

# Solaris Core Australian Equity Fund (Performance Fee Option)

(APIR: WHT0017AU)

## Quarterly Investment Report as at 31 March 2023

### Market and Fund Performance<sup>1</sup>

The first quarter of 2023 has seen the first cracks of the global rising rate cycle with the collapse of Silicon Valley Bank in the US, and the takeover of Credit Suisse by UBS in Switzerland. The higher bond yields have weighed on equities, but these events were viewed as signs of fragility in the global financial system, and prompted volatility in Australia, with the local markets giving back most of the gains from the strong start to the year, underperforming global equity markets. The S&P/ASX 200 Accumulation index finished the quarter up 3.5%.

Despite the volatility in equity and credit markets, central banks continue to raise rates as inflation continues to print high, albeit declining in Aus. The RBA raised rates for the 9th and 10th consecutive times to bring the official cash rate to 3.6% in Australia, while the Bank of England and the FOMC also raised rates during the period.

The top-performing sectors were Consumer Discretionary (+11.4%), Communication Services (+9.4%) and Information Technology (+8.1%). The worst-performing sectors were Financials (-3.0%), Energy (-1.0%) and Real Estate (+1.2%).

The top three performers for the quarter were all beneficiaries of take-over bids including Liontown Resources (+95.5%), United Malt Group (+36.9%), and Newcrest Mining (+33.0%). Liontown Resources, a lithium exploration and mining company, received a bid from US company Albermarle at a ~65% premium to its share price, which was rejected by the board. United Malt Group received a takeover bid from Malteries Soufflet and entered exclusive due diligence while gold miner, Newcrest Mining, received a non-binding indicative offer from US entity, Newmont Corporation.

The worst performers were Lake Resources (-44.4%), Brainchip (-36.2%) and Megaport (-34.7%). Lake Resources reached 52-week lows and was impacted by the chairman selling, while Brainchip, developer of AI software delivered a disappointing full year result. Megaport's CEO abruptly resigned, causing the stock to decline 15%.

A portfolio holding in focus is Cochlear, a global provider of implantable hearing solutions. We are attracted towards Cochlear as it is an excellent franchise with a clear advantage as the leader in the industry versus competitors.

Cochlear has consistently delivered growth over a long period, and Solaris expects this to continue based on three main drivers of their business -

- Traditional implant services will continue to perform well post covid disruption
- Provisions of upgrades and services to existing clients/patients
- Expansion of bone anchored hearing devices

Cochlear exercises disciplined capital management, recently announcing an on-market share buyback given its strong net cash balance sheet. Solaris expects continued strong earnings growth driven by the fundamentals of the underlying and accretion from the buyback.

<sup>1</sup>Illustrative only and not a recommendation to buy or sell any particular security.

