The University of Queensland Business School

The University of Queensland Australia

Create Change

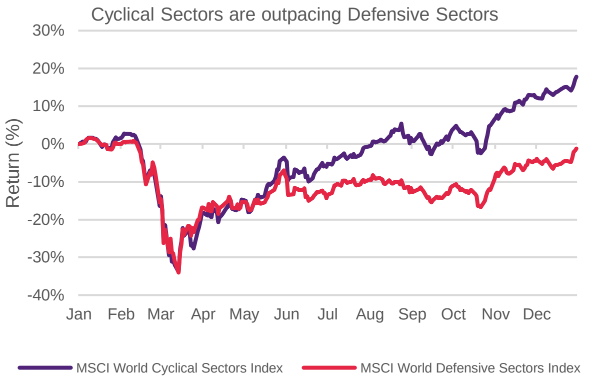
Student Managed Investment Fund December 2020 Update

December 2020 Fund Update

Fund Update

The portfolio returned 0.6% during the month of December. When compared to the benchmark All Ordinaries Accumulation Index return of 1.8% this represents a total underperformance of 1.2%.

The ASX and global equity markets ended the month positively as they continued November's strong gains. Domestically, the resurgence of COVID-19 cases in Sydney's northern suburbs has again led to the closure of domestic borders and fuelled concerns of further outbreaks. Rallies in commodities such as iron ore, crude oil and coal continued which significantly bolstered the materials sector. On the other hand, utilities, industrial and healthcare sectors underperformed compared to the benchmark as investors shifted towards cyclical sectors.



Source: MSCI, S&P Capital IQ

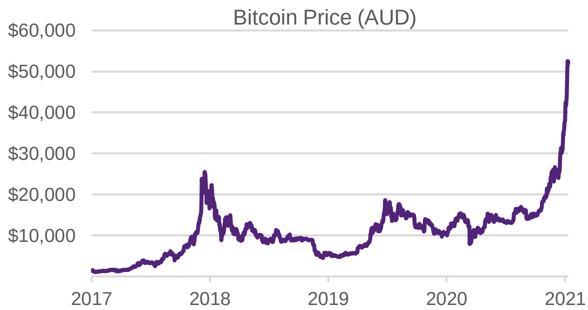
Top performers in the portfolio for the month included City Chic Collective Limited (ASX: CCX), Rio Tinto Group (ASX: RIO) and BHP Group (ASX: BHP) which returned 45.7%, 12.3% and 11.5% respectively. The poorest performers were Appen Limited (ASX: APX), Service Stream Limited (ASX: SSM) and IPH Limited (ASX: IPH) which generated returns of -21.7 %, -20.1% and -7.1% respectively.

Market Update

The Australian All Ordinaries Accumulation Index delivered a return of 1.2% in the month of December.

In overseas markets, the S&P 500 delivered a positive return of 3.7%, the NASDAQ Composite Index returned 5.7% and the Dow Jones Industrial Average returned 3.3%.

Global equity markets ended the month positively as optimism regarding the roll out of vaccines and US stimulus efforts overshadowed the short-term impact of lockdowns. Attention during the month was also drawn to the rally of Bitcoin as the cryptocurrency reached all-time highs previously achieved in 2017. Momentum in this space is largely driven by two factors: retail investors and their fear of missing out and the growing acceptance of cryptocurrency by large financial corporations and institutional investors. The ongoing slide of the US dollar also contributed to the rise of Bitcoin's price and has pushed commodity prices higher.



Source: Yahoo Finance

Monetary Policy

Global monetary policy has been stretched to its limits in 2020. By the end of December, approximately 27% of global government debt yields were sub-zero, with Australian Government debt first selling short-term treasury bills at sub-zero yields during the month. Quantitative easing has become the norm and record amounts of assets have been purchased worldwide by central banks. Monetary policy is in part responsible for the strong market recovery since the crash in March. Valuations have been supported by the low interest rate environment and investors seeking higher returns in the equity market.

In the short term, it appears central banks will continue supporting their economies by any means necessary, as they did in 2020. The RBA in their December 2nd statement said they were unlikely to increase the cash rate target for the next three years and would require substantial increases to employment and inflation. The economic recovery in Australia has been strong but a full recovery to 2019 GDP levels is not expected until the end of 2021. This trend is reflected globally; until employment makes a full recovery, inflation is unlikely to rise and neither will interest rates. Cash rate targets were approaching the zero-bound well before the COVID crisis and will likely remain there in the medium term.

