



CONCENTRATED AUSTRALIAN EQUITIES PORTFOLIO MANAGED VOLATILITY EQUITIES PORTFOLIO

PORTFOLIO UPDATE

CONCENTRATED AUSTRALIAN EQUITIES PORTFOLIO

HOW HAS CAE PERFORMED THIS CALENDAR YEAR?

Year to date the Concentrated Australian Equities ('CAE') portfolio has underperformed the S&P/ASX 300 by 4.5%¹. The key detractors year to date are not owning CSL and holdings in Downer, Beach Energy and Woodside Petroleum which all fell on Covid-19 fears. The key contributors were holdings in Healius, Metcash, Northern Star and not owning BHP. During March, CAE's relative performance has been volatile and it has been both ahead of and behind the index. CAE month to date performance as of March 16th is about 1.3%¹ behind the S&P/ASX 300 which was down 22.0%.

WHAT CHANGES HAVE WE MADE TO CAE'S PORTFOLIO POSITIONING?

Our intention is to provide clients with idiosyncratic research insights and the value risk premium and to mitigate macro risks. We stress test to various macro parameters including rates, currency and volatility and macro events. However, early in the year we realised that the portfolio had more stocks negatively exposed to Covid-19 than stocks that were likely to outperform if the virus spread rapidly. We have stress-tested stocks in various ways including whether social distancing could cause stress. For example, reduced discretionary spend would reduce future advertising spend which would hurt oOH! Media and reduced tourism and travel are both clearly bad for airlines.

Therefore we have taken action which we believe should reposition the portfolio and have exited several stocks that have since materially underperformed in both absolute terms and relative to the S&P/ASX300. This includes selling out of Qantas, Air New Zealand, Aristocrat, Origin Energy and oOH! Media. We have added to the portfolio holdings in Telstra, Metcash, Suncorp and NAB (buying from cash at the dip on Friday 13th). Stocks that have detracted such as Beach Petroleum and Downer remain portfolio holdings and we have incrementally added to these names on share price weakness. Beach Petroleum continues to be profitable at US\$30/bbl oil as it has a resilient domestic gas business and the balance sheet is debt free. Downer's revenue is 80% contracted with governments. Although some revenue will be at risk, such as its service contract with the MCG, other businesses will be in greater demand such as the cleaner services it provides to hospitals. It also has a lightly geared balance sheet. In addition we have recently added to our gold holdings through the addition of Saracen to the portfolio. Although the short term weakness of the US\$ gold price is at odds with fear in the markets, the A\$ gold price is strong and therefore our gold investments have high levels of free cash flow and low levels of debt.

As a result we believe the IRR premium of the strategy to the index is the highest it has been since the launch of the strategy and we have materially reduced the Covid-19 exposures in the portfolio.

WHAT IS OUR OUTLOOK FROM HERE?

The direction of markets is difficult to call with central bank and fiscal stimulus at odds with the ongoing health and economic disruption of Covid-19. We are likely to see downgrades to the earnings of many stocks in Australia and around the world. Historically markets have rallied before earnings trough. However, we believe that risks in the short term are still probably skewed to the downside for markets. In particular an escalation of Covid-19 cases in the US along the path currently being observed in Italy would likely to lead to more market volatility.

¹ Based on rep account preliminary performance

MANAGED VOLATILITY EQUITIES EX GLOBAL PORTFOLIO

HOW HAS MVE PERFORMED THIS CALENDAR YEAR?

Year to date the Managed Volatility Equities Ex Global portfolio has outperformed the S&P/ASX 300 by 7.1%. The key contributors year to date have been Resmed, Sonic Healthcare, Telstra and North Star and not owning BHP. The key detractors have been an underweight to CSL and holdings in Amcor and Vicinity Centre. Month to date performance as of March 16th was 6.3% ahead of the S&P/ASX 300 which was down 22.0%.

WHAT CHANGES HAVE WE MADE TO MVE'S PORTFOLIO POSITIONING?

Our strategy has been defensive and this approach has been working, with the portfolio significantly outperforming the market. Our intention is to provide good downside protection in volatile markets. We have stress-tested stocks in various ways including whether social distancing could cause stress. For example, reduced discretionary spend would negatively impact JB Hi-Fi and Wesfarmers and reduced tourism and travel are both clearly bad for Qantas and Sydney Airport. Therefore several weeks ago we sold all holdings in the stocks. We have reinvested into stocks that we believe have 'annuity'-type revenues that will be resilient against the impact of Covid-19. This includes purchases of IAG and Spark New Zealand.

As per the strategy guidelines, the portfolio has the ability to hold up to 20% in cash, for example as a short-term defensive measure at times of heightened equity market volatility. In light of the current market conditions we believe that there is both a bottom-up and top-down reason for increasing the cash position from its previous levels. A thorough stress-testing analysis of the investment portfolio and universe showed that there were more sells than buys, and this created a natural bottom-up case to increase our cash position. Consumer stocks came out of the portfolio in late February and CSL was sold more recently, as we saw increasing evidence that blood collection was falling. Top down, we've taken the view that the consideration of systemic macro risks is an important part of this strategy and it is clear from the data that the contagion rate of Covid-19 is high, posing considerable downside risk to the economy and markets. In addition we could see the broader downside risks to the market as we believed Covid-19 was likely to become increasingly prevalent outside of China. As a result of both factors, cash levels have risen to about 10% of portfolios.

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You can access our full suite of coronavirus materials on our [Volatility Insights microsite](#).



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