Providence
Independent Investment Advisory

Activity Report

January - May 2020

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About this Report

As part of our ongoing commitment to being a trusted partner for our clients, Providence reviews a number of products each month, searching for investment opportunities that fit our clients' individual requirements. Being an independent company, each opportunity is assessed solely on its merits regarding risk and return.

True to Providence's promise of transparency and independent analysis, we share the basis of our decisions with our clients in this Activity Report.

Acceptances

1. NAB Share Purchase Plan
2. Oil Search Entitlement Offer
3. Qube Holdings Entitlement Offer

1. NAB Share Purchase Plan

NAB is raising $1.25b through the retail share purchase plan (upscaled from $500m), which in addition to the $3bn institutional placement and reducing its interim dividend, will assist the bank through the Covid-19 pandemic and a potential severe economic downturn. The offer purchase price at $14.15 per share represented a 9.3% discount to NAB's 5-day Volume Weighted Average Price prior to announcement.

2. Oil Search Entitlement Offer

Oil Search completed a 1:8 non-renounceable entitlement offer, raising $80m through the retail component, on top of the US $650m placement and institutional raise. The raising was done due to low oil prices exacerbated by the Covid-19 pandemic. The offer purchase price at $2.10 represented a discount of 23.1% to the closing price on the 3rd April.

3. Qube Holdings Entitlement Offer

Qube completed a 1:6.35 non-renounceable entitlement offer, raising $236m through the retail component, on top of the $264m raised through the institutional offer. The raisings were announced to provide additional balance sheet flexibility through the Covid-19 pandemic, as they expect decreased volume in import and export logistics markets. The offer price at $1.95 represented an 11.8% discount to the closing price on Friday 24th April.

Declines

1. Macquarie Bank Capital Notes 2 (MBLPB)
2. National Australia Bank Capital Notes 4 (NABPG)
3. Other Institutional Placements/Raisings
4. Corval Multi Housing Estate Trust
5. Hampton St Ives Childcare Centre
6. Mandala Regional Accommodation Fund
7. APN Regional Property Fund
8. Realside Adelaide Office Trust
9. Fortius 100 King William Street Adelaide

1. Macquarie Bank Capital Notes 2 (MBLPB)

Macquarie Bank's new hybrid raising (MBLPB) targeting $400m, are capital notes which rank above equity, with terms such as deferrable distributions, common equity trigger and non-viability trigger events. The issue margin 4.75% over swap was slightly above trading margins of existing Macquarie hybrids MQGPC and MQGPD, however, the new MBLPB includes a common equity trigger not in the older Macquarie hybrids. We also elected not to participate in the earlier February offer (which was pulled due to Covid-19 market volatility).

2. National Australia Bank Capital Notes 4 (NABPG)

NAB's new hybrid raising (NABPG) targeting $750m are capital notes with long duration (7.5 years to first call) which is not our preference. The issue margin at 2.95% over swap was not enough when compared to existing secondary hybrids of other major banks trading with shorter duration.

3. Other Institutional Placements Raisings

There have been many other institutional placements/ broker raisings which we have not participated in over the recent period. Companies include Bapcor, Bendigo & Adelaide Bank, Cochlear, Credit Corp, Flight Centre, G8 Education, IDP Education, Invocare, Lendlease Group, Metcash, Newcrest Mining, NEXT DC, ooH!Media, QBE Insurance, Ramsay Healthcare, Resolute Mining, Southern Cross and Webjet.

4. Corval Multi Housing Estate Trust

Though attractive assets in the Manufactured Housing Estate sector, we sought a repricing of the asset in conjunction with the fund manager, which did not eventuate. Considering the changed investment environment, we decided not to proceed.

5. Hampton St Ives Childcare Centre

This offered attractive yield (circa 8%) for a newly completed childcare centre leased out to Orchard. Our preference is to keep powder dry for more distressed property assets.