In terms of fiscal policy, the JobKeeper and JobSeeker subsidies have been a crucial part of economic recovery. When the subsidies end in March of 2021, it is likely this will have a material effect on employment and continued economic recovery in Australia.

Commodities

The spot price for iron ore increased by 20.9% in December to $158.15 USD per tonne catalysed by strong demand from Chinese property developers and infrastructure managers. While China continues to embrace urbanisation, iron ore's price cycle has largely remained free from economic expansion, monetary policy or commodity speculation. Instead, iron's resilience can be attributed to the desire and demand for stability amongst market stalwarts, financial agents, miners, and builders. As such, with fiscal expenditure being muted within many Asian countries in spite of the pandemic, it is the Australian miners who have restrained their output and minimised capital expenditure to a mere third of the peak seen in 2012. By reducing sales and stabilising supply growth, Australian miners such as BHP and RIO can assert long-term upwards price pressure.

Oil's price movements can be pinned to a similar premise of stable price control through muted supply growth. With Saudi Arabia signalling they would unilaterally cut production of 1 million barrels of crude oil per day, WTI futures and Brent Crude both rose approximately 5% to settle above US$50 per barrel. As Saudi Arabia's intentions come into effect in February, Plutus believes this will have a significant impact on energy stocks and companies that produce and rely on fuels.

ESG Thematics

With the UK announcing in late November that new fossil fuel powered cars will no longer be sold after 2030, and Japan recently announcing that they will enforce the same law starting from 2035, the pandemic has accelerated a paradigmatic shift towards embracing a renewable and socially sustainable future. This has significant impacts on the sectors and industries that Plutus seek to scrutinise in the near future. With electric car manufacturers such as Tesla in the US being thrown into sharp relief as the harbingers of the impending fossil-fuel-free reality, key inputs such as lithium and aluminium draw our focus. We also seek to look at renewable energy such as solar and wind. With many REIT's seeking to invest in solar and wind farms, we are analysing the long-term opportunities such companies offer the SMIF portfolio.

Position Updates

Downer EDI (ASX: DOW)

Downer EDI is an integrated services company that specialises in a range of infrastructure management services across Australia and New Zealand. In the November update, Plutus Capital highlighted Downer's proposed sale of Spotless Laundries to private-equity backed South Pacific Laundry which was blocked by the ACCC citing competition concerns.

Since then, Downer has successfully divested 70% of Spotless Laundries to Australian private equity firm Adamantem Capital for $155 million. The retained 30% equity stake will allow Downer to participate in the future growth of the division whilst removing the requirement to provide significant amounts of capital to the business in the future.

In December, Downer also continued its divestment strategy through the sale of its open cut mining business to MACA Limited for $200 million. In addition, Downer successfully refinanced a $1.4 billion ESG-linked loan. The loan is underpinned by KPI metrics relating to Downer's greenhouse gas emission reductions and social sustainability initiatives such as cultural awareness, mental health and wellbeing training of Downer employees. If these milestones are reached it will lead to a reduction in borrowing costs under the facility. This loan highlights Downer's commitment to ESG considerations that underpin the SMIF investment mandate and UQ ESG policy.

Plutus remains optimistic Downer will use the excess cash reserves accumulated from the recent divestitures to continue to invest in its core businesses or pay a special dividend to return capital to shareholders.

Macquarie Group (ASX: MQG)

Macquarie Group is a multinational financial services company whose operations span across asset management, investment and retail banking and wealth management services. Macquarie Group was an existing holding in the UQ SMIF portfolio as Plutus Capital began their tenure. In March, Macquarie lost 53.8% of its value but as of December it has since recovered the majority of the losses. Currently, Macquarie is the largest position in the SMIF portfolio with a weighting of 6.8%.

In November, Macquarie released H12021 results recording group NPAT down 32% to $985 million. Net profit contribution from annuity style activities was down 7% pcp as a result of reductions in base fees charged by Macquarie Asset Management (MAM) funds and credit impairments incurred in the loan portfolio due to a deterioration of macroeconomic conditions from COVID-19.

