Providence
Independent Investment Advisory

Activity Report

December 2018 - May 2019

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About this Report

Information Only, No Action Required

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. VGI Entitlement Offer
2. Woolworths Share Buyback

1. VGI Entitlement Offer

We met with the VGI team (Rob Luciano and Doug Tynan) to review the recent VGI offers. We are participating in both the VGI entitlement and VGI management company offer. Existing clients owning VGI LIC are given the opportunity to purchase additional units in the ASX listed VGI LIC at NTA with no brokerage (at announcement of the offer, the LIC was trading at a 5% premium to NTA). The aforementioned offer is linked 1:4 to the management company of VGI, and we will also be participating in this offer. The headstock price of $5.50 per share would mean buying the VGI management company at 6.2x EV/EBIT and 8.8x P/E which we believe is attractive relative to similar funds management businesses, and relative to where the rest of the market is trading.

2. Woolworths Share Buyback

Woolworths announced it would return the proceeds from the sale of its petrol business back to shareholders via a $1.7bn off market buyback. The offer was heavily oversubscribed and was scaled back 85%. We participated on behalf of clients where it was tax advantageous (e.g. superfunds, pension funds and zero tax paying entities). The benefit of the stock buyback is through a low buy back price (creating a capital loss which can be used to offset capital gains) and the remainder of the offer price being a high fully franked dividend.

Declines

1. Macquarie Group Capital Notes 4 (MQGPD)
2. Perpetual Credit Income Trust (PCI)
3. Pengana Private Equity Trust
4. Metrics Capital Income Opportunities Trust
5. Regal Investment Fund
6. Barwon Morayfield Finance Trust

1. Macquarie Group Capital Notes 4 (MQGPD)

We were offered to participate in the new $500m Macquarie subordinated notes offer, the funds would be used to satisfy APRA's regulatory capital requirements to protect senior creditors, and net proceeds be used for general corporate purposes. The offer was substantially upscaled to $905m by the end of the raising, which shows a strong demand for yield in a low interest rate environment. At the time of the offer, the expected issue margin was 4.15% over BBSW, taking into consideration the first call date of 7.5 years (Sep 2026) and mandatory exchange date at 9.5 years (Sep 2029). We did not participate in this particular hybrid, as it was long duration and our preference is to be shorter duration within fixed income.

2. Perpetual Credit Income Trust (PCI)

We were offered to participate in the new $400m Perpetual Credit Income Trust (which is an ASX Listed Investment Trust). The product invests in diversified credit and fixed income securities (domestic and global) targeting a return of RBA cash + 3.25% net of fees (i.e. 4.75% net). The trust can invest between 30% - 100% in investment grade assets, and up to 70% of the portfolio in unrated or sub-investment grade assets. The fund can also invest in a separate product (Perpetual Loan Fund) to gain exposure to corporate loans, to a maximum amount of 70% of the portfolio. There is also a maximum leverage limit of 15% via derivatives. We do hold reservations regarding the maximum concentration limit of 15% for investment grade securities, which we believe is too large and not in line with our preferred diversification objectives. Overall, we would prefer to see this product list to get a clearer picture of underlying investments and average credit-rating risk level.

3. Pengana Private Equity Trust

Pengana came to market looking to raise $600m for an ASX listed global private equity trust. We commend the manager for structuring the offer which added 5% alignment shares (paid for by the manager) for those that participate in the IPO, which is an attractive incentive. The issues we had involved the time it would take to get fully invested, the potential gearing up to 25% of NAV, and an issue with ASX market liquidity vs. underlying private equity being illiquid. The mismatch in liquidity could mean it may trade at a discount to market when market sentiment is negative. At the time of writing, PE1 is trading at a slight discount to the initial offer price.

4. Metrics Capital Income Opportunities Trust

We were invited to participate in the Metrics Capital Income Opportunities Trust. It would invest in domestic private credit opportunities, which have been normally dominated by banks but have been stepping away from the space due to increased regulatory requirements. The majority would be corporate loans, subordinated and mezzanine debt. The target return for the product is 8-10% pa with a cash yield of 7% pa paid quarterly. The manager has offered to pay all listing costs of the IPO, meaning the NAV should hold its level at IPO.
Generally speaking, we have been increasing our level of safety within credit, preferring lower risk investment grade credit versus higher risk sub investment grade assets. This product also charges performance fees of 15% over a hurdle of RBA cash + 6%, performance fees are less common in credit funds. We noted there was a higher management fee of 1.25% for the credit product, which although high, may be warranted given the higher level of management required in maintaining higher risk, sub investment grade assets.

