The University of Queensland Business School

THE UNIVERSITY OF QUEENSLAND
AUSTRALIA
CREATE CHANGE

Student Managed Investment Fund June 2022 Update

June 2022 Fund Update

Dollar values are in AUD unless stated otherwise.

Fund Update

The conclusion of FY22 was met with another month of negative returns. The All-Ordinaries index performed poorly, sustaining losses of -9.36% in the month, with the market down 11% in FY22 compared to the previous period. Comparatively, the portfolio has outperformed the All Ords by 1.48%, despite a return of -7.88%. This comes off the back of continued inflationary pressures combined with the RBA's plans for further interest rate hikes.

As a result of the market's performance over June, only 4 of the portfolio's holdings were able to generate positive returns. These holdings were: Resmed Inc. (ASX: RMD), IPH Ltd (ASX: IPH), Woolworths Group Ltd (ASX: WOW) and APA Group Ltd (ASX: APA), with returns of 5.17%, 3.29%, 2.74% and 1.49% respectively. Similar to May, the positive returns were largely overshadowed by the poor performances from Northern Star Resources Ltd (ASX: NST), DDH1 Drilling (ASX: DDH) and PWR Holdings Ltd (ASX: PWH). These holdings had generated returns of -23.58%, -20% and -18.66% respectively.

The Atlanta Fed has revised its second quarter GDP growth forecast to -2.1%, suggesting potential recession in the US economy. Australia on the other hand is proving to be resilient in the face of rate hikes, with GDP growth still being forecasted to be positive over 2022, supported by strong commodity prices and growth in in private consumption and investment. We maintain our expectation that inflation will continue to be problematic for economies globally given the dangerous combination of record low interest rates and record high inflation numbers. Given our belief that inflation will be difficult to combat, we expect companies with poor pricing power will struggle to pass on costs to customers. We also expect large demand deterioration in non-essential goods as customers exhaust existing Covid-19 savings and lower real household incomes taking effect. Corresponding with these beliefs we continue to assess the portfolio for weakness in these regards, and search for companies, particularly in the consumer staples and materials sectors, for lucrative buy opportunities.

Market Update

Australian Economy

Unemployment remained at an all-time low of 3.9%. Furthermore, total job vacancies increased by 480,100, 13.8% from Feb 2022, with the majority of demand stemming from private sector, which suggests that labour markets remain tight and are likely to into the future.

Headline CPI increased by 5.1% over the year, significantly higher than the market expectation of 4.6%. Breaking down quarterly, there was a 2.1% increase in the March quarter alone, driven by price increases in automotive fuel and new dwelling purchases. Likewise, US headline CPI inflation returned 8.6%, highest since 1981, and alarmingly higher than the 8.3% market expectation.

We have previously observed countries aiming to depreciate their currency in order to boost exports, however now in the hopes of reducing imported inflation, countries appear to be battling each other for an appreciation of their currency. The US has been the main perpetrator of this "war", with their dollar significantly appreciating over what markets are deeming as aggressive monetary policy. Despite Australia's own hawkish monetary policy and concerns surrounding the strength of its exports to China, the Australian dollar has declined to 0.69 AUD/USD at the end of June.

Monetary Policy Decision

The US Federal reserve increased interest rates by 75 basis points, which was in line with US market expectations and already priced into the bond market. The rapid, front-loaded hike was aimed at targeting the higher-than-expected inflation numbers, suggesting that inflation has not yet peaked.

On the contrary, the Reserve Bank of Australia's decision to raise interest rates by 50 basis points to 0.85% was higher than market expectations, and the first 50 basis point rise since Feb 2000.

Despite thorough internal discussion around 25 or 50 basis point rise, the main argument stemmed from an ever-tightening labour market and persistent cost-push inflation. The passing of costs from producers and manufacturers has led to employees demanding higher wages to compensate for the increasing costs of living.

Some risks of higher interest rates are particularly centralised around falling prices in the housing market, increasing interest payments and potential demand destruction. However, the RBA expects household consumption to remain resilient due to the high savings rate, and effective financial buffer built as a result.

The RBA has outlined plans to continue hiking towards neutral rate of 2.5% and cash rate to reach 2.1% by the end of 2022. Summit remains aligned with the RBA's outlook per expectation theory.

