BLACKMORE CAPITAL
EQUITY INVESTORS

Australian Equities Income Portfolio

Q4 FY20 Quarterly Investor Letter | June 2020

> "While the US economy was recovering more quickly than anticipated, big risks remain as a result of the stubborn persistence of the virus."
>
> Jay Powell, Chair of the Federal Reserve

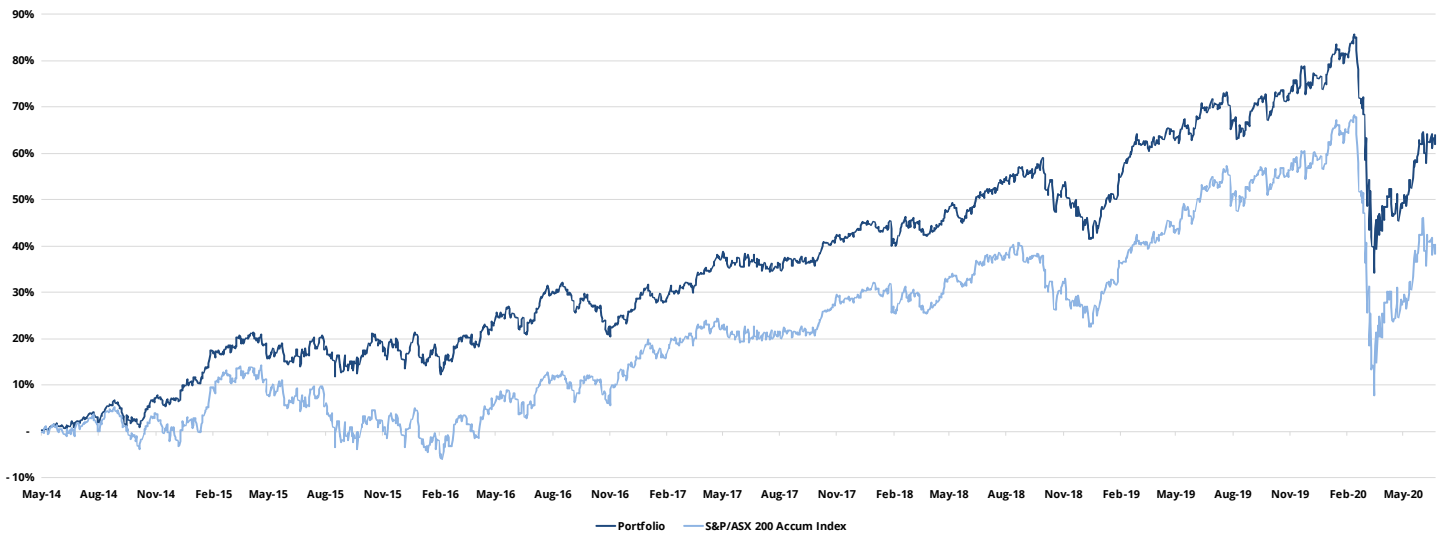
Equity markets rallied sharply during the June quarter as expectations of a global economic revival underpinned sentiment for risk assets. The COVID-19 pandemic has created what is potentially both the shortest bear market and quickest bull market in Australian history. The ASX 200 has rebounded over 30% since its March 23 low. Rising expectations for a faster than expected earnings recovery have encouraged investors to ignore elevated short-term earnings multiples, with the ASX 200 trading on a 12-month forward PE of circa 18 times, a 26% premium to its long-term average.

The arrival of unprecedented fiscal and monetary stimulus has underpinned a rapid recovery in the global economy. The global manufacturing and service PMI's rebounded in June and are now back above 50 (signaling an expansion compared to the previous month) in many economies. However, the dramatic resurgence in confirmed COVID-19 cases as resulted in authorities in the US and now in Australia either pausing or reversing reopening of their economies. The pathway back to economic and social normality will not be linear, with the likelihood of corporate earnings not recovering to their September 2019 peak until well into FY22. As such, the Blackmore Capital equity portfolios remain firmly tilted to companies with defensive growth characteristics.

