INVESTSMART

Intelligent Investor Equity Growth Portfolio

Monthly Update - November 2018

PERFORMANCE TO 30 NOV 2018	1 mth	3 mths	6 mths	1 yr	2 yrs (p.a.)	3 yrs (p.a.)	Since Inception (p.a.)
Intelligent Investor Equity Growth	-0.73%	-10.96%	-4.47%	-3.35%	3.95%	7.09%	7.82%
S&P/ASX 200 Accumulation Index	-2.21%	-9.28%	-3.67%	-0.96%	6.54%	7.69%	5.71%
Excess to Benchmark	1.48%	-1.68%	-0.80%	-2.39%	-2.59%	-0.60%	2.11%

Key points

- **Coles spin off**
- **A bid for Trade Mew**
- **Clydesdale's falling margins**

Spin-Offs have historically delivered outstanding returns, as I discussed in the recent webinar How to find value. Magic can happen when a smart, appropriately incentivised management team, freed from a bureaucratic parent company, can finally make the investments their business needs.

In contrast, the **Coles** spin-off from **Wesfarmers** isn't necessarily poised for outsized returns. First, Wesfarmers' share price increased instantly following the spin-off announcement, so expectations were high before Coles listed separately.

Second, Coles hasn't been mismanaged or starved of capital, and is well covered by the investing community i.e. it's unlikely to be mispriced and, due to its large size, large funds won't be selling due to illiquidity (a common reason why spin-offs become grossly undervalued).

Furthermore, Coles is carrying a healthy amount of debt in addition to its leases, while simultaneously promising to make large investments and pay out nearly all profits as dividends. Should profits come under pressure, perhaps due to increased competition from Amazon or other new and existing players, the dividend may come under pressure and debt could increase.

A forecast price-to-earnings ratio (PER) of ~16 doesn't provide a large margin of safety, nor does Wesfarmers' PER of closer to 18, given its large retail businesses could suffer severely in a slowing economy. We sold Wesfarmers just before the split, as we're currently buying better opportunities.

The Good

Trade Me recently received a non-binding bid from UK private equity firm Apax Partners priced at NZ$6.40 ($6.05), which was followed by interest from US private equity group Hellman & Friedman. A deal is far from guaranteed, so we reduced our position from 10% to 7% to reduce risk and

"COLES HASN'T BEEN MISMANAGED OR STARVED OF CAPITAL, AND IS WELL COVERED BY THE INVESTING COMMUNITY I.E. IT'S UNLIKELY TO BE MISPRICED"

capture some upside from the increase in the share price since the announcement.

Given the amount of investment the company has made in recent years at the expense of short-term profits, we believe the deal undervalues the company and that it would be a damning admission from the board about its fears of future competition if it agreed to a deal at the suggested price.

The Bad

In an unusual step, we sold **James Hardie Industries** at a nominal loss after a very short holding period. The stock fell 15% after announcing a massive increase in costs that impacted a swathe of US companies the same week.

The consensus is that James Hardie can pass these costs on to customers better than most (we agree), and that the cost increases will be temporary as the US economy adjusts to tight labour and product markets.

Our fear is that, in contrast to the official statistics that show negligible inflation risks, higher costs will be more permanent. The US economy is stretched for skilled labour, for example, which can't be relieved quickly. While we're still US housing bulls, we decided to sell and top up our investment in plumbing supplies company **Reece** instead.

Reece's recent US acquisition means it also has a large exposure to US housing. But having also suffered a recent similar fall in its share price, we feel more comfortable with Reece's management and less cyclical business. We'll explain the bull case for US housing and Reece in the upcoming quarterly.

As an aside, it's an important part of investing to admit quickly when you think you've made a mistake. While our valuation of James Hardie may prove too conservative, experience says there's no better time to sell than straight away when you've erred. Changing your investment case to suit the facts usually only compounds the error and you can always buy the stock back if your fears prove unfounded.

The Ugly

The ugly award this month undoubtedly goes to ageing spin-off and UK bank Clydesdale. The share price has almost halved since reaching $6.33 in August, and we've topped up our holding on the way down.

The bank's profit margins are falling more than expected as the industry cuts home loan rates in response to a slowing housing market. At a price-to-tangible equity of just 0.7 for a business that should be capable of producing a double-digit return on tangible equity in the years to come and paying a dividend yield beyond 5%, for now we're eager to hear the company's next three-year plan in June.

"A DEAL IS FAR FROM GUARANTEED, SO WE REDUCED OUR POSITION FROM 10% TO 7% TO REDUCE RISK"

Management must prove it can do more than cut costs to get the stock out of purgatory, and we believe it can. Unfortunately, a messy Brexit may delay the high returns we believe are possible.

We also introduced travel company Flight Centre and respiratory care company ResMed to the portfolio. Long-time followers of Intelligent Investor will be very familiar with these businesses, but we'll save further analysis for the quarterly.

