

InvestSMART Ethical Share Fund

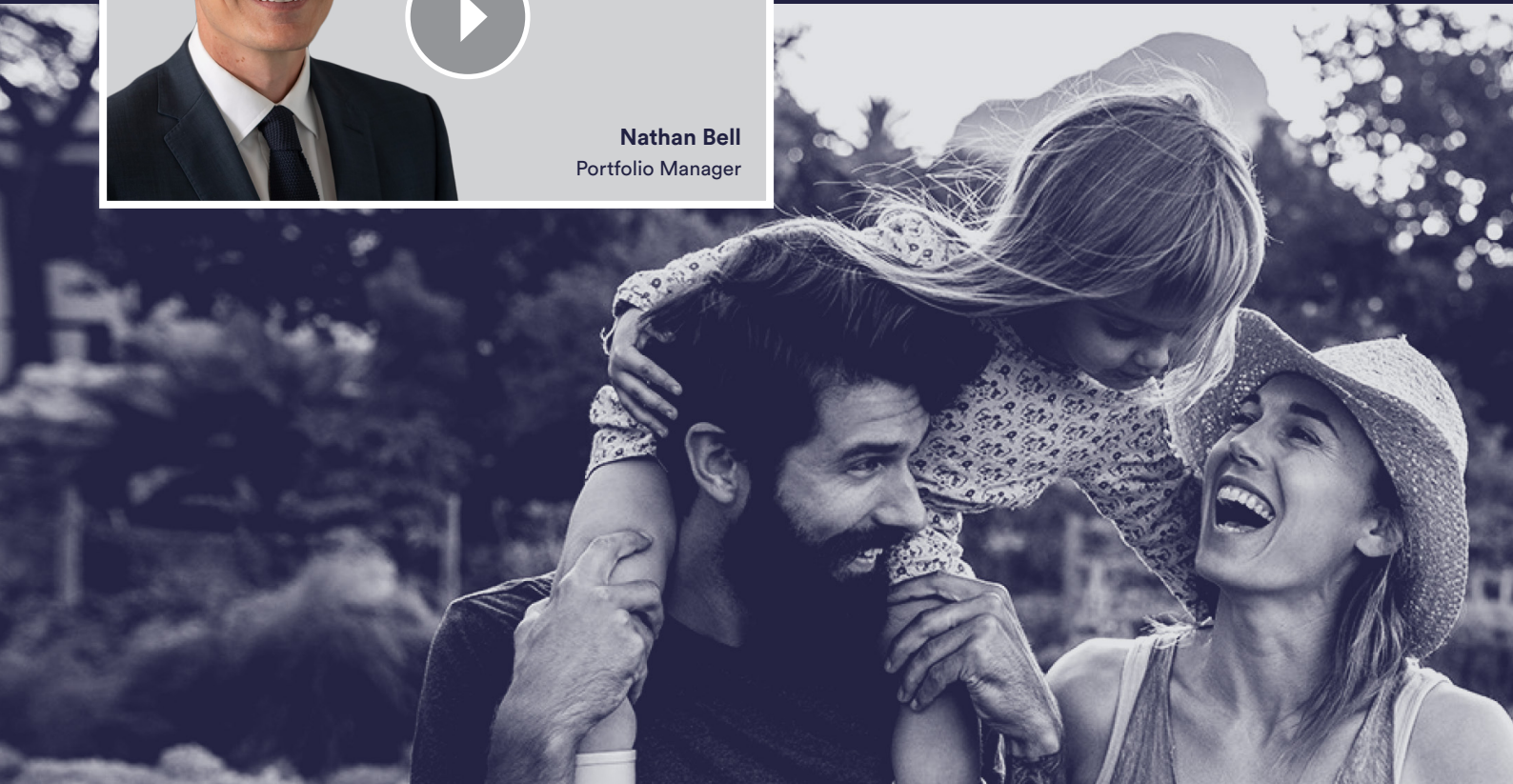
(Managed Fund) (ASX:INES)

Quarterly Report

30 SEPTEMBER 2019



- ✓ Performance matched the market
- ✓ Several changes in September
- ✓ Solid reporting season



