

# First Sentier Wholesale Geared Share Fund



Formerly the Colonial First State Wholesale Geared Share Fund

## Quarterly Factsheet

30 September 2023

For Adviser use only

### Portfolio Description

The Fund invests in large Australian listed companies, with between 30 to 40 stocks typically held in the portfolio. The Fund utilises gearing to magnify returns from underlying investments.

### Investment Strategy

We believe stronger returns are achieved by investing in growing companies that generate consistent returns and reinvest above their cost of capital. In-depth industry, stock and valuation analysis is the foundation of our process. The Fund predominantly invests in quality Australian companies with strong balance sheets, earnings growth and high/improving returns on invested capital. The Fund utilises gearing to magnify investment returns.

### Investment Objective

To magnify long-term returns from capital growth by borrowing to invest in large Australian companies. The Fund aims to outperform the S&P/ASX 100 Accumulation Index over rolling 7-year periods before fees/taxes.

### Key Investment Personnel and Experience (Industry / Firm)

Dushko Bajic	Head of Australian Equities, Growth	(1996 / 2014)
David Wilson	Deputy Head	(1987 / 2015)
Christian Guerra	Head of Research	(1996 / 2016)

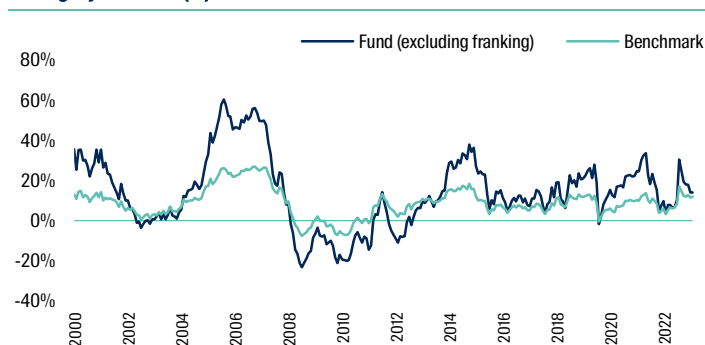
### Product Overview

APIR code	FSF0043AU
Inception date	15 August 1997
Fund Size (AS)	7,827 million
Benchmark	S&P/ASX 100 Accumulation Index
Number of stock holdings	37
Buy / Sell spread*	0.20 - 0.50% / 0.20 - 0.50%
Minimum investment (AS)	5,000
Management fees and costs (p.a.)*	1.04% (g) 2.18% (n)

\* Buy/sell spreads depend on the specific gearing level of the option.

\* Information on Management fees and costs (including estimated indirect costs) is set out in the Fund's PDS.

### Rolling 3 year return (%)



### Top 5 holdings

Stock
BHP Group
Commonwealth Bank
CSL
National Australia Bank
QBE Insurance

Sorted alphabetically

### Performance Summary (%)

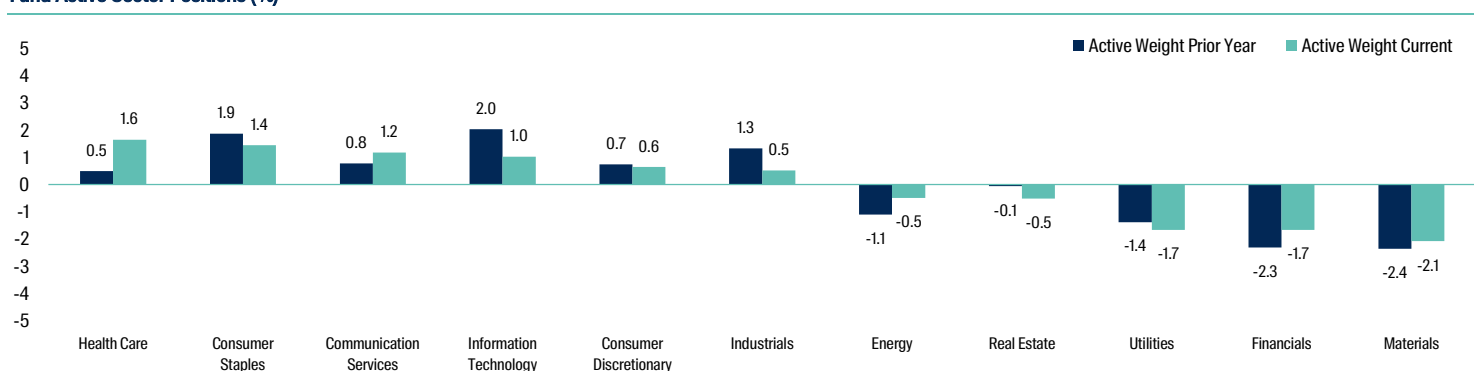
Period	3mth	1yr	3yr	5yr	7yr	10yr	SI
Net return	-4.7	20.3	14.0	10.2	13.6	12.2	13.5
Benchmark return	-0.7	13.7	11.9	7.3	8.5	7.7	8.5
Excess net return	-4.0	6.7	2.1	2.9	5.1	4.6	5.0
Income return	0.0	5.4	16.5	14.3	15.5	13.5	9.2
Growth return	-4.7	15.0	-2.5	-4.1	-1.8	-1.3	4.4

Past performance is not a reliable indicator of future performance.

