CONCENTRATED LEADERS FUND

ASX LISTED INVESTMENT COMPANY (TICKER: CLF) | MONTHLY INVESTMENT REPORT: APRIL 2019

Fund Description

Concentrated Leaders Fund Limited (CLF) is a concentrated portfolio of leading Australian companies. The CLF investment team uses a top-down macro thematic, quantitative filters and bottom-up fundamental research.

Fund Objective

CLF is a geared listed investment company, which invests primarily in companies within the S&P/ASX 200 TR index. CLF is focused on providing investors with capital growth and a consistent yield.

Net Tangible Assets (NTA) as at 30 April

Total Investments	**$113,716,004**
NTA	**$82,913,758**
Shares on Issue	**59,401,545**
NTA per Share (pre-tax) *	**$1.40**
NTA per Share (post-tax)*	**$1.34**
Share Price	**$1.29**
(Discount)/Premium to NTA (pre-tax)	**(7.86)%**
(Discount)/Premium to NTA (post-tax)	**(3.73)%**
Fully Franked Dividend Yield	**6.64%**

* On realised and unrealised gains.

Fund Information

ASX Code	CLF
Date of launch	September 1987
Benchmark	S&P/ASX 200 TR Index

Service Providers

Custodian	National Australia Bank
Administrator	Fundhost Limited
Banker	National Australia Bank
Auditor	Deloitte Touche Tohmatsu
Legal Advisor	Watson Mangioni Lawyers

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Portfolio and Market Review

Investment Performance

Performance as at 30/04/2019 **	1 Month	3 Months	6 Months	12 Months	Financial YTD	Since Inception *
CLF	3.85%	9.16%	11.80%	10.70%	7.92%	13.16%
Benchmark	2.37%	9.29%	10.87%	10.41%	5.76%	10.29%
Value Add	1.48%	-0.13%	0.93%	0.29%	2.16%	2.87%

* Inception date reflects when management of the fund was internalized as of 1 January 2018
** Gross performance excludes all expenses, fees and taxes. Net performance is reflected in the NTA calculations.

The portfolio returned +3.85% on a gross basis (pre-fees and taxes) in April versus the benchmark return of +2.37%. This equates to a 2.94 % increase in pre-tax NTA and a 3.88% increase in the post-tax NTA.

For the financial year to date, the portfolio has delivered a return of +7.92% on a gross basis versus the benchmark's +5.76%. This represents an outperformance of +2.16%.

Market Review

The S&P/ASX 200 Total Return Index gained 2.4% during the month, which is a slight underperformance relative to global equities, with the MSCI ACWI returning 3.9% over the period. The S&P/ASX 200 Total Return Index has now delivered a return of 13.5% for the calendar year-to-date and 5.8% for the financial year-to-date.

The continuation of the Q1 rally in April was primarily driven by macro factors as evidenced by the surge in equity bourses globally with Japan's Nikkei Index (+5.0%) and the Nasdaq Index (+4.7%) leading the way. Amongst the main drivers of the rally were:

- Improved US and China economic data,
- Optimism over a potential US-China trade deal,
- Better than expected US earnings, and
- Expectations of further monetary and fiscal stimulus

The local market profited from these global tailwinds, however unusually, the **Materials sector (-2.1%)** was not a beneficiary despite the price of iron ore continuing to rally. Outside of iron ore, most base metal prices fell, and it was this in conjunction with already elevated share prices which saw the sector take a breather last month. In terms of positive sectors:

- **Consumer Staples (+7.4%)** benefitted primarily from two of its China orientated constituents having stellar months. **A2M (+17.2%)** and **TWE (+15.2%)** benefitted from US-China trade optimism and stronger than expected Q1 Chinese GDP data which saw growth come in at 6.4% y/y versus consensus of 6.3% y/y. Sector heavyweights **WOW (+4.8%)** and newly separated **COL (+6.4%)** also contributed.
- **Information Technology (+7.3%)** benefitted from the Nasdaq led rally in global tech stocks. Buy-now-pay-later innovator **APT (+22.1%)** was the clear leader in the sector with investors keen to back their US and UK expansion plans. **XRO (+11.9%)** also performed well. Both stocks have been momentum 'darlings' in recent months.
- **Consumer Discretionary (+4.9%)** performed well on better than expected US and Chinese economic data and improved US-China trade relations. **BRG (+18.2%), WEB (+15.9%),** and **CWN (+15.5%)** were the best performers.

Portfolio Review

The portfolio's outperformance last month was encouraging given the market rallied strongly and we held ~20% in cash through the month, meaning that the portfolio constituents generally performed well.

We have constructed the portfolio to be balanced in terms of style, thematic tailwinds, and risk drivers. This balance gives us the opportunity to generate attractive risk-adjusted returns in a range of market environments without being excessively exposed to any one risk factor, industry and macro event.