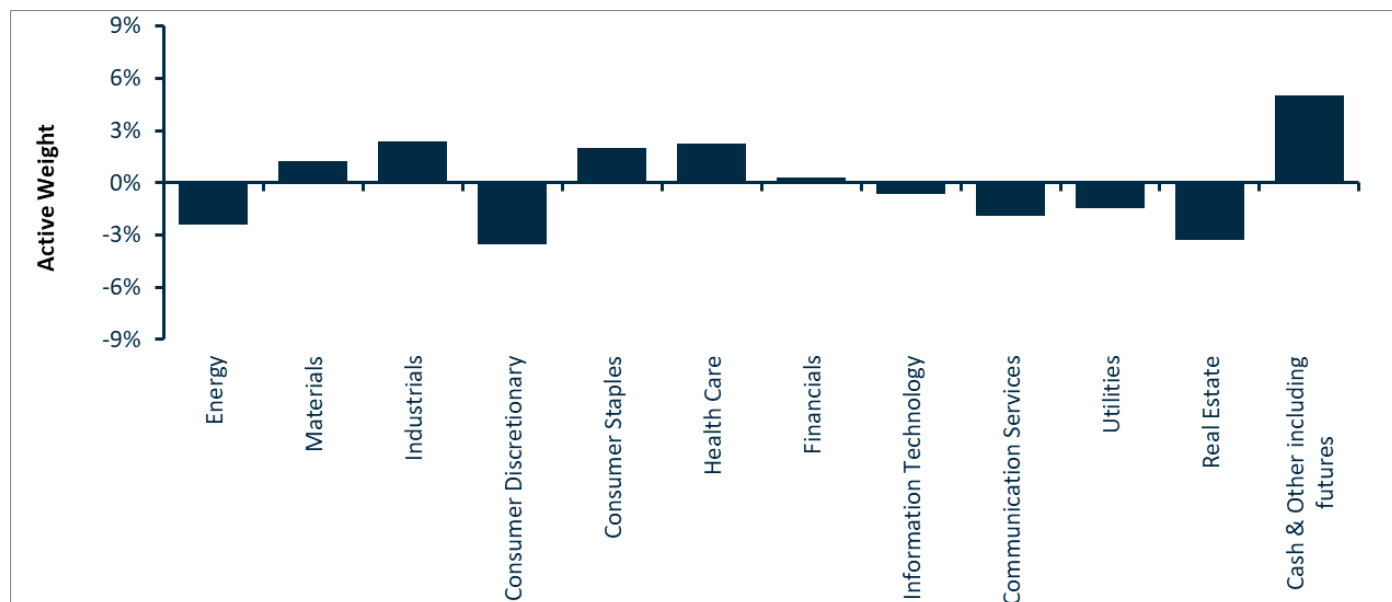
Returns	Month	Rolling Quarter	FYTD	1 Year	3 Years p.a.	5 Years p.a.	7 Years p.a.	10 Years p.a.	Inception p.a. (20/03/2009)
Fund Gross Return <sup>^</sup>	-1.02%	3.08%	13.65%	0.35%	16.07%	8.04%	9.68%	9.38%	10.48%
Benchmark Return <sup>*</sup>	-0.16%	3.46%	13.63%	0.10%	16.52%	8.69%	9.39%	8.18%	9.88%
<b>Active Return</b>	<b>-0.86%</b>	<b>-0.38%</b>	<b>0.02%</b>	<b>0.25%</b>	<b>-0.45%</b>	<b>-0.65%</b>	<b>0.29%</b>	<b>1.20%</b>	<b>0.60%</b>
Fund Net Return <sup>^</sup>	-1.10%	2.84%	12.83%	-0.61%	14.96%	7.00%	8.63%	8.35%	9.70%
Benchmark Return <sup>*</sup>	-0.16%	3.46%	13.63%	0.10%	16.52%	8.69%	9.39%	8.18%	9.88%
<b>Active Return (After fees)</b>	<b>-0.94%</b>	<b>-0.62%</b>	<b>-0.80%</b>	<b>-0.71%</b>	<b>-1.56%</b>	<b>-1.69%</b>	<b>-0.76%</b>	<b>0.17%</b>	<b>-0.18%</b>

<sup>^</sup> Performance is for the Solaris Core Australian Equity Fund (APIR: WHT0017AU), also referred to as Class C units, and is based on month end prices before tax. Net performance is calculated after management fees and operating costs, excluding taxation. Gross performance is stated excluding all fees, costs and taxation. This is historical performance data. It should be noted the value of an investment can rise and fall and past performance is not indicative of future performance. All p.a. returns are annualised. <sup>\*</sup> Benchmark refers to the S&P/ASX 200 Accumulation Index.

