The University of Queensland Business School

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AUSTRALIA
CREATE CHANGE

Student Managed Investment Fund August 2022 Update

August 2022 Fund Update

Dollar values are in AUD unless stated otherwise.

Fund Update

It has been a bumpy ride for equity markets this month with prices continuing to follow what the Federal Reserve's plans are for tackling inflation. On August 26th, in his annual Jackson Hole policy speech, Fed Chair Jerome Powell indicated that higher rates will likely persist, stating that he expects reaching their 2% inflation target will take "some time" and bring "some pain to households and businesses".

This appeared to rattle markets which seemed to have adopted a more optimistic expectation than Powell following the slowed July inflation figure. The July rally did not last and as a result S&P 500 dipped by 5.53% over the remainder of the month. Australian equities followed with weaker growth however still gained ground by 1.28%.

Given no material underlying changes to the macroeconomic backdrop or the RBA's approach to combat inflation, we maintain our view that inflation will peak later this year, though it is uncertain whether this will align with RBA's updated guidance of 7.75%. It remains difficult to say if we've seen the worst of the bear market as considerable uncertainty remains over just how hard economic activity will be hit.

August was a relatively quiet month for the portfolio's returns as the reporting season recently closed with mixed but mostly positive results. Overall, the portfolio saw gains of 0.6% representing an underperformance of 0.68% compared to the benchmark.

The performance was highlighted by decent returns from Brambles Ltd (ASX: BXB), Carsales (ASX: CAR), IPH Ltd (ASX: IPH) and PWR Holdings (ASX: PWH) which saw returns of 8.12%, 9.44%, 11.73% and 13.65% respectively. The worst performing holdings of the month were Bank of Queensland (ASX: BOQ), Codan Ltd (ASX: CDA) and Ingenia Group (ASX: INA) with returns of -6.52%, -13.56% and -6.94% respectively. At the sector level, Energy continued to record the largest gains of 7.4% followed by materials at 3.9% and telecommunication services at 1.2%. The index was weighed down by poor performances from the real estate sector, consumer staples and utilities which saw declines of 3.9%, 2.6% and 1.6% respectively.

Market Update

Australian Economy

Tighter monetary policy has continued to affect the rate-sensitive sectors of the economy as highlighted by the recent downturn in the real estate sector. Housing prices have continued to fall, down 1.6% on the month and 4.2% on the peak earlier this year. Signs of broader activity beginning to slow appeared throughout the month with new building approvals and loan commitments starting to slide.

Uncertainty still surrounds the spending behaviour of households. On one end the wealth effect is taking hold as a result of the declining housing prices however, at the other, the labour market remains tight, and more people are seeing wage increases. Wages increased y/y by 2.6% compared to the last quarter of 2021, which has been mostly in line with the RBAs forecasts. This has resulted in a majority of households building up substantial financial buffers which has been reflected in resilient retail sales.

Additionally, unemployment in Australia has increased for the first time in 10 months, rising by 0.1% from 3.4% in the prior month. However, this rise in the unemployment rate was just a reversal of factors that caused the initial reduction from 3.5% to 3.4% back in July. Participation rates also increased to 66.6% due to an uptick in people seeking employment. It is expected that these strong employment levels will not last, with leading indicators for employment growth such as job vacancies showing softer levels of growth.

Overall, the Australian economy is continuing to grow at a reasonable rate, primarily driven by record terms of trade levels. GDP rose by 0.9% over the June quarter which has raised expectations of annual economic growth to 3.6% over 2022. With the impact of the additional hikes yet to materialise, the current forecasts are less optimistic. Annual GDP growth over 2023 is currently expected to be below 2%.

Monetary Policy Decision

The RBA has met our expectations of another 50bps hike taking the cash rate target to 1.85 per cent on the 2nd of August.

We attribute this large consecutive rate hike to the RBA placing critical importance on anchoring medium term inflation expectations and maintaining credibility. The RBA's decision is a balancing act. The consequences of being too hawkish are straightforward, whilst the consequences of being too dovish risk inflation expectations to out of their control and potentially become a long-term problem. If the RBA were to soften rate hikes too soon, markets may question the RBA's capacity to combat inflation.

Globally, Covid-19 containment measures in China, pressures on productive capacity, and Russia's invasion of Ukraine continue to sustain high inflation. Domestically, prices continue to move upward due to strong demand, a tight labour market and capacity constrains in some sectors of the economy. Floods this year are also affecting some prices.

