

31 MARCH 2020
QUARTERLY REPORT
 REDPOINT INDUSTRIALS SMA



Model Portfolio performance as at 31 March 2020	1 month (%)	3 months (%)	6 months (%)	1 year (%)	2 years (% pa) ⁵	3 years (% pa) ⁵	Since Inception ⁴ (% pa) ⁵
Model Portfolio return (gross) ¹	-21.30	-21.45	-21.60	-11.21	-1.87	-1.57	1.26
– Model Portfolio cash income	0.25	0.83	1.56	3.75	4.75	4.66	4.86
– Model Portfolio price return (gross)	-21.55	-22.28	-23.16	-14.96	-6.62	-6.23	-3.60
Benchmark return ²	-21.36	-21.66	-21.98	-11.19	-1.92	-1.66	1.37
Active return (gross) ³	0.06	0.21	0.38	-0.02	0.05	0.09	-0.11

Source: Navigator Australia Ltd

Past performance is not necessarily indicative of future performance.

1. Redpoint Industrials Separately Managed Account (SMA) (Model Portfolio) – gross performance is before management fees and transaction costs (as calculated by Navigator Australia Ltd).
2. S&P/ASX 100 Industrials Accumulation Index (Benchmark).
3. Active return is the difference between Model Portfolio gross return and Benchmark return.
4. The Model Portfolio was established on 30 April 2015.
5. Returns are annualised for periods of 12 months or more.

INVESTMENT OBJECTIVE

The Model Portfolio aims to provide a return in line with the S&P/ASX 100 Industrials Accumulation Index (Benchmark), after management fees, over rolling five-year periods. The Model Portfolio seeks to deliver the key income and growth characteristics of the Benchmark while holding less than half the companies in the Benchmark. The Model Portfolio is specifically built to capture these characteristics with low turnover.

Redpoint combines long horizon sustainable quality metrics and risk management expertise to exclude or underweight poorer rated companies. The Model Portfolio will usually hold 30 to 40 companies and aims to deliver a portfolio with low active risk relative to the Benchmark while being tilted towards companies with better quality characteristics.

PERFORMANCE COMMENTARY

MODEL PORTFOLIO

For the three-month period ending 31 March 2020 the gross return of the Model Portfolio was -21.45%. The gross return of the Model Portfolio is comprised of two (2) key components: a capital (price) return of -22.28%; and an income (dividend) return of +0.83%. Over the same time period, the total return of the Benchmark was -21.66%. Consequently, the Model Portfolio outperformed the Benchmark by +0.21% (active return) for the March quarter.

The March quarter delivered a cash yield of 0.83% for the Model Portfolio versus 0.76% for the Benchmark (on an ex-dividend basis). This was more or less in line with our forecasts made in the December 2020 investment performance report (i.e. 1.01% for the Model Portfolio and 1.02% for the Benchmark respectively).

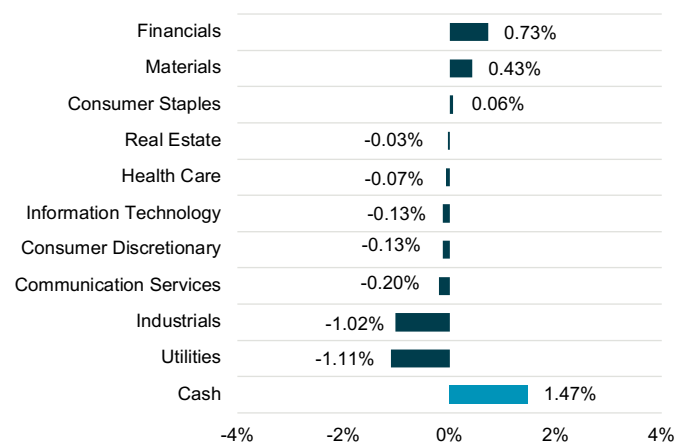
MARKET

The Australian equity market, as represented by the S&P/ASX 100 Industrials Index (Benchmark), experienced a total return of -21.66% over the March quarter, a decline not seen since the Global Financial Crisis (GFC) of 2007-2009, as markets reacted to the partial shutdown of the economy in order to deal the health implications of the COVID-19 pandemic. The market reaction to the pandemic got progressively worse as the March quarter evolved, with total returns of +6.19%, -6.19% and -21.36% for January, February and March respectively.

