

# BLACKROCK HIGH CONVICTION AUSTRALIAN EQUITY FUND

BLACKROCK®

FUND UPDATE

30 September 2023

## Investment Performance (%)

	1 Mth	3 Mths	Since Manger Incep <sup>3</sup>	YTD	1 Yr	2 Yrs pa	3 Yrs pa	5 Yrs pa	Since Incep <sup>1</sup> pa
Class D (Net of Fees)	-2.84	-0.43	3.01	-0.48	4.31	-14.85	-4.38	-2.44	3.58
Benchmark <sup>2</sup>	-2.89	-0.84	2.21	6.31	13.23	-3.38	6.17	4.54	6.71
Outperformance (Net of Fees)	0.04	0.41	0.80	-6.78	-8.92	-11.48	-10.55	-6.98	-3.13
S&P/ASX 300 (for comparative purposes)	-2.89	-0.84	2.21	3.48	12.92	1.93	10.78	6.62	8.61

<sup>1</sup> Unadjusted class D performance since inception date of 4th January 2016

<sup>2</sup> The Fund benchmark from inception to 9 March 2023 was the S&P/ASX300 Industrials Accumulation Ex Top 5 Stocks by Mkt Cap Gross Index. From 9 March 2023 the Fund benchmark was S&P/ASX300 Accumulation Index

<sup>3</sup> With an inception of 29th March 2023, Pandal Group took over management of this strategy on a sub-advisory basis

Please see ^^ in the footnotes of further information.

## Performance Summary – September 2023

### September Monthly review

Continued resilience in the US economy has pushed out the timeline for expected rate cuts and saw expectations around the ultimate terminal rate creep up.

In combination with larger US bond supply, this pushed US ten-year bond yields up materially, weighing on equity markets in the US and around the world.

The dominant narrative of resilient global economic momentum and higher-for-longer rates continues.

The S&P 500 fell -4.9% for the month. The S&P/ASX 300 proved more resilient, helped by index composition with a greater exposure to financials and commodities, which held up relatively well. It ended down -2.89% for September.

The Energy sector (+2.21%) was the only one to rise. Higher oil prices helped Woodside Energy (WDS, -1.43%) and Santos (STO, +3.00%) outperform, while Whitehaven (WHC, +16.75%) and New Hope (NHC, +12.79%) benefited from increased coal prices.

Financials (-1.61%) generally benefit from higher rates and held up better than the broader market. National Australia Bank (NAB, +0.38%) and ANZ (ANZ, +1.30%) were the best of the large banks, while insurer QBE (QBE, +4.87%) also did well.

Real Estate (-8.54%) underperformed on broad-based weakness. The recent reporting season demonstrated the effect that higher rates was having on interest expense and earnings. Goodman Group (GMG) fell -8.18% and Scentre Group (SCG) -10.55%.

The prospect of higher-for-longer rates also weighed on Information Technology (-7.74%). Again, weakness was broad-based with the sector's largest stocks Xero (XRO, -10.13%), Wisetech (WTC, -6.29%) and NextDC (NXT, -8.49%) all down.

### Fund Performance

The fund retracted 2.84% in September, beating the S&P/ASX300 Accumulation Index return of -2.89% by +0.04%.

### Contributors

#### Overweight Santos (STO, +3.00%)

A higher oil price, underpinned by OPEC supply discipline, helped support Santos. In addition, it agreed to sell 2.6% of its stake in its PNG LNG Project to Kumul Petroleum for \$576M equity. The valuation is in-line with the original agreed price, and broadly regarded as fair value. Although the amount is reduced from the original 5% sell-down, the price is a positive as are the implications for the balance sheet and capital returns.

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- Market Insights & Commentary
- Fund Performance
- Unit Prices

### **Overweight QBE Insurance (QBE, +4.87%)**

There was little material stock-specific news for QBE Insurance, however it is likely to have benefited from a strengthened higher-rates-for-longer thematic in the market. We continue to like QBE due to a supportive pricing cycle, in which premium growth is more than offsetting claims inflation. At the same time the company continues to execute on a turnaround, divesting and running-off troubled businesses.

### **Overweight Pro Medicus (PME, +14.00%)**

Medical imaging software company PME signed its largest ever deal, a ten-year agreement with US healthcare provider Baylor Scott & White Health (BSWH). This represents a material increase in PME's market share. The deal is fully cloud-based and includes all bundled services. It also includes an archive for cardiology which could be precursor to them winning more products in that space. The pricing appears robust and other terms in-line with other announced contracts.

### **Detractors**

#### **Overweight Qantas (QAN, -12.35%)**

QAN endured a month of negative headlines and CEO Alan Joyce brought forward his retirement by two months. The company has committed to restoring its damaged brand, announcing a further \$80m investment to support customer experience in FY24, on top of the \$150m already budgeted for this area at the FY23 result. The board have also made changes to management remuneration with an increased weighting to customer metrics and greater scope for discretion around long-term incentives. While there is a lot of work for QAN to do to restore their reputation, the key issue is whether profits will be structurally impacted via flight slots being reallocated, demand affected or costs rising. The stock is trading at 25-30% below pre-pandemic value, with profits 60% higher. In our view, we see this as a large buffer of value.

#### **Overweight Xero (XRO, -10.13%)**

The prospect of higher-for-longer rates weighed on many long-duration growth stocks, where higher rates tend to drag on valuation ratings. This was the case for Xero. We maintain conviction in Xero as one of our preferred growth exposures. The fundamental opportunity is compelling as it combines a large revenue growth opportunity with a more recent focus on profitability and operational efficiency which can support further earnings upgrades.