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InvestSMART Ethical Share Fund

Quarterly Report – September 2019

PERFORMANCE TO 30 SEP 2019 (AFTER FEES)	1 MTH	3 MTHS	6 MTHS	1 YR	S. I.
InvestSMART Ethical Share Fund	2.3%	2.4%	N/A	N/A	1.2%
S&P ASX 200 Accumulation Index	1.8%	2.4%	N/A	N/A	3.7%
Excess to Benchmark	0.5%	0.0%	N/A	N/A	-2.5%

Sometimes you have to give things time, and sometimes you have to do things quickly and just take the band-aid off, and I think the art and the skill is probably knowing which is which.'

– Beverley McGarvey.

Nature does not ask your permission, she has nothing to do with your wishes, and whether you like her laws or dislike them, you are bound to accept her as she is, and consequently all her conclusions.

– Russian novelist Fyodor Dostoyevsky.

Risk is what's left over when you think you've thought of everything else.

– Carl Richards.

Old solutions for old problems

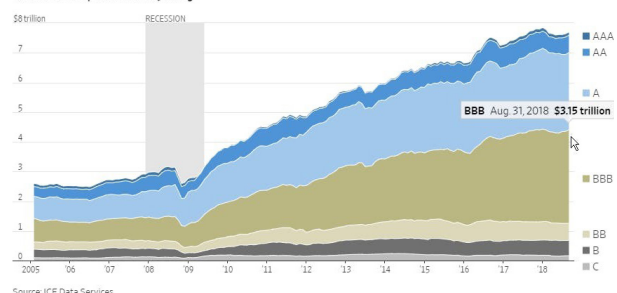
Low interest rates have boosted the stocks of perceived bond proxies, such as Transurban and Goodman Group, and companies with rapidly growing revenue, such as the WAAXA technology stocks. But this action seems tame compared with the shenanigans in the beating heart of the global financial system, the US credit market.

The following two charts show the explosion in triple-B rated bonds, which is essentially the lowest rung before becoming junk bonds, or non-investment grade bonds. Unlike the incredible metamorphosis that turns caterpillars into butterflies, there's no mystery to how triple-B bonds dissolve into junk bonds; too much debt, not enough cashflow.

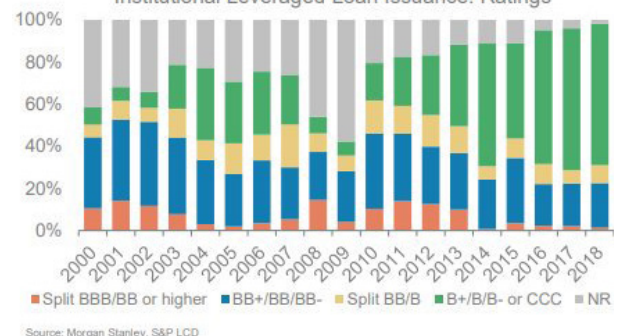
BBB My Baby

The explosion of corporate bonds since the last recession has been led by the lowest investment-grade rating, BBB.

Value of U.S. corporate bonds by rating



Institutional Leveraged Loan Issuance: Ratings



Jim Grant from Grant's Interest Rate Observer highlights one market where risky loans have reached bubbly proportions.

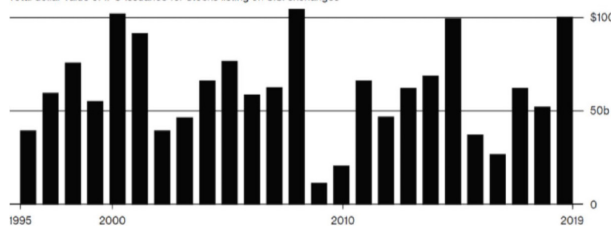
'...this provides a window into the ongoing private equity [PE] boom, as p.e. backed companies constitute 85% of the \$1.2 trillion loan market. As the post-crisis economic expansion continues into a record 112th straight month, p.e. has paid ever higher prices and tacked on more debt, with Bain Capital's 2019 Global

Private Equity Report finding that the average LBO [Leveraged Buyout] price rose to 10.9 times Ebitda last year, well above the 9.9 times seen in 2007, while leverage at p.e.-sponsored companies footed to 6 times Ebitda in 2018, compared to 4.9 times in 2007.'

