The University of Queensland Business School

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Student Managed Investment Fund October - December 2022 Update

October – December 2022 Fund Update

Dollar values are in AUD unless stated otherwise.

Fund Update

Since the last report in September 2022, the DOW and S&P indices were up 15.4% and 7.1% over Q4, breaking a 3-quarter losing streak. However, because of geopolitical tensions, inflation, and hawkish monetary policy – among many others – did not perform as strongly as they did the year prior. The All Ordinaries (XAO) was down 7.2% in the year, with US equity markets following suit. The DOW, S&P and Nasdaq were all down 8.8%, 19.4% and 33.1% respectively from the start of 2022, even despite the surge late into Q4. As central banks globally are still looking to maintain hawkish monetary policy to control inflation, we believe that equity markets could continue to experience further adverse effects (this will be discussed in further detail later).

From October to December of 2022, the SMIF portfolio was able to outperform the All-Ords, with a return of 7.08%, 5.44% above that of the XAOA. This outperformance was underpinned by China's relaxation of its "zero-COVID" policy, and the Fed's decision to slow the rate of monetary tightening in the future. The fund saw significant outperformance by 5 companies this time, with Northern Star Resources (ASX: NST), PWR Holdings (ASX: PWH), Rio Tinto (ASX: RIO), DDH1 Limited (ASX: DDH) and Ingenia Communities (ASX: INA) generating returns of 39.34%, 27.15%, 24.65%, 20.27% and 20.16% over the quarter, respectively. On the other hand, the significant upside was somewhat weighed down by Codan Limited (ASX: CDA), James Hardie Industries (ASX: JHX), Elders Limited (ASX: ELD), Dusk Group (ASX: DSK) and Resmed Inc. (ASX: RMD), with returns of -27.69%, -14.40%, -11.76%, -9.74% and -8.29% respectively.

We remain adhered to the SMIF philosophy and retain companies with solid business models and stable financials. Our allocations are not reflective of the movement in the index as we prefer to maintain a diversified portfolio with strong businesses from every GICS sector.

2023 Outlook

After almost three decades in which globalisation and technology revolution drove rapid growth in the supply side of the economy, we saw low inflation, historically low interest rates and positive market dynamics that resulted in corporate profits and rising asset prices. However, the dynamics changed in 2022 which proved to be a difficult year for global markets, characterised by global inflation, the end of expansionary monetary policy, supply chain disruptions and an unprovoked war. The combination of these events sent markets on a downward trajectory, from which we expect the challenges to persist into at least the first half of the new year.

As a result, the macroeconomy is pivoting toward a new regime whereby the supply side of the economy and productivity growth has downshifted due to reduced globalisation, deteriorating demographics, and changing political preferences in developed economies.

Supply-side Dynamics

Supply chain pressures are showing signs of easing and energy prices, namely natural gas, have fallen significantly from their late August highs last year. This indicates that there is a possibility for inflation to fall as supply corrects itself at the same time demand begins to retreat as some developed economies go into recession. However, while goods inflation may be peaking, services inflation is picking up, driven by the lagged effects of wage gains over the last year. Because of this we anticipate that global inflation falls over 2023 but remains above central bank targets due to structural changes in the supply side of the economy.

Deglobalisation and reshoring has been occurring as a result of rising costs in emerging markets, however the main driver is increasing political tensions between China and the West. Furthermore, the ageing population has become intense enough to start dragging down economic growth, particularly in China. Lastly, productivity growth in general in developed economies has been slowing for some time as a result of slower technological advancement and weaker growth in global trade. These trends are looking to remain durable in the foreseeable future which means that the market will have to persist in a new global economy with:

- Higher, stickier inflation.
- Higher interest rates across business cycles and the curve.
- More erratic, stop-start GDP growth with shorter upswings and more frequent recessions.
- Stronger wage growth and improved labour bargaining

Global Growth - Recessions and Recovery

Recessions have historically proven to, more often than not, precede sharp monetary tightening. In the US, monetary conditions have been tightening for a year now and there is evidence in the interest-rate-sensitive areas of the economy with slowing housing and construction as well as weaker components of consumer spending. The full effect of contractionary policy takes time, and we are expecting further weakness which will spread to the broader economy in income employment and profitability to round out a typical interest rate driven recession.

