MARKET MATTERS
INVEST

MONTHLY REPORT | AUGUST 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	8.30%*

**Inception Date 05.07.2017*

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 added 0.30% in August, underperforming its absolute return benchmark of 0.38%. The portfolio has returned 2.07% for the rolling 12 months, 13.45% per annum over 2 years, 8.01% per annum over 3 years & 8.30% per annum since inception, with significantly less volatility than the underlying share market.

PERIOD	1 MONTH	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	3 YEAR PA
PORTFOLIO %	0.30	-2.31	-0.08	2.07	13.45	8.01
BENCHMARK %	0.38	1.31	2.36	4.41	4.26	4.33
RELATIVE %	-0.08	-3.62	-2.44	-2.34	9.19	3.68

Benchmark: RBA Cash Rate +4%

Global equities struggled in August particularly at the back end following hawkish comments from US Federal Reserve Chair Jerome Powell at the Jackson Hole Symposium. The rhetoric implied that interest rates would need to rise further and would stay high for an extended period to curtail persistently high inflation.

The MSCI Developed World Markets Index lost 3.4% for the month while the US based S&P 500 lost 4.1% in local currency terms. Australian equities outperformed thanks to a better than feared local reporting season with the S&P/ASX 200 Accumulation Index up by 1.18%. The energy stocks were the best performers in Australia up 7.8% followed by Materials which added 4.4%. On the flip side, property stocks fell 3.5% to lead the decline while consumer staples were also weak, down by 1.8%.

Bond yields rose as bond prices fell; the Australian 10-year yield moved from 3% to above 3.50% as the RBA increased rates by another 50bps to 1.85%. US yields were also higher with the US 10-year moving up 52bps to 3.13%. Markets had moved towards a more neutral stance around interest rates as commentary around cuts in 2023 gathered momentum, however, that was short-lived, and the pendulum has now changed back to a more hawkish stance.

Commodity prices fell in August. Brent Oil prices declined US$14 to US$96/bbl after a de-escalation in Iraq stabilised oil exports. Iron Ore prices also dropped US$19 to US$99/Mt as COVID impacts linger and supply lifts. Gold prices continue to trend lower, moving down US$38 to US$1,716, amid US dollar strength and higher interest rates.

LOCAL REPORTING | 6 THINGS WE LEARNT

1. Despite downbeat headlines, Australian companies are still doing okay with beats outnumbering misses by 3:2 with profit beating consensus expectations by an average of 0.7%. This is an impressive showing given the array of headwinds companies have faced over the past six months.
2. Investors were too bearish ahead of the results which was evident in equity allocations overall plus the type of equities held. Because of more robust results against defensive positioning, investors have had to begin rebuilding back exposure to domestic cyclicals.
3. While FY22 was better than feared, there are larger cuts coming through to FY23 earnings estimates, the most obvious of which is within the Materials sector on a repricing (lower) of the global growth outlook while the building materials stocks struggled against input cost pressures.
4. Higher costs are being largely passed on which has allowed margins to hold. The consumer is in good shape for now and strong end-demand has allowed for costs to be passed through to customers relatively easily.
5. Labour shortages were the No 1 concern expressed by companies and this remains a big unknown. Such tightness in the labour market must be inflationary.
6. Trading statements & feedback from banks (given their intel on spending patterns) suggest the consumer is still spending despite weak sentiment indicators.

PORTFOLIO STOCKS

The portfolio held 17 positions at the end of August with 47% of capital allocated to Australian Equities, 32% in Fixed Interest, 4% in Listed Property and 17% in cash, which we view as a short-term, tactical decision only with the intention of re-deploying this shortly.

Monthly performance was positive but not spectacular driven by earnt income of 0.70% offset by a capital loss of 0.40%. While we are uncomfortable holding such a large current cash weighting within an income portfolio, we believe that better opportunities will avail themselves through September.

We made two changes to the portfolio during the month, selling APA Group (APA) above $12 booking a very good profit while we also sold **Bank of QLD (BOQ)** after **Bendigo Banks (BEN)** soft result.

APA Group (APA) had been a key member of the Income Portfolio over the past year with the share price outpacing the ASX 200 by over 20%.

PORTFOLIO STOCKS	
NO. OF HOLDINGS	17
ESTIMATED YIELD (%)	4.96
TOP 5 POSITIONS (% OF AUM)	32.72
TOP 10 POSITIONS (% OF AUM)	57.10

STOCK	CONTRIBUTION (%)
Pendal (PDL)	0.32
Telstra (TLS)	0.31
BHP Group (BHP)	0.28
Wesfarmers (WES)	0.20
APA Group (APA)	0.09

STOCK	DETRACTION (%)
Centuria (CNI)	-0.46%
Stockland (SGP)	-0.23%
Composite Bond ETF (OZBD)	-0.13%
Transurban (TCL)	-0.12%
G8 Education (GEM)	-0.10%

We think the outperformance is a result of investors looking for defensive exposure with embedded inflation protection in their earnings base, which is the case with APA which is leveraged to US CPI. While we think their growth outlook remains solid, and this is one of the last true defensive infrastructure stocks listed in Australia, our view is inflation has peaked, asset values have peaked and the cost of capital is now more expensive, all reasons that filtered into our decision to sell APA during the month.

One of our mistakes in FY22 was holding **Magellan Financial Group (MFG)** during its painful decline, and this ultimately cost us performance. In July we switched from Magellan to **Pendal (PDL)** with the expectation that a bid from **Perpetual (PPT)** would eventuate. That came to pass in August with the slightly larger rival making a play, framed as a takeover that includes a cash component ($1.976) plus 1 PPT share for every 7.5 PDL shares. While the market has sold PPT shares lower dragging Pendal with it, we think the combined entity makes sense in an environment where scale is very important. We hold 4% of the portfolio in Pendal, having bought shares 25% below its current price. We have no position in MFG.

Recent portfolio addition **Centuria Capital (CNI)** reported a solid FY22 update in August with few surprises for the property company that has fallen 45% over the past year. Guidance for FY23 is for flat earnings and only a slight increase in dividends, however, given the depressed valuation following a tough year, and the high chance that FY23 guidance will prove conservative, we see prices below $2.00 as attractive, having recently added CNI to the portfolio.

The market seemed to be universally negative on discretionary retail going into reporting, however portfolio holding **Wesfarmers (WES)** reported a very solid update, with all key metrics coming in ahead of our expectations, including net profit after tax around 5% better. While FY22 profit was down 1.2% on FY21, that was a result of a tough 1H with 2H earnings growth of 13.1% showing a strong rebound. The 2H dividend of $1 was a beat and while no guidance was provided, which is customary for WES, they talked to positive trends playing out at the start of FY23. The message we got from management was positive and quite the opposite of what we had with some other retailers. We remain positive on this well run, cash-up retailer.

Hybrid securities make up over 20% of the portfolio, and with a 5-year swap rate of 3.88% plus the margin, securities with a maturity profile of ~5 years can deliver a yield to call of ~7% grossed for franking. We think that is attractive for a portfolio targeting RBA cash + 4% with lower volatility than the underlying equity market. The portfolio currently holds positions in **ANZPI, CBAPG, NABPF, NABPI & SUNPI**, combined with other listed fixed income securities.

%	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	YTD
FY23	4.22	0.30											**4.52**
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													**36.74**