# Quarterly Investment Update

## Antares Dividend Builder – December 2024

For adviser use only

### Highlights for the quarter

**Performance:** The Fund's twin objectives are to provide a yield above that of the benchmark as well as moderate capital growth over the medium term. During the December quarter the Fund returned -3.0% (net of fees) compared to its Benchmark's return of -0.8%.

**Distribution and Dividends**: The annual distribution return to 31 December 2024 was 4.3%. During the December quarter, dividends were received from ANZ, BHP, CSL, HomeCo Daily Needs REIT, National Australia Bank, Nine Entertainment, Orora, South32, Super Retail Group, Ventia Services, Westpac and Woodside Energy.

**Contributors to returns:** Positive contributors IAG, Telstra and Suncorp; Negative contributors – Ventia Services, BHP and CBA (underweight).

**Stock Activity**: Buys / Additions – DigiCo Infrastructure REIT; Sells / Reductions – Aurizon Holdings

## Fund snapshot

| | |
|---|---|
| **Inception date** | 6 September 2005 |
| **Benchmark** | S&P/ASX 200 Total Return Index (prior to 1 October 2021, the Benchmark was the S&P/ASX 200 Industrials Total Return Index) |
| **Investment objective** | Deliver higher levels of tax effective dividend income than the Benchmark and moderate capital growth |

## Investment returns as at 31 December 2024[1]

| Period | 3 mths % | 1 yr % | 3 yrs % pa | 5 yrs % pa | 10 yrs % pa | Since Inception % pa |
|---|---|---|---|---|---|---|
| Distribution return | 1.2 | 4.3 | 5.2 | 4.8 | 5.7 | 5.8 |
| Growth return | -4.2 | 4.1 | 2.2 | 3.3 | 0.9 | 1.6 |
| **Net return** | **-3.0** | **8.4** | **7.4** | **8.1** | **6.6** | **7.4** |
| Bmk return | -0.8 | 11.4 | 7.4 | 8.4 | 8.3 | 8.1 |
| **Net excess** | **-2.2** | **-3.0** | **0.0** | **-0.3** | **-1.7** | **-0.7** |

[1]Past performance is not a reliable indicator of future performance. The value of an investment may rise or fall with the changes in the market.
[2] Distributions generated by the fund's assets (eg dividends, realised capital gains and any return of capital).
[3] Changes in the unit price reflecting movements in the value of the fund's net assets.
[4].Investment returns are based on exit prices, and are net of management fees and assume reinvestment of all distributions.[3] # Inception is 6/ 09/ 2005.

## Contributors to income and returns

The Fund posted a return of -3.0% for the December quarter (after fees) compared to the benchmark's return of -0.8%.

### Income

The annual distribution return (which includes dividends, realised capital gains and any return of capital) was 4.3% to 31 December 2024. It does not take franking into account.

During the December quarter, dividends were received from ANZ, BHP, CSL, HomeCo Daily Needs REIT, National Australia Bank, Nine Entertainment, Orora, South32, Super Retail Group, Ventia Services, Westpac and Woodside Energy.

## Returns

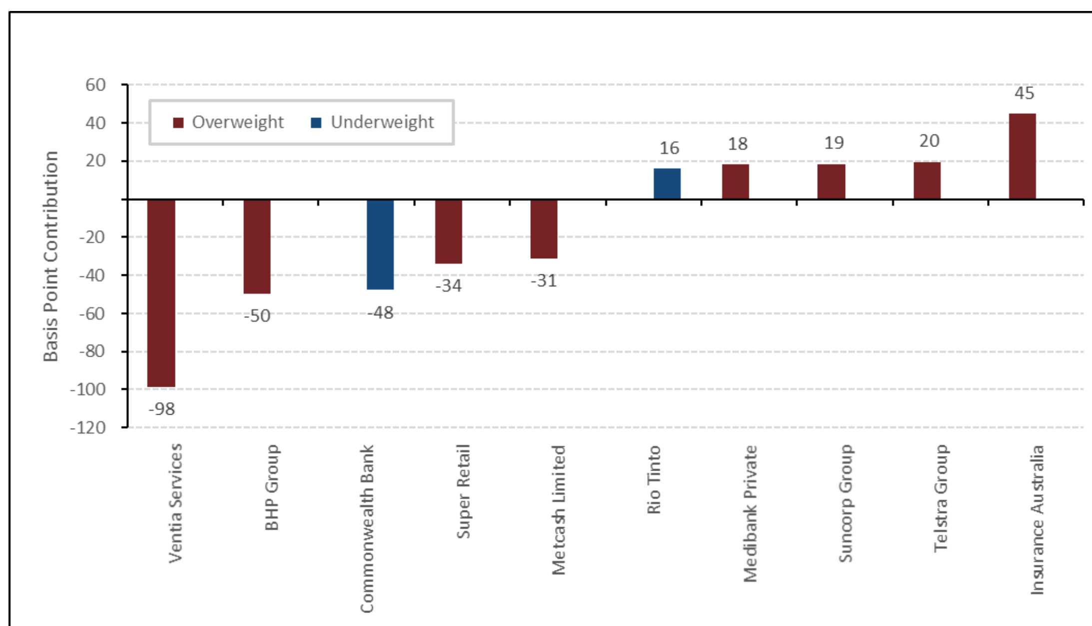
Major contributors over the December quarter included:

- **Insurance Australia Group** (IAG, overweight): IAG strongly outperformed the broader equity market during the quarter. As well as benefiting from favourable investment market conditions (positive for its investment income), there were no major natural peril events during 1H25 in Australia or New Zealand which could mean earnings upside for FY25 if that environment continues. IAG conducted an investor day in which it emphasized confidence in its retail business and the competitive advantages its new IT system will bring (in data analytics and pricing), and it also announced the acquisition of RACQ's insurance underwriting business which was well received in terms of the proposed price, the strategic rationale and the expected returns.

- **Telstra Group** (TLS, overweight): TLS announced a number of relatively modest corporate activities during the quarter (acquisition of Boost Mobile and the divestment of its stake in Foxtel). Its share price outperformance was likely driven by increasing comfort amongst investors about the state of Australia's mobile phone market (rational competition) as well as a number of positive sell-side reports, one of which highlighted the possibility of capital management.

- **Suncorp Group** (SUN, overweight): SUN's share price strength during the quarter was likely driven by the same factors as for IAG (investment income upside, lack of natural peril events during 1H25). It also conducted an investor day in which it disclosed it is reviewing various reinsurance options to help manage potential volatility, and it noted current reinsurance market conditions are more conducive for reinsurance deals (likely in recognition that SUN investors would favour such a deal for earnings volatility reduction). It also highlighted its digital transformation strategy which is expected to deliver numerous benefits such as improved customer experience, better product pricing and data analytics and cost savings.

**Figure 1: Portfolio Attribution – December Quarter**




Source: Antares; December 2024

The key detractors from returns were:

- **Ventia Services** (VNT, overweight): VNT's share price slumped after the Australian Competition and Consumer Commission (ACCC) announced it is commencing legal proceedings against it and its competitor Downer EDI for alleged price fixing activities for a number of contracts with the Department of Defense. This is a major client for VNT, accounting for around 20% of revenue. VNT has not made any specific public comments in response (except to say it is reviewing the details of the allegations) and we note VNT was recently awarded a new fire-fighting contract from the Department of Defense despite the fact the client would have been aware of this ACCC investigation.

