# MONTHLY PERFORMANCE REPORT
## March 2020

The portfolio returned -23.2% for the month, compared with -20.65% for the S&P/ASX200 Accumulation Index. The Fund has achieved its returns with lower volatility than the S&P/ASX 200, as a consequence of the stocks selected by the investment process which is designed to eliminate high risk stocks therefore avoiding the chance of permanent loss of investor capital.

### GENERAL INFORMATION

**Base Currency**: AUD

**Entity Type**: Strategy

**PMs**: Neill Colledge
Marcel von Pfyffer

**Launch date**: Jul-2018

**Benchmark**: ASX200 TR

**Fees:** 0.8% and 10% +GST

**Domicile**: Australia

**Close of Financial Year**: 30th June

**Dealing:** Daily

| PERFORMANCE (Inception JUL-2018) | Arminius Capital ALCE Strategy | S&P/ASX200 Accumulation Index (AUD) |
|---|---|---|
| 1 Month | **-23.20%** | -20.65% |
| 3 Months | **-26.04%** | -24.46% |
| Calendar YTD | **-26.04%** | -24.46% |
| 1 Year | **-16.66%** | -14.35% |
| 3 Years | **N/A** | N/A |
| 5 Years | **N/A** | N/A |
| **Cumulative since Inception July 2018** | **-13.04%** | **-6.73%** |

*All returns data for Arminius Capital ALCE Strategy and index data are sourced from the **HUB24** platform, which ALCE is available upon.*

Arminius Capital ALCE Strategy (Inception July-2018) Returns are net of fees

| % | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | **CY** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2018 | - | - | - | - | **INCEPTION =>** | | -0.05% | 0.99% | -3.17% | -7.46% | -2.66% | -4.58% | N/A |
| 2019 | 1.97% | 4.67% | 2.58% | 2.37% | 0.95% | 1.84% | 4.09% | -0.39% | 1.48% | -1.52% | 2.01% | -2.41% | 21.50% |
| 2020 | 3.48% | -6.87% | -23.2% | | | | | | | | | | -26.04% |

### INVESTMENT MANAGER

Arminius Capital Management Pty Ltd
AFSR 001244100
ACN 611519334
Licensed by:
Arminius Capital Advisory Pty Ltd
AFSL 461307
ACN 165509928

### DISTRIBUTION DETAILS

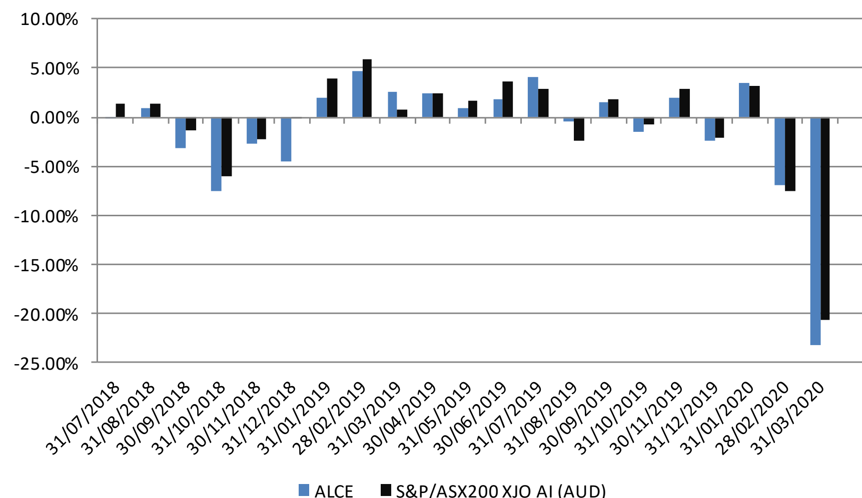
Arminius Capital Management
115 Wickham St
Fortitude Valley
QLD 4006
AUSTRALIA
+61 7 3040 9104
info@arminiuscapital.com.au

**STRATEGY OBJECTIVES:**
The aim of the ALCE (Australian Low Correlation Equities) portfolio is to outperform the S&P/ASX 200 (TR) Index over rolling 5-year periods. The portfolio will also aim to deliver above market dividend income and lower volatility than the S&P/ASX 200 (TR) Index. The investment process starts with taking the constituents of the investment universe, the S&P/ASX200, and applying quantitative filters to screen out companies which have high volatility or low dividend yield or low earnings quality. The objective is not to maximise returns, but rather to eliminate high risk stocks.

