CONCENTRATED LEADERS FUND

ASX LISTED INVESTMENT COMPANY (TICKER: CLF) | MONTHLY INVESTMENT REPORT: OCTOBER 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 31 October

Total Investments	**$109,579,116**
NTA	**$79,557,934**
Shares on Issue	**59,401,514**
NTA per Share (pre-tax) *	**$1.34**
NTA per Share (post-tax) *	**$1.29**
Share Price	**$1.275**
(Discount)/Premium to NTA (pre-tax)	**(4.85)%**
(Discount)/Premium to NTA (post-tax)	**(1.16)%**
Fully Franked Dividend Yield	**10.36%**

* 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 31/10/2019 **	1 Month	3 Months	6 Months	12 Months	Financial YTD	Since Inception *
CLF	0.76%	-1.19%	2.15%	14.21%	1.84%	15.59%
Benchmark	-0.35%	-0.91%	7.59%	19.28%	2.00%	18.66%
Value Add	1.11%	-0.28%	-5.44%	-5.07%	-0.16%	-3.07%

* 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 +0.76% on a gross basis (pre-fees and taxes) in October versus the benchmark return of -0.35%. This equates to a 0.75% increase in pre-tax NTA and a 0.00% increase in the post-tax NTA.

For the financial year to date, the portfolio has delivered a return of +1.84% on a gross basis versus the benchmark's +2.00%. This represents a relative performance of -0.16 %.

Market Review

The S&P/ASX 200 Total Return Index lost 0.35% during October, which was the second negative month for the calendar year. This was a significant underperformance relative to the rest of the world, with the MSCI All Country World Index gaining 1.9%. Japanese equities were the top performer gaining 5.4% for the month.

Australian equities sold off heavily at the start of the month in line with most global equity markets on weaker US economic data. The US ISM manufacturing PMI for September shocked the market, dropping to 47.8 down from 49.1 in August. Additionally, jobs data was weaker with US private payrolls printing at 135,000, versus an expectation of 152,000 new jobs. The August number was also revised downwards to 157,000 from 195,000. Financials came under pressure domestically after the National Australia Bank (NAB) increased its provisions for costs related to customer remediation and software capitalization by $1.18bn.

Despite this, both global and domestic equities rallied off these lows with the rest of the month being volatile, but generally positive. Perceived positive developments in the US-China trade negotiations were the key driver behind the positive sentiment, but an avoidance of a 'Brexit' hard exit, marginally better US economic data, and a better than expected US earnings season also helped buoy the market.

In terms of domestic sectors, the primary movers were:

1. Healthcare (+7.3%) was the best performing sector with CSL (+9.6%) advancing after reaffirming guidance at its AGM. RMD (+7.2%) also rallied strongly,
2. Industrials (+2.3%) performed strongly with SYD (+9.3%) and BXB (+7.5%) being the standout performers,
3. Information Technology (-3.2%) was the worst performing sector with WTC (-24.6%) falling sharply after a short report from J Capital made multiple allegations regarding earnings quality. APT (-19.5%) was also hit hard during the month, and
4. Financials (-2.9%) underperformed with the minor banks (BOQ: -8.8%, BEN: -7.3%) being the hardest hit, while CYB (+24.5%) and CGF (+8.0%) both rebounded strongly after weak year-to-date performances.

Portfolio Review

The portfolio outperformed during the month by 1.11%.

Our exposure to offshore growers added to returns during the month after several months of heightened trade concerns. This was pleasing given that low quality domestically focused companies with weak earnings have outperformed these types of companies in recent months.

Our underweight exposure to financials also added to returns after several months of price appreciation despite a regular flow of negative news, increased capital requirements, increased remediation costs, shrinking margins, increased competition and poor customer satisfaction. We find it incredible that it has taken the market so long to see the fundamental flaws in these companies and can only attribute their performance over recent months to indiscriminate flows from industry superannuation funds and passive money.

Our large cash position marginally helped given that the market finished in negative territory.

