

BMO Pyrford Global Absolute Return Fund (AU\$)

ARSN 168 994 205

For wholesale investors only

Q2 2021 Commentary

Performance The fund returned 2.91% over the quarter. Since inception in June 2014, the fund has delivered 4.91% per annum.

The aim of the fund is to provide a stable stream of real total returns over the long term with low absolute volatility and significant downside protection.

Market Commentary Central bank balance sheets are obscenely bloated. In the last six quarters the combined balance sheets of the four main central banks have exploded by around 9 trillion US dollars – whilst world output struggles to return to pre-pandemic levels. Official interest rates remain on the floor by necessity – any rise in the cost of borrowing will devastate the already stressed government accounts. Even without a rise in interest rates simply rolling over maturing debt and funding the annual budget deficit is straining government finances.

The debate on the possibility of a sustained inflation pick-up rumbles on. Inflation collapsed during 2020 so the base-effect needs to be acknowledged. Nevertheless, there are other factors at work – ongoing supply shortages being foremost together with emerging labour supply problems. The money pumped into the global economy is chasing too few goods – classic demand-pull.

The MSCI World dividend yield has tumbled to a measly 1.65%. At the same time the price earnings ratio has leapt to 27.4x. The logic running through the market is not hard to discern: if bonds yield next to nothing and money in the bank yields nothing or even less why not buy equities which at least provide some income return.

Key Drivers & Detractors Strong returns were dominated by both overseas and domestic equity allocations with our overseas bonds adding further. Overseas equities contributed 1.60% with domestic equities contributing 1.17%. Whilst the Australian bonds contribution was flat, overseas bonds generated a positive contribution of 0.56%, helped by exposure to an appreciating Canadian Dollar and UK Pound.

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Overseas equities added led by Imperial Oil and VTech. As economies begin to reopen and the belief that oil demand will rebound in 2021, Imperial Oil has benefited from an oil price increase with WTI trading over \$70 by the end of June. Imperial Oil suffered along with the rest of the oil industry in 2020 but were able to maintain their dividend whilst also using the period as an opportunity to reduce costs. Hong Kong listed VTech, one of the world's largest suppliers of corded and cordless telephones and has one of the best-known brands in the Electronic Learning Products market added. VTech reinstated their dividend payout having cut their payout in the middle of 2020 due to a lack of revenue transparency. Earnings remain strong with landline telephone demand benefitting from lockdown restrictions and working from home.

Within the domestic equity allocation both Computershare and Woolworths were notable contributors. Computershare bought the Corporate Trust business of Wells Fargo earlier this year, meaning they have increased their exposure to rising rates at what looks like the bottom. In addition, they have benefitted from a increase in corporate activity – M&A, spin-offs, listings etc which has been earnings accretive. Woolworths spun off the Endeavour business (the former alcohol retail, pub and gaming business) which has pushed more of the debt onto the Endeavour balance sheet than Woolworths, so given the supermarkets business is very cash generative there is now the expectation of a large buy-back later this year. The other news is that, perhaps unexpectedly, the Australian competition regulator, the ACCC, approved Woolworths' acquisition of PFD, a large wholesale food distribution company.

Within our domestic bond allocation, the short end of yield curves widened slightly more than the long end. The long end tightened with the 10yr hitting 1.51%, causing the yield curve to flatten. We are positioned at the short end, meaning the return from our domestic bond allocation was broadly flat. We are also positioned at the short end within our overseas bond allocation. The UK yield curve tightened across the curve whilst the US curve flattened. The long end of both yield curves tightened more than the short end meaning that whilst our position at the short end added, it the index outperformed. The Canadian Dollar and British Pound appreciated, adding to the contribution from the overseas bond allocation.

Our US Dollar exposure remains hedged, meaning we did not benefit from the positive impact of a strengthening US Dollar.

Asset Allocation & Positioning There were no portfolio changes made over the quarter.

We remain defensively positioned. Our current allocation is 52% government bonds, 45% equities and 3% cash. The equity portfolio remains positioned in defensive sectors such as utilities and telecommunications. These sectors offer predictable revenue streams and attractive valuations. The focus of the portfolio is on balance sheet strength, profitability, earnings visibility and value. In Asia, we prefer the Southeast Asian markets over Japan as the economies in Southeast Asia offer sustainable economic growth supported by increased labour output or productivity growth and trade at more reasonable valuations.

In bonds, Pyrford continues to adopt a defensive stance by owning short duration securities in order to protect the capital value of the portfolio from expected rises in yields. At the end of the period, the modified duration of the fixed income portfolio stood at around 1 year.

The US Dollar remains hedged to meet the portfolio target exposure of no more than 45% in non-AUD, unhedged currencies. Our hedging rule is to hedge currencies that are more than 25% overvalued relative to the base currency. Whilst the US Dollar is not more than 25% overvalued as per our hedging rule it is the most expensive currency relative to the Australian Dollar.

Quarterly ESG & Voting Summary As long-term shareholders of companies, we have the ability, and in our view the responsibility, to try and influence the business practices of companies.

Pyrford voted 1,716 ballots in 67 company meetings in the quarter. We voted against management in over 40% of meetings. We also engaged with 61 companies worldwide and ESG issues are a standing agenda item in every meeting we conduct.

For a detailed overview of ESG activity, please visit our website for all voting records and our latest annual ESG report.

N.B. Returns are quoted in AU\$ unless otherwise stated.

Risk disclosure

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In Q4 2021, subject to regulatory approval and customary closing conditions Pyrford International is to become part of Columbia Threadneedle Investments.

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