Commodities

With fears of widespread economic recession, the price of Brent crude has decreased over the month to USD $110.37 per barrel. This is still under May price levels, despite being substantially greater than those of 2021. Furthermore, Brent crude prices are now expected[1] to be an average price of USD $106.82 per barrel in 2022, compared to May's consensus[1] of USD $101.89 - a result of continuous supply shortages from the Russia and Ukraine conflict. Although an economic slowdown could temper the oil price rises, many analysts still expect the tight supply of oil to outweigh this concern over demand. In addition, OPEC+ (which includes Russia) has announced that they will increase their output by 648,000 bpd over July and August, up 216,000 bpd from their previous plan over these two months, with hopes of easing the prevalent supply shortages. OPEC+ however, have not commented on plans for September onwards which raises concerns over future supply of oil.

Agricultural commodities, in particular wheat, have experienced downwards pressure due to both improved harvesting conditions and an influx of Russian grain shipments. However, the shiploads of Russian grain, primarily sold to countries in the Middle East and North Africa, have been claimed to be stolen Ukrainian harvest. For more information, please refer to "Further Readings".

With the culmination of the Fed's interest rate hikes and a strong US dollar, the price of gold has dropped, now trading at USD $1828 per ounce. With the rise in interest rates, investors are worried whether investing their capital in a non-yielding asset such as gold would come as an opportunity cost to investments in alternative assets such as bonds, which have risen as central banks around the globe try to rein in inflation. In addition, a stronger US dollar meant that gold was relatively more expensive to overseas buyers, further exacerbating the reduction in gold prices over this month.

[1]As per a Reuters poll consisting of over 3 dozen economists and analysts

Position Updates

DDH1 (ASX: DDH -20.00%)

DDH1's share price has steadily declined over July driven by concerns that the company will have difficulty sustaining its historical growth because of labour shortages and supply chain constraints halting expansion of its drill fleet.

The degree to which the share price has fallen has surprised us, but true to our philosophy; we do not believe it is possible to time the market, and that these concerns do not impact our long-term investment thesis. The stock price seems to have bottomed out around $0.66/share, which is also the tangible the book value of its shares. We also note that management believed the book value of its drills (which make up the majority of NTA) to be materially undervalued in its last report. We agree with this proposition, given that the drills are depreciated over the useful life and not revalued on a mark-to-market basis.

In-line with these beliefs, we applaud DDH1's announced share buyback program starting July 18, which seeks to purchase of up to 10% of shares on the basis that DDH's management believes them to be materially undervalued.

Suncorp (ASX: SUN -3.26%)

Suncorp has fared well against its retail banking counterparts, largely due to its large stake in the insurance business. Earlier in June, rumours of Suncorp seeking Barrenjoey for advice suggest a potential sale of its $5bn banking unit. This led to talks between Bendigo and Adelaide Bank specifically regarding potential merger between the two banking businesses that would consolidate a favourable market position.

Carsales (ASX: CAR -10.29%)

As semiconductor shortages continue and car manufacturers continue to experience disruptions, the second-hand car market has remained strong. The primary movement in share price stems from its AUD $1.2 billion capital raising at $17.75 per share, subsequently causing shareholder dilution. Carsales has outlined that the proceeds from this entitlement offer are to fund a 51% acquisition of Trader Interactive for $US809m.

ResMed (ASX: RMD 5.17%)

ResMed has continually eyed advancements in its out-of-hospital-care software division, leading to its recent acquisition of MEDIFOX DAN, a German leader in out-of-hospital software solutions company for $US1bn ($AUD 1.45bn). The acquisition which is expected to be accretive provides the opportunity to expand ResMed's SaaS business while strengthening the company's global presence.

IPH Limited (ASX: IPH 3.29%)

In its recent conference to Macquarie, IPH highlighted that the company is proactively looking for acquisition targets to expand its intellectual property protection business, supported by its strong balance sheet and resilient cashflows. Furthermore, in light of its low leverage ratio of 0.4x and to maintain flexibility under its capital management program, IPH has extended its existing share buy-back program of up to $40m until 30 May 2023. As a result, shareholders have responded positively.

Northern Star Resources (ASX: NST -23.58%)

As described in our commodities outlook, the bullion market is weaker than expected due to interest rate hikes and the prospect of investors looking for alternative higher yielding investments despite gold typically being an inflationary hedge. Furthermore, investor announcements from fellow industry players such as Evolution Mining suggest a fall in full year production expectations, resulting in negative share price movement across the board.

