

Investors Mutual Equity Income Fund

Quarterly Report December 2021

Fund status: OPEN

- ▶ Global sharemarkets enjoyed a strong year on a confluence Covid vaccine efficacy and ongoing stimulus
- ▶ The Australian sharemarket also had a strong year returning +17.5%, albeit with mixed sector performance
- ▶ We continue to use volatility to top up in good quality companies we believe can do well over the next 3-5 years

| | 1 month | 3 months | 1 Year | 3 years [^] | 5 Years [^] | Since inception [^] |
|---------------|---------|----------|--------|----------------------|----------------------|------------------------------|
| Income | +1.5% | +1.5% | +6.6% | +7.2% | +7.6% | +8.4% |
| Growth | +1.1% | +0.8% | +11.8% | -1.7% | -3.3% | -0.4% |
| Total Return* | +2.6% | +2.3% | +18.4% | +5.5% | +4.3% | +8.0% |
| Benchmark** | +2.7% | +2.2% | +17.5% | +14.0% | +9.9% | +8.6% |

[^]% Performance per annum. *Fund returns are calculated net of management fees, and assuming all distributions are re-invested. Investors should be aware that past performance is not indicative of future performance. Returns can be volatile, reflecting rises and falls in the value of underlying investments. **The benchmark for this Fund is the S&P/ASX 300 Accumulation Index. The Fund has twin objectives of delivering (i) income greater than the S&P/ASX 300 Index yield +2% and (ii) returns with less standard deviation than S&P/ASX300.

Sharemarket Commentary

Global equity markets delivered their third consecutive year of double-digit gains in 2021, with the MSCI World Index returning +21% for the calendar year as the world started to re-emerge from government-imposed lockdowns. Central banks around the world continued with their very accommodative monetary policies keeping interest rates at record lows while also continuing their stimulatory bond buying programs.

The US led global sharemarkets higher in 2021, with the S&P500 recording one of its best years on record with a +29% return, setting fresh record highs throughout the year. The tech heavy NASDAQ index lagged as investors rotated out of riskier names late in the year, as investors started factoring higher interest rates in future. Across the Atlantic the mood was equally buoyant with Europe's Stoxx50 index returning +24%, whilst Japan's Nikkei returned a more modest +7%.

The year was not without its challenges, the emergence of new covid variants threatened to derail the global economic recovery as governments looked to impose further lockdown measures and stricter travel restrictions. Chinese and Hong Kong stockmarkets had a year to forget, falling -14% and -5% respectively, as investors weighed Beijing's regulatory crackdown on the tech and education sectors. The near implosion of one of China's largest property developers – Evergrande – also weighed on these two markets as investors worried about financial contagion through the Chinese property markets and economy. The rising threat of inflation weighed heavily on investor sentiment. As such bond markets sold off as yields rose in the second half of the year on expectations that central banks may have to tighten their ultra-loose policy stance as inflation around the world continued to increase. December heralded the beginning of central bank tightening with the US Fed signalling its intent to slow its bond purchases, as well as hike interest rates by 0.25% three times in 2022, whilst the Bank of England emerged as the first of the major central banks to hike its official interest rates to combat inflation.

Similar to global peers, the ASX300 enjoyed a strong year, returning +17.5% and reaching fresh record highs in the back half of the year. The calendar year saw a frenzy of M&A activity as lower interest rates tempted many acquirers to take over companies that looked good long-term value with 'old economy' companies such as AusNet, Spark Infrastructure, Crown Resorts, Sydney Airport, Z Energy and Australian Pharmaceutical Industries all receiving takeover offers.

Global sharemarkets enjoyed a buoyant final quarter to CY21 with the MSCI World Index returning +7%. This was led by the US S&P 500 which returned +11% for the quarter as re-openings drove a significant pickup in economic activity and continued strong US earnings growth, as many companies leveraged their ability to pass on rises in prices for their products.

