

First Sentier Wholesale Concentrated Australian Share Fund



Formerly the Colonial First State Wholesale Concentrated Australian Share Fund

Quarterly Factsheet

30 June 2022

For Adviser use only

Portfolio Description

The Fund invests in a concentrated selection of Australian listed companies, with between 20 to 30 stocks typically held in the portfolio.

Investment Strategy

The Fund's strategy is based on the belief that, over the medium to long term, stock prices are driven by the ability of management to generate excess returns over their cost of capital in their chosen industry. The Fund generally invests in high quality companies with strong balance sheets and earnings in the S&P/ASX 300 Accumulation Index. The Fund predominantly invests in Australian companies and therefore does not hedge currency risk.

Investment Objective

To provide long-term capital growth by investing in a concentrated portfolio of 20-30 securities. The Fund aims to outperform the S&P/ASX 300 Accumulation Index over rolling three year periods before fees and taxes.

Key Investment Personnel and Experience (Industry / Firm)

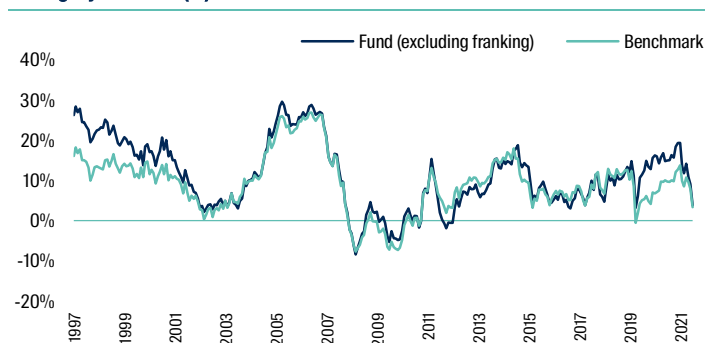
Dushko Bajic	Head of Australian Equities, Growth	(1996 / 2014)
David Wilson	Deputy Head	(1987 / 2015)
Christian Guerra	Head of Research	(1996 / 2016)

Product Overview

APIR code	FSF0016AU
Inception date	20 December 1994
Fund Size (AS)	820 million
Benchmark	S&P/ASX 300 Accumulation Index
Number of stock holdings	28
Buy / Sell spread	0.15% / 0.15%
Minimum investment (AS)	5,000
Management cost (p.a.)*	0.96%

* Information on Management Costs (including estimated indirect costs) is set out in the Fund's PDS.

Rolling 3 year return (%)



Top 5 holdings

Stock
BHP Group
Commonwealth Bank
CSL
National Australia Bank
Woolworths

Sorted alphabetically

Performance Summary (%)

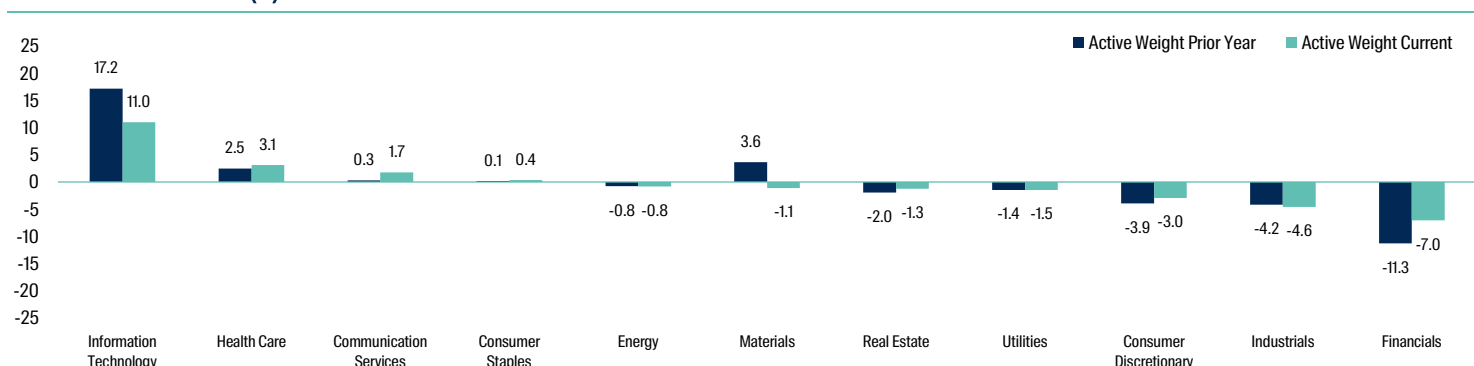
Period	3mth	1yr	3yr	5yr	7yr	10yr	SI
Net return	-18.7	-19.7	3.9	8.3	7.2	10.3	11.0
Benchmark return	-12.2	-6.8	3.4	6.8	6.9	9.4	9.2
Excess net return	-6.5	-12.9	0.5	1.4	0.3	0.8	1.8
Income return	1.4	2.7	2.2	2.6	2.7	3.0	7.4
Growth return	-20.2	-22.3	1.7	5.7	4.5	7.2	3.6

