Vested Equities
Funds Management

## ALL-WEATHER PORTFOLIO

# "FY23 (year to June) Update"

PORTFOLIO UPDATE - FY23

FNArena
FINANCIAL NEWS, ANALYSIS & DATA

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## Portfolio Overview

### June Highlights

| | |
|---|---|
| Woolworths | +5.8% |
| Macquarie | +4.0% |
| Aristocrat | +4.0% |

### June Lowlights

| | |
|---|---|
| CSL | -9.4% |
| Gold ETF | -5.0% |
| TechnologyOne | -4.2% |

### FY23 Highs &Lows

| | |
|---|---|
| TechnologyOne | +46.8% |
| Carsales | +29.5% |
| Steadfast | +20.7% |
| Dicker Data | -28.1% |
| Amcor | -17.0% |
| IDP Education | -10.1% |

## FY23 (year to June 30) Portfolio Update

By Rudi Filapek-Vandyck and the Vested Team,

The All-Weather Model Portfolio did not enjoy the full benefits from this year's share market rally in June as laggards, cyclicals and (beaten down) small caps proved the flavour of the month.

More important is probably the observation the ongoing challenging environment for Australian equities has not prevented the Portfolio from outperforming its own goals set in 2015.

But before we go there, let's first take a closer look into the year that was, for investors, and why context and details are important when judging investment performances on a year-by-year basis.

*The performances mentioned in the left-hand column are simple share price calculations for June and the past twelve months.*

*Percentages do not necessarily equal the respective contributions to Portfolio returns for those periods.*

*Most obvious example is Dicker Data whose shares were purchased after outsized losses had occurred.*

**Context &Details Matter**

I came across the following eye-witness report a number of years ago.

A fund manager is presenting his fund's performance and proudly announces: average return over the past two years is 25% per annum.

One disgruntled attendee in the audience stands up from his chair and shouts: I'm calling BS! I personally have invested in your fund and I can tell everyone the fund hasn't gone anywhere since.

Fund manager, unperturbed, moves to the following slide showing his fund gained 100% in year-1, then declined by -50% in year-2. 100 minus 50 = 50, divided by 2 = 25%.

I've never established whether this anecdote actually took place in real life, but the underlying message remains unchanged: investors should remain cognisant of how finance generally is covered and reported on, while always trying to ascertain whether the finer details do not contradict the headline impressions, or offer a much more insightful background and context.

Those among you who may not be great with mathematics might now be thinking: what's wrong with the story above? Who's correct and who's not?

The straightforward answer is there's a lot wrong with that story, but also: both the fund manager and the angry investor are correct. The fund manager, however, is using the audience's dislike for maths and details to his own advantage, like a good old snake oil salesman.

Like with so many things in finance; one needs both a broader context and the finer details to get to the true picture.

In the example above: if an investor had invested from day one in Year-1, say $30,000, then that capital would have first doubled to $60,000 (100% gain) but subsequently reverted back to the original investment as that is what a decline by half (-50%) amounts to.

The result is a great outcome for marketing purposes (25% per annum!) but not great at all for the investor whose capital went backwards because of fees and inflation.

## The ASX and the Year that was

In the never-ending debate between actively managed investment funds and passive ETFs and other listed instruments, it is my observation many a professional investor knows how to outperform the broader market during times of plenty of sunshine (Risk On, bull markets) when taking on risk gets rewarded in spades, but things can go off the rails quite quickly, and quite devastatingly so, when the overall market environment deteriorates.

Investors might keep this in mind over the coming weeks as fund managers and industry consultants are no doubt preparing for a Good News marketing story.

The ASX200 Accumulation index, which includes the dividends paid out throughout the year, has generated a return of no less than 14.78% for the year ending on June 30.

Some foreign indices have even done significantly better.

## Things to Keep in Mind

-In Australia, the market performed best in H1 while in H2 the bulk of returns were generated in the June rally, which subsequently evaporated again in July

-Such environment usually emphasises the importance of dividends, but banks have been weak in 2023, with the market preferring insurers instead

-While the lists of top performers all contain small caps, it's been a heavily polarised landscape and large caps, as a group, have outperformed their smaller peers

-FY23 has once again highlighted the sweet spot in the Australian share market lays inside the MidCap50; effectively the ASX100 minus the Top50

-The final month of FY22 saw markets take a deep dive into the abyss, creating a low point from which this year's 12 month returns are being calculated

The importance of not simply staring oneself blind on twelve month's performance numbers shows up in many forms and disguises.

