Lazard
Australian Equity Fund

Aug 2022
Factsheet

Risk Aware
Focus on benchmark and absolute risk

Disciplined 'Value' Investment Approach
Longer-term independent thinking

Stability and Experience
Team together at Lazard for more than 20 Years

Fund Facts

Number of stocks	37
Total Fund Size	$141.9m
Inception Date	16 December 2002
Total Management Costs	W Class: 0.90% p.a.
Index	S&P/ASX 200
Minimum Investment	$20,000
Buy/Sell Spread	0.20%/0.20%
Distributions	Quarterly[1]
APIR Code	LAZ0010AU

Investment Characteristics

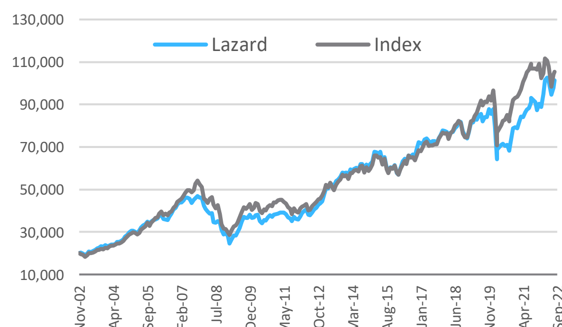
	Lazard	Index
Price/Cash Flow	7.0	8.8
Price/Book Value	1.6	2.1
Dividend Yield (%)	4.8	4.5
Forward Price/Earnings	11.0	14.2
Active Share (%)	61.1	-
3 Year Turnover (%pa)	37.6	-

Performance (%)

	Lazard (W Class)	Lazard (I Class)	Index
1 Month	3.4	3.5	1.2
3 Months	0.5	0.5	-2.4
1 Year	11.2	11.4	-3.4
3 Years (pa)	7.2	7.4	5.5
5 Years (pa)	6.8	7.0	8.1
10 Years (pa)	9.5	9.7	9.3
Since Inception (pa)	8.6		8.8
Since Inception (pa)		9.2	7.9

Inception Date (W Class): 16 December 2002
Inception Date (I Class): 17 October 2000

Growth of $20,000[2]



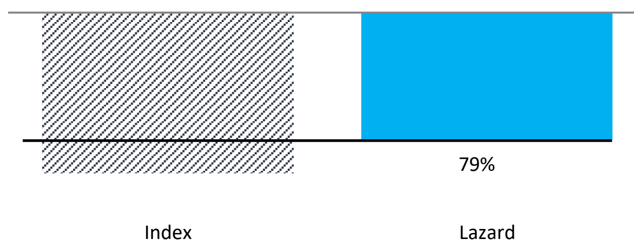
Allocations (%)

Sector	Lazard	Index	Overweight/ Underweight
Communication Services	1.1	3.9	-2.8
Consumer Discretionary	9.5	6.5	3.0
Consumer Staples	11.9	5.0	6.9
Energy	12.1	6.1	6.0
Financials	31.0	28.5	2.5
Health Care	3.7	10.3	-6.6
Industrials	5.6	5.9	-0.3
Information Technology	2.4	3.0	-0.6
Materials	17.9	23.1	-5.2
Real Estate	2.6	6.4	-3.8
Utilities	0.0	1.4	-1.4
Cash	2.3	0.0	2.3

Top 5 Holdings (%)

	Lazard	Index
BHP Group	8.2	10.0
Commonwealth Bank of Australia	4.4	8.1
Rio Tinto	4.4	1.7
Woodside Energy	4.3	3.1
South32	3.9	0.9

Down Market Capture Ratio



Index Lazard

Down Market Capture Ratio is calculated since inception and based on performance gross of all fees. Down Market Capture is a statistical measure of an investment manager's overall performance in down markets, being calendar months where the Index experiences negative performance. A drawdown ratio (or percentage) of less than 100 (or 100%) reflects that the manager has outperformed the Index during such down markets.

