Direct Equities Portfolio Performance

Responsible Investment Portfolio – March 2024 Quarter

Perpetual Private Responsible Investment Model Portfolio

Returns including dividends*	3 months (%)	1 year (%)	3 years (%†)	5 years (%†)
Responsible Investment model portfolio	**11.4**	**19.3**	**8.8**	**8.8**
S&P/ASX 300 index	5.4	14.4	9.4	9.2
Excess return (model return above benchmark)	6.0	4.9	-0.7	-0.3

*Past performance is not indicative of future performance. Client performance may differ due to timing of alignment with the model portfolio, advice fees, administration fees and transactional costs associated with the client's portfolio. Performance is indicative of the total return of the model portfolio's stocks over the period.
†Per annum, compounded.

Over the March quarter, the rally in Australian shares continued and expanded on the strong gains experienced over recent periods. Indeed, following the 8.4% gain (as measured by the S&P ASX 300 index) in the December 2023 quarter, 5.4% in the March quarter feels relatively tepid. It should be noted however, the 14.4% gain over the past 12 months, is meaningfully higher than long term annual averages for the index. As such, it is important to enjoy these returns within context. This buoyancy ultimately reflects optimism about economies, domestic and local, and monetary policy (i.e. that interest rates will soon fall). This building force of positive sentiment has now begun to 'lift all boats', with smaller companies (as measured by the S&P ASX Small Ordinaries) growing by 7.6% over the March quarter, aided by increasing levels of corporate M&A (another sign of growing confidence in the market).

As has been the case since the abrupt change in interest rate policies in 2022, different companies and different sectors experienced meaningfully different outcomes: not all boats are being lifted equally. Continuing to be weighed by reduced demand (particularly from China) whilst being squeezed on labour costs, the Metals & Mining sector gave up 7.7% over the quarter with lithium (**IGO**, **Pilbara Minerals**, and **Liontown**) and iron ore (**BHP Group**, **Rio Tinto** and **Fortescue**) unloved.

Also trailing despite a recovering oil price was the Energy & Utilities sector (+3.5%). The A-REITs sector (15%) led the market in large part due to its largest constituent **Goodman Group** which rallied 34%. Non-bank Financials (+12%) also performed well. Our recent addition to the portfolios, **Suncorp**, delivered a pleasing 21% total return with, we believe, substantially more to come as it simplifies its business and returns capital to shareholders.

The Communications & Technology sector told an interesting story over the quarter. In aggregate it outperformed the market with a 10.3% return but its constituents' returns were polarising. Older style and less growthy companies **Telstra**, **Nine Entertainment** and **Seek** fell while technology companies rallied. Included in the latter group are **Altium** which received a takeover offer, **PEXA** and **Wisetech**, highlighting the exciting promise and potential of future innovation like artificial intelligence.

Meet your Portfolio Manager

Daniel Nelson, Portfolio Manager

Daniel Nelson manages the Responsible Investment portfolio in Perpetual Private. Daniel is also the analyst responsible for research and advice on the Mining, Energy and Materials sector. Daniel joined Perpetual in 2011 and is a CFA charterholder.

Investment outlook

Having travelled through the peaks and valleys of the pandemic, followed by accelerating inflation and therefore rapidly rising interest rates, many investors had expected a global recession to have arrived. However, corporate Australia didn't get that memo. The main event in the March quarter is usually company reporting season. During February, the December 2023 reported half financial outcomes were broadly in-line and positive, with forward guidance generally constructive. A far cry from an economy that was expected to be nearing a substantial slowdown. February reporting season marked the 2nd in a row since the pandemic where "normality" was the norm.

A sense of caution led into reporting season due to the cost-of-living pressures and the latent effect of monetary tightening. However, what we saw was resilience. A resilient consumer was still spending, corporates had largely worked through the pandemic's longer lasting disruptions, and business and market sentiment was up as shown by a rebound in the small-cap section of the share market, as well as an increased level of corporate activity (mergers and acquisitions).

It wasn't plain sailing, of course, with Australia's large mining sector weighed down by an ailing Chinese economy and continuing cost pressure impacts. While the healthcare sector has been one of the slowest to recover, mostly a result of labour tightness. Driving this has been a higher-than-usual number of nurses and doctors leaving the system or significantly reducing hours, post-pandemic. We believe margins for the likes of **Ramsay Healthcare** and **Integral Diagnostics** will recover as the staffing issues normalise over the next 12 months.

