

Aberdeen Standard Focused Sustainable Australian Equity Fund



30 November 2021

Market Review

Australian equities fell for the third straight month in November, while the Australian dollar hit its lowest level of the year versus the US dollar. Commodity prices also fell slightly.

At the beginning of the month, optimism continued to build from October, with Victoria coming out of lockdown, vaccination rates continuing to impress, and the first uncapped and quarantine-free flight since March 2020 landing in Sydney. This optimism again shone through in retail sales data, with October delivering a 4.9% month-on-month increase on top of September's 1.3% increase. However, while the market shook off inflation concerns following data from the US, it was not immune to the emergence of the Omicron variant of Covid-19, which led to sharp falls at the end of the month.

House prices continued to rise across the country, but there are signs of growth slowing in the two major cities, Sydney and Melbourne. Growth may temper further following the Australian Prudential Regulation Authority's changes to capital requirements, making riskier loans such as interest-only mortgages comparatively more expensive, thus encouraging owner-occupier mortgages.

The Reserve Bank of Australia (RBA) reported annual inflation at 3.0% for the September quarter, primarily driven by the sharp rise in petrol and home-building costs, the latter having been muted by the HomeBuilder subsidy earlier this year. Inflation continued to outpace wage growth, with the latter coming in at 2.2% for the same period, according to the Australian Bureau of Statistics report. While the recovery is growing at a faster-than-expected trajectory, the RBA warned that wage growth would have to be materially higher to justify an increase to the cash rate.

Portfolio Review

The Fund returned 0.66% (gross of fees) and 0.59% (net of fees) in November. This was ahead of its performance target, which returned -0.54%.

Performance was primarily driven by Goodman, after it released a robust first-quarter update for 2022, noting an increased development pipeline and continued demand for high-quality industrial assets. As the global fund manager of choice for industrial assets, we expect Goodman to continue to benefit from strong inflows into the subsector. Megaport and ASX were the other major contributors despite little fundamental news for either. Megaport potentially benefited from increased sell-side coverage and ASX a beneficiary of the RBA's announcement to end yield-curve control, signaling the potential for an earlier rate rise that should support ASX's futures business and interest income.

In contrast, the emergence of the Omicron variant meant IDP Education gave back almost all its outperformance from the previous month as the timing of border reopenings was again in doubt. The Federal Government's statement delaying the return of international skilled workers and students until the middle of December further reinforced this. Commonwealth Bank of Australia also disappointed with its first-quarter trading update, with margin compression in mortgages one of the biggest concerns. Finally, Insurance Australia Group suffered due to storm events across South Australia and Victoria, forcing the company to increase its perils allowance. While this led to a downward revision for its insurance margin guidance for the financial year, we believe that margin improvement for the business remains intact over the medium term.

We made a few changes to the portfolio across November, increasing our positions in Spark New Zealand and Mirvac while reducing our position in ASX. We feel there is upside in Spark New Zealand with an upcoming infrastructure sale, while successful delivery of its free cash flow target should support dividend growth. We saw Mirvac's recent price weakness as an opportunity to increase our position, given office asset transactions and residential sales remain strong and therefore

Investment strategy

The Fund utilises Aberdeen Standard Investments' 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.

supportive over the medium term. Finally, ASX's strong share price was a good opportunity to take profits and reallocate this capital to better opportunities in the market.

Outlook

As we see the domestic economy begin to reopen, we expect a strong rebound in the fundamental drivers of business confidence, consumer sentiment and unemployment. While the emergence of the new Omicron variant has clearly spooked global markets, we remain cautiously optimistic and steadfast in our investment strategy as we closely monitor further evidence regarding hospitalisation and vaccine efficacies before concluding its likely impact with regards to global economic recovery. While we believe the momentum in earnings growth has peaked, we still expect a positive growth skew over the coming months and the earnings up-cycle to continue.

While we are monitoring inflation closely, we expect central banks to react cautiously with a view of ensuring stability of asset prices. At the corporate level, as the recovery continues, companies are likely to move from capital preservation to capital allocation, with a notable pick-up in M&A activity and capital management.

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 through-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 amid present uncertainties and well-placed to deliver steady returns in the long run.

Fund performance is available on the relevant factsheet.

The opinions expressed are those of abrdn Australia Limited 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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