An example: **Perpetual's global innovation fund**.

With a return of 44%, the fund is sitting on top of Morningstar's performance rankings for FY23.

No questions about it, this is a fantastic outcome, but it looks a whole lot less impressive when we add this fund lost nearly -50% in the previous year.

Let's assume our angry investor in the opening anecdote had taken his $30,000 and given it to the Perpetual fund to manage two years ago.

Today, his capital would have eroded to $30k minus 50% = $15,000 times 44% = $21,600, meaning he effectively lost -$8,400 over that period.

## Increase Cash or not? An Investor’s Dilemma

When FNArena and Vested Equities started the **All-Weather Model Portfolio** back in early 2015, we promised investors we'd manage the downside by investing in Quality growers and reliable, sustainable dividend payers.

But markets are never 100% predictable and while Quality on average falls a lot less than the majority of listed equities, the past eight years have shown plenty of occasions when extreme volatility ruled the landscape, leaving no protection at all for equities, no matter the Quality, resilience or growth prospects.

How best to deal with these circumstances remains a never-ending  dilemma.

Some investors put their faith in that all shall be okay in the long run, buying more at substantially lower prices if they have the means to do so.

Certainly, it's great to buy shares at beaten-down prices, but what if the bottom's not in until -25%, or even -50% lower?

The opposite approach is to reduce the portfolio's exposure, so that losses remain smaller.

The consequence of that approach is that subsequent gains are likely to be smaller too, as, let's face it, we're unlikely to reallocate funds back at the absolute bottom of the sell-off.

But here's the rub: **a portfolio that doesn't fall as much, needs only smaller gains to keep the overall return positive.**

I think the merits of building up a sizable level of cash during times of extreme duress have been well and truly proven in the past couple of years.

This time around last year, the All-Weather Model Portfolio held 35% in cash and thus managed to limit its losses to -3.93% in June and -2.59% for FY22.

In comparison, the ASX200 Accum lost -8.76% in June last year and -6.07% for FY22.

Yes, the All-Weather Portfolio proudly outperformed throughout those testing, extremely volatile times...

...but the portfolio's performance for the year thereafter is measured off a higher base, which creates an extra hurdle when measuring the performance for the following year.

In the end, the All-Weather's performance remains better on 3 and 6 month comparisons, advancing 2.91% and 8.91% respectively versus 1.01% and 4.46% for the ASX200 Accum.

For the full 12 months, the All-Weathers added 12.71% vs 14.78% for the index, suggesting ‘underperformance’.

Though the irony of the difference in starting points should not go lost: the index started -3.48% lower than the All-Weather Portfolio and subsequently only performed better by 2.07%.

It might seem I am making a big deal out of minor details few others appear to be concerned about, but consider the importance of it when a fund reports it has gained 15% over FY23 after losing -22% in the year prior, to name but one example.

Ultimately, **any assessment of success or otherwise needs to be made over a longer horizon**.

One prediction we made at the time of establishing the All-Weather Portfolio is that investment returns would amount to 7%-8%, on average, over time.

The average per annum return achieved for the All-Weather Portfolio since early 2015 is circa 9.25% - meaning we've done better than promised over the past 8.5 year period.

For reasons of comparison: the average annual advance for the ASX200 Accum is 7.16% for the past 5 years and 8.56% for the past decade.

## The Aussie Market's Sweet Spot

One intriguing observation is the repeated relative **outperformance in Australia of the MidCap50**; that segment of companies not large enough to be part of the ASX50 but on average too large to be included with the many smaller caps listed on the ASX.

Talk to any small cap investor this year and they will assure you times have been extraordinarily challenging.

The S&P/ASX Small Ordinaries, for example, generated 8.45% in FY23 total return, but only 1.32% for the first six months of 2023.

In comparison, the MidCap50 is up 4.60% for the six months ending June 30, which is similar to the ASX50, but for the full financial year the gain is 17.97%.

Over three years (13.50%), five years (8.80%) and ten years (14.40%) - the outperformance from this segment on the exchange is quite persistent.

Do we know why? Are there any conclusions or insights we can draw from it?

My own view is this segment includes those success stories from the small caps space that are able to grow into a much larger size, and ultimately become part of the ASX50 large caps.

Micro caps and small cap companies will always have an attraction, because such companies can grow rapidly from a low starting point, which can translate into outsized share price gains in a short time.

