Investment Update

ara Financial Guidance

July 2021

INVESTMENT RETURNS to 30 June 2021						
	3 Months %	1 Year %	3 Years % p.a.	5 Years % p.a.	10 Years % p.a.	Since Inception % p.a.
ARA Investment Fund						
Defensive	3.0	7.4	3.4	3.6	3.9	4.7
Growth	6.1	17.2	6.2	6.3	6.3	6.2
Equities	6.6	19.3	7.0	6.9	6.5	7.0 (August 2003)
Long Term Income Builder	11.3	25.6	n/a	n/a	n/a	22.9 (March 2020)
ARA Retirement Fund – Accumulation (taxed)						
Defensive	3.0	6.7	3.1	3.2	3.6	3.9
Growth	6.2	16.0	6.0	5.9	5.9	5.6
Equities	6.6	17.7	6.8	6.3	6.1	6.1
ARA Retirement Fund – Pension (untaxed)						
Defensive	3.3	7.5	3.7	3.7	4.1	4.4
Growth	6.7	17.6	6.7	6.5	6.6	6.3
Equities	7.4	19.8	7.5	7.0	n/a	6.8 (October 2013)

Returns quoted are after all costs, and before the application of management fee rebates. Exclude commissions payable prior to 1/7/2006.

Return figures for the ARA Investment Fund are pre-tax and do not include the additional benefit of franking credits as the net result is dependent on individual investors' tax position. Assume the re-investment of distributions.

Return figures for the ARA Retirement Fund – Accumulation (Taxed) are net of all fees and tax on earnings at the statutory rate of 15%.
Return figures for the ARA Retirement Fund – Pension (Untaxed) are net of all fees and tax including the refund of franking credits.

3 month return figures are for the three months to 30 June 2021 and are not annualised. Past performance does not ensure or imply a future result.

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The recovery that began in the June quarter of last year has continued on right through this past financial year, enabling strong returns to be credited to our investors.

In fact, given that interest rates and inflation are at such historic lows, these are among the best "real" rates of return we've seen since the inception of our funds.

It's almost as if the downturn in the first half of 2020 was a strange dream. If it seems like it came and went in the blink of an eye, in historical terms that's not far from the truth.

In the past 40 years, there have been eight instances in which the Australian stock market fell by more than 20%, so it's not an uncommon occurrence. See the table below.

Date Market Peak	Market Index at Peak	Market Fall	Months Peak to Trough	Months to Recover	Total Duration
29/5/1981	735	-35.2%	10	18	28
21/9/1987	2306	-50.1%	1.5	74.5	76
29/8/1989	1782	-32.4%	17	29	46
3/2/1994	2338	-22.0%	12	20	32
8/3/2002	3428	-22.0%	12	13	25
1/11/2007	6854	-54.6%	16	125	141
11/4/2011	5065	-22.5%	5.5	16.5	22
22/2/2020	7255	-37.1%	1	13	14

The table shows the extent of each fall, how long it took to get from the top to the bottom, then how long to get back again. (Those events shaded in orange are interesting in that the next big downturn occurred before the recovery from the previous one was complete!)

As to this latest downturn, you will note:

- It was pretty savage – the third biggest fall in the past 40 years;
- It was also quick, the quickest from peak to trough in the table;
- However, the recovery was also the quickest, meaning that the whole thing was over in 14 months, the quickest of all such similar events in this period.

If there is a moral to this story it would be along the lines of:

- Big downturns happen regularly, on average every five years.
- There is always a recovery, but sometimes it can take a long time, unlike this latest one.

And as we've often said, a good way to hasten the recovery is to limit the fall in the first place, as per the maths in the table below.

Loss	Return required to recoup loss
-10%	11%
-20%	25%
-30%	43%
-40%	67%
-50%	100%

For the record, the stats for the ARA portfolios in respect of the latest downturn were:

Portfolio*	Portfolio fall	Months Peak to Trough	Months to recover	Total Duration
Defensive	-5.1%	1.5	4.5	6
Growth	-11.9%	1.5	7.5	9
Equities	-14.7%	1.5	7.5	9

*Fortunately the Long Term Income Builder portfolio avoided the downturn altogether – more about that later.

Where did the returns come from?

Pretty much across the board really, except for cash holdings which, as we've said before, are not there for stellar returns, but for liquidity and capital protection.