### Risk Characteristics

Period	1yr	3yr	5yr	7yr	10yr	SI
Fund standard deviation (%)	26.1	29.6	34.2	30.4	29.6	28.4
Benchmark standard deviation (%)	12.2	13.2	16.1	14.2	13.7	13.3
Tracking error (%)	14.3	17.2	18.8	16.8	16.6	16.2
Fund Sharpe ratio	0.6	0.4	0.3	0.4	0.4	0.3
Information ratio	0.5	0.1	0.2	0.3	0.3	0.3
Beta	2.1	2.2	2.1	2.1	2.1	2.0

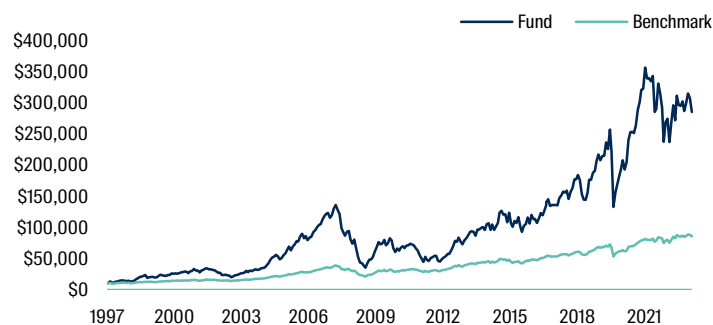
### Fund Active Sector Positions (%)



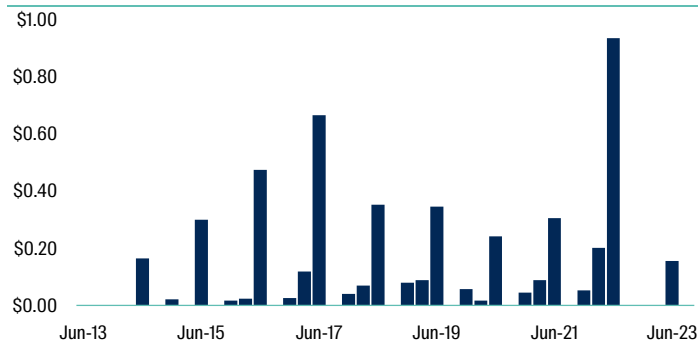
**Portfolio Beta** measures the portfolio's sensitivity to benchmark movements. Mathematically, it is the covariance of the portfolio vs the benchmark divided by the variance of the benchmark.

Performance returns are calculated net of management fees and transaction costs. Performance returns for periods greater than one year are annualised. Past performance is not a reliable indicator of future performance. Data source: First Sentier Investors 2023 Data as at: 30 September 2023

**Growth of AUD 10,000 Investment Since Inception**



**Distributions**



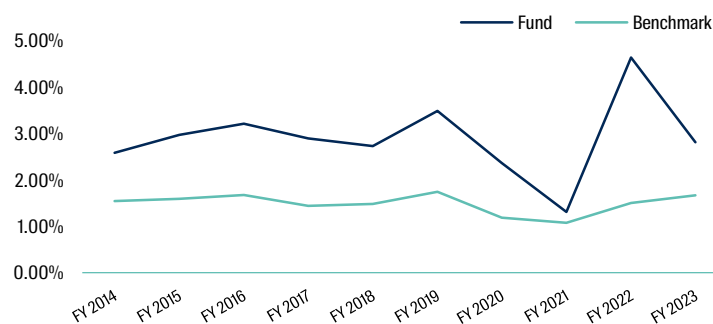
**Top 5 attributors to ungeared performance (3 months)**

Sector	Attr.
Materials	0.39%
Industrials	0.32%
Real Estate	0.21%
Consumer Staples	0.03%
Utilities	0.02%

**Top 5 detractors to ungeared performance (3 months)**

Sector	Attr.
Health Care	-0.69%
Financials	-0.29%
Information Technology	-0.28%
Energy	-0.13%
Communication Services	-0.03%

