DNR Capital Australian Equities Income Portfolio

Performance Report May 2023

Performance

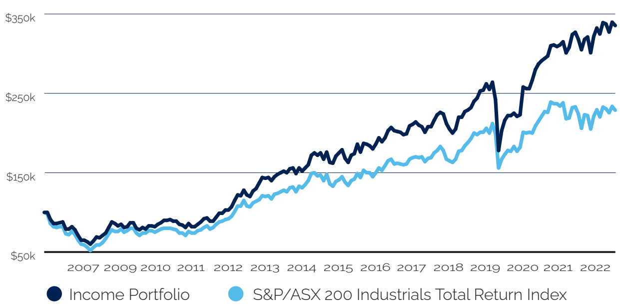
The DNR Capital Australian Equities Income Portfolio outperformed the S&P/ASX 200 Industrials Total Return Index by 0.77% in May. The Portfolio's dividend yield expectation for 2023 is currently 4.9% (6.5% grossed up for franking credits).

Gross active return as at 31 May 2023

	1mth %	3mth %	1yr %	3yr p.a. %	5yr p.a. %	7yr p.a. %	10yr p.a. %	Incep.* p.a. %
Income Portfolio	-1.24	-0.57	5.54	15.83	10.07	8.83	10.61	8.12
S&P/ASX 200 Industrials Total Return Index	-2.01	-0.75	2.08	9.72	6.20	6.34	7.84	5.48
Excess return	**0.77**	**0.18**	**3.46**	**6.11**	**3.87**	**2.49**	**2.77**	**2.64**
Income Portfolio dividend yield incl. franking credits[1]	**1.62**	**3.26**	**7.00**	**7.80**	**7.08**	**7.00**	**8.46**	**7.42**
Franking %	90.9	85.5	80.8	76.9	76.8	75.2	73.9	72.4

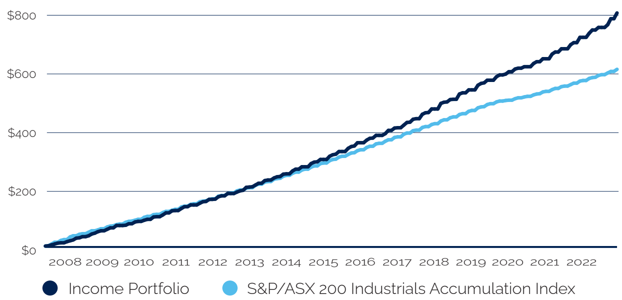
*Inception date—December 2007.
Source: DNR Capital
[1] Portfolio income yield calculated as the sum of all income received over the period divided by the capital base at the start of the period and uses income sources ex-date (including franking credits).
Performance data relates to the DNR Capital model Portfolio Performance of an investment in this model portfolio through a Portfolio Service may have different performance to the performance in this monthly update as a result of different policies and procedures at different Portfolio Service operators. Past performance is not an indication of future performance. No allowance has been made for taxation and fees are not taken into account.

Growth of $100,000 since inception



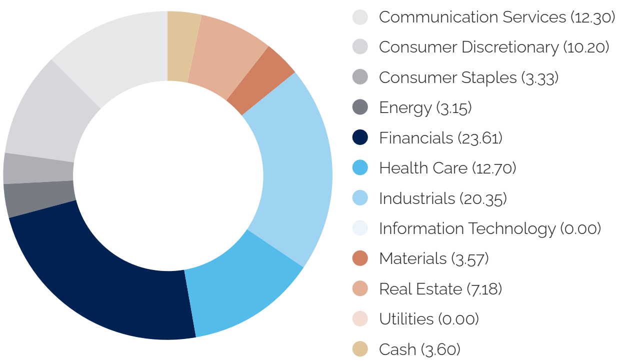
Source: DNR Capital

Accumulated income from $1,000 since inception



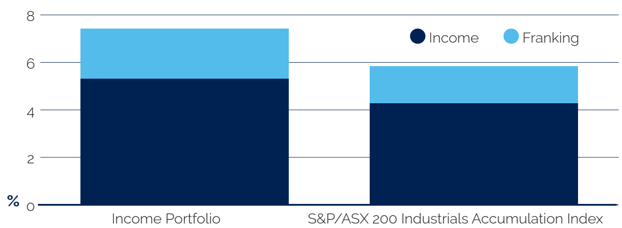
Source: DNR Capital

Sector weightings %



Source: DNR Capital

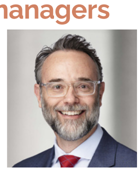
Income yield incl. franking credits since inception



