30 SEPTEMBER 2020

QUARTERLY REPORT

REDPOINT INDUSTRIALS SMA

Model Portfolio performance to 30 September 2020	1 month (%)	3 months (%)	6 months (%)	1 year (%)	2 years (% pa) [5]	3 years (% pa) [5]	5 years (% pa) [5]	Since Inception [4] (% pa) [5]
Model Portfolio return (gross) [1]	-3.41	-1.53	9.27	-14.34	-1.24	2.21	3.98	5.05
– Model Portfolio cash yield	*0.19*	*0.86*	*1.50*	*2.84*	*4.33*	*4.49*	*4.63*	*4.75*
– Model Portfolio price return	*-3.60*	*-2.39*	*7.78*	*-17.18*	*-5.57*	*-2.28*	*-0.65*	*0.30*
Benchmark return [2]	-3.31	-0.98	12.37	-12.33	-0.06	3.16	4.34	5.71
Active return [3]	-0.09	-0.55	-3.09	-2.00	-1.18	-0.95	-0.36	-0.66

Source: Navigator Australia Limited

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 (calculated by Navigator Australia Limited).
2. S&P/ASX 100 Industrials Accumulation Index – dividends reinvested (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 with a nominal portfolio value of $100,000.
5. Returns for periods of 12 months or more are annualised.

INVESTMENT OBJECTIVE

The Model Portfolio aims to provide a return in line with the 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 combines long horizon sustainable quality metrics and risk management expertise to exclude or underweight poorer rated companies. The Model Portfolio will usually hold 30-40 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

The Redpoint Industrials SMA (Model Portfolio) underperformed the S&P/ASX 100 Industrials Index by -0.55% for the quarter with a gross return of -1.53% vs -0.98% for the Index. The gross return of the Model Portfolio is comprised of a cash income (dividend) return of +0.86% and a capital (price) return of -2.39%.

MARKET

The Australian market as defined by the S&P/ASX 100 Industrials Index's upward trend since Q1-2020 stalled during the third quarter when the market declined in July (-0.42%) and September (-3.55%), despite the gains in August (+2.34%). During the quarter, the best performing sectors came from the Information Technology (+17.11%), Materials (+9.46%) and Real Estate (+6.62%), whilst the worst performing sectors were from the Utilities (-8.14%), Financials (-6.15%) and Consumer Staples (-4.71%).

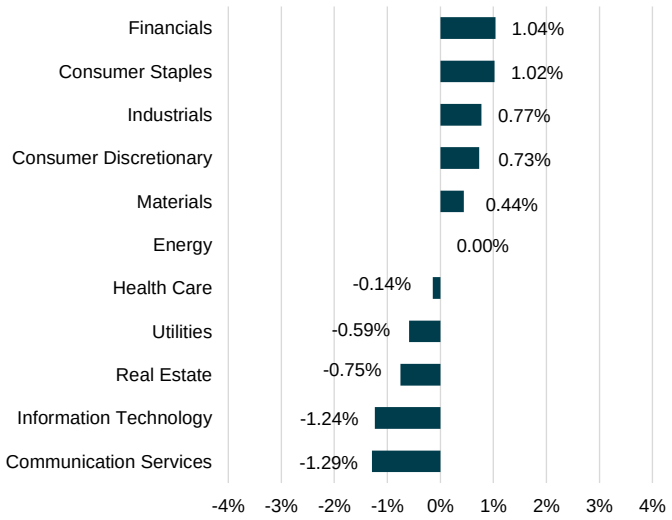
The best stock performers during the quarter were ALS Limited (+40.40%), Wisetech Global (+33.36%) and Afterpay (+31.15%). The worst performing stocks were the A2 Milk Company (-24.71%), followed by AMP (-24.62%) and IAG (-24.09%).

In the United States, the US Equity Market (as defined by the S&P 500) traded strongly at the start of the quarter rising in July (+5.51%) and August (+7.01%) before also experiencing its first monthly decline in 6 months during September, declining -3.92%, as investors shifted focus towards the upcoming U.S presidential election.

