CONCENTRATED LEADERS FUND

ASX LISTED INVESTMENT COMPANY (TICKER: CLF) | MONTHLY INVESTMENT REPORT: SEPTEMBER 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 Accumulation index. CLF is focused on providing investors with capital growth and a consistent yield.

Net Tangible Assets (NTA) as at 30 September

Total Investments	**$109,506,668**
NTA	**$78,939,547**
Shares on Issue	**59,401,514**
NTA per Share (pre-tax) *	**$1.33**
NTA per Share (post-tax) *	**$1.29**
Share Price	**$1.26**
(Discount)/Premium to NTA (pre-tax)	**(5.26)%**
(Discount)/Premium to NTA (post-tax)	**(2.33)%**
Fully Franked Dividend Yield	**11.9%**

* 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

Contact Information

Telephone	+61 2 9357 0788
Email	info@clfund.com.au
Registered Office Address	2 Paddington Street, Paddington NSW 2021
Principal Office Address	Level 12, 37 Bligh Street, Sydney NSW 2000

Concentrated Leaders Fund Limited ABN 25 003 236 173

Portfolio and Market Review

Investment Performance

Performance as at 30/09/2019 **	1 Month	3 Months	6 Months	12 Months	Financial YTD	Since Inception *
CLF	0.61%	1.07%	5.29%	8.04%	1.07%	14.72%
Benchmark	1.84%	2.37%	10.53%	12.47%	2.37%	19.08%
Value Add	-1.23%	-1.30%	-5.24%	-4.43%	-1.30%	-4.36%

* 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 +0.61% on a gross basis (pre-fees and taxes) in September versus the benchmark return of +1.84%. This equates to a 0.75% decrease in pre-tax NTA and a 0.0% increase in the post-tax NTA.

For the financial year to date, the portfolio has delivered a return of +1.07% on a gross basis versus the benchmark's +2.37%. This represents a relative performance of -1.30%.

Market Review

The S&P/ASX 200 Total Return Index gained 1.8% during the month, which was less than global equities, with the MSCI All Country World Index gaining 2.0%. It was however better than US equities with the S&P 500 Index gaining 1.7%.

Australian equities ground up during September with little volatility or industry specific news given the completion of earnings season. Trade war rhetoric was significantly less, central banks were relatively quiet and economic data was subdued. This was a major about-face from August which saw several macro factors, including domestic earnings announcements, impact the market.

During the month of September:

1. House Speaker Nancy Pelosi officially announced plans to investigate US President Donald Trump after the president pressured Ukrainian President Volodymyr Zelensky to investigate the business ties of Joe Biden's son,
2. Asian equity markets rallied on the back of optimism regarding the US-China trade war after both parties announced plans to hold deputy level talks,
3. Attacks on two Saudi Arabian oil facilities (allegedly by Iran) took place mid-month threatening ~5% of the global oil supply, and
4. European Central Bank (ECB) decided to cut one of its key interest rates and agreed to restart its quantitative easing program in November with €20bn of bond purchases each month.

In terms of domestic sectors:

1. Financials (+4.1%) were the standout performer as the housing market continued to show signs of a recovery,
2. Energy (+3.7%) performed strongly on the back of a sharp rise in the price of oil following the attack on Saudi oil facilities, and
3. Communications Services (-3.2%) were the worst performing with Telstra (TLS) falling 5.6% after a very strong run since the start of the year.

Portfolio Review

The portfolio underperformed during the month primarily due to our cash position and our underweight to banks.

Our large cash holding is primarily due to our view that the macro risks are not being adequately priced by the market and that market valuations are excessive given the weak economic backdrop.

In terms of the banks, we continue to expect margin compression driven by lower interest rates, higher operating costs post the Hayne royal commission and the fact that they are fundamentally weak businesses heading into an economic slowdown.

Major Contributors:

NAB (+8.6%) – Led the banking sector higher on little direct news, however it was arguably the cheapest bank in the market, and this saw its bounce magnified relative to its competitors.

Major Detractor:

WEB (-10.7%) – Fell sharply after it announced that it would have to write down earnings following the collapse of the UK travel operator Thomas Cook. Webjet manages the hotel bookings for Thomas Cook's customers visiting Europe via their WebBeds business.