Among the largest holdings of "risk" assets – that is, the things that are meant to do the heavy lifting to generate incremental return above the cash rate - the major stock market holdings all did pretty well.

Financial year 2020/21 returns	
Anacacia Wattle Fund	34.6%
Sterling Equities	33.4%
River Capital Growth Fund	23.6%
World-ex US ETF	24.1%
Betashares Sustainability ETF	19.4%

We also got useful contributions from a number of private company investments. Of note, Cobram Estate, everyone's favourite Olive Oil producer, announced plans to list on the stock market, which has allowed a re-assessment of its book value – up about 56% for the quarter with maybe a bit more to come when the actual listing happens. A really good local success story!

So, what now? Things have run pretty hard for some time, spurred on by ultra-low interest rates and massive stimulus programmes around the world aimed at assisting recovery from the pandemic effects and stimulating economic growth. But there is no shortage of risks either. What's the plan from here?

Well, it's back to the fabulous fridge chart for a clue – see below. According to the chart, US shares remain off-the-dial expensive. But, despite having moved up considerably, it seems there is still value in the Australian stock market at current levels, and major markets outside the US.

So that remains our position in the diversified portfolios. Strong performance dictates that we take some profits off the table and thereby de-risk the portfolios somewhat, but for now we maintain target weightings or thereabouts in Australia and the World ex-US with little or no direct exposure to the US.

Australian Shares

ASX All Ords	10-yr forecast return	Status
7615		
9500	1.5%	Overpriced
9250	1.9%	
9000	2.2%	
8750	2.6%	Fully priced
8500	3.0%	
8250	3.4%	
8000	3.9%	
7750	4.3%	
7500	4.8%	
7250	5.3%	Fair value
7000	5.8%	
6750	6.4%	
6500	7.0%	
6250	7.6%	
6000	8.2%	Cheap
5750	8.9%	
5500	9.7%	

US Shares

S&P500	10-yr forecast return	Status
4321		
4600	-0.4%	
4400	0.1%	Overpriced
4200	0.6%	
4000	1.2%	
3800	1.8%	
3600	2.4%	Fully priced
3400	3.1%	
3200	3.8%	
3000	4.6%	
2900	5.0%	
2800	5.4%	Fair value
2700	5.9%	
2600	6.3%	
2500	6.8%	
2400	7.4%	Cheap
2300	7.9%	
2200	8.5%	

World Ex-US Shares

FTSE World Ex-US	10-yr forecast return	Status
323		
510	0.9%	Overpriced
490	1.3%	
470	1.8%	
450	2.3%	
430	2.8%	Fully priced
410	3.3%	
390	3.9%	
370	4.5%	
350	5.1%	
340	5.5%	Fair value
330	5.8%	
320	6.2%	
310	6.6%	
300	7.0%	
290	7.4%	Cheap
280	7.8%	
270	8.3%	

Long Term Income Builder

Our latest portfolio offering (aka my new best friend) completed its first full financial year with something of a flourish, although maybe not in exactly the way it was envisaged.

To recap, the aim behind this portfolio is to provide an attractive income stream arising from dividends paid by companies listed on the Australian Stock Exchange. That income target is around 4% per annum plus franking credits, with some underlying growth in value as well to keep pace with inflation.

The core of the portfolio is a range of large Listed Investment Companies (LICs) – companies that trade on the stock market whose principle business is investing shareholders' funds in a range of other companies. Those we have chosen have a specific mandate of generating stable, growing dividend income streams.

In fact for its first year the portfolio's gross dividend yield will be more like 3%. This is largely because in the wake of the pandemic many companies cut their dividends to preserve cash and shore up the shop. In fact the banks, traditional dividend favourites, were ordered by the regulator APRA to restrict their dividend payouts.

In the meantime though, the portfolio appreciated in value by over 20% for the year. As consolation prizes go, could be worse! This was in part due to fortunate timing in avoiding the market downturn in early 2020 and subsequently being able to buy up stocks at lower prices. And then late in the year one of our largest holdings, Milton Corporation, announced a merger with WH Soul Pattinson, which pushed its price up over 20%. Handy.