TOP 10 HOLDINGS

Company	Model Portfolio (%)	Benchmark (%)
CSL	11.60	11.18
Commonwealth Bank	10.62	9.66
Wesfarmers	5.48	4.32
ANZ	5.31	4.19
Woolworths	4.76	3.95
Westpac	4.39	5.22
National Australia Bank	4.25	5.01
Macquarie	4.20	3.49
Telstra	3.55	2.84
Transurban	2.93	3.31

SECTOR ACTIVE WEIGHTS



MODEL PORTFOLIO FACTS

Model Portfolio code	RISMA
Model Portfolio size ($)	165,131,152
Number of holdings	40
Inception date	30 April 2015

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redpoint Investment Management

LARGEST CONTRIBUTORS

Company	Model Portfolio Average Weight (%)	Benchmark Average Weight (%)	Contribution (%)
The A2 Milk Company	0.00	1.14	0.26
AMP	0.00	0.46	0.10
Coca-Cola	1.01	0.38	0.09
GPT Group	0.00	0.65	0.07
Treasury Wine Estates	0.00	0.62	0.06
Qube Holdings	0.00	0.44	0.06
Macquarie Group	4.29	3.47	0.06
Medibank Private	0.00	0.65	0.06
Stockland	1.45	0.71	0.05
Vicinity Centres	0.00	0.45	0.05

Note: Contributions shown in the above tables are to the active return of the Model Portfolio.

LARGEST DETRACTORS

Company	Model Portfolio Average Weight (%)	Benchmark Average Weight (%)	Contribution (%)
Computershare	1.12	0.55	-0.16
ResMed	1.88	0.78	-0.15
AGL Energy	2.03	0.84	-0.14
James Hardie	0.00	1.12	-0.12
Afterpay	0.00	1.42	-0.12
ALS	0.00	0.34	-0.11
Orica	1.13	0.58	-0.08
Charter Hall	0.00	0.44	-0.08
Telstra Corp	3.65	3.15	-0.08
Dexus	1.48	0.82	-0.07

Note: Contributions shown in the above tables are to the active return of the Model Portfolio.

ATTRIBUTION COMMENTARY

A sector-based attribution shows that active return was driven by stock selection, which detracted by -0.55%, whereas sector allocation overall had an immaterial impact to active return.

SECTOR ALLOCATION

The Model Portfolio benefited from underweight exposure to Communication Services and overweight exposure to the Consumer Discretionary sectors, both of which were the two largest contributors to sector allocation return.

By contrast, the underweight exposure to Information Technology was the largest detractor followed by an overweight exposure to Consumer Staples.

STOCK SELECTION

Stock selection in the Consumer Staples and Financials sectors contributed the most to value added during the quarter.

Within the Consumer Staples sector, the Portfolio also benefited from not owning **Treasury Wine** and **A2 Milk** and from an overweight holding in **Coca-Cola.** No holding in scandal plagued **AMP** also added value for the Model Portfolio.

A2 Milk reported a softer result than expected as the COVID sale bump in the first quarter of 2020 reversed into 30 June. The company has also launched a bid to take a majority stake in milk producer Mataura Valley Milk. At quarter end the company provided softer guidance as sales were impacted by the Victorian lockdown and travel restrictions was curtailing surrogate sales made outside of China for Chinese consumers.

Treasury Wine fell 14% for the quarter, impacted by comments from China's Ministry of Commerce regarding investigations into wine dumping in their country. Notwithstanding a better than expected annual report the company moved to cut its final dividend to $0.08 per share (vs $0.20 in 2019).

Coca-Cola performed well during the quarter, rising +11% on the reported statutory loss in the most recent half year taking on a $101m impairment charge in its Indonesian business. Pleasingly the company had recognised signs of increased sales as lock down measures are being relaxed across the country which benefited the portfolio's decision to overweight relative to the Index.