## Top 10 Stocks (Alphabetical Order)

Name	Sector
ANZ Group Holdings Limited	Financials
BHP Group Limited	Materials
Coles Group Limited	Consumer Staples
Commonwealth Bank of Australia	Financials
CSL Limited	Health Care
Fortescue Metals Group Ltd	Materials
Goodman Group	Real Estate
Macquarie Group Limited	Financials
National Australia Bank Limited	Financials
Suncorp Group Limited	Financials

## Sector Allocation



Source: Solaris Investment Management, March 2023

## Market Valuation & Earnings Estimates:

	Market & Sector EPS Growth			Market & Sector PEs			Market & Sector Dividend Yield		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Pro-rated to June									
All Companies	16.8%	0.3%	3.1%	15.0x	14.9x	14.5x	4.3%	4.2%	4.4%
Banks	16.3%	13.5%	1.8%	13.7x	12.1x	11.8x	4.7%	5.6%	5.9%
Listed Property Trusts	0.0%	0.2%	-0.5%	0.0x	13.9x	14.0x	4.9%	5.1%	5.1%
Resources	20.8%	-16.5%	-2.3%	8.6x	10.2x	10.4x	7.1%	5.8%	5.6%
Industrials ex-Banks	12.7%	12.7%	8.8%	30.6x	21.1x	19.4x	2.8%	3.0%	3.3%

Estimate only, which may not be realised in the future.

The securities presented on this slide are for illustrative purposes only and are not the complete holdings of the fund. Illustrative only and not a recommendation to buy or sell any particular security.

## Market Outlook

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Uncertainty provides both opportunities and challenges, and macro uncertainty regarding peak interest rates, recession probability and inflation tapering are all prevalent currently. Mounting fears of an economic slowdown highlight the tension between interest rates, Australian business conditions, and consumer spending. Any signs of instability may spook the market, driving volatility and providing opportunity.

One such example is the recent failure of offshore banks, demonstrating the fragility of the broader global financial system in the face of macro uncertainty. Solaris has no direct investment in SVB, Signature Bank, First Republic Bank or any smaller global regional banks and has no direct exposure to Credit Suisse or UBS. Our view is that while the Australian banking sector may be impacted by sentiment, they are very different to the US market, specifically that they are extremely well capitalised (compared to the GFC), operate under much stronger regulation with capital buffers compared to their US counterparts; and do not have concentrated single sector exposure and also carefully hedge their duration risk.

The offshore banking issues have raised concerns about the cost and availability of debt. Over the past 18 months, the investment team has had a heightened focus on ensuring our portfolio companies have robust and appropriate balance sheet settings when exposed to a higher interest rate environment. Extensive analysis of companies' balance sheets over the past 18 months ensures the portfolio is on sound footing in this environment of uncertainty in the banking system. While debt is readily available for quality productive conservatively managed businesses, the cost of credit has increased, and the access to credit has reduced for lower quality and highly indebted corporates. We remain cautious companies including several real estate investment trusts that are straddling the transition to a higher interest rate environment, and we see risks to the dividend outlook and to asset valuations, which in many cases are yet to move materially, despite a significant movement in funding costs.

Inflation impacts on profit margins were evident during February's reporting season, and pricing power remains a key focus as we look forward, that is, the ability of a company to raise prices to protect profit margins. While inflation has moderated from the peak, it remains elevated, and many cost pressures, including rents and wages, are particularly sticky. The ability of a company to raise prices to offset input cost pressure immediately remains critical in this fast-moving environment.

As active managers, the team remains positioned to take advantage of opportunities. As mentioned above, uncertainty often brings market volatility and dispersion between companies allowing increased alpha opportunities. Aligned with the investment process, the team is focused on bottom-up, fundamental research and undertook many one on one meetings with company management during the quarter, providing deep insights into the current conditions and future opportunities for corporates and onsite visits to company operations across Perth, Sydney, Melbourne and Queensland.

While the macro outlook is uncertain, we construct the portfolio with well-managed, well-capitalised businesses that we believe will deliver sustainable earnings throughout this challenging environment and seek to outperform the broader market.

As always, thank you for your support and for allowing us the privilege of managing your investments.

Solaris Team.

Source: Solaris Investment Management, March 2023

## Contact Details

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