We have grown increasingly positive, as economic and corporate data continue to support the 'soft landing' (no recession) thesis. We are steadily trimming our defensive positioning but retain a sensible level of caution. That the economic environment is proving to be stronger and more resilient than feared, does not mean that there is no risk. With our large resources sector highly geared towards China's economic outcomes, there is still a lot that remains unknown (and indeed unknowable).

As always, opportunities are normally born out of uncertainty, and our raison d'etre is to seek out scenarios where we can expect outsized returns for any risk that we take. As we move forward, we expect that our diligence and hard work will be rewarded and aid in delivering the best possible portfolio outcomes.

Portfolio strategy

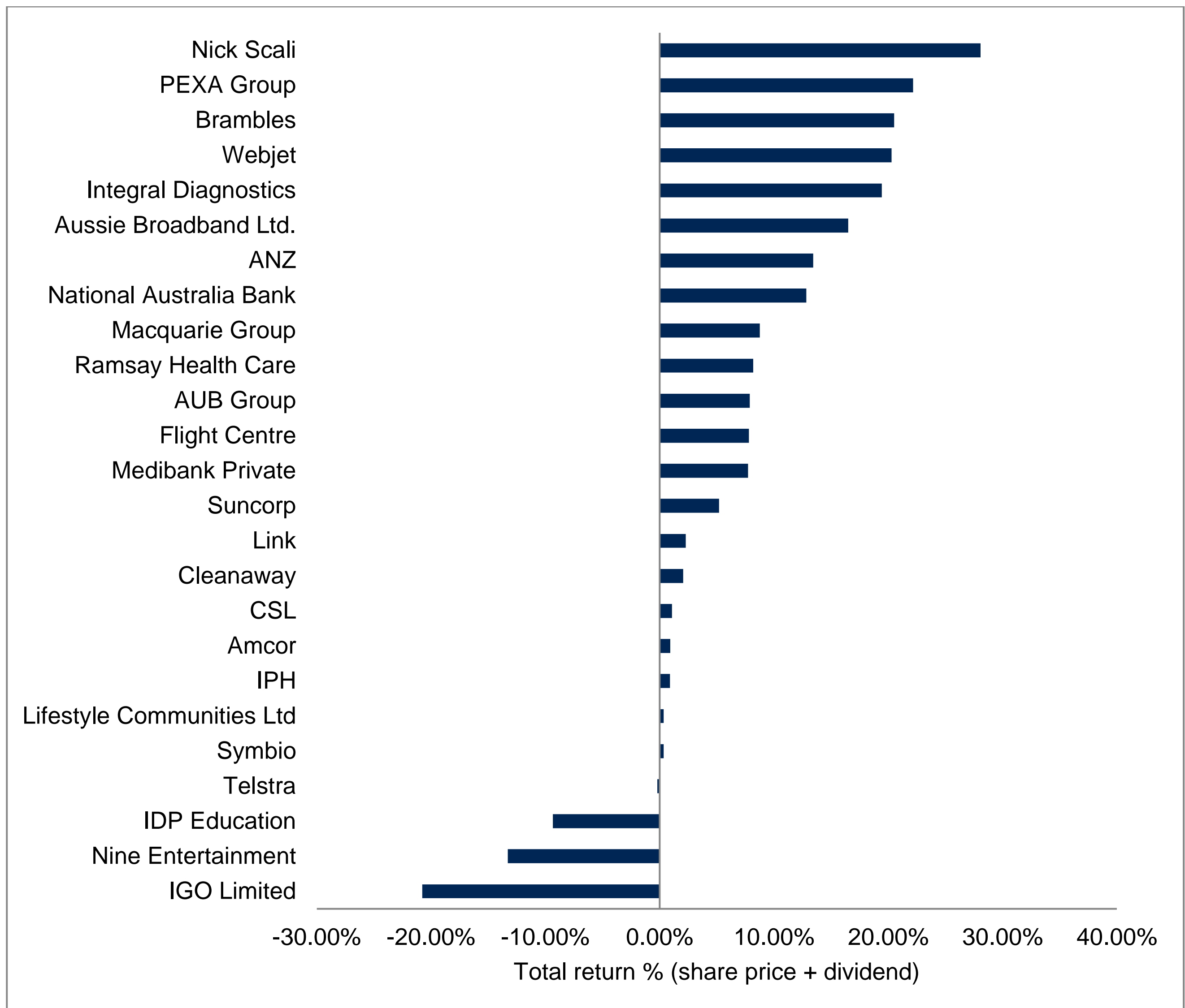
We have successfully navigated our way through a tumultuous period since the emergence of the COVID-19 pandemic in 2020. Ironically, we performed better during the early stages of lockdowns where markets moved significantly down and then back up again, when we pivoted successfully on the right side of the prevailing trend. However, we have found that the post-Covid recovery phase from 2022, marked by high inflation and rapidly rising interest rates, much more challenging (akin to the macro-economic driven period surrounding Brexit and Trump's pending presidency around 2016-18).