Source: DNR Capital

Experienced portfolio managers

Jamie Nicol
Chief Investment Officer



Scott Kelly
Portfolio Manager

Top 5 active holdings

Security details
TPG Telecom (TPG)
IPH (IPH)
Aurizon Holdings (AZJ)
QBE Insurance Group (QBE)
The Lottery Corporation (TLC)

Monthly top contributors and detractors

Top 3 contributors		Alpha*
Tabcorp Holdings	Overweight	0.33%
Suncorp Group	Overweight	0.22%
Aurizon Holdings	Overweight	0.21%
Top 3 detractors		
Endeavour Group	Overweight	-0.21%
National Australia Bank	Overweight	-0.19%
Amcor PLC	Overweight	-0.17%

* Alpha is the portfolio return less benchmark return. These tables represent the stocks contribution of alpha to overall portfolio alpha and is determined by the stocks active weight relative to the benchmark and share price return relative to the benchmark.

Contributor

- **Tabcorp Holdings (TAH):** was strong over the month as the company showed continued strategic progress following the demerger.
- **Suncorp Group (SUN):** bounce back with insurance price rises very strong.
- **Aurizon Holdings (AZJ):** defensive stocks outperformed this month. In addition, strong April volumes (up double-digits), following a weak third quarter provides confidence for the forecast volume growth rates for the second half of 2023.

Detractors

- **Endeavour Group (EDV):** underperformed following a quarterly update highlighting moderating growth in retail, strong growth in hotels but a negative shift away from gaming. Interest costs also came on higher than expected.
- **National Australia Bank (NAB):** soft results for the banks across the board, but NAB suffered most given it was well held going into reporting season.
- **Amcor PLC (AMC):** underperformed following a poor third quarter of 2023 trading update where FY23 earnings per share (EPS) guidance was downgraded by -8% at the midpoint following a significant volume deterioration in March.

Portfolio and maket review

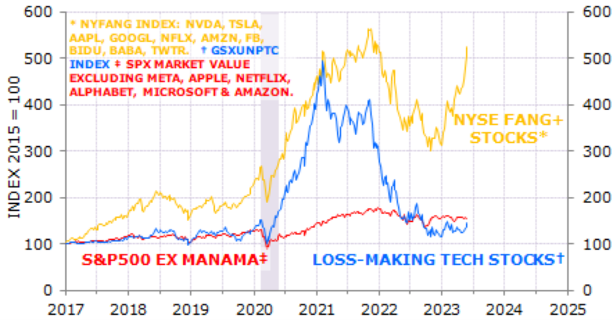
The S&P/ASX 200 Industrials Total Return Index was down 2.01% during the period. Information Technology (+11.6%) was the best performing sector, following the lead of US peers who rallied significantly due to hype surrounding Artificial Intelligence (AI) advances (WiseTech Global (WTC) +9.2%, Xero (XRO) +17.8%).

Utilities (+1.1%) also outperformed, with AGL Energy (AGL) (+13.1%) benefitting from increasing electricity prices and implicit earnings upgrades. Consumer Discretionary (-6.2%) was the worst performing sector as cracks in spending finally started to appear following a tightening of financial conditions. Financials (-4.8%) also underperformed, with mounting economic pressures weighing on the banks (Commonwealth Bank of Australia (CBA) -2.6%, Westpac Banking Corporation (WBC) -4.9%), who are vulnerable to earnings shocks after operating with record-low bad debts.

Macro volatility and commentary continues to be a significant driver of equity markets as concerns lingered around US lawmaker's intentions on the country's debt ceiling during May.

