Monthly Update

31 January 2022

Intelligent Investor Australian Equity Income Fund (Managed Fund) (ASX:INIF)

Issued by
InvestSMART Funds
Management Limited
ACN 067 751 759
AFSL 246441

Managed by
Intelligent Investor
Holdings Pty Ltd
ACN 109 360 983
CAR 1255 838

ARSN 620 031 414
ASX Code: INIF

"Mediocrity is not worth the trip."

—Sergio Marchionne

It was a wild month on the ASX, as the sharemarket finally acknowledged that interest rates will increase earlier than expected. The fund fell 3.6% during January, compared to the market's 6.4% fall.

Our resources stocks performed best, which is why the Income Fund performed better than our two other funds. It partly reflects the fund's large position in **BHP**, which benefited from a large increase in the iron ore price.

Regardless of swings in the iron ore price and China's efforts to reduce its dependence on Australian iron ore, BHP should pay healthy dividends. We'll continue to manage the position based on valuation, although it's unlikely we'll ever have 20% of the fund invested in three iron ore miners like the index.

Jeremy Grantham recently warned that the window of cheap and easy extraction of the world's once abundant natural resources is nearing an end. That means higher prices, which is why we hold a diversified cornerstone position of resources companies such as **Woodside Petroleum**, **South32** and **Alumina** amongst others.

Performance (after fees)

	1 mth	1 yr	2 yrs (p.a)	3 yrs (p.a)	S.I. (p.a)
II Australian Equity Income Fund	–3.6%	20.1%	10.9%	11.3%	6.9%
S&P ASX 200 Accumulation Index	–6.4%	9.4%	3.0%	9.8%	7.5%
Excess to Benchmark	2.8%	10.7%	7.9%	1.5%	–0.6%

Inception (S.I.): 18 Jun 2018

Fund overview

The Intelligent Investor Australian Equity Income Fund (ASX:INIF) is a concentrated portfolio of 10-35 Australian listed stocks. The Fund focuses on large, mature businesses with entrenched competitive advantages, and dominant smaller companies we believe will produce strong cash flows to support dividends in the future.

5+ yrs
Suggested investment timeframe

10 - 35
Indicative number of securities

Risk profile: High
Expected loss in 4 to 6 years out of every 20 years

S&P/ASX 200 Accumulation Index
Benchmark

Investment Fee
0.97% p.a.

Performance Fee
Nil

While large components of the current high inflation prints will be transitory, once wages start increasing it becomes entrenched, as wages don't usually fall. The more entrenched inflation becomes, the higher interest rates will need to go.

Stock updates

Company specific news is always light in January while people are on holiday in anticipation of reporting season in February.

But after the market closed on 31 January, **360 Capital** announced a long list of very positive deals. The upshot, assuming they all complete as expected, is that the company's net asset value will increase to one dollar compared to a stock price of 78 cents at month end.

The stock jumped 9% the following day, as you would expect when the company expects full year earnings of 16-17 cents and a six cent, fully franked dividend. Yet the stock remains extremely cheap. At the time of writing you can buy the company's net assets at a 14% discount and you get the funds management business and excellent management for free.

Credit Corp also confirmed its annual forecast which included more ledger purchases than previously expected. Given benign credit conditions over the past year, investors had worried that fewer bad debts would sink earnings.

Credit Corp's management is never idle, though, and has made some intelligent decisions recently to keep revenue ticking over, including the acquisition of Radio Rentals' debt ledger. Credit Corp should be one of the few genuine beneficiaries of higher interest rates.

Frontier Digital Ventures released its latest quarterly results for the final quarter of 2021. In summary, the business is performing well with rapid revenue growth across the board. Essentially every business aside from the recent acquisitions is at least breaking even, which is a key milestone for these types of businesses.

Profits should grow rapidly beyond breakeven, as online property classifieds businesses assert their dominance with minimal reinvestment needs. Excluding recent acquisitions, for example, Frontier's overall operating profit margin would've been 10%, up from breakeven around a year ago.

It will likely by next year before the company reports earnings per share (partly due to the different ownership percentages), which is what typically drives the share price over the long term. But we're delighted with the company's recent progress.

Outlook

The recent volatility is only the beginning. After nearly four decades of falling interest rates, the market isn't going to adjust to increasing interest rates in one month.

The number of profit downgrades is growing rapidly, and the bubbles in unprofitable tech companies are popping. We're starting to get excited about cheaper valuations, but we know from experience that it will likely take years for the market to adjust to tectonic changes like increasing interest rates from zero after four decades of falls.

It's vital that we don't lock in mediocre returns from premature accumulation, to quote Bruce

Berkowitz. We like what we own. The stocks are cheap and highly profitable, with big increases expected in profits and dividends from the smaller names and those impacted by COVID.

It took over a year before the market finally succumbed to the GFC. The market has only begun to adjust to higher interest rates. While we're expecting the global economy to remain relatively healthy, the types of stocks that will do well from here will be very different to what has done well recently. We've been adapting for a while and believe the next five years will be much kinder to active value managers.

The patience to wait for the right prices is all we need right now, and we look forward to increasing the potential return of the portfolio as optimistic valuations crash back to earth.

Please get in touch if you have any questions on **1300 880 160**
or at
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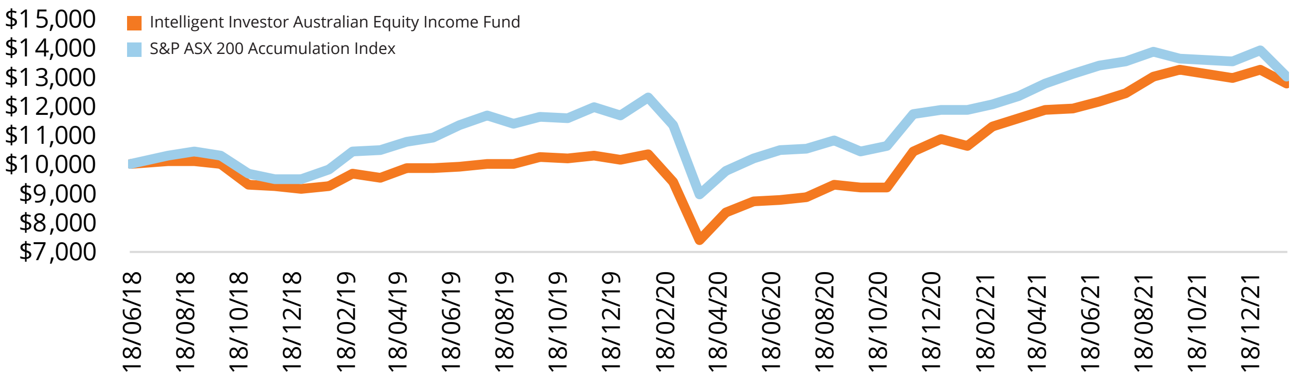
Performance since inception



Inception: 18 Jun 2018

Asset allocation

Financials	22.2%
Materials	21.9%
Consumer Discretionary	16.4%
Information Technology	9.4%
Real Estate	8.2%
Cash	5.1%
Consumer Staples	3.6%
Energy	3.4%
Industrials	2.9%
Health Care	2.8%
Utilities	2.4%
Communication Services	1.8%

Top 5 holdings

BHP Group (BHP)	10.2%
RPMGlobal (RUL)	5.4%
Woodside Petroleum (WPL)	5.0%
Star Entertainment Group (SGR)	5.0%
Crown Resorts (CWN)	4.1%

Important information

All tables and chart data is correct as at 31 January 2022.