

BLACKROCK HIGH CONVICTION AUSTRALIAN EQUITY FUND

BLACKROCK®

FUND UPDATE

31 March 2022

Investment Performance (%)

	1 Mth	3 Mths	YTD	1 Yr	2 Yrs pa	3 Yrs pa	5 Yrs pa	Since Incep ¹ pa
The Fund (Net of Fees)	1.15	-12.72	-12.72	-3.66	21.76	6.80	6.54	8.21
Benchmark ²	4.20	-6.10	-6.10	9.19	21.79	8.27	8.20	9.32
Outperformance (Net of Fees)	-3.06	-6.63	-6.63	-12.85	-0.02	-1.47	-1.67	-1.11
S&P/ASX 300 (for comparative purposes)	6.90	2.08	2.08	13.87	25.51	10.42	9.12	10.63

¹ Performance of the fund is an adjusted combination of the past performance of class X and class D to illustrate performance of the strategy since inception of the fund. It is for illustrative purposes only to show the performance of class D as if its inception date of that class was 9 December 2015. The unadjusted past performance of class D is set out [below]. Please see * in the footnotes for further information.

² S&P/ASX300 Industrials Accumulation Ex Top 5 Stocks by Mkt Cap Gross Index

	1 Mth	3 Mths	YTD	1 Yr	2 Yrs pa	3 Yrs pa	5 Yrs pa	Since Incep pa
Class D (net of fees)	1.15	-12.72	-12.72	-3.66	21.76	6.80	6.54	7.48

Please see ** in the footnotes of further information.

Performance Summary – March t2022

Fund Review

March saw a continuation of the trends we had seen in January and February with Small Industrials rallying just over 1% vs more than 6.5% for the ASX 50 and over 10% for ASX Resources. The focus remains very much on the macro with the bond market having the worst start to a year in over 40 years and interest rates moving higher at a rapid pace. The yield curve in the US inverted briefly (10's vs 2's) during March. This means yields on 2-year treasuries were higher than 10-year treasuries and this has historically been a good signal for predicting recessions in the US. The challenge however is the lag is typically 18 months and over this time equities have actually performed well on average.

We covered some of the short-term drivers of fund performance during the reporting season webinar. It was great to see this event so well attended and the inflows into the fund during the month. The support is as always greatly appreciated as is the shared conviction in the names in the fund.

Fund Performance and Stock Selection

The fund returned +1.15% for the month, net of fees, underperforming its benchmark (ASX300 Industrials ex Top 5 Market Cap Index) return of +4.21% by 3.06%.

On a market adjusted basis, amongst the top contributors for the month were our positions in Monash IVF (MVF), ALS Limited (ALQ) Superloop (SLC) and Nine Entertainment (NEC) while Fineos (FCL), Dubber (DUB) and Siteminder (SDR) were amongst the top detractors.

Contributors

There was not a lot of stock specific newsflow during the month with most companies having delivered earnings in February. **Monash IVF** continued to rally after it's peer Virtus Health continues to attract private equity interest. There was also some Medicare data out which showed a sharp rebound in cycle volumes as we emerge from lockdowns. We expect MVF to continue to take share in a growing market and the strong balance sheet adds optionality. **ALQ**

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- Unit Prices

added to performance during the month on no specific news. The shares have been somewhat range bound for the last 12 months after more than doubling from the Covid lows. We are hearing that the backlog for minerals testing is approaching three months. This is a positive indication of demand which we think should translate into pricing power for ALQ as the market leader. **Superloop** added to relative performance in March after recovering from what in our view, was an unwarranted sell off post its first half result in February. The shares look extremely good value to us with very low earnings risk into August. The settlement of proceeds from the sale of the HK and Singapore assets over the coming weeks could be the next catalyst.

Nine Entertainment was a positive performer for the month and remains a Top 10 position in the fund. During the month, we attended a strategy day for NEC's 100% owned streaming video on demand business STAN. We believe the market continues to underestimate the value of this business which has over 2.5 million paying subscribers and achieved 23% revenue growth in H1FY22. Stan's new CEO presented the two investment priorities for the business which are STAN sport and STAN originals. NEC is investing 70-80 million in STAN sports in new content as well as leveraging content from NEC's Wide World of sports. The significant investment in STAN originals is also crucial to differentiate STAN in an increasingly competitive streaming market in Australia. 2 of the top 10 series on STAN are Australian original content. STAN is leveraging the content of the investigate journalists across the AGE, SMH and 60 minutes to create new programs. Our analysis indicates that the market is only ascribing a \$200-\$300 million valuation to STAN which we view as too low.

Detractors

The detractors this month were **Fineos, Dubber and Siteminder**. There was nothing specific about each of these stocks that led to the weakness which has been ongoing for several months. They all happen to be fast growing, small cap technology stocks. This has been the hardest hit sector of the market since inflationary pressures in the global economy looked to be less transient than originally expected and the rise in bond yields as a consequence. The S&P ASX technology index fell over 30% from the peak in November 2021 to the trough in March 2022. If we look back 10 years, technology made up 0.7% of the ASX300. This grew to 1.2% five years later and at the time we called out the sector as one that could meaningfully grow over the next decade. Today it sits at 3.6% of the index which highlights how early we still are in this trend with technology increasingly touching every part of business and our lives. For reference, technology companies make up over 27% of the S&P500.