Exploration Hits Record Levels

In defiance of negative sentiment around cost inflation, commodity price volatility and the labour market, ASX listed exploration companies have spent more than $1bn in their efforts to find new mining, oil, and gas assets in the June quarter. This comes after a slump in the first quarter of the year that sparked fears over an industry downturn.

The investor appetite for future facing commodities, particularly lithium, are being cited for the increase, as well as uranium and gold. The re-opening of Western Australia's border as well as the march quarter slump have also allowed for greater capacity for drillers to get into the field. This is especially good news for Australia's largest drill fleet operator, DDH1.

Global Perspective

US

Globally, there was a large focus on the US Fed Funds Rate 75 basis point rise executed at the end of July casting doubt over the outlook of the US economy provided its technical recession. There were some positive signs in the first half of the month, such as core CPI rising less than expected by 0.3% suggesting some inflationary relief, and robust job growth adding half a million jobs over July. However, despite a fall in the overall inflation over July from 9.1% to 8.5%, core inflation continues to rise, in addition to strong wage growth which is maintaining inflation concerns. As demonstrated by the Fed Fund futures, there is a high likelihood of another large 75 basis point interest rate hike in the upcoming September meeting.

Eurozone

Over the month of August, Eurozone markets performed poorly amid inflationary concerns, exacerbated by ongoing the energy crisis which is translating to higher electricity and gas prices across the continent. Tensions continue to rise as Russia threatened to halt the Nord Stream 1 pipeline, which supplies natural gas to Germany, for three days from 31 August. Oil ended the month at 103.86 USD/barrel, down from the peaks reached in June likely due to greater OPEC production outlined in the previous Fund report. With pressures around stable energy generation, Germany and France announced plans to delay the closure of nuclear power plants, highlighting the situation. Finally, Industrial producer prices for June were up 35.8% in the eurozone compared with June 2021.

China Property Crisis

China is struggling to contain what is being called by experts as the biggest property crash the world has ever seen. A collapse in confidence amongst ordinary people in China's housing market in tandem with Beijing's zero-Covid strategy and an extreme heatwave that is affecting the supply of power is causing a slump in China's economy.

The Chinese housing market is the biggest asset class in the world, with a notional value of between $55tn and $60tn. Developers are now struggling after being deprived of easy credit, falling property prices and sales, and homeowners refusing to pay mortgages on unfinished homes.

The Chinese central bank has cut the one-year loan prime rate to 3.65 per cent from 3.7 per cent in an effort to ease these pressures. However, this cut is likely too little too late, with property sales failing to respond to the previous rate cuts.

China is the largest buyer of Australian resources, with iron ore being Australia's single biggest export earner. A further deterioration or recession of China's economy would weigh down heavily on iron ore prices, and subsequently the Australian dollar, which has already lost value this year from interest rate differentials with the US.

Position Updates

PWR Holdings Ltd (ASX: PWH 13.65%)

PWR Holdings has raced through August, where the advanced cooling and emerging technology motorsport company has reported favourably. NPAT and dividends per share have both grown YoY at 27.6% and 36.4% respectively.

Despite relying on demand for cooling parts from Formula One for revenue, PWR Holdings is positioned well considering there are minimal risks regarding F1 specifications within the short term.

This organic growth has largely been stimulated across the UK, Australia, and the US, whereby sales grew by 35.9%, 34.1% and 17.9% respectively.

In addition to revenue from motorsports, the emerging technologies division has recorded a revenue growth of 123.8% from increased sales within the aerospace and military markets.

In response to this, SMA Motors, one of Sydney's largest dealer groups, have purchased 15.7 million shares from Quadrant Private Equity. While it is unclear what the intentions of this transaction are, a 25.6% premium shows ongoing demand from the market for a slice of PWR Holdings.

Codan (ASX: CDA -13.56%)

CDA's share price reacted negatively to the FY22 results despite outperforming with record NPAT growth in a challenging year for the company. Group sales increased by 16% and marginal growth in EBITDA by 2% compared to FY21. This was due to a boost in communications revenues as a result of their acquisitions of DTC and Zetron which have made the division a more globally relevant and diversified business.