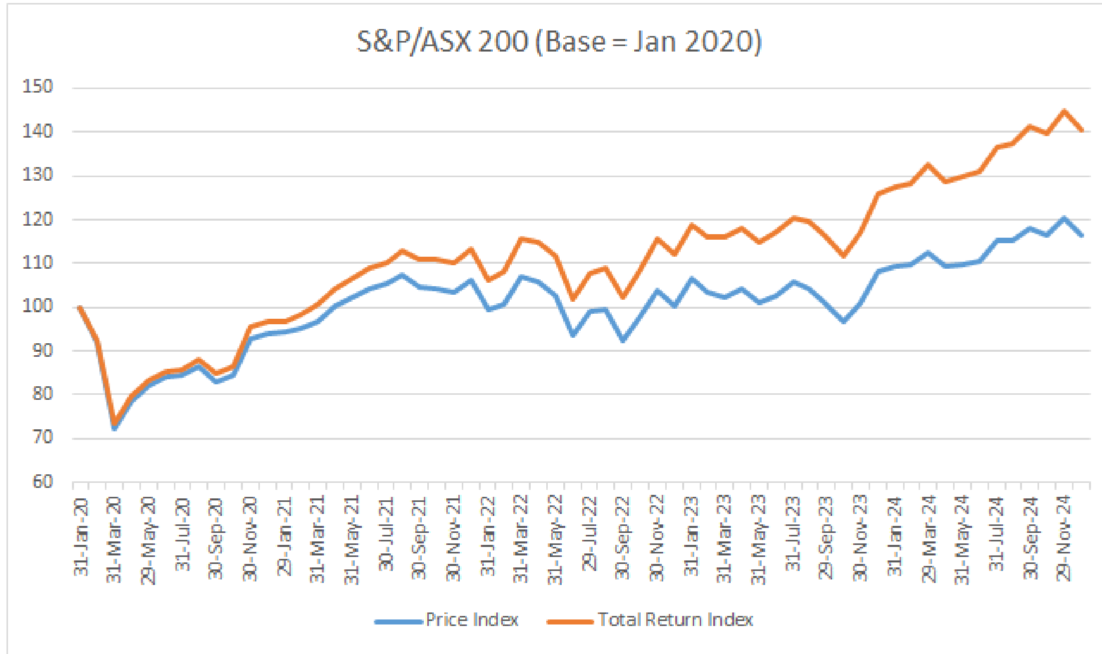
- **BHP Group** (BHP, overweight): the strong price uplift experienced in September was largely reversed during the December quarter, as the euphoria around the Chinese Government economic stimulus announcements subsided and more disappointing economic data was released from China. Key commodity prices also softened during the period. In December BHP conducted an investor site tour of its Chilean operations which highlighted the challenges faced by copper miners in maintaining production volumes (degrading ore grades, rising operating and capital expenditure requirements and permitting delays).

- **Commonwealth Bank of Australia** (CBA, underweight): the banking sector continued its stellar performance during the December quarter, and CBA was no exception. CBA provided a 1Q25 trading update which gave no cause for concern (or for major upgrades to earnings estimates) with net interest margins broadly stable and credit quality trends still benign. The sector likely benefited from investor rotation away from resource stocks back into the banks (a reversal of what occurred in September).

## Market overview and outlook

For those wanting an action-packed 2024, the investment markets did not disappoint. The S&P/ASX200 Total Return Index finished up 11.4% for the year, albeit the journey was marked by ups and downs. The December quarter was a case in point – the index gave back some of its September gains in October (down 1.3%, due to the miners), then roared back up in November thanks to the euphoria over the US elections (up 3.8%). Then as the market started to digest the potential impacts of the returning Trump Administration (fiscal, monetary, economically) and after the US Federal Reserve signaled a rate easing path for 2025 that is much slower than expected, bond yields surged and equity markets slumped (with the Index down 3.2% in the December month). The Index's top performing sectors for the calendar year were Technology, Financials and Consumer Discretionary. At the other end, the Energy and Materials sectors were the key drags.

**Figure 2: S&P/ASX200 Price & Total Return Indices (Base of 100 in Jan 2020)**

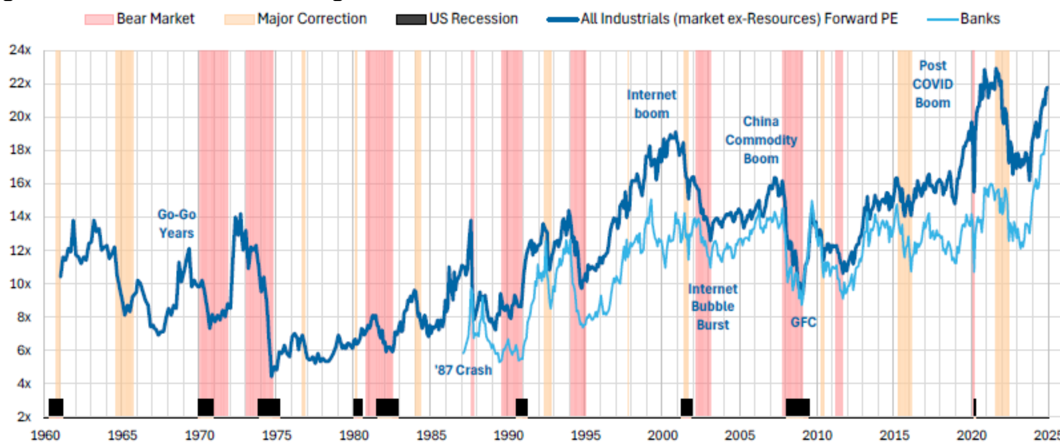



Source: Antares and Bloomberg; January 2025

We enter calendar year 2025 with similar observations and questions as we had at the start of 2024: equity valuation multiples are even more elevated versus history after a year of multiple expansion (in Australia and also the US); the US economy continues to surprise on the upside with its resilience, but signs of economic weakness are again emerging in Europe (with the added bonus of increased political uncertainty in key countries France and Germany); we are still waiting (hoping) for further "big bang" economic stimulus from the Chinese Government; and the Australian economy continues to plod along (albeit the picture looks grimmer if you look at GDP per capita) and unfortunately inflation here remains a threat for the Reserve Bank which means our prospects of rate cuts keep drifting out.

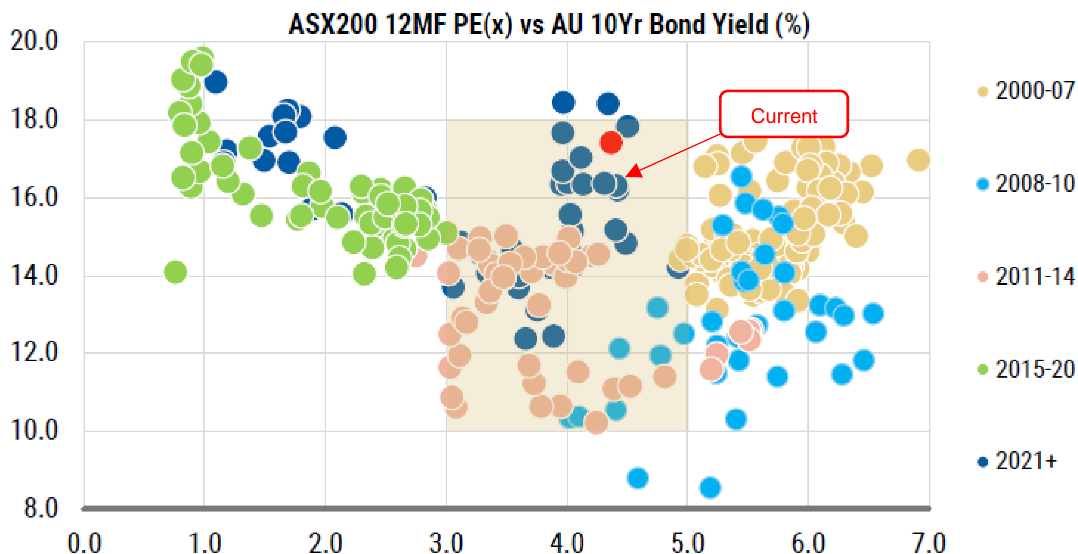
Excluding the abnormal periods around COVID, the Australian equity market is now trading at all time highs, with rapid multiple expansion during 2024 driven by an arguably surprising sector – the banks (which we discuss later on). A long-term plot of equity valuation multiples versus bond yields also adds to the argument that our equity market is screening on the expensive side of history.

