

First Sentier Wholesale Equity Income Fund



Formerly the Colonial First State Wholesale Equity Income Fund

Quarterly Factsheet

31 March 2022

Portfolio Description

The Fund invests in a broad selection of Australian listed companies, regardless of each stock's dividend yield, and extends the insights of fundamental research with an active options strategy to provide a smoother return profile than the broader share market and a higher income stream over the long term.

Investment Strategy

The Fund's returns are generated from a number of sources, including dividends, franking credits and capital returns from Australian shares, as well as option premium income. The Fund uses derivatives to modify the return profile of its Australian share holdings. The use of equity options in conjunction with Australian shares is expected to result in a greater proportion of the total return delivered as income and reduced volatility in returns. In the selection of Australian shares, investment opportunities are identified by detailed fundamental research, including a high number of company visits and utilising a proprietary database to analyse company financials. The Fund predominantly invests in Australian dollar denominated securities and therefore does not hedge currency risk.

Investment Objective

To provide a total return comprised of regular income, franking credits and some capital growth from Australian shares over the long term, delivered with consistently lower volatility than the S&P/ASX 100 Accumulation Index. The Fund aims to deliver risk-adjusted returns that exceed the S&P/ASX 100 Accumulation Index before fees and taxes over a full market cycle.

Key Investment Personnel and Experience (Industry / Firm)

Rudi Minbatiwala	Head of Equity Income	(2000 / 2000)
Jason Moodie	Senior Portfolio Manager	(1995 / 1997)
Marlon Chan	Senior Portfolio Manager	(2007 / 2007)

Product Overview

APIR code	FSF0961AU
Inception date	17 March 2008
Fund Size (AS)	316 million
Benchmark	S&P/ASX 100 Accumulation Index
Number of stock holdings	30
Buy / Sell spread	0.05% / 0.05%
Minimum investment (AS)	5,000
Management cost (p.a.)*	1.22%

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

Rolling 3 year return (%)



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: 31 March 2022

Top 10 Active Weight holdings

Stock
National Australia Bank
Santos
James Hardie
EML Payments
Commonwealth Bank
CSR
BlueScope Steel
QBE Insurance
Macquarie Group
Northern Star Resources

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Performance summary (% after fees and expenses)*

Period	3mth	1yr	3yr	5yr	7yr	10yr	SI
Net return	1.4	10.5	9.1	8.4	6.5	8.2	7.0
Benchmark return	3.0	16.0	11.0	9.4	7.8	10.5	7.6
Excess net return	-1.6	-5.5	-1.9	-0.9	-1.3	-2.3	-0.6
Net return (inc. franking)	1.7	12.8	10.6	10.1	8.1	9.8	8.7

* Performance is annualised for periods greater than one year.

Income summary (% after fees and expenses)

Period	3mth	1yr	3yr	5yr	7yr	10yr	SI
Distribution return (ex. franking)	1.8	7.5	7.5	7.3	7.3	7.6	8.9
Franking credit return	0.3	2.3	1.5	1.6	1.6	1.6	1.7

