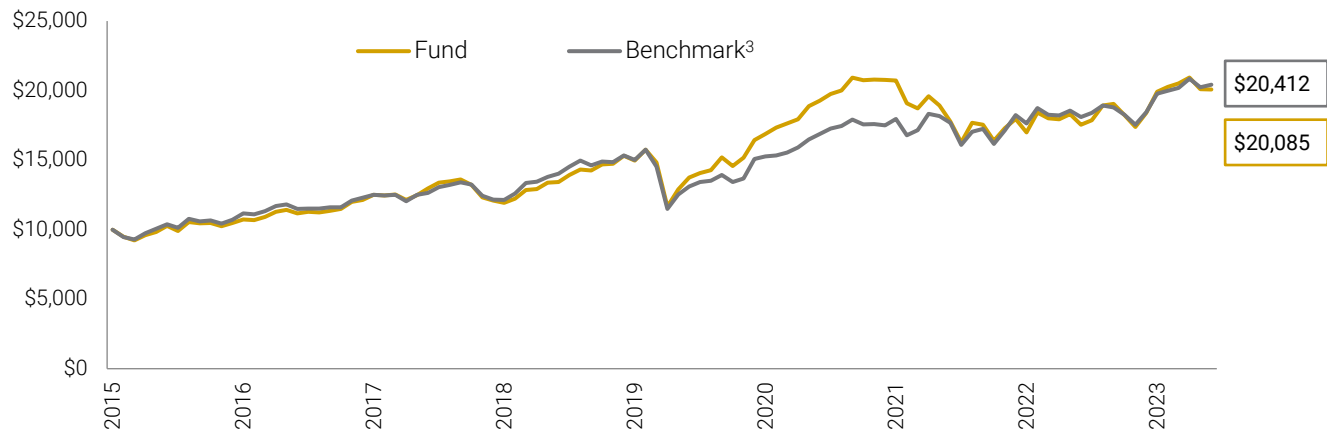


# Investor Commentary | 31 May 2024

## Bennelong Twenty20 Australian Equities Fund

### Long-term Fund performance

Growth of \$10,000 since inception<sup>1,2</sup>



Past performance is not indicative of future performance.

### Market review

The ASX300 rose by 0.85% in May. The month saw a sharp rise in volatility, with six daily moves of more than 1%. The ASX sector performance also varied greatly with technology up +5.5% and utilities up +3.4%, while communications declined by -2.6% and consumer staples by -0.9%.

The move higher in technology was supported by earnings upgrades in a number of key stocks. Despite banks also seeing upgrades of +1.9% (due to lower bad debt charges), overall ASX earnings fell by around -0.3% in the month.

Earnings momentum for global markets remains stronger than in Australia. The 12-month forward earnings for the ASX200 has fallen by -12% in the past year, while it has risen by around +12% for the S&P 500. BAEP's portfolios continue to be dominated by companies with global growth opportunities.

The US composite Purchasing Manufacturers Index (PMI) rose again in April to a healthy 54.4 from 51.3 in March (above 50 signifies that the economy is growing). Both services and manufacturing accelerated, showing a broad-based advance. US inflation is also slowly edging back towards 3%. This gradual slowdown in inflation hopefully leaves scope for the Fed to cut rates in late 2024 and into 2025. In contrast, Australian real GDP growth is below 1% and may soon be negative. All the growth is in the public sector, which is growing at +4.5% YoY, whereas the private sector is in recession. The latest Australian

inflation readings continue to move higher. The April CPI at 3.6% YoY was stronger than expected, with the annual rate for headline and core inflation increasing for a third consecutive month. The RBA held the cash rate flat at 4.35% in its May meeting, although its statement was marginally more hawkish. Reflecting this divergence in the trajectory of inflation, US 10-year yields fell by -18bp to 4.50% in the month, while Australian 10-year yields were relatively flat declining by -1bp to 4.41%.

