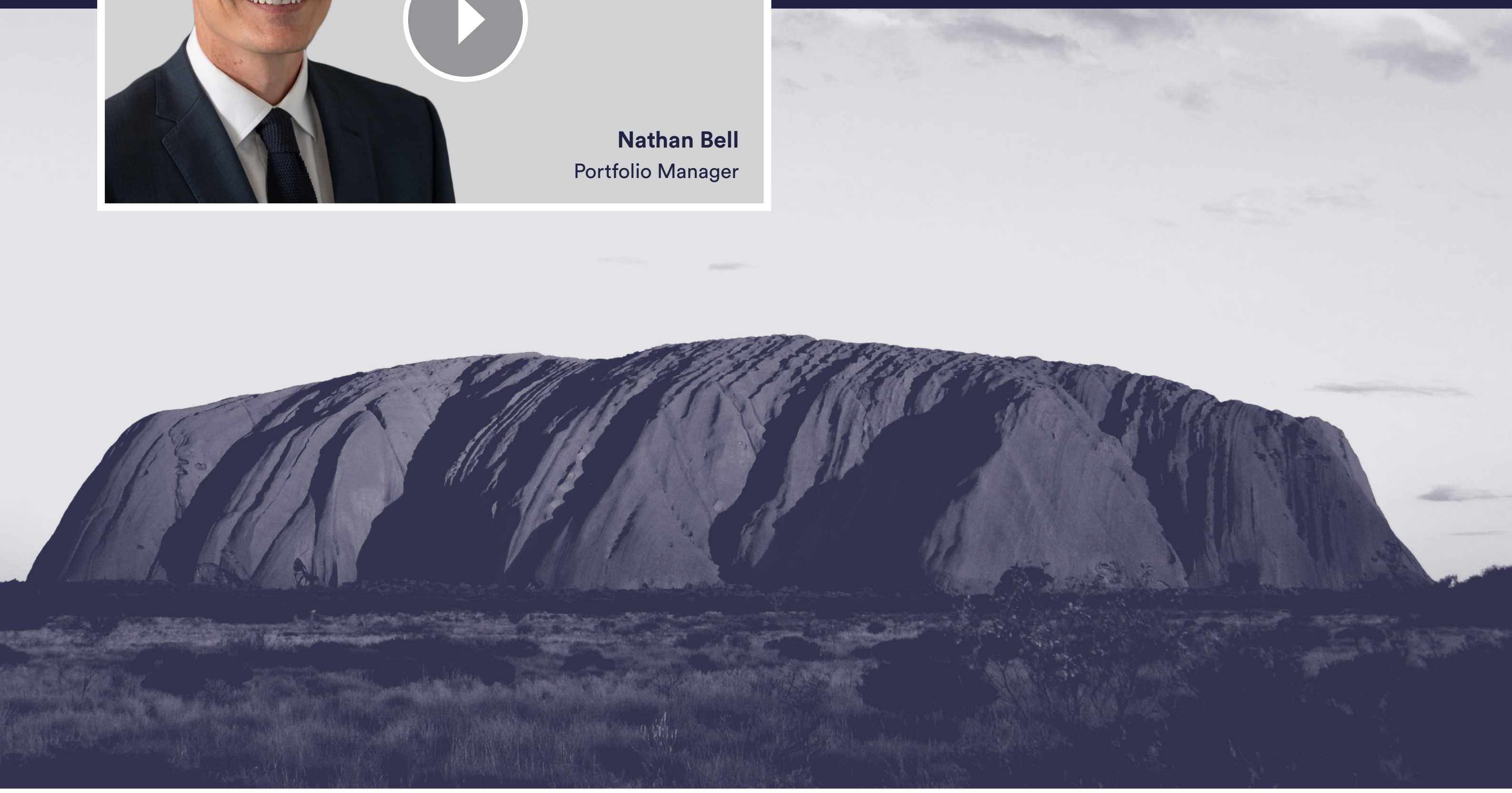
Intelligent Investor Equity Growth Portfolio

