

# Vertium Equity Income Fund

Fund Update | 30 September 2020

## Key Facts

### Investment objective vs benchmark

1. Greater income yearly
2. Lower absolute risk yearly
3. Greater returns over 5 years

### Benchmark index

S&P/ASX 300 Accumulation Index

### Inception date

April 2017

### Number of stocks

20 - 40

### Distribution

Quarterly

### Management fee

0.97 p.a.

### Buy/Sell spread

+0.25 /-0.25

### Minimum investment

\$20,000

### APIR

OPS1827AU

### External ratings

Lonsec "Recommended"

Zenith "Investment Grade"

### Suitable investors

1. Low-risk or low-tax investors
2. Pre-retirees and retirees
3. Endowments and charities

### Key Platforms

Asgard | BT Wrap | BT Panorama

CFS | HUB24 | IOOF | Netwealth

Praemium | MyNorth

Macquarie | MLC

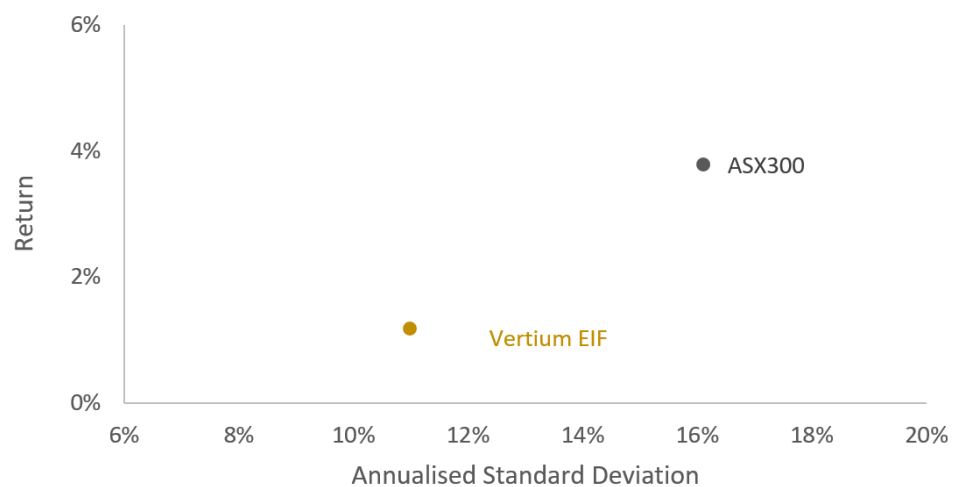
## Capital preservation metrics (since inception) ^

	Fund	ASX300
Outperformance frequency in down markets	75%	N/A
Down market capture ratio	58%	N/A
Beta	0.65	1
Maximum Monthly Drawdown	-13.8%	-20.8%

## Performance (%)

	1 Mth	3 Mth	6 Mth	1 Yr	2 Yr pa	3 Yr pa	Since Inc. pa
Income	1.2	1.2	3.0	5.2	7.0	6.6	6.1
Growth	-1.5	1.1	10.1	-12.8	-7.5	-5.9	-4.9
<b>Fund Total Return</b>	<b>-0.3</b>	<b>2.3</b>	<b>13.1</b>	<b>-7.6</b>	<b>-0.5</b>	<b>0.6</b>	<b>1.2</b>
Income	0.4	1.0	1.2	3.1	3.7	3.9	4.1
Growth	-4.0	-1.0	15.5	-13.0	-3.0	1.0	-0.3
<b>Index Total Return</b>	<b>-3.6</b>	<b>-0.1</b>	<b>16.7</b>	<b>-10.0</b>	<b>0.7</b>	<b>4.9</b>	<b>3.8</b>
<b>Fund beta</b>	<b>N/A</b>	<b>0.54</b>	<b>0.55</b>	<b>0.68</b>	<b>0.65</b>	<b>0.65</b>	<b>0.64</b>