As leverage is higher now than it was prior to the GFC, it's not surprising that insiders are dumping their shares.

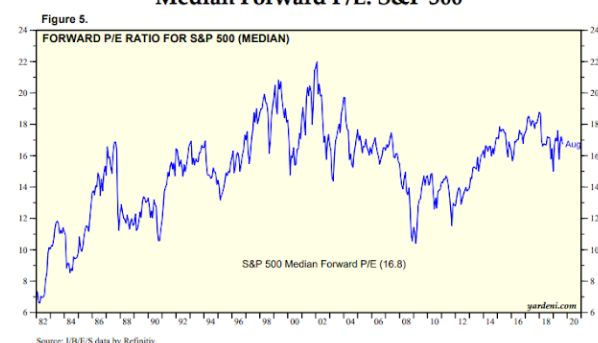
It Looks Like a Banner Year for IPOs

Total dollar value of IPO issuance for stocks listing on U.S. exchanges



The risky behaviour in credit markets is also pumping up valuations in the stockmarket. But the tide is not lifting all boats.

Median Forward P/E: S&P 500

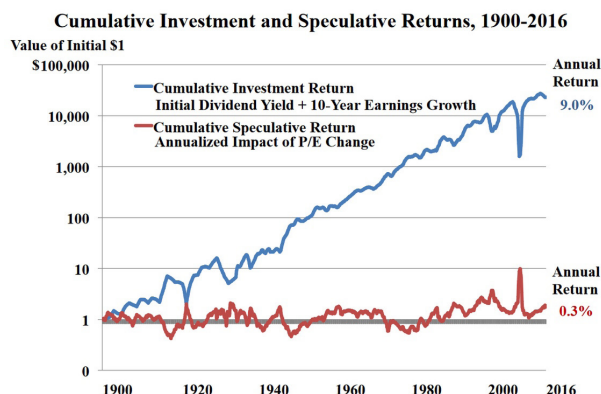


This is because the market is bifurcated much like it was in 1999, when tech stocks with no earnings were flying high while more traditional and much more profitable businesses were left trading on low multiples. In the following years value investors made fortunes while tech investors lost their shirts. Even investing legend Stanley Druckenmiller lost billions speculating on tech stocks having entered the market the day before the tech wreck began.

In the short-term share prices can swing wildly as price-to-earnings ratios reflect the fear and greed of investors. But in the long-term your returns will reflect growth in earnings and dividends, as the following chart shows.

The key message is as clear as it is simple. Stick to quality, don't get up in the hype, and if you've got lucky

owning some stocks whose valuations are currently in the stratosphere, lock in your profits.



Source: <https://johnnbogle.com/wordpress/wp-content/uploads/2016/10/Bogleheads-15-2016.pdf>

Portfolio changes

The fund's cash has increased to a third of the portfolio after we sold **Pushpay**, **Clydesdale Bank** and **Unibail-Rodamco-Westfield (URW)**. Pushpay's founders and largest shareholders have sold the vast majority of their stock recently so we followed them out the door. We suspect it's due to increasing competition, but we'll keep watching the business in case another opportunity arises.

We sold URW as our trust in URW's management has fallen along with the share price. URW has as much chance as any retail landlord to adjust to a world with more online retailing, but management has become increasingly promotional and selective with its reporting. These red flags signal tougher times ahead.

Clydesdale Bank

Clydesdale Bank also announced a massive increase in payment protection insurance claims as the window for claims finally shut in August. The amount was far bigger than anyone expected, including us, at over 20% of the company's market value.

Instead of that money being returned to shareholders through dividends and perhaps a share buyback once the acquisition of Virgin Money is bedded down, as per our investment case, that money will now go to wronged customers. With our investment case broken, we sold out.

We've lifted some important updates below from the July and August monthly reports.