#### **Overweight CSL (CSL, -7.63%)**

There was little in terms of stock specific news for CSL during September. Most growth companies sold off, including other larger-cap healthcare names – as the market started to price in the potential prospect of rates remaining higher than expected for a longer period. We maintain conviction in CSL, seeing strong prospects of revenue growth on the back of recently installed capacity as well as greater efficiency gains which can help drive margins.

## **Market Outlook**

Equity markets sit at an interesting juncture after falling over the last month.

The bullish perspective is this is a period of consolidation at a seasonally weak time of year. From here, this could see US inflation and wage growth continue to slow while the economy holds up, which may mean no recession. In this case, interest rates may have peaked despite Fed rhetoric, implying that earnings are set to grow, and valuation ratings rise, lifting markets higher.

The alternative, bearish case is that bond yields, the US dollar and the oil price have all been moving higher, which have historically been warning signals for the market. Higher oil prices means that inflation in the US, while softening, may not fall as fast as the market wants. There is also risk that the delayed effects of monetary tightening will lead to the economy slowing more materially than expected, putting pressure on earnings.

Australian GDP grew 0.4% in the June quarter and 2.1% year-on-year. While in line with expectations, it highlighted some challenges for the economy.

GDP per capita fell 0.3% for the quarter given strong population growth. When it comes to company earnings aggregate spending is what counts.

Breaking down the data, quarterly growth in household consumption was weak at 0.1% quarter-on-quarter. Savings rates have fallen to 3.1% which is a cycle low.

There is growth coming from business investment, which is up 5.6% year-on-year in mining and 9.1% in non-mining sectors. Government spending remains strong at 1.8% growth quarter-on-quarter and exports grew 4.3%, helped by mining.

Employee compensation growth is strong at 1.6% quarter-on-quarter and 9.6% year-on-year. Households continue to find ways to supplement income.

Nevertheless, Australia is an economy with slowing growth, reliant on government spending, business investment and commodity exports. All of which are either unsustainable or volatile and potentially leaves us vulnerable to an inflation surprise and/or a growth problem if the current environment shifts.

At the same time productivity is very weak, which may lead to profits coming under pressure, higher unemployment or more price inflation as companies pass costs on.

There have been some positive signs on China. While we have not seen a large-scale stimulus packages, there have been a slew of more targeted measures to help underpin the economy. The latest PMI activity indices may suggest the worst of activity data could now be behind us. Nevertheless, the property market remains weak, although the iron ore price has remained surprisingly resilient.

In this environment we see stock selection as critical. The range of macro pathways and outcomes remains wide, in our view this means it is important to try and balance thematic risks in the portfolio. Instead, we are looking for companies which offer different types of macro exposures, in combination with a company-specific opportunity for earnings growth or valuation re-rating.

In this vein, rolling twelve-month sector dispersion has fallen materially versus stock dispersion for the S&P/ASX 300 over the course of 2023, after rising for most of the previous year. This suggests an improved environment for stock picking, which we believe plays to the strengths of our team.

## Top 10 Holdings Alphabetically

### Stock

BHP GROUP LTD
COMMONWEALTH BANK OF AUSTRALIA
CSL LTD
NATIONAL AUSTRALIA BANK LTD
QANTAS AIRWAYS LTD
QBE INSURANCE GROUP LTD
SANTOS LTD
TELSTRA GROUP LTD
WESTPAC BANKING CORPORATION CORP
XERO LTD

Source: BlackRock

## Sector Exposure

Sector	Weight %
Financials	25.44
Materials	21.48
Health Care	10.34
Energy	9.90
Communication Services	8.26
Information Technology	7.01
Industrials	4.98
Real Estate	4.55
Consumer Discretionary	2.67
Consumer Staples	2.63
Utilities	-

Source: BlackRock

## About the Fund

This strategy is sub-advised by Pental Group. The strategy is operationally managed by BlackRock and aims to replicate the Pental Focus Australian Share Fund as closely as possible.

## Investment Objective

The Fund aims to provide a return (before fees, costs and taxes), that significantly exceeds the S&P/ASX300 (TR) Index over the medium to long term.

## Description of Fund

This Fund is designed for investors who want the potential for long term capital growth and tax effective income from a concentrated portfolio of primarily 15-30 Australian shares and are prepared to accept higher variability of returns. The Fund may also hold cash and may use derivatives.

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Pental's investment process for Australian shares is based on our core investment style and aims to add value through active stock selection and fundamental company research. Pental's core investment style is to select stocks based on our assessment of their long term worth and ability to outperform the market, without being restricted by a growth or value bias. Our fundamental company research focuses on valuation, franchise, management quality and risk factors (both financial and non-financial risk).

Derivatives may be used to reduce risk and can act as a hedge against adverse movements in a particular market and/or in the underlying assets. Derivatives can also be used to gain exposure to assets and markets.

## Fund Positioning

The Fund is designed to complement a conventional, core share portfolio by providing satellite exposure to selected Australian equities with the potential for performance enhancement.

## Investment Team

Pental's nineteen member Equity team is one of the largest in the Australian fund's management industry. The portfolio manager for the Fund is Crispin Murray, who has more than 31 years' industry experience. Crispin is also Head of Equity.

### Fund Details

BlackRock High Conviction Australian Equity Fund	
APIR Code (D Class)	BLK0012AU
Fund Size/strategy Size	\$19m/\$178m
Buy/Sell Spread	0.25%/0.25%
Liquidity	Daily

### Investment Guidelines

Ex-ante tracking error	3.0% - 6.0%
Max absolute stock position	15%
Min/Max sector position relative to Index	+/- 15%
Min/Max BARRA style factors	+/- 0.5 SD
SIRA style factors	Within 1 SD
Maximum cash level	30%
Shorting	No
Borrowing	No

^^ 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.