MARKET MATTERS
INVEST

MONTHLY REPORT | SEPTEMBER 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	7.26%*

**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 fell by 3.64% in September, underperforming its absolute return benchmark of 0.38%. The portfolio has returned -2.19% for the rolling 12 months, 12.06% per annum over 2 years, 5.64% per annum over 3 years & 7.26% 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 %	-3.64	0.72	-7.63	-2.19	12.06	5.64
BENCHMARK %	0.38	1.44	2.53	4.59	4.35	4.37
RELATIVE %	-4.02	-0.72	-10.16	-6.78	7.71	1.27

Benchmark: RBA Cash Rate +4%

Equities struggled in September on the back of global recession fears and an increasingly hawkish US central bank. The MSCI Developed Markets Index fell 8.3% while the US S&P 500 was worse, dropping 9.2% in local currency terms.

Australian stocks were down but outperformed global peers. The S&P/ASX 200 fell 6.2% over the course of the month, as investors priced in the most aggressive RBA rate hiking cycle since the 1990s. There was carnage in bond markets as they reflected an increasingly hawkish outlook, the Australian 10-year yield hitting a yield of 4.10%.

Over the pond, US yields rose 67bps to 3.80%, driven by better-than-expected economic data firming expectations around future interest rate hikes.

Commodity prices fell in September, Brent Oil prices declined US$9 to US$88/bbl amid concerns of slower global growth. Iron Ore prices held up relatively well, off just US$1 to US$98/Mt while gold prices were hit by continued strength in the US dollar, bullion down US$44 to US$1,672.

Locally, the material sector was the top relative performer down by 'only' 2.3% for the month, while Energy -3.8%, Healthcare -4.4%, Consumer Staples -5.4% & Communication Services -6.1% did better than the broader market. The underperforming sectors included Financials -6.5%, Consumer Discretionary -9.1%, Industrials -9.8%, IT -10.6%, Property -13.6% and Utilities -13.8%.

PORTFOLIO STOCKS

The portfolio held 20 positions at the end of September with 54% of capital allocated to Australian Equities, 40% in Fixed Interest, 4% in Listed Property and 2% in cash. Last month we ran cash to a high of 17% as a short-term tactical decision while we shuffled some 'deck chairs', ultimately increasing market exposure towards both equities & fixed interest as the month progressed. The portfolio is expected
to yield ~6% over the coming 12 months.

While portfolio returns were negative for September, this was against a backdrop of weak markets as detailed above while the income-orientated market sectors struggled most, the Property & Utility sectors were down more than 13% for the period highlighting this trend.

We were active on the buy side during September adding three new positions to the portfolio, although two of those have been held previously. Amongst equities, we bought **APA Group (APA)** & **AGL Energy (AGL)** while we allocated 5% of capital into the **Westpac Hybrid (WBCPK)** which is now paying an expected yield to the first call date of almost 7% inclusive of franking.

We wrote last month about our sale of regulated utility **APA Group (APA)**, exiting the position into a strength. Our view was that the prevailing outperformance had come as investors looked for defensive exposure with embedded inflation protection, which is the case with APA which is leveraged to US CPI.

The subsequent ~20% sell-off in the stock reversed the YTD gains, presenting an opportunity to re-buy the position sooner than we had envisaged. This owner & operator of gas transmission and distribution assets in Australia offers two key things we like in this uncertain environment. Predictable earnings that rise with inflation (90% of earnings linked to CPI) and a dependable dividend that is now back up above 5% given the share price weakness.

PORTFOLIO STOCKS	
NO. OF HOLDINGS	20
ESTIMATED YIELD (%)	4.71
TOP 5 POSITIONS (% OF AUM)	34.57
TOP 10 POSITIONS (% OF AUM)	60.35

STOCK	CONTRIBUTION (%)
BHP GROUP (BHP)	0.36
NABPF	0.31
ANZPI	0.07
CBAPG	0.06
NABPI	0.06

STOCK	DETRACTION (%)
CENTURIA (CNI)	-0.46
PENDAL (PDL	-0.68
WESFARNMERS (WES)	-0.59
COMMONWEALTH BANK (CBA)	-0.52
STOCKLAND (SGP)	-0.44

%	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	YTD
FY23	4.22	0.30	-3.64										**0.88**
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													**33.10**

While APA guided to an FY23 dividend of 55c, a lower-than-expected 4% increase on FY22, the payout ratio (of free cash flow) is only 58% versus APA's stated target of a 60-70% payout. The lower payout is due to their growth focus in the short term i.e. they are in the running to buy two assets and that would have prompted some conservatism from the board.

In terms of valuation, we price APA on its yield relative to bonds. APA generally trades at a 2.8% premium to the 10-year bond yield and while it is currently only 1.63% above 10-year yields, below $10 and applying a more typical payout, we're getting closer to this number.

AGL Energy (AGL) was another position we added during September, following a sharp decline in share price. Longer-term investors in this portfolio may recall we held AGL earlier in the year, we have now re-entered into weakness below $7.00. Our investment thesis is around the embedded value in the AGL assets, and we believe this will be unlocked in time.

They recently detailed a strategy update along with earnings guidance for FY23 that was broadly in line with existing expectations. They will close Loy Yang A in Victoria in 2035, a decade ahead of originally planned, although said that Liddel & Bayswater would still be closed at some stage between 2030-2033 i.e. no change there.

They will spend $20bn on new zero-emission generation, which mirrors the amount that Grok & Brookfield said they would need to transition the company, while underlying EBITDA for FY23 would be $1,250m -$1,450m with underlying profit after tax of $200-$320m. Consensus expectations were sitting at $1,330m EBITDA & $300m profit.

There is clearly a lot of investment that needs to occur to make these longer-term plans a reality & get to the targeted 12GW of capacity by 2036. This includes investment in power generation but also investment in transmission, while the national energy market will need to provide a structure that incentivises investment right across the board i.e. more change is needed here. Clearly, a complex issue with a lot more water to go under the bridge.

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