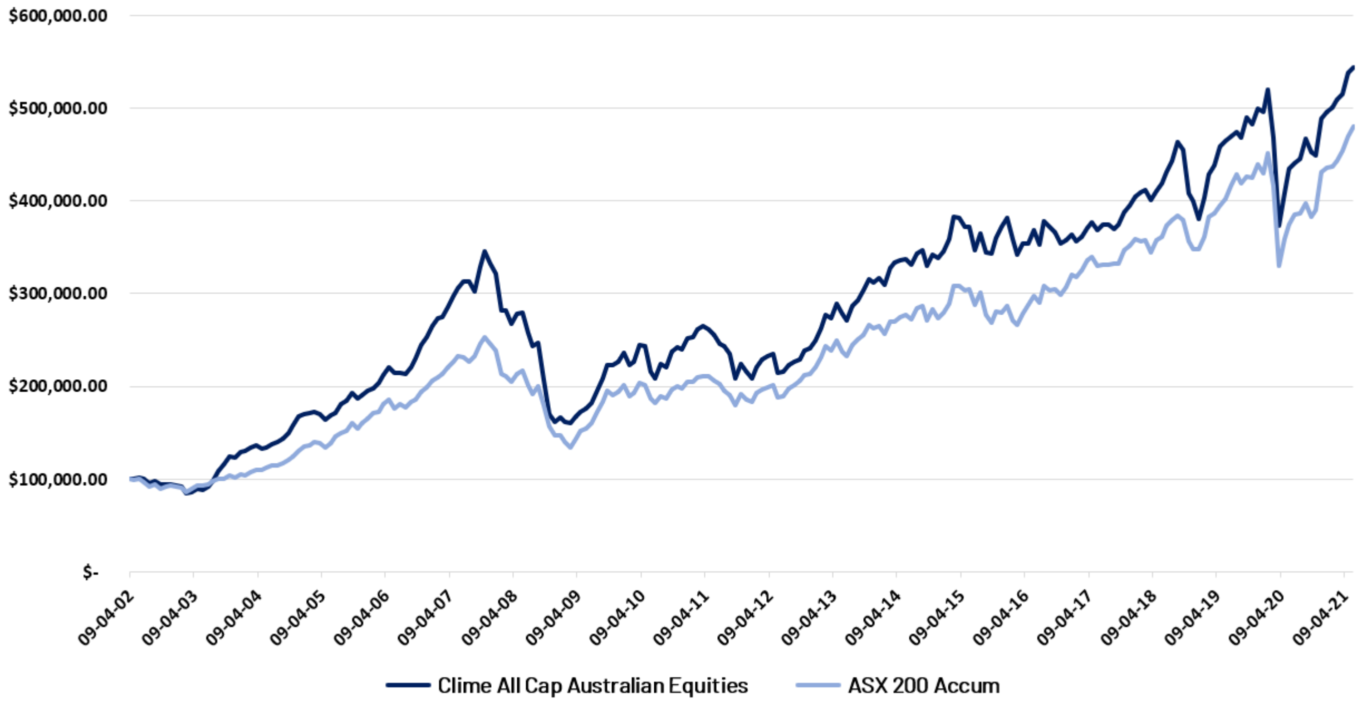
Clime All Cap Australian Equities Fund (Wholesale)

(Formerly Clime CBG Australian Equities Fund (Wholesale))

Fund Performance | May 2021

The Clime All Cap Australian Equities Fund (Wholesale) seeks to deliver strong risk-adjusted returns by investing in a portfolio of high quality large, mid and small cap Australian companies that are attractively priced. Its objective is to achieve returns in excess of the S&P/ASX200 Accumulation index.

