The University of Queensland Business School

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Student Managed Investment Fund July 2022 Update

July 2022 Fund Update

Dollar values are in AUD unless stated otherwise.

Fund Update

The global economy lost momentum over July as demand for goods faded and inflation readings for June reached new highs. Additionally, the US fell into a technical recession. Despite this, risk assets demonstrated strong returns which was reflective of a repricing following the softer rate outlook from the Fed. They announced that June represented the peak in inflation and hawkishness which could mean that the magnitude of rate hikes from the Fed among other central banks will begin to taper off. Given that equity markets had already priced in a significant amount of economic risk heading into the second half of the year, the outlook for potential easing of monetary tightening allowed risk assets to deliver positive returns.

Australian equities followed suit, bouncing back in July. The All-Ordinaries index gained ground on its June lows with returns of 6.34%. Comparatively, the portfolio outperformed the benchmark with returns of 9.29%. The July market rally was driven primarily by strong performances in, IT (15.2%) and real estate (12.1%). Despite the rebound, the conviction of the rally is dependent on whether market outlook will continue to meet expectations. Most importantly, our team questions whether inflation will peak in line with the RBA's updated guidance of 7.75% later this year. Until then, it's difficult to say if we've seen the worst of the bear market as considerable uncertainty remains over just how badly economic activity will be hit.

In contrast to prior months, the majority of the portfolio's holding generated positive returns. Only 3 holdings; BHP (ASX: BHP), Elders Ltd (ASX: ELD) and Rio Tinto (ASX: RIO) saw negative returns of -6.23%, -10.41% and -4.74% respectively. The remainder of the portfolio was in positive territory, some notable contributors being Dusk Group (ASX: DSK), PWR Holdings Ltd (ASX: PWR) and Johns Lyng Group (ASX: JLG) with returns of 32.93%, 32.12% and 31.36% on the month.

The US reporting season sported mild results with the S&P500 reporting EPS growth figures of 2.3%y/y, however, only -8.9%y/y excluding energy. It is expected that the Australian reporting season will share this trend on consumption pressures and positive tailwinds to the net interest margins of banks as yields rise. Above all, earnings growth figures will likely be distorted by the performance of the energy sector.

Market Update

Australian Economy

Headline CPI increased by 6.1% in the second quarter, with core inflation rising by 4.6% year-on-year. This was unsurprisingly driven primarily by the cost of fuel and a rise in fruit and vegetable prices as a result of the east coast floods. Higher inflation globally has continued to drive domestic inflation, however strong domestic demand and a persistently tight labour market are also contributions. Inflation is expected to continue, with the market pricing in a peak later this year at an annual rate of 7.75%, as energy prices are forecasted to continue to rise 15% over the second half of 2022.

The Australian economy has shown resilience thus far in spite of disruptions from the Omicron outbreak and recent global conflicts, having grown strongly in the first half of 2022. However, the Australian equity market has moved in line with a weaker outlook on growth for the second half of the year due to rising costs of living, higher interest rates and declining house prices representing a headwind for consumption.

On the other hand, an opposing effect exists on household consumption with participation rates close to record highs and expected wage growth boosting incomes. There is also a positive outlook for investment despite capacity constraints with indications that business credit is growing, and the pipeline of non-residential construction projects has increased. The current expectation is that GDP will grow by 3.25% over 2022.

Global Perspective

Elsewhere across the globe is providing potential insight for what is to come for Australia, which appears to lag behind other developed economies in the inflationary curve. Notably, the ongoing concern regarding the US economy was recently affirmed as it officially went into recession with two consecutive quarters of negative growth. Despite meeting the technical criteria for a recession, the National Bureau of Economic Research suggests that the strength of the labour market is at odds with this definition. The S&P 500 also rose over the month, seemingly unaffected by the news, as it embraced the view that inflation peaked in June and economists expect July figures to reveal a lower 10.4% inflation rate.