6. Mandala Regional Accommodation Fund

This hotel and conference centre in Marysville, Victoria was trading under potential before the Covid-19 pandemic. Given uncertainties in the sector now, we decided not to proceed and would look for a repricing before committing additional funds.

7. APN Regional Property Fund

Two office blocks in Newcastle, 96% leased and with conservative gearing was targeting 7.3% distribution yield. We preferred to have more information on longer term vacancy rates prior to investing in this space. We will keep our powder dry for more distressed assets and try to take advantage of lower valuations in the direct market.

8. Realside Adelaide Office Trust

Four A-grade office buildings in Adelaide leased to a diverse range of tenants and fully leased, was targeting a distribution yield of 7.26% with gearing between 50%-55%. The investment was weighted more towards core office property with long lock-up, rather than opportunistic, which is our current preference.

9. Fortius 100 King William Street Adelaide

This is a prime A-grade Adelaide CBD building on King William Street. The property had a forecast distribution yield of 7% with circa 55%-65% gearing and illiquid for 5 years. Our preference at the time was to keep more cash, in the event that more opportunities presented themselves.

Presentations

1. Sage Absolute Return Fund
2. Antler Generator Fund
3. Cash Alternatives
4. Partners Group Multi Asset Fund
5. Platinum International Fund
6. PIMCO Update
7. SG Hiscock Property Income Update
8. MiHaven Social Impact Property Funds 1 & 2
9. Growth Farms Agricultural Lease Fund (ALF)
10. Portfolio Construction Conference
11. Bentham Update
12. IMAP Conference
13. JP Morgan Quarterly Update

1. Sage Absolute Return Fund

We met with Sean Fenton, portfolio manager of Sage Capital, regarding their absolute return market neutral fund. The business has almost been running for 1 year and has delivered exceptionally strong returns compared to its peer group (absolute return, market neutral) particularly during the market fall over February and March. The fund process includes quantitative ranking, fundamental stock conviction and risk management which keeps the fund market neutral (close to zero beta) with both long and short positions. We are in the process of conducting further due diligence as the fund progresses.

2. Antler Generator Fund

Antler Venture Capital has been busy in their Cohort 2 of investments (11 new companies in recent months) and we have been attending their respective presentations. They have invested on top of the 13 companies from September last year. Cohort 2 is too early to comment on as they are in the process of building up these companies. We are encouraged to see specific companies in Cohort 1 progress well, with some raising additional capital at much higher valuations. Antler invests in each company 10% equity stake at $1m on initial seed investment. We will revisit the unit valuation at 30th June this year, which will take into consideration Antler manager fees and equity uplift from the underlying venture companies.

3. Cash Alternatives

This year we have been reviewing cash alternatives for several reasons. With front end cash rates at 25 bps (and abnormally lower Bank Bill Swap rates) the return on cash is at record lows. Although term deposit rates provide higher than daily cash accounts, there is an inherent opportunity cost of being locked up for 3 – 6 months and being unable to break certain term deposits. This year, we have been exploring several alternatives including competitor term deposit brokers; other at-call accounts; various cash specific products which have better cash returns for similar cash risk (without adding unnecessary credit risk!). Most banks and ADI's benefit from the government guarantee, but our preference has always been for higher credit quality investment-grade rated banks.

4. Partners Group Multi Asset Fund

We met with Roberto Cagnati regarding the Partners Group Multi Asset Fund. The fund invests in private equity, private debt, syndicated loans, listed credit and cash. The fund was impacted over the recent March quarter as all assets were marked to market to reflect all public data, in addition to increased cost in trading which has since come back. The fund does not have much exposure to energy/cyclicals which were areas significantly hit. The fund has retained a large cash buffer and other liquid assets. The manager commented that it would take time for quality assets to come to market (i.e. normally lower quality assets that require private funding are the first ones, so the manager is comfortable to wait for higher quality assets) and does have cash available. They are seeing opportunities in secondaries with attractive valuations from forced sellers, and in private debt where attractive spreads are available.