## Return versus risk (since inception)



## Portfolio Dashboard

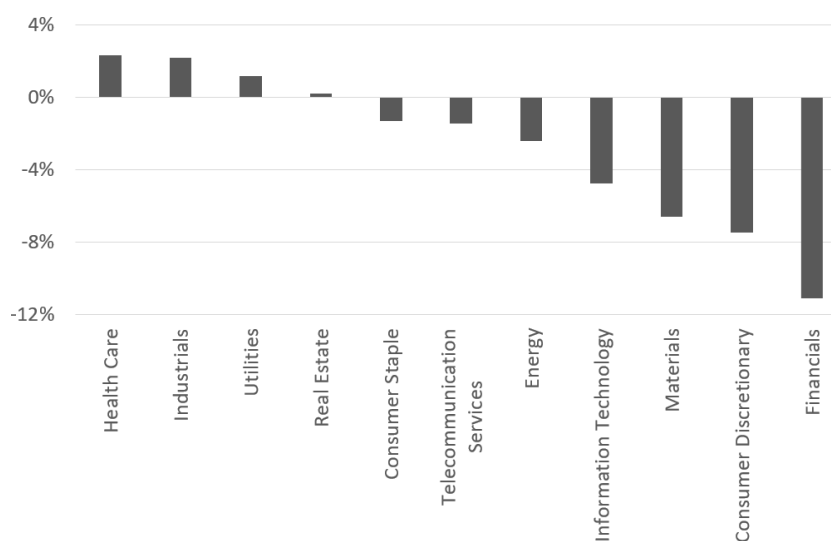
Top 10 holdings	ASX Code
CSL Limited	CSL
BHP Group Limited	BHP
Commonwealth Bank	CBA
Aurizon Holdings	AZJ
Lend Lease	LLC
Westpac Banking Corporation	WBC
Coca-Cola Amatil	CCL
REA Group	REA
Cochlear	COH
Charter Hall Group	CHC

Number of stocks	28
------------------	----

Size exposure	%
Large Cap	55
Mid Cap	14
Small Cap	2
Effective Cash	29

Option exposure	%
Shares	71
Call Options	-4
Put Options	3
Effective Cash	29

### Sector Weightings



“Our equity income fund is designed with conservative investors in mind. We seek to deliver the benefits of equity exposure including attractive, tax effective income - with a commitment and focus on capital preservation.”

Jason Teh

Chief Investment Officer

CONTACT COPIA



1800 442 129



clientservices@copiapartners.com.au



www.copiapartners.com.au

**Notes of Performance:** Due to participation in various off market buybacks, the headline performance was negatively impacted. On a tax-exempt basis, these buybacks contributed positively due to imputation credits. The following shows the negative impact on performance and the imputation benefit in brackets: Nov 2018 RIO -0.33 (+0.87); Dec 2018 BHP -0.63 (+1.25); Apr 2019 CTX -0.01 (+0.21). ^Based on monthly data.

**Disclaimer:** The total return performance figures quoted are historical, calculated using soft close, end-of-month mid-prices and do not allow for the effects of income tax or inflation. Total returns assume the reinvestment of all distributions. The performance is quoted net of all fees and expenses. The index does not incur these costs. This information is provided for general comparative purposes. Soft close unit prices are interim unit prices struck at month end before all transactions for the month have been completed. Performance data available on the Vertium website, vertium.com.au, however, is based on hard close unit prices which are struck after all transactions for the month have been completed. ^ Month-end unit prices are hard-close and cum-distribution. # In order of highest to lowest weighting at the end of the reported month. Past performance is not a reliable indicator of future performance. Positive returns, which the Vertium Equity Income Fund (the Fund) is designed to provide, are different regarding risk and investment profile to index returns. This document is for general information purposes only and does not take into account the specific investment objectives, financial situation or particular needs of any specific individual. As such, before acting on any information contained in this document, individuals should consider whether the information is suitable for their needs. This may involve seeking advice from a qualified financial adviser. Copia Investment Partners Ltd (AFSL 229316, ABN 22 092 872 056) (Copia) is the issuer of the Vertium Equity Income Fund. A current PDS is available from Copia located at Level 25, 360 Collins Street, Melbourne Vic 3000, by visiting vertium.com.au or by calling 1800 442 129 (free call). A person should consider the PDS before deciding whether to acquire or continue to hold an interest in the Fund. Any opinions or recommendations contained in this document are subject to change without notice and Copia is under no obligation to update or keep any information contained in this document current. The Lonsec Rating (10 June 2019) presented in this document is published by Lonsec Research Pty Ltd ABN 11 151 658 561 AFSL 421 445. The Rating is limited to “General Advice” (as defined in the Corporations Act 2001 (Cth)) and based solely on consideration of the investment merits of the financial product(s). Past performance information is for illustrative purposes only and is not indicative of future performance. It is not a recommendation to purchase, sell or hold Vertium Asset Management’s product(s), and you should seek independent financial advice before investing in this product(s). The Rating is subject to change without notice and Lonsec assumes no obligation to update the relevant document(s) following publication. Lonsec receives a fee from the Fund Manager for researching the product(s) using comprehensive and objective criteria. For further information regarding Lonsec’s Ratings methodology, please refer to our website at: <https://www.lonsecresearch.com.au/research-solutions/our-ratings>. The Zenith Investment Partners (“Zenith”) Australian Financial Services License No. 226872 rating (assigned June 2018) referred to in this document is limited to “General Advice” (as defined by the Corporations Act 2001) for Wholesale clients only. This advice has been prepared without taking into account the objectives, financial situation or needs of any individual. It is not a specific recommendation to purchase, sell or hold the relevant product(s). Investors should seek independent financial advice before making an investment decision and should consider the appropriateness of this advice in light of their own objectives, financial situation and needs. Investors should obtain a copy of, and consider the PDS or offer document before making any decision and refer to the full Zenith Product Assessment available on the Zenith website. Zenith usually charges the product issuer, fund manager or a related party to conduct Product Assessments. Full details regarding Zenith’s methodology, ratings definitions and regulatory compliance are available on our Product Assessment’s and at <http://www.zenithpartners.com.au/RegulatoryGuidelines>.