**Figure 3: Forward Price-Earnings Ratios of ASX All Industrials & Australian Banks**




Source: Macquarie; December 2024

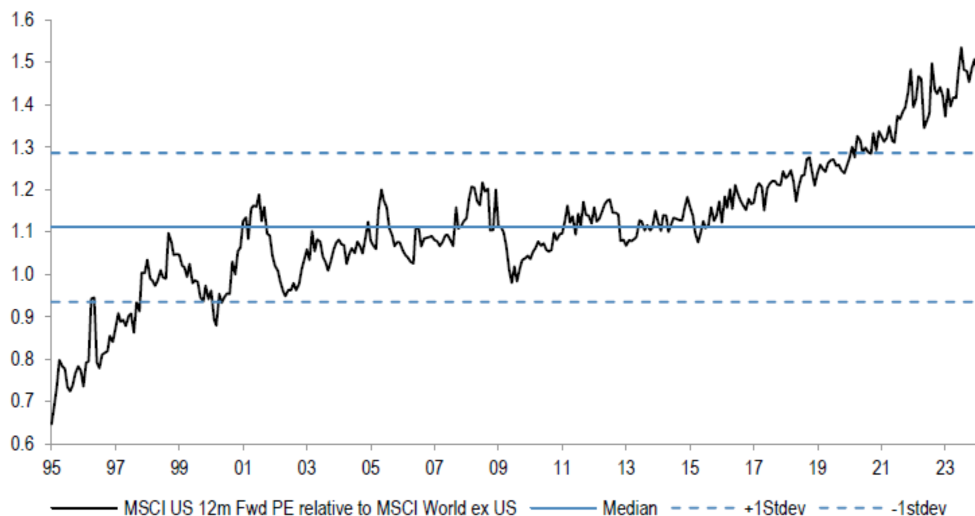
**Figure 4: ASX 200 12 Month Forward Price-Earnings Ratio vs Australia 10-Year Treasury Bond Yield**




Source: Morgan Stanley; January 2025

Globally, the investment consensus is to back "US exceptionalism" and go long US (and US exposed) equities on the thinking that a US recession has been avoided and economic growth will accelerate thanks to the returning Trump Administration and their pro-growth and pro-US agenda, whereas Europe and China will remain weak with the threat of US import tariffs potentially adding insult to injury. The preference for US stocks is clearly reflected in the relative valuation multiples of US stocks versus rest of world.

**Figure 5: Price-Earnings Ratio Relative – US vs Rest of the World**




Source: JP Morgan; January 2025

Elevated valuations don't automatically mean a sharp equity downturn is imminent, but it does mean less risk buffer for when unknown unknowns occur (or where known unknowns have bigger impacts than anticipated). So what could cause deviations from this consensus? Below is a short selection of some known unknowns (never mind potential unknown unknowns like another global pandemic):

- A major and messy economic fall-out from Trump's import tariff actions (discussed below).
- US Treasury bond holders start to baulk at the ever-rising US deficit, leading to a marked rise in US bond yields (which has negative implications for major US sectors like the housing market and the US government itself as it has to offer higher rates on new bond issuances).
- US inflation escalates again, as tax cuts overheat the economy and/or driven by the tariffs.

While the headline equity valuations appear rich, there remains much variation beneath the surface across stocks. As fundamental investors with a focus on bottom-up analysis, we continue to seek opportunities to invest in attractive but mispriced Australian listed stocks.

**Key Ponderings for 2025**

<u>Impact of the most beautiful word in the dictionary</u>

That word is "tariff", according to the incoming 47th President of the United States. Donald Trump has yet again promised import tariffs (or rather, more tariffs) – this time he is proposing a universal tariff on all imports into the US (potentially around 10-20%), and specific higher tariffs for Canada, China and Mexico which collectively account for around 40-45% of imports into the US (25% tariff for Canada and Mexico, 60% for China).

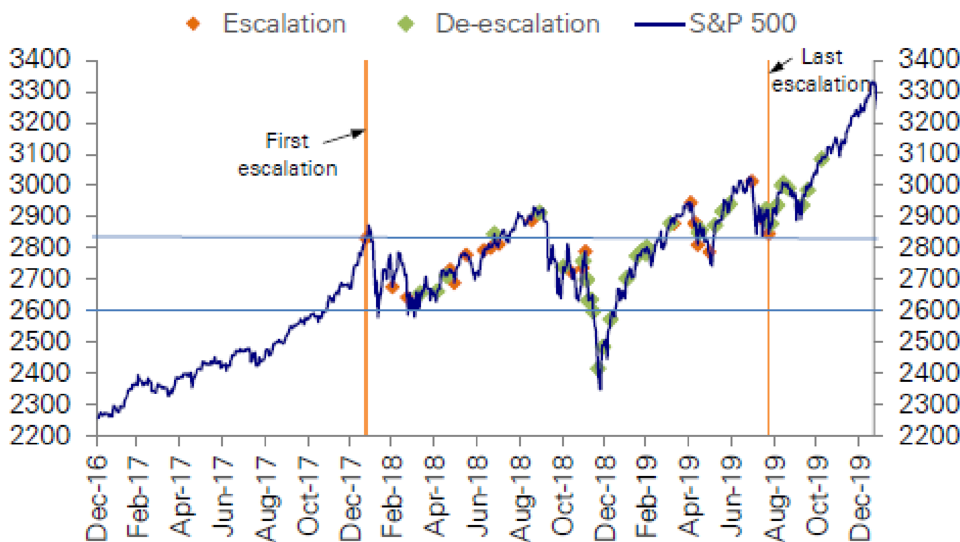
A full analysis of the potential trade outcomes and the direct and indirect impacts (political, economic and financial) is beyond the scope of this report. Instead we will consider three points:

- What does history (the 2018 trade war during the first Trump Administration) suggest could happen?
- What are investors expecting as potential outcomes (i.e. what risks are being reflected in asset prices)?
- What are the implications for Australian stocks?

Starting with a look-back at 2018: the trade war started when the first Trump Administration imposed a 25% tariff on around US$34b of Chinese imports, which was followed by China doing the same to US imports worth the same amount. The tariff war then went through periods of escalation and de-escalation (with the range of products covered by tariffs getting broader) and ultimately resulted in the two countries signing the "Phase One" agreement in January 2020 as an act of truce (which featured a commitment from China to increase its purchase of US products by US$200b versus the 2017 baseline).

The chart below compares the timing of trade war escalations and de-escalations and the performance of the S&P500. Given Trump's apparent focus on share market returns as a reflection of his performance as President, not surprisingly many of the de-escalation events occurred after bouts of share market weakness. Could we expect a similar "Trump put" this time around?

