

DNR Capital Australian Equities Income Portfolio

Performance Report December 2022

Performance

The DNR Capital Australian Equities Income Portfolio outperformed the S&P/ASX 200 Industrials Accumulation Index by 1.69% in December. The Portfolio's dividend yield expectation for 2023 is currently 3.9% (5.1% grossed up for franking credits).

Gross active return as at 31 December 2022

	1mth %	3mth %	1yr %	3yr p.a. %	5yr p.a. %	7yr p.a. %	10yr p.a. %	Incep.* p.a. %
Income Portfolio	-2.24	7.85	2.99	8.42	8.76	8.86	11.79	8.12
S&P/ASX 200 Industrials Accumulation Index	-3.93	7.42	-7.47	3.25	5.27	6.11	8.75	5.38
Excess return	1.69	0.43	10.46	5.17	3.49	2.75	3.04	2.74
Income Portfolio dividend yield incl. franking credits¹	0.00	0.82	6.03	5.64	6.37	6.73	8.88	7.14
Franking %	0.0	89.2	81.8	76.1	75.5	74.0	73.2	71.7

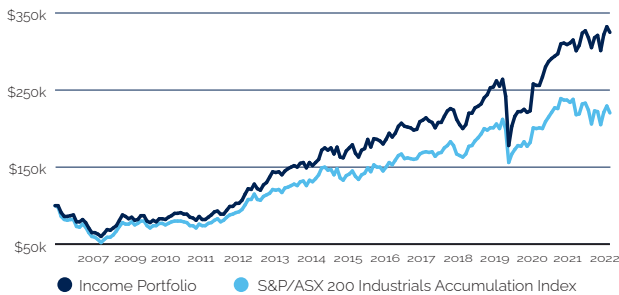
*Inception date—December 2007.

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).

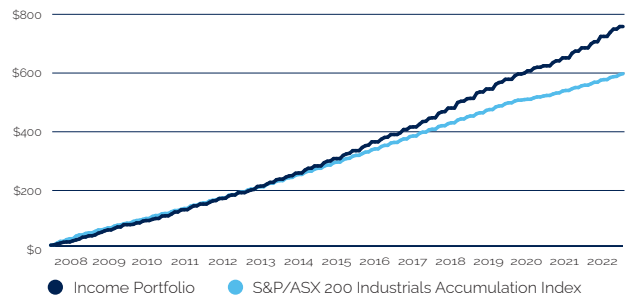
Performance data relates to the DNR Capital model Portfolio. Performance of an investment in this model portfolio through a Portfolio Service may have different performance to the performance in this monthly update as a result of different policies and procedures at different Portfolio Service operators. 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



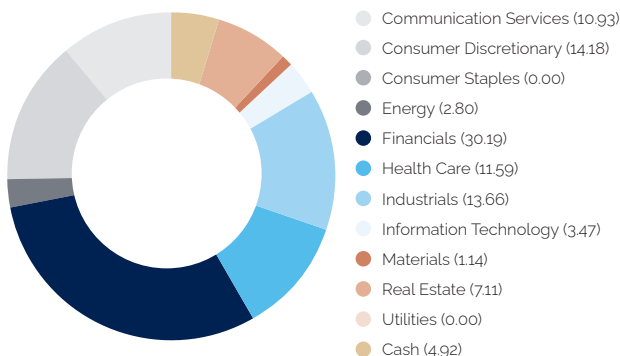
Source: DNR Capital

Accumulated income from \$1,000 since inception



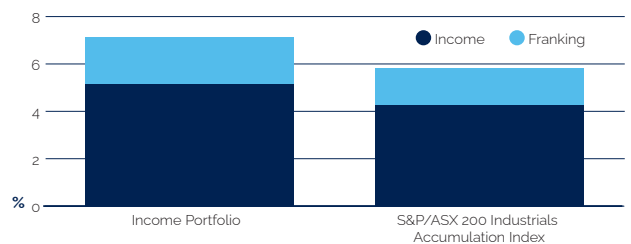
Source: DNR Capital

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

The Lottery Corporation (TLC)

QBE Insurance Group (QBE)

Scentre (SCG)

Suncorp Group (SUN)

Qube Holdings (QUB)

Monthly top contributors and detractors

Top 3 contributors

		Alpha*
QBE Insurance Group	Overweight	0.31%
Domino's Pizza Enterprises	Overweight	0.16%
Suncorp Group	Overweight	0.16%

Top 3 detractors

Skycity Entertainment Group	Overweight	-0.22%
Computershare	Overweight	-0.05%
A2 Milk Company	No Holding	-0.04%

* 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.

Contributors

- **QBE Insurance Group (QBE):** outperformed during the month on no stock specific news, but remains well positioned with top line growth improving margin and repaired balance sheet.
- **Domino's Pizza Enterprises (DMP):** outperformed during the month following a successful capital raise to fund the buyout of its German joint venture from its UK counterpart.
- **Suncorp Group (SUN):** outperformed during the period, with the group confirming progress towards selling its banking operations to ANZ in 2H23.

Detractors

- **Skycity Entertainment Group (SKC):** underperformed following AUSTRAC's announcement of civil proceedings against the group, combined with negative sentiment around fines and taxation levied on casino peer Star Entertainment.
- **Computershare (CPU):** underperformed following a strong prior month where earnings were upgraded by 20%.