5. Platinum International Fund

We held a one-to-one meeting with Andrew Clifford, CIO and portfolio manager of Platinum International fund. During the worst of the market drawdown, the fund outperformed the market with roughly 0.7 beta and similar net exposure. It is difficult to be buying bond proxies when government Treasuries are so low; it may not be bad to buy and hold Treasuries for 1 year, but not 3 or 5 years. They have been actively increasing the quality over the quarter. The pathway out for governments is not clear cut and will take months. There is a risk of the market fading from here, due to the size of the Covid-19 disruption. At the same time, there are opportunities in the unloved sectors (e.g. travel, semi-conductors, some stock specific bio-techs).

6. PIMCO Update

We dialled into Pimco's teleconference "From Hurting to Healing" with Joachim Fels. They expect it to be a "U" or "L" shaped recovery, rather than a "V" shaped recovery. The economic indicators such as business confidence and unemployment are terrible. Central bank independence is now gone, as they are working in tandem with governments to provide combined monetary and fiscal stimulus. US duration is attractive (although has been becoming more expensive) as it yields more than Japan and Europe and hedging costs have also come down. Mortgage backed securities are attractive, the sector has dislocated (spreads have widened) but the underlying fundamentals remain solid. They will continue to watch the Federal Reserve and what assets they are buying. There are risks to over-trading in a volatile market environment – being patient, considered and coordinated is important.

7. SG Hiscock Property Income Update

We attended a recent presentation from Grant Berry and Stephen Hiscock, portfolio managers of the SG Hiscock Property Income Fund. The portfolio is trading at attractive valuations: 17% discount to NAV using long term cap rates, and 30% discount to NAV using valuer cap rates. There is risk within the sector for companies which have operational and valuation risk, rather than property ownership and rental income. The impact from Covid-19 has seen deeper than GFC pricing for retail REITs, despite balance sheets being in better shape (lower gearing, better covenants, improved payout ratios, interest coverage etc.). Australia is well placed to re-open, in terms of number of active infections reducing, which will be the start of the process of returning to normality. Some longer-term challenges include more diversified supply chains, localised tourism, working from home impacting CBD office, density of public transport, immigration and short-term border impacts.

8. MiHaven Social Impact Property Funds 1 & 2

Clients invested in the MiHaven Social Impact funds have been sent the recent March updates directly. As with most property funds, they were impacted by Covid-19 with governments shutting down tourism and international students coming to Australia. At the time of update, MiHaven were reviewing all options available such as training and accommodation for other use.

9. Growth Farms Agricultural Lease Fund (ALF)

We had a teleconference with David Sackett regarding the Growth Farms fund. The fund acquired two more farms during February, with investments now in NSW and Victoria. There are three other properties due for settlement in the June quarter. Once these are finalised the fund will be 80% invested. The manager expects to be fully invested by the middle of 2020. The ALF will be diversified across irrigation land, rainfed cropping, livestock and water. During the Covid-19 crisis, the manager has been in contact with all tenants of ALF farms and none were seeing materially adverse conditions on their businesses.

10. Portfolio Construction Conference

We attended the annual Portfolio Construction Conference which brings together economists, fund managers across sectors, academics and financial advisers. Our very own Jonathan Pain (Providence Investment Committee member) presented his views on Black Swan VUCA (volatility, uncertainty, complexity and ambiguity). Several themes were presented: volatility, total social returns, China / US trade relations, market imbalances, illiquidity premia and issues with high yield debt. The benefit of the conference is the breadth of views amongst the speakers, which can differ greatly from our internal views – which is useful to test against our own convictions.