Monetary Policy Decision

At July's meeting, the Reserve Bank of Australia delivered on market expectations, raising the cash rate by yet another 50bps to 1.35 per cent. Summit expects that rate hikes will remain smaller going forward, especially given the potential risk to economic growth, though this is dependent on whether inflation expectations are met over the next half of the year.

The RBA has said that whilst the path to achieving both the inflation target of 2-3% as well as maintaining economic growth and low unemployment is not without challenges, it is possible. The main sources of uncertainty centre around the global environment, and how Australians will respond to rising interest rates, which the RBA hopes will help achieve a sustainable balance between supply and demand in the domestic economy.

The US Federal Reserve also raised its interest rate by 50bps, a less aggressive hike compared to June's 75bps rise. Given the risks to economic growth and the expectation of lower inflation in the coming months, it is likely that the Fed will continue raising rates at this softer level.

Commodities

Crude oil prices have continued to fall over the month of July, following on from the start of their decline in mid-June. Brent Crude settled at USD $94.92 per barrel while West Texas Intermediate Crude settled at USD $89.01. This has come on the back of recession worries in the US and broader concerns over weaker global growth outlook. The price of refined oil products in the North Atlantic markets in particular have been more volatile, with a noticeable fall over the last month which has partially retraced the sharp rise seen in prior months. Despite this, prices continue to be supported by Russian oil sanctions, and limited spare extraction and refinery capacity. These are supporting signs of tight supply which is keeping a relatively high floor on prices. OPEC+ released updated guidance on September output, raising their output goal by 100,000 bpd which was one of the smallest increases since quotas were introduced in 1986[1]. Furthermore, additional EU sanctions set to take effect in December are raising concerns as it remains to be seen whether Middle Eastern providers will reroute barrels to backfill the void in Europe.

Agricultural products along with other non-energy commodities have also seen a noticeable decline of late, reverting to levels at the beginning of the year. Wheat prices have fallen to 35% below their peak attributable to favourable weather conditions and increased expectations of summer-harvests in the northern hemisphere as well as anticipation over the resumption of Ukrainian and Russian exports.

Base metal prices have continued to decline in response to weak outlook for industrial activity. Iron ore prices in particular have lost gains from the start of the year due to the weakening property market in China and increasing distress among developers. The gold market was testing resistance around $1800/oz but is now seeing selling pressures due to unexpectedly strong US job growth numbers over July. Nonfarm payroll numbers significantly exceeded expectations with 528,000 new jobs created compared to a forecasted 250,000. The data is expected to relieve the impact of the recession as the fed argues that the economy cannot be in recession if the labour market remains as strong as it is. This has given the fed room to maintain their aggressive stance on monetary policy which has produced two headwinds for the gold market, as bond yields continue to push higher along with the US dollar.

1 Refer to Further Readings for the article.

Position Updates

DDH1 (ASX: DDH 24.22%)

On the 29th of July 2022, DDH initiated their share buyback scheme, purchasing 18,054 shares (out of 426m total on issue) with the board highlighting that the market "significantly undervalued DDH1". Up to 34,280,468 shares can be acquired through the buyback scheme over the next 12 months, representing approximately 10% of DDH1's current share capital. Furthermore, DDH does not expect its dividend policy to change, retaining a 30-50% payout of NPAT. With a proposed July 2023 end date, we applaud and expect the scheme to continue until completion.

Furthermore, promising preliminary FY22 results have been released for the company. Pro-forma revenue has increased by 14% over the period, attributed to strong demand and the addition of 15 rigs to the fleet, and a further 11 under build. EBITDA margins are down from 23.2% to 22.4% over the period, reflecting WA border closures, inflation pressures, and staff absenteeism. Overall, these results demonstrate the great positioning of the business, the robustness of its earnings, and intelligent capital allocation pursued by its management.

Suncorp (ASX: SUN 1.91%)

Suncorp has accepted a $4.9 billion takeover bid from ANZ for its banking arm, representing a 1.3 billion premium to its net tangible asset value (1.36x P/NTA). The move will streamline Suncorp, allowing for it to focus solely on its insurance business. The company expects to return $4.1 billion in net proceeds from the sale, which is plans to return most of to shareholders in the form of a fully franked special dividend or potential buyback program. The takeover is subject to the approval of the Federal Treasurer and the ACCC.