### Fund performance

	Fund	Benchmark <sup>3</sup>	Value added
1 mth	-0.03%	0.85%	-0.88%
3 mths	-2.13%	1.10%	-3.23%
CYTD	0.83%	3.21%	-2.39%
1 year	14.41%	12.83%	1.58%
3 years p.a.	1.37%	6.54%	-5.18%
5 years p.a.	8.39%	7.79%	0.60%
10 years p.a.	na	na	na
Since inception <sup>1</sup> p.a.	8.79%	8.86%	-0.07%

Performance figures are net of fees and expenses. 'Value added' calculation does not use rounded performance figures. Past performance is not indicative of future performance.

## Portfolio characteristics

	Fund weight	Benchmark <sup>3</sup> weight	Profile
Return on equity	14.0%	12.2%	Premium quality
Debt/Equity	21.7%	36.7%	
Sales growth	4.6%	3.7%	Superior growth
EPS growth	5.4%	4.9%	
Price/Earnings	18.0x	16.6x	Reasonable valuation
Dividend yield	3.4%	3.9%	
Beta	1.04	1	
Active share	34%	na	Genuinely active
No. of Stocks	40	297	

Source: broker consensus estimates for the next 12 months

## Portfolio review

The Fund delivered a return of -0.03% for May which was -0.88% below the +0.85% benchmark return.

The simple explanation for the underperformance was that while we had greatly reduced the JHX position, we still held a modest position when the company issued cautious guidance for FY25. In addition, travel stocks were weaker in the month as was the broader consumer sector. This was driven by a number of consumer companies reporting weaker conditions. We provide more detail below on key contributors and detractors of performance.

The portfolio benefitted from strong performance in A2M and SNL. We often caution against focusing too much on the sector weights of the fund as even stocks within the same sector can have very different earnings drivers and performance. A great example was that while the consumer staples sector declined by -0.9% this month, the only stock that we hold in the sector, A2M, rose by 16.1%.

## Top five active holdings

At month end, in alphabetical order

Stock
ARB Corporation Limited
Breville Group Limited
Car Group Limited
IDP Education Limited
The A2 Milk Company Ltd

## Top three contributors

To monthly relative performance, in alphabetical order

	Avg active position
Fisher & Paykel Healthcare	Overweight
Supply Network	Overweight
The A2 Milk Company	Overweight

## The A2 Milk Company (A2M)

There is a growing appreciation by analysts that the company's reinvestment in its brands and distribution channels is now bringing results. A2M's market share in the China label infant milk formula category is up 50% over the past two years, however it still has significant room to grow from its current level of just 3.5%. Management has been executing strongly, and we expect A2M to continue to gain share through growing brand awareness, strong sales momentum, new product ranging and expanding their distribution into lower tier cities in China.

## Fisher & Paykel (FPH)

FPH delivered a strong FY24 result in May. The momentum has returned to its hospital business following a rebasing of sales post-Covid. There has also been an improvement in its margins as elevated freight costs abate and the more predictable demand following Covid allows for greater operational efficiency. The homecare business also delivered strong results on the back of the Evora mask release in FY24, to be followed by the global rollout of the recently approved Solo and Nova Micro masks to occur over the course of FY25. Guidance for 17-36% EPS growth for the FY25 period was well received by the market.

## Supply Network (SNL)

SNL provided a trading update with FY24 NPAT expected to come in around 2% above consensus. This stronger performance was driven by solid revenue and slightly improved margins. This was a particularly pleasing result given recent updates from peers, Bapcor and Maxiparts, which were both well below market expectations. This is consistent with our view that SNL should continue to achieve market share gains.

