

First Sentier Wholesale Equity Income Fund



Formerly the Colonial First State Wholesale Equity Income Fund

Quarterly Factsheet

30 June 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)	280 million
Benchmark	S&P/ASX 100 Accumulation Index
Number of stock holdings	32
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: 30 June 2022

Top 10 Active Weight holdings

Stock
Santos
National Australia Bank
QBE Insurance
CSL
James Hardie
Aristocrat Leisure
Corporate Travel Management
Reliance Worldwide Corporation
Northern Star Resources
Rio Tinto

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Performance summary (% after fees and expenses)*

Period	3mth	1yr	3yr	5yr	7yr	10yr	SI
Net return	-12.0	-8.7	2.4	5.9	5.6	7.1	6.0
Benchmark return	-11.1	-5.0	3.9	7.2	7.1	9.6	6.6
Excess net return	-0.9	-3.8	-1.5	-1.3	-1.5	-2.5	-0.6
Net return (inc. franking)	-11.4	-6.3	3.9	7.6	7.2	8.8	7.6

* Performance is annualised for periods greater than one year.

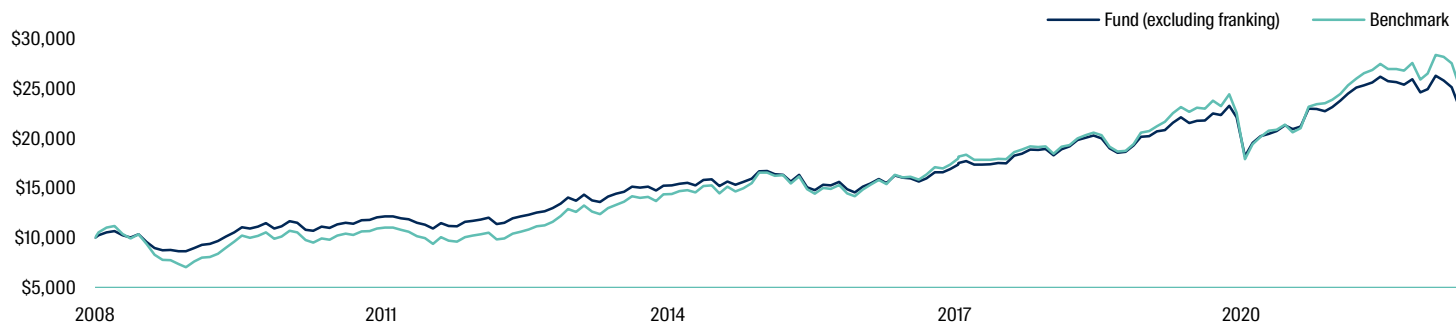
Income summary (% after fees and expenses)

Period	3mth	1yr	3yr	5yr	7yr	10yr	SI
Distribution return (ex. franking)	3.0	7.7	7.5	7.5	7.5	7.7	8.9
Franking credit return	0.7	2.5	1.6	1.7	1.7	1.7	1.7

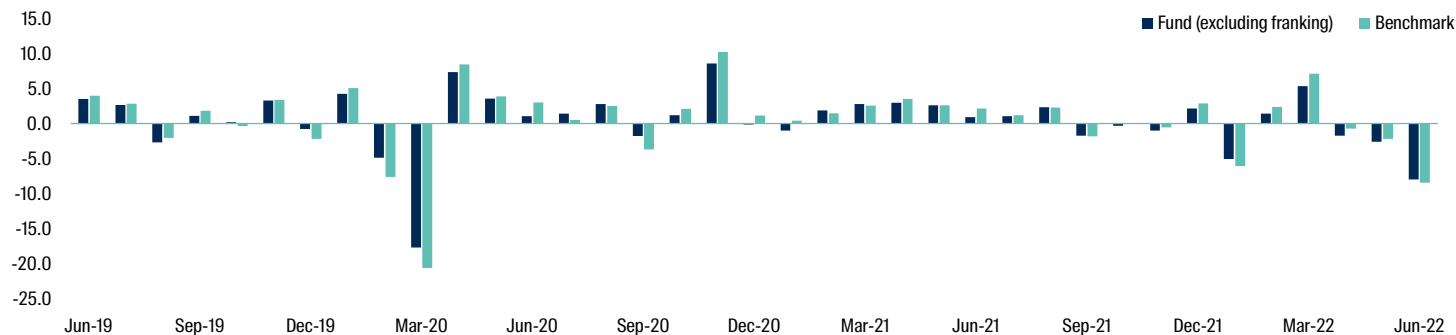
Volatility summary (%)

Period	1yr	3yr	5yr	7yr	10yr	SI
Fund volatility (ex. franking)	11.8	15.4	13.0	12.4	11.4	11.2
Reference index volatility	13.7	18.1	15.1	14.3	13.5	14.3

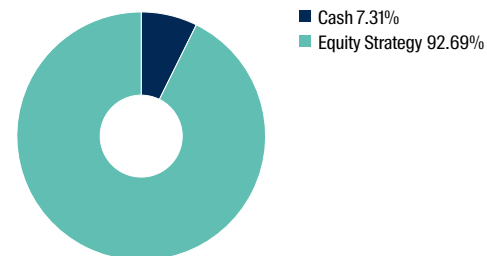
Growth of AUD 10,000 Investment Since Inception



Monthly returns vs benchmark (% excluding franking)



Invested exposure*



*Ignoring options

Market Review

Risk-off sentiment prevailed in the Australian equity market this quarter, with the S&P/ASX 100 Accumulation index declining -11.1% in the June quarter.

