Providence
Independent Investment Advisory

Activity Report

September 2019 - November 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. Ardea Real Outcome Fund

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We met with Gopi Karunakaran, a portfolio manager for Ardea, to discuss their Real Outcome Fund. It is an absolute return fixed income fund which targets CPI + 2%. The fund invests in government bonds, semi government bonds and inflation linked bonds which will constitute 90% of the fund. The remaining 10% will be cash, interest rate derivatives, inflation linked derivatives and cash repurchase agreements. The fund has minimal duration risk (interest rate risk) as this is removed by the inclusion of derivatives. Offshore foreign currency risk is hedged out and the fund does not use gearing to add additional bond exposure. The strategy is best explained as relative value arbitrage within government bonds, and there are structural inefficiencies within bond markets as certain investors are not necessarily "rational" investors (e.g. insurance companies or passive bond ETFs). The manager takes advantage of the relative value that exists between government bonds and corresponding interest rate futures. This strategy benefits from bond volatility but does not rely on duration unlike long only bond managers.

Declines

1. VGI Partners Asian Investment Company
2. KKR Global Credit Fund
3. Westpac Share Purchase Plan
4. Acure Asset Management - Currie St Adelaide Commercial Property
5. CBA Perls XII Capital Notes

1. VGI Partners Asian Investment Company

VGI announced they would raise additional funds (target $800m) for a new Asian investment strategy which would complement their existing global strategy. They were able to raise $500m through the offer and listed at $2.50 per share. We declined the investment as we have sufficient Asia exposure through existing global managers and are wary of ASX listed vehicles. At the time of writing, VG8 was trading at a discount to its listing price, currently at $2.30.

2. Fortius Central Park Retail

Although we have a high level of confidence with the fund manager, we are not looking to add to our retail exposure in property at this stage of the cycle.

3. KKR Global Credit Fund

KKR Credit launched their Global Credit Opportunities Fund which is listed on the ASX via a LIT structure, raising $925m (they increased the maximum raising size by $100m). KKR is a global firm, mainly known for their private equity arm and has 120 investment staff managing credit in loans and high yield. The fund will be 85% senior and 15% subordinated, targeting a return of 6% - 8% p.a. net of fees. Although the manager has a strong track record in the US, we have not been active in seeking credit through ASX listed vehicles which can be impacted by secondary market liquidity.

3. Westpac Share Purchase Plan

Over the quarter the Providence Direct Equity Team reviewed the Westpac (WBC) Placement and Share Purchase Plan, with WBC seeking to raise $2bn under an institutional placement and a further $500m under a Share Purchase Plan, with both offers priced at $25.32 per share. Following the release of the details of the placement Providence elected not to participate, with the decision being largely based on our concerns regarding the headwinds affecting the banking sector in general, along with any potential risks associated with the imminent release of the findings from both the Reserve Bank of New Zealand and AUSTRAC.

Subsequent to the closure of the Placement and during the investment window for the Share Purchase Plan AUSTRAC released its Statement of Claims against WBC, and in doing so announced that it had commenced proceedings against the bank in relation to an alleged contravention of WBC's Anti-Money Laundering (AML) and Counter-Terrorism Financing obligations.

Whilst we cannot know what the outcome of the claims may be, we are comfortable not participating in the Share Purchase Plan for any clients. Outside of any potential ethical issues that may arise from the bank's alleged AML control failures, we see the potential for a substantial fine for the bank, which, along with a significantly reduced participation in the share purchase plan may necessitate further action by the bank to increase its capital position.

4. Acure Asset Management - Currie St Adelaide Commercial Property

Providence met with the manager at the start of October to review what was a largely vacant (29% occupied) commercial property asset in the Adelaide CBD. The proposed raising would have consisted entirely of equity, and was being purchased as a defensive, sub-replacement cost 'vacancy play' with a view to steadily finding tenants without the pressure of servicing a large (or any) debt burden. We declined to participate due to concerns around the leasing strategy assumptions (specifically the potential for increased leasing incentives), and the potential difficulty in finding tenants – which would place pressure on prospective returns.

5. CBA Perls XII Capital Notes

CBA launched a new hybrid security (CBAPI) targeting to raise $750m with a bookbuild margin of 3% - 3.2% above swap. Upon review of the new security, which we expect would be raised at the low end (3% over swap) it was not favourable compared to existing bank hybrids in terms of offer margin and duration. One of the issues with newer hybrids is their extended duration - CBAPI has a first call of 7.5 years and mandatory exchange of 9.5 years which is longer than we would prefer. Trading margins have been compressing, meaning credit is relatively expensive and conditions of capital trigger events and non-viability events may lead to conversion to equity. At the time of writing, CBAPI was trading at $100.73, which includes accrued interest.