Stock selection detracted most in the Information Technology and Health Care sectors.

Having no exposure to IT firms such as **Afterpay**, and **Wisetech** detracted during the quarter as both stocks jumped by more than 20%. Afterpay was buoyed by news of a potential expansion into Europe. Wisetech rose on news that COVID was increasing the speed of industry change within logistics which is expected to benefit the company's roll out of digital solutions.

Resmed reported an in-line result boosted by ventilator sales in the most recent quarter. Notwithstanding this outcome and the maintenance of its dividend, the share price fell in August on beliefs that its core sleep business may face a tougher environment in the near term due to weaker economic activity across the globe which is expected to flow through to softer sales.

POSITION CHANGES

At month end the Model Portfolio holds 40 of the 80 companies in the Benchmark universe.

The Portfolio added new positions into Altium Ltd and NIB Holdings, and exited positions in Cochlear, Flight Centre and Lend Lease.

Altium develops and supplies software for electronic systems and circuit board design. The company has an impressive growth profile which delivered an increased final dividend of $0.19 per shares (vs $0.18 in 2019 and vs $0.08 in 2015).

NIB Holdings provides health insurance products in Australia. Notwithstanding the recent fall in profitability (due to COVID) the company continues to rate well in terms of quality and consistent growth. The domestic private healthcare market is expected to continue to grow in years to come with NIB well placed to benefit.

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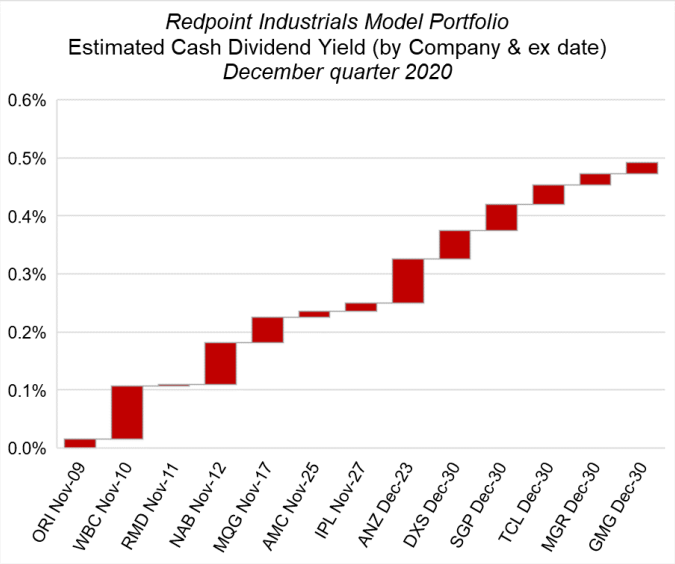
DIVIDEND INCOME

Realised dividend income for the September quarter was 0.83% plus 0.26% in estimated franking credits. Cash dividend income expectations for the December quarter are currently estimated at 0.5% for the Model Portfolio versus 0.5% for the Benchmark. The Model Portfolio is forecast to receive dividends from 13 companies; the Benchmark is expected to have dividends declared by 21 companies.

The following chart shows the dividends expected to be earned by the Model Portfolio over the course of the December 2020 quarter.



Source: Redpoint, Bloomberg

This cash yield of 0.5% is approximately half of the cash yield delivered in the same quarter of 2019 due to lower dividend payments expected from the major banks: Westpac, ANZ, National Australia Bank and Macquarie Group.

The delivery of this expected dividend yield in the last quarter will result in the calendar year yield to be ~2.4% plus 0.65% in franking credits (a gross dividend yield of 3.05%). The 2019 calendar cash yield was 5.25% (plus 1.65% in franking credits).

GENERAL COMMENTARY

Since March 2020, the Australian equity market has continued its upward trend, with sharp gains throughout the second quarter. This momentum stalled during the third quarter when restrictions were reimposed in Melbourne at the start of August and have carried through to the end of September. The ASX100 Industrials Index fell by 3.31% in September dragging the index down to be 1% lower for the quarter.

