31 December 2020

Australian Equities Fund

PARADICE
INVESTMENT MANAGEMENT

Performance Net (%)	1 Month	3 Month	1 Year	3 Year p.a.	Since Inception* p.a.
Australian Equities Fund	1.11	11.50	-6.33	3.41	6.14
S&P/ASX 200 - Total Return	1.21	13.70	1.40	6.73	8.12
Excess Return	**-0.10**	**-2.20**	**-7.73**	**-3.32**	**-1.98**

* Inception date - 02 August 2017

Investment Objective

The Fund aims to outperform the S&P/ASX 200 Total Return Index (after fees and before taxes) over a rolling three to five year period.

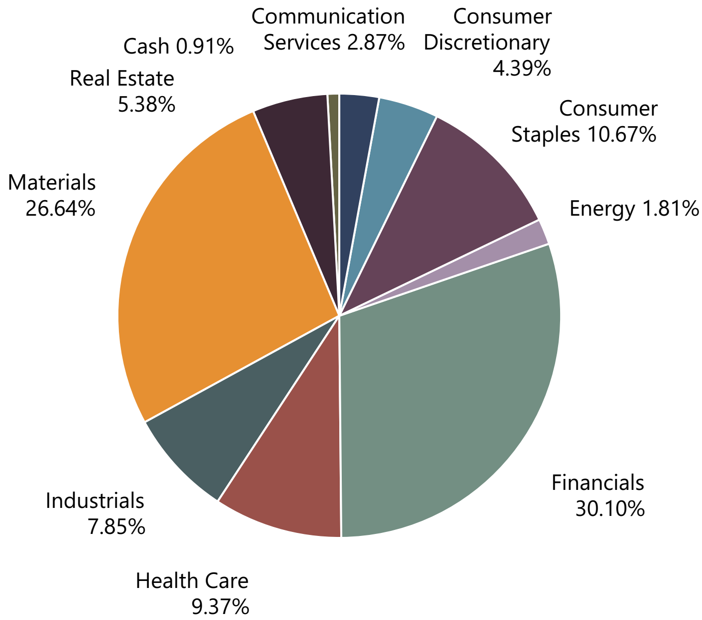
Lead Portfolio Manager

Troy Angus

Fund Overview

The highly experienced team use a detailed fundamental research process to find stocks that are growing faster with better outlooks over the next 3-5 years. The fund is agnostic of investment style and has a focus on capital preservation.

Sector Allocation



Key Details

Number of Holdings	48
Portfolio Dividend Yield	2.50%
Fund Size (AUD)	$29M

Top 10 Positions	Weight %
BHP Group Ltd.	10.37
CSL Ltd.	8.03
Commonwealth Bank of Australia	7.37
Westpac Banking Corporation	6.36
Australia and New Zealand Banking Group Ltd.	5.99
Woolworths Group Ltd.	5.55
National Australia Bank Ltd.	4.16
QBE Insurance Group Ltd.	3.59
Goodman Group	3.39
Coles Group Ltd.	3.34

Fund Details

APIR Code	ETL8084AU
Distribution Frequency	Semi-Annually
Management Fee[1]	0.75% p.a.
Performance Fee	15% p.a.
Buy Sell Spread	+/- 0.20%
Minimum Investment	$20,000
Stock Range	30 - 50
Cash Range	0-10%

Market Review

For the purpose of comparison, commentary is quoted in AUD terms and Australian sector returns refers to the S&P ASX 200 Total Return Index except where stated otherwise.

Global equity markets surged in the final quarter of 2020, taking most key markets back to around pre-COVID pandemic levels. The MSCI World Net Total Return Index gained 14.0% (in USD) over the quarter, driven principally by a November rally. The S&P ASX 200 Total Return Index closed the year up 1.4%.

The key driver of markets was several optimistic vaccine efficacy announcements, a positive reaction to Biden winning the US presidential election, ongoing material fiscal and monetary stimulus, and solid economic data as economies have seemingly operated successfully irrespective of the virus. The JP Morgan global PMI rose from 52.4 percentage points in September to 53.8 in November. Long bond yields rose, steepening yield curves globally and in Australia. The VIX Index (a measure of market volatility) fell 19.6% over the quarter, driven by November's 48% drop.

