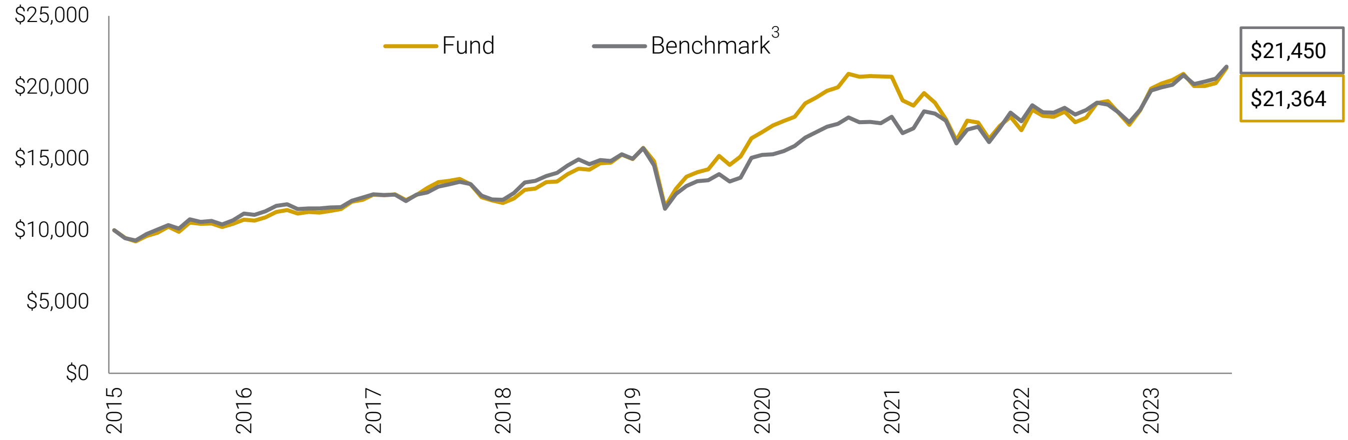
Bennelong Australian Equity Partners

Investor Commentary | 31 July 2024

Bennelong Twenty20 Australian Equities Fund

Long-term Fund performance

Growth of $10,000 since inception[1,2]



Past performance is not indicative of future performance.

Market review

The ASX300 rose by 4.1% in July to close at a record high of 8026. The industrials were broadly stronger and gained 5.7% in the month while resources continued their weakness declining by -1.1%. Global markets experienced an increase in volatility with a sharp rotation from US large-cap technology stocks to small and mid-caps. This saw the S&P500 rise by just 1.1% while the Russell 2000 rose by 10.1%.

The strength in markets was driven by expectations for easier monetary policy in Australia and abroad. This was due to better data on inflation being reported during the month. In Australia, headline monthly CPI rose by 3.8% in June, moderating from the May print of 4.0%. The trimmed mean inflation of 0.8% QoQ compared to market expectations for 1.0% which was viewed as removing the risk of an RBA rate hike in August.

While this lower print is a positive, inflation remains elevated in Australia. Around 65% of the CPI basket is increasing at more than 3% YoY, with education +5.6% YoY, health +5.7%, housing +5.2% (rents are +7.3%), and food +3.3%. It's notable that tradables CPI (which includes items for which the price is more globally driven) is +1.5% YoY while non-tradables CPI (more domestically driven) is +5.0% YoY.

This persistent inflation in Australia stands in contrast to the US where headline inflation fell -0.1% MoM in June. US core CPI has increased +3.3% YoY and is +2.1% on a three-month annualised basis. With expectations of further softness in rents, the Fed is gaining confidence that inflation is under control. The US Fed's Chair, Powell, said at the end of the month, "the broad sense of the Committee is that the economy is moving closer to the point at which it will be appropriate to reduce our policy rate…the reduction in our policy rate could be on the table as soon as the next meeting in September".

US growth continues to be solid with 2Q real GDP growth of 2.8% YoY, ahead of consensus. The issue is that some of the forward-looking indicators have weakened. The ISM non-manufacturing survey fell from 53.8 to 48.8 in June, while the ISM manufacturing index slipped from 48.7 to 48.5.

The data pointing to lower growth and receding inflation has been reflected in bond markets. The futures market in the US is now pricing in the potential for a 50bp rate cut in September, with more than 100bps of rate cuts forecast by the end of this year (which looks optimistic in our view). In Australia, one cut of 25bp is priced in by the end of the year with around two cuts over the subsequent 12 months.