1 Month Net Return (Wholesale)*	3 Year p.a. Net Return (Wholesale)	Inception p.a. Net Return (Wholesale)	Total Fund Size
1.3%	9.1%	9.3%	$69.0m



	1 month	FYTD	1- year	3 years	5 years	10 years	Inception p.a.	Inception Total
Wholesale (AUD Portfolio Return)	1.3%	23.5%	25.4%	9.1%	8.1%	7.9%	9.3%	444.4%
Benchmark (S&P ASX 200 Accum)	2.3%	25.0%	28.2%	9.9%	10.1%	8.8%	8.5%	380.8%

Inception: 9 April 2002.
*Performance figures for more than 1 year are annualised, calculated after all applicable fees and taxes. Performance figures compare unit price to unit price for the given period. The returns exclude the impact of imputation.
^Benchmark refers to S&P / ASX200 Accumulation Index

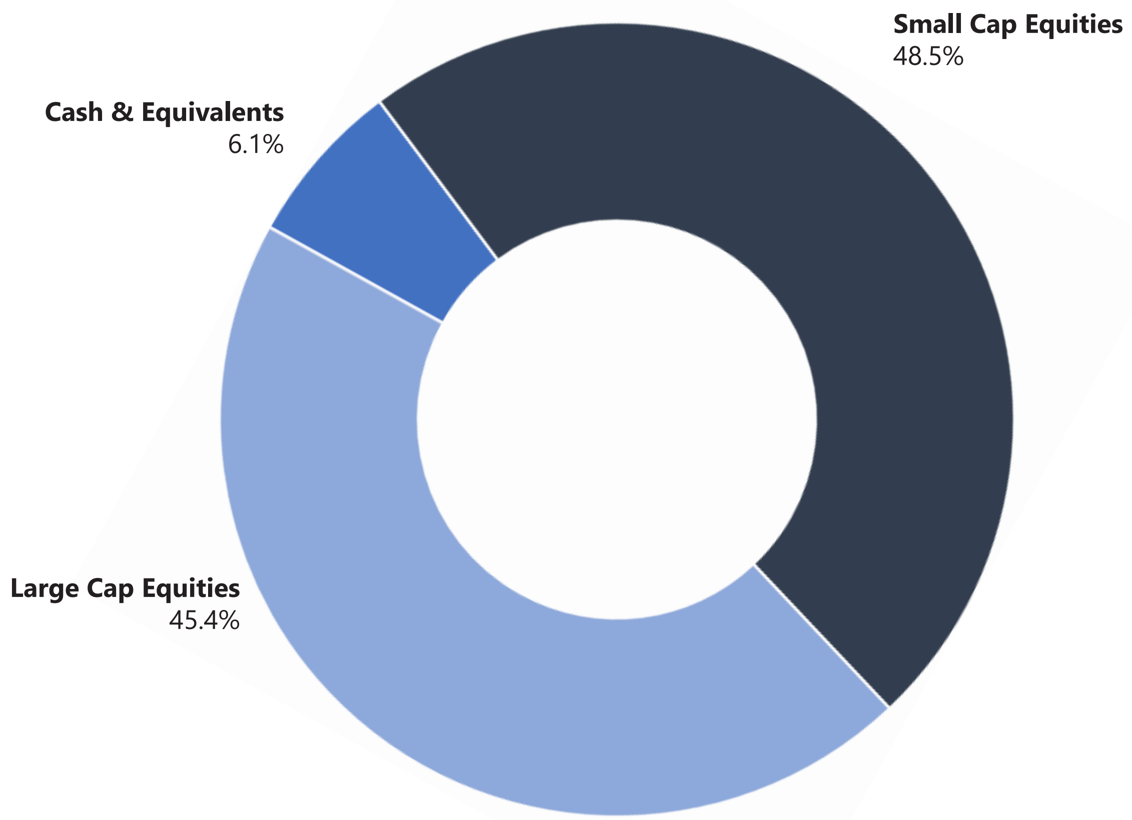
Fund Facts

Portfolio Managers	Adrian Ezquerro, Ronni Chalmers, Jonathan Wilson & Vincent Cook
Fund Inception	April 2002
Fund Size	$69.0m
Number of Stocks	25-40
Cash Distributions	Annually
Eligibility	Wholesale

