Wheelhouse Global Equity Income Fund

Monthly performance update

As at 31 December 2020 – Wholesale investors only

Performance

	1 month	3 months	6 months	1 year	3 years p.a.	Since inception p.a.
Income	1.85%	1.89%	3.79%	7.04%	7.83%	7.27%
Growth	(4.54%)	(2.44%)	(4.20%)	(5.85%)	(0.24%)	(0.49%)
Total Fund return	**(2.69%)**	**(0.55%)**	**(0.41%)**	**1.19%**	**7.59%**	**6.78%**
Benchmark*	**(0.50%)**	**5.68%**	**9.68%**	**5.73%**	**11.16%**	**10.90%**
Risk (Beta)**				0.30	0.46	0.59

Performance figures are net of fees and expenses. Past performance is not indicative of future performance. Inception date is 26 May 2017.

*Benchmark is the MSCI World ex Australia Index. **Risk is defined as Beta and sourced from Morningstar Direct. A Beta of 1.00 represents equivalent risk to the Benchmark. A minimum of 12 months data is required for this calculation.

Currency impact

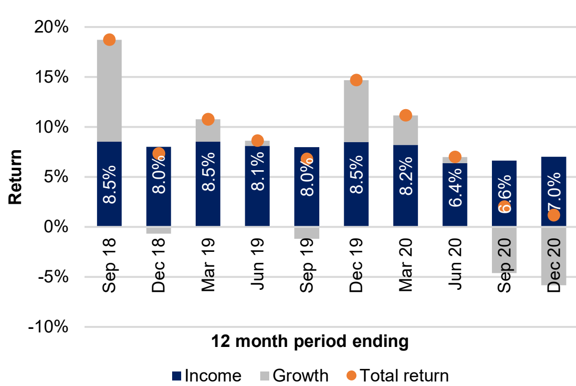
	1m	3m	1y	3y
Fund return	**(2.69%)**	**(0.55%)**	**1.19%**	**7.59%**
USD impact	(4.58%)	(7.61%)	(9.87%)	0.50%
USD return	**1.89%**	**7.06%**	**11.06%**	**7.09%**
USD benchmark	4.20%	13.78%	16.06%	10.66%
USD capture	*45%*	*51%*	*69%*	*67%*

Source: Wheelhouse

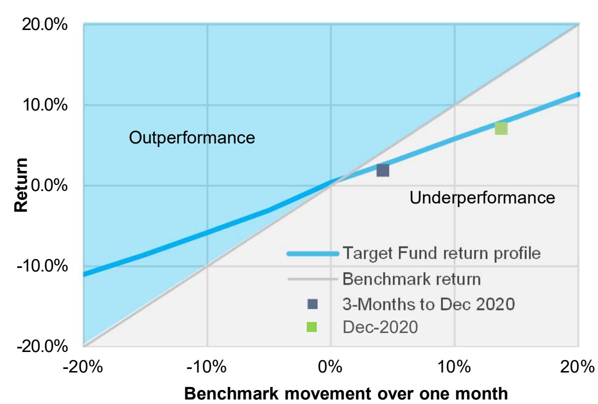
Income and protection

The strategy's high-income generation and active tail risk program are designed to lower risk and deliver equity returns with a smoother, more retiree-friendly return profile. As a result, returns are expected to add relative value in weak and low-growth markets, and to drag in more positive markets. We assess this return profile in USD to strip out the influence of the AUD/USD currency movements.

Income vs total return (12 month rolling)



Targeted monthly return profile



Source: Wheelhouse

Wheelhouse is a retirement solution designed to deliver better investment outcomes to Australian retirees. Our philosophy is based on three pillars:

- investing in global equities as a **growth asset** to address longevity risk;
- shaping returns to be **retiree-friendly** with lower volatility, better capital preservation and consistent income; and
- delivering a **lower cost** solution to help improve outcomes.

