31 August 2020

Monthly Update

InvestSMART Capped Fee Portfolios

With portfolio manager Evan Lucas

The Monthly Musing:

August, devil in the (earnings) detail

'Results ex-COVID' – what a buzz term. August is always a month of excitement for us market watchers as firms lay bare their 'dirty full year earnings laundry', and last financial year was dirty as they come when you look at the decline in earnings from a year ago. Interestingly enough, when compared to consensus forecasts results ex-COVID were in the main, better than expected.

If we look at the overall report cards of the ASX and most international markets, particularly the S&P 500, there were more beats than misses. Now there is a huge caveat here: COVID-earnings forecasts were, in some cases, 'scorched earth' forecasts, so beating them was not that hard. But, in the main, the August earnings season showed that firms, and by extension markets, are not only surviving but actually thriving in some instances.

Those instances can be categorised into market themes, themes that were almost universal across developed markets.

The themes included:

1. Social distancing equals isolated driving.

Across Australia and most developed nations, there has been a marked increase in consumers using private cars rather than public transport. They are also using private cars over flying. Europe saw increased international driving trips over flights, the US has seen an increase of interstate trips by car and Australians are driving to their desired destinations over flying as well. Auto-exposed stocks performed very well in August and the data suggests this consumer behaviour is likely to hold for the foreseeable future, as social distancing looks to be here to stay for at least the next 12 months.

2. Pandemic restrictions lead to pandemic consumption.

E-commerce, omni-channel, buy now pay later and logistics have all been huge winners from the COVID-19 world. The acceleration (at almost warp-speed) to online retailing and services has never been more telling as firm results attest too.

But it's more than this. In the six months to August 31, online sales as a percentage of total consumption increased from 20 per cent to 26 per cent. That might not sound like much but when you consider it has taken over 30 years (yes online selling started in the 80s) to get to 20 per cent, a 30 per cent increase in six months suggests structural change is afoot for online and those exposed to it. The S&P 500 was the best example of this, with the likes of Amazon showing incredible demand growth above and beyond what it was already achieving.

3. Working from home (WFH): socially embraced but 'front-loaded'.

Office and retail furniture providers boomed as the world's workforce was ordered home. Upgrading the home office after receiving government stimulus created a boon in the last months of the financial year for providers. However, the COVID-new rolling updates from firms (rather than the typical half or quarterly forecasts) paints a picture of a spending cliff because once you have upgraded and the government stimulus packages slow down, upgrading your WFH office is no longer required. This might explain why these sectors that showed great FY20 numbers lagged, as the rolling updates point to a different picture for future earnings.

There were also some Australian specific themes too.

4. Housing: If we are WFH, we want more space and better rates.

Interestingly enough, the COVID crisis has actually been a positive for housing-exposed sectors. Three main reasons for this: First, the RBA slashing the cash rate to 0.25 per cent and basically saying they won't increase rates for at least five years. Second, more government stimulus, buzz termed the 'HomeBuilder' program. Third, the desire for more space as we WFH, and we spend more time and money at home.

The economic releases around residential construction and spending beat analysts' expectations countless times over the past six months and August was no exception.

5. When in doubt spend your way out – A China motto.

China has made its intensions clear, its way out of the COVID economic crisis is to spend its way out (just like every other country around the world). Infrastructure and construction spending are booming in China which is leading to a thrust for industrial metals not seen since the 2013 peak.

Imports of iron ore into Chinese ports were the third highest on record behind the June and July figures. The three-month volume average of the June to August period is 20 per cent up on the same period last year and explains why iron ore is well above US$100 a tonne.

The advantage of this spending has both short and long-term outcomes. Short term, prices are up helping tax and economic revenues. Longer term, this kind of spending creates long-term jobs and wage growth which filters into the broader economy. Mining and material sectors are performing above expectations, as are construction and building product sectors, a theme that appears to be one for FY21 and FY22 as well.

The result of these themes saw the bulk of domestic and international equities performing strongly throughout August. Now we should point out that several countries experienced a second wave of COVID in August and that did drag on their respective markets – the prime example is Spain which saw its IBEX index falling 10 per cent in August. The second wave issues are likely to spill over into September and October.