Presentations

1. JP Morgan Quarterly Update
2. JP Morgan Fed Reserve Update
3. JP Morgan Asset Management 2019 Global Research Summit (Singapore)
4. RARE Infrastructure Fund Presentation
5. Holowesko Partners – Global Fund
6. BCA - Research Outlook
7. BCA - Global Strategy Report
8. Octopus – Early Stage Innovation
9. Sage - Market Neutral Fund
10. Colchester - Global Bond Fund
11. Revolution - Private Debt Fund
12. State Street Global Advisers - Floating Rate Fund
13. MLC Private Equity – Co Investment Funds Update

1. JP Morgan Quarterly Update

JP Morgan Asset Management's quarterly update in October highlighted the 'unconventional policies' by Central Banks in many economies, such as: forward guidance, FX intervention, cheap bank loans to try and lift liquidity, negative rates in some instances and QE (bond buying).

They note risks to the outlook however in the near term the risks are essentially all political.

The globe is currently impacted by the spread of manufacturing and capex weakness and the multiplier effect of this. Interestingly, JP Morgan noted the 'robust' dispersion of those who think the US economy is in a good or a bad position – thus not heavily skewed one way or the other. However, limits are being tested in some economies regarding monetary policies and their effectiveness now and looking forward.

With regards to Australia, confidence is still lacking, suggesting the need to step up government spending to help stimulate the economy (government spending is currently ~23% of Australian GDP). Much has been said about the unemployment level in Australia and JP Morgan noted the significance of part-time work as a driver of present employment and a lack of wages growth. Household leverages also remain a headwind for the economy.

JP Morgan are cautious of global equities, as earnings appear to be coming down and are likely to continue downwards, while valuations in some markets appear stretched.

JP Morgan Asset Management presented their Global Research (fundamental) Enhanced Index Equity Fund in October which we attended. The fund's aim is to achieve a long-term return in excess of its benchmark via a broad market exposure to international stocks. Excess returns to its Benchmark since inception (2008) have been ~0.75% p.a. We will review the fund as a potential low fee inclusion to our international equities exposure that is 'index plus'.

2. JP Morgan Fed Reserve Update

In September we joined a JP Morgan Asset Management webcast following the most recent US FED meeting. The FED remains dovish and therefore in JP Morgan Asset Management's view the bias for interest rate easing remains in place. There appears to be some divergence with FED committee members, thus creating a more opaque message regarding what to expect from the FED. The FED discussed the strength in labour market and rising pace of household spend. JP Morgan noted that the FED's commentary that US exports have been weakening is a new narrative. JP Morgan don't expect a prolonged rate cut cycle and expect one more possible cut in 2019 and one cut in 2020. However, they observed that the market expects three more cuts from the FED. The importance of that statement is that there is scope for disappointment from the market about the lack of future FED interest rate cuts. Some inflationary pressures remain present (core at 2.4%, best since 2008) and financial conditions remain easy in the USA. JP Morgan Asset Management's closing remark was that they are starting to question the effectiveness of Monetary Policy.

3. JP Morgan Asset Management 20019 Global Research Summit - Singapore

Providence attended the JP Morgan Asset Management Global Research Summit in Singapore. Providence has been conducting due diligence on a number of JP Morgan Asset Management Funds, as well as using their research capabilities as an input to our internal investment decision making process. As such, the opportunity to attend this conference and hear from 50 members of their senior leadership team including portfolio managers, strategists, the chairman and the CEO, provided deep insight into their approach. It was evident that there is an emphasis on client outcomes and an approach that aims to solve the needs of their investors. Additionally, there was a keynote speech from Dr Condoleezza Rice which provided useful political insight into the current state of geopolitical tensions including Turkey's entry into Syria, the US approach to tensions in the Middle East, the US/China trade conflict and of course Brexit. Overall, the conference provided deep insight into the state of the world and the global investment universe.