Top 5 Holdings (Alphabetical)

Company	ASX Code
BHP Group	BHP
National Australia Bank	NAB
RPM Global Holdings	RUL
Sonic Healthcare	SHL
Westpac Banking Corporation	WBC

Asset Allocation by Market Capitalisation



Asset Allocation by Sector

Industry	Weighting
Financials	24.1%
Materials	19.3%
Consumer Discretionary	13.5%
Health Care	10.6%
Information Technology	10.5%
Industrials	8.7%
Real Estate	3.0%
Communication Services	2.2%
Energy	2.0%
Cash	6.1%

Portfolio Commentary

The portfolio returned 1.3% in May, compared to a 2.3% return for the S&P/ASX200 Accumulation Index. Large cap stocks led the market strongly during May, with the ASX 50 outpacing the Small Ordinaries by 2.6 percentage points over the month.

In a reversal of fortunes on the prior month, the ASX outperformed most global indices, with the S&P500 and MSCI World delivering returns of 0.7% and 1.1% respectively. Domestically, Banks (+7.3%) and Consumer Discretionary (+3.5%) led the way, while Technology (-9.9%) and Utilities (-6.6%) underperformed.

Key contributors and detractors to the portfolio return for the month were:

- **Australian Equity Large Cap Sub-Portfolio:** Key contributors Westpac (WBC), National Australia Bank (NAB), Australia and New Zealand Banking Group (ANZ) and OZ Minerals (OZL), only detractor of note Mineral Resources (MIN).
- **Australian Equity Small Cap Sub-Portfolio:** Key contributors APN Property Group (APD), Integral Diagnostics (IDX) & RPM Global (RUL), key detractors Mach7 Technologies (M7T), Electro Optic Systems (EOS) & Hansen Technologies (HSN).

Westpac Banking Corporation (WBC), National Australia Bank (NAB) and **Australia and New Zealand Banking Group (ANZ)** contributed positively to performance, as the improving economic environment is supportive for banks. Excess capital also means that buy backs and / or special dividends are likely in the near term. WBC returned 8.2% for the month, NAB 3.4% and ANZ 6.7%. These three companies reported half year earnings results in May and Clime estimates that the excess capital positions at balance date would support buybacks of 5-6% of shares on issue.

OZ Minerals (OZL) returned 5.6% in May in the context of continued strength in the copper price, which gained 4.3% for the month in USD, taking the calendar year to date gain to 32.3%. Copper consumption is closely correlated with economic activity, while energy transition and the take up of electric vehicles are supportive for medium and long term demand.

Mineral Resources (MIN) detracted from performance, returning -5.0%, as a shortage of available truck drivers recently caused the company to reduce iron ore production guidance for the current financial year. The iron ore price increased by a further 7.8% in May and MIN plans to increase production from 20 million tonnes per annum to 90 million over the next five years, while doubling mining services work.

APN Property (APD) returned 59% for the month after announcing on 11 May it had entered into a scheme implementation deed with Dexus (DXS), under which Dexus will acquire 100% of APD. The proposed acquisition is for cash consideration of $320 million at 91.5 cents, a 50% premium over APN's previous closing price of 61.0 cents.

Integral Diagnostics (IDX) returned 8% over the month on the back of a strong rebound in diagnostic imaging volumes. Across IDX key states of Victoria, Queensland, and Western Australia, FYTD volumes are up 14% in aggregate, with Victoria yet to accelerate. IDX trades on a free cash flow yield of 5% and retains significant balance sheet capacity for acquisitions in what is still a fragmented market.

Mach7 Technologies (M7T) finished the month -14% on no news. M7T announced on 6 May that current Mach7 Platform customer, University of Vermont (UVM), had chosen M7T's eUnity Enterprise Viewer. Reflecting a large cross sell opportunity, UVM is just the 15th of M7T's 130 customers to adopt both solutions.

