Quarterly Investment Update

Antares Australian Equities Fund – December 2020

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Highlights for the quarter

Performance: The Fund returned 16.5% (net of fees) for the December quarter, in line with its benchmark.

Contributors to performance: Positive contributors – Newcrest Mining (not owned), CSL (underweight) and Coca Cola Amatil; Negative contributors – Fortescue Metals (not owned), Amcor, Afterpay (Not owned).

Stock activity: Buys/additions – IAG, Woolworths, Iluka, Northern Star, Transurban*;* Sells/reductions – Boral, Harvey Norman, Sydney Airport, Healius, James Hardie, Deterra Royalties, BHP, Nine Entertainment.

Fund snapshot

Inception date	3 July 1995
Benchmark	S&P/ASX 200 Total Return Index
Investment objective	To outperform the benchmark (after fees) over rolling 5-year periods

Investment returns as at 31 December 2020[1]

Period	3 months	1 year	3 years pa	5 years pa	7 years pa	10 years pa	Since inception pa
Net return[2] %	16.5	-5.3	2.1	6.4	5.8	6.4	8.8
Gross return[3] %	16.7	-4.7	2.8	7.2	6.6	7.3	9.7
Benchmark return %	13.7	1.4	6.7	8.7	7.4	7.8	9.2
Net excess return %	**2.8**	**-6.7**	**-4.6**	**-2.3**	**-1.6**	**-1.4**	**-0.4**
Gross excess return %	3.0	-6.1	-3.9	-1.5	-0.8	-0.5	0.5

[1] Past performance is not a reliable indicator of future performance. Returns are not guaranteed and actual returns may vary from any target returns described in this document.
[2] Investment returns are based on exit prices, and are net of management fees and assume reinvestment of all distributions.

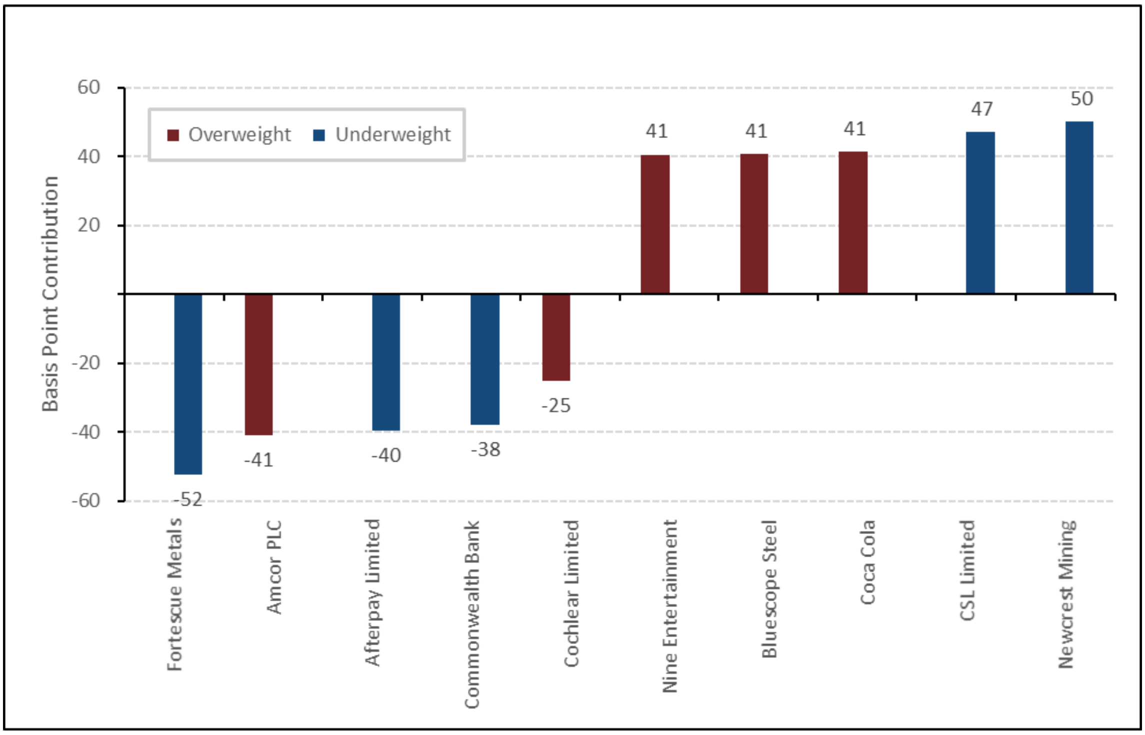
Contributors to performance

Positive

- **Newcrest Mining** (NCM, not owned) – NCM's share price fell in line with the gold price as the market became more optimistic and rebounded.
- **CSL** (underweight) – CSL underperformed in a "risk-on" environment, which saw a rotation out of very high PE stocks such as CSL into stocks with more earnings growth and better valuations.
- **Coca Cola Amatil** (CCL, overweight) - CCL benefitted from a surprise takeover by Coca-Cola European Partners PLC.