4. RARE Infrastructure Fund Presentation

In the current low-income environment, Providence has continued exploring global infrastructure investments. We met with RARE Infrastructures Co-Founder and Senior Portfolio Manager, Richard Elmslie and Senior Investment Analyst, Matt Bushby for an update on the integration of Clearbridge and the RARE business including a number of operational and senior management changes. How these significant developments will affect the operation of the fund requires further review. Both the income and value strategies warrant further exploration given reasonably attractive IRR's and we will continue our due diligence on these opportunities.

5. Holowesko Global Fund

Providence met with John Crone from Holowesko Partners regarding the Holowesko Global Fund. The Portfolio Manager and Founder, Mark Holowesko, was previously a Director, CIO and Director of Research at Templeton Global Equity Group (a renowned global asset manager) with a portfolio management track record since 1987. The fund takes a value-oriented approach to investment based on proprietary fundamental research and implemented via a long/short strategy. Long-term performance has been impressive with returns achieved through both the long and short sides of their portfolio. However, recent performance has been impacted by the relative underperformance of value as a factor. Recent portfolio changes, specifically the addition of credit, will require further due diligence before any investment decision can be made.

In August we attended a webcast hosted by Garry Evans, Chief Global Asset Allocation Strategist, BCA Research. BCA are of the view that the current scenario in the US is akin to 1998. Thus, the FED will cut rates perhaps once (soon) but not by 4 times as is currently priced and expected by the market to occur over the next 12 months. BCA feel that global government bond yields have probably hit the bottom.

They see upside for US equities as somewhat limited, as a lot of multiple expansion already has occurred. Garry noted that BCA are more positive on Australian equities and have increased their Australia weighting to neutral as a hedge against China reflation (a new narrative). BCA note that global non-manufacturing services are still holding up well, thus indicating it's a manufacturing slowdown, driven by China. BCA still expect a pick-up in activity in the second half of 2019.

In the USA, BCA remain of the view that inflation is trending up and a bottoming of the global cycle will/would see an end to USD appreciation.

A slowdown in global manufacturing can be attributed to China. BCA noted that the annual change of total social financing in China is picking up. The lag is typically 3-6 months before it is reflected in activity.

For the European Union (EU), they cite the correlation to adjusted social financing in China and EU activity (albeit with a longer lag). The EU is very much a beta economy to global growth (very dependent and reactive to global growth).

For Australia, BCA monitor Australia's relationship (the Australian equities market) with the Global Industrial Metals Price Index, which has broken down since 2017. The question then is whether the relationship re-asserts itself (thus bullish for Australian equities). BCA are of the view that the Australian 'financials' stocks (think Royal Commission etc) caused the de-coupling of this relationship with the Global Industrials Metals Price Index. So the question BCA raise is now that the Royal Commission is out of the way, will Australian equities gather pace? As for the AUD and the sharp decline in the 2019 calendar year, the AUD has now fallen below fair value on BCA models.

13. Schroders Fixed Income Presentation

This presentation highlighted a scenario whereby bond returns in a recessionary environment or lowering yields made an ongoing investment in bonds attractive on the belief that official interest rates will move lower (as in Australia for example). The rational was that by being exposed to government bonds, an investor would participate in both income generation and capital appreciation as bond values would rise, reflecting a falling interest rate environment. Whilst acknowledging the likelihood that Australia's official interest rates appear to be headed lower, Schroders noted that recent stimulus measures in Australia are yet to fully play out. They also highlighted the following measures to reflect upon: $7.5bn of tax cuts (Schroder's suggested this is equivalent to ~50bps of easing), 50bps of official interest rate cuts and APRA's easing of loan conditions.

14. BCA Global Asset Allocation

We attended a webcast hosted by Garry Evans, Chief Global Asset Allocation Strategist. BCA believe the current scenario in the US is akin to 1998, thus the FED cut perhaps once (soon) but not by 4 times as is currently priced by the market to occur over the next 12mths. BCA feel that global government bond yields have probably hit the bottom or are close to it. Do they see upside in US equities at this point? Upside from here is somewhat limited, as a lot of multiple expansion already has occurred. They remain mindful of the potential of an increase in Chinese stimulus and the implications this would have for global equities (another upward pulse). BCA have recently become more positive on Australian equities and have, as a result, increased their Australian equities weighting to neutral as a hedge against China reflation. BCA are still of the view that a pick-up in global activity in H2 is likely. They also noted that a bottoming of the global cycle will/would see an end to the USD appreciation.