Inflation continued to dominate concerns, with the May US CPI headline rate increasing 1% for the month, bringing the yearly rate to 8.6%, which is the biggest annual increase since 1981, confirming that inflation was still moving higher and that we had not experienced the peak yet. Central banks commenced on an aggressive rate hike cycle, with the US Fed raising rates by 50bps in May and 75bps in June following the initial 25bps raise in March. The RBA followed suit and raised rates by 25bps in May and 50bps in June. A risk-off sentiment developed in markets as the persistence of inflation and central banks aggressive responses flowed into concerns about a policy-induced recession as investors doubt the ability of central banks to engineer a soft landing.

Utilities (+1.7%) was the best performing sector buoyed by high wholesale energy prices and as investors sought out defensive sections of the market. This led to the positive performance of AGL Energy (+6.8%), and during the quarter AGL abandoned plans to demerge its carbon intensive assets into a separate business after they lacked confidence that they would get the required 75% support from shareholders. As one of the last infrastructure listed stocks on the market, APA Group (+8.2%) performed strongly and was also sought out for its inflation linked revenues.

The Energy (+0.4%) sector outperformed as energy prices remained elevated, with crude oil hitting US\$122/bbl at one point in the quarter. On this backdrop Ampol (+11.7%) and Worley (+10.3%) performed positively. Whitehaven Coal (+16.6%) also benefitted from the tight market for coal in the wake of Russia's invasion of Ukraine.

The Information technology (-25.6%) sector sold off as investors rotated out of growth style stocks as bond yields surged which increased scrutiny upon valuations. As such, Block (-51.2%), Wisetech (-25.9%) and Xero (-25.1%) experienced large declines.

Rising rates also presented a headwind for the Real Estate (-18.2%) sector. Property fund managers, Charter Hall (-33.2%) and Goodman (-21.4%) and property developers Mirvac (-18.7%) and Lendlease (-18.7%) were the largest contributors to the sectors decline.

Fund Performance

The Fund returned -12.0% net of fees excluding franking, and it is disappointing that the Fund lagged the benchmark in a falling market by 90 basis points. Market conditions were very turbulent throughout the quarter and overall the attractive income the Fund generated from the sale of call options was not sufficient enough to offset the effect of negative stock selection.

The outcome of negative stock selection has not been the result of the Fund holding more growth than value names as the Fund is currently positioned quite neutral across these styles. Rather, our holdings in 'value cyclical' stocks impacted performance as they were disproportionately impacted by investor

concerns about a downturn in economic activity. We remain focused on delivering through the cycle risk adjusted returns and we believe the market has overlooked the ability of these companies to deliver positive earnings growth, with operating conditions still remaining favourable. While a slowdown may occur we believe the extent to which investors have priced in a downturn may be excessive. For example, detracting from performance over the quarter were positions in building materials companies CSR Limited (CSR) and James Hardie (JHX) as the market focused on the impact of rising rates on building activity. While new starts for US single family houses has declined in recent months, underlying demand for building products from JHX is more closely related to the repair and remodel market, which historically has proved more resilient in market downturns. Further, the record levels of homeowner equity and shortage of housing inventory is also supportive of underlying demand. Meanwhile, CSR has a significant backlog of work with elongated construction times due to labour shortages, construction delays and supply chain shortages that provides a robust pipeline translating into a high degree of visibility of earnings into FY23 and FY24.

The position in EML Payments (EML) detracted from performance over the quarter as they provided a disappointing third quarter trading update where the company downgraded EBITDA by 8% and the subsequent share price reaction of -39% on the day far outweighed the actual downgrade. The majority of the downgrade can be attributed to a remediation program with the Central Bank of Ireland (CBI), where the CBI took a more conservative stance than expected and prevented new programs from being approved. This resulted in EML missing establishment fees for new programs in their European General Purpose Reloadable Business. We have undertaken extensive work on the situation surrounding the CBI and it appears that the regulatory issues are industry wide and not specific to EML. The remediation plan is expected to finish on 30 June 2022 with external sign off, after which time we think the business will return to normal operations. While the additional costs to the business are disappointing, it does not change the central investment thesis, and each of the points of the downgrade are understandable as short term in nature.

