

Intelligent Investor Australian Equity Income Fund

(Managed Fund) (ASX:INIF)

“We are built with an almost infinite capacity to believe things because the beliefs are advantageous for us to hold, rather than because they are even remotely related to the truth.” — Dee Hock

“If you don’t care whether you are rational or not, you won’t work on it. You will stay irrational and get lousy results.” — Charlie Munger

“Patience can be learned. Having a long attention span and the ability to concentrate on one thing for a long time is a huge advantage.” — Charlie Munger

In a recent [blog post](#), Cole Smead explains how Warren Buffett’s investing approach has mimicked the style of poker player Andy Beal who challenged a player’s ability to adapt.

Buffett’s early career was spent finding statistically cheap stocks known as cigar butts, looking for one last puff. Then, in 1998, Buffett invested heavily in Coca Cola.

‘He was criticized at the time for paying for what in the 1980s was a nosebleed high-teens P/E (price-to-earnings) multiple. The value crowd was following what he did, but as the flop came out on this hand, they didn’t know how to read his play.’

Performance (after fees)						
	1 mth	3 mth	1 yr	3 yrs p.a	5 yrs p.a	S.I. p.a
II Australian Equity Income Fund	6.4%	7.1%	16.0%	6.0%	9.0%	7.5%
S&P ASX 200 Accumulation Index	3.0%	7.8%	21.8%	8.4%	8.4%	9.2%
Excess to Benchmark	3.4%	-0.7%	-5.8%	-2.4%	0.6%	-1.7%


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

Back then, the value crowd coveted low statistical valuations, but eventually they adapted realising the superiority of buying quality companies that can reinvest their profits at high rates of return for decades.

Rhyming with the Nifty-Fifty episode in the 70s, the market has currently taken that approach to extremes, making the anxiety of paying high-teen multiples during the eighties and my early career laughable by today's standards.

I remember when recommending **CSL** and **Cochlear** as Buys in our subscription business at 17x earnings was a big deal, and now **Commonwealth Bank** trades for 25x with measly growth.

The big banks are an aberration in this group given their virtually non-existent growth prospects, but the key point is that what's worked recently isn't going to work anywhere near as well over the next decade. Buffett is adapting by buying oil company **Occidental Petroleum** and selling **Apple**.

We agree with Cole's conclusion that 'the future winning hands look cheaper and more cyclical but provide attractive returns on capital.'

An unlikely bubble

We've endured extreme pricing in all four major index components since I rejoined *Intelligent Investor* in 2018.

The A-REITs' dream run was felled by higher interest rates in 2021, CSL's share price remains below its peak nearly five years ago after becoming 10% of the index, the iron ore majors rallied four or five times before finally capitulating recently, and now it's the banks setting ominous records led by Commonwealth Bank reaching 10% of the index given **BHP's** and **CSL's** performance since they recorded the feat.

Several growth stocks also deserve mention, but as we've owned some and they're not a

third of the index like the banks they haven't impacted our relative performance anywhere near as much. But like every other bubble, it won't last.

In fact, at the end of the quarter the market started rewarding value in unpopular areas, such as small and mid-cap stocks and resources stocks where the fund is tilted.

We hope the early oughts in the US are instructive, when large caps trod water for six years while small cap value stocks increased 16% per year.

Performance

The fund increased 7.1% for the quarter, slightly trailing the market's 7.8% despite banks trading at record valuations, as we discussed in last month's report.

Bubbles are normally reserved for over-hyped growth stocks in rapidly changing industries, but this time it's a tidal wave of hot money escaping exposure to China heightened by the rise of passive funds.

If you own these stocks, make sure you cash in before the tide turns. We never expected bank valuations to reach these dizzying heights, and they'll become a long tailwind for our performance again soon enough if the process hasn't started already given China's latest stimulus measures.

We highly recommend reading last month's letter, which includes analysis of **Mineral Resources** and **RPM Global**, which is benefitting from inclusion in the ASX300 index. This month let's focus on recent portfolio changes and reporting season.

Portfolio Changes

This quarter we've been replacing some big winners with more defensive, cheaper staples.

Pinnacle Investments has possibly been the fund's best investment returning multiples of what we paid with fully franked dividends that have grown about 50% per year. Pinnacle is the perfect example of what we look for in the fund.

We thank Ian Macoun and his staff for their wonderful job building a business that can grow much bigger yet. But the current share price offers little protection against falling performance fees, so we cashed in and will wait patiently for the next buying opportunity.

We also sold **Wesfarmers** after its valuation soared like a tech stock's. The returns were far higher than we could've hoped in the short time we owned it, and for once our selling was perfectly timed.

We also took some profits on a bunch of big performers and reestablished positions in staples **The Lottery Corporation**, **Woolworths**, and **Endeavour** while increasing our holding in **Infratil**, whose data centres look cheap next to those recently sold by AirTrunk.