Risk Characteristics

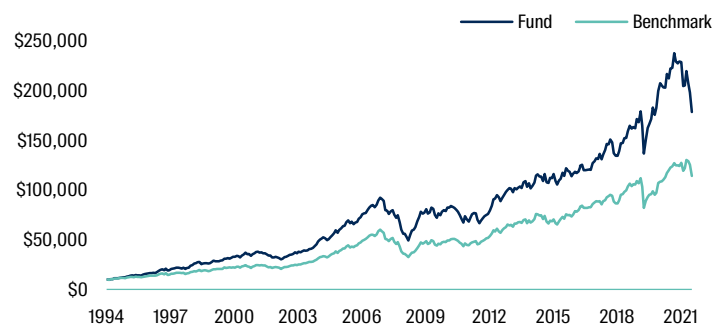
Period	1yr	3yr	5yr	7yr	10yr	SI
Fund standard deviation (%)	18.4	20.4	17.2	16.1	14.9	14.2
Benchmark standard deviation (%)	14.1	18.3	15.3	14.4	13.6	13.1
Tracking error (%)	7.9	8.1	6.8	6.2	5.8	5.0
Fund Sharpe ratio	-1.1	0.2	0.4	0.4	0.6	0.5
Information ratio	-1.6	0.1	0.2	0.0	0.1	0.4
Beta	1.2	1.0	1.0	1.0	1.0	1.0
Cashflow adjusted turnover (%)	24.1	33.4	38.6	46.1	51.3	

The benchmark from inception was the S&P/ASX 100 Accumulation Index, from 11 June 2013 the S&P/ASX 200 Accumulation Index, from 8 June 2020 the S&P/ASX 300 Accumulation Index.

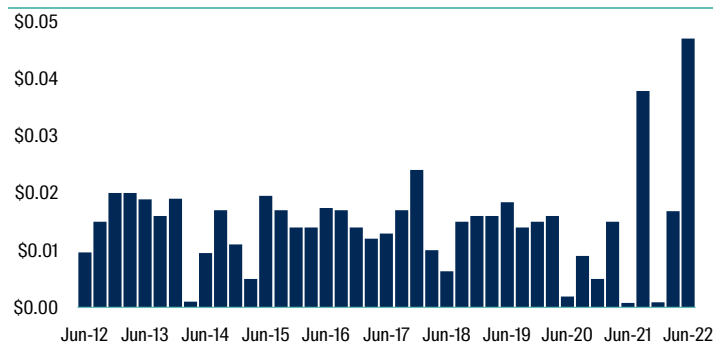
Fund Active Sector Positions (%)



Growth of AUD 10,000 Investment Since Inception



Distributions



Top 5 attributors to performance (3 months)

Sector	Attr.
Consumer Discretionary	0.15%
Financials	0.09%
Health Care	0.03%
Communication Services	0.02%
Consumer Staples	-0.03%

Top 5 detractors to performance (3 months)

Sector	Attr.
Information Technology	-5.33%
Industrials	-0.48%
Materials	-0.38%
Real Estate	-0.36%
Energy	-0.19%

Performance returns are calculated net of management fees and transaction costs. Performance returns for periods greater than one year are annualised. Past performance is not a reliable indicator of future performance.

Data source: First Sentier Investors 2022

Data as at: 30 June 2022

Market Review

The June quarter saw Australian Equities succumb to inflation and recessionary concerns driving the S&P/ASX 300 Accumulation Index -12.2% lower. Risk-off sentiment persisted in May as markets digested hawkish commentary from global central banks and the prospect that the US Federal Reserve may not be able to manufacture a 'soft landing', favouring a rotation into value stocks. Inflationary fears transformed into growth concerns exemplified by poor market sentiment stemming from China's battle with COVID, with the market extrapolating potential demand implications as a result of their elongated recovery trajectory, prompting selling within all sectors. Losses accelerated in June as higher-than-expected European and US inflationary prints – the latter a forty year high – heightened market apprehension and drove the index lower, producing its worst monthly performance since March 2020.