11. Bentham Update

We held a one-on-one teleconference with Richard Quin, portfolio manager of Bentham credit funds, to discuss the outlook on credit during the Covid-19 crisis. This is not 2008 where credit was impacted over a longer period, the impact this time around has been much faster. Governments have been more coordinated and have provided considerably larger stimulus measures than during the GFC, which has benefitted markets. The market implied default rates shot up quickly in March, with spreads widening over the period (the wide spreads have since pared back), although fundamental data regarding unemployment and wide scale business defaults have not been seen yet. The Federal Reserve acting as backer for a portion of loans and bonds has been a major difference from the GFC.

12. IMAP Conference

We attended the IMAP conference this year (Institute of Managed Account Professionals) which discussed the changing nature of technology available (e.g. SMA's, IMA's, wrap platforms) and the nature of advice being given after the Hayne Royal Commission. Discussions were around best interest duty and meeting the safe harbour requirements, so advice is properly administered, with client's interest being at the forefront. Based on an ASIC review of advice, there is a need for adviser practices to improve documentation and how advice suits client objectives.

13. JP Morgan Quarterly Update

We attended the JP Morgan Asset Management quarterly update presented by Kerry Craig – Global Market Strategist and Leon Goldfeld, Portfolio Manager – JP Morgan Asset Management Multi Asset Solutions. Broadly, JP Morgan Asset Management are of the view that the global outlook at this stage looks okay, so they are happy to lean towards risk assets. They see some evidence of a floor in global manufacturing and services PMI prints but acknowledge the shorter-term risk for volatility in data prints given the Coronavirus outbreak. Specifically, with regards to US equities they do not suggest that valuations are so stretched to warrant a significant reduction in allocation at this juncture.

With regards to the USA, confidence is still elevated at the consumer level which will assist growth, however less so with business confidence and investment. Thus, their base case is for US growth to continue but at a lowish rate (i.e. moderate). This favours equities and the risk of a sustained fall is low. JP Morgan Asset Management continue to advocate a position in bonds plus other safe haven assets now for portfolio diversification.

In Australia, despite three rate cuts, consumer confidence is still average as consumers are continuing to recalibrate to a lower income environment which takes time. They see income growth (which is very low) dictating spending not house price growth from here, a point that may be lost on some at this stage as house prices have rebounded very quickly.

Some attention was directed towards Coronavirus and the speakers noted that data will be volatile in the coming months until the outbreak stabilises. They noted some evidence that this may already be occurring, however it is still early days and data will be choppy.

The concluding remarks struck a chord with us in the form of policy uncertainty (currently very high across the globe) and the disconnect with volatility (market measure volatility is very low). Their suggestion, was that the market essentially is of the view that the Central Bank 'Put' is still very much in place (i.e. Central Banks will continue to remain accommodative). As we suggested in our recent Quarter 1 Global Outlook & Strategy, "if that changes, the game changes".

Appendix 1: Providence Investment Committee

Steven Crane

Steven has over forty years of investment experience having started in financial markets in the early 1970's. He has held such positions as Senior Portfolio Manager and member of the Asset Allocation Committee at AMP. For seven years he was the Chief Executive of ABN Amro. Steve currently holds a number of board positions, including Chairman of nib holdings limited, Director of Australian Pipeline Limited, Chairman of the Taronga Conservation Society Australia and Chairman of Global Valve Technology Pty Limited.

Chris Grubb

Chris has held senior fund management and broking positions within the Jardine Fleming Group in Japan, Hong Kong and Singapore. He was also a Director of Jardine Fleming Ord Minnett and Chairman of Investor's Mutual and Investor Web and is currently a Director of several Asian-focused investment funds. He also chairs Boardroom Australia and is a Director of Boardroom Limited in Singapore. Chris also acts as an executive coach.

Stephen Roberts

Stephen has over 40 years of experience as an economist and financial markets strategist in banking, broking and funds management. He has worked as Chief Economist with Equitilink and UBS. He worked on the Secretariat of the Australian Financial System Inquiry (Campbell Committee) in 1980, helping draft recommendations that led to the deregulation of the Australian financial system. He is an honours graduate in Monetary Economics from the London School of Economics.