CDAs gold detection business, however, took a hit from global supply chain shortages with sales down 20%. This was driven by reduced demand from their largest market in Northeast Africa, which was affected by geopolitical unrest and a decrease in the number of artisanal miners as more traditional forms of employment returned post Covid-19.

Bank of Queensland (ASX: BOQ -6.52%)

Bank of Queensland (BOQ) has struggled throughout August, where the share price fallen by 7%. The weakness within the overall market is due to negative sentiment from concerns regarding more aggressive rate hikes. This has not only effected BOQ, but other major companies within the financial industry.

Despite the sell pressure on BOQ, there is upside short term potential from rising interest rates to increase profit margins. Compounding this short-term effect, the integration of ME Bank is expected to bolster the earnings per share over the medium-term horizon.

This upside over the short and medium term does come at the expense of downside risks to revenue growth when analysing against peers within an economic environment where rates are rising. Additionally, the capital intensity and cost base trajectory are concerns following the acquisition of ME Bank.

ResMed (ASX: RMD -5.89%)

Despite ResMed's full year results being in line with earnings expectations from Goldman Sachs, the share price has resisted over August. ResMed revenue increased 13%, which was supported by strong growth in the US, Canada and Latin America divisions.

Revenue was also positively affected by the US FDA recall issue for a major competitor, Philips, for their CPAP machines.

However, ResMed was exposed to higher freight and manufacturing costs, which impacted the growth of margins.

Although earnings expectations were met, ResMed insiders have been net negative, as directors have reduced their stake in the company by 10% in the previous year.

Ingenia Group (ASX: INA -6.94%)

Ingenia Group faced the challenges of Covid-19 and poor weather, which lowered operating cashflow despite growing revenue. This reduction in operating cashflows has been attributed to the drop in the share price throughout August. EPS also fell due to an increase in securities on issue, following the $475m equity raising completed in November 2021.

Compounding the drop in share price may also be the growing concerns over the effect of increasing interest rates.

Ingenia recorded record home settlements and 32% profit increase for FY22, which supports the sentiment that fundamental metrics of the company remain positive. To support Ingenia's commitments to ESG, Ingenia announced 260 green-star homes will be built.

Carsales (ASX: CAR 9.44%)

Carsales reported strong domestic results in private and media segments, where revenue and EBITDA increased 16% and 7% from the year prior, respectively. Alongside recent acquisitions, Carsales raised $1.2bn to fully acquire the US platform, Trader Interactive.

The underlying conditions of the automotive market have contributed to the share price revving through August. Additionally, South Korean, US and Brazilian segments all saw double digit revenue and EBITDA growth, which is expected to continue into a strong FY23.

The automotive industry is currently facing supply chain shocks in semiconductor chips, haltering sales in new cars. This problem is expected to continue into FY23 and beyond, although is easing slightly, where new car sales are below 10% historical monthly averages. The dynamic relationship revenue model of new and used car sales will place Carsales in a strong market position.

Brambles Limited (ASX: BXB 8.12%)

Brambles has shown strength throughout August, where the share price has responded well to increased demand for defensive ASX companies from investors. Concerns regarding high inflation and rising interest rates has led to increased volatility, which has made resilient earning companies, including Brambles an attractive investment.

NPAT increased by 18% from FY21, with a final partially franked dividend of 12c per share announced by the board. Consequently, Brambles beat revised guidance despite the inflationary headwinds.

Although Brambles are experiencing significant inflation costs and pallet shortages, the company are managing these cost pressures better than industry peers.

Brambles initiated a market share buyback following the sale of IFCO business in June 2019. The market buy-back was completed in June 2022 and will reactivate the Dividend Investment Plan starting from the final 2022 dividend. The plan enables shareholders to apply some or all of their future dividends to the purchase of brambles shares rather than receiving cash. The final dividend payable is 13 October 2022.

DDH1 (ASX: DDH 6.92%)

DDH1 released their FY22 results in late August outlining a record year, with increased rig utilisation, shifts, and number of rigs translating to a 14% increase in revenue and 7.7% increase in operating EBITDA. DDH1 announced a fully franked dividend of 2.65 cents (up 22%) equivalent to 6.3% dividend yield. Despite the relatively low dividend, the dividend was 42.5% of the underlying NPATA in line with the 30-50% NPATA guidance provided in the past. Consistent with the ongoing share buyback program, DDH1 has now bought back a total of 3,295,956 shares (out of 34,280,468 shares). We expect that DDH1 continue the buyback program until July 2023. Per the investor presentation, DDH1 has expressed its interest in value added acquisitions, and is looking for drilling companies to add to its portfolio.