**Franking Credit Return (%) by Financial Year**



Performance returns are calculated net of management fees and transaction costs. Performance returns for periods greater than one year are annualised. Past performance is not a reliable indicator of future performance. Data source: First Sentier Investors 2023 Data as at: 30 September 2023

**Market Review**

Australian Equities started the September quarter positively with broad-based gains fuelled by improving inflation-related data and better-than-expected earnings results from large cap companies in the US. However, July gains were slowly eroded as the debate that interest rates may need to remain higher for longer ramped up and dampened sentiment. August reporting season also saw heightened intra-day volatility despite earnings beats and misses being fairly even. Forward-looking earnings guidance and the tone of outlook statements proved to be more significant in influencing sentiment towards particular stocks and sectors. By quarter end, the S&P ASX 100 Accumulation Index was down -0.7%, the first quarterly decline since June 2022.

The Energy sector was a standout performer in the September quarter, rallying +9.5%. Energy-related shares were buoyed by higher oil and thermal coal prices. WTI Crude rose by almost 30% after Saudi Arabia and Russia announced they will maintain supply cuts for the remainder of the calendar year. These moves are on top of production cuts already announced by OPEC+ and helped drive the oil price to a one year high, above US\$90/barrel.

Consumer Discretionary (+6.2%) stocks performed well in August reporting season. The rising cost of living for customers and higher cost bases weighed on earnings growth for retailers with many also reporting negative comparable sales growth for the first few weeks of FY24 trading, although investors seemed reassured that cost pressures will start to ease and that earnings will recover in the medium term.

The Health Care sector (-9.1%) was a notable laggard, reflecting disappointing trading updates from ResMed (-27.9%), Sonic Healthcare (-14.6%) and CSL (-8.9%). Previously dubbed COVID-beneficiary Sonic Healthcare saw its full year results impacted by these business segments softening whilst its pandemic-related costs and headcount remained too high. Cochlear (+12.2%) was the only constituent to produce a positive return in this area of the market.

Consumer Staples (-6.6%) stocks also tended to underperform the broader market. Endeavour Group, Coles and a2 Milk the worst performing companies for the quarter, all declining between 13% and 16%. In August, Coles disappointed investors with higher-than-expected operating costs, a decline in gross margins, and a 20% increase in stock loss from theft.

**Fund Performance**

The Wholesale Geared Share Fund underperformed its benchmark, the S&P/ASX 100 Accumulation Index, in the September quarter.

Contributing to the Fund's underperformance was the underweight position in the major bank ANZ Group (ANZ) and overweight position in medical device maker ResMed (RMD). Australia and New Zealand Bank rose by +8.2% outperforming the broader market. ANZ has historically been one of our least preferred banks. The two key bank-specific issues we see are (1) ANZ's book mix and (2) execution risk across a number of key initiatives including the probable acquisition of Suncorp Bank and the scale up of ANZ's new ANZ+ platform.

ResMed (-27.9%) produced a broadly solid FY23 result in August with 21% revenue growth driven by both devices and masks, operating profit growth of 14% and strong cash flows. However, the fourth quarter featured a further decline in gross margins in contrast to guidance for improving margins. Gross margins fell 30bps during the quarter due to FX headwinds and an unfavourable product mix caused by a step down in sales of high margin ventilators. The fumbled guidance and poor explanations triggered a sharp selloff in the in share price. Also weighing down the share price is market concerns about the longer term

impact on RMD's growth from anti-obesity GLP-1 medications such as Ozempic/Wegovy. These medicines have proven very effective in reducing weight in clinical trials and have created a lot of buzz and uptake over the last 1-2 years. Given that 70% of obstructive sleep apnea (OSA) incidence is due to obesity, these drugs have the potential to reduce the population of OSA sufferers and shrink the market. However, there are a number of real world hurdles facing these drugs (including high cost, unpleasant side effects, low adherence, and high discontinuance rates) that limit their effectiveness in achieving long term sustained weight loss necessary to eliminate OSA.

Somewhat offsetting these negative contributions was the Fund's zero-weight position in the Transurban Group (TCL) and overweight position global energy producer Santos (STO). Transurban Group fell -11.0% and underperformed the market in the September quarter. The Company's FY23 earnings result was softer than expected with investor disappointment partially attributed to TCL's 4Q23 softer traffic growth. NSW in particular declined QoQ given the impact of ongoing construction and subsequent congestion whilst Melbourne's volume recovery also slowed sequentially. TCL's large vehicle traffic mix also appeared to be weaker in some areas in the fourth quarter. TCL took another hit in September when its growth plans were snubbed by the ACCC, blocking their proposed acquisition of Horizon roads. Marking the first time that TCL had been knocked back, the ACCC stated the block was based on the grounds that the sale of the EastLink motorway may reduce competition for future toll road concessions in Victoria.