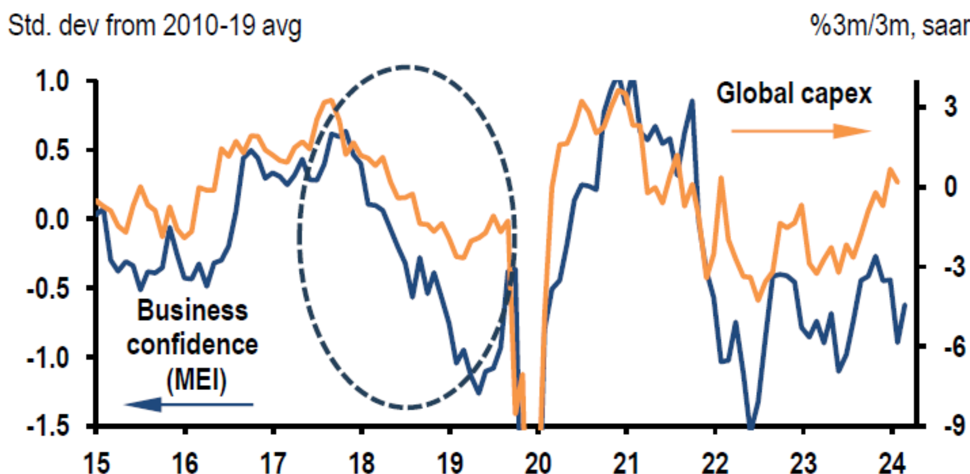
**Figure 6: Trade War Events during First Trump Administration vs S&P500**




Source: Deutsche Bank; December 2024

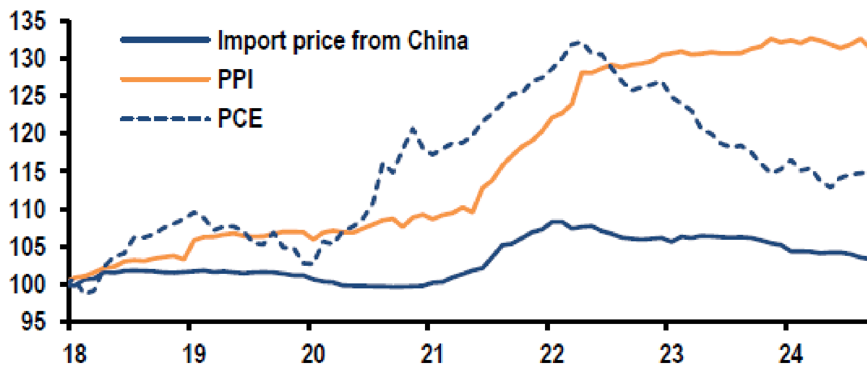
Not surprisingly, global business sentiment suffered during this trade war period as did the level of capital spending. And ultimately it was the US consumers who bore the brunt of the tariffs – Chinese exporters did not reduce their underlying prices (and sought to sell elsewhere, as well as benefiting from the Yuan depreciation), and instead the US importers passed much of the tariffs onto the end buyers (not helpful for inflation). US manufacturing construction did not rise after the tariff implementation, with the CHIPS and Science Act of 2022 arguably having done a lot more to stimulate that spending.

**Figure 7: Global Business Confidence & Change in Capital Expenditure**



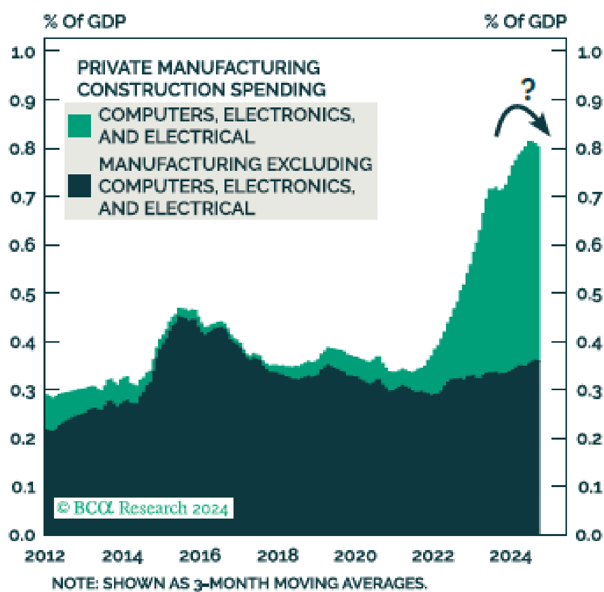

Source: JP Morgan; November 2024

**Figure 8: US Appliances – Import Price, Producer Price Index & Personal Consumption Expenditure**




Source: JP Morgan; November 2024

**Figure 9: US Manufacturing Construction Spend as % of GDP**




Source: BCA Research; November 2024

But like it or not, there will be tariff changes one way or another. The general thinking amongst investors appears to be that Trump's tariff bark will be louder than his bite and that Trump is simply laying the groundwork for negotiations with his aggressive tariff announcements (plus other comments about using "economic force"), with the ultimate result being negotiations between countries to get to an acceptable middle ground. China and Europe will feel more pain than the US, but mutual assured destruction is avoided. The path to the end game will be rough, with plenty of volatility along the way.

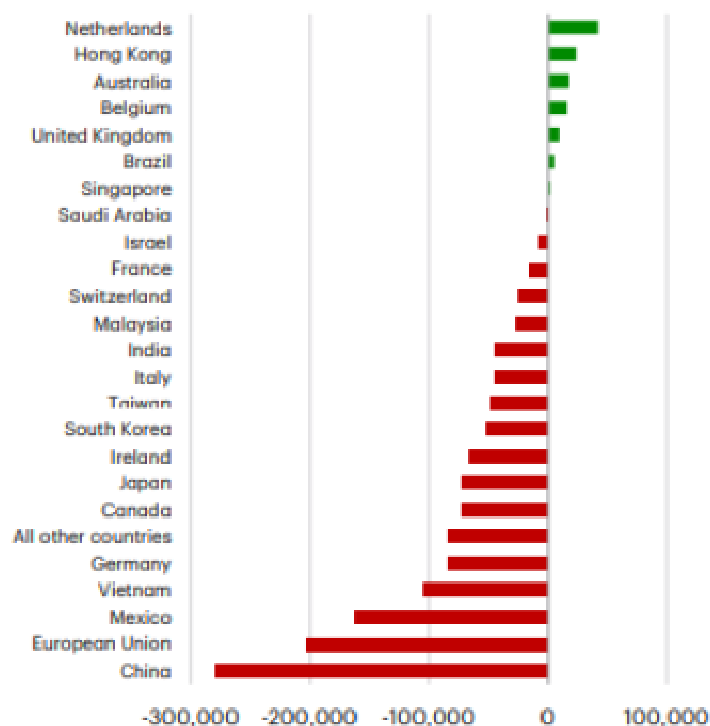
A less popular counter view is that Trump is not bluffing, and that the proposed tariffs are more than a means to an end or bargaining chips – they are the end because of Trump's unilateral and protectionist leanings (why is he proposing a universal tariff?) and the Administration will need extra money to fund all the other election promises (e.g. tax cuts). With less negotiations and flexibility, this scenario would likely also entail more retaliatory actions from other countries and more economic damage.

Rather than trying to guess the tariff outcome, we assess this risk as part of our company assessment and portfolio management by asking these questions:

- What level of revenue and earnings does the company derive from exports to the US?
- If the company has operations within the US (e.g. manufacturing), what is the reliance on imports as inputs (particularly from China)? How does that degree of reliance compare to competitors – are they in a similar boat? What pricing power does the company have?
- Thinking about the potential indirect impacts – what companies have major exposures to those countries targeted by these US tariffs (e.g. China)?
- Has the market already reacted to these risks? Could there be mispricing opportunities (too much risk baked in)?
- Will the USD likely appreciate against the AUD, thereby providing some relief to Australian exporters and those with USD exposure?
- What proportions of our Portfolios are held in stocks more vulnerable to trade war downsides?