In the UK and Euro areas, there are signs that they are already in or close to recession. The region has been hit by a number of shocks and the UK already declined by 0.2% quarter on quarter in 3Q22. The Eurozone increased in 3Q22, but manufacturing and services PMIs are significantly below average which has indicated a 70% chance of recession in the past.

After being weighed down by the zero-COVID policy restrictions and the downturn in the property market, China has begun to rebound. The reopening of the world’s largest economy has reinvigorated investor optimism as demand for key metals such as iron ore and copper has lifted, acting as the major catalyst for the outperformance of the materials sector. We are expecting to see this pace of policy easing to continue and China’s growth to accelerate steadily over the course of the year.

Equities

What does this macroeconomic outlook mean for listed equities?

If onshoring continues to be a major theme then the primary beneficiaries would be construction and engineering firms, railroads, and consumer discretionary firms.

The global energy security and net zero transition continues to be the largest trend and recent estimates indicate that renewable sources are becoming cheaper than traditional fossil fuel sources. As onshoring and the global energy transition will likely take years to accomplish, there is a large capital investment required now to create new capabilities, one that the SMIF portfolio can capitalise on. The energy transition is a structural growth driver for infrastructure developers as policy makers continue to deliver stimulus packages to accelerate investment in energy technologies. Infrastructure also produces inflation protected cashflows that will be highly desired as we enter this likely higher and stickier inflationary environment. This will attract large sums of capital from institutional investors and governments as investment in infrastructure also tends to pick up economic downturns.

Agriculture/consumer staples stocks are another that have a positive outlook in 2023. Aside from being another inflation hedge, there are compelling growth drivers from increased global protein and grain demand stemming from higher per capita incomes but decreasing arable land. Furthermore, the demand for climate solutions such as carbon offset production and carbon capture can potentially provide a new source of revenue to the agricultural sector.

Real Estate stocks and REITs face greater headwinds than other sectors of the economy due to their interest rate sensitivity. However, high quality properties with premium tenants in locations with supply-demand imbalances are expected to perform solidly. This includes the logistics sector in major metro areas or ports with high vacancy where higher construction costs can be passed on to tenants through rent. This may protect the pricing in the sector and place a floor on valuations. In general, rental growth cashflows ae expected to remain solid for industrial real estate and rental housing.

Overall, despite navigating a challenging macroeconomic climate and listed equities historically performing poorly compared to other asset classes in above average inflation conditions. We still see opportunities to allocate to sectors with structural growth drivers.

Position Update

Northern Star Resources (ASX: NST 39.34%)

Northern Star Resources experienced significant capital gain over the quarter, resulting from higher gold prices and an overall steady performance. As their sales revenue is largely dependent on the price of gold, its uptick over the Oct-Dec quarter (US$1,700/oz to US$1,790/oz) increased their 1H23 Cash Earnings to $460-$475m, approximately $30m higher than 1H22a earnings. Additionally, NST's $300m on-market share repurchase program has been a contributing factor to the appreciation in their stock price. The buyback is now 42% completed, with 45,000 shares being bought back on the 21st of December.

Management have stated that their performance was in line with expectations and that they have been able to make cost improvements to two of their projects: Pogo and Thunderbox. They maintain confidence that they are on track to deliver their FY23 guidance.

PWR Holdings (ASX: PWH 27.15%)

PWH's share price rose to $10.77 at the end of the year, as they continued to experience tailwinds resulting from their strong FY 22 performance. The now ASX300 company's revenues increased by 27.6% to $101.1m, with NPAT also rising by 24.1%, from $20.8m to $16.8m from FY21.

We expect PWR to continue to be a strong holding in the portfolio, especially given its niche market and strong tailwinds in the automotive industry.

Rio Tinto (ASX: RIO 24.65%)

Over the quarter, Rio Tinto's share price rose sharply – from $93.39 to $116.41 – as China's easing of its borders revived investor confidence. Being a major ore miner, where 59% of their FY21 revenues comprised of iron ore sales, RIO's performance is strongly dependent on the price of this commodity. By the end of December, iron ore prices rose from USD$97/T to USD$122/T, as China began to lift its "zero-COVID" policies. We expect this trend in the iron price to continue, as China continues to lift its restrictions and begins to recover its economic activity. According to the Commonwealth Bank, the major driving sector for steel demand in China is in infrastructure, despite uncertainty over whether policy makers would allow an increase in steel output given the current restrictions on the alloy already. Contrarily, Bloomberg reports that real estate should be the major focus, with Chinese Vice Premier Liu stating that this sector is a "pillar" to the economy.

