Ausbil Australian Active Equity Fund

Monthly investment report

July 2018

Ausbil Investment
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ausbil

Australian equities

Performance review

Fund performance for July 2018 was 1.29% (gross of fees) versus the benchmark return of 1.31%, as measured by the S&P/ASX 300 Accumulation Index.

At a sector level, the Fund's overweight position in the Consumer Discretionary sector contributed to relative performance. The underweight positions in the Consumer Staples, Utilities and Real Estate sectors also added value. Conversely, the overweight positions in the Energy, Materials and Information Technology sectors detracted from relative performance. The underweight positions in the Health Care, Financials and Telecommunication Services sectors also detracted value.

At a stock level, the overweight positions in Downer, Treasury Wine Estates, Clydesdale Bank, Fairfax Media, Aristocrat Leisure and QBE Insurance contributed to relative performance. The underweight positions in Scentre Group, Transurban and Insurance Australia also added value. Conversely, the overweight positions in Evolution Mining, Independence Group and Computershare detracted from relative performance. The underweight positions in Telstra and Qantas also detracted value.

Equity Market Review

The Australian equity market had a positive month, to return 1.3%, driven primarily by the Consumer Discretionary and Financials sectors. Globally, Developed (MSCI World: +3.1%) markets outperformed Emerging (+2.3%) markets but both remained in positive territory despite higher volatility. Within Developed markets, US (S&P500: +3.7%) and Europe (EURO STOXX: +3.5%) outperformed, while the UK (FTSE100: +1.5%) lagged.

Domestically, large-cap stocks (S&P/ASX 20 Accumulation Index: +2.9%) outperformed. Small-cap stocks (S&P/ASX Small Ordinaries Accumulation Index: +1.4%) were almost in line with the overall benchmark, whilst mid-cap stocks (S&P/ASX MidCap 50 Accumulation Index: +0.1%) underperformed.

Energy was mostly lower (Thermal Coal: +5.4%, LNG: -5.8%, WTI Oil: -7.3%, Brent Oil: -7.0%, Metallurgical Coal: -13.2%) Metals were mixed (Manganese: +26.3%, Iron Ore: +4.9%, Tin: +1.7%, Aluminium: -4.3%, Copper: -5.2%, Nickel: -6.0%, Zinc: -7.9%, Lead: -11.0%, Cobalt: -11.0%). Precious metals were softer (Silver: -3.4%, Gold: -2.1%, Platinum: -1.3%).

Telecommunication Services (+7.6%) outperformed. Industrials (+3.2%) was boosted by Commercial & Professional Services (+5.7%) and Capital Goods (+5.3%). Health Care (+2.2%) benefited from Pharmaceuticals & Biotechnology (+2.4%). Financials (+2.0%) outperformed over the month driven by the Banking sector (+2.7%). Consumer Discretionary (+1.8%) also outperformed, while Energy (+1.2%) and Real Estate (+1.0%) were slightly behind. The underperforming sectors were Materials (-0.3%), due to relative weakness from the Metals and Mining sector (-0.4%), Consumer Staples (-0.9%), Information Technology (-1.1%) due to expensive valuations and Utilities (-1.4%) due to perception of higher regulatory risk.

Economic review

Equity Market Outlook

The corporate profit reporting season is set to take centre stage in August. The Metals & Mining and Energy sectors are likely to come under the spotlight, as commodity prices have moderated over the past six months and higher costs have been flagged. Investors will be particularly alert to results from companies exposed to the domestic Consumer sector, which is facing strengthening headwinds in the form of declining house prices, rising indebtedness among consumers and benign wage growth. More broadly, the ongoing trade dispute between the US and China continues to overshadow the market. The prospect of a negotiated settlement has suffered a setback with the latest warning from China that it will target an increased number of US exports if the US presses ahead with plans to impose tariffs on a wider range of Chinese imports.