By comparison, the total return of the S&P/ASX 200 Index, which includes resources companies, was -23.10% for the quarter, reflecting the fact that resources companies, particularly those in the Energy sector (which were severely impacted by a sharp decline in oil prices), underperformed their industrials counterparts over the quarter.

The best performing sectors for the quarter were Health Care (+2.7%), Consumer Staples (-4.1%), Utilities (-9.1%) and Communication Services (-14.3%), which outperformed the broader market, while the worst performing sectors for the quarter were Real Estate (-36.6%), Information Technology (-29.3%), Materials (-28.7%), Financials (-27.7%) and Industrials (-27.2%), which underperformed the broader market, as defined by the Benchmark.

SECTOR ACTIVE WEIGHTS



TOP 10 HOLDINGS

Company	Model Portfolio (%)	Benchmark (%)	Active (%)
CSL Ltd	12.46	13.23	-0.77
Commonwealth Bank of Australia	11.44	10.72	0.71
ANZ Banking Group Ltd	5.49	4.84	0.65
Woolworths Group Ltd	5.14	4.54	0.59
National Australia Bank Ltd	4.88	4.74	0.14
Westpac Banking Corporation	4.87	5.59	-0.72
Telstra Corporation Ltd	4.44	3.60	0.84
Wesfarmers Ltd	4.39	3.83	0.56
Macquarie Group Ltd	3.21	2.68	0.54
Transurban Group	2.45	3.10	-0.65

MODEL PORTFOLIO FACTS

Model Portfolio code	RISMA
Model Portfolio size (\$)	132,409,348
Number of holdings	40
Inception date	30 April 2015

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SECTOR ATTRIBUTION

Sector	Model Portfolio Average Active Weight (%)	Sector Allocation (%)	Stock Selection (%)
Health Care	0.47	0.11	0.35
Real Estate	0.34	0.00	0.40
Financials	-0.79	0.07	0.16
Consumer Staples	0.48	0.12	0.04
Communication Services	-0.22	-0.04	0.14
Materials	0.66	-0.04	0.09
Information Technology	-0.37	0.04	-0.04
Utilities	-0.84	-0.11	-0.09
Consumer Discretionary	0.43	-0.02	-0.33
Industrials	-0.17	0.01	-0.66
Total	0.00	0.15	0.06

Note: Contributions shown here are to the active return of the Model Portfolio. Period: 31 December 2019 to 31 March 2020.

ATTRIBUTION COMMENTARY

The active return for the March quarter (+0.21%) can be decomposed into two (2) components:

- Benchmark stocks held by the Model Portfolio detracted -0.76% from active return; and
- Benchmark stocks not held in the Model Portfolio contributed +0.97% to active return.

Furthermore, a returns-based attribution shows that active return is comprised of two (2) alternative components:

- sector allocations, which contributed +0.15% to active return; and
- stock selection within the sectors, which contributed +0.06% to active return.

SECTOR ALLOCATION

From a sector allocation perspective, overweight positions in the Consumer Staples and Health Care sectors, which outperformed the broader market, and underweight positions in the Financials, Information Technology and Industrials sectors, which underperformed the broader market, collectively contributed +0.35% to active return. The overweight positions in the Consumer Staples and Health Care sectors had the largest impact, contributing +0.12% and +0.11% respectively to active return.

This positive outcome was partly offset by underweight positions in the Utilities and Communication Services sectors, which outperformed the broader market, and overweight positions in the Materials and Consumer Discretionary sectors, which underperformed the broader market, and which collectively detracted -0.20% from active return. The underweight position in the Utilities sector had the largest impact, detracting -0.11% from active return.

STOCK SELECTION

Stock selection in the Real Estate, Health Care, Financials, Communication Services, Materials and Consumer Staples sectors added the most value, collectively contributing +1.18% to active return. Stock selection in the Real Estate and Health Care sectors had the largest impact, contributing +0.40% and +0.35% respectively to active return.

This positive result was mostly offset by stock selection in the Industrials, Consumer Discretionary, Utilities and Information Technology sectors, which collectively detracted -1.12% from active return. Stock selection in the Industrials and Consumer Discretionary sectors had the largest impact, detracting -0.66% and -0.33% respectively from active return.