15. JP Morgan 3rd Quarter update

JP Morgan see the current environment as a time for a bit of de-risking. They are of the view that yields have probably fallen a bit too far for now and may increase slightly. A 'worry' point for JP Morgan at present is the prospect of political error and the implications this may have for markets overall. JP Morgan expect one or two 'insurance' rate cuts in USA, which is fewer cuts than currently priced by the market. With regards to the RBA and Australia, they are expecting a likely pause in any further rate cuts for now as the RBA will wish to 'see what happens'… however downside bias for RBA remains. JP Morgan remarked that investors are paying up for income and

17. BCA Geopolitics Webcast

We attended a BCA webcast hosted by Matt Gertken (Geopolitical Strategist), Marko Papic (Consulting Editor), Roukaya Ibrahim (Editor/Strategist) and Mathieu Savary (Chief Strategist). The BCA house view is that the business cycle will extend, and bond yields will rise, thus the best position is to remain in equities. BCA do however expect increased volatility re: policy uncertainty over the European summer as liquidity will likely be lower. In the short to medium term, BCA see three negative catalysts:

1. China has not retaliated yet to the blacklisting of Huawei and five other Chinese tech companies
2. Trump imposes tariffs on the remaining ~$300bn of Chinese imports to the USA
3. The USA has not yet taken action on point 1 above, as yet.

Possible positive catalysts that BCA can identify include Chinese stimulus and the bottoming of the credit impulse (which if sustained will be favourable for Chinese and global growth in H2). So far China has managed to calibrate enough stimulus to offset tariffs. BCA also noted the prospect of a more aggressive Chinese stimulus if tariff talks break down. BCA appear to be far more focused on the USD now and note that the movement of the dollar is now key to monitor. Their view is that if the USD stabilises and slows it will likely aid H2 global rebound. They also cautioned that if the USD continued to rise then "all bets are off" and any global recovery is at risk.

18. Schroders Update Session - Macro, Equities and Fixed Income

Regarding the Australian equities market Schroders noted the Japanese bid for Dulux (recent international lead M&A in Australia with Nippon bidding for the listed Australian paint producer). In a low returning global investment environment, the Japanese bid indicated that they are happy to accept say a ~5% return (vs. say 7% return being achieved for shareholders pre-bid). Why so? Yield is becoming an increasingly scarce resource. Dulux is viewed by Schroders (and the Japanese it would appear) as a sustainable business with no need for fundamental changes to the business to continue to achieve that ~5% return (at the bid price). Schroders remarked that this ~5% return for Dulux (at the bid price) is a lot better than other options in such a low interest rate environment.

With regards to the broader Australian share market, they highlighted that Australian 10yr bonds at ~1.8% implies a PE (price/earnings) multiple of ~50x for the bond market as at today. In their view, this helps put things into context when you are paying ~18-20x for equities. Schroders, being more of a 'value' style manager, note that investors in equities are far more focused on non-yield (i.e IT/Tech) stocks at present. They noted for comparison, IT stocks are trading on earnings yields of ~2.7%. This compares to an earnings yield of ~10.5% for Financials, ~9.8% for Materials and 9.7% for Consumer services. Hence, Schroders are focused on where they believe there is sustainable yield.

The Schroders Global Equities presentation again focused on the value/growth argument and Schroders note that more than 90% of all global investment managers have a current bias to growth. Their overall message was that they saw the December market reactions as a warning sign and are positioned accordingly (cautiously). The Schroders Global Funds top 3 holdings are Anglo American, Standard Chartered and South32 which plays into the remark above about where they see value. They also see value in the UK at a country exposure level and are now underweight the USA from a global position.

The Schroders Absolute Return and Fixed Income presentation highlighted Japan being cheap relative to history. Schroders are attracted to Japan as they see potential for corporate governance reform possibly leading to a release of value within Japanese corporates. In the UK they see some deep value hiding in some of the "mega caps". They also noted their view that in the UK, small/mid cap single product companies who are not well capitalised will likely be the biggest Brexit losers. With regards to Australian listed Hybrids, they see them as expensive and noted the pending Federal election may bring some pricing volatility as hybrid could be re-priced in a non-franking credit environment.

19. Providence Education Series

We hosted Providence Education sessions in Melbourne on *Concepts of Investment Management*, *Asset Allocation and Portfolio Construction* and U*nderstanding Equites (shares).* We are committed to assisting younger adults and others who would like more investment knowledge. Our next educations sessions are to be held in Sydney and Melbourne. Please let us know if you or a family member would be interested to attend.

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

DISCLAIMER: General Advice Only

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