

Colonial First State Wholesale Equity Income Fund



Quarterly Factsheet

30 September 2020

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	Portfolio Manager	(2007 / 2007)

Product Overview

APIR code	FSF0961AU
Inception date	17 March 2008
Fund Size (AS)	308 million
Benchmark	S&P/ASX 100 Accumulation Index
Number of stock holdings	36
Buy / Sell spread	0.10% / 0.10%
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 2020

Data as at: 30 September 2020

Top 10 Active Weight holdings

Stock
James Hardie
The a2 Milk Company
Webjet
BlueScope Steel
Aristocrat Leisure
BHP Group
Woolworths
CSL
Amcor
REA Group

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Performance summary (% after fees and expenses)*

Period	3mth	1yr	3yr	5yr	7yr	10yr	SI
Net return	2.4	-3.9	6.2	7.0	5.1	6.2	6.0
Benchmark return	-0.8	-10.8	4.7	7.2	5.9	7.1	5.8
Excess net return	3.2	6.9	1.4	-0.2	-0.8	-0.9	0.1
Net return (inc. franking)	2.6	-3.1	7.6	8.5	6.7	7.9	7.6

* Performance is annualised for periods greater than one year.

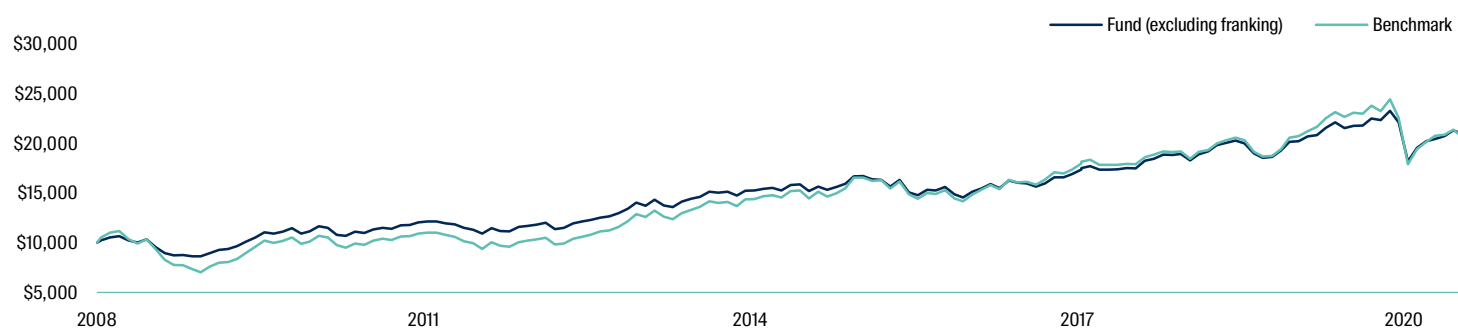
Income summary (% after fees and expenses)

Period	3mth	1yr	3yr	5yr	7yr	10yr	SI
Distribution return (ex. franking)	1.2	8.1	7.4	7.4	7.5	8.4	9.1
Franking credit return	0.2	0.8	1.5	1.5	1.6	1.7	1.6

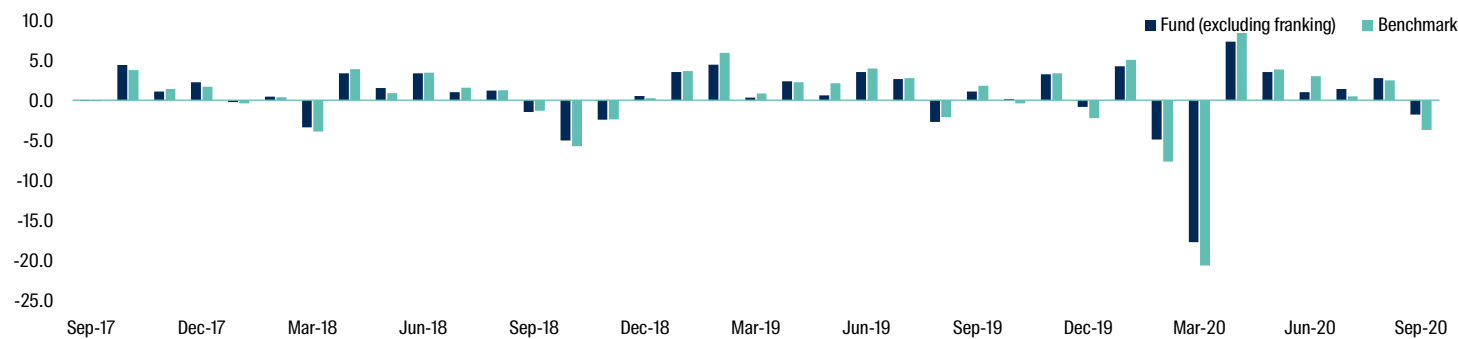
Volatility summary (%)