John Lyng Group (ASX: JLG 31.36%)

John Lyng suffered earlier in the year, despite landing a large NSW flood recovery contract, likely due to the culmination of inflationary pressures on building materials, weak supply chains and labour shortages. John Lyng had expressed these in an earlier earnings guidance, explored in our previous SMIF report. However, in a more recent earnings guidance, John Lyng provided a significant upgrade in its outlook.

In line with this guidance, the voluntary escrow of 971,940 shares were released, issued to directors of the company, which potentially suggests that the company is on path with performance. Furthermore, there are strong tailwinds, especially regarding near-term top-line earnings growth driven by margin expansions and the large influx of CAT events. Of these CAT events in NSW and QLD, there have been over 170,000 claims (>$2.3 billion in value), of which JLG is likely to be heavily involved with.

Dusk Group (ASX: DSK 32.93%)

Despite ongoing challenges with the pandemic, Dusk Group have released a soft FY22 result, which resulted in Dusk Group shares soaring throughout July. Dusk Group management have stated the FY22 results were largely impacted by government-mandated store closures in 1H FY22 which resulted in approximately 5,483 (24%) trading days lost. Investors were surprised at the better than expected Pro-forma EBIT 26.3 million - 26.8 million compared to 28.4 million in FY21 and 11.8 million in FY20. Dusk project online sales to grow by 2.9% in addition to the 27% growth in the prior year. The group opened 10 new stores during the year and is expected to open another 8 by the end of the year across ANZ. Dusk is currently trading 35% above the 52-week low of $1.55.

Elders Limited (ASX: ELD -10.41%)

Elder's share price fell heavily due to concerns surrounding the high risk of foot-and-mouth disease (FMD) to Australia. The disease has run rampant in Indonesia and has the potential to cause billions in damage. Furthermore, national trade steer prices and lamb prices both decreased in July by 15% and 3% respectively, largely due to sufficient supply and poor wet weather across the country. We believe that the large fall in share price due to fears for FMD contamination is overstated, as Australia's prudent history and active planning should largely reduce the biosecurity risks.

Furthermore, rising interest rates has pushed transactional volume for rural property in decline nationally by 29.6%. The national median price per hectare also decreased slightly by 2.5%. However, competition within rural property market remains strong, attributed to the tight supply and high confidence. Elder's believes that the price of rural properties will increase in the next 6 months. Overall, Elder's continues to exhibit strong cash flows, along with consistently solid dividend yields.

BHP Limited (ASX: BHP -6.23%)

BHP delivered a mixed quarter, with record iron ore and copper production in line with market consensus. This was balanced by metallurgical. coal deliveries, which missed the market consensus by 15%. Both iron ore and copper costs were in line with guidance, whereas metallurgical coal costs have exceeded FY22 guidance. This has allowed BHP deliver relatively low expectations, as opposed to mid-tier miners.

Additionally, there are fears of synchronised downturn across US and EU economies, which are weighing down on the commodities markets. After announcing a US$9.7bn underlying profit, BHP has also announced a US$1.50 per share interim dividend. These figures came from surging prices and demand for BHP's commodities, including iron ore, copper, coal and nickel. Since the iron ore price has slumped 35%, which accounts for the bulk of BHP's earnings.

To align with the global push to electrification and decarbonisation, BHP's attention is turning towards growth prospects, especially regarding the metals sector notably in the form potash, nickel and copper.

Rio Tinto (ASX: RIO -4.74%)

RIO's shares have remained mostly unchanged since the company delivered its half year results and declared its dividend on 27th July.

Similarly to BHP, RIO presented mixed financial results, while the ASX200 Resources Index climbed 5.5% over the same period. A slump in the iron ore price following the rally earlier this year has been the focal point as RIO derive a large portion of revenue from iron ore.