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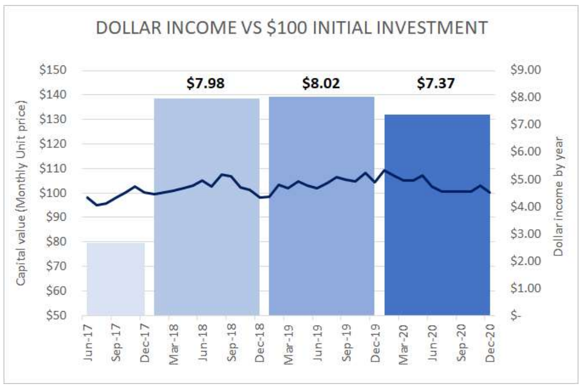
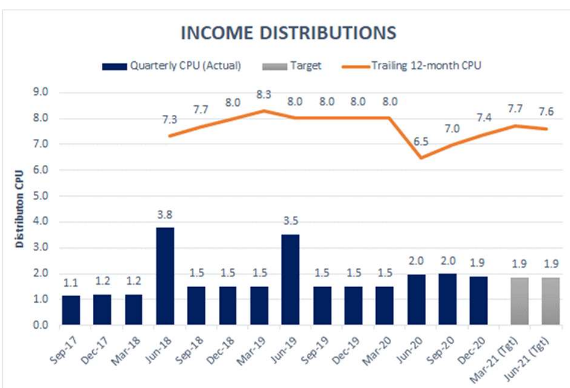
Income generation

The Fund distributed 1.90c per unit for the September quarter taking the annual income distributed per unit to 7.37 cents. The Fund is designed to deliver a 7-8% annual yield, while only taking around half the market risk (measured in Beta). This low market risk is reflected in a very stable capital value, which has hovered around $1.00 despite all the gyrations in the market since the Wheelhouse Fund inception in May 2017.



Source: Wheelhouse

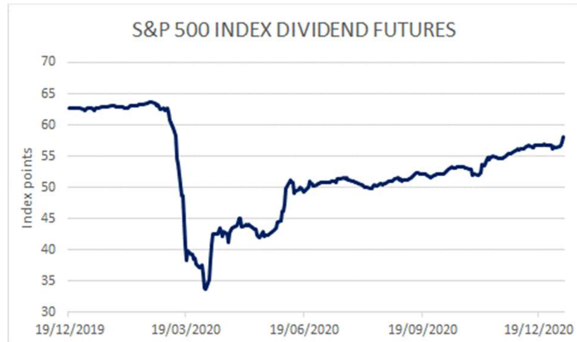
Income generation has been consistent over the years and as expected has provided most of the fund's returns. Importantly, the income generation has been nearly entirely funded by real return over this period, leaving a stable capital base that we believe will grow over time.



Source: Wheelhouse

Distributions are paid quarterly and as previously advised, we are targeting a similar cents per unit each quarter that matches the underlying income generation during that period. Historically the June quarter was a larger 'catch-up' quarter however going forward we expect it to be similar to the three interim payouts.

The distribution is principally comprised of option premium, with dividend income typically accounting for around 1.2% of the total yield. After drastic cuts during 2020 due to the pandemic, dividend expectations are increasing for the S&P500 and are now approaching levels seen pre-COVID.



Source: Wheelhouse

We remain comfortable that a 7-8% yield is sustainable in current market conditions.

Total return

Currency Effect

Total return for the Fund was (0.55%) for the December quarter, with reported returns negatively impacted by a material strengthening of the Australian dollar. As discussed in our September report, FX movements can be material over the short-term but over the longer-term currencies are typically mean reverting and are not expected to have a material positive or negative impact on returns. This longer-term trend is evident in our Currency impact table on page 1.

Historically being unhedged on currency has proven defensive for Australian investors during periods of market stress. We believe this is a valuable characteristic in terms of preserving the capital base during these periods and thus supporting income generation, particularly when other asset classes may be compromised. For this reason we are comfortable accepting some FX volatility over the short-term.

Relative returns

The Fund captured just over half of the near 14% US dollar appreciation in the Benchmark during the quarter.

This is at the lower end of our targeted relative performance but is not inconsistent with our expectations. We do expect short-term underperformance during stronger markets, as this is the quid pro quo for preserving capital much better than the market during periods of weakness. Across a full cycle, we expect the underperformance and outperformance to balance out and generate a return similar to equities.

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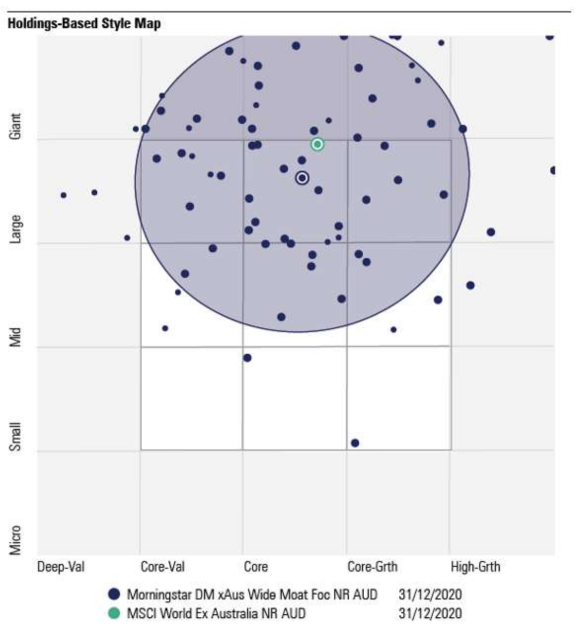
Market Commentary – Factor Rotation

The past several months has seen a significant outperformance of Value stocks versus Growth stocks. While there is no universal definition, Value stocks are typically characterised by their low valuations, be it price/earnings, price/book value or price sales. Growth stocks are usually in faster growing industries, such as Technology.

