Ralton Leaders

Portfolio Report | August 2021

Stock spotlight | Incitec Pivot (IPL) +23.5%

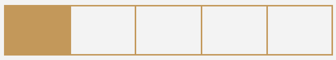
What does the price of gas in Europe have to do with an Australian and US based explosive and fertiliser producer? Europe is the major producer of Ammonia, with US gas far below the EU price, the result is a sharp increase in profit margins for IPL. At spot rates, EPS in 2022 will need to be upgraded 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.

Key facts

Income versus growth target

Income Growth

Market cap bias



Large Small

Investment strategy

A portfolio of ASX-listed equities designed for long-term capital growth and some tax-effective income

Investment objective

Outperform index by over 3% p.a.

Benchmark index

S&P/ASX 100 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

Key platforms

Brightday, Linear, OneVue, Praemium

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	**-1.43%**	**2.40%**	**33.48%**	**8.78%**	**10.29%**	**11.77%**	**7.71%**
Income	*0.79%*	*1.70%*	*3.86%*	*3.83%*	*3.99%*	*4.16%*	*4.41%*
Growth	*-2.22%*	*0.70%*	*29.62%*	*4.95%*	*6.29%*	*7.61%*	*3.30%*
Index	**-1.85%**	**1.56%**	**30.94%**	**9.91%**	**10.55%**	**11.02%**	**6.67%**

Portfolio Performance

The Ralton Leaders portfolio returned +2.40% for the September quarter, 0.84% ahead of the ASX100 Index. The prospect of opening economies & a solid reporting season was offset by acute risk of corporate failure in the Chinese property market as Evergrande teetered, inflation & Fed spiking interest rates. Any pullback will be used to increase core positioning.

Contributors	Comment
FMG (not held) (-28.62%)	A precipitous fall in the Iron Ore price from $220 down to $120 caused significant falls in commodity names. Concerns surrounding the Evergrande default combined with central policy to slow speculation cast a long shadow.
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.
OSH (+16.60%)	Surging global Oil and LNG pricing has seen strong performance from Energy names. We believe OSH remains undervalued on a standalone basis with Tier 1 assets, however the completion of the STO merger will see growth accelerate.
Detractors	
WOR (-15.16%)	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.
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.
NEC (-7.39%)	Nine Entertainment underperformed over the quarter as the market digested Stan's move into sport and further streaming competition. Despite near term competition, advertising & housing tailwinds are set to drive EPS acceleration.

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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.

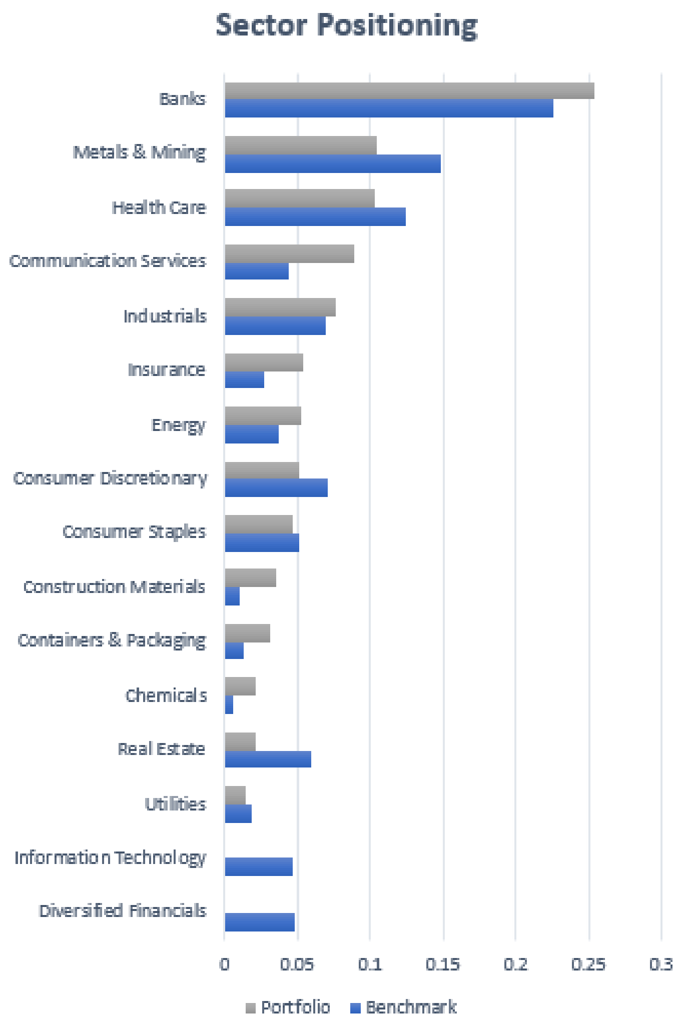
We currently identify a number of key thematics including the trend towards a de-carbonised economy, higher commodity prices and activity driven by a lack of investment as well as a return to higher interest rates collectively driving a rotation to cyclical names, away from unsustainably highly valued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

Aristocrat Leisure Limited
BHP Group Ltd
Commonwealth Bank of Australia
CSL Limited
James Hardie Industries
National Australia Bank Limited
QBE Insurance Group Limited
Telstra Corporation Limited
Westpac Banking Corporation
Woolworths Group Ltd

Portfolio metrics

	Ralton	XTOAI
# of Securities	24	100
Market Capitalization	66,514.9	75,851.8
Active Share	55.5	--
Tracking Error	3.38	0.00
Beta	1.01	1.00
Est 3-5 Yr EPS Growth	13.7	10.6
ROE	11.1	11.2
Div% NTM	4.00	1.77
P/E NTM	18.60	22.14
Price/Cash Flow	8.7	11.3

Portfolio Activity

BUY	
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.
Ansell	The headline Ansell (ANN.ASX) result reflected the impact of COVID on global economies with the healthcare division delivering significant growth. Supply chain disruption has resulted in a move lower, openeing up an opportunity to add to global company with strengthening competitive advantages trading at significant discount our internal assessment of intrinsic value.
SELL	
QBE Insurance	In the FY21 result, QBE delivered on our investment thesis that the combination of a strong global insurance market and improving company performance would result in a better than expected set of numbers. However given a near 40% return in less than 12 months we have taken the opportunity to reduce the position to align with our broader portfolio risk parameters.
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.