Quarterly Report

30 JUNE 2019

- Top 20 stocks unlikely to repeat recent performance
- Good announcements from 360 Capital
- Turnover back to normal levels since February



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Intelligent Investor Equity Growth Portfolio

PERFORMANCE TO 30 JUNE 2019 (AFTER FEES)	1 MTH	3 MTHS	6 MTHS	1 YR	2 YRS (P.A.)	3 YRS (P.A.)	4 YRS (P.A.)	S. I. (P.A.)
Intelligent Investor Equity Growth	0.40%	5.68%	12.56%	2.99%	5.86%	8.17%	9.14%	9.14%
S&P ASX 200 Accumulation Index	3.70%	7.97%	19.73%	11.55%	12.28%	12.88%	9.66%	9.66%
Excess to Benchmark	-3.30%	-2.29%	-7.17%	-8.55%	-6.42%	-4.71%	-0.52%	-0.52%

'Abraham Lincoln once posed the question: "If you call a dog's tail a leg, how many legs does it have?" and then answered his own query: "Four, because calling a tail a leg doesn't make it one." Abe would have felt lonely on Wall Street.' – **Warren Buffett**.

'The mind of man at one and the same time is both the glory and the shame of the universe.' – **Blaise Pascal**.

'If everything you do needs to work on a three-year time horizon, then you're competing against a lot of people. But if you're willing to invest on a seven-year time horizon, you're now competing against a fraction of those people, because very few companies are willing to do that. Just by lengthening the time horizon, you can engage in endeavours that you could never otherwise pursue. At Amazon we like things to work in five to seven years. We're willing to plant seeds, let them grow-and we're very stubborn. We say we're stubborn on vision and flexible on details.' – **Jeff Bezos, 2011**.

If you'd told me at the beginning of the year that our top six performers would produce an average return of 48% then I would've expected the portfolio to at least return 12%, if not much more.

Unfortunately, mistakes including **IOOF**, **AMP** and **Thorn Group**, which were sold, and a string of profit downgrades, have offset the good performances. In between there's also a long list of fairly valued stocks that have been sold, while their replacements haven't had time to prove themselves.

There's only one thing worse than losing money in the stock market, and that's seeing others making more. That describes our financial year. Despite a lot of hard work, the portfolio increased 3.0% while the index produced an 11.6% return.

It was a tale of two halves, with the index increasing almost 20% this calendar year after producing the worst December quarter since the GFC. Our portfolio increased 13% over the same period, but the silver lining is that we can turn the deficit around quickly given our returns are often lumpy.

The iron ore majors, including **BHP**, **Rio Tinto** and **Fortescue**, which constitute a mammoth 18% of the index, had a phenomenal year that won't repeat. **Commonwealth Bank**, **Newcrest Mining**, **CSL** and **Telstra** also performed well.

In summary, the top 20 stocks that comprise almost 60% of the index had an exceptional period, with the average return from each stock reaching almost 20%. But given their huge size, and the bubble building in perceived safe stocks, the performance is unlikely to repeat.

To show you how confused and desperate parts of the market have become, let's examine two examples. First, the gold price has soared, particularly in Australian dollars as the currency has fallen due to falling interest rates that signal a weakening economy. Yet, despite lower interest rates also crunching bank profit margins, bank share prices have also increased. Eventually this conflict must be resolved.

There's also a bubble in many stocks showing rapid revenue growth, judging by the nonsense being used to justify valuations. Take one bank's recent commencement of coverage of a stock we recommended way back in 2014, **Nanosonics**, which we sold a few months back due to its hefty valuation.

Despite forecasting earnings of just 10 cents per share in 2023 for a price-to-earnings ratio of 65 in four years' time, the analyst justified half this eye watering valuation on products that haven't even been announced yet. Bear in mind that the company's novel Trophon device used to disinfect probes has taken a decade to produce a small profit.

While the market is currently consumed with perceived safe stocks and companies showing rapid revenue growth, of which we have a couple, we also own some hidden gems where the value is building but being completely ignored by the market.

Take **360 Capital**, for example. We explained the investment case in detail in our December quarterly. In summary, you were paying net tangible assets – which is mostly cash – and you were getting a fledgling funds management business and the excellent track record of insider-owner Tony Pitt for free.

