Ralton Concentrated Australian Equity

Portfolio Report | August 2021

RALTON ASSET MANAGEMENT EST. 2005

Key facts

Income versus growth target

Income — Growth

Market cap bias

Large — Small

Investment strategy

A portfolio of ASX-listed equities designed to provide capital growth with some tax-effective income

Investment objective

Outperform index by over 3% p.a.

Benchmark index

S&P/ASX 300 Accumulation Index

Portfolio Manager

Will Riggall

Inception date

February 2008

Management fee

0.75% p.a. (may vary across platforms)

Number of stocks

25-35

External ratings

Zenith "Approved"

Key platforms

HUB24, NetWealth, Praemium, OneVue, Powerwrap, Linear, Xplore, Wealth02

Stock spotlight | Incitec Pivot (IPL) +23.5%

What does the price of gas in Europe have to do with an Australian and US based explosive and fertiliser producer? Europe is the major producer of Ammonia, with US gas far below the EU price, the result is a sharp increase in profit margins for IPL. At spot rates, EPS in 2022 will need to be upgraded by 50%. When combined with improving operational performance we see a strong outlook for the group. Key industry exposures of explosives and fertilisers look set for an improved period ahead as strong commodity prices drive mining volumes and 3 years of below average agriculture yields are set to be broken increasing on farm investment. The combination of these factors should see stronger growth with the added benefit of a lower capex period ahead set do drive free cashflow and further share price gains.

Performance (%, returns greater than one year are per annum p.a.)

At month end	1 mth	3 mth	1 yr	3 yr	5 yr	10 yr	Inception
Ralton	**-1.24%**	**2.37%**	**29.27%**	**6.16%**	**8.02%**	**11.28%**	**7.43%**
Income	*0.76%*	*1.69%*	*3.77%*	*3.78%*	*3.87%*	*4.02%*	*4.22%*
Growth	*-2.00%*	*0.69%*	*25.50%*	*2.38%*	*4.15%*	*7.26%*	*3.20%*
Index	**-1.89%**	**1.79%**	**30.86%**	**9.87%**	**10.52%**	**10.77%**	**6.39%**

Portfolio Performance

The Ralton Concentrated portfolio returned +2.37% for the September quarter, ahead of the market by +0.59%. The prospect of opening economies & soldi reporting season was offset by increasing risks of corporate failure in the Chinese property market as Evergrande teetered, inflation and the Fed spiking interest rates. Stock weakness will be used to increase positioning.

Contributors	Comment
IPL (+23.53%)	After a period marked by manufacturing issues, the market cheered a return to normal production at its US Ammonia plant, soaring commodity prices as well as a positive market outlook comments at its annual Investor Day.
SIQ (+31.56%)	SIQ received a bid from global PE firm TPG. The price at $10.35 is attractive at a 60% premium to our average entry price. The price reflects the improving outlook and strong cashflow. We will be patient to receive full value.
AMC (+9.96%)	There was a lot to like about Amcor's FY21 result with 16% EPS growth coming in 1% ahead of market estimates. Outlook remains positive with leverage to growing economic activity and a strong strategy to driver 10% MT growth.
Detractors	**Comment**
ANN (-20.00%)	Concerns regarding cost headwinds and the roll off of COVID healthcare demand has clouded the outlook. However, we see the business as strongly positioned to benefit from increased economic activity within its industrial business. We are meeting with the company to address concerns.
WOR (-15.16%)	Worley delivered an FY21 result marginally below expectations as global COVID actions limited access to sites. Conversely the outlook looks to have strengthened, with energy transition projects to deliver growth and margin.
NST (-12.26%)	Underperformed the market over the quarter as its key commodity Gold declined from recent highs driven by global rate increases. NST is well placed to drive growth post its KCGM and SAR transactions independent of the commodity price, offering strong value with 10% FCF yield at current prices.

September Quarter Market Commentary

Concerns related to the pandemic delta wave, supply chains, iron ore pricing and the Evergrande crisis sent most global market sharply lower during the month. The MSCI AC World index was down 3.5% last month, with the US and China equity markets both falling close to 5% in September.

During their September meeting, US Federal Reserve (Fed) officials indicated that they expect to soon slow the asset purchases they have been using to support the economy and predicted they might raise interest rates next year. This sent a clear signal that policymakers are preparing to curtail emergency monetary help.

Inflation has moved sharply higher in recent months, elevated by supply chain disruptions and other consequences of the pandemic. Fed officials expected inflation to average 4.2% in the final quarter of 2021, before falling to 2.2% in 2022.

Evergrande epitomises the vulnerability of China's economy. Property development has been a huge factor in China's economic growth and accounts for around 28% of GDP. Ultimately, thanks to state intervention, the chances are slim of a disorderly bankruptcy, however it is also likely to slow down China's economic growth, which may become a problem , especially for Australia's commodity exporters.

Yields on 10-year Australian bonds rose by 22 basis points, to end September at 1.50%. The rise in global bond yields is part of a worldwide bond sell-off as central banks move to reduce pandemic stimulus. The Bank of England in the last week of the month raised the prospect of increasing interest rates as soon as November. Norway delivered the first post-crisis hike among advanced countries, and officials signalled an accelerated cycle to come.

Given current equity pricing, the positives of economic and earnings recovery now appears to be more finely balanced with the risks associated with the pandemic, supply chain disruptions and other inflationary pressures. We therefore maintain a constructive stance towards high quality companies.