Conversely the ASX300 was a little lacklustre in the final quarter of CY21, returning +2.2%. Sector performance was mixed. The Resources sector enjoyed a strong quarter up +9%, primarily driven by the iron ore miners courtesy of restocking from Chinese steel producers. Base metal and gold miners were also firmer as inflationary expectations continued to increase. The Industrials segment of the market was held back by a poor performance from the Financials sector as the banking sector was sold off on concerns on how earnings are likely to be impacted by a sharp compression in the sectors net interest margins, as record low interest rates and fierce competition in mortgage pricing take their toll. Similar to moves across the globe, the local Technology sector sold off as investors weighed the prospect of higher interest rates on much of the speculative fare within the sector. Afterpay, the previous star of the sector, was one of the more prominent victims shedding over -30% of its market value. Positively, the Utilities sector enjoyed a strong quarter with both Origin and AGL up firmly reflecting expectations for an improvement in electricity prices through 2022. Also buoyant was the Communication Services sector led by Telstra, with the company continuing to benefit from the better prospects for its mobile division and from the company's share buyback. Furthermore, Nine Entertainment continued its strong run with both Stan and Domain continuing to demonstrate very strong revenue growth in the second half of calendar 2021.

Fund information

| | |
|--------------------|--|
| APIR | IML0005AU |
| Inception | 1 Jan 2011 |
| Size | \$527 M |
| Application (Ex) | \$0.9180 |
| Redemption (Ex) | \$0.9134 |
| Management fee | 0.993% p.a. |
| Investment horizon | 4-5 years |
| Distributions | Quarterly |
| Managers | Anton Tagliaferro Michael & O'Neill Tuan Luu |

Level of Franking (%)*

| | |
|------|-------|
| FY17 | 53.4% |
| FY18 | 27.5% |
| FY19 | 39.6% |
| FY20 | 36.2% |
| FY21 | 28.8% |

*As per FSC Standard

Security Category Effective Exposure

| | |
|-----------------|-------|
| Ordinary Shares | 89.0% |
| Call Options | -9.3% |
| Put Options | 0.6% |
| Cash | 19.7% |

Performance & Strategy

The **Investors Mutual Equity Income Fund** had a positive year returning +18.4% which was ahead of the benchmark's return of +17.5%. The Fund's performance was helped in the second half by what we see as the start of a return to more fundamental investing with the prospect of the end of free money looming large. Takeover bids for good quality companies which were trading at very attractive valuations also helped. Our core holdings in Telstra, Tabcorp, AusNet (under takeover), Amcor, Incitec Pivot and Suncorp all enjoyed a strong year.

For the final quarter of the year, the Fund posted a solid return of +2.3%, broadly in line with the benchmark. Our caution to the Resources sector weighed on relative returns although we remain comfortable with this positioning given high commodity price levels and the inherent volatility in the sector - as we saw during 2021 with the iron ore price halving in value. Over the quarter the portfolio benefited from its holdings in Telstra, Crown Resorts (under takeover), Incitec Pivot and Steadfast. Conversely, IAG and Pact Group endured a weaker quarter on short term impositions, and we remain very confident in the long-term outlook for both businesses, especially in light of their attractive valuations and strong positioning in their respective industries.

Over the December quarter, volatility was elevated with rising bond yields and renewed uncertainties due to the emergence of the new Covid variant Omicron. The Fund utilised the daily market fluctuations to earn supplementary income by selectively writing options at target entry and exit prices on some of our holdings including Alumina, Ampol, Incitec Pivot, Newcrest Mining and Tabcorp. The Fund benefited from the completed acquisition of Spark Infrastructure (receiving a fully-franked 12c special distribution). We also participated in CSL's discounted capital raising to help fund the acquisition of Swiss pharmaceuticals company Vifor Pharma which specialises in renal disease and iron deficiency.

Stock Stories

CSL (CSL) finished the quarter down slightly after making the \$17.2bn AUD acquisition of Swiss company Vifor pharma. Vifor is a specialist pharma company focused on Iron deficiency and kidney related drugs. Vifor's key asset is a highly profitable JV with the largest provider of dialysis services in the world, providing Vifor with a large pool of customers to sell its kidney related drugs. The deal was funded with debt and a \$6.3bn equity raising at \$273 share price. The acquisition is forecast to be double-digit accretive to CSL's earnings as well as provide them with a strong distribution channel to sell their kidney related drugs currently in phase III development. CSL continues to look attractively priced considering the quality of the business and the large number of potential products they have in phase III trails, including CSL 112 and a number of transplant drugs.