The Fund's equity portfolio is designed to have similar characteristics (or *factors)* to the Benchmark, which helps deliver a more predictable return without large 'bets' on any specific investment style or sector concentration. Historically the portfolio has had a mild Growth exposure, however over the past 12 months this has decreased as many Growth stocks were removed on valuation grounds. As a result, the portfolio was largely style neutral during the December quarter, being neither overly Value or Growth tilted. This is evidenced in the Morningstar style box below. The green dot represents the aggregate exposure of the benchmark.



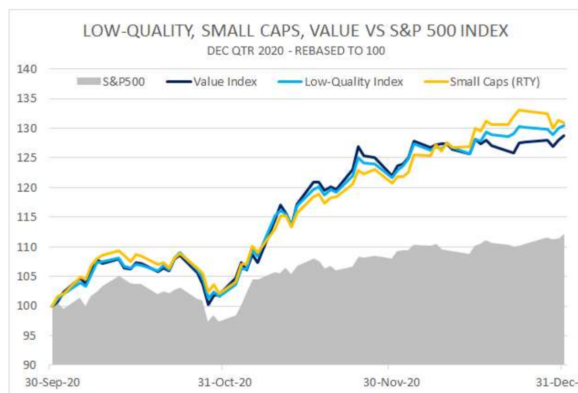
Source: Morningstar Direct

The scatter plot highlights the broad spread of individual positions owned across both Value and Growth styles. This diversified exposure of small individual positions helps explain why the equity portfolio returns are usually highly predictable versus the benchmark, but also illustrates that the portfolio was not materially impacted by the Value factor rotation, as both Value and Growth exposures were reasonably evenly distributed.

Separate to Value or Growth, there does exist one consistently large single factor exposure within the portfolio, namely Quality. Due to the investment selection process (Morningstar's "Wide Moat" criteria) the Quality factor is a perennial exposure within the equity portfolio, which also creates an increased exposure to larger capitalisation companies (at the expense of small caps).

Quality, in factor terms, is different to the Value/Growth style definitions. Most definitions of Quality include high and stable profit margins, high Return on Equity ratios, in addition to a measure of balance sheet strength. Value, on the other hand, emphasises 'cheapness', usually with little or no consideration of business quality.

During the quarter the lowest Quality shares, or the bottom quintile of securities ranked from a Quality perspective, meaningfully outperformed their benchmark. Furthermore, small cap shares also outperformed. The outperformance from this 'junk' rally was even greater than the outperformance from Value. These contributions can be illustrated though the returns of the Dow Jones Low-Quality index, the Dow Jones Value Index, and the Russell 2000 Index (for small caps).



Source: Wheelhouse, Bloomberg

As we hold no low-Quality shares, and have very limited exposure to small caps, the equity portfolio underperformed slightly during the December quarter simply by virtue of having very limited exposure to 'junk' and smaller capitalisation companies. As our Value exposure is evenly balanced with Growth, we were largely unaffected by the Value rotation, and do not expect future performance to be impacted should the rotation continue (or reverse!).

Looking forward, we don't believe any one factor is likely to deliver continual outperformance or underperformance, as most evidence suggests meaningful mean reversion occurs over time (otherwise everyone would simply bet on the same winning formula!). Indeed, over longer time periods, the Quality factor has delivered very similar returns to the Benchmark, and we expect some positive mean reversion to our equity portfolio may be in store.