## Quarterly perspective | **the Markets**

The S&P/ASX 300 Accumulation Index delivered a lacklustre -0.06% return for the September quarter. The best performing sector for the quarter was Information Technology (+13.0%), while the worst performing sector was Energy (-13.5%).

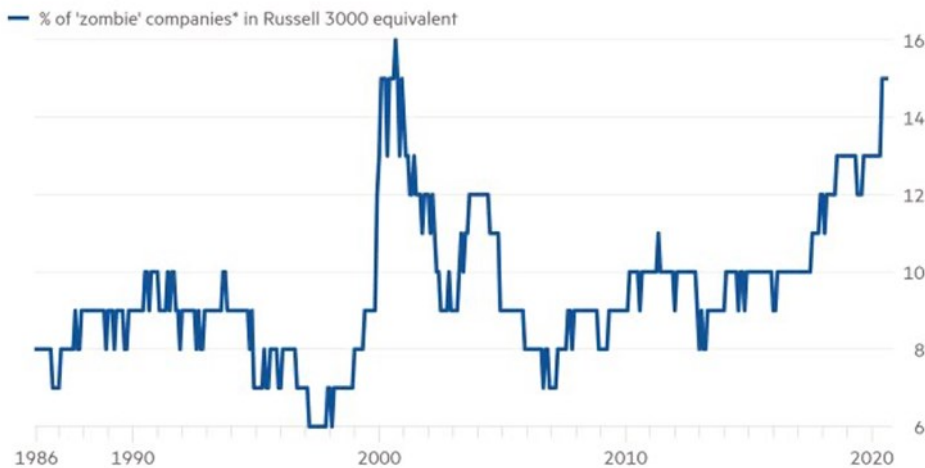
Australia's annual GDP shrank 6.3% as the COVID pandemic pushed the economy into its first recession in 30 years. The unemployment rate increased to 7.4% and the annual inflation rate was -0.3% for the June quarter of 2020.

Commodity prices were mixed during the quarter. The Brent oil price (0.9%) was flat because global demand for oil is recovering slowly due to travel restrictions still in place in many parts of the world. On the other hand, copper and iron ore prices were strong (9.5% and 18.2% respectively) due to increased Chinese demand coinciding with global supply issues. The gold price (+5.9%) also rose as yields were weak for the quarter.

An economic recovery is in sight given the immense amount of stimulus injected by Governments and Central banks. However, the pace of the recovery is likely to be fragile and mixed. Given this uncertain backdrop, the speculative activity in global share markets is astounding and is reminiscent of the Dot-com boom 20 years ago.

The Dot-com bubble was characterised by many growth companies with unproven business models not making profits. Today, about 15% of US listed companies are zombies – companies where profits are less than interest payments on their debt. The US market's appetite for loss-making companies is approaching its Dot-com peak.