Figure 1: Fund attribution – December quarter

Source: Antares, December 2020



Negative

- **Fortescue Metals** (FMG, not owned) – China cut many different imports from Australia, but not their largest import which is iron ore. The iron ore price rallied strongly over the quarter with production from Brazil once again below expectations. The market believes China can not source sufficient iron ore elsewhere, hence will not be able to impose import restrictions on Australia. We continue to believe the longer term iron ore price will likely be around half the current price.
- **Amcor** (AMC, overweight) - There was no material individual stock news, however from a macro perspective as a stable earning stock AMC does not benefit from a perceived cyclical pick up in the global economy, hence it did not participate in the strong market rally**.**
- **Afterpay** (APT, not owned) - Afterpay's share price saw a spurt in October as the market rallied and the company continues to report excellent growth in users. Late in the quarter APT was added to the S&P/ASX 20 index which meant that many index related funds globally had to buy the stock.

Overview, Outlook and Portfolio activity

Introduction

The portfolio experienced a strong rebound in the December quarter, as valuations and the prospect of a way out of covid (with vaccination) became a bigger focus of investor behaviour.

The very strong December quarter has resulted, in many instances, in very high valuation levels in an historical context. The issue with very high valuations is that eventually these correlate with longer term expected returns. In short, higher than average valuations generally imply lower than average long term returns.

Fortunately, some parts of the market remain reasonably priced, and it is in these areas that we intend to continue to concentrate the portfolio's exposure.

An emerging, yet still nascent, issue is that of inflation. For example, US 5yr breakevens (which are a forecast of five year inflation) trade at around 1.9%, significantly above the five year bond rate of around 0.36% (according to Bloomberg). This means that bond investors are currently not being appropriately compensated for the expected inflation risk. Early in the year at the height of the coronavirus market panic in March these breakevens were trading at around 0.20%. Will the huge global stimuli packages, many of which dwarf the GFC packages, and monetary accommodation eventually see a rise in inflation? Low interest rates have been the bedrock upon which the historically high equity market valuations have been justified. For this reason we believe they are one of the most important factors to monitor in 2021.

In other words, the market assumes that overvalued bonds justify equity prices that in an historical context are overvalued. The logic is that as rates approach zero, almost any price can be paid for an equity with growth. This theory has been working in recent years, but is likely temporary, and especially reliant upon market sentiment.

We also note that while Central Banks have made forecasts about how long interest rates will remain low, historically, market rates move in advance of central bank interest rates, and it is not always possible for market rates to be controlled in an orderly manner.

The strong performance of the portfolio over the quarter was assisted by a “value” rotation. We have addressed this issue in detail in the last quarterly report and several times previously. The current metrics suggest the discrepancy in valuations between “growth” and “value” stocks remains extremely high in an historical context. The rotation to value occurred early in the quarter amidst peak optimism for an economic rebound in 2021. As covid cases worsened late in the quarter, a more sobering outlook saw the growth stocks stabilise.

We expect that over the longer term the growth / value equation will mean-revert, but in the short term, sentiment around economic growth “risk on /risk off”, and interest rates often overrides other factors.

COVID impacts

Year end news headlines are dominated by the new covid variant strain (or strains) overseas, and locally outbreaks in Sydney and Melbourne have caused more travel closures and increased social distancing measures. Scientists seem to suggest that the current vaccines should work against the new covid strains. If so, we would expect that by the middle of 2021, many countries will have vaccinated large percentages of the vulnerable populations, which should allow for a strong growth rebound in the back half of 2021. (It appears the vast majority of deaths and severe cases occur in those over 60, or in those with comorbidities such as diabetes, obesity, and respiratory diseases, so it is hopefully achievable to vaccinate these groups along with health workers and other front line responders by mid-year). Against this is the surprisingly low roll out of vaccinations in countries that have approved and available vaccines. The US is of note, implying herd immunity there will not be reached for several years at current rates of vaccination. We expect a new administration to prioritise this issue and attempt to remove roadblocks, many of which seem to be state based.