As shown in the table below the ASX100 Industrials currently stands 12% below where it started in 2020. The ASX200 has fared slightly better (-10.8%) due to the strong performance from the Metals and Mining sector: iron ore miner Fortescue, one of the best performers, is up over 75% so far in 2020. Over the same period the Energy sector has fared far worse as oil prices have fallen by 30% in 2020 resulting in companies such as Woodside Petroleum to be down over 45% year to date.

	ASX100 Industrials	*ASX200*	*FTSE Hi Yield*
Sept Qtr	**-1.0%**	-0.4%	-2.3%
June Qtr	**13.5%**	16.5%	16.4%
Mar Qtr	**-21.7%**	-23.1%	-24.6%
2020 CYTD	**-12.0%**	**-10.8%**	**-14.1%**
3 Years (to 30/9)	**3.2%pa**	4.8%pa	0.0%pa
5 Years (to 30/9)	**5.7%pa**	7.3%pa	4.2%pa
7 Years (to 30/9)	**6.2%pa**	5.9%pa	2.9%pa
7 yr price return	*1.6%pa*	*1.6%pa*	*-2.4%pa*
7 yr income return	*4.6%pa*	*4.4%pa*	*5.4%pa*

Total return index performance: Source Bloomberg

The hunt for higher dividend yields (in its own right) has also been somewhat unrewarded in terms of overall return as shown by the weaker performance of the FTSE Australian High Dividend Yield Index (down -14.1% thus far in 2020). This benchmark has benefited from exposure to mining and resources companies but has been held back by avoiding low yield sectors such as Healthcare and IT as well as Real Estate Trusts which do not pay franked dividend yields due to their tax structure which passes through earnings before tax (and thus without franking credits) to unit holders.

The global COVID pandemic has imposed a global economic shock the likes of which has not been seen in over 100 years. This has impacted almost every sector of the economy. Within the ASX100 Industrials benchmark this has caused dividend yields to halve in 2020 (relative to calendar 2019) as companies have sought to hold cash against the uncertainty of their operating environment. Expectations are that dividends will not return to pre-COVID levels until 2022.

While dividend payments have fallen, share prices have been surprisingly resilient thanks mainly to the massive fiscal and monetary stilumus being applied by goverments and central banks across the globe. From our investing perspective this has inflated the share prices of otherwise poorer quality firms as investor sentiment has whipsawed from bearish to risk loving in a matter of weeks through mid March to early April.

Within this environment the Model Portfolio has underperformed its benchmark over the last six months. This result can be attributed to three main reasons which are discussed below. Notwithstanding such outcomes, our conviction in the long term effectiveness of the strategy is unchanged.

IT Exposure

The buy-now-pay-later star, AfterPay (APT), has captured investor imagination like no other stock in recent years. APT's share price has rallied from a low of $8.90 in late March to finish at $80 by the end of September. Not owning Afterpay in the portfolio has detracted -1.23% in performance relative to benchmark over the past six months.

The company has been bouyed by significant uptake of their service which has swelled underlying transaction value to over $10b. Current estimates are for the company to deliver its maiden profit in 2021: estimated at $130m.

While our growth indicators see the top-line revenue growth our data indicates that the cashflow generation from this revenue remains weak. The Company is currently valued at over $25b. This is larger than retail giant Coles Group, global supply chain group Brambles and more than triple the value of utilities group AGL Energy. In aggregate these three companies are set to deliver a combined profit of over $2b in 2021.

In combination this leads us to believe that there is downside risk given the extreme valuation, potential for new competitors, regulation and execution risk as the company expands outside of Australia. Of course, the company may well deliver exactly and beyond its massive total addressable global market. Unfortunately investors have already priced in significant upside but we retain a watching brief on the stock on risk management grounds.