Telstra (TLS) shares added 6.4% for the quarter, on the back of positive news flow. In October TLS announced that it had acquired Digicel Asia Pacific in conjunction with the Australian Government, with the Government contributing around 80% of the \$1.6bn purchase price while TLS will retain 100% of the equity and receive a guaranteed dividend stream. While not overly material from a financial perspective, the deal cements a stronger relationship between TLS and the Government (since highlighted by a 5 year \$1bn contract with the Department of Defence). The company also announced at its investor day in November that it has finalised the separation of the company's fixed line infrastructure into InfraCo Fixed, paving the way to unlock further value through a potential partial sale of that asset. This follows the sale of a 49% stake in the company's tower assets (Amplitel) to the Future Fund earlier in 2021 for a higher than expected price, highlighting the strong valuations currently being achieved for infrastructure-type assets in the current environment.

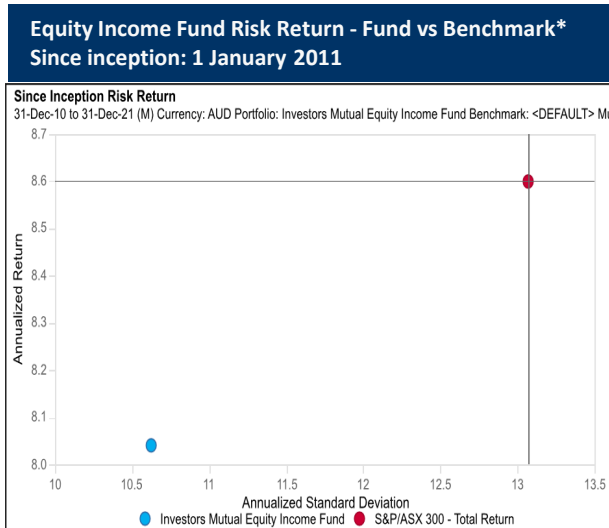
Outlook

As we head into 2022, we believe sharemarkets will be primarily influenced by the direction of interest rates as central banks continue to mull over whether current inflationary trends are transitional or becoming embedded. As such, we continue to steer away from the riskier parts of the sharemarket and remain focused on identifying and holding what we assess to be good quality companies, that we believe are well managed, which offer sound value, and which can do well over the next 3-5 years.

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| Researcher | Rating |
|-------------|--|
| Lonsec | Contact IML for the most recent rating |
| Zenith | Recommended |
| Morningstar | Bronze |

| Portfolio Top Holdings | ASX Code |
|---------------------------|----------|
| Telstra | TLS |
| AusNet | AST |
| National Australia Bank | NAB |
| Crown | CWN |
| Westpac | WBC |
| Orica | ORI |
| Aurizon | AZJ |
| Insurance Australia Group | IAG |
| BHP | BHP |
| Tabcorp | TAH |



*Benchmark = S&P/ASX 300 Accumulation Index, Source: Factset

The Value and Income Fund was restructured and renamed the Equity Income Fund on 1 January 2011 where the strategy of the Fund was changed to not hold international shares and to focus on its current strategy of generating income for unitholders. If the performance of the two funds are combined the results would be as follows:

| | Fund return | Benchmark** |
|-----------------------------|-------------|-------------|
| Since Inception^ 1 May 2004 | +7.3% | +9.0% |

^% Performance per annum *Fund returns are calculated net of management fees, and assuming all distributions are re-invested. Past performance is not indicative of future performance. Fund returns are the Value and Income Fund prior to 31 December 2010 and the Equity Income Fund from 1 January 2011. **The benchmark is the UBS Bank Bill+2% benchmark prior to 31 December 2010 and S&P/ASX 300 Accumulation Index from 1 January 2011.