We have seen spending surges in Australia as lockdowns finish, and expect the same sort of pent up spending will occur elsewhere in the world. Much of this additional spending will be in areas that citizens were unable to spend on due to the covid impaired restrictions - hospitality, travel, experiences, events, sport.

Portfolio Characteristics

The portfolio has above market forecast growth, and an above market price earnings ratio, yet below market price to book ratio.

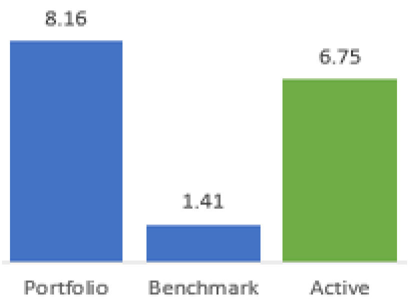
Table 1: Portfolio metrics

Earning Statistics			
	Portfolio	S&P/ASX 200 Total return	Active
PE (x)	18.19	17.35	0.84
EPS Growth (%)	6.85	5.72	1.14
ROE (%)	12.89	14.89	-2.00
Div yield (%)	3.41	3.37	0.04
Payout ratio (%)	66.15	79.75	-13.60
Price to Book (x)	2.31	2.56	-0.24
Raw Beta (x)	1.05	1.02	0.03

Source: Bloomberg, Antares Equities; December 2020

Based on Antares fundamental research, reasonable upside exists for the portfolio, however, after the massive rally in the December quarter the extent of the upside is now much lower than was the case at the end of September.

Figure 2: Portfolio expected returns



Source: Bloomberg, Antares Equities; December 2020

The stock activity section provides more detail about recent portfolio positioning, with sector weights largely being the result of bottom up stock selection decisions.

Major stock activity

(Note no commentary is provided on positions where we may be active in the market)

Purchased / added

- **Insurance Australia Group** (IAG) - Early in the quarter, uncertainty was being shunned by investors and Insurance stocks were sold down around potential exposure to business interruption (BI) insurance. We added IAG to the portfolio at around $3.62 per share before the market had a strong rally. Unfortunately, later in the quarter the loss of a business interruption case saw IAG have a large capital raising in which we also participated. The effect of this raising and court ruling saw all of the momentum knocked out of the stock, which was then compounded when the stock was removed from the S&P/ASX 20 index. While some BI risk remains, we think that in the vast majority of instances IAG are now well provisioned to cover adverse eventualities, and that on a medium term view substantial upside exists as earnings normalise.

- **Woolworths** (WOW) - We added to the Woolworths position as we see earnings upside and a catalyst around the demerger of the alcohol business.

- **Iluka** (ILU) - After the demerger of Deterra Royalties, we saw Iluka perform somewhat worse than Deterra, which was somewhat out of line with our valuations and expectation, so we switched part of the Deterra holding into Iluka for stronger valuation upside.

- **Northern Star** (NST) - We added to our position in NST during the share price sell-off which occurred over the quarter, primarily as a result of a weak bullion price, and the market concentrating on stocks with more cyclical rebound potential.

- **Transurban** (TCL) - We started to build a position in Transurban and reduced the position in Sydney Airport (SYD). As the market rallied strongly on a "reopening" trade, SYD substantially outperformed TCL. We believed that this relativity had moved too far. especially since road traffic is returning strongly, yet it will likely take years for international air traffic to recover fully. Also, Transurban is more diversified.

Sold/reduced

- **Boral** (BLD) - BLD has enjoyed extremely strong recent performance, which has been from a mixture of economic recovery, corporate interest and new management. The balance sheet remains weak, with the company adjusting dividends to restore cashflow. After the recent share price rally, BLD's forward yield is an unattractive 1.3%, based on consensus forecasts. We also believe most of the rerating has now occurred, and exited the majority of the position.

- **Harvey Norman** (HVN) – HVN has performed extremely well during the covid shutdowns (after initially being sold-off harshly in March). We expect that going forward as consumers can increasingly spend money on hospitality, entertainment, travel, and on other forms of impacted discretionary spending, comparative earnings and revenue growth for HVN will become extremely difficult, suggesting we may be close to peak earnings that may not be exceeded for several years.

- **Sydney Airport** (SYD) - refer Transurban commentary above.

- **Coca Cola Amatil** CCL) – We reduced the position after the takeover bid saw the stock perform strongly.