In saying that, we are overweight in companies that generate much of their revenues offshore and thus the portfolio can be sensitive to geopolitical risk, such as trade tensions, which can impact the market psyche and hence short-term volatility. This portfolio sensitivity in conjunction with the belief that the market is not adequately pricing in the risk of a trade deal not getting done in the near term is one of the key reasons for our current large allocation to cash – it is a counterbalance the overall portfolio risk. As such, we think it is prudent to wait for some clarity on this issue, in addition to the domestic political situation, before deploying further capital into the market given the recent rally.

In terms of contributors for the month:

BRG (+18.2%) – There was little news for Breville during April, however the stock continued to benefit from strong investor momentum following its earnings update in February. Optimism around US-China trade talks, global growth and moderately better European economic data also boosted the stock given its European growth strategy.

A2M (+17.2%) – A2 Milk rallied on trade optimism and improved Chinese economic data during April. It also announced that it will start producing a Smart Nutrition fortified milk drink for children aged 4 to 12 years and that its coffee creamer products are now offered in over 12,700 stores in the US including Costco.

WEB (+15.9%) – Webjet updated the market on its new business venture, Umrah Holidays International, which focuses on religious pilgrimage travel services saying that it expects ~30 million religious tourists to visit the Kingdom of Saudi Arabia annually by 2030. WEB also confirmed earnings guidance for FY 2019, which should see earnings increase by 37% year on year.

TWE (+15.2%) – Treasury Wines benefitted from improved wine export data from Wine Australia which showed a 5% increase in exports for the 12 months to March to $2.78 billion. Later in the month, TWE also reiterated guidance with earnings growth expected to be ~25% for FY19 and in the range of 15-20% for FY20.

Detractors:

APA (-3.6%) – The stock dropped on little news with most interest rate sensitive companies underperforming after rallying strongly from the start of the year. The bulk of the declines came in the first half of the month when the Australian 10-year bond rate increased from 1.73% to 1.96% in the period from 28/3/19 to 17/4/19. Unfortunately, these stocks did not rally back when yields fell back down towards the end of the month.

ALX (-3.1%) – As with APA, the share priced weakened along with most REIT and infrastructure related stocks on higher bond yields.

BHP (-2.8%) – The stock dropped on news that Brazilian iron ore giant Vale would restart its Brucutu mine after a local judge allowed the company to resume use of three tailing dams. Vale was forced to close numerous mines following the devasting collapse of one of its dams in January. Interestingly, the decision to re-open Brucutu was swiftly suspended by another judge so the situation is still developing.

Sector Exposure

Sector	Weight (%)
Consumer Discretionary	11.2%
Consumer Staples	6.9%
Energy	0.0%
Financials	20.2%
Health Care	8.3%
Industrials	15.5%
Information Technology	6.0%
Materials	7.7%
Real Estate	1.6%
Telecommunication Services	0.0%
Utilities	2.7%
CASH/LIQUIDITY	**19.9%**

Top 10 Holdings (in alphabetical order)

Company	Ticker
A2 MILK COMPANY	A2M
AMCOR LIMITED	AMC
AUSTRALIA AND NEW ZELAND BANKING GROUP	ANZ
BHP BILLITON LIMITED	BHP
COMMONWEALTH BANK OF AUSTRALIA	CBA
CSL LIMITED	CSL
MACQUARIE GROUP LTD	MQG
TABCORP HOLDINGS	TAH
TRANSURBAN GROUP	TCL
WEBJET LIMITED	WEB

Outlook

While we are not overly negative on the outlook for Australian equities, we think that too much optimism and too little risk is currently being priced into the market. With the S&P/ASX 200 Index trading at 6,325 and at an earnings multiple of 15.6x at the end of April, we question how much further the market can run in an environment where:

1. The domestic economy and housing market are both continuing to weaken with seemingly no end in sight,
2. An upcoming Federal election is creating uncertainties over everything from minimum wages, energy policy and taxes, and
3. Corporate earnings are anemic with few large-cap companies growing earnings meaningfully above GDP growth expectations.

As such, our views have changed little from last month except that the market has rallied further and looks more stretched considering the fundamentals. We remain defensively positioned and overweight cash.

A popular argument being put forward for a continuation of the rally is that global central banks have become dovish and hence further stimulus or interest rate cuts are likely should economies weaken or market volatility increases. However, given most of the recent US, China and European economic data has been stronger, we do not think central banks will react unless market volatility increases meaningfully, as happened in Q4 2018. As such, rationalizing and positioning for additional stimulus before the volatility event occurs seems illogical.

However, we do think that the RBA is likely to cut interest rates at some stage given the weaker domestic economic outlook and are positioned accordingly. We are overweight what we call quality yielders who can a) produce some enterprise and/or earnings growth over the medium term, b) deliver stable and growing cashflows, and c) potentially benefit from a low interest rate environment. We also maintain our overweight to offshore-earners that can benefit from favorable global economic growth and consumption trends in addition to a weaker Australian dollar.

Important Information