### Number of US 'zombie' companies nears 2000 peak



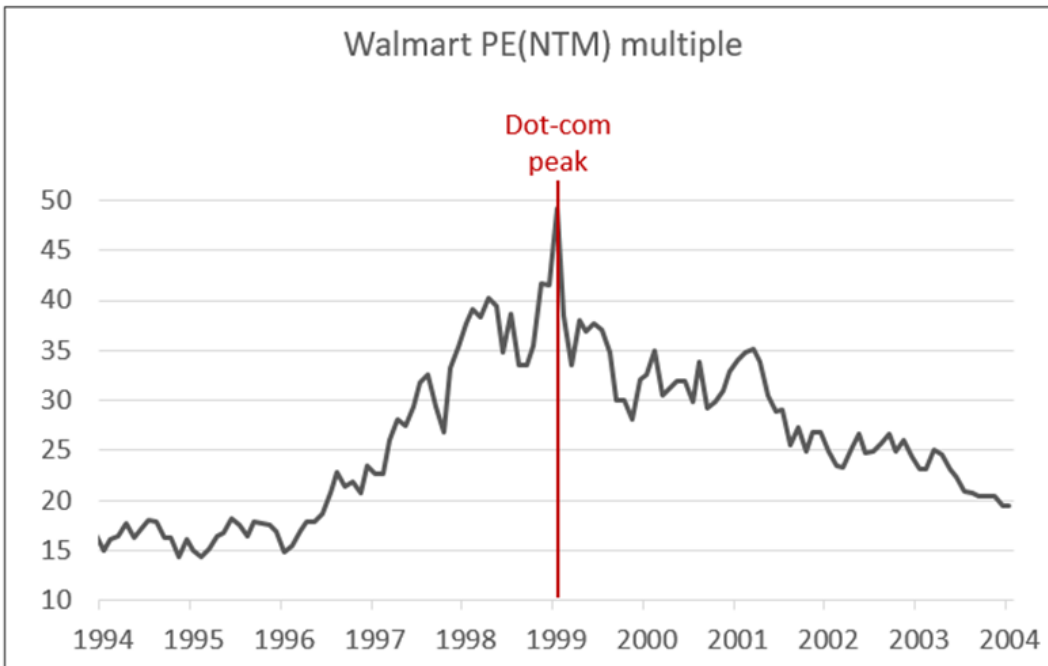
\*Companies where profits are less than the interest paid on their debts for at least 3 years / Data based on the Leuthold 3000 Universe (Russell 3000 equivalent)

Source: The Leuthold Group

© FT

While investing in zombie companies may be considered speculation, many market commentators have suggested that investing in companies with a long track record of earnings growth is the best way to navigate a low growth, uncertain environment. Over the long-term share prices track earnings, however, there are times where valuations can substantially disconnect from underlying fundamentals. This is best exemplified by Walmart, where a high quality, robust company was caught up in speculative fever during the Dot-com mania. The following chart highlights Walmart's PE multiple for the period between 1994 and 2004.

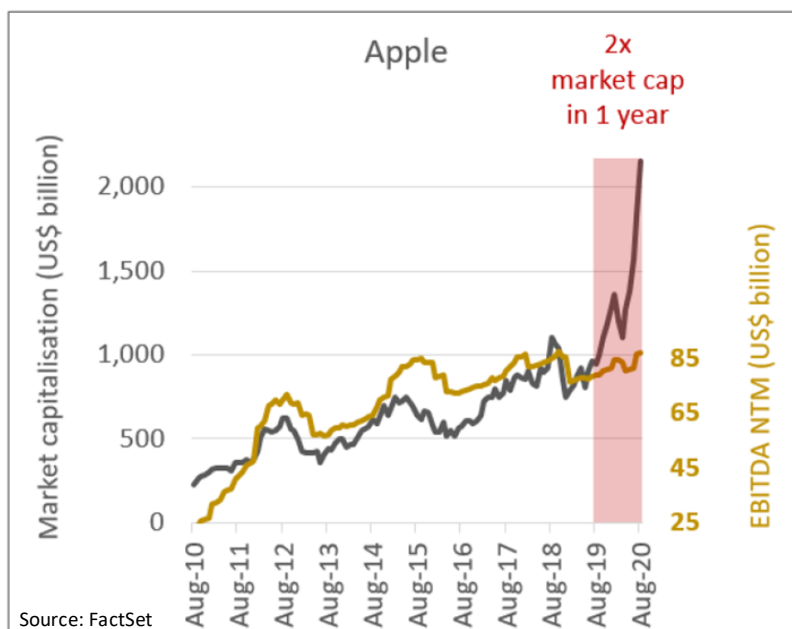
## Quarterly perspective | **the Markets**