Major Contributors:

GMA (+14.7%) – Outperformed after announcing a near 30% lift in third quarter net profit as housing markets across Sydney, Melbourne and Brisbane showed signs of improvement. GMA also announced a special dividend of 24.2c / share.

SVW (+7.7%) – Performed strongly on an improved US-China trade-war outlook and a more stable iron ore price.

CYB (+24.5%) – Rebounded after being oversold into the Brexit result, which was less negative that the market expected. This led to a repricing of the British Pound and 10-year Gilt rates which were both positive for the stock.

Major Detractors:

NGI (-26.4%) – Fell sharply after announcing further assets under management (AUM) outflows totaling $520mn ($350mn in customised solutions and $170mn in comingled funds) following the MAS acquisition.

NST (-11.3%) – Fell for a second month in a row alongside other gold stocks. However, NST also suffered from a weaker production result and forward guidance from its Pogo mine.

TWE (-11.3%) – Shares fell 11.8% on 21/10 after chief executive Michael Clarke announced his retirement. Clarke has led the company since 2014 and remains committed to the company until the September quarter 2021-22.

Sector Exposure

Sector	Weight (%)
Consumer Discretionary	7.8%
Consumer Staples	5.1%
Energy	1.5%
Financials	16.9%
Health Care	6.1%
Industrials	10.6%
Information Technology	5.1%
Materials	9.5%
Real Estate	6.0%
Telecommunication Services	0.0%
Utilities	3.1%
CASH/LIQUIDITY	**28.3%**

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
TCL	TRANSURBAN GROUP	Industrials
WEB	WEBJET LIMITED	Consumer

Outlook

As we come into the final months of the year, global equity markets continue their charge higher with the US market leading the way. The positive rhetoric regarding US-China trade relations during October was probably the biggest driver of sentiment with most experts expecting a phase 1 trade deal to be signed in November. However, we caution that the world has seen this script before and the actual substance of phase 1 is limited with few of the original US concerns, such as intellectual property rights, currency manipulation and the trade balance, being addressed.

We have been concerned about the macro risks for several months now, and while most remain elevated, we do think they moderated somewhat over the last few weeks as central banks globally have eased financial conditions. The US Federal Reserve (Fed) has provided a stunning amount of liquidity in a short period of time, increasing its balance sheet from $3.75 trillion at the start of September to $4.01 trillion at the end of October (Source: Board of Governors of the Federal Reserve System (US)) – a 7% increase in two months.

Additionally, the US-China trade war appears to be mellowing a little, although a solution, if one is even possible, seems a long way away given the structural changes China would need to make. The UK has also avoided a hard ‘Brexit’ for the time being and again this is a good thing for markets generally. However, UK uncertainty remains high with an election due to be held on the 12th of December and still no resolution in sight with regards to its exit from the European Union.

Focusing back on Australia, the interest rates cuts by the Reserve Bank of Australia (RBA) are not yet helping the economy if the latest retail sales are anything to go by. Lower interest rates are benefitting the housing market but there is little flow through the rest of the economy as homeowners simply pay off more of their mortgage, they don’t increase their spending. The economy remains stagnant with the private sector experiencing little growth and only net exports and public sector spending driving GDP higher.

On top of this the largest sector of the market, Financials, are facing a multitude of headwinds, increased costs, more competition and shrinking margins. The S&P/ASX 200 Index is trading on a forward earnings multiple of 17.1x, which is a 15-year high and well above its average level over any time period. The dividend yield for the S&P/ASX 200 Index is 4.1%, which is the lowest it has been for over 10 years. The equity market appears expensive even with record low interest rates.

We have made few changes to the portfolio except to take profits on outperforming positions. We maintain a balanced portfolio and are overweight quality yield stocks which should continue to benefit from a lower interest rate environment and quality offshore growth stocks. Our cash holding has been a detractor for most of the year but will hold us in good stead when valuations normalise, allowing us to deploy the capital at much more attractive prices compared to current valuations.

Important Information