If a universal tariff is implemented, Australia won't be immune. However, our US goods exports are relatively modest (mainly comprising soft and hard commodities such as meat and gold) and the direct economic fall-out will likely be limited. The bigger concern will be the economic impact on our key trading partners and the flow-through effects to their imports from Australia (e.g. iron ore demand from China).

**Figure 10: US Trade with Selected Countries**




Source: TD Cowen; January 2025

Overall, companies in the Portfolio have very limited direct exposure to these tariff related risks (most of the investee companies are domestically focused). It will be some time before we can more fully grasp the broader economic implications from the above.

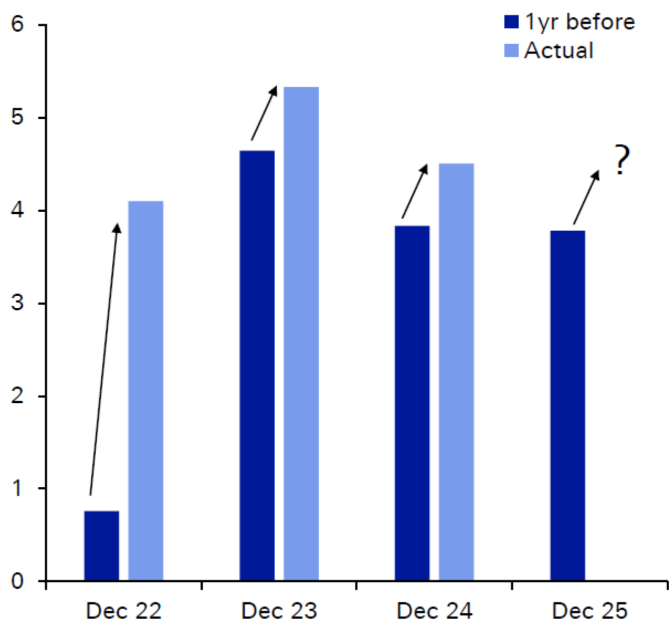
<u>Central banks to take a backseat?</u>

To put it mildly, central bank cash rate decisions have had significant influence on investment markets since the rate hike cycle began across most developed markets. We received a reminder of this in December when the US Federal Reserve accompanied its 25bps rate cut with a suggestion that only two rate cuts are anticipated in 2025, a major disappointment for the market which was factoring in more (a cue for a significant equity market drop).

But for many countries, we are now decidedly in the cutting phase of the rate cycle (perhaps with Australia and Japan as exceptions). As central banks reduce their cash rates towards neutral levels, could we see the central banks ease their grip on investment markets (i.e. less correlation between central bank statements and decisions and investment asset returns)? Could 2025 be the year we can talk less about rate expectations and rate sensitivity? With the US Federal Reserve having reset expectations for 2025, is there much less downside risk on the rate front and perhaps even upside (i.e. more than two rate cuts)?

Right now the general expectation for the most important cash rate in the world (US) is for that rate to end 2025 at around 4%. Hopefully in future Quarterly Reports there will be less need to keep explaining how rate movements are materially impacting equity returns!

**Figure 11: US Federal Reserve Cash Rates – Actual vs Estimates 1 Year Before**

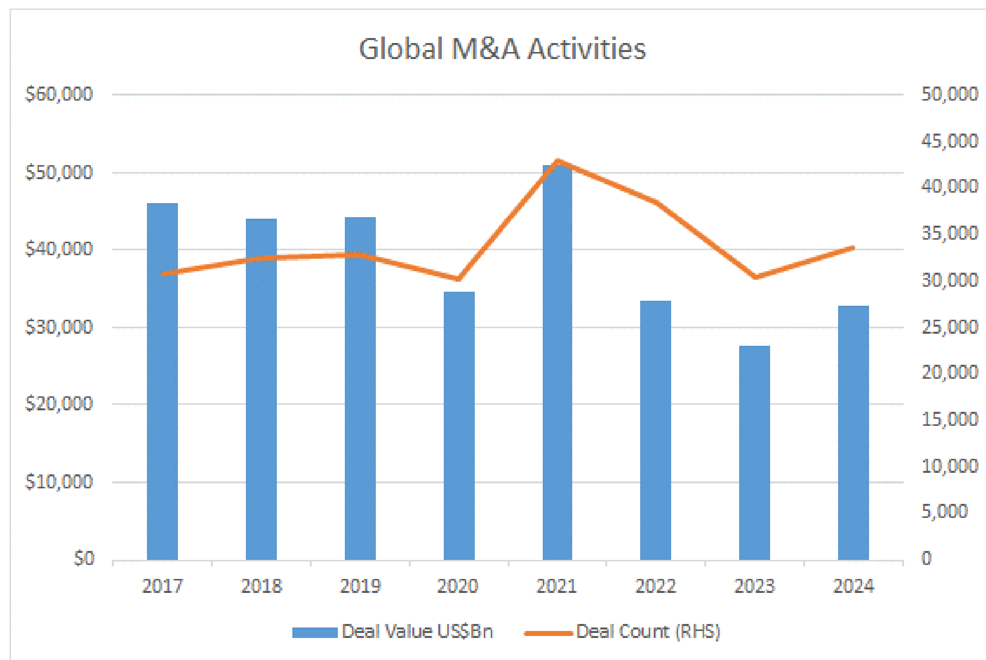



Source: Deutsche Bank; December 2024 (Note: interest rate estimates as implied by futures pricing)

<u>The return of mergers & acquisitions (M&A)?</u>

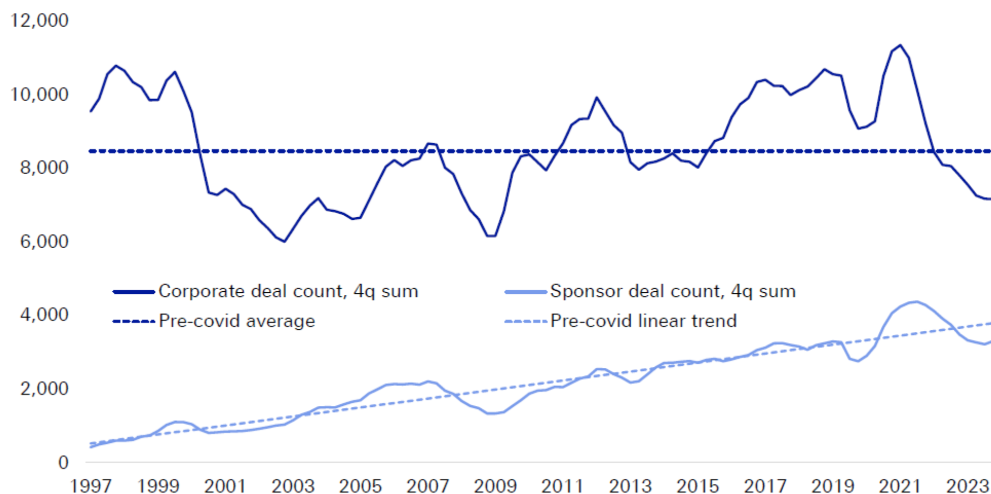
With rising interest rates and economic uncertainty, it's not surprising that M&A activities have eased in recent years. Financial buyers (e.g. private equity) were particularly quiet during 2023, but we have seen more action from them during 2024.