Source: Refinitiv

Since its IPO in the 1970s, Walmart has delivered consistent earnings growth spanning multiple decades. For example, in the five-year period pre-and post the Dot-com peak its EPS (next twelve months) growth was 14.7% p.a. and 14.0% p.a. respectively. While its earnings growth was robust, its share price disconnected from fundamentals when it skyrocketed during the Dot-com boom. When the bubble popped its future earnings growth was not strong enough to offset the unwinding of its extreme PE multiple. Walmart was so overvalued (peak PE multiple of 49x) that it subsequently delivered a decade of zero returns.

The recent surge in valuation of some US mega companies makes the Walmart bubble look tame. During the Dot-com mania, Walmart's share price increased 59% during the 12-months prior to its peak in December 1999. In comparison, Apple's share price has surged about 150% for the 12 months to August 2020. The disconnect is more apparent when its market capitalisation is compared to its EBITDA (next twelve months) history. Over the last five years Apple's EBITDA has hardly grown, just 0.6% per annum, a clear sign that the company is maturing.

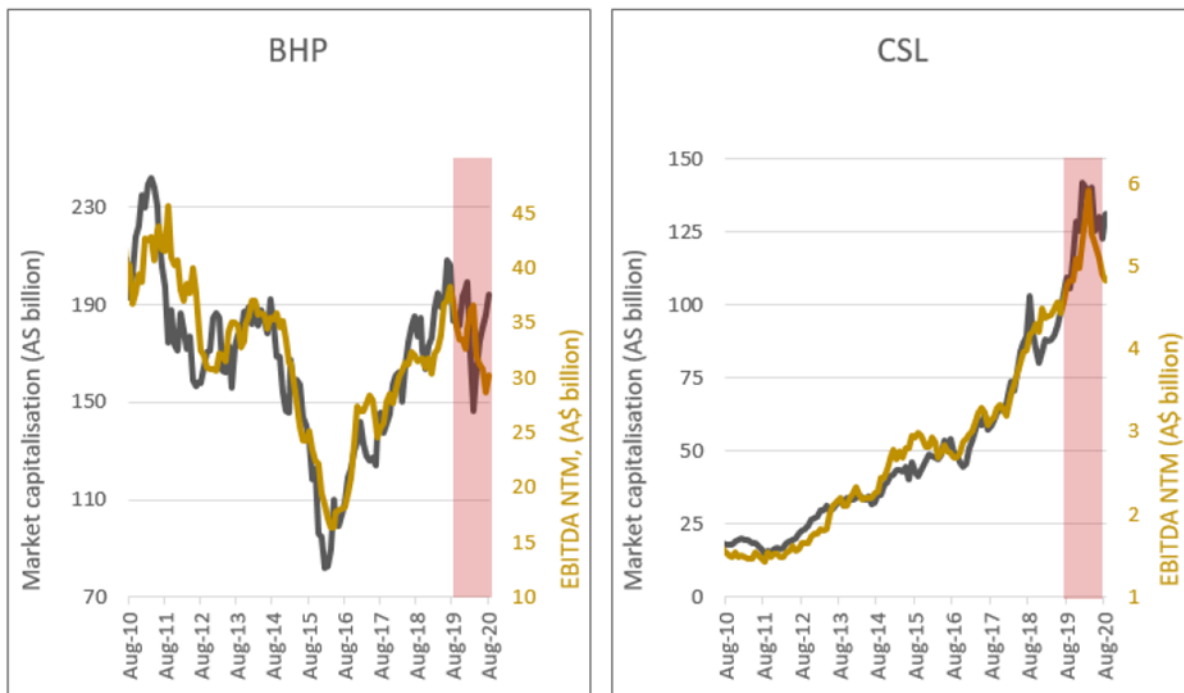


Source: FactSet

## Quarterly perspective | **the Markets**

It took Apple about 40 years following its IPO to be valued at US\$1 trillion. It took only one more year to add another US\$1 trillion to its valuation. Apple is currently the world's most valuable company by market capitalisation.

