



Invest with Experience

Quest Australian
Equities
Concentrated
Portfolio

QUARTERLY REPORT
SEPTEMBER 2022



Australian Equities Concentrated Portfolio

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Sydney NSW 2000

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Portfolio Movement

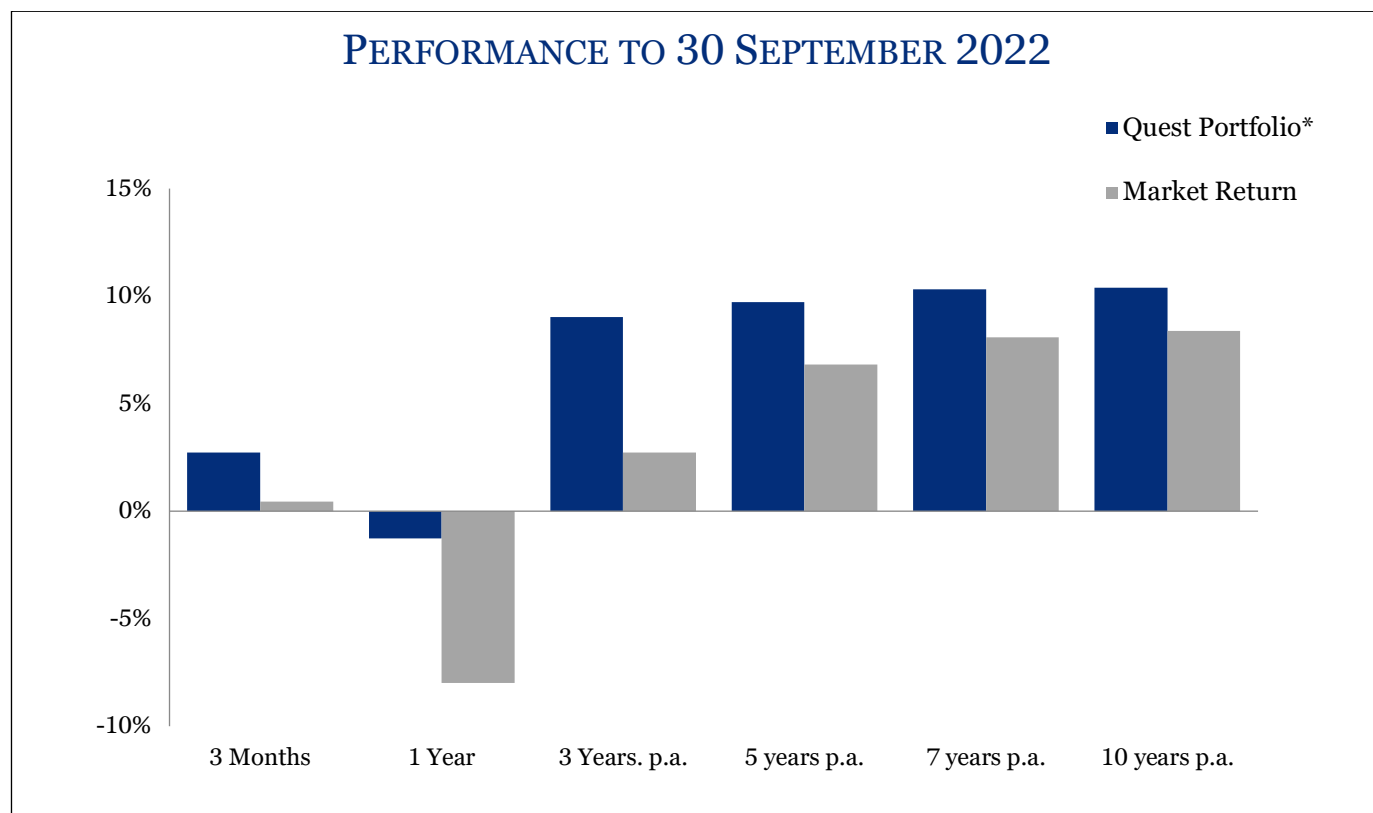
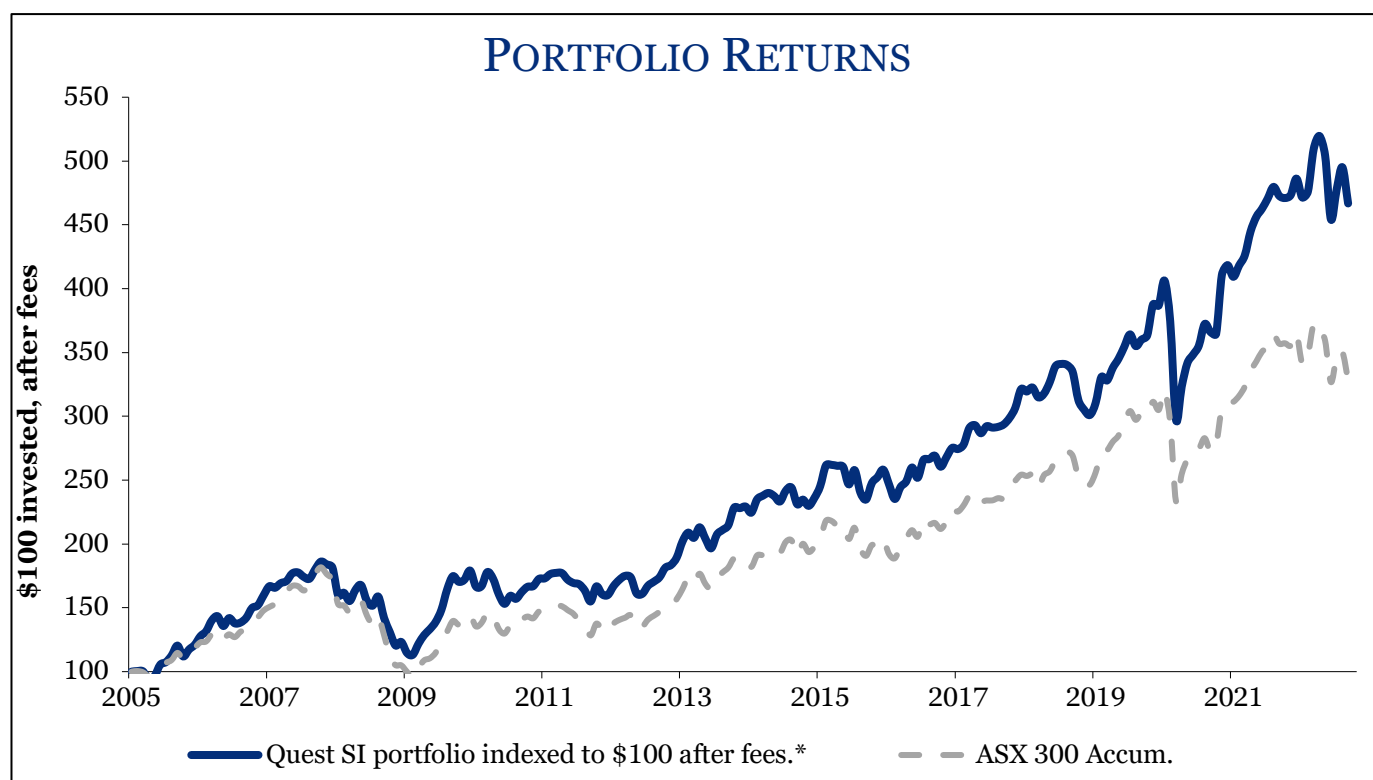
Previous market value 30 June 2022	
Contributions during Quarter	
Portfolio movement*	
Market Value 30 Sept 2022	