We would expect things to revert to a more "normal" situation in the coming year or two – that is, a higher dividend yield and a more realistic growth rate. There is plenty of suggestion that companies will restore their dividend payments, and APRA has lifted its restriction on the banks – in fact there are whispers of special extra dividends from banks that find themselves flush with cash.

So we have taken the opportunistic step of adding additional bank exposure to the portfolio, at least for the short-medium term, to take advantage of this possibility.

If we do a "look-through" to see which companies make up the bulk of the portfolio, it currently looks like this:

Long Term Income Builder Major holdings	
Commonwealth Bank	7.9%
Westpac	7.3%
Macquarie Group	6.4%
National Australia Bank	5.0%
BHP	4.9%
CSL	4.5%
ANZ Bank	3.2%
Wesfarmers	3.2%
Woolworths	2.9%
WH Soul Pattinson	2.7%
Transurban	2.5%
Telstra	1.8%
Rio Tinto	1.8%
Amcor	1.3%
Eagers Automotive	1.3%
Aust. Stock Exchange	1.1%
Sydney Airport	0.8%
Mainfreight	0.7%
Brickworks	0.7%
Coles	0.6%

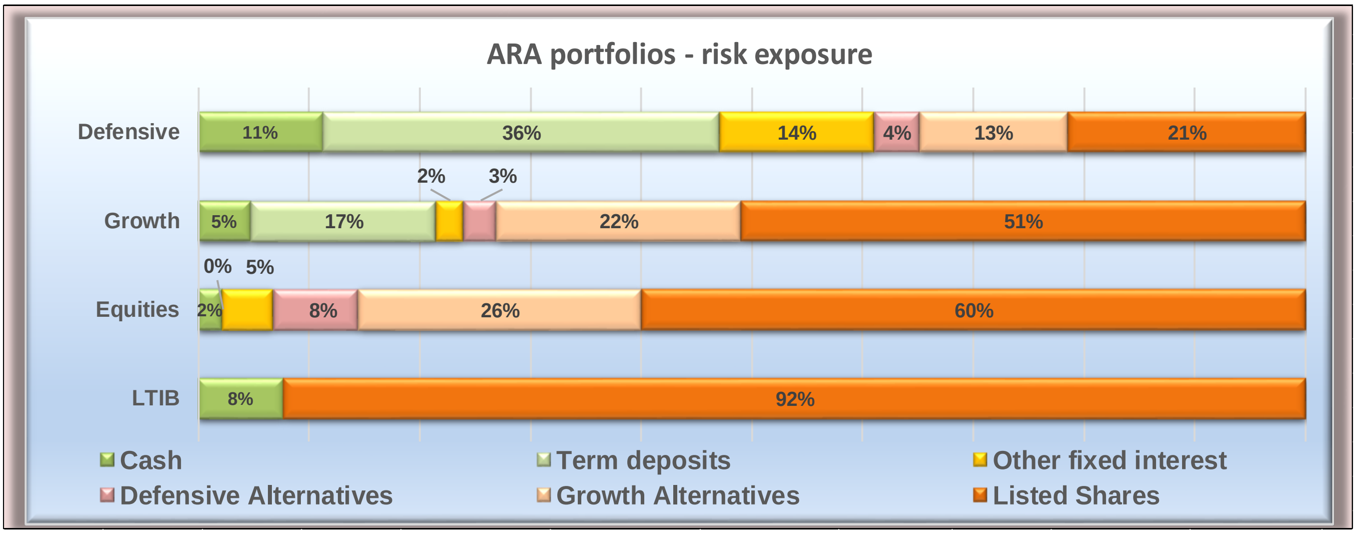
These are the 20 largest holdings at present, accounting for just over 60% of the portfolio. As mentioned, by design it's a bit bank-heavier than usual in anticipation of a pick-up in banks' dividends. This will normalise in due course.

It's also worth noting that companies usually pay dividends twice a year. We pay out income as and when it is received, so typically the Long Term Income Builder will also generally pay two distributions a year, not four.

So, who's got what?

The table below shows the ARAIF's investments at the time of writing. Please note, the percentages refer to the proportion of each portfolio allocated to that investment, not its rate of return.

