-0.07

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RESOURCES INTO FY24

In association with Livewire Markets, Market Matters hosted a Webinar in June focussing on the resources sector. Lead Portfolio Manager James Gerrish was joined by Portfolio Manager Todd Warren from Tribeca and Head of Research Andrew Hines from Shaw & Partners.

A recording of the 1-hour webinar can be accessed here.

%	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	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**

DISCLOSURE

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