**INVESTMENT STRATEGY:** The investment strategy underlying this portfolio is founded on the belief that (i) stocks with above-average dividend yields tend to outperform in the long term, provided that a filter for earnings quality is applied and (ii) low volatility stocks tend to outperform in the long term, especially if a valuation measure is added to the stock selection process.

The portfolio is designed for investors who (i) are seeking exposure to a concentrated core portfolio of Australian equities with returns comprising of both capital appreciation and income; (ii) accept the risk of price fluctuations particularly over periods less than the minimum investment timeframe and accept that capital preservation is not guaranteed; and (iii) are prepared to invest for the minimum investment timeframe of five years.

***Portfolio performance statistics will be provided as soon as the ALCE portfolio has sufficient history to be meaningful.***




**DISCLAIMER:** This report is made for information purposes only, reflecting Arminius' interpretation of a specific historic period, source referenced from the prime broker "Interactive Brokers" proprietary reporting software "*PortfolioAnalyst*". All other data is sourced from FACTSET and Hedge Fund Research Inc. This report is only made to investors who are wholesale clients (as defined in section 761G of the Corporations Act 2001) or which do not otherwise require the provision of a Product Disclosure Statement under Division 2 of Part 7.9 of the Corporations Act. This report does not constitute a Product Disclosure Statement, prospectus or other disclosure document within the meaning of the Corporations Act. It has not been, and is not required to be, lodged with the Australian Securities and Investments Commission under the Corporations Act 2001.

## INVESTMENT PERFORMANCE

The ALCE portfolio returned negative 23.2% in March, 255 basis points worse than the negative 20.65% return from its benchmark, the S&P/ASX200 accumulation index.

The five largest favourable movements in the ALCE portfolio during March were Coles (+3.3%), APA (-5.4%), Amcor (-10.3%), AGL (-11.9%), and Orora (-12.3%). The largest negative movements were Vicinity (-54.6%), Stockland (-48.0%), IOOF (-38.6%), Macquarie (-38.5%), and QBE (-37.5%). At month-end the Fund's largest holdings were Wesfarmers, ANZ Bank, National Australia Bank, Coles, and Transurban. There were no changes to the portfolio during the month.

Daily price movements in Australian and US shares ("volatility") are currently six times as large as they usually are. Price changes of **20% in a day** – up as well as down – have now become common. In these conditions the values of all portfolios fluctuate wildly, and the ALCE portfolio has been far above the benchmark one day and far below it the next. **We are confident that the companies in the ALCE portfolio will recover in due course, because they are *not* in the industries which are most seriously affected by the pandemic**, such as transport, travel, tourism and hospitality.

We remind our investors of a Reserve Bank study published in June 2019, which calculated that, **over the past century, the average return from the ASX was 10.2% per year**. This return of 10.2% per year is what you would get if you had invested in 1916 and kept holding the shares, re-investing dividends and changing the portfolio as the top 100 companies changed. This comprises an average return from dividends of 4% per year and an average return from rising share prices of 6% per year. It is important to remember this average return of 10.2% includes the negative effects of all the bad years. If the investor doesn't panic and doesn't crystallize his unrealized losses, a diversified portfolio will recover and keep growing. (***Source: Matthews, T. 2019. A History of Australian Equities. RBA Research Discussion paper 2019-04, page 12, Table 2.***)

In our January report, we warned that a sharp correction was likely because global markets had underestimated the impact of COVID-19. After a slow start in late February, the correction accelerated into a full-on panic in March. The panic was triggered by news that COVID-19 was spreading rapidly throughout the world. Capital markets had adjusted to the "supply shock" caused by the lockdown of the Chinese economy from 23 January on, which had disrupted supply chains in industries ranging from cars to pharmaceuticals. Investors now realized that the spread of COVID-19 would lead to similar lockdowns in the affected countries, slashing demand for goods and services as people lost their jobs and were forced to "shelter in place".

The US S&P500 price index crashed by -33% in record time, from a peak of 3386 on 19 Feb to a trough of 2237 on 23 March, before recovering to 2585 by month-end. The S&P/ASX200 plunged -21%, the Stoxx Europe 600 slumped -17%, and Japan's Nikkei 225 slid -11%. The Shanghai Composite price index fell only -5%, supported by State buying.

Commodities have joined in the wild ride. Oil prices collapsed from USD65 in January to USD25 in March. The initial cause was the economic lockdown in China which suppressed the demand for oil as a transport fuel in cars and planes. Then Russia and Saudi Arabia started an oil price war with the intention of driving US shale oil producers out of business. In early March the Australian dollar was trading at USD 67c, but by 19 March it had plunged to USD 57c, before staging a half-hearted recovery to USD 60c by 31 March. Nor have bond markets been exempt from the turmoil: yields have fallen as central banks cut cash rates, and investors have exited equities in favour of cash and government bonds.