The rising rate environment coupled with increased inflation expectations continued to hurt multiple valuations for the Information Technology sector, particularly constituents within the high growth/cash burning segment. Although earnings forecasts remained largely unchanged, sell-off pressure continued to manifest within the sector, which declined -26% in the June quarter. Fintech Tyro payments (-66%) was the worst performer for the quarter closely followed by battery technology company Novonix (-63%).

Similarly, the resulting increases to bond yields following the RBA's decision for a lift in the official cash rate to 0.85%, burdened constituents in the Real Estate sector (-18%). Poor contributions were made by listed property stocks Centuria Capital Group (-35%), Home Consortium (-35%) and Charter Hall (-33%) with Irongate Group (2%) the only company in the property space to end the quarter positively.

Energy prices remained at elevated levels and continued to be bolstered by a tight demand supply dynamic given the Russia-Ukraine war and global underinvestment. Although facing volatility in the latter stages of the quarter, Brent oil rose 5% for the quarter and 45% in the calendar year to date, buoying the Energy (2%) and Utilities (2%).

Fund Performance

The Wholesale Concentrated Share Fund underperformed its benchmark, the S&P/ASX 300 Accumulation Index, in the June quarter but continues to deliver attractive levels of excess returns over longer periods as our be-spoke fundamental research process allows us to identify high quality, growth stocks that we believe will generate superior returns for our investors over time.

Contributing to the Fund's underperformance were the overweight positions in the digital payments company EML Payments and cloud connectivity services provider Megaport (MPI). EML Payments (-59%) continued to de-rate in the June quarter alongside other tech and payment names. A FY22 trading update in April lowering profit guidance accelerated a downward trajectory for EML given cuts were 8% lower than consensus expectations. The downgrade was largely attributed to a loss in non-recurring revenues and higher costs in the European business related to the Central Bank of Ireland's remediation process. While disappointing, we believe these issues are very short term and maintain a positive growth outlook for the company following the resolution of the remediation process. We remain attracted to EML as its Australian and North American businesses performed in line with expectation and core business grew ~18% in the third quarter, demonstrating robust growth in their underlying business. We are also optimistic about the pipeline of growth particularly as they enter the ~A\$88bn Employee Benefits Market through their latest partnership with Up Spain and look to pursue further penetration within the open banking market through their NuPay products.

Similarly, poor sector sentiment has placed Megaport under short term pressure resulting in the Information Technology constituent falling -61% over the June quarter. MPI is a global cloud connectivity leader via its Network-as-a-Service (NaaS) model and its cloud computing addressable market is growing at more than ~30% annually as enterprises and governments continue to migrate to public and hybrid cloud. However, in this current volatile environment, the market reacted poorly to MPI's third quarter trading update given a slowdown in underlying monthly recurring revenue (MRR) growth and FX headwinds. However, we were of the view that MRR growth headwinds were largely temporary and instead were encouraged by a number of strong KPI results including 489 new ports, 67 new Megaport Cloud Routers (MCRs) the second highest quarter on record and 19 new Megaport Virtual Edge (MVE) instances. We maintain conviction in the strength of MPI's global footprint which underpins its offering, as MPI's network spanning over 750 data centres in almost 25 countries. The company has built a rich, global ecosystem that is a key attraction for enterprises, data centre operators and cloud service providers (CSPs), a key competitive advantage. We are of the view that MPI has a strong long term growth pipeline and forecast annual sales growth for MPI of over 40%.

Somewhat offsetting these negative contributions were the overweight positions in the supermarket retailer Woolworths Group (WOW) and oil and gas producer Santos (STO). Woolworths lowered -4% for the June quarter, however the supermarket company illustrated its ability to pass through inflationary costs and maintain resilient earnings in their third quarter trading update. The market was particularly encouraged by the 4.4% increase in WOW's Australian Food LFL sales which was 2% above consensus expectations and 0.5% above competitor Coles. This beat was partially offset by the impact of COVID disruptions within their New Zealand supply chain and is consequently of a one-off nature implying further earnings strength in the near term margin. WOW's trading update also saw online market penetration decrease pointing to a return to brick and mortar stores which typically have healthier sales margins. We continue to be encouraged by WOW's defensive qualities and ability to pass on rising costs.