Period	1yr	3yr	5yr	7yr	10yr	SI
Fund volatility (ex. franking)	21.2	14.2	12.2	11.7	10.9	11.2
Reference index volatility	25.2	16.6	14.3	13.9	13.2	14.5

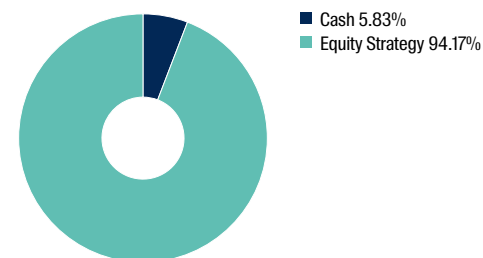
Growth of AUD 10,000 Investment Since Inception



Monthly returns vs benchmark (% excluding franking)



Invested exposure*



*Ignoring options

Market Review

The Australian equity market enjoyed positive returns through the first half of the September quarter as vaccine developments, improving economic data and monetary and fiscal stimulus programs boosted investor sentiment. However, the gains experienced through July and August were erased in September as an extension of Victoria’s lockdown restrictions, US election uncertainty and a global sell-off in technology and energy stocks dragged on sentiment. Over the quarter as a whole, the S&P/ASX 100 Accumulation Index finished -0.8% lower.

Despite the volatility experienced in September, the Information Technology sector ended the quarter +17.1% higher. Logistics software company WiseTech Global (WTC), Buy-Now-Pay-Later firm Afterpay (APT) and data centre operator NextDC (NXT) were among the best performers as each delivered positive FY20 results. WTC rose +33.4% as it experienced strong organic growth on its CargoWise platform in FY20 and an improved outlook in global trade activity. Strong demand for capacity at its data centres helped push NXT +24.3% higher. Over FY20, contracted utilisation grew 30% to 70MW while EBITDA rose 23% to hit the top end of management’s guidance. Accounting software provider Xero (XRO) also rose 11.8% despite not reporting in the August period. The firm did acquire lending platform Waddle, a complementary business that extends XRO beyond traditional accounting reporting services.

The Real Estate sector (+6.6%) also performed strongly, although constituent performances were mixed. Leading the sector higher were the positive performances from Charter Hall Group (CHC) and Goodman Group (GMG). CHC rallied +28.3% as it benefited from a strong FY20 result, which detailed impressive operating earnings and AUM growth for the year. Similarly, the diversified property developer GMG (+20.8%) also benefited from AUM growth combined with the expectation that its predominately industrial-focused assets were positively exposed to the surge in e-commerce activity. Retail and office real estate companies, such as Scentre Group (+1.4%) and Dexus (-3.4%), were relatively unchanged as lockdown and social distancing restrictions continue.

The Energy sector fell -14.0% as constituents realised various impairment charges and earnings declines given the weakness in oil prices. The oil market continues to suffer from the demand-sided shock caused by the coronavirus pandemic, particularly due to decline in transportation activity as the industry accounts for two-thirds of global consumption. Among the worst performers were Origin Energy (-24.9%), Ampol (-17.5%) and Woodside Petroleum (-17.3%).

Fund Performance

The Fund had a very strong quarter returning 2.4% against the S&P/ASX 100 Accumulation index which fell -0.8%. This strong performance is a result of the combination of strong stock selection and also the result of call option premiums that were earned. While the market was volatile over the quarter, the end result of the market ending relatively flat meant that the Fund was able to earn premium with only a small amount of forgone upside. This contributed positively to the Fund performance.

While international travel stocks have remained volatile with fears of a second wave in Europe and the ongoing uncertainty around a vaccine, Australian travel stocks have fared better. In particular Corporate Travel Management (CTD) has performed strongly over the quarter. In its annual result it reported a much better outcome than expected with higher revenues especially in the US, resulting from their larger exposure to government and essential travel. This higher

revenue meant that they had much lower cash burn than expected, resulting in a stronger financial position. A large proportion of corporate travel is also domestic in nature, and the market looked to examples such as New Zealand where domestic travel recovered to pre-covid levels very quickly once the virus was kept under control. Corporate Travel also took the opportunity to raise capital to acquire competitor Travel and Transport to expand its US footprint. The acquisition makes sense both strategically and financially.

