Intelligent Investor Equity Income Portfolio & ASX:INIF

Monthly Update - February 2019

PERFORMANCE TO 28 FEB 2019	1 mth	3 mths	6 mths	1 yr	2 yrs (p.a.)	3 yrs (p.a.)	Since Inception (p.a.)
Intelligent Investor Equity Income	4.74%	4.92%	-4.05%	-0.78%	5.74%	9.89%	8.90%
InvestSMART Australian Equity Income Fund (Managed Fund)(ASX:INIF)	4.76%	4.67%	-4.12%	-	-	-	-3.11%
S&P/ASX 200 Accumulation Index	5.98%	9.95%	-0.26%	7.05%	8.57%	12.91%	8.08%
Excess to Benchmark*	-1.24%	-5.03%	-3.79%	-7.83%	-2.83%	-3.02%	0.82%

‘Our valuation and size today are much more based on our energy and spirituality than it is on a multiple of revenue.’ **- WeWork CEO, Adam Nuemann.**

‘Many shall be restored that now are fallen and many shall fall that are now in honor.’ **- Horace.**

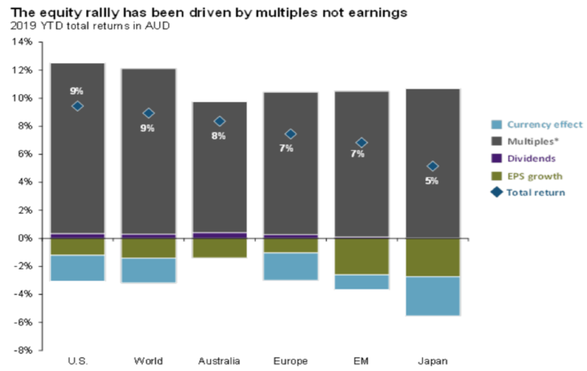
Key points

- **Market favouring hyper-growth stocks**
- **Sold remaining low-quality businesses**
- **Replaced with higher quality stocks**

The market has continued to bounce back after December’s falls, but it’s the handful of hyper-growth stocks that are rallying hardest. They also delivered exceptional operating results during reporting season.

More broadly, reporting season was a mixed bag. Most of the market’s returns this year have come from investors willing to pay more for the same dollar of earnings. You can see how increasing price-to-earnings ratios (PERs) have outpaced the other more sustainable components of returns in Chart 1.

Chart 1: The equity rally has been driven by multiples not earnings

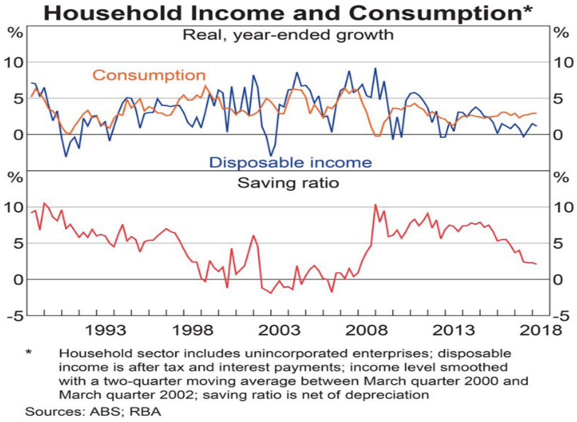


Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management. *Multiple expansion is based on the forard price-to-earnings ratio. Chart is for illustrative purposes only. Past performance is not indicative of future results. *Guide to the Markets - Australia.* Data as of 20 February 2018.

This means the market has become riskier, particularly given earnings growth is becoming harder to come by. Weak results from **Coles** and **Woolworths**, combined with the

*Excess to Benchmark refers to the Intelligent Investor Equity Income Portfolio recent collapse in Australia's savings ratio.

