Lazard
Select Australian Equity Fund

Sep 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	$59.5m
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

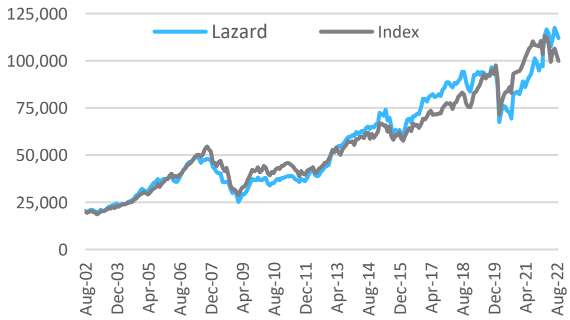
Investment Characteristics

	Lazard	Index
Price/Cash Flow	5.9	8.1
Price/Book Value	1.4	1.9
Dividend Yield (%)	5.2	4.9
Forward Price/Earnings	9.5	12.8
Active Share (%)	74.6	-
3 Year Turnover (%pa)	71.4	-

Performance[2] (%)

	Lazard	Index	Excess Return
1 Month	-4.7	-6.2	1.5
3 Months	4.0	0.4	3.7
1 Year	10.5	-7.7	18.1
3 Years (pa)	6.5	2.7	3.8
5 Years (pa)	6.6	6.8	-0.2
10 Years (pa)	10.2	8.4	1.8
Since Inception (pa)	8.9	8.2	0.8

Growth of $20,000[2]



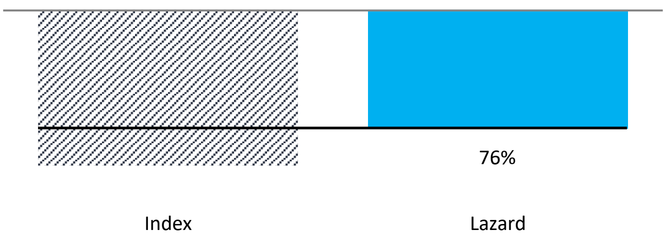
Allocations (%)

Sector	Lazard	Index	Overweight/ Underweight
Communication Services	1.2	4.0	-2.8
Consumer Discretionary	9.1	6.4	2.7
Consumer Staples	10.5	5.1	5.4
Energy	17.6	6.3	11.3
Financials	30.3	28.5	1.8
Health Care	1.0	10.5	-9.5
Industrials	6.4	5.8	0.6
Information Technology	2.0	2.8	-0.8
Materials	15.2	23.4	-8.2
Real Estate	2.5	6.0	-3.5
Utilities	0.0	1.3	-1.3
Cash	4.0	0.0	4.0

Top 5 Holdings (%)

	Lazard	Index
QBE Insurance	10.0	0.9
Woodside Energy	8.8	3.1
AMP	7.4	0.2
Rio Tinto	7.3	1.8
South32	4.2	0.9

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 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 Select Australian Equity Fund returned 4.0% (net of W Class fees), outperforming the S&P/ASX 200 Accumulation Index which returned 0.4%.

Contributors to Performance

- Whitehaven Coal's (WHC) share price continued to outperform the market during the Q3 2022, underpinned by elevated global coal prices and a record full year result. Benchmark Newcastle (NEWC NAR 6,000 kcal/kg) coal was average over US$420/t during the quarter, more than doubled compared to 12 months ago and was 15% higher compared to June quarter. 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. At current spot coal prices, the stock is trading on over 50% FCF yield and is sitting on a net cash position. Strong capital management is underway with management looking to finish the current A$550m buyback before the end of the year and will seek shareholder approval for further buyback of 25% of its outstanding shares. Our valuation captures the near-term strength in coal prices but remains anchored to our long-term coal price assumptions of US$85/t for NEWC 6,000kcal/kg. On this basis, WHC is still looking relatively attractive. We continue to believe shareholders will be increasingly rewarded with higher dividend payments and share buybacks in the near term.

- Ridley (RIC) performed well during the current quarter with the shares rising 13.9% outperforming the benchmark returns. 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 Hildebrand 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 continue to hold RIC in the portfolio.

Detractors from Performance

- Skycity Entertainment's (SKC) stock price underperformed the market during the quarter. SKC reported full year result in August 2022, which was largely in line with management's guidance in June and near-term trading outlook suggesting a better operating performance than market consensus. We suspect the weak price performance in the quarter was due to a current NSW regulatory inquiry into its competitor Star Entertainment, which has unveiled some questionable industry behaviour mostly in its international business. In early July, the South Australian gaming regulator notified SKC, that they intend to undertake an independent review of SKC's Adelaide operation. There hasn't been much detail on the review process, but it is expected to last for the next 6-8 months. SKC has a very small international business in Adelaide and has been immaterial in terms of earnings contribution to the group. In terms of gaming regulation, South Australia already hosts one of the most restricted licenses in the country and has one of the highest standards for responsible gambling obligation applying to casino operators. So far there has been no announcement from the NZ regulator about an independent review to SKC's main asset in Auckland. The most recent license review in Auckland with the anti-monetary laundry regulator was completed in the mid of 2021. Overall, SKC's total international business was contributing only 10% of its earnings pre-COVID-19, which is much smaller compared to its competitors Star and Crown, who both had almost 25% of its earnings from international segment. We don't see any significant license or earnings risk for SKC at this moment. The business should continue to ramp up its performance post the ease of COVID-19 restriction in this region, which should drive earnings growth in the near-term. We believe casinos are a relative defensive business which should hold up value well in a recession and have also observed that casino businesses around the globe are performing strongly since their reopening with many of them already trading above their pre-COVID-19 levels.

- 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.

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.au