Quarterly Investment Update

Antares Dividend Builder– December 2020

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Highlights for the quarter

Performance: The Fund's twin objectives are to provide a yield above that of the S&P/ASX 200 All Industrials Total Return index, as well as moderate capital growth over the medium term.

Yield: The annual income yield to 30 June 2020 was 4.38% versus the benchmark's yield of 3.21%. Many companies have announced changes to their dividend payments due to the coronavirus pandemic. We emphasize the importance of not using past performance as a guide to future performance. However, it is our objective to deliver income in excess of our benchmark. During the December quarter, dividends were paid by Amcor, ANZ, Coca Cola Amatil, Harvey Norman, NAB, Nine Entertainment, Pendal, Suncorp, Viva Energy, Wesfarmers and Westpac.

Contributors to capital returns: Positive contributors – CSL (not owned), Coca Cola Amatil, Nine Entertainment; Negative contributors – CBA (underweight), Aurizon, Afterpay (not owned).

Stock Activity: Buys – Alumina, Orora, Pendal, Transurban; Sells – Amcor, Boral, Coca Cola Amatil, Harvey Norman, Nine Entertainment, Scentre Group, Tabcorp, Viva Energy

Fund snapshot

Inception date	6 September 2005
Benchmark	S&P/ASX 200 Industrials Total Return Index
Investment objective	Deliver higher levels of tax effective dividend income than the S&P/ASX 200 Industrials Total Return Index, and moderate capital growth

Investment returns as at 31 December 2020[1]

Period	3 months	1 year	3 years pa	5 years pa	10 years pa	Since inception pa
Portfolio[3,4] income yield %	-	4.38	5.05	4.80	4.45	4.13
Benchmark[5,6] inc yield %	-	3.21	3.90	3.99	3.94	-
Net return[2] %	17.7	-2.2	0.6	3.3	8.3	6.5

[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.[3] Calculated as the sum of the income yields over the period where the yield is income distributed during the period divided by the unit price (before fees) at the start of the distribution period. [4] Income yield at 30 June. 5 Calculated as the sum of the monthly returns of the S&P/ASX 200 Industrials Total Return Index minus the monthly returns of the S&P/ASX 200 Industrials Index (price index). [6] Income yield at 30 June.

Strategy, outlook and portfolio activity

Introduction

The portfolio experienced a strong rebound in the December quarter, returning 17.7%, 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.

Contributors to income and returns

Income

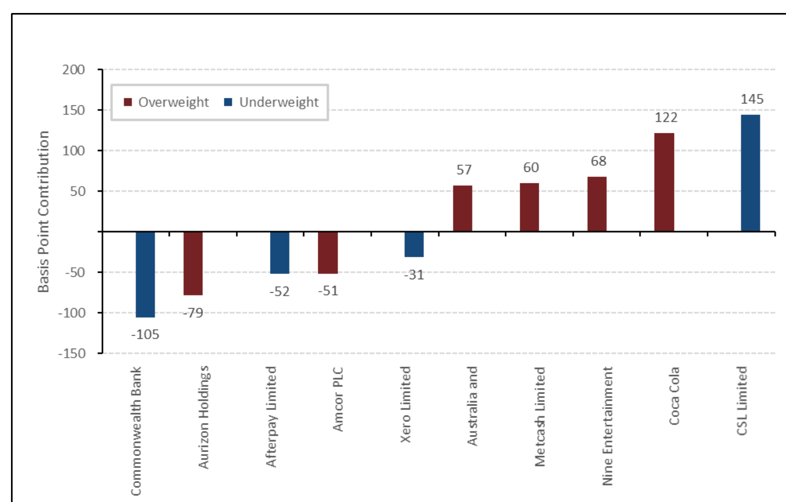
During the December quarter, dividends were paid by Amcor, ANZ, Coca Cola Amatil, Harvey Norman, NAB, Nine Entertainment, Pendal, Suncorp, Viva Energy, Wesfarmers and Westpac.

Returns

Major contributors over the quarter included:

- **CSL** (not owned) - 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.
- **Nine Entertainment** (NEC, overweight) – NEC's earnings were upgraded a couple of times over the quarter as advertising rebounded, and Nine's digital assets continue to perform extremely well. The subscription service STAN continues to amass a large subscription base which makes it extremely valuable.