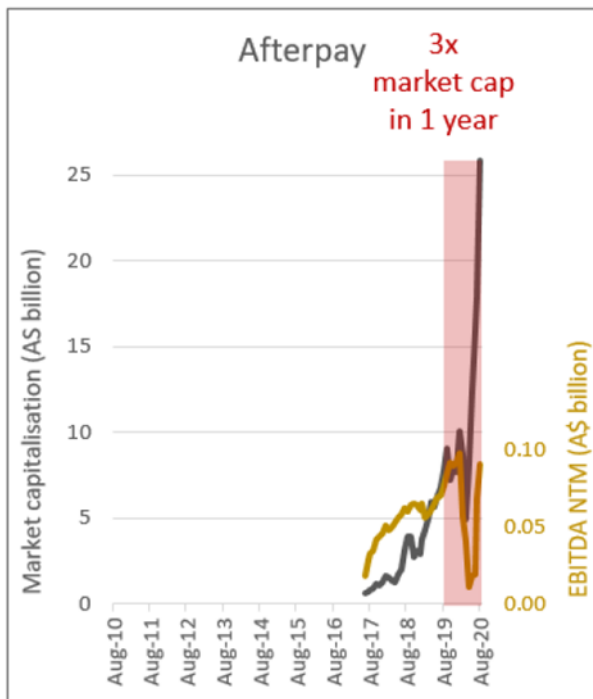
Fortunately, in Australia the disconnect between valuations and fundamentals are not as prevalent as the US stock market. For example, BHP and CSL's share prices have largely followed earnings estimates over the last 10 years, including the last 12 months, when market euphoria has been rife in many parts of the stock market.



Source: FactSet

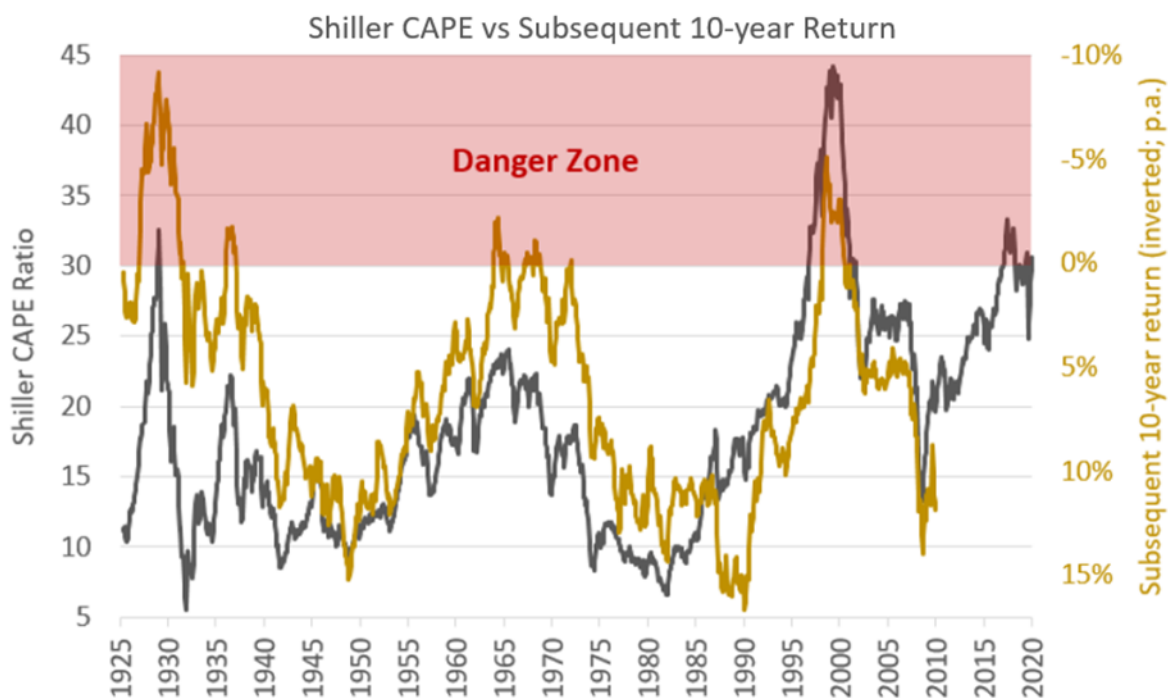
The pockets of speculation in the Australian market include the buy now, pay later sector led by Afterpay (APT). Over the last 12 months, APT's market capitalisation has tripled despite its EBITDA estimate being similar to levels a year ago. In other words, its current market capitalisation is implying that its future profit expectation is three times greater than a year ago. APT has surged to become the 16<sup>th</sup> largest stock by market capitalisation listed on the ASX.