Higher energy prices and a positive trading update regarding a partial asset sale drove Santos +6.9% higher in the quarter. In August, STO released their half year earnings result producing US\$1.1bn of free cash flow and an underlying profit of US\$801m. The Company also provided updates on their major growth projects Moomba CCS, Barossa and Pikka Phase 1. Later in the quarter the oil and gas producer announced the sale of a 2.6% interest in PNG LNG with Kumul Petroleum (subject to approvals). Notably the agreement has a call option to acquire another 2.4% for a total interest of 5%. We were pleased with the binding sale agreement particularly as it will help bolster STO's balance sheet and provide the opportunity to deploy capital to other growth areas.

### Fund Activity

During the quarter we took the opportunity to introduce a health and medical insurer to the Fund. We established the position based on the view that the structural tailwinds in the private health insurance industry will sustain profit margins for longer. In addition, we think the Company's strategy in the NDIS industry is compelling and shows further upside potential.

We also added to our position in a high quality Materials constituent after it experienced a pullback in share price due to the decrease in lithium prices. We remain attracted to the Company given it holds an interest in one of the highest grade, lowest cost lithium mines in the world.

These investment decisions were partially funded by the trimming of our exposure to a retail drinks and hospitality operator and a diversified miner. The former's operating results released in August was in generally in line with the market however, higher interest costs attributed to a higher capex burden led to small downgrades. A larger number of pub acquisitions coupled with ongoing transition costs from its share services contract is also expected to be larger than forecast going forward. Market share losses in the retail business have also created concern about the performance of the group.

We decreased our position in a diversified miner in order to recycle capital into other opportunities. The Company has a heavy development pipeline of mining services, iron ore and lithium in FY24 but from FY25/26 capex should decrease materially with free cash flow increasing as projects come on line.

### ESG Activity

August reporting season highlighted a few ESG themes, notably relating to safety and climate change. Sadly, six listed companies reported two fatalities over the last year (BHP, Downer (DOW), Nickel Industries (NIC), Perenti (PRN), South32 (S32) and Woolworths Group (WOW)). Some of these were contractors. There were also single fatalities at another 7 companies. Consequently, we met with the executives of companies we own to discuss the circumstances that led to these fatalities and the initiatives that are needed to reduce the risk of fatalities in future.

As most of Australia's largest listed companies have now set climate targets, the focus has largely shifted to the credibility of transition plans and the challenges associated with delivering on the targets that have been set. While many companies are on track, others are noting higher project costs or regulatory or supply chain delays.

We also observed a shift among some heavy emitters. With federal government policy on emissions clearer, some companies commented that they now have the investment certainty to invest. Bluescope (BSL) said that supportive government policy underpinned its decision to upgrade and reline its blast furnace at Port Kembla while Orica (ORI) upgraded its emissions targets as a result of decarbonisation projects it has on foot.

Of the many meetings we held with companies during the quarter, we specifically raised ESG issues with 22 of these companies, including BHP, Rio Tinto (RIO), Qantas (QAN), WDS, Santos (STO), WOW, Wesfarmers (WES) and CSL. The issues raised included climate change, emissions reduction targets, policy risk, decarbonisation challenges, modern slavery due diligence, nature-related risks, safety and relationships with traditional owners.

There were only four shareholder meetings at companies held by the Growth Equities team during the quarter. We supported all resolutions in line with management.

### Market Outlook

Macro uncertainty resurged as a driver of market returns in September with the interest rate debate firmly at the wheel. Higher energy prices coupled with hawkish commentary from the FED and resilient economic data continued to fuel the argument that interest rates will need to remain restrictive for longer, prolonging the fight against inflation. The challenging economic outlook implies that cost pressures may continue to persist in the near term and company earnings expectations have lowered as a result. This was reflected in the first quarterly decline in the market's P/E NTM multiple. Whilst, August reporting season demonstrated that many companies have been successful in passing on costs to customers through pricing, defending their gross margins. This will be far more challenging in a slowing economic environment, especially for cyclical stocks, increasing the necessity to right-size headcount and reduce spending amidst weakening demand.

As the market responds to the gradual global economic slowdown we continue to adhere to our long-term investment process and place our conviction in growing companies which generate consistent returns and can reinvest above their cost of capital. We believe that high quality, market-leading companies with distinctive products/services and strong structural tailwinds will be better placed to navigate the uncertainties of the future.

[www.firstsentierinvestors.com.au](http://www.firstsentierinvestors.com.au)

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