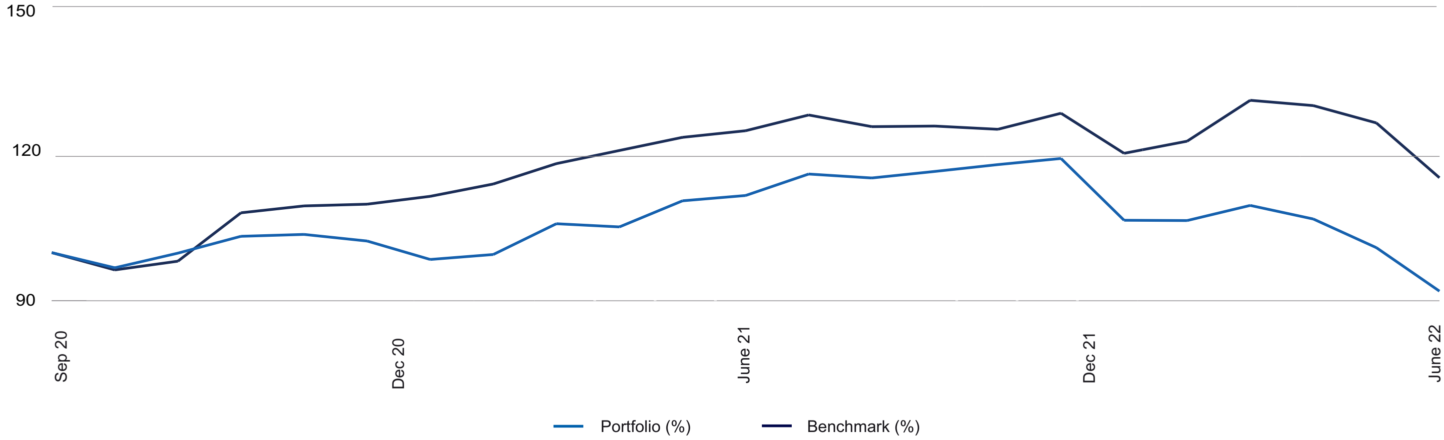
Sterling abrdn Ex20 Australian Equities Portfolio

Monthly Factsheet - June 2022

Investment Objective

To outperform the benchmark, the S&P/ASX 300 Accumulation Index excluding S&P/ASX 20 Leaders Index, after fees, over rolling five year periods.

Performance – 30 June 2022



Cumulative and annualised performance

	1 month	3 months	YTD	1 year	3 years (p.a.)	5 years (p.a.)
Portfolio (%)	-8.94	-16.20	-23.04	-16.93	-	-
Benchmark (%)	-10.23	-14.45	-15.92	-9.01	-	-
Portfolio vs Benchmark (%)	1.29	-1.75	-7.12	-7.92	-	-

For the purposes of reporting, the Benchmark is the S&P/ASX 300 Accumulation Index, excluding the S&P/ASX 20 Leaders Index. Per the advisory agreement, the model portfolio aims to outperform the S&P/ASX 300 Accumulation Index, excluding S&P/ASX 20 Leaders Index, after fees, over rolling 5-year periods. Portfolio performance is provided Net of fees on underlying investments but gross of Advisory/Platform fees.

Inception Date : 01 September 2020

Past performance is not a reliable indicator of future results.

Performance review

For the quarter to end-June, the portfolio fell by –16.20%, underperforming the benchmark, which fell by –14.45%. Overall, our stock selection in the materials and real estate sectors was the main cause of the underperformance. On the other hand, our allocation to the energy sector and stock selection within the communications sector were additive to returns.

Contributing negatively to returns were:

- Our exposure to Megaport, which weighed on returns as it becomes more evident that its change in sales strategy is likely to drag on its growth outlook in the short term. Furthermore, with its profitability expectations delayed, it has been caught up in the global sell-off in growth-focused companies.

- Our stock selection within the materials sector, including Oz Minerals. Its share price dropped following the steep fall in the price of copper off the back of concerns that aggressive rises in interest rates will lead to an economic slowdown.

- Pilbara Minerals, which was also affected by these recessionary concerns, with investors expecting slower sales of electric vehicles to cause a softening in demand for lithium, despite spot prices currently remaining elevated.

Conversely, key contributors to performance were:

- Beach Energy, rebounding from last quarter despite mixed quarterly results. Production numbers were soft, but other development activity remains on track and total revenue came in ahead of expectations. Meanwhile, the company benefited from a broader sector rerating as oil prices rose as a result of the increased geopolitical risk regarding the situation in Ukraine.

- Our stock selection within the communication services sector, with Spark New Zealand performing well following confirmation that it has now officially commenced the process of monetising its fixed TowerCo assets. This was viewed favourably given recent comparable transactions in the market.

