

Lazard

Select Australian Equity Fund

Jul 2022
Factsheet

High Conviction

Benchmark unconstrained, with high active share and best ideas

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	32
Total Fund Size	\$55.5m
Inception Date	22 August 2002
Total Management Costs	W Class: 1.15% p.a.
Index	S&P/ASX 200
Minimum Investment	\$20,000
Buy/Sell Spread	0.20%/0.20%
Distributions	Quarterly ¹
APIR Code	LAZ0013AU

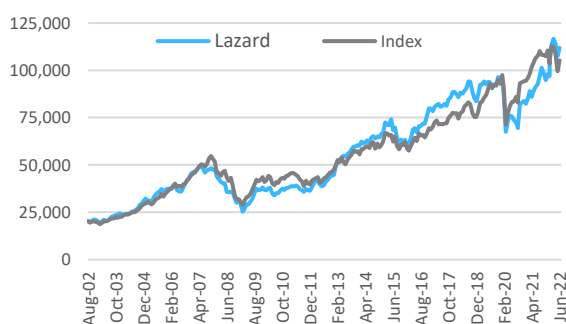
Investment Characteristics

	Lazard	Index
Price/Cash Flow	7.7	9.6
Price/Book Value	1.5	2.1
Dividend Yield (%)	4.2	4.6
Forward Price/Earnings	9.9	13.9
Active Share (%)	75.1	-
3 Year Turnover (%pa)	72.5	-

Performance² (%)

	Lazard	Index	Excess Return
1 Month	4.0	5.7	-1.7
3 Months	-4.0	-6.0	2.0
1 Year	20.5	-2.2	22.7
3 Years (pa)	6.1	4.3	1.8
5 Years (pa)	6.6	8.0	-1.4
10 Years (pa)	11.1	9.4	1.7
Since Inception (pa)	9.0	8.5	0.5

Growth of \$20,000²



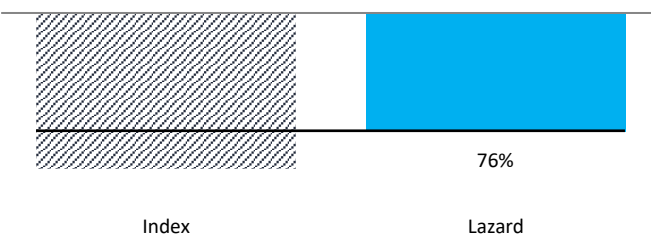
Allocations (%)

Sector	Lazard	Index	Overweight/ Underweight
Communication Services	1.5	3.9	-2.4
Consumer Discretionary	8.8	6.5	2.3
Consumer Staples	10.9	5.2	5.7
Energy	18.7	5.7	13.0
Financials	33.4	29.0	4.4
Health Care	1.6	10.4	-8.8
Industrials	5.9	5.9	0.0
Information Technology	3.4	3.0	0.4
Materials	12.8	22.3	-9.5
Real Estate	2.5	6.7	-4.2
Utilities	0.0	1.5	-1.5
Cash	0.6	0.0	0.6

Top 5 Holdings (%)

	Lazard	Index
QBE Insurance	9.4	0.8
Woodside Energy	8.9	2.9
AMP	7.4	0.2
Whitehaven Coal	6.4	0.3
Rio Tinto	5.8	1.8

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 Down Market Capture ratio (or percentage) of less than 100 (or 100%) reflects that the manager, on average, 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.au 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

Global equities rebounded in July 2022, driven by a positive US reporting season and US GDP contraction which softened investor expectations of the steepness of future rate hikes. The MSCI Developed Markets Index rose (+8.0%), driven by a strong month for the S&P 500 which gained (+9.2%) in local currency terms. The S&P/ASX 200 gained +5.7% over July, benefiting from the expectations of a less hawkish Federal Reserve and rising Mining and Energy stocks. On a sector basis, Information Technology was the strongest performer, while REITs, and Financials also outperformed in Australia. The Materials, Energy and Utilities sectors were the worst performers. The RBA's July meeting hiked the cash rate by 50bps to 1.35%, which was widely expected. This came after larger and earlier than expected hikes of 50bps in June, and 25bps in May. Hence, rates are now further above their pre-COVID peak (0.75%), and the highest level since 2019.

During the month ended July 2022, the Lazard Select Australian Equity Fund returned 4.0% (net of W Class fees), underperforming the S&P/ASX 200 Accumulation Index which returned 5.7%.

Contributors to Performance

- Our underweight position in BHP contributed to relative performance in July 2022. Iron ore prices have been volatile and fell almost 20% during the month but finished the month only down by 5%. It looks like the market has stepped back from its previous optimism about the improved demand outlook for iron ore into China. We have held underweight positions in iron ore for some time, as we are cautious about the increased spend into infrastructure by the Chinese government will be enough to cushion the weakness in property sectors. Property still accounts for 40% of steel demand in China compared to Infrastructure which only accounts for 15% of demand. The latest data from China continues to show very weak consumer confidence and there is not much improvement in property sale data which is still negative. These are usually good lead indicators for demand for steel and ultimately translate to demand for iron ore. It also seems the Chinese government is slowly accepting a weaker growth outlook for the second half of this year and is unlikely to further boost its stimulus program to heat up the economy to achieve the previous GDP target. Overall, we have a more conservative view on iron ore and only capitalize earnings on our long-term iron ore price of US\$60/t vs current spot price of \$120/t, on that basis we see better relative value among other stocks in our investment universe.
- AMP's share price rose 14.7% over July, despite the only news during the period being the loss of the management rights of AWOFF by AMPC/Dexus to Mirvac. These management rights had been sold to Dexus and the loss to Mirvac reduces the maximum possible earn-out payment by Dexus to AMP by approximately \$150m. Pro-forma NTA per share for AMP is expected to be reported at about \$1.40 at the 1H22 results. Excess regulatory capital of A\$1.75bn (excluding 1H22 earnings and representing over 40% of market cap) consisting of cash holdings can be mostly returned to shareholders. For as long as AMP trades at below NTA, on-market buybacks are not just EPS, but also NTA per share accretive, and we expect the company to commence buybacks over 2H22. The company will also retire corporate debt. AMP's shares are no longer in the top 5 of our stock ranks but remain absolutely and relatively undervalued at a 22% discount to NTA.

Detractors from Performance

- Costa Group (CGC) shares fell 11% in July, underperforming the market. The weakness was driven by reports of quality issues in the citrus crop which typically results in lower received prices. We view a sell off of this size as an overreaction, noting only part of the crop will be affected and that the crop last year was also of lower quality providing a lower hurdle. Pricing data for most of CGC's other produce segments appears strong indicating there may be positive offsets. We await the H1'22 result in August for confirmation.
- After rising by over 5% over the very weak June quarter, QBE's share price fell 5% over the month of July 2022. In the absence of company specific news, this may reflect (1) a slightly stronger AUD, (2) some retracement of bond yields across Australia, the UK and the US (where QBE holds its technical reserves) and (3) the overall better performance of "growth stocks" over the month. Global and US premium rates continue to rise strongly, however, and EPS revisions for QBE were strong over the trailing quarter. We own QBE for the on-going hard market in premium rates, which continues to surprise by its longevity. It is important to note, though, that while higher interest rates boost the P&L, on-going rates of high inflation would require reserve strengthening by QBE and other insurance companies. QBE trades on only 8.5x 2023 consensus EPS, a 40% discount to the ASX200, which is well below the long-run 16% discount multiple.

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, however, 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 a ~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.au

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