Lazard
Australian Equity Fund

Sep 2022
Factsheet

Risk Aware	Disciplined 'Value' Investment Approach	Stability and Experience
Focus on benchmark and absolute risk	Longer-term independent thinking	Team together at Lazard for more than 20 Years

Fund Facts

Number of stocks	37
Total Fund Size	$135.9m
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

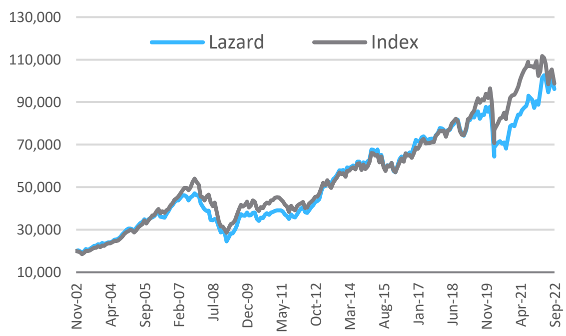
	Lazard	Index
Price/Cash Flow	6.2	8.1
Price/Book Value	1.5	1.9
Dividend Yield (%)	5.4	4.9
Forward Price/Earnings	10.4	12.8
Active Share (%)	59.9	-
3 Year Turnover (%pa)	38.4	-

Performance (%)

	Lazard (W Class)	Lazard (I Class)	Index
1 Month	-5.2	-5.2	-6.2
3 Months	1.5	1.6	0.4
1 Year	3.2	3.4	-7.7
3 Years (pa)	4.5	4.6	2.7
5 Years (pa)	5.9	6.1	6.8
10 Years (pa)	8.8	8.9	8.4
Since Inception (pa)	8.2		8.2
Since Inception (pa)		8.9	7.6

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

Growth of $20,000[2]



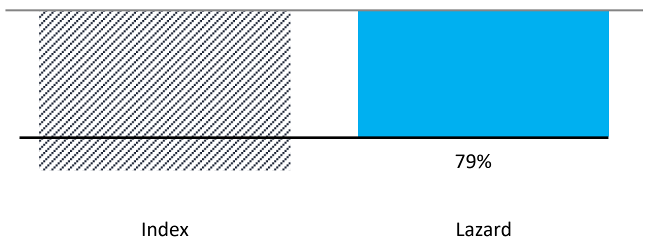
Allocations (%)

Sector	Lazard	Index	Overweight/ Underweight
Communication Services	1.0	4.0	-3.0
Consumer Discretionary	9.2	6.4	2.8
Consumer Staples	12.7	5.1	7.6
Energy	12.8	6.3	6.5
Financials	29.1	28.5	0.6
Health Care	3.7	10.5	-6.8
Industrials	5.8	5.8	0.0
Information Technology	1.6	2.8	-1.2
Materials	18.9	23.4	-4.5
Real Estate	2.5	6.0	-3.5
Utilities	0.0	1.3	-1.3
Cash	2.8	0.0	2.8

Top 5 Holdings (%)

	Lazard	Index
BHP Group	9.2	10.2
Rio Tinto	4.8	1.8
Woodside Energy	4.6	3.1
Santos	4.3	1.2
Commonwealth Bank of Australia	4.3	8.1

Down Market Capture Ratio



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.

LAZARD
ASSET MANAGEMENT

Commentary

The S&P ASX 200 fell -6.2% in September 2022 as investors priced in one of the most aggressive rate hiking cycles since the 1990s from the RBA. Global Equities also struggled on the back of global recession fears and an increasingly hawkish US Federal Reserve ('the Fed'), with the S&P 500 closing the month down -9.2% in local currency terms. Bond markets also reflected a hawkish outlook, as the Australian 10-year yield sold-off by 29bps to 3.89% following the widely expected RBA's 50bps hike to 2.35% on 7 September 2022. On a sector basis, Materials was the strongest performer, while Energy, and Health Care also outperformed in Australia. The Utilities, REITs and Information Technology sectors were the worst performers.

During the quarter ended September 2022, the Lazard Australian Equity Fund returned 1.5% (net of W Class fees), outperforming the S&P/ASX 200 Accumulation Index which returned 0.4%.

Contributors to Performance

- AMP's share price rose 16% over the September quarter, well ahead of the benchmark, despite an overall disappointing operational 1H22 result, the loss of two wholesale property funds (and thus contingent future earn-out payments from Dexus) and weak markets. As we noted in the past, close to half of AMP's value is the excess cash held by the company, which makes AMP a much lower beta stock than in the past and less cyclical than suggested by the common focus on the wealth business. The September quarter did see the start of the first buyback tranche of $300m, which may have assisted sentiment. As at the Q3 2022 closing price of A$1.10 per share, AMP continued to trade at a close to 20% discount to NTA. At such discounts, on-market buybacks are not just EPS, but also NTA per share accretive, and we expect the further capital management in 1H23. The company will also retire corporate debt. AMP's shares are no longer in the top 20 of our stock ranks but remain absolutely and relatively undervalued at a 19% discount to NTA.

- Monadelphous (MND) outperformed the benchmark during Q3 2022, with its share price up ~30%. In August, the company reported a FY22 result that was ahead of management's own guidance set in February this year. Group revenue declined 1.5% versus pcp whilst expectations were for a 5-10% decline. EBITDA margin also improved sequentially, even though second half revenue was substantially lower due to the timing of project roll offs. More importantly though, MND management pointed to a strong pipeline of mining construction activity over the next two to three years across various commodities including iron ore, lithium, and copper. Repeated comments, by a normally conservative management team, that "there will be more work available than capacity to do the work" presents a bullish tone for medium-term revenue growth and supports a recovery in profit margins to pre-COVID levels or above. We remain shareholders of MND, a best-in-class engineering construction and maintenance company. MND has a long-standing management team who take a sensible and conservative approach to risk management. This is evidenced by the absence of any significant project cost overruns over the last two decades and a balance sheet that is continually kept in robust shape, with A$172m in net cash today. On our FY25 forecasts, MND currently trades on 14.0x P/E and 8.0x EV/EBIT. This is modestly lower than its long-run averages of 16.0x and 10.0x respectively.

Detractors from Performance

- Costa was a material underperformer during Q3 2022 falling by 22%. The share price experienced an initial leg down in July this year when it was announced that wet weather had impacted the quality of the citrus crop which means a higher proportion will be sold at lower price points. This will likely lower current year earnings although we don't foresee the impact to persist beyond 2022. The full year profit result on the 8 of August was well received by the market with recently commissioned assets, the Monarto Mushroom facility and tomato Glass House 4 at Guyra, showing progress towards achieving the investment case. A greater emphasis on return on capital was also well received with the shares rising through August. The shares experienced another sharp fall on the 21 of September when CEO Sean Hallahan announced he was leaving the company. As far as we have ascertained, this early and unexpected departure was not related to business performance but personal factors impacting the CEO. Costa has been a disappointing position in the portfolio for some time now. We do see positive underlying trends and opportunities to improve profitability. While former CEO and current board member Harry Debney will act as CEO, we look forward to the appointment of a new Chief Executive who can articulate how Costa will improve performance.

- Aurizon's (AZJ) share price fell -7.5% in the September month underperforming the index which fell -6.2%. Aurizon (AZJ) underperformed 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 sceptical 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.

Commentary

Outlook

In retrospect we can now identify 9 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 the 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 benchmark 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, we believe, very likely 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 potentially 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 greater than usual. Such a recession could 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 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 potentially 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