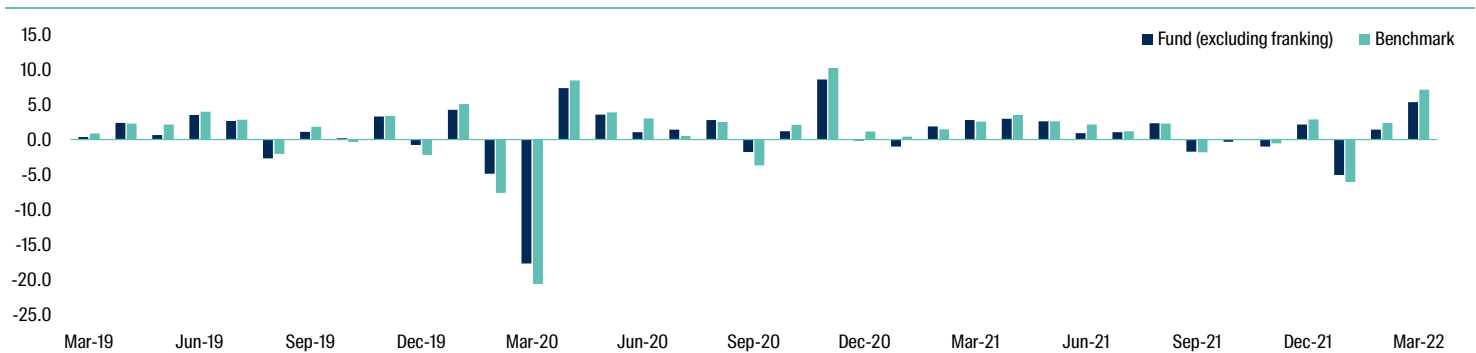
Volatility summary (%)

Period	1yr	3yr	5yr	7yr	10yr	SI
Fund volatility (ex. franking)	8.9	14.5	12.3	12.0	11.2	11.0
Reference index volatility	10.7	17.3	14.6	14.0	13.3	14.2

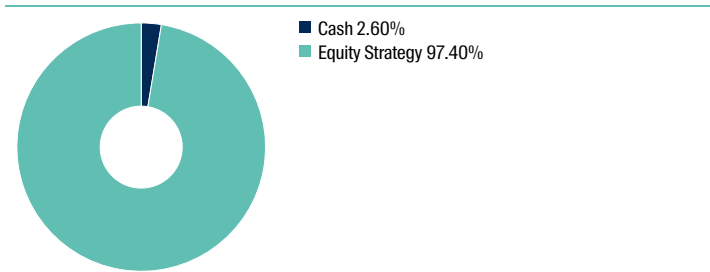
Growth of AUD 10,000 Investment Since Inception



Monthly returns vs benchmark (% excluding franking)



Invested exposure*



*Ignoring options

Market Review

Market moves proved to be volatile over the quarter, however overall the market moved higher with the S&P/ASX 100 Accumulation index returning 3.0%.

Monetary policy was the overarching theme this quarter, with markets initially driven lower in January as they adapted to hawkish shift in tone from the US Federal Reserve. The shift in tone from the central banks came about as it became clear that inflation was not as transitory as previously thought, with inflationary pressures persisting and the US CPI reaching its highest level in 40 years. Following the decline in January, the Australian equity market rose in February and March, with the US Fed's decision in March to raise rates by 25bps coming as no surprise to markets. Russia's invasion of Ukraine contributed to a degree of volatility in the markets throughout the quarter, particularly as western powers rolled out a number of sanctions driving commodity prices higher and further constraining already congested supply chains.

The Energy (+29.3%) sector outperformed as it was buoyed by rising oil prices which topped US\$123/bbl as sanctions were imposed on Russian oil exports. Gas prices in Europe have soared as buyers seek to diversify their supply away from Russian gas producers and as Putin demands buyers to begin purchasing oil and gas using Russian roubles instead of dollars or euros. Woodside (+54%) is set to capitalise upon higher gas prices, particularly as they announced they have additional LNG supplies to export after processing from its Pluto project will begin several months ahead of schedule. On the backdrop of elevated energy prices, oil and gas producers Santos (+24.8%) and Worley (+24.0%) also performed strongly.

The Materials sector (+16.1%) was boosted by elevated commodity prices with iron ore, gold and lithium miners the most notable outperformers. Iron ore prices experienced a rebound hitting US\$160/tonne as sentiment was underpinned by the prospect for additional policy support in China and continued positive signs of industrial demand. This aided the performance of iron ore miners, BHP (+30.5%), Rio Tinto (+26.1%) and Fortescue Metals (+12.7%).