Reporting season

BHP continues to mint money at lower iron ore prices but cut its dividend to invest, particularly in copper. We took profits at higher prices earlier in the year, but more recently it's the company's expensive ambitions including the \$74bn failed bid for Anglo American that warrants attention.

BHP has been lauded for its financial discipline in recent years given the company's wasteful past, which has fuelled high dividends with help from high iron ore prices. But judging by BHP's recent moves and those across the resources industry, the future is less profitable and more expensive.

We waited five years for our underweight position in the iron ore majors to pay off, only to be partially offset by Mineral Resources and our coal stocks which rebounded after China

announced economic stimulus measures and good results from **Newhope Coal**.

MA Financial's share price is finally showing signs of life after treading water for two years. If its MA Money lending business continues growing, financial markets remain calm and corporate activity recovers, profits could increase 50% by 2026.

On a price-to-earnings ratio of 20, which seems mundane compared with current bank valuations, the stock would nearly double. The company's shareholder friendly dividends will hopefully make this Pinnacle 2.0.

ResMed's share price has gone from strength to strength as confidence increases that new weight loss drugs may help increase sleep apnoea diagnosis. For the first time in many years **Telstra** could increase its dividend sustainably under impressive new CEO Vicky Brady, and **Sonic Healthcare**'s share price seems to have finally settled now that the abnormal profits from Covid have washed through.

We reintroduced New Zealand fibre owner **Chorus** to the portfolio in anticipation of a favourable regulatory review, which worked out perfectly. The increased profits from the favourable review will underpin healthy dividends as the company's massive investment in its network morphs from cash consumer to generator.

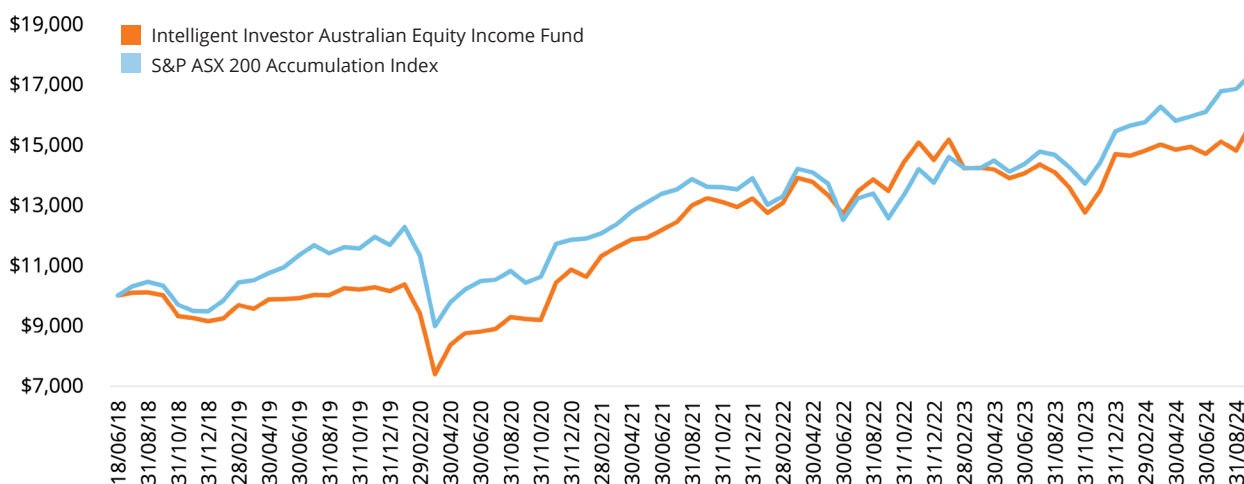
Lastly, **Aussie Broadband** finished the quarter up 10% after initially falling 20%. Concerns around growth and the cost of a new, cheaper service that requires investment were forgotten as the company reported another good set of numbers.

Please get in touch if you have any questions

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Performance since inception



Inception (S.I.): 18 Jun 2018

Asset allocation

Materials	22.2%
Information Technology	16.3%
Health Care	13.7%
Consumer Discretionary	10.4%
Energy	9.5%
Communication Services	7.4%
Consumer Staples	6.9%
Financials	4.8%
Utilities	4.2%
Cash	3.7%
Real Estate	0.8%

Top 5 holdings

RPMGlobal Holdings (RUL)	8.4%
BHP Group (BHP)	7.8%
New Hope Corporation (NHC)	6.6%
CSL (CSL)	5.7%
Mineral Resources Limited (MIN)	5.3%

Fund Stats

Distribution Yield	1.9%
Net asset value	\$2.93

Important information

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All tables and chart data is correct as at 30 September 2024