Electro Optic Systems (EOS) receded -11% in May, with weakness continuing in the share price after the company's March quarterly release on 30 April. Negative sentiment persists, despite EOS subsequently announcing on 12 May cash receipts of $43 million since 1 April, and net cash of $60 million (up from $41.5 million) at the AGM on 28 May. We think shares grossly undervalue EOS's contract pipeline and SpaceLink business, both of which are near term catalysts.

Hansen Technologies (HSN) returned -7% for the month. HSN held its investor day on 18 May at which it reaffirmed FY21 EBITDA guidance of between $115 and $121 million and FY25 target of $500m revenue at between 32% and 35% EBITDA margin. HSN's market valuation of $1.06 billion remains attractive relative to our valuation.

Market Commentary

A resurgence in virus cases and some setbacks to vaccination programmes have pushed back the timing of recoveries in some countries somewhat, but we still expect strong global growth of over 6% this year – the fastest rate since 1973. The US will continue to lead the way, and the recovery in the euro-zone is about to step up a gear. However, downside risks are rising, mainly among Emerging Markets, and while China has emerged strongly from the pandemic, growth there will soften as credit is restrained. Inflation will continue to rebound in the coming months almost everywhere. Whereas underlying inflation pressures should dissipate in most cases next year, they are likely to hold up stronger in the US.

As COVID-19 vaccinations are being aggressively administered across regions, the consensus economic outlook has become more positive for reacceleration in Q2 and Q3. The Eurozone still lags the US and the UK in the rate of shots administered, but the production outlook across these regions indicates that we are likely to reach critical mass across developed markets by the end of Q3.

Such a rapid roll-out is fuelling a reacceleration in global growth. Growth continues to be supported by the backdrop of continued dovish monetary policy. Global central banks' efforts to avoid the combined effects of a global recession and a credit crisis in 2020 had a positive impact on global financial markets and helped corporations weather the significant fundamental stress but resulted in a significant increase in central bank balance sheets.

Back in August of 2020, the Federal Reserve softened its language around its 2% inflation target, messaging to market participants that it is unlikely to engage in monetary tightening in the shorter term and is instead inclined to allow inflation to run moderately higher than the standard 2% target for some time before hiking interest rates. This is reflected in the flatness of the Fed Funds Futures curve.

The expected economic acceleration with the backdrop of continued easy monetary policy has fed into renewed inflationary fears by market participants. Market-based measures of inflation pricing have climbed higher in recent months, with the 10-year Breakeven Inflation Rate for US Treasury Inflation Protection Securities (TIPS) now trading above the 2% Fed target level.

Ten year TIPS Breakevens have reached levels not seen since early 2013. Back in 2013, longer term interest rates began to rise as inflationary pressures translated into a more hawkish stance from the Federal Reserve. This ultimately resulted in the Fed tapering its asset purchases in December 2013, which caused temporary market turmoil but ultimately helped to quell inflationary fears.

In some ways, the 2013 Fed asset purchase tapering looks similar to the current market environment. However, whereas Bernanke indicated as early as May 2013 that the "[The Fed] could, in the next few meetings, take a step down in our pace of purchases", Chairman Powell has indicated as late as mid-March that the Fed is not yet ready to taper. Said Chairman Powell, "Until we give a signal, you can assume we're not there yet. As we approach it, well in advance, well in advance, we will give a signal that yes, we're on a path to possibly achieve that, to consider tapering."

The question as to whether inflationary fears will materialize and the extent to which the Fed will proactively address inflationary concerns if they do, in fact, materialize are paramount for investors over the coming years. Our view on the inflationary outlook is largely dependent on time horizon. In the short term, we expect significantly higher inflation rates. One reason for this includes base effects, such as the oil price. Currently, the oil price (at $60 USD/barrel) is more than 200% higher than one year ago. However, such one-off effects should be ignored by the central banks as they do not constitute structural inflation.