## Top three detractors

To monthly relative performance, in alphabetical order

	Avg active position
AP Eagers	Overweight
Flight Centre Travel	Overweight
The Reject Shop	Overweight

## Flight Centre (FLT)

FLT was impacted by a weaker-than-expected earnings update in early May from its much smaller peer, Hello World Travel. FLT then reaffirmed its FY24 guidance at the Macquarie conference and said that trading was broadly in line with expectations with positive trends emerging. It noted that its busiest trading months of the year were yet to come. While the FLT update was well received, the broader consumer sector continued to experience a number of downgrades though the month, which weighed on the travel stocks, including FLT.

## AP Eagers (APE)

APE provided a trading update and 2024 guidance at their AGM in May. While it's tracking ahead of its previous revenue guidance after four months, it highlighted the earnings drag from their joint venture with Chinese auto maker BYD, where it is having to provide support to clear

excess inventory in one particular model. While margins remain stable in the remainder of the franchised business, there are pockets of margin pressure in some brands that are also carrying too much inventory, despite customer order intake remaining healthy. Management is expecting the BYD performance to improve through the year as they clear the remaining excess stock.

### The Reject Shop (TRS)

TRS was negatively impacted by the trading update it provided in May. While LFL sales momentum improved to +3.3% for 2H24 to date from +2.3% in 1H24, it had more store closures in the half dragging slightly on total sales vs expectations. Management also flagged ongoing cost headwinds from shrink/theft, despite managing its other cost lines well in the inflationary environment. Management is pleased with the performance of its new product ranges, and are focused on improving sales and margins into FY25.

## Outlook

Since the inception of the Fund, there have been a few drawdowns in relative performance similar to the current experience. In each occurrence, performance was very strong just prior to the pullback. In the four months from Nov 23 to Feb 24, the Fund rose 18.1% while the ASX300 was up 15.0%. Historically, following a strong advance by the Fund, there is often a partial retracement before the ongoing earnings growth reasserts itself and the longer-term gains resume. As occurred in the past, we are also finding that the more volatile environment at present is providing increased opportunity to invest in quality companies delivering sustainable compound earnings growth. We believe this can lay the foundations for attractive returns over the medium and long term.

It is also important to acknowledge not just the level of returns, but also the volatility. The volatility is largely a function of the portfolio's concentration. It is ironic that many investors manage risk by adding more stocks which they naturally must have less conviction in and cannot understand as well as their core high conviction holdings. There is an increasing amount of academic literature regarding the concentrations of returns in global stock markets. Some of the best work has been done by Professor Bessembinder from Arizona State University. In his 2023 paper, *"Long-term shareholder returns: Evidence from 64,000 global stocks"*, he found that over 1990-2020 inclusive, the top-performing 1% of firms in Australia generated 63.4% of gross returns. There are many more surprising statistics in that paper, but the conclusion is that it is essential to concentrate portfolios to maximise longer term returns and minimise the risk of holding the many poorly performing stocks. This strategy does, however, come with more month to month and quarter to quarter volatility.

When considering the health of the portfolio and the prospect for future returns, we do not focus too much on past performance, if at all. The best indicator of future performance is the level of quality and expected earnings growth of the portfolio. Over the long term, earnings delivery drives company share prices. The likelihood of the forecast growth being delivered is higher for better quality

portfolios. Given economic growth is still solid, well-run companies that have reinvested in their businesses, and that are trading on reasonable PERs, should continue to grow earnings and deliver solid returns. The cumulative forecast three-year earnings growth for the portfolio using market consensus forecasts is 16% which is similar to the ASX300's growth. This similar growth is explained by the Fund's index position in the ASX20. The portfolio is higher quality however, with an ROE of 14.0% versus the ASX300 of 12.2%. This higher ROE also comes despite lower levels of debt. The portfolio's gearing of 21.7% compares to the ASX300 at 36.7%. Over the long term, we expect the high quality and compounding double digit earnings growth of the fund to drive strong returns.

## About the Fund

The Bennelong Twenty20 Australian Equities Fund provides a cost-effective exposure to the S&P/ASX300 universe through a combination of actively managed ex-20 securities and a passive exposure to the top 20 securities. It typically holds 40-55 names.