Additionally, RIO also succeeded in their acquisition of a Canadian mineral exploration and development company, named Turquoise Hill Resources. The $3.3b cash acquisition was completed on December 16th, at CA$43 per share in Turquoise Hill.

DDH1 (ASX: DDH 20.27%)

With the continuation of their buyback program from July 2022, supplemented by further tailwinds from their FY22 performance, DDH has been able to generate outsized returns for the portfolio throughout this quarter. The last buyback announcement for the program to date was on the 13th of December, with a repurchase of 387,165 shares, bringing the total number of repurchased shares to 18.5m. The approximate value of shares bought back is ~16m (using Dec 30 share price).

Over FY22, DDH was able to improve their revenues by 14% compared to FY21, whilst maintaining a low leverage of 0.15 Net Debt/EBITDA. They also achieved an ROIC of 27%, whilst maintaining an 80.9% rig utilisation rate.

Looking to FY23, DDH aim to concentrate on sustaining or improving on the following factors:

- Fleet utilisation, productivity and usage rates,
- Cash flow generation,
- Their ability to integrate Swick and extracting synergies,
- Being a forerunner in the renewable transition,
- Being disciplined in their investments on additional capacity.

DDH have stated that they anticipate ongoing strong demand for their service and aim to have

193 rigs available for use by 1H23 (calendar year) to meet that.

Ingenia Group (ASX: INA 20.16%)

Having performed poorly in September, Ingenia has rallied over the October to December period, rising back to $4.47 at the end of the year. Despite the reduction of various financial metrics in their FY22 report, INA had reported record home settlements. They have also recently been able to acquire 2 new development projects in Melbourne and Cairns. This project has a potential for a total of 425 land lease properties. The increase in settlements provides potential tailwinds for INA's revenue growth into the future and could be the reason to the increase in share price to the end of December.

Despite the upwards movement in the share price, INA have indicated that their FY23 performance is expected to be on the lower end of their guidance. We expect this could induce some reduction in their price as the new year approaches.

ResMed Inc (ASX: RMD -8.29%)

Following the release of Resmed's quarterly update, United States investors responded negatively, where the NYSE listed shares fell by 3.5%. 2Q earnings reports showed NPAT and EPS both up 13%, alongside robust sales growth. Additionally, revenue showed to benefit from the Medifox Dan acquisition, which was illustrated through a 7% growth in the 'Home Medical Equipment channel'.

Despite 2Q results exceeding market expectations, there are concerns of global market headwinds limiting operating leverage. Additionally, gross profit margin fell 80bp due to unfavourable FX and product mix. Regardless of strong performance across products, there are concerns margin headwinds will ease slowly. These include lower than expected mask sales, execution around SaaS acquisitions, pricing pressure and FX headwinds.

Dusk Group (ASX: DSK -9.74%)

Dusk Group shares have dropped following the release of a trading update. This update informed that the total sales for the first 5 months of FY2023 were up 23.9% on the prior period. While this figure is an increase, it is a slowdown from the 33.2% growth reported for the first 2 months of FY2023.

Consequently, there are uncertainties surrounding the effects of the RBA during typically heavy retail periods. The CPI growth rate for December 2022 was reported to 1.9%, which results in a growing cost of living for Australian shoppers during Christmas shopping periods.

Elders Limited (ASX: ELD -11.76%)

In the wake of the full year results release, investor outlook has been negative. Despite strong growth in FY22, the announcement of the retirement of the CEO and management's outlook have placed significant selling pressure on the share price. The CEO, Mark Allison, is retiring after 10 years with Elders, signalling a phase of leadership change. The strong growth was largely driven by the Rural Products business outperforming expectations alongside growth from strategic acquisitions.

The outlook for FY23 remains uncertain for investors, with concerns regarding the impact of extreme rainfall events affecting the cropping regions and harvest potential for both summer and winter crops. Therefore, Elders have faced numerous challenges, which has been reflected by the share price decreasing.