Risk aversion is increasing, as shown by the pace of the falls in interest rates and the fact that short-term rates are falling much faster than longer-term rates. US two-year yields fell by 46bp in July. The spread between the 10-year and two-year bond yields, which has been inverted (i.e. negative) since 2022, has contracted sharply and is now just minus 5-10 bps. It did get as wide as minus 110bp in mid-2023. This suggests that the market is losing confidence in the “soft landing” scenario for the US economy, and is pricing in an aggressive rate cutting cycle by the Fed. The volatility in markets may have been exacerbated by news flow surrounding US elections. Trump has been outspoken about the power of Big Tech while generally proposing favourable policies for small and medium business. He is also pro US domestic growth and increasing trade barriers and tariffs for Chinese exports to the US. The critical point is that US economic growth remains resilient, and fiscal and monetary policy remains supportive. Volatility in markets such as we are seeing now may therefore offer more opportunities to invest in quality companies at attractive valuations.

Chinese growth is already weak, as China’s Caixin manufacturing PMI dropped from 51.8 to 49.8 in July. The government again failed to deliver any substantive stimulus or policy direction. The weaker growth, particularly out of China, saw commodity prices fall in July with iron ore down by -4.2%, coking coal -7.5%, copper -3.9% and Brent crude oil -6.6%. This was reflected in the ASX sector performance with resources -1.0% and energy -0.4%. Utilities was the weakest sector, down by -2.9%, while the leaders were consumer discretionary +9.1%, banks +7.1% and REITs +6.8%.

Fund performance

	Fund	Benchmark[3]	Value added
1 mth	5.25%	4.13%	1.12%
3 mths	6.34%	5.98%	0.36%
CYTD	7.25%	8.46%	-1.21%
1 year	12.94%	13.27%	-0.33%
3 years p.a.	2.22%	7.12%	-4.91%
5 years p.a.	8.34%	7.46%	0.88%
10 years p.a.	na	na	na
Since inception[1] p.a.	9.39%	9.31%	0.09%

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[3] weight	Profile
Return on equity	14.1%	12.1%	Premium quality
Debt/Equity	21.7%	37.0%	
Sales growth	3.9%	3.6%	Superior growth
EPS growth	3.6%	4.8%	
Price/Earnings	19.6x	17.4x	Reasonable valuation
Dividend yield	3.0%	3.7%	
Beta	1.07	1	
Active share	34%	na	Genuinely active
No. of Stocks	41	292	

Portfolio review

The Fund delivered a return of 5.25% for July which was 1.12% above the 4.13% benchmark return.

There was a benefit from the Fund’s exposure to offshore earners, in particular, those companies with US earnings. This included JHX, ARB, and CCP which were the top three overweight contributors in the month. The primary detractors this quarter included CAR Group, IDP Education, and The Reject Shop.

At a sector level, the Fund benefited from the underperformance of energy and mining, with the underweight position in resources contributing +35bp in performance. The overweight position in healthcare added +18bp.The REIT sector detracted -23bp as a number of property stocks moved higher in response to lower interest rates.

Top five active holdings

At month end, in alphabetical order

Stock
ARB Corporation Limited
Breville Group Limited
Credit Corp Group Limited
Fisher & Paykel Healthcare
James Hardie Industries PLC

Top three contributors

To monthly relative performance, in alphabetical order

	Avg active position
ARB Corporation Limited	Overweight
Credit Corp Group Limited	Overweight
James Hardie Industries PLC	Overweight

ARB Corporation Limited (ARB)

ARB rebounded in July following weakness in the June quarter. The market has been concerned about consumer spending coming under pressure, particularly for higher value discretionary items, such as new vehicles. There are, however, a number of positive drivers that should help ARB grow earnings independent of broader macro trends. These include the company's export division recovering from disruption in the wholesale channel in the US, as well as the launch of its collaboration with Toyota on the Trailhunter models. The company's US business should also benefit through its investment in ORW retail stores. We continue to like ARB for its investment in new products, strong balance sheet and opportunities in new markets.

Credit Corp Group Limited (CCP)

Credit Corp reported its FY24 results at the end of the month. NPAT of $81m was in-line with consensus as was the FY25 guidance for $90-100m of NPAT (the midpoint of the guidance range represents 17% growth on FY24). Management expressed confidence in the US operational improvement which was visible in the result, with 6% YoY growth in US 4Q24 collections and 14% YoY growth in debt collector productivity. CCP have guided to $200-250m of debt purchasing in FY25 (FY24 $260m) and have started strongly with $144m already secured in July. These more stable operating metrics lay the foundation for greater debt purchasing and earnings growth in the future.