Information technology (-12.0%) was the worst performing sector as expectations increased for rate hikes led investors to re-examine valuations. As such, Xero (-27.4%), Altium (-24.0%) and Wisetech (-12.7%) contributed to the sectors decline. The Consumer Discretionary sector (-10.3%) also underperformed the broader market, as stock specific news impacted performance in a number of names. Domino's Pizza (-24.7%) declined as the release of its half year results disappointed investors with same store sales growth weaker than expected, particularly in Japan which reflected a change in consumption patterns as covid restrictions were lifted.

Fund Performance

The Fund returned 1.4% net of fees excluding franking for the March quarter, underperforming the benchmark. Moves in the market were volatile over the quarter with equity markets experiencing a sharp pullback in January before bouncing back in February only for investor sentiment to be zapped by Russia's invasion of Ukraine. Once the market settled, March saw an extraordinary rally with the best monthly return since November 2020. Buy-write strategies

generally underperform in strongly rising markets as the option overlay, which provides a cushion in falling markets, can act to cap the upside in strongly rising markets particularly during short time frames. While the Fund acted to provide a cushion during the market declines, the subsequent short sharp rallies led the Fund to lag the market.

Over the quarter, the Fund benefitted from its positions in iron ore miners BHP and Rio Tinto as iron ore prices rose higher. Iron ore prices have been boosted by expectations that China will increase stimulus spending in order to lift economic activity, in combination with supply concerns as heavy rain in south east Brazil forced producers to stop production and as the war in Ukraine disrupts supply from the region. The Fund also benefitted from its nil position in Wesfarmers (WES) as supply chain issues, wage inflation and higher input costs drove concerns about near term margin compression.

The Fund's position in Santos (STO) added to performance as they benefitted from rising energy prices and from the announcement of a 43MMbbls oil discovery at the Pavo-1 exploration well, located 46km east of the Dorado project. STO has flagged its desire to sell down its stake in this project from 80% to 50%, and the discovery will increase the value of the project and make it easier to offload and remove key uncertainties for prospective buyers. Woodside Petroleum (WPL) also benefitted from rising energy prices, particularly as they have a greater exposure to spot LNG prices. As the Fund does not hold a position in WPL, this detracted from performance over the quarter.

James Hardie (JHX) performed weakly across the quarter, impacted by concerns about a slowdown in building activity due to increasing mortgage rates in the USA. We believe that this concern is likely overplayed by the market, as leading indicators continue to show strong demand and with the repair and remodel market likely to remain beneficiaries of record levels of home ownership equity and a shortage of housing inventory. JHX's strategy of greater marketing directly to home owners, driving price/mix and the implementation of its LEAN program, continues to be validated by their market share growth and increases in the average selling price of their products. The lift in capital expenditure as JHX invests in capacity extensions are also indicative of management's view of strong multi-year growth.

Fund Activity

The Major Banks have been struggling to improve their net interest margins on the backdrop of low interest rates and intense competitive dynamics. While the prospect for higher interest rates should benefit the banks, it is likely that continued industry competition will continue to place downward pressure on their net interest margins. Hence, the Fund reduced its exposure to the Major Banks, decreasing positions in Westpac (WBC) and National Australia Bank (NAB). The decrease in Westpac reflects concerns about the execution risk of successfully completing their \$8 billion cost out program at a time when they are competing for market share. The Fund increased its position in Macquarie Bank (MQG) as it continues to operate in favourable conditions and its commodities and global markets division is well placed to leverage the surge in oil and gas market volatility stemming from the Russian-Ukraine conflict.

This quarter, the hawkish shift in tone of central banks and increasing expectations for aggressive rate hikes has forced investors to re-examine high valuations. In light of this environment, the Fund reduced its position in Wisetech (WTC) as the current share price left limited room for further upside while Xero's (XRO) current valuation presented a more attractive opportunity for the Fund to increase its position. Wisetech still remains a preferred information technology exposure, as it continues to drive strong revenue growth benefitting from the acceleration of long term structural changes as logistics companies digitally transform their operations.