LARGEST CONTRIBUTORS

Company	Model Portfolio Average Weight (%)	Benchmark Average Weight (%)	Contribution (%)
ResMed Inc	2.28	0.75	0.44
Scentre Group Ltd	0.72	1.37	0.27
Vicinity Centres	0.00	0.54	0.23
Coles Group Ltd	2.12	1.44	0.16
Ansell Ltd	1.24	0.31	0.15
Tabcorp Holdings Ltd	0.00	0.62	0.14
Treasury Wine Estates Ltd	0.00	0.71	0.14
Woolworths Ltd	4.79	4.10	0.13
Boral Ltd	0.00	0.38	0.12
James Hardie Industries Plc	0.00	0.95	0.11

LARGEST DETRACTORS

Company	Model Portfolio Average Weight (%)	Benchmark Average Weight (%)	Contribution (%)
Flight Centre Travel Group Ltd	0.81	0.14	-0.50
Downer EDI Ltd	1.10	0.30	-0.42
Qantas Airways Ltd	1.56	0.64	-0.37
The A2 Milk Company Ltd	0.00	0.88	-0.30
Stockland Corporation Ltd	1.85	0.83	-0.15
APA Group	0.00	1.01	-0.14
Aristocrat Leisure Ltd	2.40	1.59	-0.13
Lend Lease Group	1.38	0.75	-0.12
Computershare Ltd	1.14	0.59	-0.12
Incitec Pivot Ltd	0.87	0.37	-0.08

Note: Contributions shown in the above tables are to the active return of the Model Portfolio. Period: 31 December 2019 to 31 March 2020.

ASSETS

CONTRIBUTORS

On a relative basis, some of the best performing stocks for the quarter were overweight positions in ResMed Inc (Health Care), Coles Group Ltd (Consumer Staples), Ansell Ltd (Health Care) and Woolworths Ltd (Consumer Staples) and underweight positions (i.e. with the exception of Scentre Group Ltd, not held by the Model Portfolio) in Scentre Group Ltd (Real Estate), Vicinity Centres (Real Estate), Tabcorp Holdings Ltd (Consumer Discretionary), Treasury Wine Estates Ltd (Consumer Staples), Boral Ltd (Materials) and James Hardie Industries Plc (Materials), which collectively contributed +1.89% to active return.

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Stocks in the Health Care sector (e.g. ResMed Inc and Ansell Ltd) and the Consumer Staples sector (e.g. Coles Group Ltd and Woolworths Ltd) performed relatively well over the quarter as they are somewhat insulated from the economic consequences of the COVID-19 pandemic. Overweight positions in these stocks contributed +0.44%, +0.15%, +0.16% and +0.13% respectively to active return for the quarter.

By contrast, stocks in the Real Estate sector (e.g. Scentre Group Ltd and Vicinity Centres) performed relatively poorly over the quarter. Commercial properties like these have been severely impacted by the social distancing restrictions put in place as a response to the coronavirus. Shopping centres are currently devoid of customers and the owners of these properties are likely to offer rent reductions to their tenants for the foreseeable future. Underweight positions in these companies contributed +0.27% and +0.23% respectively to active return for the quarter.

DETRACTORS

By contrast (on a relative basis), some of the worst performing stocks for the quarter were overweight positions in Flight Centre Travel Group Ltd (Consumer Discretionary), Downer EDI Ltd (Industrials), Qantas Airways Ltd (Industrials), Stockland Corporation Ltd (Real Estate), Aristocrat Leisure Ltd (Consumer Discretionary), Lend Lease Group (Real Estate), Computershare Ltd (Information Technology) and Incitec Pivot Ltd (Materials) and underweight positions in The A2 Milk Company Ltd (Consumer Staples) and APA Group (Utilities, not held by the Model Portfolio), which collectively detracted -2.33% from active return.