RIO announced a fully franked dividend of $3.837 per share to be paid on 22nd September. Management have stated the 52% decrease in dividend from the prior period is due to challenging market conditions, as profits were hit.

RIO are looking for opportunities to gain exposure to lithium to meet the demand of global car manufacturers. Additionally, RIO are assessing if it's undeveloped mine in Argentina can have an earlier starting date to diversify the iron ore dominated business into copper and lithium.

Performance:

	1 Month	3 Months	6 Months	1 Year	Inception p.a.*
SMIF	9.29%	-5.94%	-1.93%	-6.39%	9.58%
All Ordinaries Accumulation Index	6.34%	-6.62%	0.73%	-2.60%	9.96%
Alpha	2.95%	0.68%	-2.66%	-3.79%	-0.38%

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

* Return since fund inception on 19 November 2018.

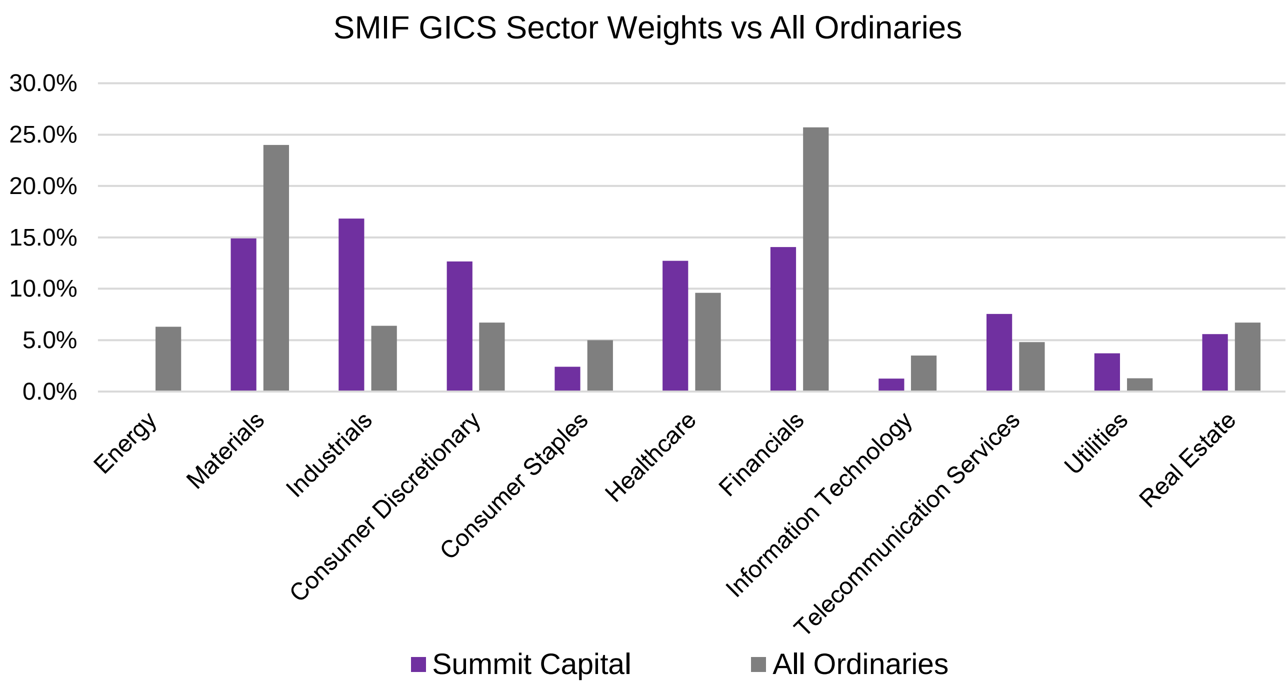
Sector Breakdown:

	% Weight	Change in rank
Energy	0.00%	
Materials	14.89%	
Industrials	16.83%	
Consumer Discretionary	12.67%	
Consumer Staples	2.43%	
Healthcare	12.73%	
Financials	14.07%	
Information Technology	1.27%	
Telecommunication Services	7.54%	
Utilities	3.72%	
Real Estate	5.59%	

Contributors to Returns (%)

Top 5 Contributors (%)	
DSK	32.93
PWH	32.12
JLG	31.36
CDA	24.57
DDH	24.22

Top 5 Detractors (%)	
ELD	-22.50
BHP	-22.23
RIO	-18.28
-	-
-	-



SMIF Portfolio Holdings:

Ticker	Company Name	Portfolio Weight		Position 30th July	Capital Gains	Dividends	Return*
MQG	Macquarie Group Ltd	7.91%		$22,460	12.2%	4.7%	16.0%
JLG	Johns Lyng Group	5.03%	▲2	$14,288	69.4%	2.7%	70.8%
PWH	PWR Holdings Ltd	4.84%	▼2	$13,761	43.2%	2.8%	45.0%
RMD	Resmed Inc	4.36%	▼1	$12,384	21.2%	1.1%	22.0%
DDH	DDH1 Drilling Ltd	4.18%	▲3	$11,880	0.6%	0.0%	0.6%
UWL	Uniti Group Ltd	4.02%	▼4	$11,427	21.4%	3.7%	25.1%
CWY	Cleanaway Waste Ltd	3.77%		$10,721	11.7%	2.3%	13.9%
APA	APA Group	3.72%	▼2	$10,555	1.0%	5.0%	5.9%
BOQ	Bank Of Queensland	3.56%	▲3	$10,122	-0.1%	0.0%	-0.1%
CNU	Chorus Ltd	3.52%	▲3	$9,995	10.3%	4.6%	14.2%
SHL	Sonic Healthcare	3.46%	▼2	$9,835	12.8%	4.2%	15.9%
BXB	Brambles Ltd	3.44%	▼1	$9,778	5.5%	2.5%	8.0%
CSL	CSL Ltd	3.37%	▲1	$9,565	8.6%	1.3%	9.7%
JHX	James Hardie Industries	3.12%	▲2	$8,870	11.0%	2.7%	13.4%
CLW	Charter Hall REIT	3.11%		$8,827	-3.8%	6.5%	2.7%
BHP	BHP Group Ltd	3.06%	▼6	$8,703	5.8%	12.0%	16.6%
WES	Wesfarmers Ltd	2.99%		$8,487	-0.6%	0.0%	-0.6%
SUN	Suncorp Group Ltd	2.60%	▲1	$7,385	6.4%	8.0%	14.3%
CAR	Carsales.Com Ltd	2.54%	▲3	$7,207	-4.5%	2.6%	-1.8%
INA	Ingenia Group	2.48%	▲3	$7,039	10.4%	2.4%	12.5%
RIO	Rio Tinto Ltd	2.45%	▼3	$6,946	3.1%	12.9%	15.4%
QUB	Qube Holdings Ltd	2.44%	▼1	$6,941	1.9%	3.0%	4.7%
DSK	Dusk Group	2.31%	▲3	$6,549	-29.2%	4.6%	-24.7%
ELD	Elders Ltd	2.18%	▼4	$6,181	-6.6%	5.2%	-1.4%
IPH	IPH Ltd	2.15%	▼1	$6,094	7.2%	4.4%	11.3%
NST	Northern Star Resources	2.08%	▼1	$5,896	17.7%	4.1%	20.7%
IDX	Integral Diagnostics	1.54%		$4,369	-4.1%	3.8%	0.0%
CDA	Codan Ltd	1.27%		$3,607	-18.0%	2.6%	-15.0%
WOW	Woolworths Group Ltd	0.25%		$713	0.1%	3.2%	3.3%
CASH	Cash and Dividends Receivable**	8.27%		$23,491			
		TOTAL		$284,078			

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

Further Readings:

[Oil Prices: OPEC+ Agrees to Raise Production Next Month at Much Slower Pace - Bloomberg]

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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.