**Figure 12: Global M&A Activity Levels**




Source: Antares using Bloomberg data; January 2025

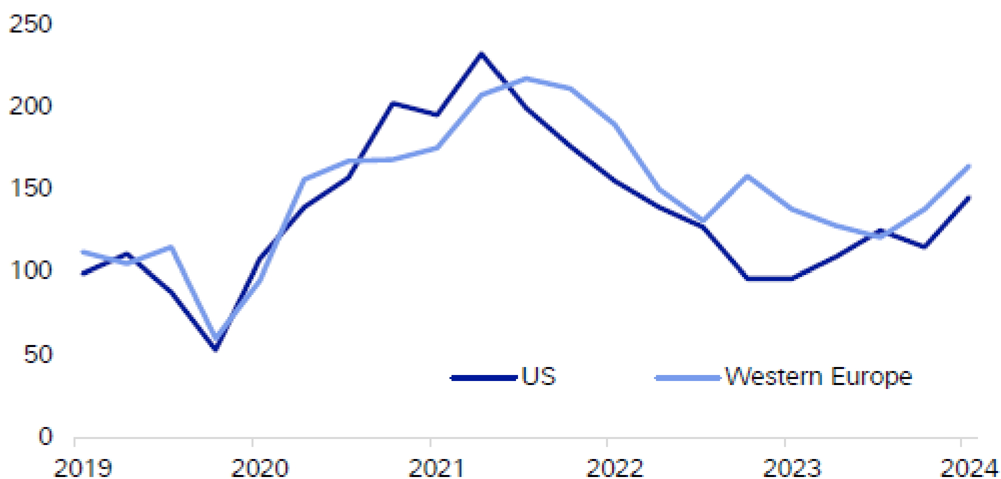
**Figure 13: Number of US Merger & Acquisition Deals**




Source: Deutsche Bank; November 2024

With greater economic confidence (particularly in the US) and interest rates trickling back down (plus private equity funds supposedly cashed up), could 2025 be the year that gets investment bankers excited and where we see more companies become take-over targets? Despite the high headline valuation multiples for equity indices, there are still many beaten-up stocks trading below intrinsic value due to near-term challenges – could we see more of them get into the cross-hairs of private equity or strategic buyers? 2025 started with Insignia Financial receiving its second take-over bid from US private equity firm CC Capital, having received and rejected one from Bain Capital in December 2024 (another US private equity firm). Last year we had Orora (ORA) receive a take-over bid from US private equity player Lone Star after a period of severe share price underperformance – could Lone Star come back with a better price after its initial bid was rejected by the ORA Board? Nine Entertainment has also underperformed on the back of weak advertising markets – could its cash generative businesses and cheap valuation catch the eyes of financial buyers (again)?

**Figure 14: Number of Asset Exits by Private Equity (Lead Indicator for Future New Deal Making)**




*Source : White & Case, Deutsche Bank. Note: through Q3.*

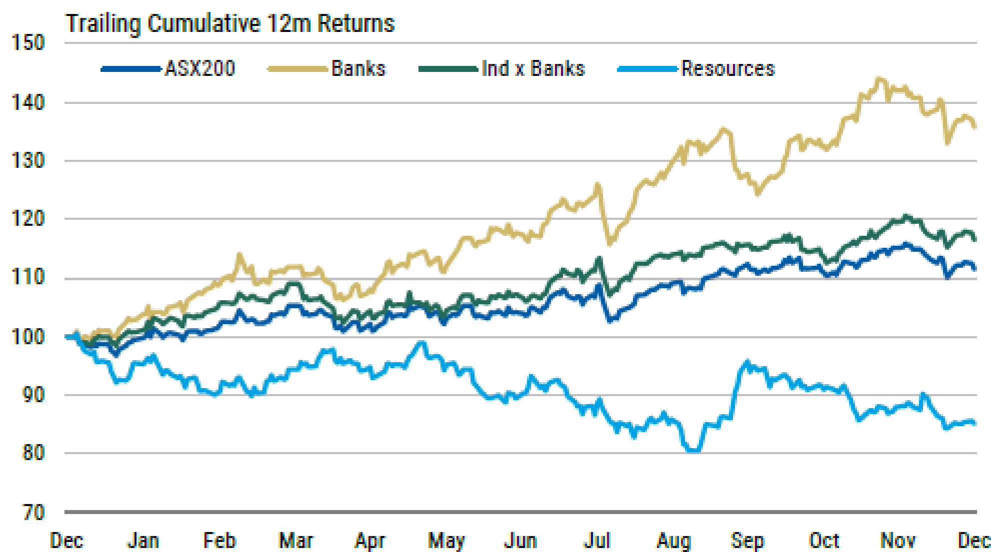
Source: Deutsche Bank; December 2024

For companies which we believe have attractive fundamentals and are materially mispriced due to short-term challenges, M&A activities can bring helpful attention to such companies' intrinsic values and assist with share price recovery.

<u>Where to from here for Australian banks?</u>

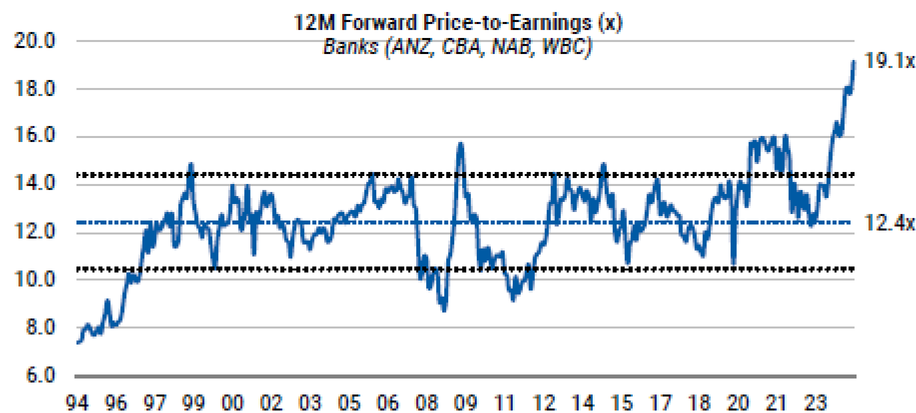
One of the big surprises for the Australian equity market during 2024 was the stellar total returns from the "Big 4" banks (ANZ, Commonwealth Bank, National Australia Bank, Westpac). Despite the lack of underlying earnings growth, having more earnings headwinds than tailwinds and a lack of Buy recommendations from the sell-side brokers for the sector, the Big 4 banks re-rated to unprecedently high valuation levels during the year.