Recently the company launched three small funds aiming to raise $25m each from yield hungry investors. Following that, Pitt announced a joint venture with successful telecommunications businessman David Yuile. Yuile led Nextgen Networks from 2014-15 before selling out in a deal that included **Vocus** and was chief executive of data centre operator Metronode prior to his departure in 2018. Yuile is renowned for turning around businesses and selling them at large premiums.

The US$250m fund will invest in all manner of modern telecommunications assets, such as data centres and telecommunications towers, designed to provide investors with a 10% annual return.

It should sell itself in an environment of falling interest rates. And given the subsequent announcement that it's likely to be separately listed on the ASX, it seems there's no shortage of interest. This is only the beginning for 360 Capital's funds management business, and you're not paying a cent for it at the current price.

360 Capital isn't a rare case. Investors are steering clear of small cap stocks generally, with the small companies index flat over the past year.

Selling from several small cap funds winding up is also likely weighing on some of our smaller value stocks. This trend won't last forever, either. As long as we keep our discipline and the value in our portfolio keeps building the market will eventually catch on, just like it's starting to with **Frontier Digital Ventures**.

Stock news

With the portfolio much more settled over the past quarter after an unusually large period of change, there haven't been any major changes recently other than selling **Crown Resorts** as it traded around fair value following interest from overseas acquirers.

Let's now look at some recent news for specific holdings, but as always please see past monthly and quarterly reports for more detail on the investment case for newer holdings.

"WHILE THE MARKET IS CURRENTLY CONSUMED WITH PERCEIVED SAFE STOCKS AND COMPANIES SHOWING RAPID REVENUE GROWTH, OF WHICH WE HAVE A COUPLE, WE ALSO OWN SOME HIDDEN GEMS WHERE THE VALUE IS BUILDING BUT BEING COMPLETELY IGNORED BY THE MARKET.

Clydesdale Bank is down a third from our average purchase price. In simple terms, our original investment case was that we believed a bank that could produce a return on equity of around 12% deserved a value above book value.

While the UK economy has held up reasonably well despite the Brexit mess, lower interest rates, intense competition selling mortgages, and doubts about the motivation and price chief executive David Duffy paid to acquire Virgin Money has sunk the bank's price-to-book value to just 0.6.

Duffy recently laid out the bank's three-year financial targets at an investor day. Along with rebadging Clydesdale Bank to Virgin Money, Duffy is aiming to produce a 12% return on equity. Were that achieved, the stock price would likely increase 50-100%, as it would be trading on a mammoth 9% dividend yield based on the current price.

> **"THE ABILITY TO CARRY OUT A LONG-TERM, CONTRARIAN INVESTMENT STRATEGY IS ONLY AS GOOD AS ITS CLIENT'S SUPPORT. WITHOUT IT, IT'S IMPOSSIBLE.**

Duffy's plan is to reduce the bank's reliance on mortgages and increase unsecured and business loans. Merging Clydesdale and Virgin Money gives Duffy a national footprint to offer an increasingly digital experience and Virgin's broader range of products, which will include a revamped loyalty program.

Duffy will also be cutting costs in line with the most efficient UK banks, which is what he's renowned for. The market is clearly sceptical, as some of Duffy's previous financial targets haven't been met. The usual risks of running a bank also apply. But given the low share price and the big increase in dividends expected in 2021 and 2022, we're remaining patient.

Following a profit downgrade that knocked 26% off **Link Administration**'s share price, the share price has fallen a further 10% due to Link's administration of Neil Woodford's UK funds. But rapid withdrawals following poor performance combined with many unlisted holdings caused a subsidiary of Link to halt redemptions.

The UK regulators are now investigating Link's actions, which included a dubious listing of some illiquid stocks. Whatever the outcome, it's unlikely to cost the company $300m as suggested by the market's reaction. Although the potential returns are nothing like when the share price of pokie manufacturer Aristocrat Leisure fell to two dollars per share in 2011, the situation feels similar. More unexpected bad news piled on top of bad news, that's unlikely to have long-term consequences.

