# Bennelong Twenty20 Australian Equities Fund
## Performance update

As at 31 March 2017

### Performance

| | 1 mth | 3 mths | 6 mths | 1 Year | 3 years pa | 5 years pa | Since Inception** pa |
|---|---|---|---|---|---|---|---|
| Fund | 3.43% | 5.02% | 7.71% | 17.46% | na | na | 11.06% |
| Benchmark* | 3.28% | 4.71% | 9.88% | 20.24% | na | na | 13.28% |
| Value added | +0.16% | +0.31% | -2.17% | -2.78% | na | na | -2.22% |

Performance figures are net of fees and expenses. 'Value added' calculation does not use rounded performance figures.
*S&P/ASX 300 Accumulation Index
**Inception date is 2 December 2015

### Introduction to the Twenty20 Fund

The Fund has been operating since December 2015. It combines a passive investment in the S&P/ASX 20 Index and an actively managed investment in Australian listed stocks outside this index. The passive investment is one that mimics the performance of the S&P/ASX 20 Index, while the active management seeks to invest in a limited selection of ex-20 stocks that the manager believes will outperform.

The **passive position in the S&P/ASX 20 Index** is achieved by investing individually in each of the index's constituent stocks, including for example Commonwealth Bank, Telstra and CSL. The weighting in each of these 20 stocks approximates the same weight they represent in the S&P/ASX 300. The Fund's overall weight in the S&P/ASX 20 will thus approximate its weight in the S&P/ASX 300. Currently, this weight is approximately 60%.

Given this heavy weight in the S&P/ASX 20, the Fund's largest positions will typically coincide with those of the market, as seen in the table of the Top 10 Holdings.

The **active position in ex-20 stocks** has the goal of allowing the Fund to outperform the broader market. This active investment is managed according to the same strategy adopted in respect of the Bennelong ex-20 Australian Equities Fund. This strategy seeks to identify high quality, strongly growing companies whose earnings prospects are underestimated by the market.

Divergence in the performance of the Bennelong Twenty20 Australian Equities Fund from its benchmark, the S&P/ASX 300, will arise from the relative performance of the Fund's active investment in ex-20 stocks.

The Fund gives broad exposure across the Australian stock market and is available at a low management fee of 0.39% (plus a performance fee where applicable).

| Top 10 Holdings |
|---|
| Commonwealth Bank |
| Westpac Banking |
| Australia and New Zealand Banking |
| National Australia Bank |
| BHP Billiton |
| Aristocrat Leisure |
| Domino's Pizza |
| CSL |
| Telstra |
| Wesfarmers |

*Source: BAEP*

The Fund's sector exposures will deviate from the benchmark to the extent that its actively managed investment in ex-20 stocks results in an over or under-weighting to any particular sector.

| Sector | Fund Weight | Benchmark* Weight | Active Weight |
|---|---|---|---|
| Discretionary | 19.6% | 5.0% | 14.6% |
| Consumer Staples | 12.7% | 7.2% | 5.5% |
| Liquidity | 1.1% | 0.0% | 1.1% |
| Health Care | 7.9% | 6.8% | 1.1% |
| Telco's | 3.5% | 4.0% | -0.5% |
| Utilities | 1.9% | 2.7% | -0.7% |
| IT | 0.0% | 1.2% | -1.2% |
| Industrials | 5.0% | 6.7% | -1.7% |
| Financials | 36.2% | 38.2% | -2.0% |
| Energy | 1.5% | 4.3% | -2.8% |
| REIT's | 2.5% | 8.4% | -5.8% |
| Materials | 8.2% | 15.6% | -7.4% |

*Source: BAEP. *Benchmark is as for the Fund.*

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BAEP
Bennelong Australian Equity Partners



## Performance review

The stock market had a reasonably strong March and a strong March quarter. The Fund slightly outperformed the market over both time frames. The Fund returned 5.02% for the quarter, compared to the benchmark's return of 4.71%. For the month of March, the Fund returned 3.43% compared to the benchmark's return of 3.28%.

As stated on the previous page, the Fund's performance is dictated largely, although not entirely, by the performance of the S&P/ASX 20 Index. Deviation from the benchmark, the S&P/ASX 300, arises to the extent of the Fund's relative performance in respect of its active management of ex-20 stocks. That is, the relative performance of the ex-20 sleeve of the portfolio will determine the Fund's out or underperformance versus the market.

This quarter's outperformance owed itself to the large outperformances of Aristocrat, Treasury Wine Estates and BWX. On the other hand, the Fund has a large position in Domino's Pizza Enterprises, which performed poorly.