James Hardie Industries PLC (JHX)

The US Census Bureau reported housing starts increased 3.0% to 1,353m in June, which was slightly above expectations. The US builders have also rallied in response to data showing lower inflation, which raises the prospects of interest rate cuts and therefore lower mortgage rates. Industry feedback has generally pointed to continued softness in the repair and remodel (R&R) market, however, builders are also reporting that enquiry levels picked up when mainstream media began talking about the potential for interest rate cuts as soon as September.

Top three detractors

To monthly relative performance, in alphabetical order

	Avg active position
CAR Group Limited	Overweight
IDP Education Ltd	Overweight
The Reject Shop Ltd	Overweight

CAR Group Limited (CAR)

The stock fell by 1.1% in July, with sentiment impacted by softening levels of new vehicle sales in Australia. The Australian Automotive Dealers Association (AADA) conference in Melbourne was held during the month where dealers reported falling new vehicle profitability along with lower orders and enquiry levels. That being said, some dealers also acknowledged that the tougher conditions and elevated inventories would actually increase the need to utilise CAR's platform and products.

We also note that CAR's Australian business (~50% of earnings) is primarily exposed to used cars, the sales of which have remained resilient. Broader CAR Group earnings is expected to sustain at double digit growth rates due to CAR's international growth businesses in the USA (Trader Interactive), Brazil (Webmotors) and Korea (Encar), where there is a long-term structural growth opportunity leveraging CAR's existing IP in Australia.

IDP Education Ltd (IEL)

The stock declined by 1.4% in the month. The market appears to be digesting the June report from IDP, where management said that they expect FY25 industry-wide study abroad market volumes to fall 20-25% given the significant regulatory challenges in Australia, the UK and Canada. They added that they expect to meaningfully outperform the industry as IDP continues to gain market share in student placements.

The Reject Shop Ltd (TRS)

There was no specific news flow from TRS in July, although the market remains concerned about softening consumer spending on discretionary items. This comes as TRS management are looking to revitalize sales growth and drive stronger product mix. Management has managed costs well in the current inflationary environment. They have also reported strong customer counts and better performance from new product ranges. The goal is to hold costs as a percentage of sales flat in FY25. This combination should deliver operating leverage and a recovery in margins and earnings in FY25.

Outlook

While economic growth is slowing, it remains at a reasonable level, particularly in the US and Europe. Inflation is also moderating, which provides ample room for central banks to reduce interest rates. Fiscal policy should remain supportive, with elections approaching in the US and Australia. This provides an economic backdrop for well-run companies that have reinvested in their business to continue to grow earnings.

August will see most ASX companies report FY24 earnings. Resources will be the main drag on index earnings, with consensus expecting the sector EPS to decline by around -16%. Bank sector earnings are also expected to decline by -4%. We continue to have an underweight exposure to both sectors. The domestically exposed retailers are also expected to deliver lower earnings for the second year in a row. This stands in contrast to the healthcare sector, which the Fund is overweight, which is expected to deliver around +15% growth YoY. In the recent US reporting season, a number of US companies beat due to better margins, driven by lower costs from stronger US productivity growth. The Fund's stocks with high US exposure may benefit from this trend.

The cumulative forecast three-year earnings growth for the portfolio using market consensus forecasts is 15%, 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 12.1%. This higher ROE also comes despite lower levels of debt. The portfolio's gearing of 23.3% compares to the ASX300 at 37.0%. Over the long term, we expect the high quality to drive superior returns.

BAEP's investment philosophy and approach remains unchanged. We invest in high-quality companies that are global leaders in their niche and can sustainably compound their earnings at above market growth rates, over the medium to long term. They do this by investing in R&D to develop a superior product or service which enables them to take market share and grow earnings largely irrespective of the cycle. We take a bottom-up research approach driven by extensive company and industry contact to deepen our understanding of the companies we invest in and where earnings prospects may be under-appreciated by the market. Over the long term we believe earnings delivery drives company share prices. So, investing in quality companies delivering sustainable compound earnings growth is what will drive attractive returns for our portfolios over the medium and long term.

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[3] weight	Active weight
Discretionary	19.2%	7.7%	11.5%
Health Care	13.8%	10.1%	3.7%
Communication	7.1%	3.7%	3.4%
Consumer Staples	4.5%	4.1%	0.4%
Liquidity	0.1%	0.0%	0.1%
Financials	30.7%	31.8%	-1.2%
Energy	3.2%	4.5%	-1.4%
Utilities	0.0%	1.4%	-1.4%
IT	0.0%	2.9%	-2.9%
Industrials	3.0%	6.9%	-4.0%
Materials	16.0%	20.0%	-4.0%
REIT's	2.5%	6.8%	-4.4%

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[4]	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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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.