

If 24 LICs ran the Melbourne Cup, which would be our favourites...?

05 November 2018 | Daryl Wilson, Affluence Funds Management

We are proud to present our second annual form guide for the 'LIC Cup'. This race is even bigger than the Melbourne Cup! There is approximately \$35 billion of gamblers' (investors') money at stake in this sector, so the stakes are certainly a lot higher!

To win the real Melbourne Cup requires a horse that is well trained, has a great jockey, and importantly hasn't been hit too hard with a weight handicap from the stewards.

To win the Affluence LIC Cup, an LIC requires many of the same attributes. They require a great trainer (the investment manager), an opportunistic jockey (the individual portfolio manager responsible for investment decisions), and a favourable handicap (starting discount or premium to NTA).

We would hasten to mention that training conditions in the last month have been more difficult than usual. We believe a 7%-10% equity market correction is similar to a month's solid rain on the track for the real Melbourne Cup, and conditions are a little soggy. This has made the field a little trickier to pick this year!

Affluence LIC Cup form guide

We have analysed the field of over 100 LICs, and here, in no particular order, are our 24 starters for the "Race that Stops the Investing Nation"...

LIC	Starting Handicap	"Affluence LIC Cup" Form Guide
WAM Capital (WAM)	22.5% premium	Despite not being in top form in recent races, the stewards have hit WAM with an even bigger handicap than last year. Starting at a 20+% premium makes it hard to see how it can win from here. However, this jockey knows a thing or two about long races, and if there is any horse play mid-race we would expect this LIC to come through better than most.
Forager Australian Share Fund (FOR)	5% premium	Hasn't been the best preparation going into this year's race. However, the stewards have taken this into account and reduced the handicap to a 5% premium. This will put FOR into a much more competitive position. The jockey likes to take the path less travelled, but we expect FOR to be there into the final straight.

LIC	Starting Handicap	“Affluence LIC Cup” Form Guide
WAM Research (WAX)	25% premium	We think the stewards must really have it in for this trainer, as they have increased the handicap for WAX this year as to a 25% premium as well. We like the trainer and we like the jockey. But we just can’t understand the stewards’ determination with these premiums.
NGE Capital (NGE)	20% discount	Last year’s surprise winner and the handicap still appears well overdone at a 20% discount. NGE has a real advantage due to its small size and unconstrained training strategy. Likes to take chances and could be a real challenger. Distantly related to the bigger and more popular LSF, but short term has gone much better.
Blue Sky Alternatives Access Fund (BAF)	25% discount	This is a real chance. The trainer had a nasty fall during the year and looks to be out of the game. While there were only limited injuries to BAF, it didn’t stop the stewards from slashing the handicap to a 25% discount. There are now two competing trainers trying to take over. It appears this is now in play!
Monash Capital (MA1)	15% discount	One of our favourites last year, but despite putting in a big effort has really struggled to get much traction in the races. Trainer has copped some criticism for poor form and an approach was recently made by a rival, but the owners have decided to stay put for now. Can be an inconsistent runner but on its day is able to match it with the best of them. An outside chance.
MFF Capital Limited (MFF)	5% discount	Ran second last year and this big American has been there or thereabouts for the past few years. Stewards have continued to add more weight and conditions increasingly are not to the horse’s liking. Might struggle to keep the momentum going to the finish line this year but it’s a champion and champions can surprise. Continues to outclass its more fancied stablemate.
Antipodes Global Investments (APL)	5% discount	Excellent global trainer who is in with a good chance. The stewards appear to have become distracted by the large volume of options that have recently been exercised and have given APL a handy starting handicap of a 5% discount to NTA. Now that the options have expired, the trainer and jockey can get down to business.
WAM Leaders (WLE)	Around NTA	One of our top picks last year and ran well, without troubling the top three. Given its stablemates in WAX and WAM continue to be hit with sky high premiums, we are surprised that WLE continues to trade around NTA. We think it looks pretty good at this level and expect another strong race this year.

