

30 November 2022

Market Review

Australian equities rose in November, in line with most other markets worldwide. The Australian dollar reversed its decline against the US dollar, with the currency notably strengthening over the month. Meanwhile, commodity prices ended slightly higher at the end of November.

Australian equities continued their strong momentum in the last quarter of the calendar year, recovering much of the ground lost over the past 12 months. Investor confidence rose further, buoyed by lower-than-expected October inflation readings in the US for both headline and core inflation. However, purchasing managers' index readings for Australia, the US and the EU all fell into contractionary territory at the end of November, indicative of global growth slowing on weaker corporate earnings.

In economic news, the Reserve Bank of Australia (RBA) raised interest rates again during the month, to 2.85%, with expectations of a further rate rise at the December meeting before the RBA breaks for two months. Meanwhile, Australian employment data came in above expectations in October, with 32,200 jobs added, compared to forecasts of 15,000. The unemployment rate now sits at 3.4%, while sequential wage growth for the September quarter was 1% - slightly above expectations. Meanwhile, Westpac's Consumer Sentiment Index dropped even closer to record lows. NAB's Quarterly Business Survey showed that conditions remain resilient, but sentiment continued to fall.

Portfolio Review

The Fund returned 2.97% (gross of fees) and 2.90% (net of fees) in November. This was behind its performance target, which returned 6.58%.

Detracting from performance was our overweight to Mercury New Zealand. The company was affected by the Reserve Bank of New Zealand raising its official cash rate by 75 basis points to 4.25%, though there was no stock-specific news. Also weighing

on performance was our overweight to Elders, which underperformed during the month after announcing the departure of long-serving CEO Mark Allison. The stock was also affected by extreme wet weather in New South Wales that weighed heavily on the expected winter crop yield. Our lack of exposure to BHP hurt returns, as the business had a solid month driven by positive news flow from China, with Chinese policymakers releasing measures to relax Covid-19 controls and support the property sector. This resulted in a stronger iron ore price in November, which is beneficial to the business.

On the other hand, OZ Minerals outperformed, as the company received a revised \$28.25/share takeover offer from BHP. This was a 13% increase on the original \$25/share offer, which OZ Minerals had previously rejected. Elsewhere, our lack of exposure to Westpac contributed positively to returns. The stock underperformed after strong performance in October, as investors digested the potential risks of deposit margins unwinding and costs increasing in financial year 2023. The bank may also face potential credit risks in 2023 and 2024 if the macroeconomic environment deteriorates alongside borrowers making significantly higher repayments. Not holding James Hardie also contributed positively to returns. The stock was affected by its second-quarter profit result, which missed consensus expectations. James Hardie issued a significant downgrade to its financial year 2023 profit guidance. It now expects profits of USD 650 million, compared to its prior guidance of USD 730 million. In addition, readthroughs from contractor surveys and competitors reinforce the perception of ongoing downside risk to earnings.

Activity

In terms of Fund activity, we increased our position in Charter Hall Group, noting that economic indicators are starting to soften, which implies the rate cycle may be nearing its peak. Long-term interest rate stability is most conducive to property fund managers like Charter Hall Group. The valuation is

Investment strategy³

The Fund utilises abrdn'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.

reasonable, in our opinion, and underlying trends announced since the AGM give us confidence regarding the outlook for the business.

Conversely, we reduced our position in National Australia Bank (NAB) as part of a broader decrease in our exposure to banks. NAB screens as expensive relative to its historical valuation, and we see risks regarding the credit cycle in 2023 and 2024 in the event of a cyclical economic downturn. Further, we expect net interest margin benefits from funding tailwinds to start to unwind at the beginning of 2023.

ESG Engagement

We engaged Fortescue on its strategy to decarbonise the business and diversify its revenue streams. The detail provided has been good, and we appreciate the ambitious strategy of the company. We are looking to continue our engagement and see further concrete plans to achieve these targets.

Outlook

Inflationary pressures remain the key concern for investors. While inflation may well be nearing its peak, ongoing increases in global interest rates are likely to persist in the short term, coupled with increasing risks of an economic slowdown. This will likely see higher market volatility remaining a feature for some time.

We remain cautious into 2023. Recent trading updates from many Australian corporates revealed that while consumer spending is still brisk, early signs of belt-tightening can be seen, with some companies reporting slowing sales momentum. Meanwhile, cost pressures and higher-than-normal inventory positions also increase the risk of a discount cycle should consumer demand slow markedly.

Given this volatile backdrop, our portfolio positioning remains biased toward businesses that offer strong pricing power and those that exhibit defensive business moats while remaining cautious on rate-sensitive sectors and businesses that are just beginning their journey toward profitability.

Our focus is on quality companies. 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. We believe holdings' defensiveness (i.e., their robust balance sheets and prospects for generating healthy through-the-cycle earnings and dividend

growth) is an added advantage in 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.

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