5. Regal Investment Fund

We were invited to participate in Regal Investment Fund ASX listed trust (RF1) which is looking to raise $500m. The trust would invest 50% towards its highly successful Tasman Market Neutral strategy, then split the remaining across 4 existing strategies (Australian long short, Australian small companies, Emerging Companies and Global Alpha). The benefit of this product is that retail investors would be able to gain access to the manager more easily as it's ASX listed and not restricted by wholesale/sophisticated investor requirements. Regal would be paying all the ASX float costs meaning the NTA should be same as the IPO price.
Our HNW client base affords us the ability to access the underlying strategies on a strategy level versus having to blend them through this product, giving a more direct clean exposure. We would prefer watching this product after listing to get a better feel for the makeup of the strategies and also give more comfort around the newer strategies which have less track record.

6. Barwon Morayfield Finance Trust

We were offered to participate in a refinance loan against unsold land lots in Morayfield, Queensland (45 kms north of Brisbane). On review of the offer, we have sought more attractive deals which have better security and appropriate return for the level of risk taken. We are in the process of reviewing short duration property finance deals which may be suitable for certain clients, depending on the underlying security of assets, level of gearing, expected return and duration of the loans.

Presentations

1. Partners Group Global Income Trust
2. Neuberger Berman Corporate Income Trust
3. Schroders Investment Outlook
4. Stewart Investors
5. Acadian Asset Management
6. PIMCO Trends
7. BCA Global Investment Strategy
8. Partners Group Conference
9. Walter Scott Manager Visit
10. Baillie Gifford Manager Visit
11. EFG Bank

1. Partners Group Global Income Trust

We met with Edward Tong (manager of Private Debt) to discuss the upcoming Partners Group Global Income Trust listing on market later this year, aiming to raise $500m. The trust will invest in global private debt – senior secured loans, subordinated and second lien loans and special situation loans. Majority of the trust will be in senior secured loans, and is expected to be highly diversified across companies, sectors and geography. The trust aims to deliver RBA cash + 4%, from offshore distributions hedged back to AUD. The manager will be paying all ASX listing costs so underlying NTA should be equivalent to the IPO price. We are in process of reviewing the offer, with more details to follow closer towards listing date.

2. Neuberger Berman Corporate Income Trust

We met with Adam Grotzinger from Neuberger Berman, to discuss the NB Corporate Income Trust. The fund is doing another capital raising of $475m in addition to their existing FUM of $425m. The trust invests in global high yield bonds (sub investment grade) and targets 5.25% pa net of fees with income paid monthly. The additional raising offer costs are being paid by the manager, to the benefit of unit holders. The fund will invest majority in US Corporate High Yield, but can also allocate exposure to European High Yield (circa 20%) and Emerging Market High Yield (circa 20%). The benefit of global income is the diversity of companies, unlike in Australia which bonds are concentrated towards financials. The benefit of high yield includes the higher coupons and shorter duration vs investment grade bonds. We are in the process of reviewing this against other fixed income offerings coming to market.

3. Schroders Investment Outlook

We attended a Schroders investment seminar which covered Australian equities, global equities and fixed income. Schroders made note of some of the more recent corporate activity in Australia and made the following observation; yield is becoming an increasingly scarce resource. Therefore, this creates M&A appeal (as targets) for companies with a sustainable business and little need for fundamental changes to operations of that business. They highlighted in such an environment, a takeover target offering, say a ~5% return at the bid price for the aggressor, may be a much better investment option than others in such a low interest rate environment.

They see Australian bonds as expensive relative to history and noted the high 'effective PE' that Australian bonds are trading on relative to history. This helps provide context when the Australian equity market is currently trading on a ~18-20x PE multiple.

Broadly, they view the equities market as focused on non-yield companies/sectors (such as technology) where the current earnings yield is at 2.7%. On their observation, this compares to Financials on an earnings yield ~10.5% and Materials on an earnings yield ~9.8%. Their view is the market will migrate towards those higher earnings yielding companies given the low-yield global environment.

The widely discussed disparity between value stocks and growth stocks was noted with the following observations made; >90% of all global investment managers have a current bias to growth.

With regards to the global investment universe, they noted that the UK is this cheap for the first time in 50yrs.

Their overall message regarding equities was that the December market reactions and volatility was a warning sign and are positioned accordingly.

4. Stewart Investors

We met with Nick Edgerton from Stewart Investors to discuss their sustainable investment approach. The fund's core focus is on quality of management, franchise and financials. The result is a portfolio of companies that provide sustainable goods and services, required infrastructure and/or provide responsible finance. With these elements at their core, the fund tends to have a large proportion of their funds in companies where the founding families are still major shareholders. The meeting provided a clear understanding of Stewart Investors approach to sustainable investing as we continue to refine our capability within the ESG space. Further review is required to determine the efficacy of the fund within client portfolios.

5. Acadian Asset Management

We met with Ilya Figelman and Clifton Hill from Acadian to discuss the Multi-Asset Absolute Return Strategy. The fund generates approximately 50% of its risk-adjusted return from alternative risk premia (value, quality, carry, momentum) and 50% from systematic macroeconomic trading. It uses futures, forwards and options to gain exposure to 100+ markets across equities, fixed income, FX, commodities and volatility to target a return of 5% over the US 90-day treasury bill rate net of fees with approximately 8% volatility. The fund is attractive as a diversifying strategy given its low correlation to equity markets and other risk assets coupled with daily liquidity and a flat fee structure. Post this initial meeting we will continue our due diligence process on the fund.