The Model Portfolio has benefited from its holding in accounting software provider Xero (XRO). XRO has risen by almost 50% since March 2020. Our metrics also point to strong revenue growth which is delivering incremental free cashflow growth to support ongoing development and expansion. This holding has added 0.26% to relative performance over the past six months.

Building Materials

The government and monetray stimuli (COVID response) in the USA and Australia have bouyed building materials firms such as James Hardie (JHX) & Boral (BLD) as these measures are supportive of both residential building and infrastructure development.

The Model Portfolio has never held JHX due to its poor rating on environmental and social metrics. Corporate performance for JHX has improved in recent years resulting in the stock closing the quarter at an all time high of $33.14: more than double its March low of $15.45. James Hardie has not paid a dividend thus far in 2020.

The Model Portfolio has not held Boral Ltd (BLD) since closing out its position in 2015 at $5.25. After rising to $8 in early 2018 the share price has consistently fallen over subsequent years: starting 2020 at $4.50 before falling to a low of $1.80 by late March before rebounding to $4.57 at the end of September. BLD paid a $0.095 per share dividend in mid March but has omitted its September dividend. The stock has been plaugued over recent years with profit warnings and allegations of accounting irregularities related to its USA acquisition of Headwaters. New mangement has recently been installed and financial performance is seen to be improving. This may warrant reassessment for inclusion in the Model Portfolio.

Not holding of JHX and BLD has detracted -0.62% and -0.27% respectively in relative performance over the past six months. In contrast the Model Portfolio has held positions in paper and packaging groups Amcor and Orora as well as global explosives manufacturer Orica. These companies have thus far paid dividends in 2020 in line with prior years except for Orica, which paid an interim dividend of $0.165 in May (vs $0.22 in 2019). It should also be noted that these three companies fell less than BLD and JHX as COVID concerns drove equity prices down in February and March, but they have lagged as markets have rebounded: AMC and BLD have delivered similar returns over the calendar year to date.

Cash holdings

The Model Portfolio is contrained to hold a minimum of 1% in cash at all times (this is a platform imposed constraint). As markets have bounced back over the past six months the Model Portfolio's cash holding has detracted -0.3% from performance relative to benchmark.

OUTLOOK

The past six months have been an emphatic reminder of the forward-looking nature of equity markets and how fiscal and monetary intervention continues to counteract traditional notions of risk and uncertainty. A low interest rate world makes future growth potential more attractive and provides a tailwind of cheaper capital to fund such endeavours. The flip side to this coin is that it can breed over investment which leads to lower pricing power and lower profitability in the future. The longer the lead time to generate meaningful profitability, the greater the risk that future earnings may fail meet the high expectations which investors have today.

The table of performance above highlights that investment in larger Australian Industrial companies provides attractive long-term income and growth returns for investors. While income delivery from dividends has been reduced recently, we expect that this will return through FY 2021 and 2022. Even at the current low point for dividend income the Model Portfolio is expected to deliver a stronger income than cash like investments plus tax credits for investors.

A major catalyst for increased dividend income will be the performance of Australia's major retail banks. APRA has provided further guidance to authorised deposit-taking institutions (ADIs) stating that their expectation is that dividends should be limited to half of their earnings while making lending to households and businesses their priority. Improving statistics for unemployment and loan arrears/defaults will be good indicators to monitor as well as guidance updates from each Bank.

Our approach to building a diversified Model Portfolio of better-quality companies for exclusive implementation in an SMA structure delivers a range of benefits.

Having direct ownership of stocks enables investors to both manage their specific tax position while ensuring that dividend income is received directly from each company. Our approach remains focused on the long term which supports a tax effective delivery of investment returns.

The SMA structure also limits our ability to hold every security in the index. Our approach to solving for this is to focus on long term investment drivers of company quality and sustainability. Where risk budget allows, we will not own those companies which rate poorly on our metrics or at very least hold them at an underweight position. We then reinvest this capital into better quality firms in a diversified and risk-controlled manner.

