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INSIGHTS

Fund Commentary

Quarterly Review June 20

By Julian Morrison on 10 Jul 2020

In this extract from the June 2020 Quarterly Commentary, Julian Morrison, CFA, Head of Research Relationships and National Key Accounts, reviews the performance of the Allan Gray Australia Funds. Click here (<https://www.allangray.com.au/b/publications-library/>) to read the full Quarterly Commentary.

Allan Gray Australia Equity Fund

The Australian sharemarket rebounded strongly in the June quarter, with the S&P/ASX 300 Accumulation Index gaining 16.8%. The Allan Gray Australia Equity Fund (Class A) outperformed its S&P/ASX 300 Index benchmark by 1.5% during the quarter.

The June quarter saw some reversal in trends that have been a headwind to our portfolio previously. Notably, strength in the Energy sector made our overweight position in Energy a strong positive for relative performance. Within that sector, Oil Search Limited was the largest contributor at the stock level.

The quarter also saw weaker relative performance for the Healthcare sector. Consequently, the absence of Healthcare exposure in the Fund was another significant positive. Exposure to Financials was positive



overall for relative performance, with a meaningful position in AMP Limited being the largest positive driver at a stock level within the Financials sector.

The worst performing sector for the Fund was Consumer Staples, due to the holding in Metcash Limited. We had reduced exposure to this stock on the extreme strength of the first quarter and we remain comfortable with the current holding.

Performance from the Materials sector was negative overall, with Nufarm Limited, Incitec Pivot Limited and Alumina Limited all detracting from relative performance. But it was not entirely one-

sided. Our largest holding in the sector, Newcrest Mining Limited, was also the largest positive contributor of all stocks held in the portfolio.

Cyclically-exposed sectors and companies remain key positions in the Fund currently. Notwithstanding some bright spots this quarter, it is our opinion that they still offer significantly greater value and price upside than the more stable earners (staples, utilities, healthcare) and disruptors (technology companies) which appear to trade at blue-sky valuations. Our portfolio remains firmly skewed away from healthcare, staples and technology, having used recent strength to sell almost entirely the positions we had in those sectors (such as Coles and Telstra) and invest the proceeds in a number of, in our opinion, very cheap but cyclically-exposed companies currently experiencing earnings headwinds.

Allan Gray Australia Balanced Fund

The Allan Gray Australia Balanced Fund outperformed its composite benchmark by 1.7% for the June quarter.

The Fund had 70% in shares at quarter end, although about 7% of the global share exposure is reduced through the use of exchange-traded derivatives which allows for some protection in those periods when market indices fall. The Fund has been overweight global shares versus global fixed income. This contributed strongly to relative performance for the quarter, as global shares outperformed fixed income. In addition, stock selection in both the Australian and global shares further bolstered relative returns.

The Fund, on average, held 25% in fixed income securities and cash during the quarter. This has remained significantly shorter in duration than the benchmark – at one year versus eight for the benchmark. This had limited impact on the Fund for the June quarter, with government bond yields fairly flat, on average, during the quarter. The Fund remains more defensively positioned than the benchmark in terms of both relative and absolute returns, in the event interest rates rise.

Allan Gray Australia Stable Fund

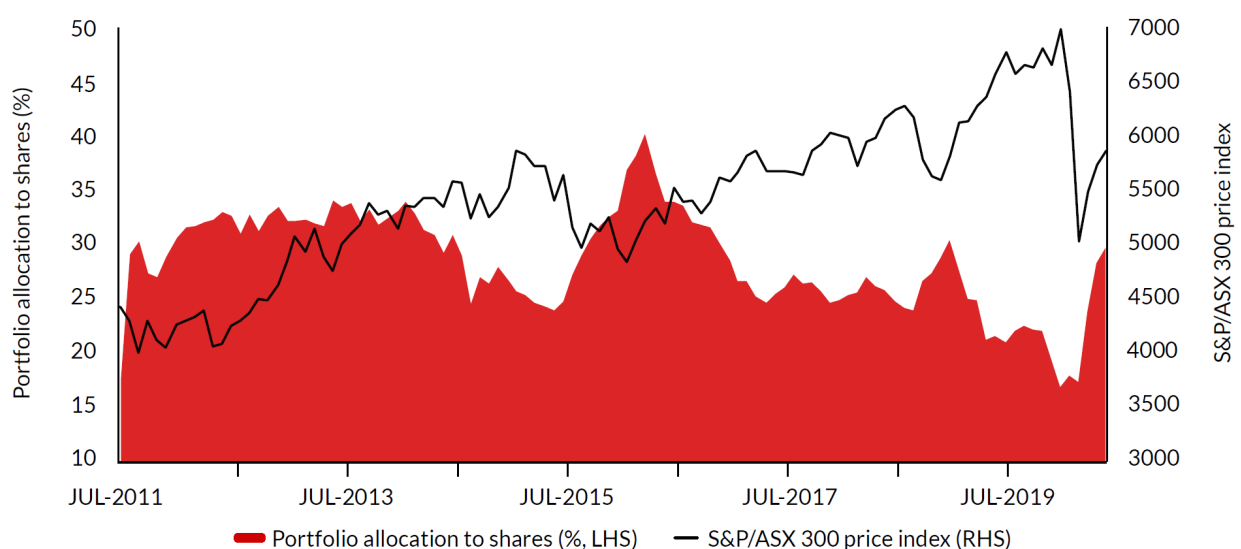
The Allan Gray Australia Stable Fund outperformed its cash rate benchmark by 4.9% in the June quarter.

The performance of the Stable Fund is driven by the performance of our favoured Australian share holdings and the decision on how much is invested in shares versus cash. The Fund benefited from having built increased exposure to shares during the weakness of the first quarter, and this continued to increase selectively during the second quarter.

As at the end of June, the Fund had around 30% invested in shares, with the remainder in cash and money market investments. This can be seen in the graph below, which shows our allocation between cash and shares over time.

The broad Australian sharemarket is still some way from its previous high. However, the market average fails to highlight that some popular stocks and sectors are priced at levels that in our view are far too optimistic. We therefore remain focused on avoiding those areas and the risks that come with excessive valuation. Instead, the shares held in the Fund will be those we have assessed as most attractively priced and where risk of permanent capital loss is low.

Stable Fund portfolio weightings – share allocation rises where we see value in shares



Source: Allan Gray Australia, Bloomberg, as at 30 June 2020.

Julian Morrison holds a Bachelor of Arts (Honours – University of Sheffield) and the Chartered Financial Analyst designation.

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