Figure 1: Fund attribution – December quarter



Source: Antares, December 2020

Major detractors over the quarter included:

- **CBA** (underweight) – CBA rallied along with the banking sector as the market became comfortable that covid provisions will remain contained, meaning the banks will likely now have several years of reasonable earnings growth.
- **Aurizon Holdings** (AZJ, overweight) – AZJ suffered from ESG issues, but the apparent wish of China to punish Australia was partly reflected in an indication to favour coal from other countries. As such Aurizon underperformed the market.
- **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.

Portfolio fundamentals and characteristics

The current portfolio characteristics based on Bloomberg and consensus data at the end of the year show the portfolio with a strong prospective yield, reasonable EPS growth and a significantly below benchmark Price Earnings ratio.

We expect dividend growth to exceed earnings growth in 2021. Many companies attempted to preserve cash in the covid-related uncertainty during 2020 (and in the case of financials the regulators also played a part), which meant that dividends fell more than earnings. We expect to see a reversal of this effect as dividend policies normalise in 2021.

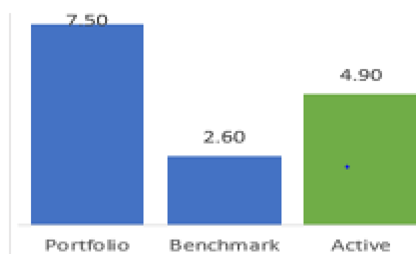
Table 1: Portfolio metrics

Earning Statistics			
	Portfolio	S&P/ASX Industrials 200 Total return	Active
PE (x)	18.65	23.30	-4.65
EPS Growth (%)	6.55	7.77	-1.22
ROE (%)	12.07	13.96	-1.89
Div yield (%)	4.29	3.18	1.11
Payout ratio (%)	108.24	77.75	30.49
Price to Book (x)	1.74	2.52	-0.78
Raw Beta (x)	0.91	1.06	-0.15

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 this upside is now much lower than was the case at the end of September.

Figure 2: Expected Returns (12 month forward estimate %)



Source: Antares Equities, Bloomberg; December 2020

Antares has a long record of ESG analysis. One of the measures we have used for the past 14 years, is to rate the environmental, social and governance characteristics into a traffic light system of green amber and red, with red being high risk. Currently the portfolio is underweight to red traffic lights, with the only exposure being Aurizon, which is rated an environmental red for its exposure to coal. We believe Aurizon to be well managed and undervalued, and expect Australian coal will make up an important part of baseload power for many years, however, we acknowledge that coal investment is becoming increasingly unpopular, which complicates the investment decision.

In terms of sectors the largest underweight remains healthcare, due to the unattractive yield characteristics. Overweight sectors include materials, which is mainly due to the Amcor and Orora packaging stocks being included, financials, which is not as a result of banks, but mainly due to the positions in general insurers Suncorp and IAG and the new position over the quarter in Pendal. Communication services remains overweight due to the large Telstra position, and the Staples overweight comes from the Coles, Coca Cola Amatil and Metcash positions.

The stock activity section provides more detail about recent portfolio positioning.

Outlook and Strategy

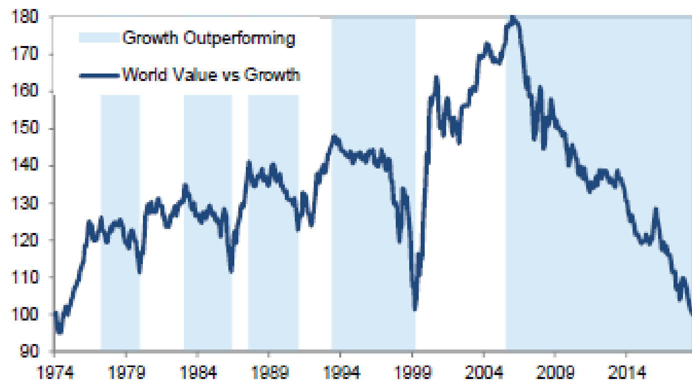
The dispersion between Value and Growth remains extreme, even after the factor rotation in the December quarter.

