

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

Performance² (%)

	Lazard (W Class)	Lazard (I Class)	Index
1 Month	4.5	4.5	6.6
3 Months	5.4	5.4	6.0
1 Year	22.2	22.3	5.0
3 Years (pa)	6.7	6.9	5.9
5 Years (pa)	7.2	7.3	8.2
10 Years (pa)	9.4	9.5	9.4
Since Inception (pa)	8.7		9.2
Since Inception (pa)		9.4	8.1

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

Allocations (%)

Sector	Lazard	Index	Overweight/ Underweight
Communication Services	1.1	3.8	1.1
Consumer Discretionary	9.6	6.3	9.6
Consumer Staples	10.4	4.7	10.4
Energy	13.1	6.3	13.1
Financials	28.9	28.7	28.9
Health Care	5.2	10.0	5.2
Industrials	5.8	5.8	5.8
Information Technology	1.0	2.7	1.0
Materials	19.3	24.2	19.3
Real Estate	3.1	6.1	3.1
Utilities	0.0	1.5	0.0
Cash	2.5	0.0	2.5

Investment Characteristics

	Lazard	Index
Price/Cash Flow	6.4	9.0
Price/Book Value	1.7	2.1
Dividend Yield (%)	5.0	4.4
Forward Price/Earnings	11.8	14.5
Active Share (%)	59.9	-
3 Year Turnover (%pa)	38.2	-

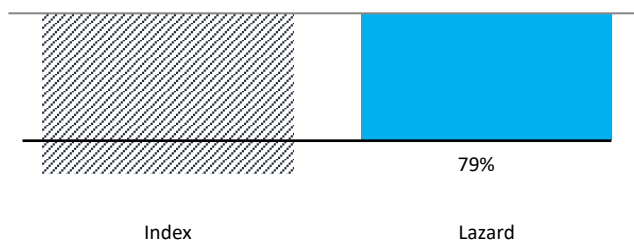
Top 5 Holdings (%)

	Lazard	Index
BHP Group Ltd	9.9	10.7
Woodside Energy Group Ltd	5.6	3.3
Rio Tinto Limited	5.0	1.9
Commonwealth Bank of Australia	4.4	8.5
Santos Limited	4.1	1.2

Fund Facts

Number of stocks	36
Total Fund Size	\$157.5m
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

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.

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.

Commentary

Equities had a strong month in November 2022 following on from a strong performance in October, as Federal Reserve Chair Powell's comments on potentially slowing rate hikes "as soon as December" provided relief to markets. The S&P/ASX 200 outperformed the developed market indices, rising over +6% during November, as investors responded to a more dovish than expected RBA 25bps hike to 2.85% during the month. This was reflected in Australian bond markets, as the Australian 10-year yield moved down by 23bps to 3.53%. On a sector basis, Utilities was the strongest performer, while Materials, and Health Care also outperformed in Australia. The Communication Services, Financials and Energy sectors were the relative worst performers.

During the month ended November 2022, the Lazard Australian Equity Fund returned 4.5% (net of W Class fees), underperforming the S&P/ASX 200 Accumulation Index which returned 6.6%.

Contributors to Performance

- South 32 (S32) outperformed the market strongly in November as the Chinese government's push for a reopening of the economy gathers pace. Both aluminium and copper prices recovered over 10%, and nickel price jumped over 20% during the month in response. S32 is a mining conglomerate with more than 95% of its portfolio leveraged to the green energy transition. During Q4 2021, S32 announced an acquisition of a 45% interest in the Sierra Gorda Copper mine in Chile for US\$1.5bn. This mine has 20 years of reserve life and annual production of 210kt. This transaction adds another future facing commodity to the portfolio. Copper is estimated to account for 20% of underlying earnings on an annualized basis for FY21. The Sierra Gorda deal was attractively priced at 3.3x EV/EBITDA or 2x EV/EBITDA at spot copper prices. Our value for Sierra Gorda is lower than the markets due to a conservative copper price but this doesn't include the option value for mine life extension or a phase 2 concentrator expansion. In addition, S32 bought an additional 25% interest in the Mozal aluminum smelter, which is backed by hydro power, at an attractive acquisition multiple of 3.6x. The deal will increase S32's ownership in this smelter to 72%, adding another 145kt pa of green aluminum production. Overall, despite some headwinds for near-term recession risk, we continue to see S32 as attractively priced today.
- Computershare (CPU) outperformed the market in November following a trading update at the company's AGM, which pointed to margin income guidance likely being beaten by over 20 per cent in FY23, and by a similar amount the following year. The implied margin income yield therefore is at a 14 year high. As we like to focus on what a company can earn sustainably, we used the occasion to take profit in CPU, noting that updated expectations of global rate hikes through 2023 in the face of early signs of inflation deceleration and slowing GDP growth, increased the risks to margin income. The company otherwise remains a steady dividend payer with a strong balance sheet at a relatively fair valuation of 16.5x forward P/E.

Detractors from Performance

- Collin's foods (CKF) experienced a ~25% share price fall in the wake of the release of the H1'23 financial results during the month. While the profit for the first half of the year broadly met expectations, CKF's downgraded margin expectations for the full year. Australian margin expectations were downgraded to 15-16% from 16-17% and European margins are now expected to decline by 2-3% compared to the 1-2% decline initially expected. CKF also expects a slower recovery in margins from current low levels. There was also an impairment of the emergent Taco Bell store network which, while disappointing, is immaterial for the valuation. While this near-term earnings downgrade is disappointing, we note it is solely due to cost pressures and that the top line of the business, indicative of demand, remains robust. Cost pressures should, we believe, ease in time and with pricing initiatives expected to support margins. Crucially, management has not altered their long-term profitability expectations for the business. We remain attracted to CKF's long term growth profile through store expansion and have used this share price weakness to increase our position in the company.
- Healius was a detractor in November following a market update for the first four months of FY23. In our view, there were a few points that were disappointing. Firstly, COVID-19 testing revenues that are usually very high margin have fallen more quickly than expected. That particularly doesn't affect our longer-term valuation too much, although our expectation of a small ongoing contribution from PCR testing is less likely. Secondly, the base business recovery is also slower than expected (no catch-up apparent and still below normal trends). Management is pointing to a slow recovery in referrals as the older cohort is still cautious to visit the GP combined with staff shortages. However, even taking all the above into account, our forecast revenue FY23-26 is not the key concern. Our concern is the margins. Management is of the view that the weak post-COVID-19 recovery is all temporary and that Pathology testing and margins will revert to historic trends. They have also reaffirmed the Sustainable Improvement Programme which adds 300bps to EBIT margins (FY19 pre-COVID-19 base). Nevertheless, we are concerned that Medicare rates may not fully recover cost increases. Consequently, we have taken a more cautious view about margins in our final valuation year as we remain invested.

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.

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