6. PIMCO Trends

We met with Mike Connor to review the recently released AUD PIMCO Trends fund. PIMCO is launching an Australian unit trust version of their managed futures strategy that has been available in the US since 2014. The major difference being the Australian unit trust will be run at a slightly higher target volatility level of 12% vs. the US version at 10%. Relative to its peers, PIMCO Trends uses short "look-back" windows to determine a trend and hence the position which has provided higher negative correlation to equities, however leaves it more susceptible to rapidly changing market movements. It also tends to scale positions more rapidly than its peers. Risk limits are set wide, however there is an emphasis on providing diversification to equity portfolios which results in asymmetric equity market limits. Positions are expressed through futures, exchange traded and over the counter swaps and forwards, with a focus on using PIMCO's proprietary execution platforms to source the most efficient and cost-effective position. Follow up meetings have been arranged to assess the possibility of an unhedged version of the Australian unit trust and whether this may add further diversification benefits to client portfolios.

7. BCA Global Investment Strategy

We attended a webcast with BCA. Peter Berezin, Senior Vice President, Global Investment Strategy updated us on BCA's macro views. BCA are of the view that the next leg to global equities is likely to be up, partly driven by easier financial conditions (in CY19 so far) (which will boost global growth) and some signs of green shoots emerging in some of the leading economic indicators that they monitor. BCA down played significance for now of the flat yield curve as long term bond yields have fallen as the FED has recently turned more accommodative – thus extending the cycle. They also note that the US economy is also in good shape and they feel that during this year, US housing will bottom out.

Corporate debt in the US has been a focus point in the last six months or so and BCA noted that net debt as a share of GDP relative to other major countries is still okay. They also observed that the corporate financial balance (difference between what they earn and what they spend) for US companies is okay. They reinforced this observation noting that historically, there has almost never been a case where US has gone into recession when the corporate sector financial balance is in surplus.

With regards to China, BCA are of the view that Chinese government appears satisfied with their attempts to slow down credit growth and, historically, whenever credit growth has converged towards trend nominal GDP growth, the government has allowed for credit growth to pick up. Bottom line - BCA expect Chinese credit growth to pick up.

In broad summary, BCA see any pick up in global growth will benefit Europe and they expect the European economy to surprise on upside. If global growth re-accelerates in 2HCY19, the USD will likely peak soon. BCA see that there remains a window where stock prices can continue to rise from here.

Finally, with regards to the US FED, the market still says that the FED is done with regards to raising rates. BCA is saying a pause for now, but once into 2020, the FED will start to raise rates again. Interestingly, BCA have FED funds rate peaking at 4% (currently at 2.5%) which is substantially above the market's current views. We need to keep watching inflation closely (fine for now)… this will remain key.

8. Partners Group Conference

We attended the Partners Group AGM on behalf of clients to get a better understanding of the investment process and the product suite. There was an investment committee session which went for a number of hours and tied in many of the teams across the globe. Extensive due diligence was done on every investment prior to investing and key members of the investment committee were able to rate how good the investment idea was. If too many scores were sub investment quality then the investment didn't proceed and visa versa if above investment quality. The main take away for us though was the upfront recognition that there was over USD1.5trillion of dry powder in Private Equity which meant that current valuations were high and there was an expectation that assets may be sold on a lower PE multiple. This highlighted that every new investment had to have a large value add component as PE expansion was not a given.

9. Walter Scott Manager Visit

We met with Walter Scott on a recent trip to Edinburgh and went through their current portfolio and views. Although Walter Scott had comfortably outperformed their respective benchmark over the last 12 months, it was clear that they were not complacent. They are constantly trying to refine and improve their investment process whilst staying true to their original *quality growth at "Scottish" prices* mantra.

10. Baillie Gifford Manager Visit

Baillie Gifford are an Edinburgh-based fund manager who we met up with recently for an initial introduction to their Global Growth Fund. They are a growth manager who seek to find strong long-term trends in which to invest in. Their tagline is "Backing Exceptional Companies for the Next Decade and Beyond". Whilst their investment process looks robust and their performance has been very good over the last 5 years, we are wary of including a reasonably aggressive growth manager in portfolios at this point in the cycle. However, we are still interested in watching this fund and will continue our due diligence process.

11. EFG Bank

We met with the Swiss global banking group EFG in Geneva on behalf of Providence clients who utilise their global custody and investment services. EFG continue to expand their business and after combining BSI, one of Switzerland's oldest banks, back in 2016, they have followed that up with the recent acquisition of a majority stake in Shaw & Partners, one of Australia's preeminent investment and wealth management firms.

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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