In contrast, markets-facing segments were down 42% pcp with Macquarie Capital (MacCap) recording a $189 million operating loss as a result of reduced M&A activity and underperforming loan facilities. The loss was partially offset by strong equity and debt capital markets activity as companies raised additional capital to shore up their balance sheets amid uncertainty surrounding business operations from COVID-19.

In December, Macquarie Group announced the acquisition of Waddell & Reed Financial Incorporated, a US-based active asset manager and private wealth management provider, for $2.3 billion which represented a 48% premium to market value. The acquisition will increase Macquarie's assets under management (AUM) to $650 billion and solidify the division as a global top 25 fund manager. The additional AUM will increase base fees and diversify MAM's revenue sources into asset classes such as US mid-cap, large cap and high-yield fixed income which provide greater growth prospects and increased margins.

Also, as part of the transaction, Macquarie will divest the wealth management division (with US $63 billion assets under administration) for $300 million and enter a strategic partnership with LPL Financial to provide asset management advisory services.

Plutus is confident Macquarie will realise significant synergies from the deal and the continued focus on building scale within the industry will lower cost bases and enhance margins. However, we do acknowledge current trends in the market towards low-cost, passive investment vehicles which may place pressure on margins in Macquarie's core-funds management business, with both Waddell & Reed and Macquarie recording net outflows in H12020.

Despite this, we believe MAM's equity, fixed income and alternative investment vehicles provide unique exposure and will continue to provide strong annuity-style revenues for the company over the long-term. Currently, MAM provides 47% of the group's net profits.

City Chic Collective Limited (ASX: CCX)

City Chic's price soared 45.7% in December as the company acquired UK based retailer Evans Group. City Chic has made a name for themselves in Australia as a plus-sized clothing retailer with a strong emphasis on eCommerce.

City Chic had slumped slightly in September and October as the failed acquisition of US retailer Catherine's left them with a net cash surplus of $112m after an equity raising in July. The announcement of the Evans Group acquisition on December 21 saw a strong response from investors, rallying 16% to the end of December.

City Chic had previously acquired retailer Avenue in late 2019 after the company had entered administration, converting the business into a primarily eCommerce brand. With the announced acquisition of Evans Group, part of recently collapsed Arcadia Group, it is likely the same strategy will be enacted. City Chic products had been sold through Evans eCommerce channels for several years and City Chic Chief Executive Phil Ryan states the transition to eCommerce is well underway for the Evans brand, demonstrating a strong opportunity to integrate into the existing brand. We see this acquisition as a strong strategic expansion in the UK where the TAM is currently $9 billion and growing.

City Chic is a growing global brand with 42% of revenue from the Northern Hemisphere in the last financial year. With strong organic and inorganic growth opportunities, City Chic remains a key holding of the SMIF portfolio.

Appen Limited (ASX: APX)

Appen has been a strong performer in the SMIF portfolio; however, December saw Appen downgrade their profit forecasts after significant COVID performance disruptions leading to a monthly loss of 21.74%. The company has a global presence operating in 130 countries, developing artificial intelligence systems and machine learning products.

Appen is part of the five primary tech stocks, commonly referred to as WAAAX stocks on the ASX. As an artificial intelligence developer, a large majority of their business, and therefore revenue, comes from the tech mega caps in the US such as Amazon, Facebook and Google. In the first two quarters of FY2021, renewed lockdown orders in California coupled with the FAANG stocks shifting funds away from Appen led projects has impacted the Australian company's bottom line greatly with the second quarter earnings missing previous profit forecasts by 15%. Despite this, reports affirm the AI sector is expected to grow at approximately 30% until 2025 and, with Appen possessing a dominant market position, the company is poised to take advantage of this rapid growth. Firm CTO, Wilson Pang, has also outlined plans for a dynamic growth strategy supplementing organic growth with strategic acquisitions to consolidate market share and bolster underlying returns.

As such, despite short term pains for Appen, a clear strategy and high sector growth in a five-year time horizon ensures that the company remains a part of the SMIF portfolio.

Acknowledgement

Our team would like to extend our sincerest and most heartfelt gratitude to Clive Gaunt for his tireless efforts and contributions to SMIF. From the fund's inception, Clive was instrumental in procuring seed capital of $200,000 and has provided students with continued guidance and networking opportunities while concurrently promoting SMIF as a forum for new market ideas and philosophies.

On behalf of the entire SMIF community, past fund managers, and future fund managers who shall surely reap the benefits of his unwavering dedication, we would like to wish Clive all the very best for his future endeavours and life in retirement.