The hallmarks of equities in 2023, i.e., growth over value and concentration of mega-cap tech, were on show again with the NASDAQ up +5.8%, while the equal-weighted S&P 500 fell -4.0%. The key driver is optimism about the earnings potential of Artificial Intelligence (AI).

US index performance, 1/1/2017 = 100



Source: Minack Advisors

In Australia, the RBA's resumed hawkish tone and a higher-than-expected April inflation print of +6.8% dragged the ASX 200 Industrials Total Return Index (the strategy's benchmark) lower, down -2.01% for the month.

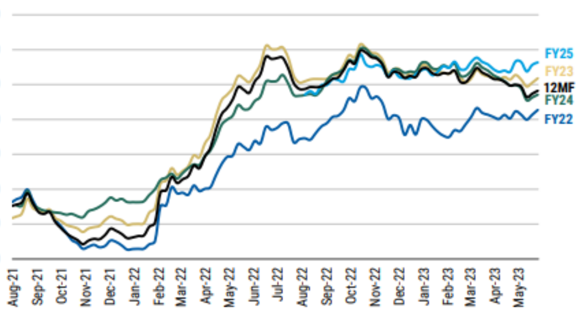
The ASX 200 Industrials Total Return Index 12-month forward PE of ~17x is substantially lower than the peak over the prior two years however, it still remains elevated relative to history, particularly in light of uncertainties and earnings risks.

ASX 200 Industrials 12mf price-to-earnings (Latest = 17.0x)

Source: RIMES, IBES, Morgan Stanley Research

This month we saw a range of companies provide trading updates and/or deliver quarterly results with generally underwhelming results, albeit the magnitude of disappointment has been marginal, taking FY23 and FY24 earnings lower by just -0.1%.

FY22-25 annual aggregate consensus EPS trends



Source: RIMES, IBES, Morgan Stanley Research Data

As has become the norm, Democrats and Republicans ultimately agreed on the debt ceiling.

Markets took their cue and continued to price the goldilocks scenario of a quick return to target inflation, a sustained Fed easing cycle and an economic soft landing.

And places the market equity risk premium into the 'high risk zone'.

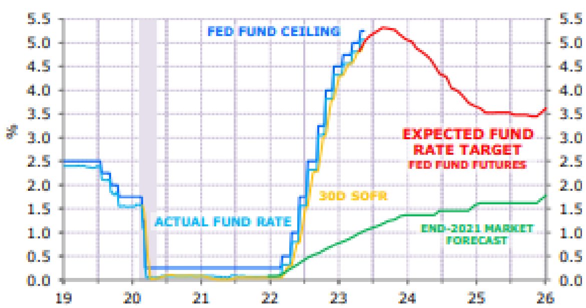
S&P 500 equity risk premium (bps)

Source: Bloomberg, Morgan Stanley Research

Currently, market forecasts imply that the Fed fund rate is at or close to the peak, and with a chance the Fed will be easing at the September FOC meeting. This is the least likely scenario.

Expecting a low peak in the Fed fund rate

Fed funds target market and FOMC forecasts

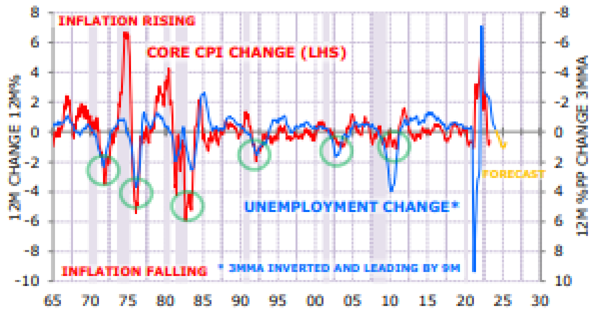


Source: Federal Reserve, Bloomberg, NBER; Minack Advisors

Wage-driven service sector inflation remains sticky, and it is unlikely that inflation can return to target without higher unemployment (inflation always falls as unemployment rises).