# Quarterly perspective | **the Markets**



Source: FactSet

There have been a number of manias over the last century, which all ended badly. The chart below plots the Shiller CAPE ratio (PE ratio over the last 10 years of earnings adjusted for inflation) and the subsequent 10-year returns for the S&P500 (inverted).



Source: <http://www.econ.yale.edu/~shiller/data.htm>, Vertium

While the Shiller CAPE ratio does not help in guiding short to medium term returns, it provides a good barometer for long term returns. When valuations are extremely high the subsequent 10-year returns are low and vice versa. For example, the 1920s (roaring 20s), mid-60s (nifty fifty) and late 90s (Dot-com boom) were followed by negative 10-year returns.

## Quarterly perspective | **the Portfolio**

The Vertium Equity Income Fund delivered a total net return of 2.3% during the quarter, outperforming the market. The Fund also paid a 1 cent per unit distribution for the September quarter. This is in line with the Fund's objective of delivering higher levels of income than the benchmark over the coming year.

During the quarter, stocks that performed well for the Fund included positions in Auckland Airport (+18%), Aristocrat (+18%) and Charter Hall (CHC; +28%). These stocks were bought during the COVID Crisis when they were disproportionately sold by the market.

CHC was a classic case of the baby thrown out with the bathwater. Specifically, the malaise in the REIT sector dragged down the property fund manager as the market failed to differentiate between its business and other REITs that were more impacted by COVID.

When the COVID Crisis hit it became increasingly evident that CHC's funds management business was still relatively healthy. Specifically, CHC had a record year in FY20 when funds under management (FUM) grew to \$40.5 billion. The growth in FUM was aided by \$7.3 billion in acquisitions, implying an acquisition run rate of \$0.61 million per month. In the first two months of FY21, CHC had acquired about \$1.3 billion of property including the Ampol and Owen Illinois (Visy) portfolios. This implied an FY21 acquisition run rate of \$0.65 million per month. While it is still early in the financial year, CHC's acquisition run rate is currently stronger than their record FY20 year, despite the COVID pandemic. Management's conservative earnings guidance means that the company is likely to deliver positive earnings surprises over the coming year.

A laggard in the portfolio during the quarter was Aurizon (AZJ, -10.8%). AZJ's share price has recently drifted lower because of the poor sentiment associated with weak coal prices. While coal prices are highly cyclical, AZJ's business is more stable as it derives its earnings from transporting coal. About half of AZJ's business is a regulated monopoly that owns rail networks (below rail). The other half of its business owns the trains that transport coal via take or pay contracts (above rail). Furthermore, the company currently has excess capital of about \$1.2 billion, of which \$300 million is currently being returned to shareholders via an on-market share buyback.

At its current depressed share price AZJ is extremely attractive. Using the current market capitalisation as a starting point and assigning a conservative valuation to the 'below rail' business and corporate costs, the implied value for the 'above rail' business is extremely cheap.

### Implied Value of AZJ's Above Rail Business

	EBITDA(FY21)	Value (\$m)	Valuation Comment
Above Rail	626	1,212	Implied EV/EBITDA 1.9x
Below Rail	811	5,900	1x regulated asset base
Corporate	-14	-112	8x EV/EBITDA
Excess Capital		1,200	1x excess capital
Current Market Cap		8,200	

Source: Vertium

In other words, if the business was split apart (which the company has reviewed in the past) the implied enterprise value of the 'above rail' business can be bought for under 2x earnings. There is no company listed on the ASX that is valued with such a low valuation multiple.

## Quarterly perspective | **the Portfolio**

### **Concluding remarks**

Over the last several months, the COVID Crisis has created a highly uncertain environment for financial markets. The challenging environment of a fragile economic recovery mixed with high levels of speculation in certain areas of the stock market is best navigated with a capital preservation mindset.

In this complex environment the Fund remains disciplined in its approach to identifying mispriced investment opportunities and avoiding investment traps. The Fund is well positioned to deliver on its objectives of higher income, reasonable total return through time and preserving capital in falling markets.

We are grateful for managing your capital and thank you for your support. Please keep safe and healthy.