But remember, our diversified portfolios are deliberately weighted across assets and geographies. This smooths out market issues that arise in one market or sector (e.g. the IBEX). Diversification also gives you exposure to 'positive issues' that arise in markets or sectors likes those mentioned in the themes above, the prime example here is the S&P 500 which added 4.02 per cent in August. The other advantage of the diversified portfolios is that the S&P 500 has a significantly higher weighting in the portfolios than the IBEX.

Our portfolios are designed to give you exposure to the markets you need with asset weightings that fit your risk profile. If 2020 and the COVID reporting season has taught us anything, it's that these designs continue to work, providing you solid and reliable growth but with the buffers in place to give you peace of mind when a COVID event comes along.

Keep safe.

Performance of the Capped Fee Portfolios

Diversified Portfolios

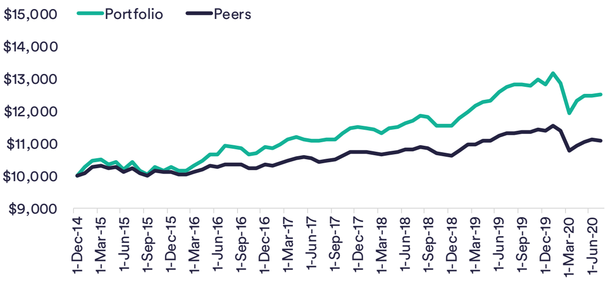
Individual capital performance of the securities held by the Diversified Portfolios, with weightings varying depending on risk appetite.

Conservative

Performance to 31 Aug 2020

	1 mth	6 mths	1 yr	3 yrs	5 yrs
Conservative Portfolio	1.1%	-1.5%	-1.0%	4.4%	4.4%
Morningstar Aus Msec Moderate TR AUD	0.8%	-0.3%	1.1%	5.4%	5.0%
Peers	0.6%	-1.2%	-0.5%	3.1%	3.2%
Excess to Peers	**0.5%**	**-0.3%**	**-0.5%**	**1.3%**	**1.2%**

Peformance of $10,000 since inception



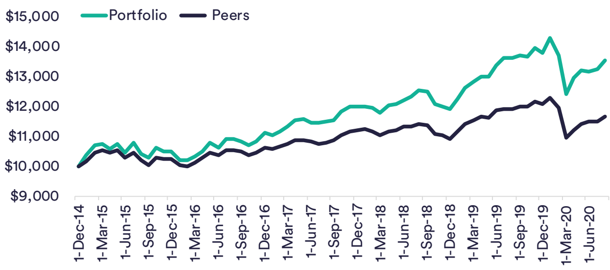
- With equities continuing to grow, the portfolio expanded 1.1 per cent after fees in August, beating peers by 0.48 per cent.
- All growth aspects attributed to the portfolio, with domestic equities (+0.36 per cent), listed property (+0.42 per cent) and international equities (+0.62 per cent) the biggest contributors.
- The yield on the Conservative Portfolio at the close of August was 2.34 per cent.

Balanced

Performance to 31 Aug 2020

	1 mth	6 mths	1 yr	3 yrs	5 yrs
Balanced Portfolio	1.9%	-1.3%	-0.7%	5.4%	5.2%
Morningstar Aus Msec Balanced TR AUD	1.7%	-0.6%	1.0%	6.8%	6.2%
Peers	1.3%	-1.4%	-0.7%	3.9%	4.3%
Excess to Peers	**0.6%**	**0.1%**	**0.0%**	**1.6%**	**0.9%**

Peformance of $10,000 since inception



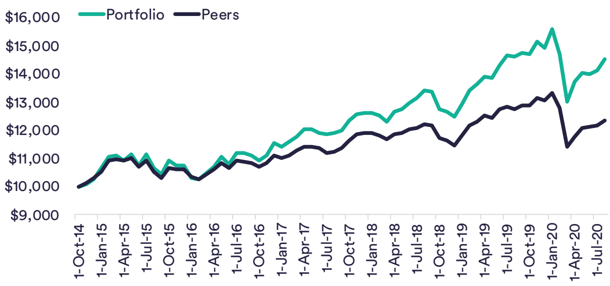
- With equities continuing to grow, the portfolio expanded 1.90 per cent after fees in August, beating peers by 0.60 per cent.
- All growth aspects attributed to the portfolio, with domestic equities (+0.67 per cent), listed property (+0.36 per cent) and international equities (+1.12 per cent) the biggest contributors.
- The yield on the Balanced Portfolio at the close of August was 2.67 per cent.