The Fund also benefitted from the position in James Hardie (JHX). Even before covid the company had been successful in expanding market share and increasing margins through its 'LEAN' program. As covid emerged, the company was able to quickly adapt and prepare for different potential scenarios. The US housing market rebounded strongly from lockdowns, driven by historically low interest rates and a stronger than expected economy; James Hardie benefitted from this strong recovery and led to a very strong first quarter result (James Hardie reports using a March year-end).

The biggest detractor for the Fund was A2 Milk (A2M). Initially benefitting when covid first impacted China in January through to April as the Chinese consumer rushed to stock up their pantries, over the last quarter A2M has been impacted by a combination of these trends reversing as China recovers the quickest from covid outbreaks, while its Australian sales that are mainly driven by its daigou distribution channel has been interrupted primarily by the Melbourne lockdown. This combination of factors led to the company downgrading in September, after it initially held guidance in its August annual result. This led to the stock underperforming for the quarter.

Fund Activity

There were several changes in portfolio positioning over the quarter including exiting our holding in Telstra (TLS) and adding a new position in Qantas (QAN). TLS provided the market with a very lacklustre full year result in August highlighting significant earnings headwinds including significant declines in mobile subscriber growth and a continued fall in revenue from international roaming thanks to sustained global travel restrictions.

While global border reopening and international travel may be delayed for some time yet we believe that domestic travel will likely improve as internal border restrictions ease. We believe that QAN will be well positioned to benefit from travel starved consumers likely substituting expensive international trips with domestic travel in the near term.

The Fund reduced its overweight holding in Bapcor, the aftermarket automotive equipment company. Despite a defensive earnings stream, along with several growth opportunities, we feel that the recent share price reaction to the "re-opening trade" leaves less valuation upside. As such we allowed some stock to be called away as a call option written over the position was profitably exercised.

The Fund increased its exposure to global steel producer BlueScope Steel over the quarter. Improved production volumes should remain high domestically as well as in the US and NZ. Steel spreads have also improved greatly which will help earnings in the near term. Longer term the North Star expansion in the US will drive significant value for the company once fully commissioned.

The Fund continued to increase its position in Newcrest Mining over the period. The strengthened company balance sheet post a successful capital raising earlier in the year and strong organic growth and exploration opportunities, including the recent 70% acquisition of the Red Chris mine in Canada, look particularly promising.

Forward uncertainty over the quarter reduced somewhat and resulted in slightly lower levels of individual stock implied volatility. This reduction in volatility improved the mark to market exposure of the existing options in the Fund and also allowed for still impressive levels of option premium income to be received by the Fund in return for continued selling of call options. This additional diversified source of income not only serves to supplement a decline in dividend distribution received by investors but also serves to provide a level of cushioning during periods of market weakness.

Market Outlook

With reporting season now past, investors will be focusing on quarterly trading updates and Annual General Meeting's (AGMs) over the months ahead. The impact and importance of these events will be greater than "normal" given the broader macroeconomic environment. Investors will be eager to analyse the quarterly results given the scarcity of guidance offered by management during the August reporting season.

The number of domestic coronavirus cases are improving, which bodes well for the struggling travel industry as state borders may open by early November. Vaccine optimism continues to grow as the World Health Organisation admitted that there is a possibility that a vaccine could be ready as early as the end of the calendar year. Developments on this front will help guide market movements for the short-term.

The 2020/21 Federal Budget, delivered by the Treasurer in early October, detailed the extraordinary steps being taken to help the domestic economy to recover. The support being offered includes a number of income support programs, health related spending, income tax cuts, employment support programs and infrastructure spending. As a result, the budget is forecast to be in a deficit by 11% of GDP for 2020/21 – the largest since the Second World War. Despite the massive increase in debt, the support programs were positively received as it is widely believed that the economic return will far exceed the interest costs of the debt.

The Australian Equity Income Fund is well positioned to continue to deliver on its multiple objectives regardless of the market environment. Our unique approach to portfolio construction has proven to be crucial to navigating the past year, and the proven success provides confidence in the portfolio's resilience going forward. By being completely agnostic to the yield of the stock, the Fund can be constructed in a balanced manner, with different high conviction stock ideas that play different roles within the portfolio. This has been important in a year where at various times different types of stocks have provided the outperformance. The options can then be applied to reduce volatility and to increase the income generated. While there is a significant amount of uncertainty in the near future with the upcoming US elections, potential worsening of the covid situation as well as the ongoing geopolitical tensions, the Fund is well positioned to deliver against a wide range of potential outcomes.

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