Key results

Frontier Digital Ventures reported an excellent set of numbers in July. Its largest investment, a 30% stake in Zameen – Pakistan's version of realestate.com.au – continues to grow rapidly. Revenue increased 120% in local currency in the first half of this year compared to a year earlier producing the company's inaugural profit at the EBITDA (earnings before interest, tax, depreciation and amortisation) level.

Next year is a pivotal year for Zameen and Frontier Digital. Assuming revenue continues to grow rapidly, Zameen should produce its first free cashflow as profits take off. Once online classifieds businesses have clear market leadership and are profitable, they require very little reinvestment as network effects grow stronger and increase the barriers to entry.

“RELIANCE IS NOT THE WORLD'S GREATEST BUSINESS, BUT ITS GLOBAL DISTRIBUTION OF PUSH-TO-CONNECT PLUMBING SUPPLIES THAT SAVE PLUMBERS HUGE AMOUNTS OF TIME IS A COMPETITIVE ADVANTAGE.”

What Zameen's management decide to do with the company's cash will be a test of Frontier's model of backing local management with minority shareholdings. With so many respected and experienced industry veterans involved in different capacities with the company we expect a good outcome that could eventually lead to Zameen listing via an IPO.

Link Administration

Link Administration's share price had fallen 40% from a peak of nearly \$8 in May due to regulatory changes, problems associated with its \$1.5bn UK acquisition two years ago and increasing scepticism about the time it's taken to resign key Australian superannuation clients.

Costs to deal with Australian regulatory issues have remained stubbornly high, but they should subside in a year or so when the company should've also upgraded old IT systems in the UK.

The company also finally agreed terms with REST superannuation recently, which means it has resigned two of its four major Australian superannuation clients that produced half the company's profits when it listed in 2015. The proportion has roughly halved since the large UK acquisition, but the contracts are still very important to Link's profitability.

Pricing power in Link's financial administration businesses, such as share registry management, is constantly falling and growth is slow. That means management must continue making tuck-in acquisitions to keep lowering costs.

Link will suffer when corporate and market activity slows. But longer term, Link should benefit from increased outsourcing and opportunities such as the UK pension system switching to Australia's system or favouring defined contribution schemes over defined benefit schemes.

Link currently trades on a forecast price-to-earnings ratio of just 11 after adjusting for its 44% stake in property settlement company PEXA. That leaves plenty of room for a higher valuation should management return the business to growth in 2021 and beyond.

Reliance Worldwide

Reliance Worldwide had previously announced a profit downgrade that included a laundry list of issues. But its share price has been recovering since its full year result included a rosier outlook and management confirmed its recent acquisition of UK business John Guest remains on track.

Reliance is not the world's greatest business, but its global distribution of push-to-connect plumbing supplies that save plumbers huge amounts of time is a competitive advantage.

While the fittings are cheap, they're also easy to replicate. Success relies on plumbers paying a premium

for Reliance's SharkBite branded fittings, and continued innovation to maintain pricing power and benefit from the switch away from time consuming soldering and crimping methods typically used for plumbing repairs.