A2M (-10.3%) – Fell for a second month in a row after investors rebased optimistic margin expectations following A2M's China investor tour. Investors have grown increasingly concerned about A2M's increased marketing expenditure and adverse margin mix driven by lower margin baby store sales and its push into the US liquid milk market.

CHC (-7.9%) – Charter Hall has performed strongly this year (up ~60% YTD), but remains highly responsive to changes in bond yields. CHC suffered this month as yields rose from record lows.

ALX (-6.5%) – Similar to Charter Hall, Atlas Arteria is highly sensitive to bond yields and after rallying for most of the year (up ~60% YTD), ALX fell during September as bond yields rebounded.

Sector Exposure

Sector	Weight (%)
Consumer Discretionary	6.1%
Consumer Staples	4.0%
Energy	0.9%
Financials	19.9%
Health Care	6.0%
Industrials	10.8%
Information Technology	5.1%
Materials	9.9%
Real Estate	5.9%
Telecommunication Services	0.0%
Utilities	3.0%
CASH/LIQUIDITY	28.6%

Top 10 Holdings in alphabetical order

Code	Company Name	Sector
AMC	AMCOR LIMITED	Materials
APA	APA GROUP	Utilities
BHP	BHP BILLITON LIMITED	Materials
CBA	COMMONWEALTH BANK OF AUSTRALIA	Financials
CSL	CSL LIMITED	Health Care
MQG	MACQUARIE GROUP LTD	Financials
NAB	NATIONAL AUST. BANK	Financials
NXT	NEXTDC LIMITED	Information
SVW	SEVEN GROUP HOLDINGS	Industrials
TCL	TRANSURBAN GROUP	Industrials

Outlook

Little changed during September to allay our fears over the strength of the global economy. Economic data continued to weaken globally by the day and geopolitical risks are now higher than they were previously given the Saudi Arabia attacks and the prospects of a Trump impeachment. Equity markets however continue to clutch onto lower interest rates as the savior for markets. This, however, is flawed logic and doesn't respect the fact that lowering interest rates to near zero has little impact on fundamentals and simply increases speculative behavior and corporate balance sheet manipulation. Despite this, domestic equity values went from being overvalued to being even more expensive.

The US economy continues to weaken with the ISM manufacturing data coming in much weaker than expected and in contractionary territory. In addition, the non-manufacturing data has also come in well below expectations. The US-China war is not having the domestic impact that President Trump would have hoped for and the threat of a US recession is becoming very real and is flowing through the rest of the world. The US Federal Reserve (Fed) meets on the 29th of October and it is almost certain that it will reduce interest rates. Our non-consensus view is that if equity market volatility increases during October, it may have to cut by 50 basis points (bps) instead of 25bps.

The Reserve Bank of Australia (RBA) followed the ECB in early October and cut its official interest rate by 25bps to 0.75%. To our mind, this was relatively predictable but an entirely unnecessary and potentially dangerous decision. Lowering the official interest rate to near-zero has not worked anywhere in the world, yet the RBA for some reason thinks Australia will be different – it won't. The risk is threefold, first, it could reignite a housing bubble which will be detrimental to the country in the medium-term and only add to Australia's already massive housing related debt and vulnerability. Secondly, it hurts savers and the efficient allocation of capital due to the desperation in seeking out yield at any cost. Thirdly, the RBA has fired one of the few bullets it has left to bail out the economy if things get worse. They are effectively betting the house on this helping turn the economy around but unfortunately it won't.

We have made few changes to the portfolio over the month, except to slightly increase our exposure to 'value' stocks which appear to be excessively cheap. We maintain a balanced portfolio and are overweight quality yield stocks which should continue to benefit from a lower interest rate environment. However, these have rallied hard since the RBA cut interest rates and are not as attractive as they once were with dividend yields reaching record lows for many of these stocks. We also remain overweight offshore growth companies despite the weaker global economic environment as we think they can deliver superior earnings growth compared to domestically orientated companies over the medium term. They are however creating short term portfolio volatility as they demonstrate high beta to global markets, but they should benefit from a weaker Australian dollar if the RBA continues to cut interest rates or if the price of iron ore continues to fall.

Important Information