	Asset Class	Defensive Portfolio	Growth Portfolio	Equities Portfolio	Long Term Income Builder
National Australia Bank Cash account	Cash & Tier 1 Fixed Interest	2.8%	2.7%	2.3%	7.7%
Bank Term Deposits		22.9%	14.6%	0.0%	
Challenger Life Guaranteed Annuities		12.8%	2.2%	0.0%	
Coolabah Cash Fund		2.6%	1.3%	0.0%	
GCI Capital Stable Fund		6.0%	0.7%	0.0%	
Coolabah Active Credit Fund	Other Fixed Interest	10.1%	0.0%	0.0%	
River Capital Global Credit		3.4%	1.4%	3.9%	
Other credit		0.5%	1.0%	0.7%	
River Capital Growth Fund	Listed Securities	3.0%	8.1%	6.7%	
Sterling Equity		7.4%	9.8%	11.4%	
Anacacia Wattle Fund		5.9%	12.9%	9.5%	
Betashares Aust Sustainable ETF		1.4%	2.4%	11.0%	
Vanguard World Ex-US ETF		3.1%	16.1%	17.3%	
Anacacia Global Fund		0.7%	1.8%	4.0%	
Listed Investment Companies		0.0%	0.0%	0.0%	80.7%
Van Eck Banks ETF		0.0%	0.0%	0.0%	11.6%
Anacacia Capital	Alternative assets (Growth)	1.3%	10.0%	12.6%	
Cobram Estate		2.6%	2.4%	1.2%	
Polaris Marine		0.8%	1.2%	0.8%	
Morrison Utilities Trust		0.0%	4.5%	2.2%	
Proserpine Capital Partners		4.1%	1.7%	1.4%	
Performance Equity Mgrs Fund 4		0.4%	0.8%	1.4%	
JP Morgan Global Opportunities		4.2%	1.5%	2.0%	
Gold ETF		0.0%	0.0%	4.0%	
Infradebt	Alternative assets (Defensive)	0.0%	1.5%	5.6%	
JCB Dynamic Alpha Fund		4.0%	1.4%	2.0%	
		100.0%	**100.0%**	**100.0%**	**100.0%**



Major Holdings – diversified portfolios

Apart from bank deposits and other interest-bearing accounts, Defensive, Growth and Equities portfolios invest in a range of assets through the fund managers listed in the table above. If we drill through to the assets selected and overseen by those managers, there are in fact over a hundred individual securities providing diversification of risk and exposure to a wide range of opportunities.

The table below shows the 20 largest individual holdings and what proportion of each portfolio they represent. These are the investments that will have the biggest impact on the portfolios' returns.

Investment	Type	Principal Activity	Defensive Portfolio Exposure	Growth Portfolio Exposure	Equities Portfolio Exposure
Cobram Estate	Private company	Olive oil producer	2.6%	2.4%	1.2%
Direct Couriers	Private company	Transport & logistics	0.0%	1.9%	2.6%
Schaffer	ASX listed company	Diversified industrial	1.4%	1.9%	2.2%
Westpac Bank	ASX listed company	Banking & financial services	1.3%	1.8%	2.1%
Nearmap	ASX listed company	Aerial imaging	1.2%	1.6%	1.8%
Sureway	Private company	Employment services	0.0%	1.6%	2.1%
Infradebt	Private trust	Infrastructure lending	0.0%	1.5%	5.6%
Perth Airport	Infrastructure	Transport hub	0.0%	1.5%	0.7%
Big River Industries	ASX listed company	Building supplies	0.8%	1.4%	1.3%
Objective Corporation	ASX listed company	Software solutions	0.7%	1.4%	1.1%
Data#3 Ltd	ASX listed company	Info and comm's technology	0.6&	1.3%	1.0%
3PLearning	ASX listed company	Online education software	1.0%	1.3%	1.5%
Polaris Marine	Private company	Marine services	0.8%	1.2%	0.8%
SmartPay	Private company	Financial services	0.5%	1.2%	0.9%
Opteon	Private company	Property services	0.0%	1.2%	1.6%
Quota Trust	Private trust	Statutory fishing rights	3.9%	1.1%	1.1%
IRESS	ASX listed company	Financial services	0.8%	1.1%	1.3%
PWR Holdings	ASX listed company	Cooling equipment	0.4%	0.9%	0.7%
Force Fire	Private company	Fire safety services	0.5%	0.9%	0.8%
MWave	Private company	Ecommerce	0.5%	0.9%	0.8%

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