Chart 2: Household Income and Consumption



Although selling groceries is a stable business, shoppers can save money by focusing on sales, buying more generics, shopping less frequently and avoiding treats. This means lower sales volumes and lower margins for Coles and Woolies. If this is how people are currently behaving at the supermarket, imagine what it means for the broader economy if property prices keep falling.

Portfolio changes

During February we sold mining titan **BHP**, as its share priced increased. It's been an excellent investment but it's benefitting from a high iron ore price, which isn't likely to last. We also sold **Trade Me**, as a superior bid for the company seems unlikely.

Shopping centre owner **Scentre** and **Newscorp** were sold as they reached fair value. **Ovato** (formerly PMP Limited) was also sold, as it's an inferior business that has dragged on performance.

Crown Resorts was also reduced to make way for **Tabcorp.** Although they're both exposed to discretionary betting, through the acquisition of Tatts Group, Tabcorp now owns a very attractive lottery business that should be more stable than wagering.

Tabcorp operates nearly 4,000 lottery outlets where the switch to online purchases will reduce the cut of online distributor **Jumbo Interactive** and newsagents to increase profit margins. According to Morgan Stanley, the digital share of lottery revenues has increased from 6.6% in 2012 to 17.7% in 2018 i.e. 3% per year and increasing.

Tabcorp's wagering business should also regain market share as a tax change levels the playing field with its online rivals. This, and steady growth in its online lottery business, will help grow its starting 4.5% dividend yield.

We also bought **Amcor**. After recently acquiring Bemis, it's now the world's largest flexible packaging company.

Amcor only grows slowly, but now with EU approval to acquire Bemis it can cut costs, reduce debt, and increase earnings and dividends for a total return of at least 9-10% p.a. Having global exposure, stable end markets and the opportunity to create value through the acquisition of Bemis, adds ballast to the portfolios to help support more cyclical exposures, such as **SEEK**.

Link Administration has been growing by acquisition (it has integrated 40 businesses over 15 years) and is now a dominant player in the global fund administration industry. The share price has been under pressure due to concerns surrounding the productivity commission's superannuation report and Federal budget and policy changes should Labor win government.

These issues have already been factored into the share price. Its forecast PER of 16 is similar to the market multiple, yet it's a far better than average business. Higher interest rates may also help earnings, and there are still plenty of costs to cut from the LAS acquisition. Its 44% stake in digital real estate transaction business PEXA, which has cost nearly $800m to develop, isn't turning a profit yet, either. But it's clearly a valuable asset.

The large amount of accounts Link manages for REST remains a risk given Link is a high fixed-cost business, but the company's global expansion and low valuation provide some protection. Fortunately, chief executive John McMurtrie is taking this issue seriously having taken over the head of funds administration role after losing the CareSuper contract (250k of Link's 10m accounts).

We also bought a stake in fast-fashion jewellery company **Lovisa**. Although it reported a 1.8% fall in same-store-sales in Australia, it's busy hiring staff to find leases in the US where management has big expansion plans. If management succeeds in the US and elsewhere, as retail billionaire and 41% shareholder Brett Blundy believes it will, then its value could increase by multiples.

We'll dig deeper into several key holdings in next month's quarterly.

PORTFOLIO HOLDINGS

ASSET ALLOCATION

Sector	Weighting
Financials	21.94%
Consumer Discretionary	17.87%
Cash	13.22%
Real Estate	12.87%
Industrials	12.43%
Consumer Staples	7.94%
Information Technology	4.18%
Materials	3.93%
Energy	3.56%
Health Care	2.07%

TOP 5 HOLDINGS

Security	Weighting
Commonwealth Bank	8.52%
Westpac Banking	6.42%
Sydney Airport	4.87%
Seek	4.84%
Lovisa Holdings	4.52%

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 28 February 2019. 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.

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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 Income Portfolio is a concentrated portfolio of 10 - 35 Australian-listed stocks, focused on generating income while still achieving capital growth. The Portfolio 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.

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 Income 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

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