Cleanaway Waste Management (ASX: CWY -16.00%)

A series of natural weather events and a slew of bad luck have negatively affected Cleanaway Waste Management's operations. In a recent investor presentation, Cleanaway outlined $40m in costs due to rectification of repeated flood damage at its New Chum landfill. Additionally, no recovery of costs through insurance are to be evident in FY22 statements. This translates to total $17m decrease in EBITDA in FY22, due to temporary closure and volume restrictions, and a further $10m EBITDA decrease in FY23. Bad press regarding the management of the New Chum landfill did not bode well for Cleanaway.

In late June, Cleanaway announced the occurrence of an unfortunate fire that damaged its medical waste facility in Victoria. The subsequent disruption to services is projected to decrease EBITDA in the Health Services business unit by $3m per month.

Brambles (ASX: BMB -1.56%)

Investors applauded Brambles decision to scrap its transitional investment in plastic pallets due to disagreements around pricing and commercial terms with the big-box retailer Costco it had originally partnered with. The transition would have needed approximately $1bn in capex but failed to reach the 15% ROI hurdle. Brambles shares reacted positively, almost reaching the 7-week high.

Performance:

	1 Month	3 Months	6 Months	1 Year	Inception p.a.*
SMIF	-7.88%	-12.92%	-15.99%	-11.25%	6.75%
All Ordinaries Accumulation Index	-9.36%	-12.91%	-11.50%	-7.44%	8.11%
Alpha	1.48%	-0.01%	-4.49%	-3.81%	-1.36%

Alpha may not equal SMIF return minus All Ordinaries return due to rounding.

* Return since fund inception on 19 November 2018.

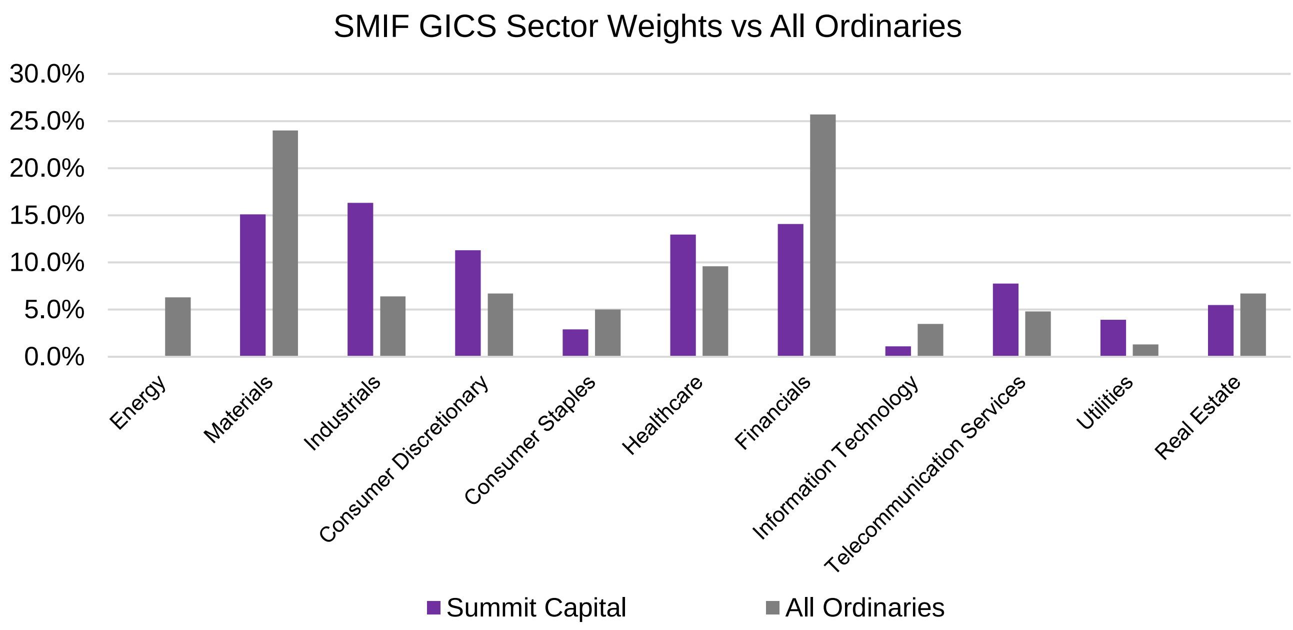
Sector Breakdown:

	% Weight	Change in rank
Energy	0.00%	
Materials	15.10%	▼1
Industrials	16.32%	▲1
Consumer Discretionary	11.29%	
Consumer Staples	2.91%	
Healthcare	12.97%	
Financials	14.07%	
Information Technology	1.11%	
Telecommunication Services	7.77%	
Utilities	3.92%	
Real Estate	5.50%	

Contributors to Returns (%)

Top 5 Contributors (%)	
RMD	5.17
IPH	3.29
WOW	2.74
APA	1.49
-	-

Top 5 Detractors (%)	
NST	-23.58
DDH	-20.00
PWH	-18.66
DSK	-16.08
CWY	-16.00



SMIF Portfolio Holdings:

Ticker	Company Name	Portfolio Weight		Position 30th June	Capital Gains	Dividends	Return
MQG	Macquarie Group Ltd	7.84%		$20,399	9.0%	4.8%	13.1%
UWL	Uniti Group Ltd	4.33%	▲4	$11,267	19.7%	0.0%	19.7%
RMD	Resmed Inc	4.27%	▲4	$11,110	17.0%	1.1%	17.9%
JLG	Johns Lyng Group	4.18%	▲1	$10,877	52.1%	2.8%	53.9%
PWH	PWR Holdings Limited	4.00%	▼3	$10,415	27.4%	2.9%	29.6%
APA	APA Group	3.92%	▲3	$10,211	-0.2%	5.2%	5.0%
CWY	Cleanaway Waste Ltd	3.80%	▼3	$9,896	7.2%	2.4%	9.5%
DDH	DDH1 Drilling Limited	3.67%	▼5	$9,564	-19.0%	0.0%	-19.0%
SHL	Sonic Healthcare Limited	3.64%	▼1	$9,474	12.0%	4.3%	15.2%
BHP	BHP Group Limited	3.57%	▲1	$9,281	8.1%	12.3%	18.8%
BXB	Brambles Limited	3.51%	▲2	$9,146	-0.1%	2.7%	2.6%
BOQ	Bank Of Queensland	3.45%	▼2	$8,978	-11.4%	0.0%	-11.4%
CNU	Chorus Limited	3.44%	▲2	$8,962	6.1%	4.7%	10.4%
CSL	CSL Limited	3.41%	▲2	$8,879	6.2%	1.3%	7.3%
CLW	Charter Hall REIT	3.18%	▼3	$8,284	-9.3%	7.0%	-2.3%
JHX	James Hardie Industries	3.08%	▼2	$8,006	6.9%	2.8%	9.5%
WES	Wesfarmers Limited	2.93%	▼5	$7,628	-10.6%	0.0%	-10.6%
RIO	Rio Tinto Limited	2.80%		$7,292	5.1%	13.3%	17.4%
SUN	Suncorp Group Ltd	2.78%	▲1	$7,247	5.2%	8.6%	13.7%
ELD	Elders Limited	2.65%	▲1	$6,899	2.4%	5.5%	7.9%
QUB	Qube Holdings Ltd	2.64%	▼2	$6,866	1.6%	3.1%	4.6%
CAR	Carsales.Com Ltd.	2.47%		$6,418	-11.0%	2.7%	-8.1%
INA	Ingenia Group	2.32%	▲1	$6,038	3.1%	2.5%	5.5%
IPH	IPH Limited	2.19%	▲2	$5,696	4.2%	4.5%	8.5%
NST	Northern Star Resources Limited	1.98%	▼2	$5,144	13.0%	4.3%	16.4%
DSK	Dusk Group	1.89%	▼1	$4,927	-46.8%	4.6%	-42.2%
IDX	Integral Diagnostics Ltd	1.65%		$4,284	-5.1%	4.0%	-0.9%
CDA	Codan Limited	1.11%		$2,895	-28.6%	2.7%	-25.2%
WOW	Woolworths Group Ltd	0.26%		$676	-1.9%	3.3%	1.6%
CASH	Cash and Dividends Receivable**	9.03%		$23,491			
		TOTAL		$260,250			

*Total return on each position since purchase
** Sydney Airport privatisation is accounted for in the Cash and Dividends Receivable

Further Readings:

Russia Seeks Buyers for Plundered Ukraine Grain, U.S. Warns, New York Times: https://www.nytimes.com/2022/06/05/world/africa/ukraine-grain-russia-sales.html

Shiploads of Russian Grain and Good Weather Temper Wheat Crisis, Wall Street Journal: https://www.wsj.com/articles/shiploads-of-russian-grain-and-good-weather-temper-wheat-crisis-11656596088

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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.