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Australian Leaders Fund (ALF)	15% discount	This LICs form, along with stablemates WMK and WGF has been terrible. Given track conditions over the past year (until last month) this is not overly surprising. It’s a wet weather specialist and stewards have reduced the handicap even further to a 15% discount. Still not showing any pace, however at least it’s not running backwards anymore. On the right track it may have a chance. Trainer has indicated that they may use some other training methods if results don’t improve.
Australian Foundation Investment Co (AFI)	5% premium	This huge mare and local favourite seems like she’s been around forever. Largest horse in the field and still a solid racer. Usually around mid-pack but struggles to have the top speed to win in any given year. Starting off a small premium, as she has almost every year since 1928. Expect a solid but not spectacular result.
Hearts and Minds (HM1)	Around NTA	This LIC will miss the start but is likely to fly out of the gate late and it could just make up the distance. The capital raising has shown that it may well be the peoples champion, and time will tell if it can live up to its hype. Superb ensemble of trainers and jockeys, as long as they can all agree on which direction to run.
Tribeca Global Natural Resources Limited (TGF)	Around NTA	A new entrant to the race, and one we have high expectations of. Nothing else like it in the field, and the trainer has a large array of techniques available to get results. Could be a surprising all-weather performer.
Henry Morgan Limited (HML) and Benjamin Hornigold (BHD)	No idea	Named after pirates, and with a curious style of racing with only one blinker, little is known about these Brisbane based stablemates. Last year, both were MIA and scratched at the last minute. Twelve months on, they’re rumoured to still be training on a private track out the back of the Gold Coast. But it’s believed the stewards are still not happy...
Future Generation (FGX) and Future Generation Global (FGG)	5% premium	One of our top picks last year and FGG did manage a third place. Brilliant stayers and the longer the race, the better these two will perform. Over the long run (perhaps over 3 to 5 race distances), regardless of any changes in track conditions, these two will just keep going. Best credentialled combination of trainers and jockeys in the race.
Bailador Technology (BTI)	30% discount	We thought the handicap was too soft last year, but now the stewards have lost the plot and let them start with a 30% discount. It has taken a few years for the trainers to get this LIC ready to fire, and they may well just be entering the race at the right time.

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8IP Emerging Companies (8EC)	15% discount	Has had a poor year but the Stewards continue to demand a reasonably high weight. A recent and very public spat between the trainer and a substantial owner hasn't helped matters. Is likely to struggle until the ownership dispute is sorted.
Ozgrowth (OZG)	20% discount	The only West Australian horse in the field this year. Has run well in the last couple of races but without much reward. Well trained and if conditions suit is in with a shot.
Sandon Capital (SNC)	7.5% discount	Well regarded runner. Talented trainer and jockeys and has been a consistent performer. Stewards have been kinder than last year, which provides a better chance in the race. Should be a good show but may not be able to go with the faster runners at the end.
Thorney Opportunities (TOP)	10% discount	Recent results have been soft for this LIC compared to the trainers and jockey's high standards. While unconfirmed, we believe TOP may have taken a tumble during October. Just remember, this is a long race and this LIC is definitely still up for it.
Global Value Fund (GVF)	Small discount	UK horse with Australian jockey. A unique racing style and a big heart make this one a real chance. Seems to go well in all conditions, but without the blazing top speed of some of its competitors.
L1 Long Short Fund (LSF)	Small premium	After a stunning run in the lower classes, this big hometown hero has struggled since stepping up to the big leagues. Was heavily backed earlier in the season and disappointed badly. The punters have voiced their displeasure. More recently has started to show some positive signs. Likely to be well back early, but this horse is capable of overtaking the entire field as it builds momentum.
Absolute Equity Performance Fund (AEG)	Small premium	This one could finish anywhere. Has a long track record of quality wins, but can be very inconsistent, even within a race. Often flies to the front with blinding speed, only to fall back to mid-pack. On its day can win easily. Goes OK on a wet track and one to watch out for.
Ryder Capital (RYD)	15% discount	The ultimate dark horse. This Sydney horse has run well all year but mostly on country tracks, so is largely unknown by the punters. Jockeys are also part-owners which we like to see. Coming off some good form and could be a real surprise package in the big race.

Who would fill the top 3 places?

Like the Melbourne Cup, the field is wide open and we should always expect the unexpected. But we realise everybody loves a hot tip so here are our picks. We've gone with one consistent performer and a couple of roughies.

Antipodes Global Investment (ASX code: APL)

We believe the manager of this LIC, Antipodes Partners led by Jacob Mitchell, to be one of the best global equity managers in Australia. Prior to establishing Antipodes, Jacob was a long-term senior investment executive at Platinum Asset Management.