The Australian Income Equity Portfolio finished the June quarter up 15.18% compared to the ASX 200 Accumulation Index up 16.48%. Positive attribution for the Australian Income Equity Portfolio was driven by BHP Group (BHP), Macquarie Group (MQG), and Wesfarmers (WES). Whereas, CSL Limited (CSL), Telstra (TLS) and Chorus (CNU) weighed negatively on attribution.

For the **2020 financial year** the Australian Income Portfolio fell 3.74% (-2.64% inclusive of franking credits) compared to the ASX 200 Accumulation down 7.68%. Positive attribution for the Australian Income Portfolio was Wesfarmers (WES), Ampol (ALD), and Woolworths (WOW). Whereas, National Australia Bank (NAB), Commonwealth Bank (CBA) and Brambles (BXB) weighed negatively on attribution.

Investment Performance since Inception (%)



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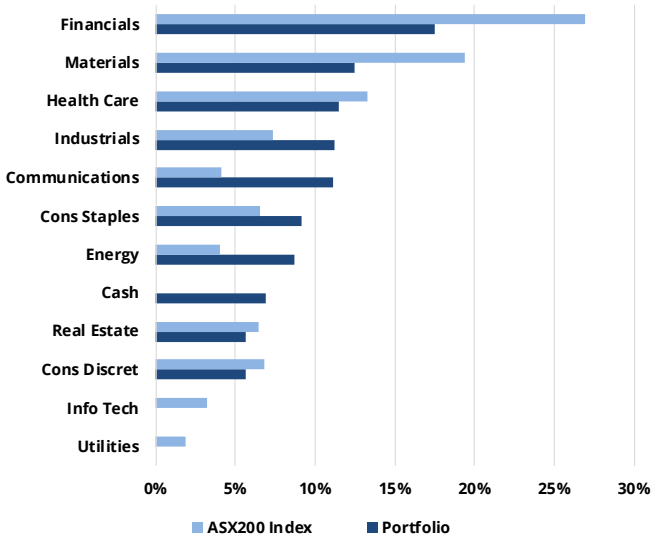
Portfolio returns

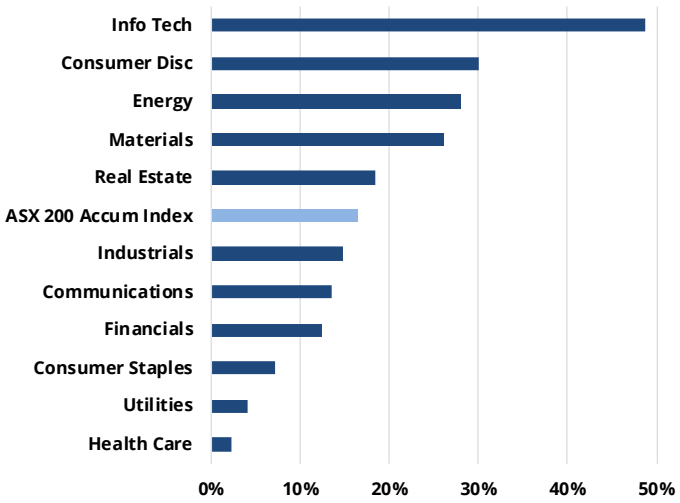
	1 mth	3 mths	6 mths	FYTD	1 Yr	3 Yr	5 Yr	Inception p.a	Since inception	FY15	FY16	FY17	FY18	FY19	FY20
Portfolio performance	3.7	15.2	-5.6	-2.9	-2.9	6.3	7.4	8.4	64.0	13.6	7.7	10.5	10.8	11.8	-2.9
ASX 200 Accum Index	2.6	16.5	-10.4	-7.7	-7.7	5.2	6.0	5.7	40.2	5.7	0.6	14.1	13.0	11.5	-7.7
Relative performance	1.1	-1.3	4.8	4.8	4.8	1.1	1.5	2.7	23.7	7.9	7.1	-3.6	-2.2	0.3	4.8

Figures shown are before fees and inclusive of franking credits

Relative sector weights - June 2020



Sector returns - Q4 FY2020



The Search for Sustainable Yield

The impact of COVID-19 pandemic has accelerated the compression of yield for financial assets.