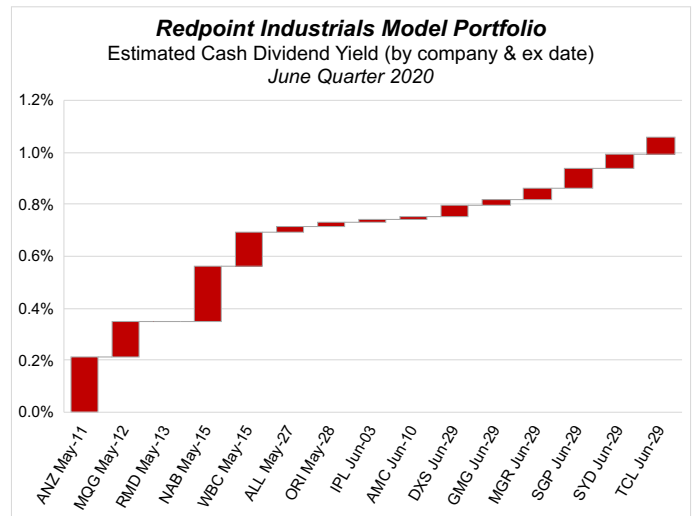
Stocks in the Consumer Discretionary sector (e.g. Flight Centre Travel Group Ltd) and the Industrials sector (Qantas Airways Ltd) performed relatively poorly over the quarter. Companies with exposure to the air travel industry were severely impacted as governments worldwide closed their borders and restricted internal travel in an attempt to halt the spread of the coronavirus. Overweight positions in these companies detracted -0.50% and -0.37% respectively from active return for the quarter.

Stocks in the Real Estate sector (e.g. Stockland Corporation Ltd and Lend Lease Group) also performed relatively poorly over the quarter. Similar to Scentre Group Ltd and Vicinity Centres, Stockland Corporation Ltd has been adversely affected by the social distancing restrictions imposed by state governments to mitigate the spread of the coronavirus. Lend Lease Group is under pressure as the COVID-19 pandemic has put a brake on major residential and commercial office tower developments. Overweight positions in these companies detracted -0.15% and -0.12% respectively from active return for the quarter.

DIVIDEND INCOME

A key characteristic of the Model Portfolio is its focus on capturing the key income and growth drivers of the Benchmark over the longer term in a low turnover, risk managed portfolio. To deliver this outcome we utilise a combination of risk management and long horizon quality metrics to select a diversified set of companies that we wish to hold for the longer term.

Cash dividend income expectations for the June 2020 quarter are currently estimated at 1.06% for the Model Portfolio versus 1.04% for the Benchmark. The Model Portfolio is forecast to receive dividends from 15 companies; the Benchmark is expected to have dividends declared by 23 companies. The following chart shows the dividends expected to be earned by the Model Portfolio over the course of the June 2020 quarter.



Source: Redpoint, Bloomberg

We have a great deal of uncertainty regarding company dividend forecasts for the quarter ahead. The bulk of the income is being derived from ANZ Banking Group Ltd, National Australia Bank Ltd and Westpac Banking Corporation. APRA has asked the large Australian banks to review their dividend policy in light of the COVID-19 pandemic. We would expect that dividend policy will be reviewed by all companies given the economic impact of managing COVID-19 infection rates. In many ways we are in uncharted territory in how to best forecast the economic impact of this pandemic. Looking back to the Global Financial Crisis (GFC) of 2008 we note that Australia's major banks cut dividends by 20% on average for a 12 month period before returning to more normal levels. Our base case would be that dividends are cut in 2020 before returning to more normal levels in 2021/22. We are encouraged by the unprecedented fiscal stimulus being applied in Australia (as well as in other jurisdictions overseas) along with a continuation of extremely accommodative monetary policy settings. We believe that these initiatives will assist many businesses to adequately hibernate in the near term such that they can return to normal operations in the second half of 2020 and hopefully mitigate the likelihood of corporate failures.

We also caution against chasing higher yielding stocks at this juncture as these high yields can simply be due to a large price fall and may in fact be a sign of stress as opposed to an opportunity. We believe that our focus on company quality and strength of cash flow will be rewarded in times such as these, when uncertainty is at its highest.

At the same time, we expect that markets and share prices will remain volatile. While the Model Portfolio outperformed the Benchmark over the quarter, we note that the Model Portfolio outperformed the Benchmark by +0.53% from 1 January to 25 March. However, the market bounce at quarter end brought relief to many low quality names and this detracted some relative performance into quarter end. The Model Portfolio relinquished a large proportion of these gains in the last week of March to finish ahead of the Benchmark by +0.21% at the end of the quarter. While such share price movements are disconcerting, we encourage clients to take a long term approach, as we do in managing your capital. Please see our market commentary below for more detail.