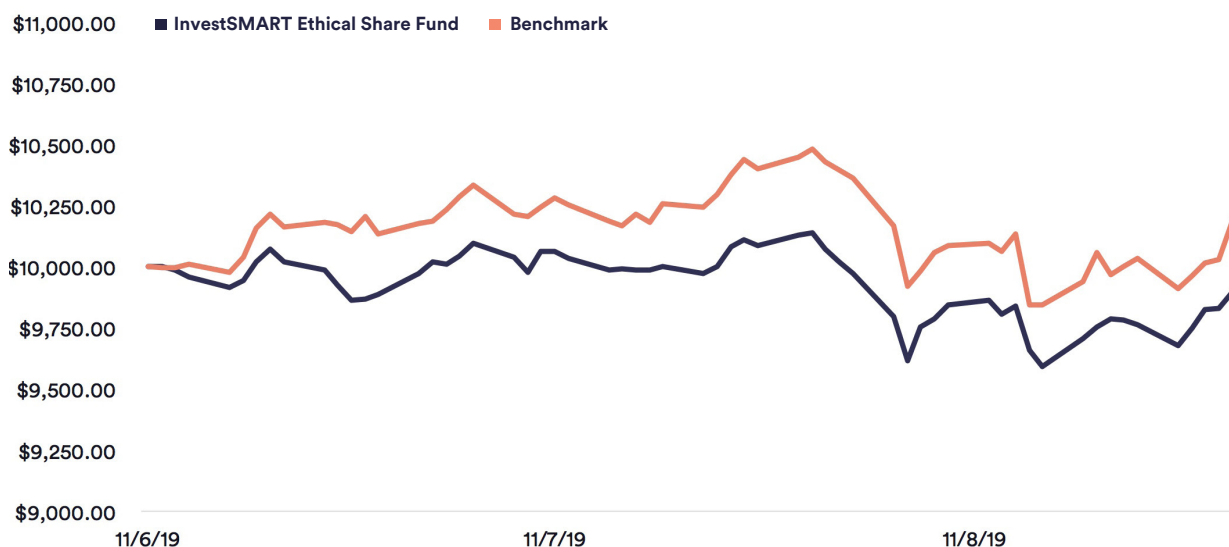
Smartgroup

The recent increase in Smartgroup's share price suggests it reported a scintillating annual result. More truthfully, it reflects fading fears of a large fall in earnings due to lower new car sales.

Smartgroup chief executive Deven Billimoria has made an art form out of acquisitions, but his large anchor of past success will drag on future returns. Still, with the stock trading on a forecast PER of 18 and a 4% fully franked dividend yield, and with a chief that still has skin in the game despite selling a quarter of his shareholding last year, we hope to be long-term shareholders.

It's a little frustrating when the excitement of investing in a new fund is replaced by the patience required to invest the money in safe and promising opportunities. We generally don't like having high levels of cash, but with the strong market move this year we know from experience that like the right used car, the right opportunities will come along eventually. It's far better to wait patiently than risk losing money on marginal ideas.

PERFORMANCE OF \$10,000 SINCE INCEPTION



ASSET ALLOCATION

Sector	Weighting
Cash	34.5%
Industrials	15.5%
Communication Services	13.5%
Information Technology	12.7%
Financials	7.0%
Health Care	6.7%
Real Estate	4.2%
Consumer Discretionary	4.0%
Consumer Staples	1.8%
Materials	0.0%
Energy	0.0%

TOP 5 HOLDINGS

Security	Weighting
Frontier Digital Ventures (FDV)	4.3%
360 Capital Group (TGR)	4.2%
Carsales.Com (CAR)	4.2%
Smartgroup Corporation (SIQ)	3.7%
Audinate (AD8)	3.6%

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 Sep 2019. Table of performance figures on page 2 is after investment and admin fees, and includes brokerage. Unit pricing taken at the end of each month.

InvestSMART Group Limited (INV)

InvestSMART 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 InvestSMART Ethical Share Fund is a concentrated portfolio of 10 – 35 Australian-listed stocks. The Fund invests in a diversified selection of Australian companies that produce growing, sustainable profits at low risk of interruption from the increasing threats associated with Environmental, Social and Governance (ESG) factors and financial criteria to achieve medium to long-term capital growth. This is available as a listed fund (ASX code: INES) or as a separate account through the PMA.

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 invest in the InvestSMART Ethical Share Fund?

Australia has one of the world's most stable and highest returning share markets and is often considered a safe-haven by investors. Using a negative screen, the InvestSMART Ethical Share Fund protect against increasing risk from threats from environmental, social and governance (ESG) factors. As value investors, producing safe and attractive returns in the stock market means sticking to a disciplined and repeatable process. We do this by waiting patiently for overreactions in share prices, so we can buy at comfortable discounts to 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 2019 for the PMA

12 June 2019 for the Listed Fund

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 for the PMA

\$1 for the Listed Fund

Important information

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Investment in securities and other financial products involves risk. An investment in a financial product may have the potential for capital growth and income, but may also carry the risk that the total return on the investment may be less than the amount contributed directly by the investor.

Past performance of financial products is not a reliable indicator of future performance. InvestSMART does not assure nor guarantee the performance of any financial products offered.

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