## MARKET OUTLOOK

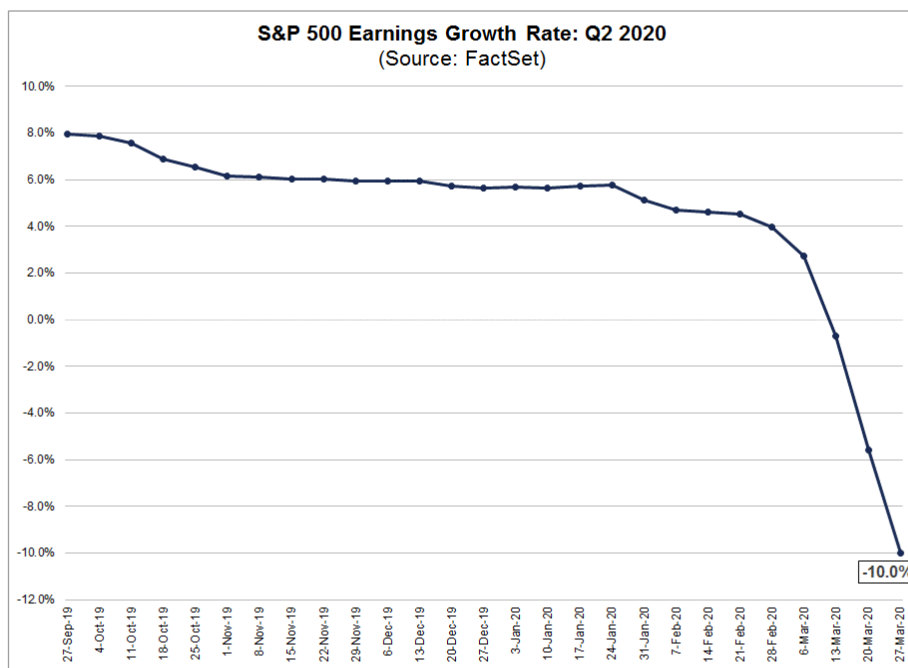
Has the panic stopped? Only temporarily, because there is a lot more bad news to come out of the US and Europe. Despite having some of the world's best epidemiologists, the US government has failed miserably in

**DISCLAIMER:** This report is made for information purposes only, reflecting Arminius' interpretation of a specific historic period, source referenced from the prime broker "Interactive Brokers" proprietary reporting software "*PortfolioAnalyst*". All other data is sourced from FACTSET and Hedge Fund Research Inc. This report is only made to investors who are wholesale clients (as defined in section 761G of the Corporations Act 2001) or which do not otherwise require the provision of a Product Disclosure Statement under Division 2 of Part 7.9 of the Corporations Act. This report does not constitute a Product Disclosure Statement, prospectus or other disclosure document within the meaning of the Corporations Act. It has not been, and is not required to be, lodged with the Australian Securities and Investments Commission under the Corporations Act 2001.

preparing for the COVID-19 pandemic, even though it has two months of advance warning clearly visible in China. The US does not have enough tests to identify the disease carriers and it has not devoted enough resources to contact tracing. Hospitals do not have enough masks and other equipment to protect medical staff, nor do they have enough ICU beds or ventilators to treat the seriously ill. COVID-19 will continue to spread because quarantines and lockdowns are being applied erratically by a patchwork quilt of State and county and city authorities. President Trump recently admitted that 100,000 to 240,000 Americans might die from COVID-19: any realistic model of the epidemic can predict over 1,000,000 deaths.

Hospitals in the wealthy States of California and New York are barely coping at present. Once COVID-19 spreads south of Virginia, case fatality rates will be higher because the population in the South is less healthy and the hospital systems are under-resourced. Chronic conditions such as diabetes, obesity, heart disease, hypertension, cancer and lung disease are more common, even among people under sixty. These are of course the co-morbidities which make COVID-19 more likely to kill you. The Southern States are not only poorer, they have historically spent much less on healthcare – currently under USD30 per head, compared to USD84 in New York. The worst affected communities will be prisons and retirement facilities.

The chart below shows how forecasts for S&P500 earnings growth in the June 2020 quarter have changed over the last six months. When China shut down on 23 January, the market was expecting 6% growth year-on-year. At end-February the forecast was still 4%. Now it is minus 10%, and there is worse to come.