- **Healius** (HLS) – We reduced after strong performance. Our primary concern is that the pathology business is making huge margins on covid-19 testing, and that as covid eventually moderates as a concern, the pathology earnings will be materially reduced.
- **James Hardie** (JHX) – We reduced after JHX stellar share price performance meant the stock was trading well above our target price, and leaves no valuation support should sentiment for building products in the United States change.
- **Deterra Royalties** (DRR) - Refer Iluka commentary above.
- **BHP** - We reduced our position to around index after the strong rally, however, subsequently the iron ore price shot up on the belief of tight iron ore supply, making this trade sub optimal.
- **Nine Entertainment** (NEC) - We reduced the size of our quite large overweight after strong share price performance but retain an overweight position.

Outlook and Strategy

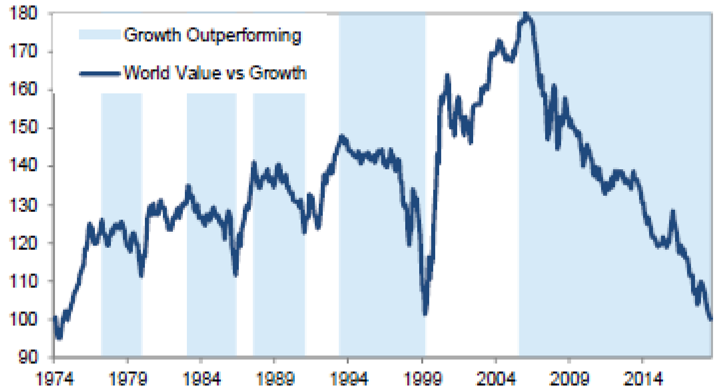
The dispersion between Value and Growth remains extreme, even after the factor rotation in the December quarter.

Figure 3: Relative returns for Australian Value vs Growth stocks

Source: Factset, Macquarie Research; December 2020

From a global context, the discrepancy is even more marked

Figure 4: Global Growth vs Value comparison



Source: Goldman Sachs Matt Ross Strategy presentation; 20 November 2020

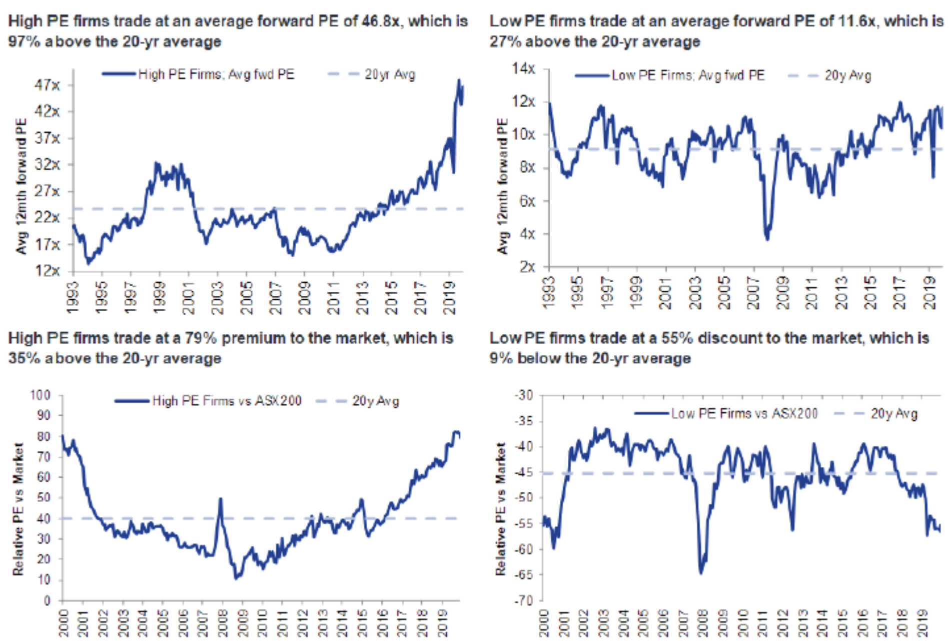
Figure 5: Relative performance of Australian Styles - valuation

Source: Factset, Goldman Sachs Investment Research. Aussie Weekly Kickstart, 21 December 2020

Figure 6: Relative performance of Australian Styles – offshore vs defensive

Source: Factset, Goldman Sachs Investment Research. Aussie Weekly Kickstart, 21 December 2020

Figure 7: Valuation dispersion



Source. Factset, Goldman Sachs Investment Research. Aussie Weekly Kickstart, 21 December 2020.

As vaccines are rolled out in 2021, we expect the value rotation to continue, although probably not at the pace of the December quarter. Accordingly, we intend to position the portfolio away from those stocks trading at historically extremely elevated valuations, and focus on areas where more reasonable valuations provide the prospect of better long term returns.

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