## Portfolio Positioning

In terms of the ex-20 sleeve of the portfolio, we have taken the opportunity to selectively add to existing positions, particularly where prices have come off but fundamentals have improved, and to add a few new names. The Fund holds a number of high quality and strongly growing companies in this ex-20 sleeve. Many of their products or services should continue to sell well regardless of the economic environment, including pizzas, wine, plumbing products and hospital services. They should also be selling more and more of their products or services over time, which should augur well for longer growth in earnings, value, and ultimately shareholder returns.

Some of the larger ex-20 positions in the portfolio include the following.

- **Aristocrat** manufactures slot machines for casinos, pubs and clubs, and develops online social casino games for play on networks such as Facebook. Momentum within the business is strong. At its AGM in February, the company guided towards earnings growth for this financial year of 20%-30%, which was above market expectations. The company has developed a popular range of products, and has an attractive pipeline of new games to follow. Increasingly, the company is selling on a participation basis, in which it shares in the revenues its casino customers make from the machines it sells. This improves the visibility and predictability of earnings, which warrants a high valuation multiple.
- **BWX Limited** is a relatively smaller company with a market capitalisation of less than $500 million. It owns the Sukin range of skincare creams and other personal care products. Sukin is a leading natural skincare brand in Australia, and is gradually building up an export business, with sales building into markets such as the UK, Canada and China. At its recent first half result, it reported that sales of Sukin products grew 49% in Australia, and by 116% to export markets. The company should enjoy strong earnings growth over the longer term if it can continue to execute on its growth strategy in Australia and offshore.
- **Fisher & Paykel Healthcare** manufactures breathing-support devices that assist with breathing difficulties, including humidified ventilation systems and CPAP devices. At its half-year result in November, it reported profit growth of 26%. The company has very large markets that remain underpenetrated, particularly for its humidified ventilation products. With a strong track-record and a large opportunity in front of it, the company looks likely to grow earnings and shareholder value over the long term. Indeed, the company has recently provided longer term targets to double revenues every five to six years and achieve EBIT margins of 30% (from approximately 25% today).
- **Ramsay Health Care** is the largest private hospital operator in Australia, the largest private operator in France, and has smaller operations in the UK and Asia. At its recent half year result, it upgraded its earnings guidance range for the full year from 10%-12% to 12%-14%. Over the next few years, the company has outlined a significant opportunity to reduce procurement costs, which could be quite substantial. Over the long term, it should continue to benefit from the strong growth in demand for hospital services, not least because of an ageing population.
- **Reliance Worldwide** manufactures plumbing products and water control valves. These include the Sharkbite brand of push-to-connect plumbing fittings that are growing in popularity among plumbers. The company was listed in early 2016 but has a long track record of through-the-cycle revenue growth. At its recent half year result, it reported earnings growth of 19%, and guided to full year earnings slightly ahead of its Prospectus forecast. Over the longer term, the company should be able to grow nicely through market share gains, especially with Sharkbite in the US, and expand into other markets.
- **Treasury Wine Estates** produces and distributes wines, focusing on luxury and 'masstige' brands that include Penfolds, Wynns and Wolf Blass. It is part way through a transformation that essentially involves re-orientating from a price-taking production company and more towards a price-



making brand company. The transformation is allowing to the company to arrest pricing power back to itself, which is in turn allowing to price up its wine. This is resulting in higher revenues, margins and profits. At its recent half year result, the company reported a more than doubling of earnings over the prior period. Over the longer term, the company looks set to continue the transformation and build out its Chinese and US businesses.

## Outlook

Some investors are concerned that the market has run too hard in recent months, that market valuations are too high, that the macro picture remains troubled, and/or that there is potential for a market downturn, or worse. These concerns always seem sensible. As Joseph Schumpter once said, “Pessimistic visions about anything usually strike the public as more erudite than optimistic ones.” It is true that there is some justification for the market’s caution, and given we are talking about the future, anything is possible.

However, valuations are still quite reasonable, particularly in the context of the lowly yields and prospective returns available elsewhere. The stock market trades on a PE multiple of just 16 times the consensus earnings for the next 12 months, offers some (albeit sluggish) growth longer term, and is set to pay a dividend yield of 4.4%. In fact, the market’s dividend yield rises to 5.8% when grossed up for the value of franking credits, which one doesn’t get on other assets. This appears reasonably attractive compared to other asset classes. To take the most commonly used reference rate, the Australian 10-year government bond yielded just 2.69% as at the end of March (and less at the time of writing). For so long as long-dated yields remain low, the equity markets are likely to remain well supported.