But only few can turn that operational momentum into a sustainable, long-term growth story.

In other words: the best out of the bunch eventually end up in the first half of the ASX200, and if they're truly successful they continue advancing through the rankings until they leave this segment through the front door, i.e. they join the ASX50.

Another way of approaching this is through the balance between risk and reward.

Since companies that keep climbing through the ranks have proven the merits and success of their products and services, I'd argue they represent a much better risk-reward balance, in between smaller peers that yet have to prove themselves and the larger sized companies that can be quite sluggish in their growth.

I haven't done or seen any dedicated data analysis, but logic tells us companies that have strongly contributed to the MidCap50's relative outperformance in Australia include Cochlear (COH), ResMed (RMD), Seek (SEK), Treasury Wine Estates (TWE) and Xero (XRO) but also Fortescue Metals (FMG), Mineral Resources (MIN), and Pilbara Minerals (PLS).

All are part of the ASX50 today, but for many years these companies have been growing their business, climbing the ranks of the ASX, to ultimately join the Top50 on the Australian bourse.

Before they got there, these companies helped the MidCap50 consistently outperform all other segments on the ASX.

This doesn't mean we should ignore these companies from the moment they enter the Top50, but equally valid: not every member of the MidCap50 will be a generator of long-term outperformance; picking the winners remains important.

A quick glance through the curated lists from which the All-Weather Portfolio picks its exposures reveals this segment is amply represented, even without a specific dedicated focus on mid-caps.

Companies included are Ansell (ANN), Carsales (CAR), REA Group (REA), Steadfast Group (SDF), TechnologyOne (TNE), WiseTech Global (WTC), and others.

As far as general observations go: I think the numbers and the facts speak for themselves.

## All Good Strategies Include Making Changes

When it comes to investing and the share market, Mike Tyson described the experience of the past years best:

*"Everybody has a plan until they get punched in the mouth".*

Wall Street legend Bob Farrell's rule number ten also springs to mind:

*Bull markets are more fun than bear markets.*

To say that events, extreme polarisations and momentum switches have tested investors to the max in the three years past can only be a grave understatement.

While much of today's public discourse is whether equities are still in a bear market or not, a prudent investor would be prepared for challenging times ahead.

Our view that prudence is best in the slipstream of the steepest central banks tightening cycle ever, and still ongoing, has been repeatedly and severely tested over the past 16 months.

This, however, has not relegated the All-Weather Portfolio to significant underperformance, even despite the Portfolio carrying 20%-plus in cash, and 5% in gold.

But not everything has worked out as planned, and at times changes and amendments needed to be made.

## Let's Talk Stocks

Among the newcomers that joined the Portfolio throughout tumultuous and volatile times are Dicker Data (DDR), Steadfast Group (SDF) and HomeCo Daily Needs REIT (HDN).

The first two additions have contributed positively, but the REIT has been weighed down by bond market volatility, which we always knew was a key risk.

At some point, the bond market will provide relief.

In the meantime, we are enjoying a prospective dividend yield in excess of 7%.

Dicker Data shares equally offer a juicy yield, expected to grow to 6% next year. Insurance broker Steadfast has performed better; its shares are trading on a much lower implied yield.

In terms of your typical income-oriented investments, one of the Portfolio's largest exposures remains Telstra (TLS), which, apart from a 4% yield, offers upside through asset sales and much improving industry dynamics.

Dialling back the risk-taking, and reducing the overall equity exposure by lifting the percentage held in cash (and gold), has meant saying goodbye to some investments that we would have liked to still own today.

But as the old expression goes: one cannot make an omelette without breaking some eggs.

Sometimes sacrifices need to be delivered for the higher cause, in this particular case: limiting capital losses and remaining prepared for tougher, challenging times ahead.