Commodities performed well over the quarter mirroring the solid global economic outcome, robust Chinese and global demand, weakness in the USD and supply constraints in the instance of LNG and Iron Ore. The BBG Commodities Index gained 2.7% in AUD terms. The top performing commodity was Japan LNG which gained 164%. Iron Ore rose 25.4% and Brent oil 11.1%. Gold though retreated 6.6%. The USD weakened 5.0% over the quarter.

Value outperformed Growth globally again on the back of improving economic conditions. In Australia, Energy was the best performing sector, delivering 26.3% over the quarter. Financials and Materials, traditional value sectors, delivered 22.8% and 15.4% respectively. Banks benefited from improving mortgage deferral data. IT returned 24.8% as it continued to benefit from positive investor sentiment. Utilities was the weakest sector falling 5.4%.

Stimulus has played an important role in the solid economic outcome. For example, US non-farm payroll employment increased by 12m between April and November, but even after that large rise payrolls are still 6.5% below the prior cycle peak. Nonetheless, the improving labour market, as well as income transfers from the US government, prevented many of the adverse second round effects of large job losses. For example, the US mortgage delinquency rate peaked at a much lower level than in the GFC. Transfers from government (more benefits and less tax paid) are the important reason for this seemingly arithmetic impossibility.

Performance

The portfolio underperformed over the quarter largely due to negative stock selection.

The top relative contributors to performance for the quarter are as follows:

Transurban (TCL) Underweight / Not held Transurban fell on the Victorian lockdown and subdued traffic recovery. TCL's 2.5% estimated FY21 distribution yield also compares unfavourably to other infrastructure and REIT stocks.

SIMS (SGM) Overweight Sims rallied on improving fundamentals and pricing in scrap markets as well as general strength in commodity stocks given the weakness in the USD.

BHP (BHP) Overweight BHP rallied on stronger iron ore as well as general strength in commodity stocks.

The top relative detractors from performance for the quarter are as follows:

Newcrest (NCM) Overweight Newcrest underperformed on a weaker gold price and as investors rotated to cyclicals.

Fortescue (FMG) Underweight Fortescue rallied on stronger iron ore and the portfolio was underweight. The portfolio though now holds a position due to our now positive view on the iron ore outlook.

QBE Insurance (QBE) Overweight QBE underperformed after warning on higher catastrophe and past claim costs. We continue to hold the stock as we remain confident on the pricing cycle.

PORTFOLIO CHANGES

Positioning was rotated more towards stocks with cyclical exposure in the December quarter, with funding sources coming from defensive names. The portfolio has taken new positions in commodity stocks exposed to Electric Vehicles as governments globally look to accelerate that transition.

ESG

The Paradice ESG effort has been greatly assisted by the hiring of Nick Varcoe who commenced at the start of September as Head of ESG. Since that time the following tools have been adopted:

- Engagement tool –financially material, sub-sector specific question bank for companies
- Modern Slavery tool – determines companies with exposures to locations with a higher risk of modern slavery.
- Climate Change Risk Analysis tool – in the process of constructing, it is based on analysing 3 key risks: 1. The transition to a low carbon economy, 2. Physical climate change risk, 3. Management capability and willingness to adapt.

Outlook

We expect equity market volatility to remain elevated due to the uncertainties of government stimulus levels and COVID pandemic health outcomes, albeit likely less so than in the past as vaccines are rolled out and virus management techniques are improved.

The 12-month forward Price to Earnings ratio of the S&P ASX200 is elevated at 20.5x (versus 17.5x a year ago) highlighting investor conviction that governments will do whatever it takes to backstop economies and markets. A P/E of 20x on recovered earnings is the highest multiple the S&P ASX200 has traded at in 20 years and is a high bar to clear before the market can push higher. Earnings expectations have recovered from down 23.8%, from pre-pandemic levels to their trough in May 2020, to be down 14.9% now. To put that 14.9% decrease in context, the weakness evident in the back end of calendar 2019 drove a 5.3% decrease.

Our expectation is that stimulus continues to be provided, however as these measures are wound back we need to see an acceleration of underlying economic activity providing an offset. While vaccines, improved treatments, testing, and contact tracing offer significant hope for a recovery, the transition may not be smooth.

In summary, we need to see a self-sustaining economic recovery drive earnings higher to justify current valuations.

Given this outlook we have remained disciplined on individual stock valuations when constructing the portfolio.