That economic backdrop is now shifting again as the investment world increasingly accepts that a 'soft' economic landing scenario is now most likely (ie. no debilitating recession). In addition, February saw the second company reporting season which has shown an operating playing field that has returned to normal, with good cost control in the Jun-Dec period indicating that management now has greater influence on their destiny. Thus, through this period of transition, we have been increasingly active in adjusting our portfolios to benefit from a share market shifting back to being driven by fundamental quality and value factors, rather than top-down macro-economic factors. Essentially, we have shifted incrementally away from defensive exposures, and more towards undervalued growth or cyclical companies. Examples would be the topping-up of existing holdings in **IGO**, adding new growth names such as **ResMed**, and reinstating historical holdings in quality stocks such as **Computershare**.

When investing, sometimes you are rewarded for the actions you do take, sometimes for the actions you don't. While we have deliberately avoided being too brave and engaging too strongly with risk, we are now more willing to move portfolio positioning to a more aspirational state. This is based on the recent shift to a balance between the level of forward visibility and an attractive level of prospective opportunities. However, under-valued stocks are quickly being identified by investors and acted upon. We also remain wary not to chase quality at the expense of value.

Overall, we will continue to maintain a balanced approach to our Direct Equities portfolios. With the likelihood of a recessionary slowdown dissipating and confidence in the economic climate continuing to hold we will continue to sell down more of our more defensive exposures, but we will not exit them altogether as balance is key to managing the unexpected. We are also mindful that an improving economy, or one outperforming low expectations, is unlikely to experience further significant moderation in inflationary pressures. Hence, our balanced approach must also consider the increasing chances of interest rates remaining higher-for-longer.

Figure 1: Responsible Investment model portfolio total return for the March 2024 quarter



Source: FactSet, March 2024. Past performance is not indicative of future performance.

Perpetual

Stock in the spotlight

Suncorp Group: An industry leader getting focused on its core

Suncorp Group is an established financial conglomerate with operations in general insurance and banking (the latter division currently being sold). Its core business is general insurance which operates under various well-known brands such as AAMI, GIO, and Suncorp. Similarly to the Australian banking sector, there is a high level incumbency and concentration of participants in the Insurance industry which in our view, provides a level of defensiveness given the large players occupy strong business positioning. What is different compared to the banking sector, is that the Insurers exhibit quite strong pricing power, as evident by the robust premium price increases we have seen over the past few years. Suncorp and Insurance Australia Group (IAG) are the largest general insurers with a combined market share of around 50% across most consumer and commercial lines.

Suncorp is a company we have tracked for a long time and have previously owned. It has been our preferred listed general insurer and as such we recently initiated a position in both our Core and RI portfolios. We found an attractive entry point for a high-quality leading insurer, which is delivering above industry growth and is on the cusp of potentially announcing up to ~$4b in capital management initiatives following the sale of its Australian banking and NZ Life insurance arms. The group is well capitalised and we regard the management team highly; noting that since CEO Steve Johnston took over in 2019, Suncorp has built up a fortress like balance sheet, under promised and over delivered on expectations, and carried out initiatives such as the sale of its Bank business to drive better shareholder return outcomes. Below talk to each of these points in turn and highlight why we are attracted to the business.

Suncorp's drawn-out sale of its bank business to ANZ has received ACCC and various other regulatory approvals and is now expected to be completed by the middle of this calendar year. The ~$5b sale was first announced in 2022 and at one stage looked unlikely to be approved given competition concerns. In our view, the sale is a positive catalyst for Suncorp. Its regional bank business is sub-scale, not large enough to compete on price with the Big 4 and not nimble enough to compete with emerging digital players. Further, banking is a lower P/E multiple business when compared to Insurance and divesting this should drive a re-rate in the firm's P/E multiple. Finally, Suncorp in early April also announced the sale of its NZ Life business for ~$400m, with completion expected within the next 9 months.

Given Suncorp already is a well-capitalised insurer, with a track record of share buybacks and special dividends over the last few years, we expect the proceeds from these two divests to ultimately be returned to shareholders. If the bank sale timeline goes according to the current guidance, we believe there is a high likelihood of a share buyback announcement towards the latter end of this calendar year. The combination of ~$4b of capital management initiatives over the near to medium term and a pure play insurer should mean the market attributes a higher P/E multiple to Suncorp compared to <16x implied at ~$16 per share.

