

Bennelong Twenty20 Australian Equities Fund

Performance update

As at 31 March 2019

Net client returns (after fees and expenses)

| | 1 mth | 3 mths | 1 Year | 3 years pa | 5 years pa | 10 years pa | Since Inception** pa |
|-------------|--------|--------|--------|------------|------------|-------------|----------------------|
| Fund | 0.64% | 8.44% | 6.58% | 10.40% | na | na | 8.63% |
| Benchmark* | 0.73% | 10.92% | 11.74% | 11.39% | na | na | 9.59% |
| Value added | -0.10% | -2.48% | -5.16% | -0.98% | na | na | -0.97% |

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 mirrors 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 over 50%.

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 Holdings

| |
|-----------------------------------|
| Commonwealth Bank |
| BHP Billiton |
| Aristocrat Leisure |
| Goodman |
| Westpac Banking |
| CSL |
| Dexus Property |
| Australia and New Zealand Banking |

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 | 16.6% | 6.4% | 10.2% |
| REIT's | 12.6% | 7.9% | 4.7% |
| Health Care | 11.6% | 8.4% | 3.2% |
| Liquidity | 2.2% | 0.0% | 2.2% |
| Consumer Staples | 7.6% | 5.5% | 2.1% |
| Communication | 3.4% | 3.7% | -0.3% |
| Industrials | 6.3% | 8.2% | -1.9% |
| Utilities | 0.0% | 2.0% | -2.0% |
| IT | 0.0% | 2.5% | -2.5% |
| Energy | 1.8% | 5.6% | -3.9% |
| Financials | 25.2% | 30.9% | -5.7% |
| Materials | 12.7% | 18.9% | -6.2% |

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



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Fund performance & attribution

The market recovered hard in the March quarter, with the ASX enjoying one of its best quarters for the past decade. The Fund also recovered hard, albeit lagging the benchmark.

The difference in performance between the Fund and the benchmark owes itself to the positions in ex-20 stocks.

The main detractors from performance over the quarter were Reliance Worldwide, Costa Group and Resmed.

Costa Group announced in early January that it had been experiencing weaker-than-expected trading, and it lowered its earnings guidance for the December half and the current June half. This largely owed itself to weakness in demand for its key products, including berries. We believe this weakness was mostly short-term in nature, and not indicative of longer term issues.

Indeed, at its half year result, Costa continued with its guidance for greater than 30% earnings growth for the 2019 calendar year. We in fact believe there is a very decent probability the company will do even better.

Looking out further, the company is making sizeable investments to expand production, and an important part of this is in its Chinese berry venture. The investments being made are warranted by strong growth in its key product categories - notwithstanding the recent short term weakness - and they should underpin relatively reliable long term earnings growth.

Costa's shares were sold off hard following its announcement in January, and this unfortunately hit the Fund's performance. Whilst partly recovering, its price-to-earnings multiple now sits at bottom end of the range at which it has historically traded. Investors will likely need to regain confidence in earnings delivery before re-rating its shares back upwards. The risk-return equation now presents nicely. Today's investor expectations are built on circumspection, and this improves the probability the company performs better than expected. The potential combination of strong growth in earnings and an upward re-rating of the multiple paid for those earnings offers the possibility of a 'double play' that could give rise to very attractive returns.

Shares in **Reliance Worldwide** have also de-rated over the past six months, but this has occurred without any deterioration in the prospects for its business.

Among the issues the market has been concerned of are:

- a slowdown in US housing starts (despite around 85% of revenues being from the more resilient repair and remodel markets);
- fallout from Brexit hitting its newly acquired John Guest business;
- rising copper prices, which adds to the cost of manufacturing its brass plumbing fittings (it has historically been successful in ultimately passing on higher input prices to its customers); and
- freeze events in the US, from which Reliance can benefit as a result of broken piping.

These issues do not alter the longer term prospects of the company, and mostly act as a distraction from what fundamentally underpins the investment case.

In February, the company reported decent half year results and reaffirmed full year earnings guidance. Importantly, underlying sales growth remains strong at 9.5% and last year's John Guest acquisition in Europe is performing well.

The market initially reacted positively to the result and its shares traded up nicely. However, the founding family took this as an opportunity to sell its remaining 10% stake in the company. Given the size of the block of shares sold, the discounted sale price, and the implications of an insider selling out, the sell-down weighed on the company's shares. It will be the company's operating performance that determines investors' returns from here, and in this respect, we see the recent results – and our ongoing on-the-ground research – as indicating continuing strong momentum in the business.

On consensus numbers, Reliance's shares trade on around 18 times next year's earnings. We believe this is very attractive given its quality and growth prospects.

Resmed had been a strong performer for the Fund but tripped up this quarter when it announced with its half year results a larger-than-expected investment in ancillary businesses that will act as a drag on profitability in the short term. We take comfort from momentum in the company's core business and we believe in its long term prospects.

The largest positive contributors to performance for the quarter were **Goodman Group**, **IDP Education** and **Breville**.

These are all global businesses operating across a range of different industries that again reported very strong financial results.

Market outlook

Investor sentiment still remains cautious despite the strong recovery over the past quarter. It usually takes some time for investors to come out of their shells after a large retracement like we had at the end of last year. Matching that, the consensus outlook remains weak, particularly in respect of domestically focused stocks and the broader domestic economy.

We observe that investors are still very much attracted to what is perceived to be safe. This is seen in the continued recent outperformance of bonds, gold stocks, REITs, infrastructure and comfort stocks like Woolworths that are now trading expensive. Investors are, however, incrementally paying more attention to fundamental drivers like earnings and growth. Importantly for the Fund, this will be supportive of returns.

Reflecting the cautious investor sentiment, valuations are relatively attractive. On consensus numbers, the market trades on 15.7 times next year's earnings, and is paying a dividend yield of 4.7% (which grosses up with franking credits to around 6%). These metrics are around historical averages despite record low interest rates and other assets generally valued far beyond historical norms.

The issue is in the earnings. Based on consensus numbers, earnings are expected to grow just over 5% over the next 12 months. However, in our view, there is significant earnings risk right across the market. This is the risk that a stock disappoints the market by delivering earnings that fall short of expectations. Our view implies that earnings projections are optimistic, which in turn would mean the true price-to-earnings multiple for the market is actually somewhat higher.

We believe it is necessary to be particularly conscious right now of earnings risk taken within one's portfolio. On the other hand, to the extent that companies can deliver to expectations, we believe investors can expect attractive returns.

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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, disciplined and proven 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 macro-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 is managed in accordance with BAEP's robust, disciplined and proven investment philosophy and process.
- 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 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 | +/-0.20% |
| 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 (Elements Investment, Elements Pension, iAccess, My North, North, Portfolio Care, Portfolio Care eWrap, PPS, Summit, Wealthview eWrap Inv)

AON Macquarie Wrap (IDPS, Super)

CFS (FirstWrap) Mason Stevens

Credit Suisse Netwealth (Super Service, Wrap Service, IDPS)

Federation

Contact details

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

The Fund is managed by Bennelong Australian Equity Partners, a Bennelong Funds Management boutique.

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