The Fund is a single portfolio made up of two parts:

1. **An indexed position in the S&P/ASX 20 Index ('the top 20')** – The Fund has a position in each top 20 security in the same weight it has in the S&P/ASX 300 index. This means the Fund's largest positions are the largest companies on the ASX. For example, if Commonwealth Bank has a weight of 7% in the index, it will also have a weight of 7% in the Fund.
2. **An active position comprising BAEP's best picks from outside the top 20 ('the ex-20')** – The Fund is also invested in a selection of ex-20 securities we believe will outperform, which in turn allows the Fund to outperform the benchmark. These securities are chosen using our proven approach that focuses on fundamental factors such as earnings, growth and valuations.

## Benefits of the Fund

- Cost-effective, with a low management fee (plus a performance fee where applicable)
- Provides broad exposure to the Australian market via a combination of passive and actively managed securities
- The Fund's ex-20 exposure is managed as per the Bennelong ex-20 Australian Equities Fund's strategy, which has a track record of adding value by outperforming the market over the long term
- Managed in accordance with BAEP's robust, disciplined and proven investment philosophy and process

## About BAEP

Bennelong Australian Equity Partners (BAEP) is a boutique fund manager investing in Australian listed equities. It was founded in 2008 by Mark East, in partnership with Bennelong Funds Management.

BAEP is a genuinely active, award-winning and highly-rated fund manager with an experienced and performance

oriented team. Its investment philosophy is to selectively invest in high quality companies with strong growth outlooks and underestimated earnings momentum and prospects. Its investment process is research-intensive, with a focus on proprietary field research, and is supported by macro-economic and quantitative insights.

## Portfolio sector allocation

Sector	Fund weight	Benchmark <sup>3</sup> weight	Active weight
Discretionary	18.8%	7.2%	11.6%
Communication	6.8%	3.6%	3.2%
Health Care	11.6%	9.7%	1.9%
Consumer Staples	5.6%	3.9%	1.6%
Liquidity	1.3%	0.0%	1.3%
Financials	28.8%	29.7%	-0.9%
Energy	3.5%	4.9%	-1.4%
Utilities	0.0%	1.5%	-1.5%
Materials	19.4%	22.7%	-3.3%
IT	0.0%	3.3%	-3.3%
REIT's	2.6%	6.8%	-4.2%
Industrials	1.7%	6.9%	-5.2%

## The Fund at a glance

Feature	Fund facts
APIR code	BFL0017AU
Benchmark	S&P/ASX 300 Accumulation Index
Investment objective	2% p.a. above benchmark measured over rolling 3-year periods
Active stock limit	± 5%
Cash limit	0 - 10%
Inception date	02 December 2015
Recommended investment period	Long term (five years plus)
Buy/sell spread	+/-0.20%
Entry/exit fees	Nil
Management fees and costs <sup>4</sup>	0.44% 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 via the PDS (available on our [website](#)), mFund (code: BAE04), or the following platforms.

- AMP (Elements Investment, Elements Pension, iAccess, My North, North, Portfolio Care, Portfolio Care eWrap, PPS, Summit, Wealthview eWrap Inv)
- BT Asgard (Master Trust, Employee Super, Infinity eWrap)
- BT (Panorama)
- CFS (FirstWrap)
- Dash
- Hub 24 (Super, IDPS)
- Macquarie Wrap (IDPS, Super)
- Mason Stevens
- Netwealth (Super Service, Wrap Service, IDPS)
- Praemium (Non Super, Super)

## Get in touch

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 1800 895 388 (AU) or 0800 442 304 (NZ)

1 Inception date is 2 December 2015

2 Calculations are based on net returns (after fees and expenses) and assume the reinvestment of distributions.

3 S&P/ASX 300 Accumulation Index

4 Management fees and costs consist of annual management fee rate and capped recoverable expenses. For a detailed split of the fees and costs, please refer to the fund(s) PDS.

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