

Fund Commentary

Performance drivers and positioning of the fund for the recent calendar quarter are explained below. Our investment experts also provide regular investment updates at mlcam.com.au/insights

The Australian share market posted relatively flat returns over the June 2023 quarter. The S&P/ASX200 Total Return Index ('market benchmark') returned 1.01% and the MLC Australian Share Fund returned 1.03% (before fees and tax) outperforming the market benchmark by 0.02%.

The fund over one year returned 15.71% (before fees and tax) to 30 June 2023. This was 0.93% better than the market benchmark's 14.78% return and was due to the strong outperformance from two of our appointed managers, Northcape and Antares.

The ASX 200 lagged global markets over the quarter as the strong lead from overseas was tempered by somewhat unexpected Reserve Bank of Australia (RBA) interest rate hikes which made investors more cautious. The drivers in the June quarter were similar to those which have played out for most of this year, with Technology and Consumer stocks doing much of the heavy lifting as investors attempt to put a value on 'Artificial Intelligence' (AI) and assess any productivity gains this technology might produce. Materials were weaker in line with lower commodity prices and consumer facing sectors also struggled as interest rates continue to bite.

China's disappointing economic performance continued to weigh on emerging markets and contributed to relative weakness in here given the exposure of our mining sector to China's tepid growth. There was little joy for the miners, as commodity prices were generally lower over the period. Oil was down 6%, Coal -27%, Iron Ore -11%, Zinc -19%, Nickel -14%, Aluminium -11%.

From a sector perspective, there are few clear winners in the current environment. Consumer-exposed sectors, other than perhaps supermarkets, are seeing broad-based weakening. Banks are facing higher funding costs, slower credit growth and potentially higher credit losses while, for Resources to perform, China would likely need to meaningfully step up its stimulus measures – something its government to date has been unwilling to do.

The upcoming August reporting season should provide further insights into the extent of the economic slowdown the RBA has tried to orchestrate since the current interest rate tightening cycle started in May last year.

Please refer to the 'Market commentary' for an overview of what happened in other domestic and global markets over the quarter.

Stock story

One of our Australian shares managers, Northcape, provided the following stock story for one of the fund's holdings, which you may find interesting:

"Australian retail sales have significantly slowed this calendar year, a natural consequence of the rising interest rate environment, mortgage and rent increases and soaring utility costs. Many investment market analysts have been writing about the looming 'cliff' in retail sales for some time but as yet we have not seen this outcome eventuate. Strong employment and high household savings levels not only spurred spending during the pandemic but have cushioned the decline to date. Our view is that sales levels will continue to moderate and there will be some poor monthly data points, but for JB Hi-Fi we believe that this slowing environment is more than factored into their earnings forecasts and valuation.

The company sells consumer electronics and household appliances, both areas have come under above average pressure this year. In the electronics space where competitors are showing double digit declines, JB Hi-Fi stores have maintained some growth, though we do expect this to turn negative. The Good Guys sales are declining, although they are winning market share. On the cost front we know the company will have worked hard to reduce spend where possible while the market share gains will assist to improve buying terms from their suppliers. While we have factored in lower earnings in FY '24, due in part to some normalisation from the high spending witnessed during COVID and the current environment of low consumer confidence, we do not subscribe to the bear case for significant further earnings erosion than is already forecast.

On the valuation front, the company is trading on an historic low multiple, a result of two years of moderate underperformance of the market but having at the same time consistently provided results that have comfortably beaten market expectations. The resultant de-rating of the stock appears a significant over reaction, more than pricing in the fall in earnings we have forecast in FY '24 and indeed the bear cases for profits some in the market promote.

Considering these factors, we increased the portfolio weighting to JB Hi-Fi during the quarter."

Notes:

- As our investment managers are constantly reviewing and making changes to their holdings, this company may no longer be included in the portfolio.

- Commentary for this fund will be updated approximately three weeks after the end of the calendar quarter.