- **A2 Milk Company (A2M, no holding):** outperformed on optimism of a Chinese reopening and potential opportunities for reinvigorated Chinese sales and recovery of its Daigou channel.

Portfolio and market review

The S&P/ASX 200 Industrials Accumulation Index was down 3.93% during the period. Consumer Staples (-1.87%) outperformed with Coles Group (COL -1.36%) and Woolworths Group (WOW -2.64%) benefitting from resilient supermarket sales and normalising industry market shares. Utilities (-2.17%) also outperformed during the month, with Origin Energy (ORG -1.78%) still running on positive news regarding the private equity takeover process. Consumer Discretionary (-7.04%) was the worst performing sector, with Aristocrat Leisure (ALL -12.87%) selling off following a strengthening AUD and regulatory concerns in Australia. A-REITS (-5.61%) also underperformed, with climbing bond rates over the month negatively affecting REIT valuations.

The DNR Capital Australian Equities Income Portfolio outperformed its benchmark for the period, with the portfolio's defensive positioning acting as a counterbalance to the fall in markets. Key stock contributors were QBE Insurance Group (QBE), Domino's Pizza Enterprises (DMP) and Suncorp Group (SUN). Key stock detractors were Skycity Entertainment Group (SKC), Computershare (CPU) and A2 Milk Company (A2M, no holding).

Equities and bonds were both troubled by renewed fears about central bank tightening, for example, the European Central Bank's (ECB's) quantitative tightening (QT) plans, and the Bank of Japan's (BoJ's) move to lift the cap on Japanese government bond (JGB) yields by 50bps. In addition, investors became concerned about complications from inflation from a re-opening of the Chinese economy. These factors dominated despite evidence of slowing US growth and core inflation and more dovish pricing of the trajectory for the Federal Reserve (Fed) funds rate as a result.

2022 review

2022 was a challenging year for markets with persistent higher inflation the key driver as central bankers responded with higher interest rates. Russia's invasion of Ukraine added to the uncertainty and fuelled higher commodity prices, in particular oil and gas.

The S&P ASX 200 Industrials Total Return Index (the strategy's benchmark) was down 7.47% for calendar year 2022. Leverage to higher interest rates benefited stocks like Computershare (CPU +31%) and QBE Insurance

Group (QBE +16%). Resources stocks also performed well due to higher commodity prices, for example BHP Group (BHP +24%) and Woodside Energy Group (WDS +58%). On the other hand, duration / high PE growth stocks did poorly, particularly Tech (Megaport, MP1 -67%, Xero, XRO -53%) and REITS (Goodman, GMG -35%, Charter Hall, CHC -42%).

Australian equities fared relatively better than global equities, with the MSCI down 12.24%, primarily due to its lower weighting in tech stocks.

The DNR Capital Australian Equities Income strategy outperformed its benchmark over the period and delivered a gross dividend yield of 6.03%.

2023 outlook

The market continues to debate the timing of a Fed pivot (i.e. a peak in rates, followed by falling rates). The market consensus timing is 2HCY23, albeit with the risk it occurs in CY24 in our view. The pressure from central banks to curb inflation and curtail demand has been unable to counterbalance generationally low unemployment and historically high household savings to date.

Higher rates have had a negative impact on equity valuations. With the prospect of rates peaking and an economic slowdown, the market's focus will shift to earnings. Global Purchasing Managers Indices (PMI) have been trending lower, indicating a softening in growth. Whilst we have seen small negative revisions to earnings, we remain wary about the likelihood of a further downside (perhaps in the region of 5-10%).

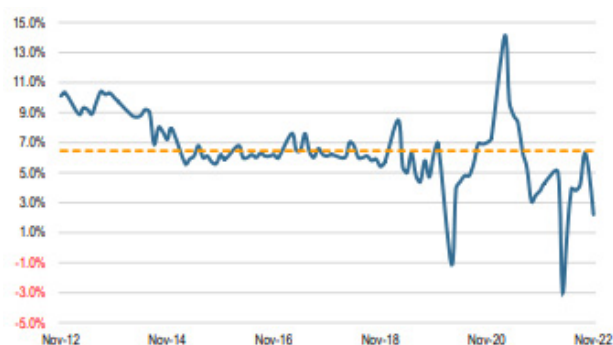
JPM Composite PMI: November reading falls again, now well below the 20-year average



Source: Bloomberg Finance L.P.

The most significant development in China has been the earlier and faster-than-expected reopening. The market has taken this positively, despite the likelihood that rising infections will create setbacks and dampen growth in the short term.

China Industrial Production (Year on Year %)



Source: Bloomberg Finance L.P.

With the risk of an economic slowdown heightened, the strategy remains tilted to quality companies with defensive characteristics and resilient earnings, e.g. CSL (CSL), IPH (IPH), The Lottery Corporation (TLC), Telstra Group (TLS) and we remain underweight the Big 4 Banks, with National Australia Bank (NAB) preferred and no holding in Commonwealth Bank of Australia (CBA) on valuation grounds. Over the course of the year, the opportunity may present to add to existing holdings, quality cyclicals that are oversold, e.g. Qube Holdings (QUB), SEEK (SEK), Super Retail Group (SUL).

The market expects a CY23 gross dividend yield of 5.5%, albeit with risk to the downside of 5-10%, in-line with potential earnings revisions.

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 undervalued 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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