Diversified Portfolios

Growth

Performance to 31 Aug 2020					
	1 mth	6 mths	1 yr	3 yrs	5 yrs
Growth Portfolio	2.7%	-1.4%	-0.8%	6.6%	6.3%
Morningstar Aus Msec Growth TR AUD	2.4%	-1.3%	0.4%	7.6%	7.0%
Peers	1.9%	-1.9%	-0.7%	4.6%	5.1%
Excess to Peers	**0.8%**	**0.5%**	**0.1%**	**2.0%**	**1.2%**

Peformance of $10,000 since inception

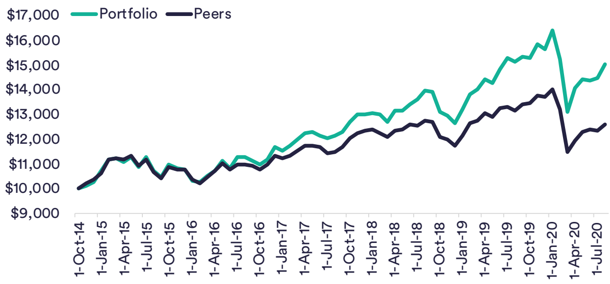


- With equities continuing to grow, the portfolio expanded 2.72 per cent after fees in August, beating peers by 0.86 per cent.
- All growth aspects attributed to the portfolio, with domestic equities (+0.85 per cent), listed property (+0.42 per cent) and international equities (+1.64 per cent) the biggest contributors.
- The yield on the Growth Portfolio at the close of August was 2.91 per cent.

High Growth

Performance to 31 Aug 2020					
	1 mth	6 mths	1 yr	3 yrs	5 yrs
High Growth Portfolio	3.7%	-1.1%	-0.3%	7.2%	6.9%
Morningstar Aus Msec Aggressive TR AUD	3.0%	-1.3%	0.9%	8.8%	8.1%
Peers	2.6%	-2.8%	-1.9%	5.3%	6.0%
Excess to Peers	**1.1%**	**1.7%**	**1.6%**	**2.0%**	**1.0%**

Peformance of $10,000 since inception



- With equities continuing to grow, the portfolio expanded 3.70 per cent after fees in August, beating peers by 1.10 per cent.
- All growth aspects attributed to the portfolio, with domestic equities (+1.12 per cent), listed property (+0.33 per cent) and international equities (+2.35 per cent) the biggest contributors.
- The yield on the Growth Portfolio at the close of August was 3.81 per cent.

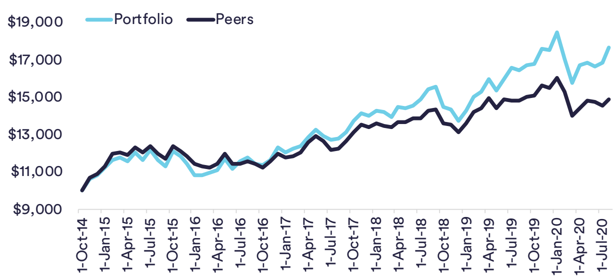
Single Asset Class Portfolios

International Equities

Performance to 31 Aug 2020

	1 mth	6 mths	1 yr	3 yrs	5 yrs
International Equities					
MSCI World Ex Australia NR AUD					
Peers					
Excess to Peers					

Peformance of $10,000 since inception



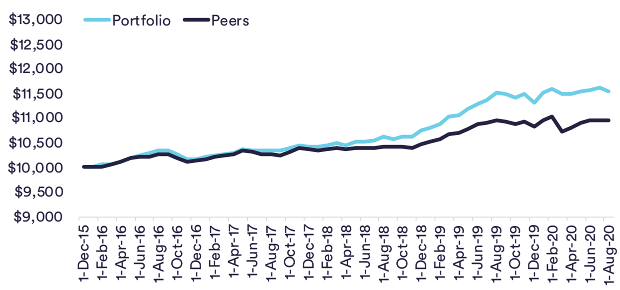
- The portfolio expanded 4.70 per cent after fees in August as the International Portfolio beat peers by 2.22 per cent.
- S&P 500 (IVV) attributed +2.23 per cent, European equities (VEQ) attributed +0.2 per cent while the global holding VGS attributed +2.11 per cent.
- All facets of the portfolio contributed to performance.