Your portfolio performance for the quarter*	2.74%
Market return (S&P / ASX 300 Accumulation Index)	0.45%
Your portfolio performance for the 12 months*	-1.17%
Market return (S&P / ASX 300 Accumulation Index)	-8.00%

* Includes fees for the period.



Portfolio Returns



* The portfolio returns shown above are for an actual client portfolio on the JBWere Multi Asset Platform. They demonstrate the returns achieved if invested in the Quest portfolio since inception (February 2005). Individual returns will differ for investors that made an initial investment after this inception date or where additional investments, redemptions or any SPP investments have been made. Quest returns are net of fees. Past performance is not a reliable indicator of future performance.



Market Review

In early September, Quest attended a speech by Reserve Bank Governor Philip Lowe. In response to questions from the floor, Governor Lowe repeatedly referred to inflation as a 'scourge'. He said inflation is a scourge for the damage it does to the standard of living, in creating uncertainty, eroding savings and in extending inequality.

Global actions to regain control of inflation continue to weigh on global equity and bond markets. The US 10-year Treasury bond climbed to a yield of 3.7% at the end of September. It now sits at a level well above the August 2020 low of 0.5%. The Australian 10-year Bond yield climbed to 3.9% from 3.6%.

Global equity markets were weak. The US S&P 500 dropped over 5% and the German DAX Index was also more than 5% lower. The US S&P 500 has now dropped 25% since December 2021, whilst the ASX has fallen 10% over the same period. The Shanghai Composite fell 11% in the quarter, the MSCI World Index dropped 6.6%.

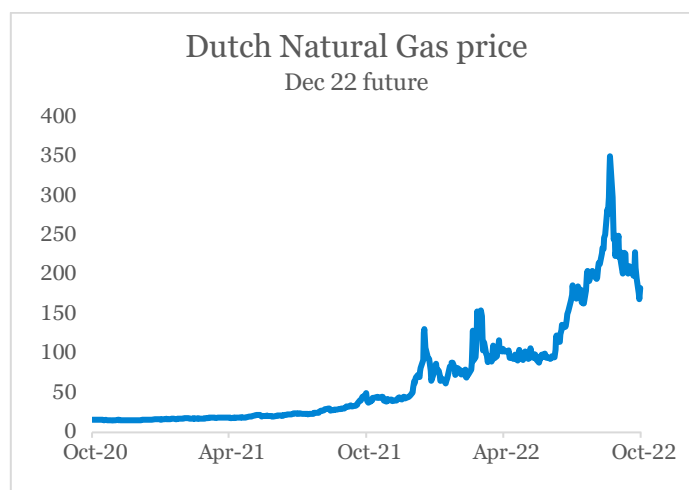
The ASX 300 Accumulation Index continues to be a safe haven and did well to produce a slightly positive return for the quarter with the inclusion of some hefty dividends. BHP's \$2.55 per share fully franked dividend paid in September was a total payment of \$12.9bn. High coal, LNG and iron ore prices and a weak \$A have resulted in large dividends as well as tax payments well above Treasury forecasts for 2022. Reports of Australia not benefitting from the resources boom is a myth.

Funds continued to flow towards the US dollar. It has now risen against the Euro for six quarters in a row. This \$US strength is true for most major currencies. The \$A has fallen 11.9% this year relative to the \$US, mostly in the last quarter. The TWI has however fallen only 2.1%, suggesting all currencies are weak against the \$USD.

High inflation is partly due to the energy shortages caused by Russia's invasion of Ukraine. During the quarter some of this pressure eased with Brent oil dropping 23% to a still elevated \$US88/barrel. The fall was caused by lower global GDP forecasts.

Europe is the epicenter of the global slowdown. Their energy crisis is much worse than in other markets. The chart above shows the recent huge spike in European gas prices. One Quest client reported the energy costs for a peer's Europe print business has lifted 1000%. Industrial production is being constrained to ensure sufficient gas is stored for winter heating. With EU gas storage

now at 90% of capacity ahead of the northern winter it appears the crisis is averted for now but refilling of storage in 2023 will be a challenge. Russian gas flows are down 90%.