Peter Hooker

Peter has held such positions as an Industrial Analyst at BZW Australia (now ABN Amro), Director reporting to Head of Research, was on the Equities Executive Committee and Director and Head of Industrial Research. He has a B.Sc. in Chemistry, B.E. in Chemical and Materials Engineering, and Graduate Diploma in Finance and Investment. He has over 25 years of experience in investment markets.

Jonathan Pain

Jonathan has 30 years of international investment experience. He has held such positions as Chief Investment Strategist of HFA Asset Management, Chief Investment Officer of Rothschild Australia Asset Management, Head of Investments at Gulf International Bank in Bahrain and Chair of the International Asset Allocation Committee at Paribas Asset Management in London. He holds a joint honours degree in Economics and Politics from Keele University and a Masters degree in the Economics of Finance and Investment from Exeter University.

Ian Wenham

Ian has over 30 years of experience in equity research, investment strategy and portfolio management. He has held such positions as Equity Analyst with Meares and Philips and Research Director of BZW Australia covering equity strategy and industrial research. He was also Regional Research Director with BZW Asia and Director of Asian Research at Lehman Brothers Asia where he chaired the Investment Policy Committee and was the firm's supervisory Analyst for the Asia-Pacific Region. He has also managed strategic global equity investments for the Lowy Family Private Fund. He currently heads his own investment firm.

Richard Nicholas

Richard has over 30 years of experience in private client portfolio management in London, Hong Kong and Australia. Richard started his career with Deloittes in London before cutting his investment teeth with the Rothschild family. He was the founding Research Director at S&P Fund Research UK and Investment Director at Hill Samuel Pacific in Hong Kong. He has also held senior positions with Hambros Pacific in Hong Kong, Alliance Capital in Asia and ANZ Private Bank. He is currently Director at Peak Investment Partners.

Marc Wait

Marc has over twenty years of investment experience. he began his career in Sydney with HSBC and Citigroup Global Asset Management (CGAM) managing Fixed Income and Money Market portfolios. Marc has also held positions in London with CGAM as a Fixed Income Portfolio Manager and Fidelity International where he was the Group Leader, Short Dated Bonds and chaired the Fixed Income Asset Allocation meetings for the firm. Marc was subsequently the Head of Treasury at the Abu Dhabi Investment Authority. Marc has a B.Agr.Ec(Honours) from the University of Sydney and is a Chartered Financial Analyst.

Grant Patterson

Grant has over 30 years of experience in equity markets. Prior to forming Providence he was a Director of ABN Amro and Head of Retail Broking. He has also held other senior positions such as Senior Institutional Dealer, Head of the Sydney Institutional Dealing Desk and also Head of Corporate Liaison. Grant is currently an Ambassador of the ASX Refinitiv Charity Foundation.

Michael Ogg

Michael has over 20 years of experience in investments, starting his career at JPMorgan Investment Management in London in the early 90s. In Australia, Michael worked for AMP Asset Management holding senior roles in Institutional Equities and for Deutsche Bank as a Client Advisor in Private Banking. Michael has an MA (Honours) Economics from Aberdeen University.

Stephen Christie

Steve has over 20 years of investment and finance experience, including as Director and Head of Private Wealth for Ord Minnett, Chairman of the Ord Minnett Investment Committee and Head of Asset Allocation for Goldman Sachs JBWere Private Wealth Management. Steve holds a PhD in Applied Finance and is a Trustee Director and Chairman of the Investment Committee of major industry super fund QSuper.

James Smith

James has over 20 years of investment market experience (cash equities). Prior to joining Providence, he held the position of Deputy Head of Domestic Sales at CIMB Securities (Australia) and was a member of the CIMB Equities (Australia) Management Committee. He has also held positions as Director - Sales at RBS, ABN AMRO and Sales at Deutsche Bank. James was responsible for Melbourne Sales/Account management in his previous roles over the last decade and in the last two years, was also responsible for New Zealand.

Safe Passage

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