

31 March 2022

Market Review

Australian equities rose in March, continuing their momentum from February and outperforming most developed market indices. The Australian dollar also continued to perform well, gaining against the US dollar.

Meanwhile, the rise in commodity prices continues to be a boon, with many Australian companies benefiting directly or indirectly from this. Consequently, the utilities, material and energy sectors all performed well. Financials also had a good month. On the other hand, growth-focused tech stocks have continued their trend in the opposite direction, with many now trading at their pre-pandemic levels.

In economic news, GDP for the fourth quarter comfortably beat expectations, growing at 3.4% versus expectations of 3.0%, with full-year GDP growth also growing by 4.2%. Elsewhere, the Reserve Bank of Australia (RBA) has become slightly more hawkish, suggesting it was prudent to expect an interest rate hike later this year. This change in rhetoric is likely due to the continued strength of the labour market - which appears to now be the RBA's key metric - with the unemployment rate falling 0.2% to 4% in February, its lowest level since March 2008, despite the participation rate increasing to 66.4%.

Meanwhile, according to the Council of Financial Regulator's Quarterly Statement for March 2022, "housing credit grew strongly through 2021 and loan commitments suggest this will continue to be the case in the months ahead". However, the council noted that housing price growth has moderated in certain locations.

Portfolio Review

The Fund returned 5.21% (gross of fees) and 5.14% (net of fees) in March. This was behind its performance target, which returned 6.89%.

Detracting from performance was the structural underweight to the resource sector, particularly mining, given the Fund

undertakes a Sustainability and Responsible Investing framework. As a result, we do not own the likes of BHP Billiton, a large benchmark constituent that outperformed in March. Fisher & Paykel also suffered as fiscal year ending 2022 revenue and gross margin guidance missed market expectations. Volatile demand, a challenging operating environment and questions over the sales base after a post-pandemic sales slowdown in an oversupplied market are also creating uncertainties. Meanwhile, James Hardie detracted as the market considered the impact of a more complex macroeconomic background for construction with rising mortgage rates and a more hawkish US Federal Reserve.

On the other hand, IDP Education bounced back following a difficult February, as the market digested a February result that indicated solid forward demand. The company also benefited from a broad-based recovery in some of the higher-quality growth names. Commonwealth Bank of Australia was another holding to benefit from a strong rebound in March. The market rapidly brought forward its expectations of rate increases and associated margin benefit for the business, with some participants forecasting a rate increase as early as June 2022. Macquarie Group was an indirect benefactor of elevated commodity prices, which have led to significant levels of volatility in energy markets in March. This increased activity lifted the market's expectations of Macquarie's trading income for fiscal year ending 2022, as the company has a good track record of managing risk and trading profitably through volatility. In addition, Macquarie's infrastructure division completed a number of acquisitions after the February result, which bodes well for base fees.

In terms of activity, the ongoing inflationary environment in food retailing led us to initiate a position in Coles. The business has also proven effective at managing its elevated costs and Covid-19 disruptions, has a strong balance sheet and trades at a discount to its closest peer Woolworths. On the other hand, we exited Altium given

Investment strategy

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.

near-term concerns around its Chinese business, recent changes to the financial outlook and potential further reinvestment requirements to achieve sales targets.

Outlook

The economy is continuing its post-pandemic recovery, though the outbreak of war in Ukraine presents a degree of economic uncertainty at this point in time. Cost-push inflation has accelerated due to sharp increases in energy prices and key commodities, and supply chain disruptions during a period where demand remains robust. This has been exacerbated by the war in Ukraine, which also may present itself as a drag on global growth. The economy remains resilient, however, with unemployment at 4%, and underemployment also around its lowest level in over a decade. Inflation has accelerated faster than anticipated but remains low in comparison to Australia's global peers. How quickly cost-push pressures abate is the key source of uncertainty regarding the current outlook for inflation, though inflationary pressures are likely to remain elevated for much of this calendar year.

Financial conditions remain strong with interest rates still at historically low levels, though borrowing rates have begun to rise. Interest rates have steadily risen, as have expectations of future policy rate increases. The RBA took a more hawkish turn at the end of this quarter, with Governor Lowe having dropped the reference to being "patient" and it being "too early" to determine if inflation is within the target range in his most recent statement. The RBA's rising inflation expectations suggests that the pre-conditions for rate hikes (inflation sustainably within 2-3%) has been met. Markets now appear to be pricing the RBA hiking to a roughly 3% cash rate or higher by the end of 2023, which is a significant step-up from the previous quarter.

We aim to hold a balanced mix of 1) long-term compounders with structural tailwinds, regardless of what path the economy takes; 2) defensive companies offering very predictable earnings and strong cash generators, albeit lower growth; 3) businesses that are more cyclical in nature, but with very strong fundamentals that may be unfairly punished by the market due to short-term volatility. Many of the companies we hold are market leaders in governance and sustainability, which positions them well to adapt to future challenges and opportunities. We remain committed to our bottom-up investment style, and

will continue to look beyond volatility and accumulate positions in high-quality companies with strong moats, excellent management teams, healthy balance sheets and positive earnings prospects.

Fund performance is available on the relevant factsheet.

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