Source Iress

Reporting season in August was relatively uneventful with results generally strong, helping the tone of our market at that time. However, these are backward looking results. Companies were reluctant to give earnings guidance as the impact of the hefty RBA interest rate hikes since May is still to be felt. Analysts continue to downgrade forecasts, despite the current buoyant economy. We expect there is further to go and remain cautious on growth expectations. The upcoming AGM season is likely to generate earnings downgrades. Our company visitation confirms that the cost of doing business is rising.

Banks (+2.9%) and Healthcare (+2.6%) were the best local sectors during the quarter. Banks have been rapidly passing on every RBA move, but predictably deposit rates have been slower to follow. Net Interest Margin (NIM) pressure for Australian banks has abated for the moment.

Utilities (-13.6%) and REITS (-7.5%) were both impacted by higher bond yields.

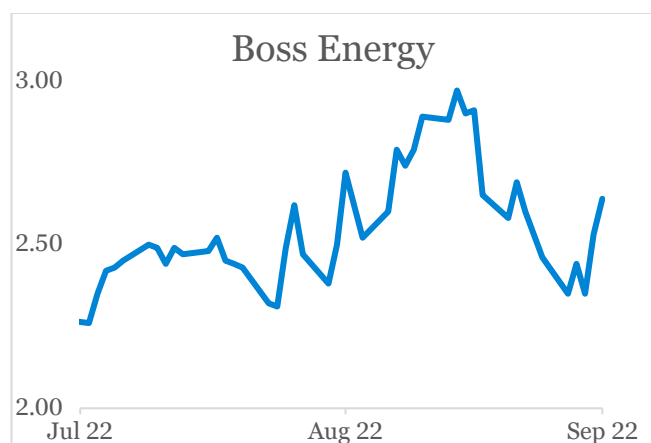
Market interest in future facing metals: copper, nickel, lithium and manganese continues. Lithium stocks are in strong demand. We own **Mineral Resources, Allkem and IGO Limited**. Lithium chemical prices are at record highs.



Our field trips confirm that lithium miners are being pressured to supply more from a broad range of buyers. Benchmark Intelligence report that the number of built and proposed battery gigafactories by 2030 has surged from 200 to 236. They will all be hungry for feedstock. There are still no operating gigafactories in Europe, the bulk are in China and North America is seeing major construction.

Lithium buyers want consistent supply from stable jurisdictions and there is no better source than Australia. We have the lithium bearing rock at multiple sites and there are now three lithium hydroxide plants under construction in Western Australia. Two have reached the commissioning stage. Each of Mineral Resources, Allkem and IGO Limited will soon have downstream processing plants giving buyers a non-China source of supply.

Our team have a position in uranium miner **Boss Energy** (BOE) who are rebuilding an existing plant in South Australia. Commissioning will be in 2023. BOE was strong in the September quarter as Germany, the UK and Japan confirmed that nuclear power is a priority for the future.



Source Iress

Australian companies continue to attract global interest. US software investment firm Thoma Bravo launched a \$1bn acquisition 'scheme' for aerial photographer **Nearmap** (NEA). The Nearmap Board has endorsed the scheme. Point of Sale system supplier **Tyro Payments** (TYR) rejected an indicative \$657m proposal by a consortium led by Sydney based Potentia Capital.

Copper producer **OZ Minerals** (OZL) rejected **BHP's** 'opportunistic' \$8.4bn offer at \$25 per share as a falling copper price associated with reducing global GDP forecasts dropped share prices of multiple copper producers. The bid lifted the OZL price by 50% and is another indication of the outlook for demand of 'future facing metals'. We are not an owner of OZL unfortunately but see strong synergies in relation to infrastructure in South Australia. BHP are likely to lift this bid.

KKR eventually restructured their 'proposal' to acquire **Ramsay Health Care** (RHC) to exclude the partly owned French operations in August and then finally redrew their offer in September. This put an end to a drawn-out affair which began when KKR's interest in Ramsay surfaced in April 2022. Ructions in global markets and ongoing COVID challenges for the Ramsay business resulted in KKR finding the deal too hard to complete.