Fund Strategy

The Fund increased positions in the Insurance and Consumer Staples sectors whilst positions were trimmed in the Banking, Energy, Commercial Services and Building Materials sectors. Overall positioning continues to favour a growth tilt with overweight positions in Materials and offshore earners, whilst maintaining underweight tilts to interest rate sensitive sectors such as Real Estate Investment Trusts and Utilities.

For the S&P/ASX 300 Index, consensus EPS forecasts are now at +7.2% for FY19 with +5.8% for FY20, which delivers PE valuations of 15.7x and 14.9x for 2019 and 2020 respectively and a dividend yield of 4.4%.

Economic Review

Risks of an intensifying global tariff war were markedly reduced after European Union Commission President Junker and US President Trump agreed to “work together toward zero tariffs, zero non-tariff barriers, and zero subsidies on non-auto industrial goods”. US real GDP growth surged to an annualised rate of 4.1% in the June quarter, following an upward revision of the March quarter result to 2.2%. Averaging the last six months, real growth has accelerated to 3.1% in the June quarter, up from 2.6% in the December quarter of 2017.

The European Central Bank left policy unchanged and “took note” of the positive meeting between President Trump and his EU counterpart. ECB President Draghi was quick to point out that it was “a good sign”. Forward guidance was adjusted slightly to “convergence of inflation to rates that are below but close to 2% over the medium term”, from “evolution of inflation remained aligned with current expectations of sustained improvement”.

Chinese authorities aggressively eased policy settings due to slower economic activity and tightening financial conditions. The State Council agreed to make fiscal policy more “proactive” and to keep liquidity conditions “reasonably adequate”. The Bank of Japan introduced greater flexibility into its monetary policy operations, lowered its inflation forecast and retained its GDP macroeconomic forecasts. The BoJ will be reducing the size of financial institution excess reserve balances currently subject to a negative interest rate. It will resize its equity ETF purchases and will continue to target a 10-year bond yield of zero, responding promptly to any large deviations.

The Australian Labor Party benefited from ‘Super Saturday’s’ five by-elections. The seats of Braddon in Tasmania and Longman in Queensland were expected to be close, but resulted in comfortable wins for Labor. Headline inflation rose by 0.4% in the June quarter, with the annual rate rising to 2.1%. The average of the RBA’s underlying inflation measures was steady at 0.5% with the annual rate at approximately 1.9%, just below the lower end of its target band.

Economic outlook

Economic Outlook

2018 will see ongoing synchronised global growth at a robust 3.9% plus pace compared to the post-crisis period average of 3.3%. The US economy accelerates to between 2.7% and 3%, as fiscal policy drives a capital expenditure investment boom. The Eurozone consolidates at 2.3%, Japan maintains a positive output gap growing at 1.4%, and China remains focused on 'high quality' growth in achieving its 6.5% target.

Cash rates and bond yields continue to rise at a modest and gradual pace, with the US Federal Reserve hiking 3 maybe 4 times, taking the cash rate to between 2.25% and 2.50%. On auto pilot, there is ongoing 'quantitative tightening' as US$480bn of bonds mature in 2018 and US$600bn in 2019 and 2020 respectively. European Central Bank QE tapering is extended and volume is reduced in stages from €30bn per month to zero, with rates on hold until Q3 2019. The Bank of Japan is expected to shift its target bond yield rate later this year and again in 2019. US dollar appreciation leads to a modest tightening in financial conditions and the Euro depreciates on ongoing QE. The currency and rate adjustments should see developed equity markets outperform, while the peripheral emerging markets underperform. The risk of contagion flowing into the core emerging markets seems limited, but is a risk requiring monitoring.

The Australian economy is entering a record 27th year of uninterrupted growth, with unemployment heading lower and core inflation a little below its target range. GDP growth is forecast to be 2.7% to 3.0% in 2018, rising to 3.1% in 2019 as growth transitions to the non-mining sector and broadening business activity offsets potential downside risk from indebted households. The unemployment rate is expected to trend lower to 5.1% and core inflation to rise to 2% in 2018. Broadening economic growth and higher wage and inflation outcomes should see a tightening cycle commence. The timing has been pushed out to Q3 2019 from Q4 2018. Reflecting the themes voiced by RBA board members: (1) the next interest rate move will be up, but not just yet; (2) the Reserve Bank should be a source of stability and confidence; and (3) expect a slowing in housing credit growth from tightening mortgage lending standards. Meanwhile an unchanged cash rate should place downward pressure on the Australian dollar as the interest rate differential moves further in favour of the US. The currency is forecast to test the lower part of the 72-78 US cent range before closing at 75 US cents by year-end 2018 and 2019.