XRO dominates cloud accounting in every market it operates in outside of North America and there continues to be upside to its subscriber growth in ANZ from the increased TAM as they penetrate the trusts/SMSFs market and as SME's require multiple subscriptions. Longer term, they will also benefit from the increase in businesses shifting to cloud accounting, particularly as tax becomes digital in key jurisdictions driving increased uptake of their product. XRO continues to build out 'a platform offering' with the addition of bolt on products to their offering such as Planday, which provides an opportunity to increase their ARPU.

The Fund took to the opportunity to establish a position in Reliance Worldwide (RWC) as they continue to benefit from the strength in the housing market. Their strategy to gain shelf share while expanding their product portfolio should continue to drive margin expansion and earnings growth throughout the business. Valuation also looked attractive after it sold-off on macroeconomic concerns despite providing a strong 1H22 result in March. The market seems to have overplayed concerns of rate rises upon the housing market, as demand currently remains strong and supply chain constraints delaying projects are likely to elongate the cycle rather than destroy demand. Further RWC believes there has been a structural change in the market with more people working from home which should continue to underpin repair and remodel activity.

Market Outlook

The market will continue to play close attention to central bank commentary and economic data releases as the macroeconomic backdrop remains the driving force behind investor sentiment. Global central banks have begun to raise rates for what markets expect to be an aggressive tightening cycle in order to combat inflation which continues to climb higher. The RBA contends they are willing to be patient, but it is widely expected that they will follow suit from as soon as June and begin raising rates. Views are mixed on how aggressive the RBA will be in lifting rates with the market futures currently pricing in 150bps of rate rises by the end of 2022. Some commentators argue that rising levels of inflation will necessitate multiple rises over the year with the economy able to withstand the hikes considering the strong momentum in the economy, low unemployment rate and strong household balance sheets. However, others are sceptical of how realistic the implied market level of interest rates are, given the highly leveraged nature of Australian households and their sensitivity to interest rates. This leaves us questioning if markets have more than sufficiently priced in the expected interest rate rises. Given the divergence in views any developments are likely to contribute to ongoing volatility within the market.

With rising rates likely on the horizon, investors have been increasingly examining the impact of rising rates upon their portfolios. The thinking is two fold, considering the impact upon both earnings and valuation. Recently, investors have seemed to place more focus upon valuations with the impact being quite pronounced on higher growth technology names as a higher proportion of their valuation is made up of future earnings that become discounted at a higher rate. It is interesting that the market may be undervaluing the impact of interest rates upon earnings as economic growth slows and companies have to pay more on their loans. For certain companies, higher interest rates can lead to increased revenues whilst others will experience diminishing earnings. We believe that our equity income approach that actively considers all stocks in the investment universe, regardless of their dividend yield, provides a greater degree of flexibility to navigate these macroeconomic uncertainties impacting the outlook for different stocks and sectors.

Overall, a degree of volatility is likely to continue in the market as investors react to the changing macro-environment. Single stock volatilities on equity options continue to remain attractively high and provides the Fund opportunity to generate higher levels of income. The active implementation of our options overlay allows us to maximise insights from fundamental research and creates an added level of downside cushion which helps to navigate turbulent markets and deliver more consistent outcomes for our investors.

www.firstsentierinvestors.com.au

For further information

Acting Head of Wholesale Ross Crocker	+61 2 9010 5424	Business Development Manager - VIC/TAS Jack Heinz	+61 3 9225 5056
Key Account Manager - NSW Paul Sleiman	+61 2 9010 5393	Key Account Manager - QLD Quin Smith	+61 4 5509 5505
Business Development Manager – NSW Justin Sultana	+61 2 9010 5326	Business Development Manager – QLD Julie Day	+61 4 6641 3176
Key Account Manager - VIC/TAS Nicholas Everitt	+61 3 9225 5055	Key Account Manager - WA/SA/NT Nathan Robinson	+61 4 0327 2440

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