Finally, it is worth highlighting that for several periods now, Suncorp's core domestic insurance business has outperformed its key competitor IAG and the overall industry. At its most recent interim result, Suncorp delivered >15% gross written premium (GWP) growth across its consumer book, driven by strong price increases across Home and Motor insurance as well as volume/unit growth. Most competitors relied on price to drive top-line growth, but Suncorp was able to deliver unit growth which in our view demonstrates the strength and price inelasticity of its portfolio of brands. Overall, we believe SUN's strong momentum across its core business will continue and if anything should improve as it becomes a standalone insurer without the drag from its bank division.

Figure 2: Home and Motor Portfolio Growth

(versus pcp; normalised for portfolio exits)

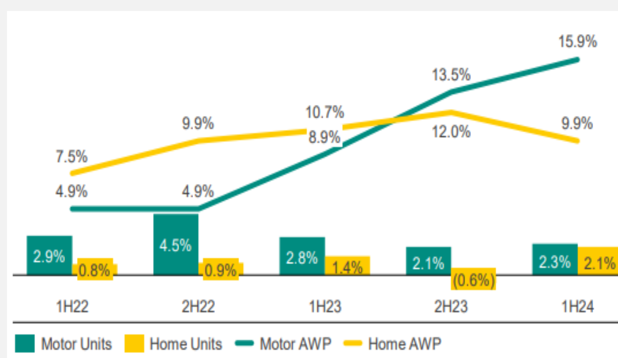
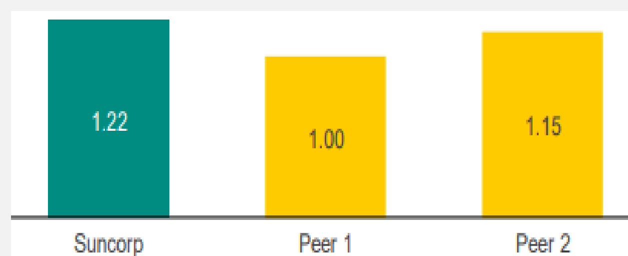


Figure 3: Capital Relative to Other Peers

GI CET1 Capital Ratio



Source: Company reports

Portfolio changes – March Quarter 2024

Weight changes	Date	Previous weight %	New weight %	Sector
★ Computershare (CPU)	17/04/2024	0.0	2.9	Non-bank Financials
★ ResMed Inc. (RMD)	17/04/2024	0.0	2.7	Health Care
▼ Brambles (BXB)	17/04/2024	4.9	4.4	Industrials
⊘ Link Administration Holdings (LNK)	17/04/2024	3.0	0.0	Non-bank Financials
⊘ Nine Entertainment Group (NEC)	17/04/2024	2.2	0.0	Communications & Technology

Top 5 high-conviction holdings – as at 15/04/2024

Model portfolio stock	Relative weight‡ %	Holding weight %	Sector
Audinate (AD8)	+4.4	4.5	Communications & Technology
ANZ Banking Group (ANZ)	+4.1	7.7	Banks
Altium (ALU)	+4.0	4.3	Communications & Technology
National Australia Bank (NAB)	+4.0	8.4	Banks
Virgin Money UK (VUK)	+3.7	3.9	Banks

‡Reflects portfolio manager conviction. Represents the percentage held above the stock's weight in the ASX 100 index.

Perpetual Private advice and services are provided by Perpetual Trustee Company Limited (PTCo) ABN 42 000 001 007, AFSL 236643. This publication has been prepared by PTCo. It contains general information only and is not intended to provide you with financial advice or take into account your objectives, financial situations or needs. You should consider with a financial adviser whether the information is suitable for your circumstances. The information is believed to be accurate at the time of compilation and is provided by PTCo in good faith. This document may contain information contributed by third parties. PTCo does not warrant the accuracy or completeness of any information contributed by a third party. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on any information in this publication. Performance is indicative of the total return of the model portfolio's stocks over the period. Client performance may differ due to timing of alignment with the model portfolio, advice fees, administration fees and transactional costs associated with the client's portfolio. Past performance is not indicative of future performance. No company in the Perpetual Group (Perpetual Limited ABN 86 000 431 827 and its subsidiaries) guarantees the performance of any portfolio, stock or the return of an investor's capital. No allowance has been made for taxation. Published in April 2024.

More information

Contact your financial adviser or call:
Perpetual Private: 1800 631 381
Email: perpetualprivate@perpetual.com.au
www.perpetual.com.au/advice

Trust is earned.