It is true that the Nasdaq had one of the worst bear markets in history in 2000 with peak to trough declines of more than 80%. Many technology stocks at the smaller end have already seen corrections close to this magnitude over the last 12 months. We think the parallels between now and the dot com crash of 2000 however are very few. As we highlight above, even just a decade ago, I.T was barely a sector in our market, let alone 22 years ago. Over this time, we have been living in a disinflationary world where interest rates have gone lower and lower which, when combined with attractive growth metrics has seen tech companies enjoy very rich valuations. The market seems convinced that "tech is dead" in an era of higher inflation and interest rates and many of the equities have certainly been priced like that at the moment. Perhaps there is an opportunity to fade this narrative and try and find opportunities where others aren't currently looking. There are several structural changes that suggest to us inflation may run higher than we have been used to for a period going forward. We won't debate how long or how high inflation will go in this note but let's assume that remains the case. The three companies mentioned above (and many other tech companies) have several attractive features in an inflationary world. They have high

gross margins which means the price rises they need to put through to recover cost inflation is lower than those required by companies with low gross margins. Part of the reason inflation is running hot is because of supply chain bottlenecks. Technology companies deliver their services mostly over the internet and are immune from shipping rates, truck shortages, rising fuel prices etc. The other obvious feature is they have growth, the world had been growing quite slowly before the pandemic. Post the pandemic we have added more debt to the global economy, demographics have turned for the worse with developed countries fertility rates falling well below replacement. If interest rates settle higher then it seems that economic growth will be even more challenging to come by and therefore companies that have structural growth remain attractive in our view.

Technology companies had been singularly focused on growth with very little regard for profitability. It is this low or no profit feature that effectively makes them duration assets and therefore very sensitive to moves in interest rates. There are parts of the market where we never thought the business model made sense (regardless of where interest rates went) such as the Buy Now Pay Later sector. Many of these once darling stocks are now down over 90%. We don't think they recover. There are however many technology companies that we think have already reflected a large amount of the multiple compression upfront. The difference between this time and 2000 is that despite the share price sell off many are still growing rapidly and reporting good numbers. This did not happen in 2000 where the share prices went down, the fundamentals got even worse, and the stocks were down and out for the count. The market also hasn't yet seen how companies behave in this new environment. If growth at all costs is no longer been rewarded by the market, then management can slow reinvestment down and increase profits quite quickly. There is a trade off between profit and growth. The three companies mentioned above make up just over 5% of the portfolio so we haven't all of a sudden switched from being style neutral to a growth fund, but we are keeping an open mind and think that in each case the upside vs downside is significantly skewed in our favour even with higher rates.

Top 10 Holdings Alphabetically

Stock
ALS LTD
ARISTOCRAT LEISURE LTD
GENERATION DEVELOPMENT GROUP LTD
GOODMAN GROUP UNITS
MAAS GROUP HOLDINGS LTD
MONASH IVF GROUP LTD
NINE ENTERTAINMENT CO HOLDINGS LTD
PETER WARREN AUTOMOTIVE LTD
SUPERLOOP LTD
TREASURY WINE ESTATES LTD

Source: BlackRock

Sector Exposure

Sector	Weight %
Consumer Discretionary	17.79
Industrials	14.47
Communication Services	11.26
Financials	10.08
Information Technology	9.47
Real Estate	9.33
Health Care	9.32
Consumer Staples	6.33
Materials	5.50
Utilities	-

Source: BlackRock

About the Fund

Investment Objective

The Fund aims to deliver returns that are 4-6% (before fees) p.a. above those of the S&P/ASX 300 Industrials Accumulation Index ex top 5 stocks by market capitalisation (Benchmark) over rolling 3-year periods.

Fund Strategy

Our investment style is based on the belief that a small team of experienced investment professionals focusing on the quality stocks in the market, will outperform over the long-term.

The Fund applies a fundamental approach that is focused on bottom up analysis, where detailed research is conducted prior to any investment decision. There is a strict focus on quality first and only those companies that meet the following quality filters will be considered for inclusion in the Fund:

- ▶ **Management:** engagement with key executives and board members to identify talented management teams.
- ▶ **Profitability:** rigorous evaluation of companies' ability to generate profits
- ▶ **Debt:** strict assessment of debt levels and the ability to service and repay debt.
- ▶ **Businesses:** superior businesses that are easy to understand.
- ▶ **Sustainability:** analysis of ESG risks and factors to identify companies well positioned to grow sustainability.

We believe that the focus on quality first adds significant outperformance, particularly in times of market dislocation, where successful investing is as much about avoiding the losses as picking the winners.

Fund Details

BlackRock High Conviction Australian Equity Fund

APIR Code (D Class)	BLK0012AU
Fund Size/strategy Size	\$164m/\$351m
Buy/Sell Spread	0.275%/0.275%
Management Fee	0.70%
Performance Fee	15%
Liquidity	Daily

[^] The BlackRock High Conviction Australian Equity Fund ("Fund") is structured to allow for different classes of units with different fee structures. The same investment strategy is applied holistically across all unit classes in the Fund. The first class of units for the Fund ("class X") was launched on 9 December 2015 with more than \$220m of assets. A second unit class ("class D") was launched for retail investors on 4 January 2016. This report is designed for class D unit holders. In order to illustrate the performance of the Fund's strategy across both classes since the official launch date of the Fund on the 9 December 2015, performance since inception quoted here is based on the period from 9 December 2015. Performance figures quoted here apply the fees charged to the class D units in order to provide class D unitholders with an estimated performance estimate over the period. This adjustment is estimated and unaudited and is for illustrative purposes only. Past performance is not a reliable indicator of future performance. Net of fees performance is calculated on exit-to-exit price basis, e.g. net of ongoing fees, performance fees and expenses.

^{^^} Performance figures represent past performance and are not indicative of future performance. Current performance may be higher or lower than that shown. Net performance figures are calculated after fund management fees and expenses, and assume reinvestment of distributions. Unless otherwise stated, performance for periods greater than one year is annualised and performance calculated to the last business day of the month.

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