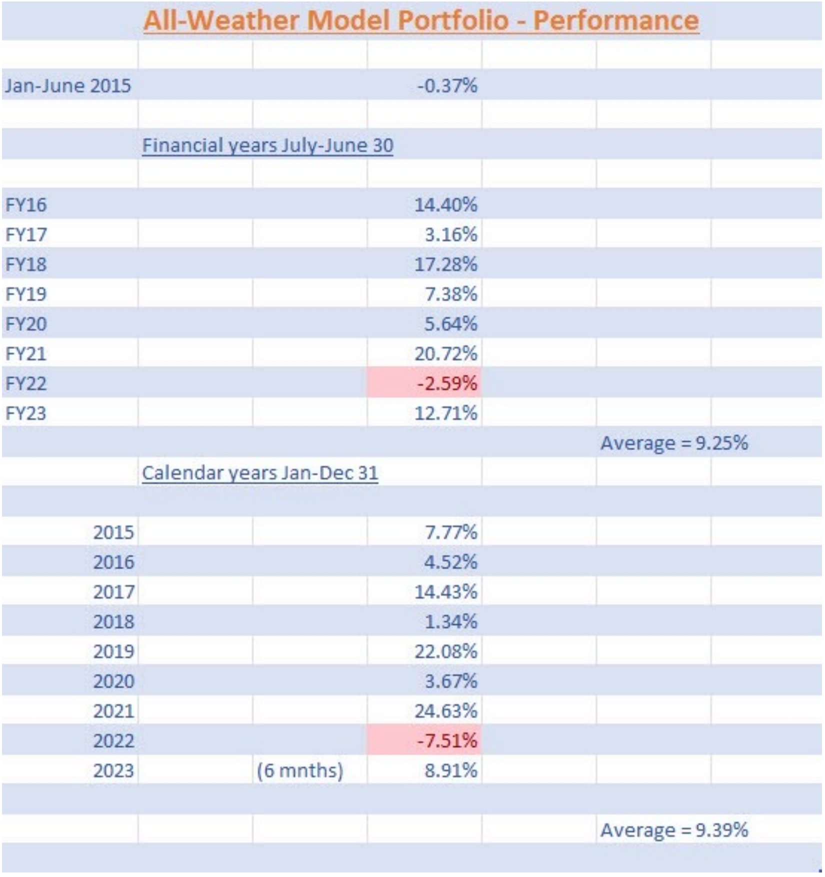
Stocks that remain high on the Wish List include Breville Group (BRG), Pro Medicus (PME), REA Group, Seek, WiseTech Global (WTC), and Xero (XRO).

The most prominent disappointment in the Portfolio relates to CSL with new management issuing a rare profit warning towards the end of the financial year. Most importantly: the forecast remains for EPS growth in the order of 14%-18% in FY24.

It goes without saying, even the highest Quality growth stock on the ASX is not 100% immune to bad news! But it doesn't by any means imply that CSL's growth story is nearing its end.

With confidence that this year's setback is just that, a delay in the post-covid recovery, the Portfolio has responded by purchasing more shares on persistent weakness.

CSL is now the largest single exposure, which is likely to act as a bonus once investors start looking for reliability and Quality during times of corporate stresses and duress.



All-Weather Model Portfolio - Performance

| | | | |
|---|---|---|---|
| Jan-June 2015 | | -0.37% | |
| | Financial years July-June 30 | | |
| FY16 | | 14.40% | |
| FY17 | | 3.16% | |
| FY18 | | 17.28% | |
| FY19 | | 7.38% | |
| FY20 | | 5.64% | |
| FY21 | | 20.72% | |
| FY22 | | -2.59% | |
| FY23 | | 12.71% | |
| | | | Average = 9.25% |
| | Calendar years Jan-Dec 31 | | |
| 2015 | | 7.77% | |
| 2016 | | 4.52% | |
| 2017 | | 14.43% | |
| 2018 | | 1.34% | |
| 2019 | | 22.08% | |
| 2020 | | 3.67% | |
| 2021 | | 24.63% | |
| 2022 | | -7.51% | |
| 2023 | (6 mnths) | 8.91% | |
| | | | Average = 9.39% |

The All-Weather Portfolio initially started on the Praemium platform but migrated to WealthO2 from the second quarter of 2020 onwards.

For the above performance table, Praemium data have been used until 30 June 2020.

**All returns are unaudited and exclusive of fees and brokerage**.

If you require more specific information on past or current platform performance, please send an email to your advisor.

The All-Weather Portfolio invests in High Quality, structural growers that tend to outperform over long periods of time, albeit not every single time.

Stock selections are based on proprietary research & analysis by FNArena Editor Rudi Filapek-Vandyck, also including High Quality emerging business models and Quality dividend opportunities.

Typical portfolio inclusions are Carsales, CSL, Goodman Group, Macquarie, REA Group, ResMed, Seek, TechnologyOne, Wesfarmers. and Woolworths, though variations and exclusions occur from time to time.

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