The nil position in Block (SQ2) benefitted performance as it was impacted by the broader sell down in technology names. The position in QBE Insurance (QBE) added to performance as they benefit from the strength of the global insurance pricing cycle driving premium rate rises and as improving bond yields add to investment income. The Fund does not hold a position in ANZ Bank, which benefitted performance as they continue to struggle to grow their retail business with their 1H22 result demonstrating only 0.1% growth significantly below system growth of 4%. Other positions that added to Fund performance over the quarter included Santos (STO), Brambles (BXB) and Amcor (AMC).

Fund Activity

The position in CSL was increased, reflecting the more positive outlook for the company as a strong late cycle re-opening story. CSL is well positioned for strong earnings growth in FY23 and beyond, supported by a recovery in plasma collections with industry participants noting that collection levels are close to pre-pandemic levels. CSL will also benefit from its operating leverage coming through with stronger volumes collected, and they have pricing power which has enabled them to pass through price increases. Further, the rollout of the new Terumo "Rika" plasma collection device in CSL's collection centres next quarter will act to decrease collection times and improve their fixed cost leverage.

The Fund gained a position in Woodside (WDS) over the quarter as a result of the demerger of BHP's petroleum division. The position was further increased as the BHP/WDS merger is transformational, strengthening the balance sheet, doubling the annual production capacity and significantly diversifying the portfolio commodity-wise and geographically. BHP's growth assets provides WDS a platform for growth and reduces the concentration of execution risk at Scarborough and Pluto T2. Further the increased exposure to oil and the 25% leverage to spot LNG prices makes WDS an attractive investment opportunity.

In the context of a rising rate environment, the Fund added a position in Computershare (CPU) due to its leverage to short-term interest rates. The Fund also added a position in Telstra (TLS) which has been a beneficiary of the defensive nature of their earnings and as they continue to grow their earnings from their mobile division as a result of subdued competition.

The position in Oz Minerals (OZL) was exited through the profitable exercise of options early in the quarter. This reflected our view that the current valuation was stretched on the basis that the market was not pricing in the risk of a delay to the final investment decision at West Musgrave due to cost pressures, labour availability and the potential need for additional financing.

The Fund decreased the position in Westpac (WBC) and increased the position in Commonwealth Bank (CBA) and National Australia Bank (NAB). WBC continues to struggle to grow their earnings, with mortgage growth stalling at ~1% in 1H22 below system growth of 4%. Further, the execution risk of achieving their \$8 billion cost target is heightened in the context of an inflationary environment and considering other major banks have abandoned cost targets. WBC also risk a large underinvestment in tech and digital and a significant catch up spend or large market share losses as other competitors invest.

Market Outlook

Investor sentiment is currently highly sensitive to changes in the macroeconomic backdrop, with inflation and a rapid response of interest rate changes unseen for many years. In some cases we believe this has resulted in share prices that have dislocated from fundamentals. We do not attempt to forecast shifts in investor sentiment that drive stock prices over the short term. Rather we believe that in the long-term the market will value the fundamentals of the company and our portfolio is curated based on the belief that companies that can demonstrate their ability to grow earnings deliver better returns and higher income over the long term. In the upcoming reporting season, outlook statements will be scrutinised and will test market expectations both for companies that have been sold off and for companies that have held up.

Currently, there are differing opinions as to what extent central banks will have to raise interest rates to get inflation within their target levels and the resulting impacts upon the economy. On one hand, if interest rates have the desired effect and there are indications of slowing demand leading to a deceleration of inflation, the economy could avoid a recession or only experience a shallow recession. On the other hand, if the rise in interest rates does not have desired effect of taming rising inflation, there is a possible outcome of rising inflation and rising interest rates, which would likely be indicative of a deep recession. Therefore, investors will be looking for signs that inflation has peaked and will be closely monitoring commentary from central banks about what they need to see to slow down the aggressive pace of tightening. The key question is will the RBA be able to raise rates to the levels implied by the market considering the level of indebtedness of borrowers in Australia. Consumers have seen wealth benefits with asset prices rising and have accumulated large saving buffers, which if they are willing to spend could support household consumption. However, the consumers reaction to declining asset values and increased cost of living pressures remains a key overhang and casts doubt upon the 'savings

buffer' narrative. Already, consumers are pessimistic about the future and the Westpac consumer sentiment index declined 4.5% in June to 86.4, which is nearly as low as levels seen in the global financial crisis and peak of the pandemic.

We remain patient through periods of volatility, confident in our investment process that has consistently delivered results for our investors over the long term, and as always, we monitor market developments closely with the view of seeking out the best investment opportunities. Further, single stock volatilities remain elevated above historical levels, which makes the generation of income from sold call options more attractive. This supports the generation of high levels of income and aids to provide a downside cushion in turbulent market conditions.

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