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

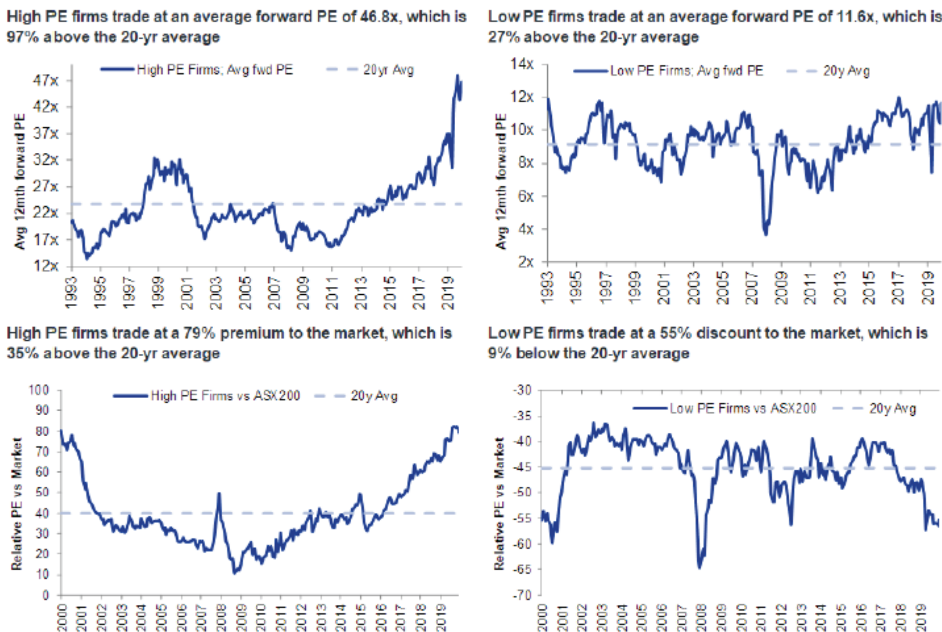
Figure 5: Relative performance of Australian Styles - valuation

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.

Stock Activity

Bought/added

- **Orora** (ORA) **-** ORA owns world class packaging assets in Australia, with a lower quality business in America, which is likely through the worst. Assets include glass and aluminium packaging, which are oligopoly assets in Australia, and play to the sustainability theme as Orora is a large-scale recycler. It also has a very strong balance sheet, attractive cashflow characteristics, good yield and given that it is trading at reasonable multiples it also may attract corporate interest.
- **Pendal Group** (PDL) **–** PDL was sold-off by the market after announcing a full year result that slightly disappointed and missed consensus expectations. We believe the underlying fundamentals are improving as costs were elevated due to expanding the distribution footprint. We believe this will bear fruit in future years, a view also helped by strong investment performance. The company has no debt, a sustainable and growing yield of well over 6%, and trades on a low multiple. Pendal also has strong credentials in the growing focus on sustainable investment thematics.
- **Alumina** (AWC) **–** We added to the position early in the quarter in price weakness.
- **Transurban** (TCL) - Transurban had underperformed the market by over 20% in the first two months of the quarter, and has underperformed the market over a rolling 12 months. In light of looking better value relative to the market, we decided to take a slightly more defensive approach to the portfolio late in the quarter after the market had such a strong rally taking many previously attractively valued stocks to quite high multiples. TCL had been left behind in the reopening trade rally, while at the same time Australian traffic numbers have been improving substantially, restoring much improved dividend prospects, and leaving reasonable valuation upside.

Sold/reduced

- **Nine Entertainment** (NEC) - After the very strong share price rally of the past six months we reduced the size of the large overweight position.
- **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.
- **Amcor** (AMC) **–** We trimmed back what is a very large position, as the increasing AUD somewhat reduced the potential returns of international businesses for Australian shareholders. We retain a large weight as Amcor provides defensive growth characteristics.

- **Tabcorp** (TAH) **–** We reduced our large position after a substantial rally reduced potential expected returns.
- **Viva Energy** (VEA) - We believe the Viva retail fuel and convenience business is operating well, however, the large share price move saw us reduce the size of the overweight position.
- **Coca Cola Amatil** (CCL) – We reduced after the takeover bid saw a very strong share price performance.
- **Scentre Group** (SCG) – We slightly reduced the size of the overweight after SCG's strong share price performance from its covid lows.
- **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.

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