Inflation is a process rather than a one-time price jump. Therefore, central banks will not react on transitory price increases. In the medium term, the outlook for inflation is dampened as economies still faces tremendous capacity underutilization, and it will take time to close the output gaps. This is especially true in Europe which lags in recovery, but is also the case in the U.S. where the economy is still far from full employment.

In the long run, however, inflationary pressures are certainly conceivable. Concerns about a rise in inflation also surfaced post the 2008 financial crisis, based on the simple view that inflation is possibly the easiest way to deflate debt obligations. As inflation never materialised, one could be tempted to dismiss such concerns, but such an approach is not prudent given the continued rise in the levels of debt.

It is thus important to review how such inflationary dynamics will impact various asset classes. As inflationary concerns take hold, investors are increasingly seeking to shift portfolio allocations toward assets that can benefit from inflation. Within this context, we highlight that the primary risk to investors comes from a prolonged period of rising inflation (like the one in the 1970s), rather than a temporary one. While uncertainty remains as to the likelihood of inflation risk over the longer term, it is nonetheless prudent to assess a range of scenarios.

The universe of fixed income investments stands to suffer the most from any material shift higher in the long-term inflationary outlook. Ultimately, fixed income (apart from TIPs and floating rate securities) is a nominal asset with a fixed stream of income payments. Even absent a material rise in interest rates, which has been the historical experience during periods of inflationary pressure, these fixed nominal returns may look less attractive in real terms if consumer prices rise.

During periods of positive inflation surprises, equity market returns typically trend lower while volatility increases. Energy and materials have commonly outperformed during such periods, while some other sectors with strong competitive advantage and pricing power have historically provided some inflation protection (IT, Healthcare, some Consumer sectors such as Staples).

We now enter the final month of what has been an extraordinary financial year. While we maintain a constructive stance on exposure to risk assets, given risks associated with valuation, inflation and monetary policy, a selective approach focused on quality remains paramount.

Adrian Ezquerro
Head of Investments

Fund Information

Investment Objective

The Clime All Cap Australian Equities Fund (Wholesale) is a concentrated portfolio providing a balanced exposure to high quality companies across the large, mid and small cap segments of the ASX.

The Fund invests in leaders that have good economics, strong balance sheets, and significant growth prospects. The Fund is managed to generate a sound balance of capital growth and income.

Its objective is to achieve returns in excess of the S&P/ASX200 Accumulation index.

Investment Methodology

The Clime All Cap Australian Equities Fund (Wholesale) has a quality focus with a valuation discipline. Fund holdings are characterised by:

- A competitive advantage, leadership within a specific niche
- High levels of profitability and margin
- Low financial leverage
- Capital-efficient growth and cash generation
- Capable management aligned with shareholders
- Sustainable long-term growth
- Attractive share prices relative to assessed value

Position sizing reflects not only our assessment of valuation and quality, but also the degree of strategy execution.

Portfolio Managers

Adrian Ezquerro
Head of Investments

Ronni Chalmers
Portfolio Manager - All Cap Australian Equities

Jonathan Wilson
Portfolio Manager - Small Caps

Vincent Cook
Potfolio Manager - ASX 100

Name	Clime All Cap Australian Equities Fund (Wholesale)	**Investor Eligibility**	Wholesale
Structure	Managed Investment Scheme	**Minimum Investment**	Wholesale: $100,000
Benchmark	S&P/ASX200 Accumulation Index	**Fees**	Wholesale: 1.03% p.a. management and 20.5% performance (S&P/ASX200 Accumulation Index)
Stock Holdings	25-40	**Admin**	Mainstream Fund Services
Liquidity	Weekly Unit Pricing Applications and Redemptions	**Stock Limit**	15% at cost

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