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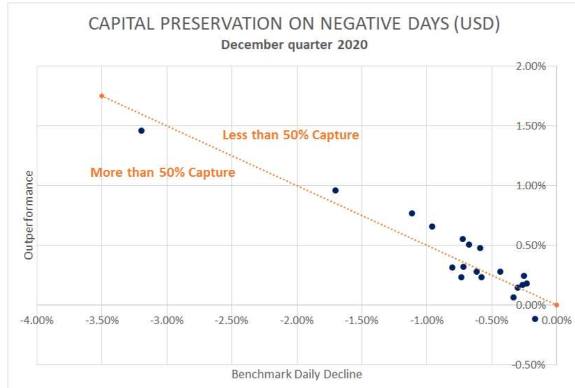
Risk

With the market delivering powerful growth during the quarter, there were few opportunities to demonstrate the defensive characteristics of the portfolio. In US dollar terms the daily benchmark return was only negative on 22 days or roughly one third of the time, meaningfully less than the near 50% of days it usually is. Despite this, protection levels were maintained every day within the Fund, as we do not believe market crises can be forecast with any accuracy.

The chart to the right plots every negative day for the quarter (in US dollars), versus the value added. The relationship is consistent with taking approximately half the equity market risk. In more normal markets, and in particular in weak markets, we believe our defensive approach will be more heavily relied upon.

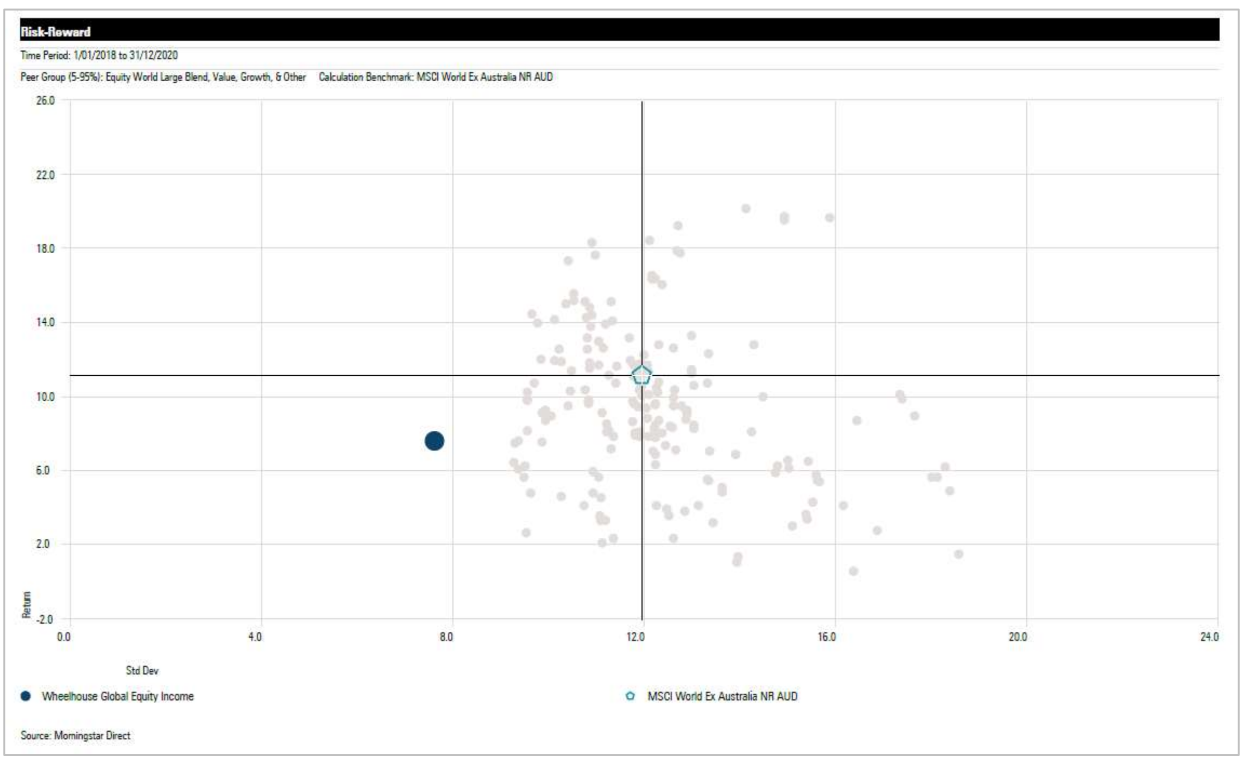


Source: Wheelhouse

The Fund's meaningfully reduced risk profile can be illustrated in other ways. In the chart below we plot 3-year annualised return versus risk (measured in Volatility) of the Fund versus:

- the global equity benchmark MSCI World ex Australia Index in AUD (the centre cross), and
- every other long-only global equity fund in the Morningstar universe (the grey dots)

The Wheelhouse point is clearly an outlier from a risk perspective and represents by some margin ***the lowest risk equity strategy in this universe of funds.*** This highlights the goals-based nature of our approach, where we seek to reduce risk as much as possible, yet still consistently deliver a 7-8% income return every year, plus some capital growth over time.