1 Distributions are made quarterly if of an economic size.
2 Performance is presented net of W Class fees, please refer to www.lazardassetmanagement.com for performance of the I Class. Investments can go up and down. Past performance is not necessarily indicative of future performance. Net returns are quoted after the deduction of Management Costs. Performance assumes reinvestment of all distributions.

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Commentary

The S&P/ASX 200 closed higher by +1.2% in August 2022 driven by a resilient reporting season where results impressed in a tough environment and outperformed the Developed Markets. Global Equities struggled in August, as hawkish commentary from the Federal Reserve's annual Jackson Hole symposium softened investor sentiment. The S&P 500 lost ground with a fall of -4.1% in local currency terms. Locally, following the RBA's 50bps hike to 1.85% on 3 August 2022, bond markets showed investors pricing a more hawkish outlook, as the Australian 10-year yield sold-off by 54bps to 3.60%. On a sector basis, Energy was the strongest performer, while Materials and Communication Services also outperformed in Australia. The REITs, Consumer Staples and Information Technology sectors were the worst performers.

During the month ended August 2022, the Lazard Australian Equity Fund returned 3.4% (net of W Class fees), outperforming the S&P/ASX 200 Accumulation Index which returned 1.2%.

Contributors to Performance

- Whitehaven Coal's (WHC) share price continued to outperform the market in August, underpinned by further increases in global coal prices and a record full year result. Benchmark Newcastle (NEWC NAR 6,000 kcal/kg) coal finished the month at US$425/t, up another 5% from the start of the month to average over US$400/t during the Q2 2022. There is typically a 6 to 9 months lag between spot price and the realised price achieved by WHC, meaning the high prices will likely continue to flow through into WHC's earnings over the next 12 months. The backdrop for the global coal market continues to be very supportive in the short to medium term. Europe's embargo of Russia coal imports commenced on August 10 and supply from the two largest seaborne exporters, Australia and Indonesia, remains very tight as 'La Nina' brought an extended period of rainfall which has impacted coal production and logistics. Australia is one of the few alternative suppliers of higher quality coal than that produced in Russia, further boosting demand. At current spot coal prices, the stock is trading on a 70% FCF yield and is sitting on a net cash position. Strong capital management is underway with the management looking to finish the current A$550m buyback before the end of the year and will seek shareholder approval for further capital returns. Our valuation captures the near-term strength in coal prices but remains anchored to our long-term coal price assumptions of US$80/t for NEWC 6,000kcal/kg. On this basis, WHC is still looking relatively attractive. We believe shareholders will be increasingly rewarded with higher dividend payments and share buybacks in the near term.

- Ridley (RIC) performed well during August with the shares rising 24% against an index that was marginally down. The company reported full year profits results on 18 August 2022, slightly beating expectations and achieving a third consecutive year of double-digit earnings growth. CEO Quinton Hilderband articulated a second 'Three Year Growth Pan' with the result, confirming the positive earnings trajectory. RIC's shares have performed well in recent years due to strong earnings growth; the EV/EBITDA multiple has been relatively stable. We remain holders of RIC.

Detractors from Performance

- Aurizon (AZJ) underperformed during August on the back of a slightly soft earnings result and a disappointing earnings outlook. Management provided qualitative commentary that both FY22 and FY23 guidance were impacted by wet weather but without additional quantification, the market is taking current earnings as an underlying base. The market also remains skeptical of AZJ's bulk growth strategy, particularly the One Rail Australia acquisition and the divestment of East Coast Rail. We continue to hold AZJ due to the modest expectations implied in the share price and the company's economically defensive earnings with inflation protection.

- Coles (COL) underperformed in August after the company reported it's 2022 financial results, which were ahead of the markets expectations by 5%. However, the company announced an increase in their capex expectations related to their warehouse upgrades and the installation of the new online shopping warehouse system. The cost increases were all inflationary led. On top of the higher spend, the management comments on the outlook were cautious around higher operating costs due to inflationary pressures and a tougher macro-outlook. The business is not seeing any operating leverage from inflation as there are leads and lags between revenue and costs. COL has been a strong relative performer over the last 12 months, and we lowered the portfolio weight leading into reporting season.