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GENERAL COMMENTARY

The novel coronavirus quickly emerged as a major global pandemic crisis during the month of March. Sadly, COVID-19 (the disease caused by the virus) is responsible for a growing global death toll, which continues to rage through Europe (especially Italy and Spain) and is more recently impacting the United States. While Australia has not been immune to the coronavirus, our relative isolation coupled with early intervention with social distancing measures are so far proving successful at containing its spread.

Global equity markets fell substantially in the last week of February and continued in a one-way trajectory until late March, with the S&P/ASX 200 Index falling 36% over this period. The global economy is being thrown into a "hard stop" event, with severe public lockdown measures in some jurisdictions the only feasible way to slow the contagion. Equity markets have staged a modest (~10%) recovery from late March due largely to the size and scope of fiscal stimulus packages being applied by governments across the globe in concert with monetary support from central banks. Energy markets were doubly impacted by a growing feud between Russia and Saudi Arabia over oil production output. This demand and supply issue has driven oil prices to around USD 20 a barrel by quarter end, a price level not seen since 2001.

As we noted in our February report, there is still great uncertainty regarding how badly the global economy will be impacted by this pandemic event and which companies can survive a prolonged period of being effectively idle. This leads us to believe that the price volatility we have endured over recent weeks is likely to continue. At the same time, we have confidence that the current pandemic will also be resolved and that many businesses, currently impacted, will be able to return to normal operations later in 2020. Our experience leads us to believe that investors will often over-react in uncertain times and this will bring opportunities for the disciplined investor focused on the long term.

In responding to this increased volatility, we have refocused our portfolio construction towards utilising shorter horizon risk models (as opposed to medium horizon) at this time. Our risk partner, Axioma (now part of Qontigo), provide us with both medium and short horizon fundamental and statistical risk models. We believe that this approach is warranted due to the significant change in the risk environment over such a short period of time. We expect that this approach will assist in ensuring that active risk in the Model Portfolio is adequately diversified. These measures are constantly being assessed and reviewed.

Retaining a focus on corporate balance sheet strength, cash flow generation and resilience will be critical in the near to medium term. At the same time, we must remain vigilant to the inevitable resolution of this crisis: a lesson learned in the aftermath of the GFC in early 2009. We expect that there will be a large number of capital raisings in the weeks ahead, which should bring opportunities to provide capital to companies at attractive prices on the basis that they can return to more normal business operations in the second half of 2020.

We believe that there are many companies which, while impacted by this COVID-19 pandemic, are businesses that will thrive once more post this event. We view companies such as Qantas Airways Ltd (ASX: QAN) as one such example. We note that profitability for QAN is concentrated on domestic travel (which could return to more normal capacity well before international travel does) and they have ongoing operations for freight and their rewards business to further underpin their ability to survive the current challenging environment.

As also noted in our February report, we retain conviction that these unsettling events for financial markets and the global economy will deliver a greater focus on company fundamentals. We expect this increased focus on fundamentals to usher in a more conducive stock selection environment for our investment strategy. Notwithstanding this expectation, we will remain true to our long-term objective of delivering a well-balanced portfolio of better-quality industrial companies to provide both growth and income for the long term.

POSITION CHANGES

As at 31 March 2020 the Model Portfolio holds 40 of the 80 companies in the Benchmark universe.

Over the quarter the Model Portfolio established new positions in Orora Ltd and Xero Ltd and sold completely out of CIMIC Group Ltd and WiseTech Global Ltd. Furthermore, the Model Portfolio reduced existing positions in Amcor Plc, Goodman Group, ResMed Inc, Stockland Corporation Ltd and Westpac Banking Corporation and increased existing positions in ANZ Banking Group Ltd, Commonwealth Bank of Australia, Macquarie Group Ltd, National Australia Bank Ltd, QBE Insurance Group Ltd, Suncorp Group Ltd, Telstra Corporation Ltd and Transurban Group. Despite these position changes, the turnover for the Model Portfolio continues to be relatively low.

The S&P/ASX will review index memberships in June 2020 and any additions/deletions to the Benchmark may prompt a rebalance of the Model Portfolio at that time.

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