Downside risks to the global economy include challenges to existing trade arrangements, instability in the euro area and possible global negative feedback from US Federal Reserve benchmark rate increases. The Australian economy may be at risk from an exogenous shock to the highly indebted household sector stemming from: (1) liquidity constraints from out-of-cycle housing rate increases; (2) ongoing low nominal wages; (3) rising living costs for energy; (4) a negative change in the employment outlook; (5) further tightening in lending standards and slower credit growth; and (6) a change in government.

Fund overview

Fund return

Period	Fund Return % Gross	Fund Return % Net	Benchmark[1] %	Out/Under Performance % Gross	Out/Under Performance % Net
1 month	1.29	1.22	1.31	-0.02	-0.09
3 months	5.08	4.87	5.78	-0.70	-0.91
6 months	7.16	6.73	6.05	1.11	0.69
FYTD	1.29	1.22	1.31	-0.02	-0.09
CYTD	6.92	6.41	5.63	1.29	0.78
1 year	18.73	17.78	14.70	4.03	3.07
3 years pa	9.58	8.70	8.09	1.50	0.61
5 years pa	10.91	10.01	9.15	1.76	0.87
7 years pa	11.65	10.74	9.79	1.86	0.95
10 years pa	8.55	7.65	6.93	1.61	0.72
15 years pa	12.00	11.05	9.36	2.63	1.68
20 years pa	11.70	10.72	8.66	3.04	2.05
Since inception pa Date: July 1997	11.41	10.43	8.37	3.04	2.06

Top Ten Stock Holdings

Name	Fund %	Index[1] %	Tilt %
BHP	9.14	6.48	2.66
CSL	6.24	5.16	1.09
Westpac Bank	6.24	5.87	0.37
Santos	5.40	0.65	4.75
Commonwealth Bank	4.68	7.63	-2.95
BlueScope Steel	4.53	0.56	3.97
ANZ Bank	4.50	4.92	-0.42
QBE Insurance	4.07	0.80	3.27
Aristocrat Leisure	3.76	1.19	2.57
Macquarie Group	3.47	2.25	1.22

Fund Sector Tilts

Name	Fund %	Index[1] %	Tilt %
Energy	6.94	5.74	1.20
Materials	29.76	18.20	11.56
Industrials	4.15	7.36	-3.20
Consumer Discretionary	5.62	4.97	0.65
Consumer Staples	6.86	7.94	-1.08
Health Care	8.05	8.51	-0.46
Financials	30.42	32.84	-2.42
Information Technology	5.00	2.45	2.55
Telecommunication Services	0.00	2.37	-2.37
Utilities	0.00	1.94	-1.94
Real Estate	2.99	7.69	-4.70
Cash	0.21	0.00	0.21
Total	**100.00**	**100.00**	**0.00**

1. The benchmark is S&P/ASX 300 Accumulation Index.

Fund activity

Fund activity

Major Purchases and Sales

Purchases	Sales
Suncorp	Nil

The Fund purchased a holding in Suncorp during July. No positions were sold during the period.

Suncorp Group (SUN) is a major diversified provider of financial services, and occupies a duopoly position in the domestic general insurance market where a process of rate remediation is currently underway. This should benefit Suncorp's 2018 financial year earnings, with an anticipated strong cost discipline likely to pave the way for a return to a 10% insurance trading ratio (ITR) next financial year. Suncorp is also likely to announce the disposal of its life insurance business. The company has a banking operation, which provides a high level of earnings certainty, but offers limited growth prospects.

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