It seems many equity investors have assumed that long-dated interest rates are on the way up. Most seem to have considered this inevitable based on the consensus thinking that the Fed would hike rates three times this year, with more to go next year. Other things being equal, rising long-term rates should act to pressure equity market valuations. However, since the Fed hiked rates in mid-March, long-dated bonds yields have in fact fallen, indeed quite materially. Immediately before the Fed’s hike, the Australian 10-year yielded 2.98%, which means it has fallen approximately 30bps since. Similarly, the US 10-year yield also fell, albeit slightly less.

Interestingly, in the last Fed rate tightening cycle starting in 2004, which lasted two years and involved a total of 17 rate hikes that increased the funding rate from 1.00% to 5.25%, the US 10-year bond actually fell by almost 100bps, from 4.87% to 3.88%.This might seem counterintuitive, but it just goes to show how hard it is to forecast long-term bond yields. Inherently, long-dated bond yields price in the market’s expectations for rate hikes or cuts over the following 10 years. More recently, the long-term yields had already factored in the consensus rates hikes for 2017 and the prospect for more next year. Few have considered the possibility that the Fed would look to contract its balance sheet, which has the effect of and replaces some of the need for actual rate hikes. Where they go from here is of course difficult to predict. The reality however is that interest rates are low and could well remain low for some time. Coming out of the Depression in the early 1930’s, the yield on the US 10-year Government Bond remained below 3% for two decades.

As always, there are some pockets of the market that look vulnerable; some that look quite attractive. It will increasingly pay to be selective. In this respect, and in terms of the active ex-20 sleeve of the portfolio, the Fund is positioned in high quality, above average growing companies.

| | Fund | Benchmark* | |
|---|---|---|---|
| Return on Equity | 14.1% | 12.0% | Premium Quality |
| Debt/Equity | 19.5% | 25.1% | |
| Sales Growth | 6.6% | 4.3% | Superior Growth |
| EPS Growth | 13.4% | 12.9% | |
| Price/Earnings | 17.1x | 16.0x | Reasonable Valuation |
| Dividend Yield | 4.0% | 4.4% | |
| Beta | 0.96 | 1 | |
| Active Share | 35% | na | Genuinely Active |
| No. of Stocks | 49 | 301 | |

# Bennelong Twenty20 Australian Equities Fund
## Monthly performance update
As at 31 March 2017

### About BAEP

Bennelong Australian Equity Partners (BAEP) is a boutique fund manager focused on Australian equities. It was founded in 2008 in partnership with Bennelong Funds Management. BAEP is a genuinely active fund manager with a consistent and disciplined investment approach.

BAEP's investment philosophy is to selectively invest:

- in high quality companies;
- with strong growth outlooks; and
- underestimated earnings momentum and prospects.

BAEP's investment process is research-intensive with a focus on proprietary field research and is supported by economic and quantitative insights.

## About the Fund

The Bennelong Twenty20 Australian Equities Fund combines an indexed investment in the S&P/ASX 20 Index and an actively managed investment in Australian listed stocks outside of this index. It typically holds 40-55 stocks.

Benefits of the Fund

- BAEP is an award winning and highly rated equities fund manager with an experienced and performance-orientated team.
- The Fund provides a broad exposure to the Australian market via a combination of passive investment (in respect of the S&P/ASX20) and an actively managed investment (in respect of stocks outside of the S&P/ASX20).
- The Fund's ex-20 exposure is managed in accordance with the strategy adopted in the Bennelong ex-20 Australian Equities Fund. This fund is of high conviction and it has a track record of adding value by outperforming the market over the long term.
- The Fund is managed in accordance with BAEP's robust, disciplined and proven investment philosophy and process.

### The Fund at a glance

| Feature | Fund fact |
|---|---|
| APIR code | BFL0017AU |
| Benchmark | S&P/ASX 300 Accumulation Index |
| Investment objective | 2% p.a. above benchmark measured over rolling 3-year periods |
| Investment manager | Bennelong Australian Equity Partners (BAEP) |
| Active stock limit | ± 10% |
| Cash limit | 0-10% |
| Inception date | 2 December 2015 |
| Recommended investment period | Long term (five years plus) |
| Buy/sell spread | +/-0.30% |
| Entry/exit fees | Nil |
| Management Fee | 0.39% p.a. of Net Asset Value of the Fund |
| Performance Fee | 15% of any amount by which the Fund's return is greater than the return generated by the S&P/ASX 300 Accumulation Index |

## How to invest

The Fund is open to investors directly via the PDS, available on our website.

**Platforms**

- AMP Personalised Portfolio
- CFS First Wrap
- Federation Managed Accounts
- Macquarie Wrap

## Contact details

For more information, call 1800 895 388 (AU) or 0800 442 304 (NZ) or visit baep.com.au