Since listing in October 2016, performance at the portfolio level has slightly underperformed their benchmark. The manager has a value bias and the strategy is long/short, so this slight underperformance is to be expected given the very strong market conditions over this period. As at September 2018 the portfolio had a gross exposure of 122% and was net long 62%. The portfolio appears to have performed substantially better than the global market during October, which is what we would expect from this strategy when markets get turbulent.

We believe there is an additional opportunity presently as the LIC is trading at a greater than average discount to NTA. The discount is currently approximately 7%, which we believe is larger than deserved. Options issued at the IPO expired in October. The majority of options were exercised, which translated into some dilution to NTA. This is a common pattern for LICs, when the discount increases leading up to the option expiry date. What quite often follows is a narrowing of the discount, as investors know the dilutionary impact is over.

Blue Sky Alternatives Access Fund (ASX code: BAF)

This might be controversial, but hear us out. The LIC is currently managed by Blue Sky Limited. It provides exposure to a range of alternative assets including private equity, real assets (water rights and agriculture investments), and real estate. It historically traded in a range around NTA, but that all changed in early 2018 when Blue Sky Limited was targeted by short sellers. This triggered a massive sell-off in the manager, and BAF was caught in the downdraft. There has been limited impact on the underlying assets in the portfolio, with the NTA holding relatively steady. Nonetheless, BAF is now trading at approximately a 25% discount to NTA.

This in itself looks to be an opportunity. However, during October Blue Sky announced they had signed agreements with a subsidiary of Pinnacle Investments to transition the management of BAF under a new investment mandate. BAF would effectively evolve to be a fund-of-funds for the Pinnacle stable (pun intended). Then in late October, there was an announcement that Wilson Asset Management had put

forward a proposal for them to take over management of the fund and implement a new investment mandate.

At this point, it is very difficult to know what will happen. However, Blue Sky is obviously agreeable to let go of the management rights, and it would appear likely either Pinnacle or WAM will take the reins (pun intended). Under either of the new managers, we believe the discount to NTA is likely to close significantly. But there are risks. There is no certainty who the new manager will be, or even if there will be a new manager. It is likely that large parts of the existing BAF portfolio will need to be sold for cash. There are some liquidity challenges with some of these assets, actual realisations may be below current carrying values and there may be tax to pay on any gains.

Notwithstanding the above risks, we believe a starting discount to NTA of 25% allows a reasonable margin of safety for the opportunity to generate uncorrelated returns.

Bailador Technology Investments (ASX code: BTI)

Bailador aim to provide investors with exposure to expansion-stage technology companies with global addressable markets and a high growth trajectory. It is managed by David Kirk and Paul Wilson who both have very impressive resumes and are well experienced in private equity. The portfolio currently comprises 10 investments, with 9 unlisted companies and 1 recently listed.

BTI has been listed for almost four years. During this period, it has traded at between a 30% discount and 10% premium. It got off to a fantastic start with the NTA increasing from \$1.00 to \$1.26 per share within 16 months. However, through dilution from options exercising and some valuation write downs, the NTA decreased back to \$1.06. The NTA has since increased to \$1.16 per share, however the discount to NTA is now approximately 30% and the share price is languishing around \$0.80.

We believe that part of the increase in the discount is due to investors lack of patience. Investors may have expected that as BTI invests in private equity, they should be generating 30% returns every year. Given the portfolio is invested in expansion stage companies, it often takes time for the underlying businesses to mature and realise value. BTI has partially realised one of their investments this month through an IPO (Straker Translations ASX: STG). The IPO was at a premium to BTI's previous carrying value and it is currently trading at a slight premium to the listing price. It is likely a few of these realisation events will occur in the next 1-2 years. If realisations occur at premiums to carrying values, this may well be the catalyst for the discount to NTA to close. The key risk is that any major correction in listed tech shares is likely to affect both values and realisation prospects for the BTI portfolio.

Before you invest, read this!

We encourage you to do your own research before investing in any LIC. Remember, a great LIC and a great manager is only part of the story. We also like to make sure they're trading at the right price and that the assets they are investing in are not themselves overvalued. We explain how we do this in our [LIC Guide](#), but in the end it's up to you to make the investment decision that's right for you, in conjunction with your financial advisor if you have one.

Take care and all the best with your investing.

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