As shareholders of ASX companies, the current experience of unsolicited, non-binding, conditional approaches to companies needs to be addressed. The success rate of announced "indicative" takeover offers over recent years has been very low. There appears little downside to a bidder company approaching a company, having a good look inside and then terminating discussions. The disruption for the company and their shareholders can be significant. Whilst its disappointing that the Ramsay takeover did not complete, it did highlight the inherent value that we see in the business and the property portfolio held by Ramsay. We remain as shareholders.



Portfolio Review & Outlook

A positive return for your Quest portfolio for the quarter provides a welcome contrast to the global uncertainty. Quest portfolio returns over multiple periods are well ahead of the benchmark. We are pleased with the portfolio performance where the recent returns are a continuation of our extended track record.

Lithium investments have again provided excellent returns and dominate the performance table below. We hold Mineral Resources, Allkem and IGO Limited. Lithium spodumene prices and chemical prices are at record highs as the EV phenomenon continues. It is likely that forecast EV sales estimates by 2030 are too high given the lack of lithium material available to satisfy the soaring demand. The scramble for supply by battery makers and automotive companies will however continue well into next year.

Our investment in future facing metals also includes uranium company **Boss Energy** (BOE) which rose +49% in the quarter.

Recent IPO investment **Qualitas** (QAL) jumped 53% to \$2.35 after announcing they had secured a \$700m investment mandate from the Abu Dhabi Investment Authority (ADIA) as well as a making a 10% placement of options to the ADIA exercisable at \$2.50. QAL was trading at a \$1.67 prior to the announcement. We see the provision of credit by a listed company as a new asset class within the REIT sector that has captured little attention from the market. The addressable

market for credit is expanding as the large banks have chosen to pull back from this market.

Our team have reinvested in **Charter Hall** (CHC) following a large fall in the share price during 2022. Charter Hall is a direct owner and manager of property assets including office, retail and industrial. The stock is capitalised at \$5.7 billion and sits just outside the Top 50 Australian companies. We have owned the stock twice before and rate the business model a high B in our Q Stocks process. In 2021 we sold our holding between \$18 and \$20 as part of a shift in our portfolio away interest rate sensitive businesses.

Our valuation assessment involved discounting carrying values of assets by 20% to allow for a serious fall in property values. We have then assessed the funds management business on a conservative multiple. The sum of these parts gave us confidence to buy Charter Hall below \$12 during the market slump in September. We see this level as an excellent entry point taking a three-to-five-year view.

We added to existing positions in **Domino's Pizza** (DMP) and **Xero** (XRO) during the quarter. Both have been additions to the portfolio this year after substantial falls. Domino's and Xero are well managed but currently weak due to the anticipated impacts of the European recession on a portion of both businesses. We believe they are solid long term investments at these levels.

Holdings in **Steadfast** (SDF) and **Woolworths** (WOW) were reduced at good prices during the quarter. Their defensive qualities have been attractive to the market recently, outperforming in a weak market. Higher share prices provided the opportunity to reduce the exposures. Steadfast subsequently reported a result a little better than expected and announced a capital raising to continue their journey of owning more of their insurance network. We took the opportunity to buy back the prior sales at a lower price.

The **BHP** position was similarly rebalanced. BHP went ex a large \$2.55 dividend in September and traded over nearly a 20% range in the period. This volatility provided both purchase and sale opportunities in the quarter. Our holding in **Pilbara Minerals** (PLS) has been sold. This was always intended to be a trading position. We sold our holding in **Kazia** (KZA) during the quarter. The update from the company regarding the flagship GBM Agile trial was disappointing. This investment has always been viewed as a high return and high risk opportunity which is why our holding was relatively small.