Rising unemployment lowers inflation

US unemployment and the change in core inflation



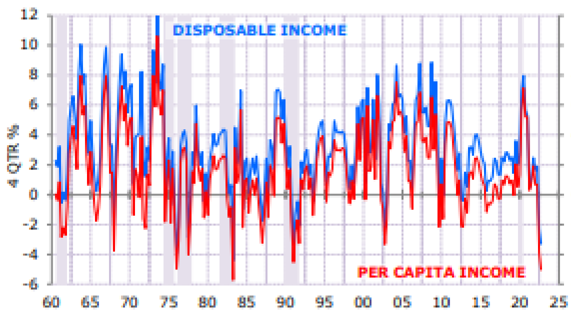
Source: BLS, Bloomberg, NBER, Minack Advisors

In Australia, the RBA hiked the cash rate by 25bp to 3.85% in May-23. Since the same time last year, the cash rate is up by 350bps.

Real household disposable income is now falling at the fastest pace in 40 years and at a rate never seen outside of a recession.

Income collapses

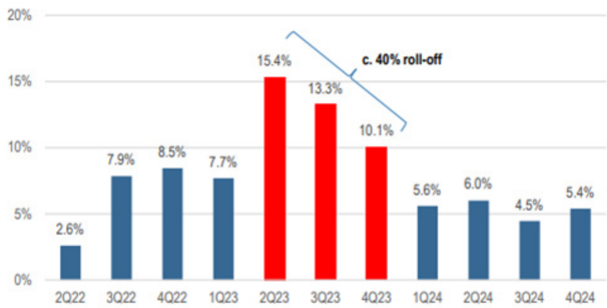
Real household disposable income



Source: ABS, Melbourne Institute, Minack Advisors

The prospect of further RBA hikes is of concern as the mortgage market runs through the peak of the fixed rate roll-off over the second half of 2023.

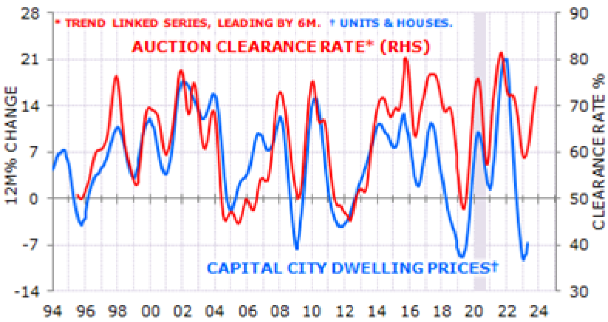
Australian mortgage market | peak of the fixed rate roll-off is high



Source: Bloomberg Finance L.P.

It's also surprising that Australian house prices are rising (albeit on limited supply), as the RBA seemingly remains on a tightening bias. These are not likely to be sustained if the RBA continues to raise rates.

Capital city prices & auction clearance rate



Source: Minack Advisors

About DNR Capital and the Portfolio

Concentrated: Investing in 15-30 highest conviction, Australian listed equities. Concentrated portfolios of quality companies maximise the opportunity for outperformance.

Style neutral and quality focussed: A disciplined approach to quality and valuation.

Dual investment objective: Acknowledging the value of both income and capital, this strategy focuses on delivering a high level of tax effective income, that grows over time, in addition to growing the investors capital.

A diversified set of opportunities: At DNR Capital, we categorise income generating companies as:

- **Growers:** A company that is delivering below market income in the short term, however is expected to deliver above market income growth over the long term.
- **Compounders:** A company that is delivering a market level of income, with the potential to deliver above market income growth on a sustainable basis.
- **Cows:** A company with a solid balance sheet and capital management potential that is being under-valued on traditional earnings-based metrics.
- **Yielders:** A company that is delivering sustainable and cash-backed dividends, however with minimal (or no) income growth.**Experienced and aligned team:** The portfolio managers have more than 45 years of combined investment experience and are invested alongside our clients.
- **Proven process:** DNR Capital was established in 2001 and a consistent firm-wide investment process has delivered more than 19 years of investment outperformance.

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