Expectations of earnings declines in the upcoming FY20 reporting season could herald one of the largest reductions in dividends in Australian corporate history, magnified by dramatic cuts in bank dividends. The search for dividend sustainability has become of paramount importance for investors particularly as yields for cash & bonds have evaporated.

During the June Quarter Blackmore Capital added to a group of companies that are well placed to deliver sustainable dividends in coming years.

Goodman Group (GMG)
The company's focus on urban warehousing and logistics property ownership, management and development has been an advantage relative to the broader property asset class during the past decade and increasingly during COVID-19. Its long-term drivers of growth from supply chain consolidation, increasing inventory levels, e-commerce expansion and data storage capacity have experienced growth through the asymmetrical economic impacts of virus lockdowns and changes in consumer behaviour.

GMG's ability to reaffirm its earnings guidance and distribution, with the conservative position of its balance sheet reflects the acumen of highly invested entrepreneurial management. GMG's balance sheet reflects the lessons of the GFC, with gearing of circa 10% at the low end of its 0-25% range, accompanied by ample liquidity and its modest payout ratio of c.50%.

CHORUS

Chorus Limited (CNU)
Chorus Ltd is New Zealand's major wholesale telecommunications infrastructure provider to telephone and broadband service retailers. It owns most of the country's telephone lines and exchanges and is responsible for building ~70% of the Ultra-Fast Broadband (UFB) network, due for completion in 2022. In 2011 Chorus was demerged from Spark, the privatised Telecom NZ, to participate in the UFB project. It is now the largest owner and manager of the open access internet network, with more than 1.5m broadband connections.

The company's product portfolio encompasses a range of wholesale broadband, data and voice services across a mix of regulated, contracted, and commercial products. Declining connections for copper services are offset by growing broadband connections and increasing data usage on the UFB network. While there remains an element of regulatory uncertainty for the post 2022 period, the company's capex will step down considerably and it will transition to a dividend policy based on a pay-out range of free cash flow. This should result in a step up in the annual dividend into FY23-24, with sustainable modest growth beyond. In the current environment of extremely low interest rates and extremely high uncertainty, Chorus exhibits a low risk profile and a 3.2% dividend yield with potentially substantial growth into the mid-2020's.

Waypoint REIT

Waypoint REIT (WPR, formerly Viva Energy REIT)
The Trust was listed in 2016 to hold Viva Energy Australia's portfolio of Shell service stations convenience retail properties. The 469 properties are geographically diversified with 73% by value located in metropolitan areas, valued at approximately $2.65b with a capitalisation rate of 5.8%.

The distinguishing characteristics of the portfolio are its long weighted average lease expiry of 11.7 years, fixed annual 3% rental reviews and that 92% of the portfolio's income is derived from triple net leases, under which the tenant is responsible for all property outgoings and capital expenditure. These characteristics are particularly attractive during a period when the retail, office and residential property asset classes face challenging conditions for maintaining and growing income and asset values.

With gearing at 30.4% versus the target range of 30-45% and a yield of 5.6%, we consider Waypoint's income well secured and capable of modest growth through annual reviews and ongoing acquisitions. Under the internalisation announced in February with the exit of Viva Energy from the register, Viva's pre-emptive rights over the remaining properties it leases from external parties have been grandfathered to Waypoint until 2030 and there are no change of control clauses to hinder any corporate interest in Waypoint. New management appointed under the internalisation is also reviewing the portfolio for value adding opportunities and alternative uses in the longer term.

Investment Conclusion

The June quarter has enjoyed strong equity returns, led by valuation expansion. Equity markets have been buoyed by unrivalled fiscal stimulus measures and improved earnings momentum. However, the strong rebound in economic activity that has supported risk assets since April now appears likely to moderate as governments reimpose restrictions due a to resurgence in COVID-19. Our preference remains firmly weighted towards companies that exhibit durability in their earnings and are equipped with a balance sheet that can withstand the buffeting winds of uncertainty.