Largest September Quarter Portfolio Movements

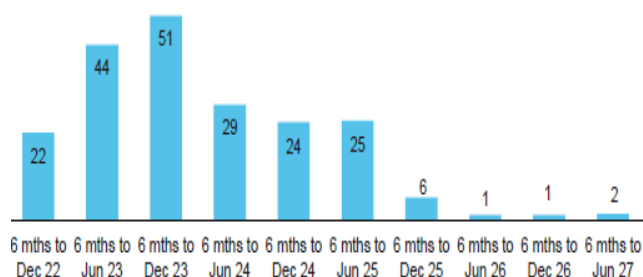
<u>Best</u>		<u>Worst</u>	
Pilbara Minerals	+56%	Kazia	-59%
Qualitas	+53%	Domino's	-23%
Boss Energy	+49%	Ramsay	-21%
Ai-Media	+45%		
Mineral Resources	+38%		
IGO	+38%		
Allkem	+34%		
29Metals	+32%		



Markets are adjusting to the changed economic environment but there are few signs of the consumer altering behavior. Retail sales remain strong, restaurants are full, wage growth is being rolled out. Discretionary purchases like travel, eating out and shoes are holding up. The standard statement from the RBA is that rate rises take six to nine months to have an effect. This time it may take longer than normal for a couple of reasons. Firstly, almost half of mortgages have recently shifted to a fixed rate, temporarily protecting consumers from the RBA tightening.

Commonwealth Bank of Australia (CBA) has funded a quarter of Australia's \$2 trillion of mortgages. As at 30th June, 40% of those CBA loans has a fixed rate, with an annual cost of approximately 2%. Almost half of all mortgages being fixed is low relative to the US and NZ markets but it is more than double the normal Australian level. The following chart from CBA shows the expiry schedule of their fixed rate mortgages. The real household budget tightness arrives in 2023, especially in the June quarter. The refinancing cost will be materially higher than when borrowers were fixing rates at extremely low rates during Covid.

Fixed Rate HL Expiry Schedule (\$bn)³



Source CBA

Household cash buffers were also boosted by Government support and limited travel options during Covid. Approximately half of this abnormal increase has already been consumed.

The Quest portfolio turnover has been unusually subdued this year, as we patiently wait for the market to reprice the economic outlook. With a fall of 25% in the S&P 500, a sizable portion of this has occurred but as we write the most obvious adjustment in earnings forecasts is yet to occur. We anticipate that broking houses will cut earnings estimates from here, possibly after the upcoming AGM season. Companies will update shareholders at these meetings now that the year is well advanced.

There have been some notable US and European company downgrades such as US transport company **FedEx** and UK retailer/software company **Ocado** (who are a **Coles** (COL) supplier) but at a macro level the level of earnings reduction here and overseas to date has been small. Whether the impact is from less consumer demand, higher costs, higher interest costs or higher taxes, we are yet to see much of the impacts of central bank actions. Central banks were slow to act and the economic momentum post Covid was very strong. A careering horse is not easy to slow.

The Quest team have recommenced travel with many trips recently concluded. Company visitation included the Greenbushes lithium mine in WA which is partially owned by **IGO Limited**. We have visited lithium sites owned by **Mineral Resources**, a batch of oil and gas companies in South Australia and small industrials in Queensland.

Volatility is likely to continue with central bank actions. Data shows some actions behind the scenes to temporarily restrain the market weakness. This can result in rapid market rises, such as the 6.2% rise in the ASX in the first three days of October. These rapid rises provide a good indication we need to continue to be patient.

Market weakness can however provide some extraordinary investment opportunities. The Quest Investment Philosophy (section 4) reads:

"Invest because opportunity exists not because cash is available".

Markets look forward. A study of the history of periods of RBA tightening reveals the market bottoming well before the earnings bottom. Historically, longer term bond yields peak as the RBA begins the tightening cycle. Central banks will lower the scourge of inflation and the cost of funds will settle. We therefore see this correction as well advanced with opportunities appearing.

We have been gradually using the cash balance in the portfolio to acquire higher quality businesses at prices we anticipate will provide minimum 15% returns to our clients. The opportunity to establish and accumulate new portfolio positions arises infrequently. Our aim is to continue to build long-term wealth for clients by consistently compounding returns, as we have done over the last 17 years.

Performance Fees No performance fee is payable for the September 2022 quarter.