Commentary

Outlook

In retrospect we can now identify 9th November 2020 as an important turning point of internal stock market dynamics in Australia, even if speculative activity only reached its peak in the first quarter of 2021. Value style started to outperform from November 2020, although to end 2021, better returns were driven entirely by superior EPS growth, partly offset by continuing increases in the dispersion of valuations due to ever increasing multiples for the high multiple stocks of the ASX. This widening dispersion finally started to reverse over January and February of 2022, resulting in dramatic relative gains for our portfolios. As of end of March 2022, about 40% to 50% of the gap that had opened up had mean-reverted, when measured against the benchmarks of the last 25 low inflation years and dispersion measures tracked mostly sideways over the June quarter. Even after the 1H22 unwind of the 2020/21 excesses, absolute forward earnings multiples for the high quintile multiple stocks remain near the levels of March 2000, and the majority of the relative mean-reversion and thus of the associated out-performance is yet to unfold. History suggests that a distortion of this magnitude, which has built up over several years of boom, will similarly correct over a multi-year period, but so far, the mean reversion has been more rapid than in the "tech wreck" years of 2000-2003 or post the China boom of 2007. This may be due to the greater extremes reached and/or the current inflation risks that were not present in these prior post-bubble normalisations. Historical experiences suggests, however, that the rapid unwind of the bubble over the last seven months is unlikely to continue in such a straight-line fashion, as even during the March 2000 to March 2003 "tech wreck", there were several explosively rapid ~30% rallies in the NASDAQ, even as the overall index declined 80%. We should experience similar market volatility over the current normalisation period as well.

A significant contributor to outperformance over 1H22 were our Energy positions. Even following the gains in 2022 to date, the sector remains very attractively priced as the sector price index continues to be below end 2019 levels, for example, despite dramatic increases in coal, gas and oil prices since that time and we have only lowered the Fund's exposure modestly through the period. The increased likelihood of a US recession presents risks to energy commodity prices, but there is considerable structural support from accumulated under-investment.

In prior quarterly commentary we have focused on the inflation risks arising from the MMT-driven increases in broad money across the western world and the US in particular, where a wage-price feedback dynamic has developed. Exogenous shocks on Western inflation have come from the Russian-Ukraine conflict placing upward pressure on food and energy prices, off-set by China's economic problems arising from its adherence to a COVID-19 elimination strategy in the face of increasingly infectious omicron sub-variants.

We outline our market expectations in low or high inflation scenarios below.

1. If inflation subsides, rates remain in the low range that has prevailed over the last 30 years and market multiples remain supported by the "fed put", we expect outcomes similar to those following 2001 – an extended period of normalisation of relative multiples driving value out-performance, in the context of overall negative US and subdued Australian equity returns.

2. If inflation rates remain significantly higher than central bank targets, a global or at least developed world recession is almost certain within the next 18 months. Returns across all asset classes – bonds, property, equities – would likely be negative, some significantly so, but the relative gains by value equities would probably be even greater than those that seem likely from multiple normalisation in any case. The combination of extreme distortions as the starting point and a rise in inflation could result in the most dramatic relative gains by value stocks since the early 1970s.

For very different reasons, namely a property downturn, the risk of a Chinese recession is thus also much greater than usual. Such a recession would alleviate food, commodity and energy inflation pressures globally and thus may even be of some net benefit for western commodity-importing manufacturing nations, although it would clearly be a significant negative for Australia.

Domestically, the rise in interest rates once more raises the risks associated with extended home prices and the high level of household debt, and we are watching house price developments in New Zealand closely, as rates rose earlier in that market. As of the end of June, CoreLogic report that Auckland prices had declined by 10.5% from the 2021 peak, which by itself this decline is not concerning, and national prices have declined by less, but the rate of decline is rapid for residential property and the rate of decline has accelerated. We see an approximately 15% national decline as approaching a "danger zone" beyond which internal market dynamics and self-fulfilling sentiment changes could lead to a recession and yet further falls beyond the ability of monetary policy to prevent.

For more information, call us on 1800 825 287
or visit www.lazardassetmanagement.com

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