PORTFOLIO ALLOCATION

Industrials	17.30%
Cash	15.40%
Consumer Discretionary	15.03%
Information Technology	13.67%
Financials	9.99%
Communication Services	6.62%
Materials	5.57%
Energy	4.58%
Real Estate	4.13%
Health Care	7.73%

TOP 5 HOLDINGS

Security	Weighting
Trade Me	6.80%
BHP Biliton	5.42%
Hansen Technologies	4.99%
Seek	4.78%
Sydney Airport	4.53%

Performance numbers exclude franking, after investment and admin fees; excludes brokerage. All yield figures include franking. All performance figures, graphs and diagrams are as at 30 November 2018. Performance figures are based on the portfolio's previous investment structure, a Separately Managed Account (SMA). This portfolio is now offered as a Professionally Managed Account (PMA), as of 1 November 2018. The underlying securities remain the same between the SMA and PMA structures. The inception date refers to the SMA. Please see the Investment Menu for full PMA fee details.

InvestSMART Group Limited (INV)

was founded in 1999 and is a leading Australian digital wealth advisor which has over 32,000 clients and over $1.4B in assets under advice. InvestSMART's goal is to provide quality advice and low cost investment products, free from the jargon and complexities so commonly found in the finance industry, to help you meet your financial aspirations.

The Portfolio

The Intelligent Investor Equity Growth Portfolio is a concentrated portfolio of 10 - 35 Australian-listed stocks. The Portfolio invests in a mix of large, mid and small cap stocks, focusing on highly profitable industry leaders that have long-term opportunities to reinvest profits at high rates of return.

Investment objective

The Portfolio's investment objective is to produce a sustainable income yield above that of the S&P/ASX 200 Accumulation Index.

Why the Intelligent Investor Equity Growth Portfolio?

Australia has one of the world's most stable and highest returning share markets and is often considered a safe-haven by investors. As contrarian value investors, producing safe and attractive returns in the stock market means sticking to a disciplined and repeatable process. We do this by patiently waiting for overreactions in share prices, so we can buy at a large discount to our estimate of intrinsic value.

Who manages the investment?

Nathan Bell, has over 20 years of experience in portfolio management and research and is supported by our Investment Committee, chaired by Paul Clitheroe. Before returning to InvestSMART in 2018 as Portfolio Manager, he was the Research Director at our sister company, Intelligent Investor for nine years which included over four years as Portfolio Manager and being a member of the Compliance Committee. Nathan has a Bachelor of Economics and subsequently completed a Graduate Diploma of Applied Investment and Management. Nathan is a CFA Charterholder.

Key Details

INVESTMENT CATEGORY
A portfolio of individually-selected Australian Equities

INVESTMENT STYLE
Active Stock Selection, Value Investing Approach

BENCHMARK
S&P/ASX 200 Accumulation Index

INCEPTION DATE
1 July 2015

SUGGESTED INVESTMENT TIMEFRAME
5+ years

NUMBER OF SECURITIES / STOCKS
10 - 35 stocks

INVESTMENT FEE
0.60% - 0.97% p.a.

PERFORMANCE FEE
N/A

MINIMUM INITIAL INVESTMENT
$25,000

STRUCTURE
Professionally Managed Account (PMA)

SUITABILITY
Suitable for investors who are seeking domestic equity exposure with a growing stream of dividends to offset inflation

PORTFOLIO MANAGER
Nathan Bell, CFA

Important information

While every care has been taken in preparation of this document, InvestSMART Funds Management Limited (ABN 62 067 751 759, AFSL 246441) ("InvestSMART") makes no representations or warranties as to the accuracy or completeness of any statement in it including, without limitation, any forecasts. Past performance is not a reliable indicator of future performance. This document has been prepared for the purpose of providing general information, without taking account of any particular investor's objectives, financial situation or needs. An investor should, before making any investment decisions, consider the appropriateness of the information in this document, and seek professional advice, having regard to the investor's objectives,financial situation and needs. This document is solely for the use of the party to whom it is provided.

This document has been prepared by InvestSMART. Financial commentary contained within this report is provided by InvestSMART. The information contained in this document is not intended to be a definitive statement on the subject matter nor an endorsement that this model portfolio is appropriate for you and should not be relied upon in making a decision to invest in this product.

The information in this report is general information only and does not take into account your individual objectives, financial situation, needs or circumstances. No representations or warranties express or implied, are made as to the accuracy or completeness of the information, opinions and conclusions contained in this report. In preparing this report, InvestSMART has relied upon and assumed, without independent verification, the accuracy and completeness of all information available to us. To the maximum extent permitted by law, neither InvestSMART, their directors,employees or agents accept any liability for any loss arising in relation to this report.

The suitability of the investment product to your needs depends on your individual circumstances and objectives and should be discussed with your Adviser. Potential investors must read the Product Disclosure Statement (PDS) and Investment Menu (IM), and FSG along with any accompanying materials.

Investment in securities and other financial products involves risk. An investment in a financial product may have the potential for capital growth and income, but may also carry the risk that the total return on the investment may be less than the amount contributed directly by the investor.

Past performance of financial products is not a reliable indicator of future performance. InvestSMART does not assure nor guarantee the performance of any financial products offered.

Information, opinions, historical performance, calculations or assessments of performance of financial products or markets rely on assumptions about tax, reinvestment, market performance, liquidity and other factors that will be important and may fluctuate over time.

InvestSMART, its associates and their respective directors and other staff each declare that they may, from time to time, hold interests in Securities that are contained in this investment product. As Responsible Entity, InvestSMART is the issuer of the product through the Managed Investment Scheme (ARSN: 620 030 382).

InvestSMART Funds Management Limited
PO Box 744
Queen Victoria Building
NSW 1230 Australia

Phone: 1300 880 160
Email: invest@investsmart.com.au

www.investsmart.com.au