James Hardie Industries (ASX: JHX -14.40%)

Building materials provider, James Hardie Industries, have faced the negative effects of rising interest rates. Consequently, the share price has decreased over the last 3 months, due to the slowdown in housing from a lack of investment appetite. This is exemplified by the rate of deterioration on volume outlook, where growing their economic footprint appears to be difficult over the short term horizon. James Hardie Industries announced they are slashing hundreds of jobs globally, with 100 of employees cut coming from the APAC region. This is in anticipation of a slowdown in the housing market for 2023, which allows the business to better align their cost basis to market conditions. These changes come as new CEO, Aaron Erter restructures the company for macroeconomic uncertainty, aggressive inflation and rising interest rates.

Despite these challenges, James Hardie Industries are positioned strongly to benefit from changes in product mix to meet demand.

Codan Limited (ASX: CDA -27.69%)

Codan's share price significantly fell, which was driven by numerous factors. Firstly, the release of a trading update during the AGM revealed that trading conditions were tough at the beginning of FY2023 and profits are expected to decrease by 50% from the previous period. This saw heavy selling pressure from investors, who are concerned about forward guidance, particularly a fall in Minelab sales. Additionally, there is waning demand for detector sales from a reduction in sales in Africa, due to a military coup. This placed pressure on investors who expect to see a ~$60m hole in sales. To improve profits, Codan will likely expand into new markets or secure large communications contracts, both of which Codan have a long track record of. Codan's management have previously shown ability to acquire communications businesses when necessary to support expansion into new markets.

Performance:

	Oct-Dec 2022	Oct-Dec 2021	LTM (as of 31st Dec)	Inception p.a.*
SMIF	7.08%	-1.07%	-8.76%	8.82%
All Ordinaries Accumulation Index	1.64%	-2.28%	-12.50%	8.97%
Alpha	5.44%	1.21%	3.74%	-0.15%

Alpha may not equal SMIF return minus All Ordinaries return due to rounding. Returns also include any closed positions during the months analysed.

* Return since fund inception on 19 November 2018.

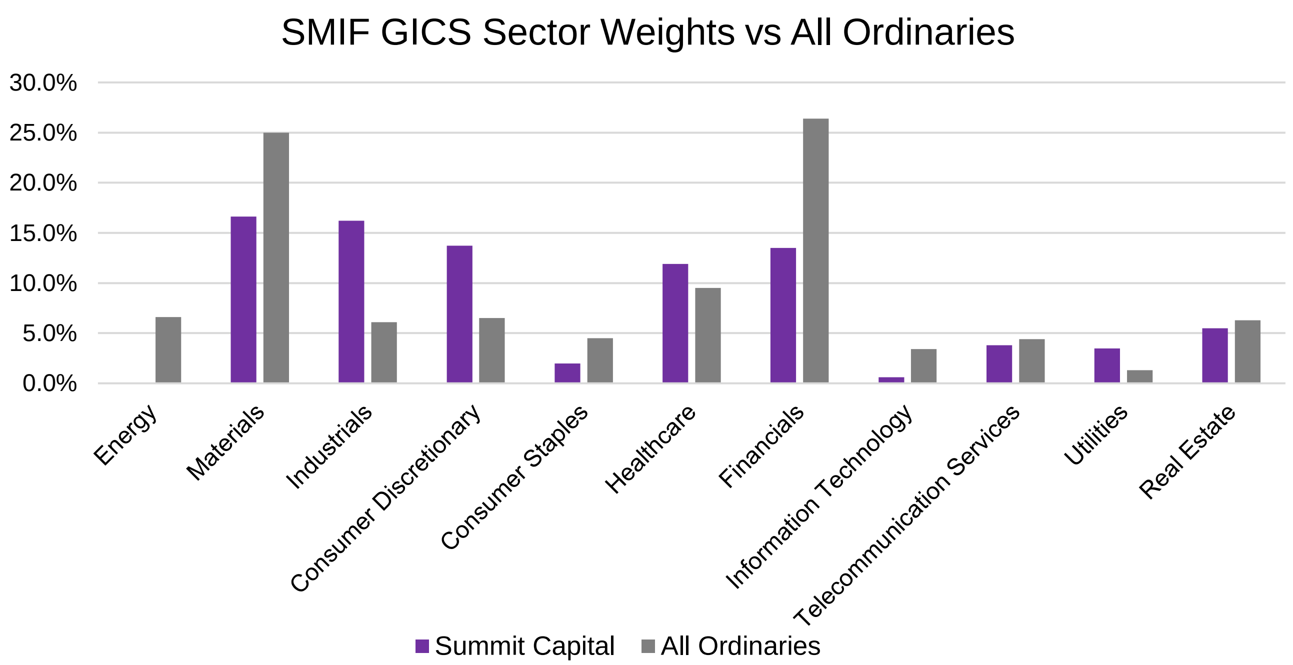
Sector Breakdown:

	% Weight	Change in rank
Energy	0	
Materials	16.63%	▲1
Industrials	16.22%	▼1
Consumer Discretionary	13.73%	▲2
Consumer Staples	1.98%	
Healthcare	11.91%	▼2
Financials	13.51%	
Information Technology	0.61%	
Telecommunication Services	3.79%	
Utilities	3.47%	
Real Estate	5.48%	

Contributors to Returns (%)

Top 5 Contributors (%)	
NST	39.34%
PWR	27.15%
RIO	24.65%
DDH	20.27%
INA	20.16%

Top 5 Detractors (%)	
CDA	-27.69%
JHX	-14.40%
ELD	-11.76%
DSK	-9.74%
RMD	-8.29%



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SMIF Portfolio Holdings:

Ticker	Company Name	Portfolio Weight	**	Position 31st Dec	Capital Gains*	Dividends*	Total Return*
MQG	Macquarie Group Ltd	7.37%		$20,703	7.3%	4.9%	11.54%
PWH	PWR Holdings Ltd	6.32%		$17,749	49.0%	3.5%	50.88%
DDH	DDH1 Drilling Ltd	4.74%	▲2	$13,300	12.7%	4.8%	17.45%
JLG	Johns Lyng Group	4.18%		$11,730	44.4%	2.9%	46.04%
RMD	Resmed Inc	3.99%	▼2	$11,208	18.0%	1.2%	18.96%
CNU	Chorus Ltd	3.79%	▲3	$10,638	18.8%	5.0%	23.24%
CWY	Cleanaway Waste Ltd	3.68%	▼1	$10,328	7.6%	2.3%	9.71%
BXB	Brambles Ltd	3.67%	▼1	$10,308	9.3%	3.4%	12.58%
BHP	BHP Group Ltd	3.66%	▲4	$10,267	11.1%	12.8%	21.37%
APA	APA Group	3.47%	▲2	$9,749	-1.6%	5.1%	3.62%
CSL	CSL Ltd	3.38%	▼3	$9,496	7.3%	1.3%	8.44%
BOQ	Bank Of Queensland	3.31%	▼1	$9,287	-8.4%	4.6%	-3.81%
SHL	Sonic Healthcare	3.06%	▼3	$8,601	7.9%	4.6%	11.54%
CLW	Charter Hall REIT	3.06%	▲2	$8,594	-4.4%	6.5%	2.26%
WES	Wesfarmers Ltd	2.98%	▼1	$8,356	-2.1%	3.0%	0.92%
RIO	Rio Tinto Ltd	2.94%	▲1	$8,265	10.3%	12.5%	21.00%
NST	Northern Star Resources	2.92%	▲6	$8,204	31.3%	4.1%	34.28%
SUN	Suncorp Group Ltd	2.83%	▲1	$7,946	9.5%	7.2%	16.39%
CAR	Carsales.Com Ltd	2.58%	▲1	$7,245	-3.4%	2.8%	-0.53%
QUB	Qube Holdings Ltd	2.52%	▲2	$7,067	2.1%	3.2%	5.12%
INA	Ingenia Group	2.42%	▲4	$6,781	7.1%	2.6%	9.42%
JHX	James Hardie Industries	2.37%	▼7	$6,653	12.0%	2.5%	14.21%
IPH	Iph Ltd	2.17%	▼5	$6,094	6.0%	4.6%	10.22%
ELD	Elders Ltd	1.98%	▼3	$5,557	-11.0%	5.3%	-5.23%
DSK	Dusk Group	1.85%	▼1	$5,192	-39.3%	7.8%	-30.92%
IDX	Integral Diagnostics	1.48%		$4,143	-5.4%	3.7%	-1.37%
CDA	Codan Ltd	0.61%		$1,706	-39.4%	2.8%	-34.35%
CASH	Cash and Dividends Receivable	12.67%		$35,556			
		TOTAL		$280,722			

* On each position since purchase
** Changes in position from last September update

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.