Marcus Bogdan
Chief Investment Officer

Richard Colquhoun
Portfolio Manager

Appendix

Portfolio Objective

The portfolio seeks to deliver long term growth in both capital and income by investing in Australian listed equities. The portfolio aims to do so with lower volatility and greater downside protection relative to the S&P/ASX 200 Accumulation Index.

Investment Principles

Our investment approach aims to generate long-term risk adjusted returns, by investing in companies that focus on producing high-quality earnings and operate in industries that exhibit favourable long-term growth prospects. More broadly, we consider a range of attributes which we view as important qualities in the companies we invest in. We construct and manage the Australian Equities Income Portfolio with eight consistent guiding principles:

- Grow capital and income over the long term;
- Focus on the quality of company earnings;
- Identify quality assets at an attractive valuation;
- Generate a suitable return on capital employed;
- Invest in companies operating in robust industry structures;
- Select for balance sheet latency and sustainability of dividend income;
- A corporate governance structure that actively promotes alignment with key stakeholders; and
- A vigilant process of portfolio risk analysis.

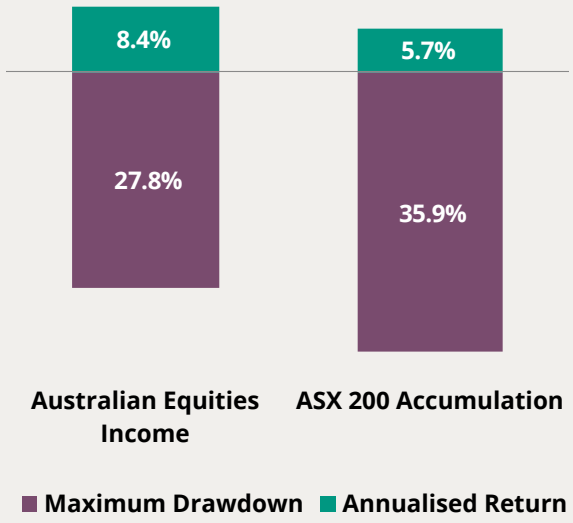
Benefits of Active Management

Performance and Risk (%) Comparison since Inception

A key benefit of active portfolio management is the recognition that return, and risk are inseparable. A core portfolio objective of the Australian Income Portfolio is to generate returns that exhibit lower volatility and greater downside protection relative to the ASX 200 benchmark index. The accompanying chart illustrates the value of understanding the interlocking nature of return and risk.

The chart below shows both the annualised return (green bar) generated by the Australian Income Portfolio compared with ASX 200 Accumulation Index, and the maximum loss/drawdown (purple bar) in the value of the portfolio compared to the ASX 200 Accumulation Index since the inception of the portfolio in May 2014. Maximum drawdown measures the magnitude of the worst loss an investor would have incurred by investing in the portfolio or benchmark. Drawdown is a useful measure of risk management, as it indicates the portfolio's response to periods of market stress as well as the relative sensitivities to market risk.

Return and Drawdown since Inception



Our investment stance is predicated by two central tenets:

- At a portfolio level we want to broadly participate when equity markets rise, but importantly we want the portfolio to be able to decline less when the market declines; and
- With a portfolio buttressed by a solid cash position, we can be more assertive in participating when the market is low, thus providing a better chance in participating meaningfully in a subsequent market recovery.

Platform availability

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Performance of the Blackmore Capital Australian Equities Income Portfolio is based on a model portfolio and is gross of investment management and administration fees, but net of transaction costs. The total return performance figures quoted are historical and do not allow the effects of income tax or inflation. Total returns assume the reinvestment of all portfolio income. Past performance is not a reliable indicator of future performance. The performance comparison since inception is for illustrative purposes only. Performance is calculated on a gross basis. Actual performance will vary depending on the amount of fees charged by the relevant platform that a client uses to implement the portfolio. The comparison with the S&P/ASX 200 Accumulation Index is for illustrative purposes only. Index returns do not allow for transaction, management, operational or tax costs. An index is not managed and investors cannot invest directly an in index. There is no guarantee these objectives will be met.

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