Portfolio Management Team

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Quantitative Data:

SMIF Portfolio Holdings:

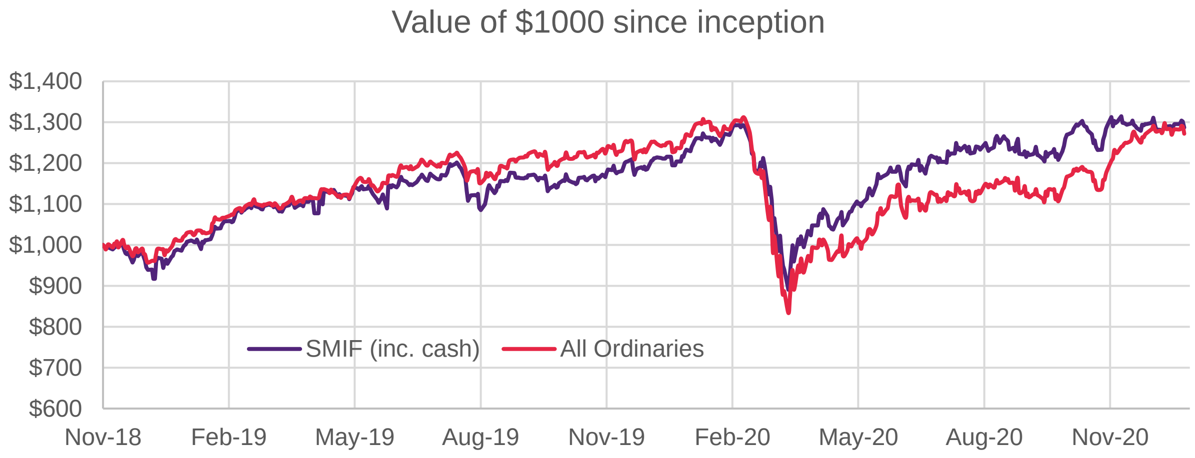
Ticker	Company Name	Portfolio Weight		Position 31th December	Return*
MQG	Macquarie Group Limited	6.8%		$17,172	9.0%
JHX	James Hardie Industries plc	4.8%		$11,772	47.2%
BHP	BHP Group	4.2%	▲3	$11,202	32.3%
BRG	Breville Group Limited	4.0%	▲1	$10,688	41.4%
RIO	Rio Tinto Group	4.0%	▲7	$10,359	26.6%
CNU	Chorus Limited	4.0%	▼3	$10,247	33.3%
MD	ResMed Inc.	3.9%	▼4	$9,857	33.7%
CSL	CSL Limited	3.7%	▼1	$9,345	25.6%
CWY	Cleanaway Waste Management Limited	3.7%	▲1	$9,228	4.9%
SHL	Sonic Healthcare Limited	3.7%	▼1	$9,227	46.6%
CBA	Commonwealth Bank of Australia	3.7%	▲3	$9,114	17.3%
ANZ	Australia and New Zealand Banking Group Limited	3.6%	▲1	$9,057	16.2%
APA	APA Group	3.6%	▼2	$8,743	-14.9%
CCX	City Chic Collective Limited	3.5%	▲9	$8,340	70.0%
WOW	Woolworths Group Limited	3.1%	▼1	$8,019	5.0%
INA	Ingenia Communities Group	3.0%	▲3	$7,464	31.8%
PWH	PWR Holdings Limited	2.8%	▲2	$7,449	19.5%
APX	Appen Limited	2.8%	▼10	$7,432	40.9%
QUB	Qube Holdings Limited	2.8%	▼2	$7,394	14.2%
CAR	carsales.com Ltd	2.8%		$6,983	-10.7%
SYD	Sydney Airport Limited	2.4%	▼3	$6,852	-25.0%
IDX	Integral Diagnostics Limited	2.4%		$6,137	28.2%
JLG	Johns Lyng Group Limited	2.3%		$5,988	33.9%
BAP	Bapcor Limited	2.2%	▲3	$5,508	9.8%
DOW	Downer EDI Limited	2.1%		$5,367	9.0%
SAR	Saracen Mineral Holdings Limited	2.0%		$5,178	-14.8%
SSM	Service Stream Limited	2.0%	▼6	$4,888	-15.2%
CDA	Codan Limited	1.9%	▲1	$4,651	-9.3%
COE	Cooper Energy Limited	1.7%	▲2	$4,622	-5.4%
IPH	IPH Limited	1.7%	▼2	$4,488	-14.1%
NST	Northern Star Resources Limited	1.7%	▼1	$4,340	22.0%
	Cash and Dividends Receivable	3.5%		$9,113	-
		TOTAL		**$256,223**	