The share price of Frontier Digital Ventures has been strong recently, but we'd like to see higher volumes traded based on rapidly improving profitability before getting excited. The selling that's dogged the share price since listing appears to be exhausted. Too many shares were given to investors hoping for a stag profit when it listed a couple of years back.

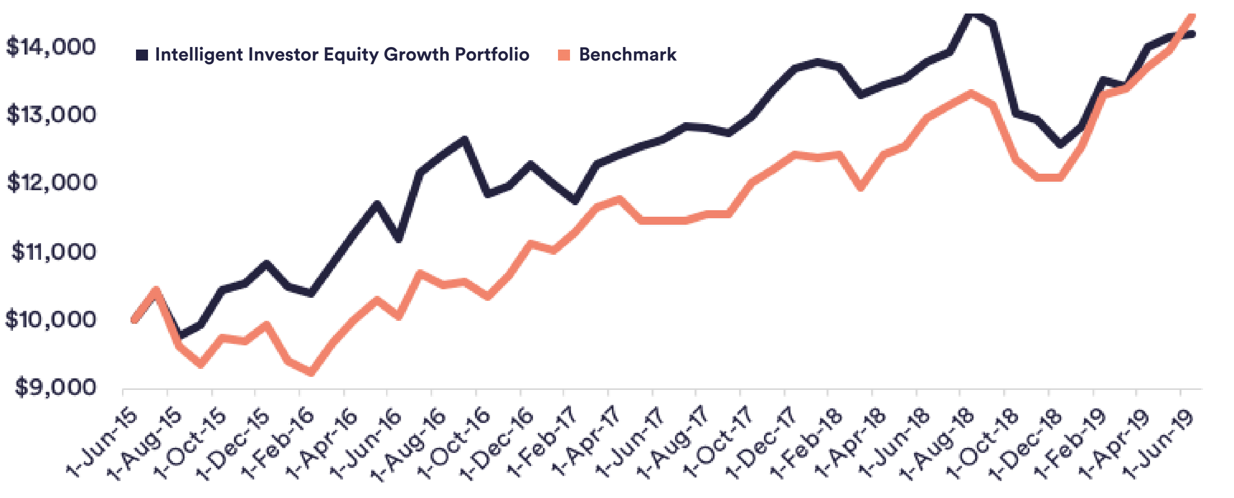
Also helping is a couple of respectable long-term investors recently joining the share registry and the recent announcement that Zameen, by far Frontier's largest investment, reaching breakeven with revenue doubling from a year earlier. The range of possible outcomes is wide, but it includes the share price increasing many times over if Zameen follows the success of online property classifieds businesses around the world include Realestate.com.au in Australia, Rightmove in the UK and 99acres.com in India.

The ability to carry out a long-term, contrarian investment strategy is only as good as its client's support. Without it, it's impossible.

Thank you for your support, and if you have any questions about the portfolio please call us on 1300 880 160 or email us at **support@investsmart.com.au**.

Kind Regards,
Nathan

PERFORMANCE OF $10,000 SINCE INCEPTION



ASSET ALLOCATION

Sector	Weighting (%)
Industrials	19.09
Consumer Discretionary	16.63
Information Technology	15.88
Financials	9.97
Communication Services	9.81
Real Estate	8.34
Cash	7.38
Health Care	6.76
Materials	4.12
Consumer Staple	2.02

TOP 5 HOLDINGS

Security	Weighting (%)
Frontier Digital Ventures	6.35
Audinate	5.95
Hansen Technologies	5.18
SEEK	5.18
Lovisa Holdings	4.89

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 June 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. Table 1 performance figures; after investment and admin fees, includes brokerage. Unit pricing taken at the end of each month.

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 achieve a return of 1% above the S&P/ASX 200 Accumulation Index per annum over five year rolling periods by investing in a diverse mix of Australian equities and cash.

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
0.97% p.a.

PERFORMANCE FEE
N/A

MINIMUM INITIAL INVESTMENT
$25,000

PORTFOLIO MANAGER
Nathan Bell, CFA

Important information

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