We would expect that companies with stronger financial positions, higher margins and strong cashflow will deliver better overall returns (in both price and income terms) in the long run and especially in an environment of economic uncertainty. We saw this thesis play out correctly through late February and early March as the Model Portfolio outperformed as markets fell. With markets strongly rebounding this discipline has underperformed more recently. Notwithstanding these recent events we retain conviction in our approach for the long term.

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SUSTAINABILITY

Since our inception, Redpoint's investment approach has sought to incorporate environmental, social and governance practices into our assessment of company quality. As UNPRI signatories we are proud to be A-Rated for our efforts in the areas of investment strategy and incorporation.

Our proprietary asset ranking model [0-1] evaluates the investment quality of a company along environmental, social and corporate governance (ESG) criteria. The table below shows that the Model Portfolio maintains a higher average score to companies that rate well according to each individual component and ESG in aggregate.

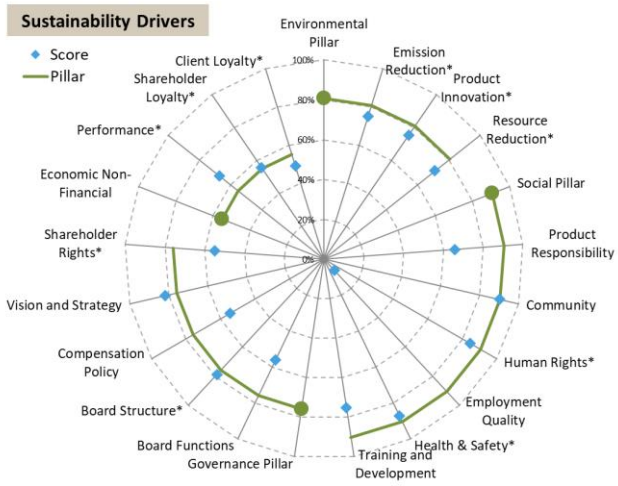
Cohort	Model Portfolio	ASX100 Indl	ASX200
Redpoint ESG	**0.70**	0.62	0.68
Environmental	*0.70*	0.64	0.66
Social	*0.60*	0.58	0.66
Governance	*0.59*	0.54	0.57
Carbon Intensity[1]	**152.3**	**227.9**	**303.9**

1. *Carbon Intensity is measured as Tonnes of CO2 emissions divided by revenue*

The Portfolio has a significantly lower carbon intensity than the benchmark due to our investment in AGL Energy over Spark Infrastructure. While AGL Energy is a large CO2 emitter we note that they are also making significant investment in renewable energy sources as they move to a less carbon intensive operating model. We note that companies such as James Hardie and IT Data Centre provider Next DC (not owned) have the next highest carbon intensity scores within the benchmark.

The Model Portfolio's recent divestment from Cochlear has reduced its overall Social responsibility score (due to Cochlear being highly rated). The overall Model Portfolio score is still above benchmark thanks to positions in Ansell, AGL Energy and Resmed: all especially strong on human rights and health and safety scores.

The chart below highlights a range of sustainability metrics for AGL Energy



Source: Redpoint

This graphic shows that the company scores highly across environmental initiatives related to emission reduction and improvements in resource utilisation. Social elements are generally strong except for employment quality. Governance scores are also above average.

KEY CONTACTS

INVESTMENT MANAGEMENT

Max Cappetta
Phone (direct): 02 9119 5808

Toby Bellingham
Phone (direct): 02 9119 5812

Address: Level 19, Governor Macquarie Tower
1 Farrer Place, Sydney NSW 2000
Website: www.redpointim.com

CLIENT SERVICES (NAVIGATOR SMA)

Email: info@mlcam.com.au
Phone: 1300 738 355
Address: Level 21, NAB House
255 George Street, Sydney NSW 2000
Website: www.mlcam.com.au

CLIENT SERVICES (MACQUARIE SMA)

Email: managedaccounts@macquarie.com
Phone: 1800 501 180
Address: 1 Shelley Street
Sydney NSW 2000
Website: www.macquarie.com.au