

31 July 2022

Market Review

Australian equities rose in July, in line with the rebound in markets worldwide. The Australian dollar also performed well against the US dollar, recovering from a two-year low towards the middle of the month. Meanwhile, commodity prices continued to decline, falling for the third month in a row.

Australian equities had a solid month in July, led by a recovery in technology stocks, which rebounded following a torrid start to the year for the sector. The materials and resource sectors, which have performed well for most of the year, were affected by the decline in commodity prices and slowing growth in China. However, solid results for the June quarter helped to cushion these headwinds.

In economic news, the Reserve Bank of Australia raised interest rates by 0.5% in July and guided that there was still more to come, given strong spending data and household savings. Elsewhere, employment data remained strong, with the unemployment rate, at 3.5% in June, hitting its lowest level in 48 years. That said, given employment data is often a lagging indicator of economic health, National Australia Bank's latest business survey and Westpac's consumer sentiment survey are potentially better reflections of what is to come. Both of these have fallen over recent months, with the Westpac survey down almost 20% since December - the sort of decline associated with a recession. This lack of confidence was also evident in slowing retail sales growth, which, despite coming in at 0.2% in June, would have been negative after adjusting for inflation.

Portfolio Review

The Fund returned +9.02% (gross of fees) and +8.95% (net of fees) in July. This was ahead of its performance target, which returned +5.75%.

Contributing to performance was our lack of exposure to BHP as the company released soft FY23 production guidance against a backdrop of increased volatility in commodity prices. Our overweight to Megaport also boosted returns as the company benefitted from a return to favour for high-growth names as bond yield expectations fell. Another beneficiary of the change in market sentiment was Pinnacle Investment Management, which rallied on market expectations of lower

long-term interest rates, which should be supportive of the business.

On the other hand, our holding in Elders was negatively impacted by a fall in cattle and lamb prices during the month due to reduced processing capacity from Covid-19 outbreaks. The risk of a domestic outbreak of foot-and-mouth disease was also a concern, causing farmers to rapidly offload cattle and sheep at reduced prices as a hedge. Finally, Auckland International underperformed. While the company is benefitting from a strong recovery in travel, there is increasing concern on how demand for both corporate and leisure travel will fare should a global recession eventuate.

There was no major activity for the Fund in July.

Outlook

Inflationary pressures that, in many cases, are just peaking, combined with aggressive and ongoing increases in global interest rates, are providing the right ingredients for a potential economic slowdown.

We are taking a cautious view for the remainder of 2022. Increasing evidence of consumer belt tightening is evident, due to the rising cost of living and higher mortgage servicing costs, which is likely to translate into a demand slowdown. If cost pressures continue to run rampant, the risk of stagflation increases and an economic recession is likely to follow.

This has various implications for both the outlook for corporate earnings and stock valuations. Despite equity markets already experiencing a steep drawdown in the first half of 2022, our observation is that only earnings multiples have normalised, mainly driven by the rising cost of capital, although earnings estimates remain fairly robust and have yet to fully capture the increasing risks of slowing economic growth. The upcoming earnings season is likely to reveal signs of initial softness and we expect market expectations for earnings growth to be progressively revised downwards.

Given this volatile backdrop, our portfolio positioning remains biased to businesses that offer strong pricing power and those that exhibit defensive business moats. We continue to be cautious on rate-sensitive sectors and businesses

Investment strategy³

The Fund utilises abrdr's Sustainable and Responsible Investment process to invest primarily in a concentrated portfolio of around 20-35 companies that are listed or proceeding to listing on the Australian Securities Exchange (ASX) and have the potential for capital growth and increased earning potential.

Investment objective

To outperform the benchmark, the S&P/ASX 200 Accumulation Index, after fees, over rolling three year periods.

that are just beginning their journey towards profitability.

We remain committed to our 'bottom-up' investment style, with a focus on quality companies. We favour businesses with clear growth prospects that are leveraged to long-term structural shifts. Our holdings' defensiveness, in terms of their robust balance sheets and prospects for generating healthy through-the-cycle earnings and dividend growth, is an added advantage. Many are also leaders on governance and sustainability, positioning them well to adapt to future challenges and opportunities. This will ensure that the portfolio remains resilient despite the current uncertain environment.

Fund performance is available on the relevant factsheet.

The opinions expressed are those of abrdn as of the date of publication and are subject to change at any time due to changes in market or economic conditions.

Contact us
Telephone:
1800 636 888 or +61 2 9950 2853 if
calling from outside Australia
Email: client.service.aust@abrdn.com

abrdn.com.au

Important information

Issued by abrdn Australia Limited ABN 59 002 123 364 AFSL No. 240263. This document has been prepared with care, is based on sources believed to be reliable and opinions expressed are honestly held as at the applicable date. However it is of a general nature only and we accept no liability for any errors or omissions. This is not an offer of securities. A Product Disclosure Statement (PDS), application form, and Target Market Determination (TMD) is available for each Fund by calling abrdn Australia Limited Client Services on 1800 636 888, at www.abrdn.com/aus, or from your financial adviser. This document has been prepared without taking into account the particular objectives, financial situation or needs of any investor. Investments are subject to investment risk, including possible delays in payment and loss of income and principal invested. It is important that before deciding whether to acquire, hold or redeem an investment in a Fund that investors consider the Fund's PDS, the Fund's appropriateness to their own circumstances, objectives and financial situation and consult financial and tax advisers. Past performance is not a reliable indicator of future results. All dollars are Australian dollars unless otherwise specified. Indices are copyrighted by and proprietary to the issuer.