Portfolio positioning and outlook

The Ralton process focuses on the convergence of strong company fundamentals with clear valuation discipline and identification of thematic drivers, both macro and industry specific, which together are set to drive sustainable growth and shareholder returns.

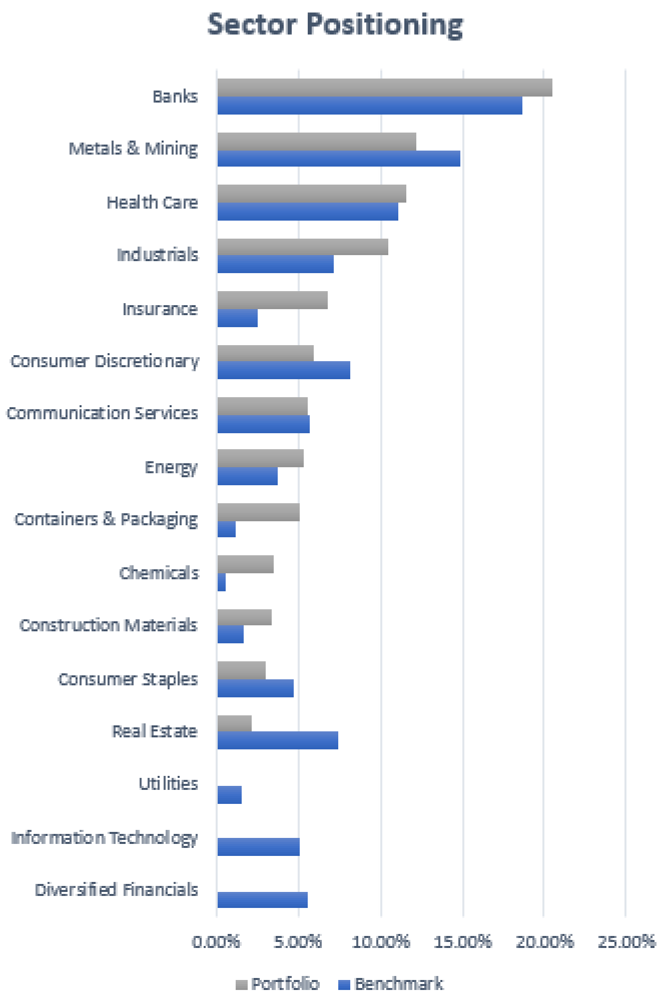
We currently identify a number of key thematics including the trend towards a de-carbonised economy, higher commodity prices and activity driven by a lack of investment as well as a return to higher interest rates collectively driving a rotation to cyclical names, away from unsustainably highly valued components of the market.

At a sector level these drivers, in combination with robust bottom of fundamental analysis positions the portfolio to be overweight Energy and those companies exposed to increased commodity investment, global insurers set to benefit from higher investment returns and strengthening premium rates. As well as a broad set of Industrial names set to benefit from the opening of the global economy.

As a reflection of valuation discipline the portfolio remains underweight Information Technology and Healthcare, while holding selective names where we see an attractive risk/return trade off.

As such key risks to the portfolio performance in the near would be a sharp reversion of the recent increase in global rates however we are conscious to mitigate this risk by continuing to hold Gold names and US housing which benefit from lower rates.

In the event of a major dislocation in global market, our lower than market beta and disciplined focus on valuation should see Ralton continue to deliver its historical trend to outperform in major drawdown.



Top 10 holdings (alphabetical)

Amcor PLC
Aristocrat Leisure Limited
BHP Group Ltd
Commonwealth Bank of Australia
Incitec Pivot Limited
National Australia Bank Limited
QBE Insurance Group Limited
Ramsay Health Care Limited
Telstra Corporation Limited
Westpac Banking Corporation

Portfolio metrics

	Ralton	XKOAI
# of Securities	26	200
Market Capitalization	54,013.8	64,861.6
Active Share	65.9	--
Tracking Error	4.20	--
Beta	0.99	1.00
Est 3-5 Yr EPS Growth	14.9	11.0
ROE	10.7	10.6
Div% NTM	4.04	3.64
P/E using FY2 Est	15.3	17.5
Price/Cash Flow	8.2	11.7

Portfolio Activity

BUY	
Oil Search	We are incrementally positive on the oil price outlook as a period of low industry spend is converging with surging global growth. Trading at a discount to peer and historical valuations we see a number of near term catalysts including FID for Alaskan Pikka project and aligned equity sell down as well as Papua LNG progress as a catalysts for upside, independent of M&A outcomes.
Insurance Australia Group	IAG looks set to benefit from a strong premium pricing cycle with internal cost out efficiencies set to drive insurer margin expansion, delivering growth independent of the economic recovery path. we see the prospect of PE expansion, EPS upside and a better than market yield as an attractive combination.
SELL	
Beach Energy	We move to exit from Beach as post the recent surprise downgrade to its production outlook we have a lower level of confidence in its building blocks for value.
Endeavour Group	The demerger of Endeavour Group and potential for capital return were key catalysts for value which has been realized as the market has re-rated the combined entities of EDV and WOW post completion.
Challenger	We have seen the price to book multiple recovery from a discount to a premium, gaining near 30%. Given the share price recovery, low yielding investment markets as well as the added uncertainty post the announcement that well respected CEO Richard Howes will leave at the end of the year, we exit the position.