Interest Income

Performance to 31 Aug 2020

	1 mth	6 mths	1 yr	2 yrs	3 yrs
Interest Income	-0.5%	-0.4%	0.3%	4.2%	3.6%
Bloomberg AusBond Composite 0+Y TR AUD	-0.4%	0.3%	1.6%	6.3%	5.5%
Peers	-0.3%	0.3%	1.4%	5.2%	4.6%
Excess to Peers	**-0.2%**	**-0.7%**	**-1.2%**	**-1.0%**	**-0.9%**

Peformance of $10,000 since inception



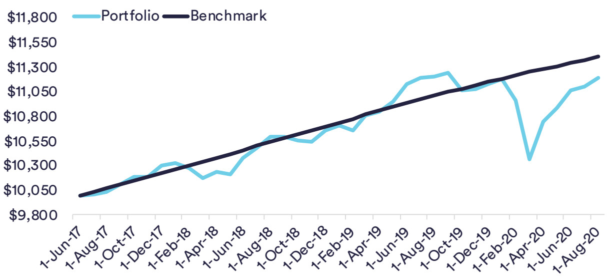
- The portfolio fell 0.52 per cent after fees in August as investors rotated out of fixed income.
- Treasuries detracted from performance, down 0.55 per cent while corporate fixed interest attributed 0.06 per cent while cash was flat.
- The yield on the Interest Income Portfolio sits at 2.89 per cent.

Single Asset Class Portfolios

Hybrid Income

Performance to 31 Aug 2020	1 mth	6 mths	1 yrs	2 yrs	3 yrs
Hybrid Income	0.8%	2.1%	0.2%	3.1%	3.9%
RBA Cash Rate + 3%	0.3%	1.6%	3.6%	4.0%	4.2%
Peers (BetaShares Austr Hybrid Fund)	0.4%	0.0%	1.1%	2.3%	2.0%
Excess to Peers	**0.4%**	**2.1%**	**-0.9%**	**0.8%**	**1.9%**

Peformance of $10,000 since inception

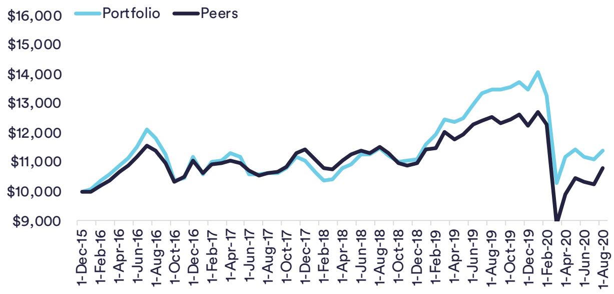


- The total portfolio return was 0.80% for the month including franking credits. The estimated running yield is approximately 5.0%, and estimated yield to call/maturity is 5.00% including franking credits.
- The total portfolio return was 2.74% and 0.18% for the quarter and 12-month periods respectively. Since inception the total portfolio return is 3.78% including franking credits, which is -0.45% under its return objective of the RBA Cash rate plus 3%.
- There were no transactions in the portfolio during the month.
- The RBA maintained the cash rate at 0.25%, with the prices of cash futures predicting it to remain in a narrow range until the end of 2021.
- One security in the portfolio paid a distribution in August - NABHA.
- At end of August the portfolio had a 3.10% allocation to cash after investing capital in existing positions.

Property and Infrastructure

Performance to 31 Aug 2020	1 mth	6 mths	1 yr	2 yrs	3 yrs
Property and Infrastructure	2.5%	-13.8%	-15.2%	-0.4%	2.3%
A Composite Benchmark	1.0%	-14.7%	-14.8%	-1.4%	2.9%
Peers (BetaShares Legg Mason Real Income Fund)	7.6%	-15.7%	-17.3%	-1.5%	3.4%
Excess to Peers	**-5.1%**	**1.9%**	**2.1%**	**1.1%**	**-1.1%**

Peformance of $10,000 since inception



- The portfolio contracted 2.48 per cent after fees in August.
- Domestic property attributed 2.27 per cent, international infrastructure attributed 0.33 per cent and international property attributed 0.32 per cent. TCL detracted 0.27 per cent while APA and AGL detracted 0.18 per cent each.
- The yield on the Property and Infrastructure Portfolio sits at 3.83 per cent.

For more information on our Diversified Portfolios, click here.

investsmart.com.au/invest

1300 880 160

Important information