**Figure 15: CY2024 Total Return - Australian Banks vs Resources vs Indices**



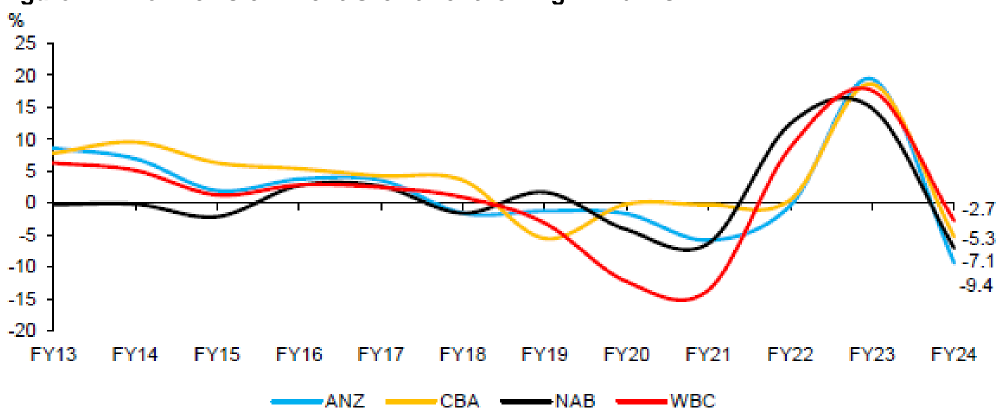

Source: Morgan Stanley; January 2025

**Figure 16: Forward Price-Earnings Ratios of the "Big 4" Australian Banks**




Source: Morgan Stanley; December 2024

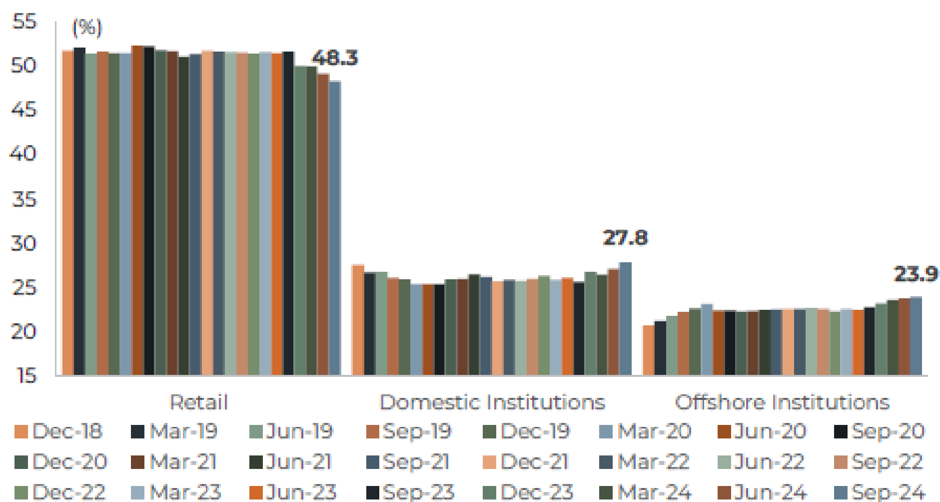
**Figure 17: Pre-Provision Profit Growth of the "Big 4" Banks**




Source: Macquarie; November 2024

So who is buying? Looking at the share registers of the Big 4 banks, retail investors have been taking profit whereas institutional investors have been buying (We use CBA as an example; the others show the same trends). However, most domestic active equity managers report to be materially underweight the Financial sector.

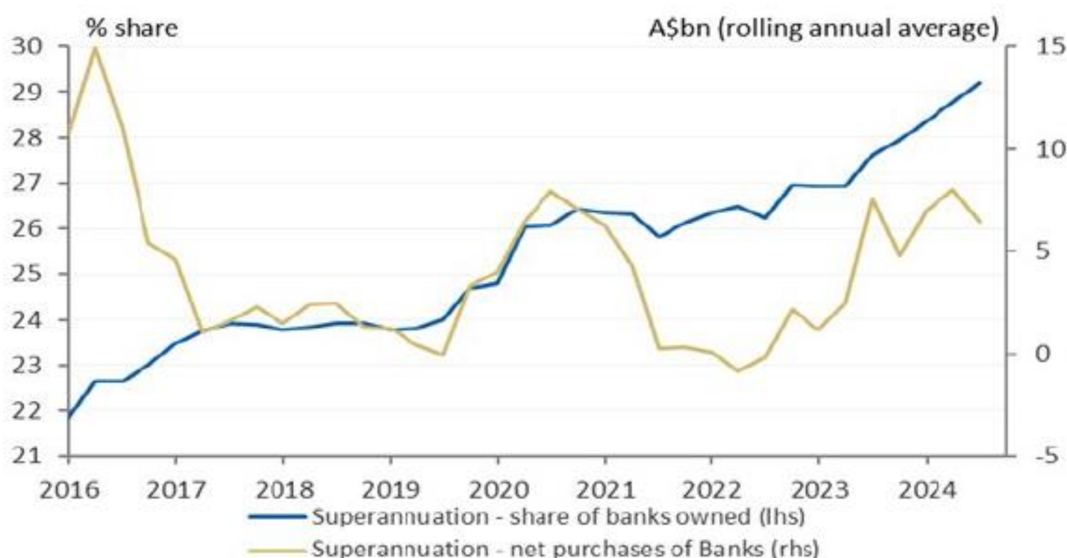
**Figure 18: Commonwealth Bank of Australia Share Register Mix**




Source: Barrenjoey; November 2024

This leads us to the other groups of major institutional investors – the Australian superannuation funds and passive index funds. Data shows the superannuation sector has been an active net buyer of the banks in 2024, with their share of the bank stocks now at all time highs.

**Figure 19: Share of Australian Banks Owned by Australian Superannuation Funds**

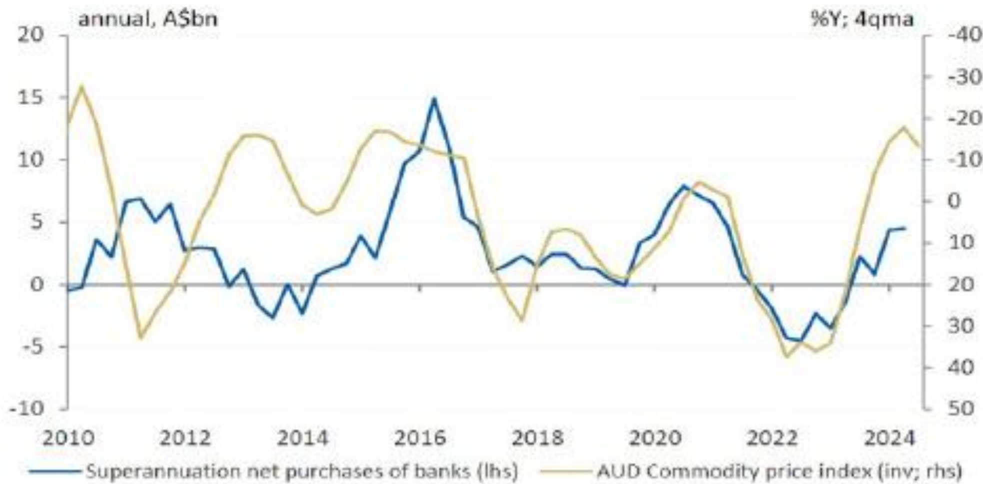



Source: Morgan Stanley; December 2024

Do the superannuation funds see something the rest of the market doesn't? One explanation provided is with the MySuper superannuation comparison and assessment regime, there is less risk appetite amongst the super funds to move too far from the "pack" (benchmark). Hence as the super funds grow bigger, so will their bank holdings (natural structural demand).

While unexciting, banks are still perceived as a very liquid place to hide. With the resource sector in the doldrums during 2024 due to weaker commodity prices and the uncertainty around China, another possible explanation is that overseas investors (particularly Asians) and the super funds were parking their cash in Australian bank shares until there is more appetite to rotate back into resources and other Asian stocks.

**Figure 20: Net Bank Share Purchases by Australian Superannuation Funds vs AUD Commodity Price Index**




Source: Morgan Stanley; December 2024

And then there are the passive index funds – the more funds they receive, the more that gets invested in banks. The Big 4 banks account for around 23.5% of the ASX200 Index at present, up from 19.9% one year ago. For how long could the virtuous circle work to keep lifting the banks up?

Can the banks continue their stellar performances in 2025? By how much more can they re-rate upwards? The extremity of their valuation multiples would suggest not much more (you can get cheaper bank stocks elsewhere including the US, even after their own upwards re-rating in 2024), and the higher the bank share prices the lower their dividend yields become (historically the key attraction about these stocks). Fundamentals and valuations suggest this must be a ceiling for these banks, and the month of September 2024 demonstrated how quickly sentiment can turn away from them (when China announced its economic stimulus policies, leading to a rapid but short-lived rotation towards the resource sector). Perhaps 2024 has offered us a lesson that while company fundamentals should remain a priority, in this day and age one also needs to be mindful of these structural factors at play.