Although finishing -4% down for the quarter, Santos has enjoyed the growing strength in LNG and oil prices given persistent global tight supply demand which we believe they are well capitalised to continue to take advantage of price momentum and grow in the current environment. We were encouraged by STO's first quarter results which detailed record quarterly production, revenue and free cash flow (FCF) and reaffirmed FY2022 guidance. Production volumes were a slight miss in comparison to consensus expectation as a result of poor weather conditions and an outage, however, this was largely offset by higher-than-expected realised prices accessed through flexible JKM contracting. We are of the view that STO's robust balance sheet, supported by US\$865 million in FCF generated from the first quarter and potential for further gains from a sell down in assets, will support STO's strong pipeline of growth projects including Barossa, Moomba CCS and Pikka Phase 1.

Fund Activity

We adjusted the Fund's holdings across a variety of sectors through the quarter, particularly Financials and Materials. We exited our position in Westpac Bank (WBC) as our outlook for the bank has softened given our expectation for slowing credit growth as interest rates rise, house price gains moderate, and consumer and business confidence continue to recede. Slowing activity is also likely to impact fees and commissions. While rising interest rates are positive for bank net interest margins (NIM), the impact of competition and rising funding costs will blunt this. We do not see a significant asset quality cycle ahead. However, the banks will see higher loan impairment expenses (LIE) as they raise provision levels to reflect the downgraded economic outlook. We see better opportunities elsewhere given these headwinds.

These additional funds were then redirected to form two new positions with a large global investment bank and insurance broker. We introduced a large global investment bank into the Fund due to our attraction to the strong earnings power held by each of the bank's business divisions. Although we do not see the bank repeating the stellar FY22 result in FY23, we expect strong earnings growth to continue and see the bank delivering a double digit ROE.

We added to our position in an insurance broker given their ability to invest capital into its broker network at attractive rates of return and benefit from rising premiums without the cost of general inflation and increased natural peril costs.

Adhering to our long-standing DCF valuation sell discipline, we have exited our position in the copper-gold miner Oz Minerals (OZL) as it approached our valuation target. With copper prices falling we believe there is increased risk on OZL's development profile, particularly in West Musgrave. The company also released a trading update whereby lowering copper production guidance at Carrapateena and increasing cost guidance due to COVID related absenteeism and equipment issues.

Market Outlook

The distortion caused by unprecedented stimulus on the profits of cyclical companies has started to unwind from the unsustainable pull-forward in demand for physical goods. Consumption is shifting away from these goods towards services at a time when supply chain pressures are easing and retailers are receiving bulk inventory orders in expectation of continuing demand. In the United States, the demand transition has driven sharp increases in Real Retail Inventories and the Real I/S ratio, both of which are above their pre-COVID trend rates. Given the costs associated with holding excess inventory, retailers will likely be forced into discounting prices to move stock, contributing to inflation abating.

Prolonged periods of low interest rates have created vulnerabilities and increased sensitivity in the domestic housing market as highlighted by a larger, second consecutive decline in CoreLogic's Home Value Index (-0.8%) in June, corresponding with the RBA's rate hikes. Notably, reversing monetary and fiscal stimulus coupled with slowing house and stock prices will restrict household balance sheets causing market earnings and overall economic growth to deteriorate in the short-term and accelerate the transition from an inflation scare to a growth scare.

In our view, cyclical stocks will be most susceptible to the impact of this slowdown reinforcing now more than ever, the need to invest in high quality companies that have the ability to grow irrespective of the market cycle. We are not deterred by short term price movements and maintain our long-term mindset to diligently scour the investment universe to identify those companies likely to come through this crisis, as their competitors falter, and benefit from their stronger market position.

Portfolio Beta measures the portfolio's sensitivity to benchmark movements. Mathematically, it is the covariance of the portfolio vs the benchmark divided by the variance of the benchmark. The covariance and variance are ex ante calculations based on current weights and historic patterns of return over the past five years.

Turnover is the average of sales and purchases divided by the average portfolio size. **Cashflow Adjusted Turnover** is the same as above, except that the lesser of sales and purchases is used in place of the average of the two. This is to adjust for turnover that is related to investing inflows or selling stocks to meet outflows rather than related to active management of the portfolio.

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