Johns Lyng Group (ASX: JLG -5.84%)

Johns Lyng Group 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. Johns Lyng Group had expressed these in an earlier earnings guidance, explored in our previous SMIF report. However, in more recent earnings guidance, Johns Lyng Group 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, signalling management confidence. Furthermore, there are strong tailwinds, especially regarding near-term top-line earnings growth driven by margin expansions and the large influx of catastrophe (CAT) events. Of these CAT events in NSW and QLD, there have been over 170,000 claims (>$2.3bn in value), of which JLG is likely to be heavily involved with.

IPH (ASX: IPH 11.73%)

IPHs strong performance over the last month was highlighted by the announcement of their $387m acquisition of leading Canadian IP firm Smart and Biggar. This positions IPH towards being a global leading IP services group.

This marked their first expansion outside the Asia pacific region. The Australian and Canadian IP markets operate similarly, and the acquisition will give the company reach into key secondary markets. The deal is expected to see a 10% EPS accretion in the first year of operations.

IPH recorded an increase in NPAT of 14% from the prior year, demonstrating the strong position of IPH within the industry. IPH has a runway for organic growth, which will be supported by further growth from the acquisition over the medium-term horizon.

Performance:

	1 Month	3 Months	6 Months	1 Year	Inception p.a.*
SMIF	0.60%	1.27%	0.82%	-2.30%	13.70%
All Ordinaries Accumulation Index	1.28%	-2.38%	0.28%	-3.86%	10.35%
Alpha	-0.68%	3.65%	0.54%	1.56%	3.35%

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

* Return since fund inception on 19 November 2018.

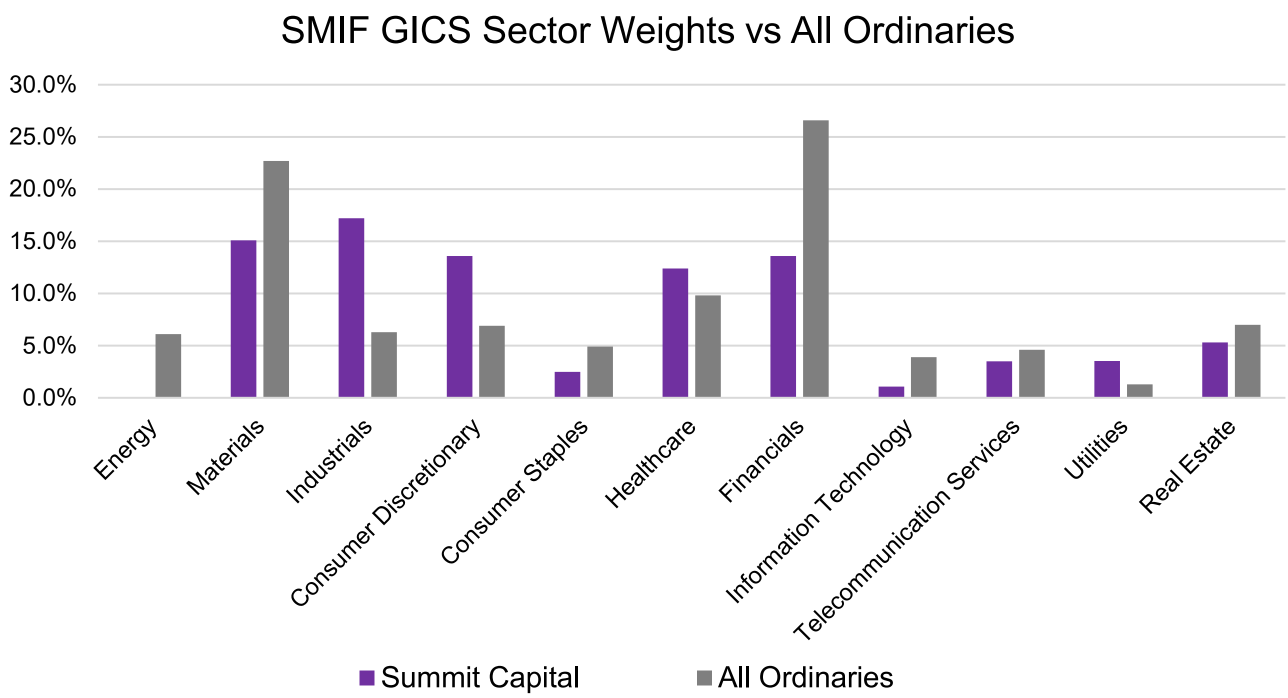
Sector Breakdown:

	% Weight	Change in rank
Energy	0	
Materials	15.08%	
Industrials	17.20%	
Consumer Discretionary	13.59%	▲2
Consumer Staples	2.47%	
Healthcare	12.39%	▼1
Financials	13.57%	▼1
Information Technology	1.06%	
Telecommunication Services	3.51%	▼2
Utilities	3.53%	▲1
Real Estate	5.32%	▲1

Contributors to Returns (%)

Top 5 Contributors (%)	
PWH	13.65%
IPH	11.73%
CAR	9.44%
BXB	8.12%
DDH	6.92%

Top 5 Detractors (%)	
CDA	-13.56%
INA	-6.94%
BOQ	-6.52%
RMD	-5.89%
JLG	-5.84%



SMIF Portfolio Holdings:

Ticker	Company Name	Portfolio Weight		Position 30th August	Capital Gains	Dividends	Return*
MQG	Macquarie Group Ltd	7.72%		$21,980	-2.1%	0.0%	-2.1%
PWH	Pwr Holdings Ltd	5.49%	▲1	$15,640	13.7%	0.0%	13.7%
JLG	Johns Lyng Group	4.73%	▼1	$13,455	-5.8%	0.0%	-5.8%
DDH	DDH1 Drilling Ltd	4.46%	▲1	$12,702	6.9%	0.0%	6.9%
RMD	Resmed Inc	4.09%	▼1	$11,631	-6.1%	0.2%	-5.9%
CWY	Cleanaway Waste Ltd	3.86%		$10,996	2.6%	0.0%	2.6%
BXB	Brambles Ltd	3.71%	▲4	$10,573	8.1%	0.0%	8.1%
APA	APA Group	3.53%	▼1	$10,048	-4.8%	0.0%	-4.8%
CNU	Chorus Ltd	3.51%		$9,981	-0.1%	0.0%	-0.1%
SHL	Sonic Healthcare	3.43%		$9,758	-0.8%	0.0%	-0.8%
CSL	CSL Ltd	3.40%	▼1	$9,687	1.3%	0.0%	1.3%
BOQ	Bank Of Queensland	3.32%	▼4	$9,462	-6.5%	0.0%	-6.5%
BHP	BHP Group Ltd	3.21%	▲2	$9,135	5.0%	0.0%	5.0%
CLW	Charter Hall REIT	3.05%		$8,672	-1.8%	0.0%	-1.8%
WES	Wesfarmers Ltd	3.01%	▲1	$8,556	0.8%	3.1%	3.9%
JHX	James Hardie Industries	2.97%	▼3	$8,445	-4.8%	0.0%	-4.8%
CAR	Carsales.Com Ltd	2.77%	▲1	$7,887	9.4%	0.0%	9.4%
QUB	Qube Holdings Ltd	2.55%	▲3	$7,268	4.7%	0.0%	4.7%
SUN	Suncorp Group Ltd	2.53%	▼2	$7,194	-2.6%	2.2%	-0.4%
RIO	Rio Tinto Ltd	2.36%		$6,710	-3.4%	5.6%	2.2%
IPH	Iph Ltd	2.34%	▲3	$6,673	9.5%	2.2%	11.7%
DSK	Dusk Group	2.32%		$6,608	0.9%	0.0%	0.9%
INA	Ingenia Group	2.27%	▼4	$6,462	-8.2%	1.3%	-6.9%
ELD	Elders Ltd	2.23%	▼1	$6,346	2.7%	0.0%	2.7%
NST	Northern Star Resources	2.08%		$5,926	0.5%	0.0%	0.5%
IDX	Integral Diagnostics	1.48%		$4,200	-3.9%	0.0%	-3.9%
CDA	Codan Ltd	1.06%		$3,028	-16.0%	2.5%	-13.6%
CASH	Cash and Dividends Receivable	12.51%		$35,604			
		TOTAL		$284,626			

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

Portfolio Management Team

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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.

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.