Regardless of what happens in China and Europe, the US will be in recession from March to September at a minimum. The official statistics for March say that the number of jobs fell by 700,000, and that the unemployment rate leapt from 3.5% in February to 4.4% because an extra 1.35 million people started looking for work. These figures only take into account the very beginning of the problem. We know that things are going to get worse because the last two weeks have seen **ten million Americans** apply for unemployment benefits.

How bad will it get? We were pessimistic early, and we still are pessimistic. China may succeed in re-starting its economy without re-starting COVID-19, but if it doesn't, lockdowns will be reimposed. Europe may manage to contain the pandemic in certain areas, but the US is headed for a major outbreak. COVID-19 may recede in the northern hemisphere summer, but if it does, the "second wave" will arrive next winter – just as the Spanish Flu did in 1918. The coronavirus will of course mutate from the present eight strains, and the new mutations may be more dangerous. No vaccine or treatment will be available in mass quantities before mid-2021 (and no vaccines have been found for any coronaviruses so far).

**DISCLAIMER:** This report is made for information purposes only, reflecting Arminius' interpretation of a specific historic period, source referenced from the prime broker "Interactive Brokers" proprietary reporting software "*PortfolioAnalyst*". All other data is sourced from FACTSET and Hedge Fund Research Inc. This report is only made to investors who are wholesale clients (as defined in section 761G of the Corporations Act 2001) or which do not otherwise require the provision of a Product Disclosure Statement under Division 2 of Part 7.9 of the Corporations Act. This report does not constitute a Product Disclosure Statement, prospectus or other disclosure document within the meaning of the Corporations Act. It has not been, and is not required to be, lodged with the Australian Securities and Investments Commission under the Corporations Act 2001.

We will not be "buying the dip" because this bear market has only just begun. Excluding the Great Depression (when share prices fell by 80%), the ASX has fallen by more than 30% on seven separate occasions since 1935. These seven **bear markets have an average duration of 21 months**, ranging between 5 months and 61 months.

The depth of the bear market depends on the severity of the COVID-19 pandemic, in economic terms rather than in numbers of deaths. Some epidemiological models suggest that the epidemic is already ten times as prevalent as the number of reported cases (1.2 million globally at the time of writing) because for many people it is no worse than a seasonal flu and they haven't been tested. If so, the economic effects will be less severe because the maximum-risk individuals can be more easily identified and scarce medical resources can be devoted to them.

Our base case for Australia is a recession that ends in September, so that CY20 is characterized by 30% profit falls and 20% dividend cuts rather than by mass unemployment. We are only six weeks into this bear market, so we think it would be foolish to predict a bottom **until**:

- COVID-19 is under control in Australia,
- China is clearly on the road to economic recovery (e.g. China's schools re-open), and
- we know more about the shape and timing of the "second wave".

Domestically, the Federal Government has finally rolled out an effective support package which will insulate much of the population from economic disaster. But the conflict between commercial landlords and tenants is a long way from resolution, as are the relationships between commercial debtors and creditors. The banks may come under the same pressure as their UK and European counterparts to suspend dividends. For most industries, it is still too early to pick winners.

Australia's new giant government deficit raises several questions for investors, starting with "Who will be taxed more to pay for this?" Some economists have claimed that the deficit will cause inflation: we are sceptical, because that was what they said back in 2009 about the GFC stimulus packages. For most workers the lay-offs and lockdowns are a net loss of purchasing power, not a period of pent-up demand which will be unleashed once the pandemic is over. We are monitoring inflationary pressures, but it is too early to bet on a resurgence of inflation.

The ALCE portfolio remains defensively positioned. At end-March it had a FY2020 forecast P/E of 12.0x and **yield of 5.6%**, making it cheaper than the S&P/ASX200, where the consensus forecasts imply a P/E of 12.7x and a dividend yield of 5.2%. The consensus figures are still failing to take into account the size of profit falls and dividend cuts, partly because company management teams are still trying to work out how bad things will get.

**DISCLAIMER:** This report is made for information purposes only, reflecting Arminius' interpretation of a specific historic period, source referenced from the prime broker "Interactive Brokers" proprietary reporting software "*PortfolioAnalyst*". All other data is sourced from FACTSET and Hedge Fund Research Inc. This report is only made to investors who are wholesale clients (as defined in section 761G of the Corporations Act 2001) or which do not otherwise require the provision of a Product Disclosure Statement under Division 2 of Part 7.9 of the Corporations Act. This report does not constitute a Product Disclosure Statement, prospectus or other disclosure document within the meaning of the Corporations Act. It has not been, and is not required to be, lodged with the Australian Securities and Investments Commission under the Corporations Act 2001.