*Total return on each position since purchase, net of fees, excluding dividends

Performance:

	1 month	3 months	6 months	12 months	Inception (Nov 2018)*
SMIF	0.6%	5.9%	7.9%	7.7%	28.1%
All Ordinaries Accumulation Index	1.8%	14.4%	15.7%	3.6%	27.2%
Alpha	-1.1%	-8.5%	-7.8%	4.1%	0.9%

Alpha may not equal SMIF return minus All Ordinaries return due to rounding.
*Total return since fund inception on 19 November 2018.



Sector Breakdown:

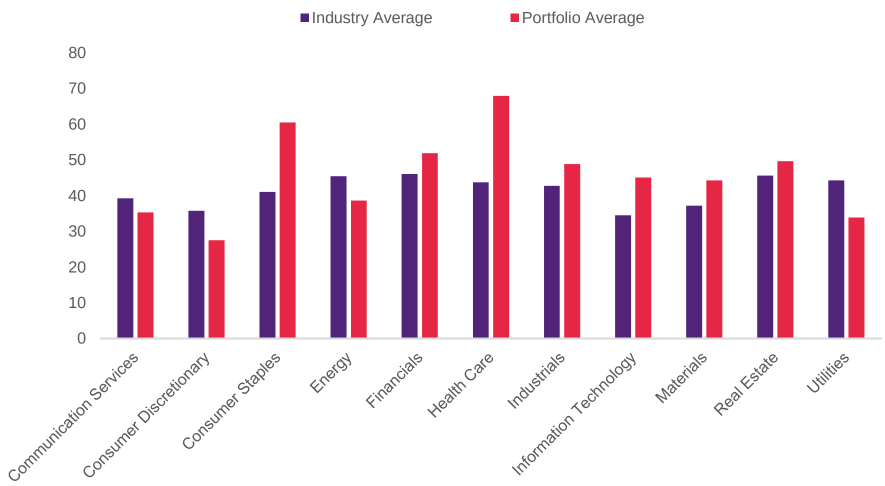
	% Weight	Change in rank*
Industrials	17.9%	-
Materials	17.3%	-
Financials	14.3%	▲1
Health Care	14.0%	▼1
Consumer Discretionary	12.9%	-
Communication Services	7.0%	-
Information Technology	4.9%	-
Utilities	3.5%	-
Consumer Staples	3.2%	-
Real Estate	3.0%	-
Energy	1.9%	-

*Since last update

Key Portfolio Metrics:

	SMIF	All Ords Acc.
Returns		
Annualised return	12.5%	11.6%
Risks		
Annual volatility	20.9%	23.2%
Beta	0.89	1.00
Tracking error	10.5%	0.0%
Risk/Return Trade Off		
Sharpe ratio	0.41	0.33
Information ratio	0.17	0.00
Jensen's alpha	1.8%	0.0%
Treynor's measure	0.10	0.08
Distribution of Returns		
Capture ratio	90%	100%
Downside capture	92%	100%
Upside capture	83%	100%

ESG Metrics:



Source: Eikon Refinitiv ESG Combined Score (FY0). Industry Average comprised of S&P/ASX300 GICS Sector average scores.

Information on the Fund and Disclaimer

This update has been prepared by the student portfolio managers of the University of Queensland Business School Student Managed Investment Fund. The Fund was seeded by the University with $200,000 in 2018 and the first investments were made in November 2018. The University of Queensland is the sole owner of the assets in the Fund and no fees are payable by the University for the management of the Fund. The Fund recognises the support of Morgans Brisbane as stockbroker to the Fund.

The information in this update is prepared primarily for educational purposes and to keep internal and external Fund stakeholders informed. Any views expressed in this update are the views of the student portfolio managers. The accuracy, reliability or completeness of data or information presented in this update is not guaranteed. The information is not intended as a securities recommendation or statement of opinion intended to influence a person or persons in making a decision in relation to an investment.