## Stock Activity

**Buys/ additions**

- **DigiCo Infrastructure REIT** (DGT, new): The Portfolio participated in the initial public offering of DigiCo Infrastructure REIT in December. DGT is an owner, operator and developer of data centres in Australia and the US, with an attractive development pipeline which could potentially deliver substantial earnings and distribution growth (with the billed capacity to grow from 35MW today to over 237MW if all the identified and targeted growth options are developed). Its key asset is its Sydney data centre, which is attractively located in downtown Sydney with connections to all the major telecommunication cables and with the potential to quadruple its capacity. It also has a strategically located data centre in Chicago which is under construction and to be fully leased to Oracle under a long term contract when the centre comes online during 2025. We like the earnings stability which DGT should derive from its long-term contracts and the earnings and distribution growth potential from its development pipeline, as well as the experienced and credentialed management team behind this investment fund (HMC Capital). While DGT is currently trading below its IPO price, we remain confident in the long-term fundamentals of the data centre industry and the specific growth opportunities DGT offers.

**Sells / Reductions**

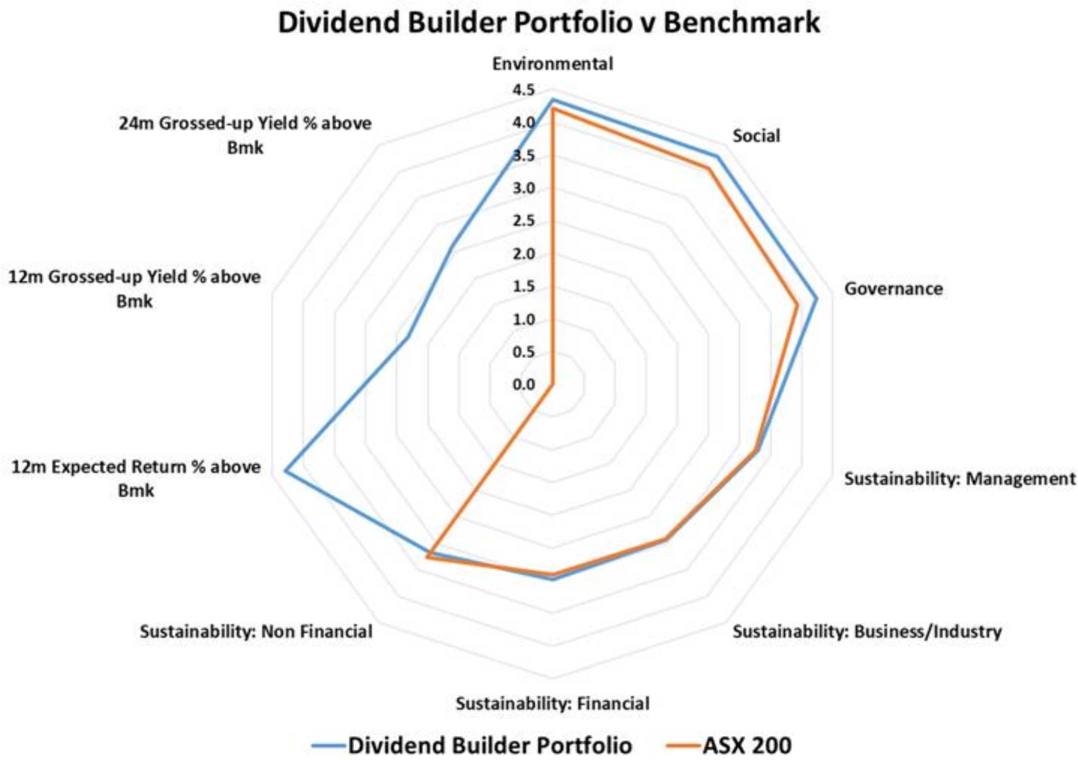
- **Aurizon Holdings** (AZJ, exit): The Portfolio exited its position in AZJ after it gave another disappointing trading update during its Annual General Meeting. It guided to lower earnings in 1H25 due to weakness in its Bulk division, which is the business we had anticipated would deliver solid earnings growth after AZJ's acquisition of the One Rail business. The Bulk division has disappointed over consecutive periods now, and we are concerned this trend will not reverse over the near-term and that AZJ's $2.3bn acquisition of One Rail will prove to be a disappointment in terms of returns generated and earnings growth achieved. As we have lost confidence in the total return potential of the stock, we have divested our holdings.

## Portfolio Positioning

Figure 21 shows the positioning of the Dividend Builder portfolio (the blue line) at 31 December compared with the benchmark (the orange line) in various metrics that we consider when constructing the portfolio.

The blue line indicates that the portfolio shows superior characteristics to the benchmark in all of Antares' Environment, Social and Governance ratings and comparable characteristics for Antares proprietary sustainability ratings. The chart also shows that on our current forecasts we expect the portfolio's yield to be above benchmark, grossed-up for franking, both one year and two years ahead. Finally, it also shows that Antares' 12-month forward target prices mean that we expect the portfolio's total return to be greater than the benchmark over the next year.

**Figure 21: Dividend Builder positioning vs S&P/ASX 200**




Source: Antares; December 2024

LEGAL DISCLAIMER

Important information: MLC Investments Limited ABN 30 002 641 661, AFSL 230705 (“MLCI”) is the Responsible Entity of, and the issuer of units in, the Dividend Builder ARSN 115 694 794 (‘the Fund’). MLCI has appointed Antares Capital Partners Ltd ABN 85 066 081 114, AFSL 234483, trading as Antares Equities (Antares) as the Investment Manager of this product.

MLCI and Antares are part of the Insignia Financial group of companies (comprising Insignia Financial Holdings Ltd ABN 49 100 103 722 and its related bodies corporate) (‘Insignia Group’).

The information is a summary only and should not be relied on for decision making. This communication has been prepared for licensed financial advisers, and it is not intended for distribution to investors and potential clients.

The information contained in this communication may constitute general advice and does not take into account an investors objectives, financial situation or needs. Because of that, before making any decision about whether to acquire or continue to hold an investment in the Fund, an investor should consider its appropriateness, having regard to your objectives, financial situation and needs, plus consider the relevant Product Disclosure Statement. We recommend that investors obtain financial advice tailored to their own personal circumstances.

The capital value, payment of income and performance of the Fund are not guaranteed. An investment in the Fund is subject to investment risk, including possible delays in repayment of capital and loss of income and principal invested. Neither MLCI or Antares nor any other member of the Insignia Financial Group guarantees the repayment of your capital, payment of income or the performance of your investment. Past performance is not a reliable indicator of future performance. The value of an investment may rise or fall with the changes in the market.

Any projection or other forward looking statement (‘Projection’) in this report is provided for information purposes only. No representation is made as to the accuracy or reasonableness of any such Projection or that it will be met. Actual events may vary materially. Opinions constitute our judgement at the time of issue and are subject to change. Neither MLCI, Antares nor any member of the IOOF Group, give any warranty of accuracy, nor accept responsibility for any loss or liability incurred by you in respect of any error, omission or misrepresentation in the information.

Bloomberg Finance L.P. and its affiliates (collectively, ‘Bloomberg’) do not approve or endorse any information included in this publication and disclaim all liability for any loss or damage of any kind arising out of the use of all or any part of any such information.

## Get in contact

**antarescapital.com.au**

Phone: 1300 738 355
Email: investorservices@antaresequities.com.au
Mail: PO Box 200, North Sydney NSW 2059