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Focus Australian Share Fund Update

April 7, 2020

- COVID-19 containment measures are showing signs of success in Australia and overseas, although material uncertainties remain. The policy response has also been on a grand scale. The federal government's JobKeeper program takes total fiscal response above 10% of GDP.
- Rapid liquidity response by central banks seems to have fixed the plumbing issues in funding markets for the moment. This area is showing more signs of stability.
- All this has helped improve recent equity market sentiment. Lower correlations within the market also suggest more rationality.
- Nevertheless, we remain cautious and expect we will trade sideways in a "sawtooth" pattern of high volatility for a period.
- Why?
    1. The sticker shock of economic data that will emerging coming weeks and days.
    2. We are yet to see hard data around the impact on corporate earnings. It is simply too early – with too many unknowns about the duration of lockdowns – for the market to quantify the scale of earnings falls.
    3. We are also starting to see capital calls come through. The most leveraged companies are tapping the markets early given more immediate stress. But there are also signs of better quality companies with seemingly less imperative seeking to obtain a capital buffer at reasonable prices. We expect the steady flow of cash calls will absorb some liquidity and have a limiting effect on any near-term market gains.

Portfolio

- ***Recession Protection:*** We have lightened the position in Metcash, which gained 27% in March. We think it is well positioned, but have reduced exposure given the strong run.
- ***Policy Beneficiaries:*** We have lightened the exposure to iron ore miners which have held up well. Fortescue Metals (FMG) is up 7% for the month. The iron ore price remains strong on the back of expected Chinese demand, but we are also mindful of demand destruction in Europe and the US and the possible effect on iron ore prices.
- We continue to add selectively on weakness to the ***Long-term franchise winners***. These are companies that will take a near-term hit to demand – but have competitive positioning, management quality and balance sheet to ride out the disruption. They look compelling value on a three-to-five-year view. Here, we have been adding to Aristocrat and Monadelphous as an example. Companies such as JB Hi-Fi (JBH) and Nine Entertainment (NEC) are offering some attractive opportunities on a longer-term view. It is interesting to note the lines blurring between some of these companies and ***Policy Beneficiaries*** – recent strength in JBH and NEC last week was linked to policy moves.

- We remain cautious on the *Recovery Insurance* names. It's too early to add materially to our exposure here. It's important to remember history shows us that market leadership in a rebound does not tend to come from stocks that have fallen the most. After a plunge they often have something of a dead cat bounce. But they can then flat-line for a period if there is a structural factor that needs to be overcome. The long path to recovery for some technology stocks post-2000 illustrates this. We need to be careful on this front. The crucial element here is understanding the balance sheet and liquidity position in the event of a prolonged disruption.
- One area for consideration across all parts of the portfolio is a company's domestic versus overseas exposure. This could prove to be an increasingly material factor if we start to see a larger divergence in the outlook for infection rates and faster ability to normalise in Australia versus other parts of the world.

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