Source: Morningstar Direct

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Outlook

There is a saying that “Americans can always be trusted to do the right thing, but only after exhausting all other possibilities”. Perhaps that is where America finds itself this week after the political violence in Washington. Or perhaps we’re not quite there yet!

Either way, the set-up for equity markets after the Democratic Senate win and a more certain Biden agenda appears to be:

- More cash stimulus cheques
- More healthcare spending on Medicare/Medicaid
- More infrastructure investment

Viewed in isolation there not much to dislike here and markets are clearly starting to reprice accordingly.

However, there is always another side to the ledger. With Treasury yields inching above 1% for the first time since March, it appears the market is also starting to price higher borrowing costs and potentially higher inflation, albeit much further down the road. This steepening yield curve creates a very positive environment for financials and commodities, so it is hardly surprising these sectors, and the Value rotation, have assumed market leadership.

How long this rotation continues is very difficult to determine, as the question becomes one of market timing and we are not big believers that perfect timing can be achieved on a regular basis. As our portfolio is neither Value or Growth skewed, we don’t lose sleep whether this rotation continues, or reverses, as the rotation does not affect our primary objectives on income generation and preserving capital integrity.

Our greater concern is market valuations. We felt valuations were expensive this time last year, yet they are higher still today. Particularly in fixed income, but also in equities, the goldilocks environment of super-low interest rates has given rise to bubble like conditions for most asset classes, where the only way equities can be classified as ‘cheap’ is because they are ‘cheaper than’ bonds. Even Professor Schiller, creator of the Schiller PE which has been a reliable market barometer for decades, has recently amended his view and suggested the current market PE (which is reporting valuations almost as high as the peak of the tech bubble in 2000), should be ‘adjusted’ to reflect super low interest rates. In other words, we should take more of a relative view and that on this basis, equities are cheap again.

This ‘relative’ view is incompatible with an investor seeking to preserve the dollar value of their income. If markets materially retreat, the income streams being generated by that capital must retreat accordingly. This presents an unacceptable risk for income investors as expenses are unlikely to also decline (they usually just go up).

This issue highlights the importance of maintaining capital integrity for an investor reliant on income streams to fund their lifestyles. In this environment of extreme market valuations, taking a more absolute return mindset to income portfolios seems the safest path to achieve the goals-based objectives of our investors.

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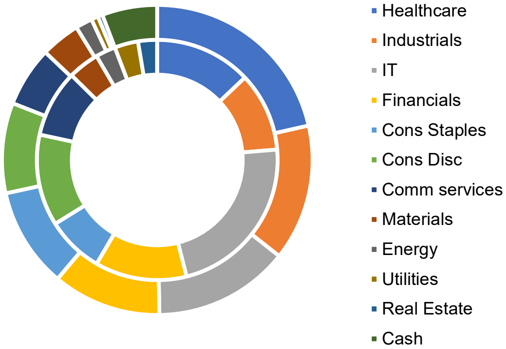
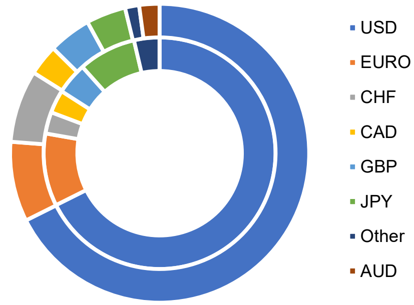
Sector exposure



Currency exposure

Outer circles: Wheelhouse
Inner circles: Benchmark



Contributors	Detractors
John Wiley & Sons	Salesforce.com
Disney	Pfizer
Starbucks	Sanofi
Nabtesco	Dominion Energy
Roche	Unilever

How to invest

The Fund is open to investors directly via the PDS, available on our website, or the following platforms.

Platforms
Hub24 (Super, IDPS), Netwealth (Super, Wrap, IDPS), Powerwrap (IDPS), Praemium (IDPS), Wealth02 (IDPS).

Contact us

For more information, call (07) 3041 4224 or visit www.wheelhouse-partners.com

Fund at a glance	
APIR Code	BFL3446AU
Benchmark	MSCI World Index (ex-Australia)
Stock range	50 to 100 stocks
Buy/sell	+/- 0.30%
Cash limit	0-10%
Recommended investment period	Medium to longer term (five years plus)
Investment amount	Initial investment minimum: $10,000
Fees and charges	0.79% p.a. (including GST net of reduced input tax credits) of the NAV of the Fund. There is no performance fee.
Inception date	26 May 2017