- Our overweight to Medibank, which also contributed positively as, despite mobility restrictions easing considerably, it has yet to see claims costs revert back to pre-Covid-19 levels. This, combined with what is a highly defensive non-discretionary stream of premium income, has boosted confidence in its earnings and led to its outperformance.

Portfolio Activity

During the quarter, we initiated positions in Elders and Infratil. Elders is a well-run agricultural services business, with strong capital discipline and multiple internal growth options. Elders is expected to benefit from robust ongoing seasonal conditions and offers the potential for bolt-on acquisitions. Infratil is a high-quality and diversified holding of operating businesses that we believe will be more resilient to challenging economic conditions. The Infratil portfolio includes defensive assets, ranging from data centres with long government-backed leases to a New Zealand energy utility provider and a network of medical imaging centres, as well as a strong and growing pipeline of renewable energy projects. We also exited Temple & Webster, as while it is a good business with no debt and generating positive free cash flows, the short-term outlook remains increasingly challenged thanks to frontloading of rates by the RBA. This is expected to have a severe impact on consumer confidence particularly large household items.

Market review

Australian equities fell during the quarter, in line with the sell-off in markets worldwide. The Australian dollar also weakened against the US dollar, hitting its lowest level since 2020. Meanwhile, commodity prices dipped in SDR terms, although were relatively flat in local-currency terms.

Australian equities fell over the second quarter of 2022, weighed down by concerns of a recession as interest rates continue to rise globally as central banks try to counter persistently high inflation. The Reserve Bank of Australia (RBA) was no different, surprising the market with a first increase in interest rates since 2011 coming before the federal election in May and then again with a larger-than-expected 50-basis-point rise in June. The initial move was prompted by the Consumer Price Index rising 5.1% year-on-year to the end of March, above estimates of 4.6%. and the fastest quarterly increase in 20 years. The RBA also guided that further rate rises were likely in the coming months. Losses were fairly broad-based across sectors, but were led by growth-oriented ones, as has been the trend for most of the year.

In economic news, NAB's latest business survey still showed high (if slowing) confidence. On the other hand, Westpac's consumer sentiment survey has now dropped to levels normally associated with weak economic growth or a recession, reflecting concerns over the rising cost of living. Other data points were encouraging, with job vacancies rising to a record 480,000 in May, while retail sales for the same month were also solid, growing 0.9% from April. However, none of this economic data reflected the recent rise in interest rates, so next quarter's releases will be keenly anticipated by the market.

Top ten holdings (%)

Insurance Australia Group Ltd	4.5
Medibank Pvt Ltd	4.4
Endevour Group Ltd/Australia	4.2
OZ Minerals Ltd	4.1
ASX Ltd	3.8
Auckland International Airport Ltd	3.7
Cochlear Ltd	3.7
Pilbara Minerals Ltd	3.6
Mirvac Group	3.4
Spark New Zealand Ltd	3.3

Sector (%)

Financials	18.5
Materials	16.7
Industrials	10.7
Real Estate	9.8
Consurmer Staples	8.5
Health Care	8.3
Consumer Discretionary	7.1
Energy	5.9
OTHER	12.2
Cash	2.4

Source : abrdn 30/06/2022.
Figures may not always sum to 100 due to rounding.

Outlook

The combination of inflationary pressures – that are, in many cases, just peaking – and the aggressive and ongoing increases in global interest rates are providing the right ingredients for a potential economic slowdown.

Given this backdrop, we are taking a cautious view for the remainder of 2022. Increasing evidence of reduced consumer spending, as the rising cost of living and higher mortgage servicing costs take their toll, is likely to translate into a demand slowdown. Moreover, if cost pressures continue to run rampant, the risk of stagflation increases and an economic recession is likely to follow.

This has various implications on both the outlook for corporate earnings and stock valuations. Despite equity markets already experiencing a steep drawdown in the first half of 2022, our observation is that only earnings multiples have normalised, mainly driven by the rising cost of capital. However, earnings estimates remain fairly robust and have yet to fully capture the rising risks of slowing economic growth. As a result, the upcoming earnings season is likely to reveal signs of initial softness, and we expect market expectations for earnings growth to be progressively revised downwards.

Given this volatile backdrop, our portfolio positioning remains biased to businesses that offer strong pricing power and those that exhibit defensive business moats. We continue to be cautious on interest rate-sensitive sectors and companies just beginning their journey towards profitability.

We remain committed to our ‘bottom-up’ investment style, with a focus on quality companies. We favour businesses with clear growth prospects that are leveraged to long-term structural shifts. Our holdings’ defensiveness, in terms of their robust balance sheets and prospects for generating healthy through-the-cycle earnings and dividend growth, is an added advantage. Many are also leaders in governance and sustainability, positioning them well to adapt to future challenges and opportunities. This will ensure that the portfolio remains resilient despite the current uncertain environment.