MONTHLY PERFORMANCE REPORT
June 2020

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

The portfolio returned +1.08% for the month, compared with +0.93% 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.

PERFORMANCE (Inception JUL-2018)	**Arminius Capital ALCE Strategy**	S&P/ASX200 Accumulation Index (AUD)
1 Month	**1.08%**	0.93%
3 Months	**14.50%**	14.13%
Calendar YTD	**-17.18%**	-14.25%
1 Year	**-10.32%**	-7.64%
3 Years	**N/A**	N/A
5 Years	**N/A**	N/A
Cumulative since Inception July 2018	**-5.44%**	**1.58%**

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%	7.05%	6.48%	1.08%							-17.18%

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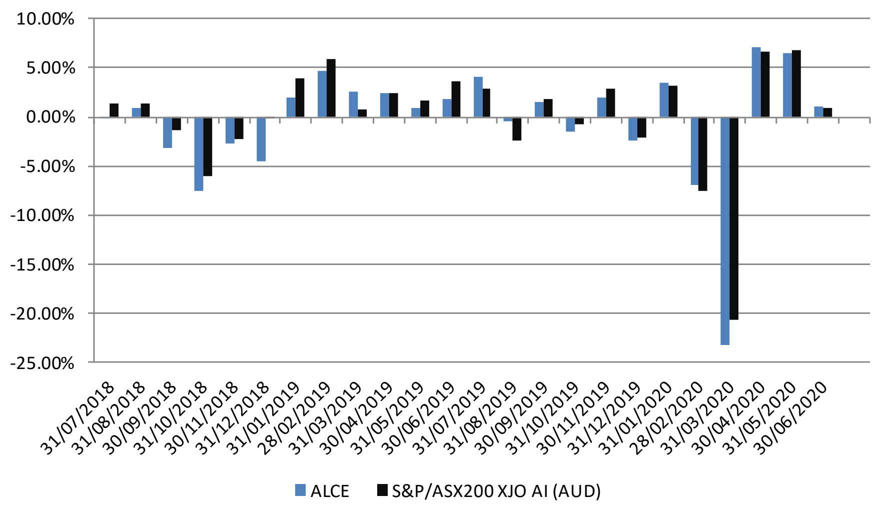
STRATEGY OBJECTIVES:
The aim of the ALCE (Australian Low Correlation Equities) portfolio is to outperform the S&P/ASX 200 (TR) Index over rolling 5-year periods. The portfolio will also aim to deliver above market dividend income and lower volatility than the S&P/ASX 200 (TR) Index. The investment process 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.



INVESTMENT PERFORMANCE

The ALCE portfolio returned +1.08% in June, 15 basis points above the +0.93% return from its benchmark, the S&P/ASX200 accumulation index. The benchmark rose due to material appreciation in June of global commodity prices, leading to gains in resource stocks. During June, Copper rose +13.23% and Iron Ore rose +11.25%. The portfolio does not hold BHP or RIO due to their volatility.

The global rebound from the March lows slowed down in June, partly because the number of coronavirus infections continued to rise in the US, Mexico, South America, Russia, and India. In the US, several states which had opened up after the lockdown saw infections accelerating sharply upwards again. The US S&P500 price index rose 1.84%, led by the tech sector, and the Stoxx Europe 600 gained 2.85%, while Japan's Nikkei 225 increased by 1.88%. All major markets are still below their February peaks, and all are down on the year to date.

In contrast, Chinese share markets picked up on good economic releases which showed that the economy was continuing to recover, and Chinese state media actively encouraged retail investors to buy shares. During June the Shanghai Composite index climbed 4.64% and Hong Kong's Hang Seng index jumped 6.38%.

Uncertainty about the outcome of the COVID-19 pandemic continues to cause very high volatility in share markets and in the prices of individual companies. The companies in the ALCE portfolio are selected because they operate viable businesses, pay dividends, and carry lower than average risk, so we are confident that they will not only survive but thrive, regardless of the course of the pandemic.

The five largest favourable movements in the ALCE portfolio during June were GUD (+12.8%), Coles (+12.2%), Wesfarmers (+10.0%), Macquarie Group (+5.2%) and Chorus (+3.1%). The five largest negative movements were Nine Entertainment (-6.8%), Ausnet (-4.3%), Orora (-4.2%), Amcor (-3.8%) and ASX (-3.6%). At month-end the Fund's five largest holdings were Wesfarmers, National Australia Bank, ANZ Bank, Macquarie and Transurban. There were no changes to the portfolio during the month.

MARKET OUTLOOK

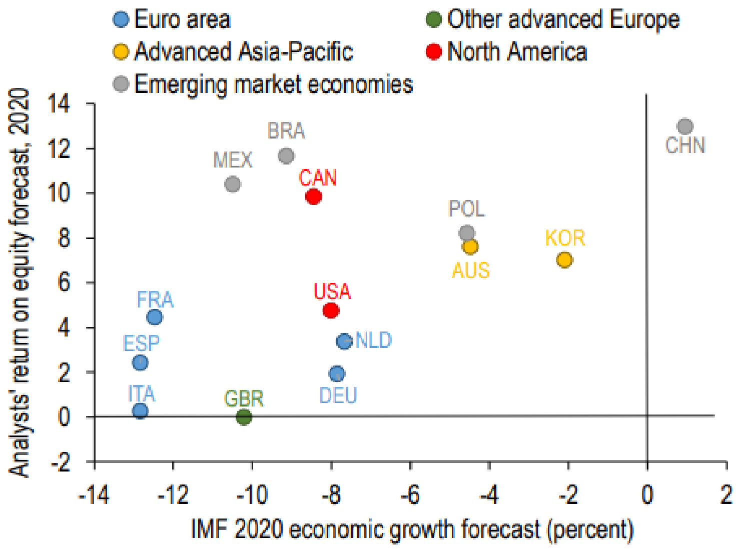
The reason why global share markets have rebounded is massive fiscal and monetary stimulus. Governments around the world have been handing out subsidies to workers and businesses, while central banks have slashed interest rates and started buying corporate bonds. The colossal inflow of cash has propped up capital markets and staved off a wave of insolvencies and bond defaults.

But stimulus programs like Jobkeeper and Jobsaver won't last forever. When the money taps are turned off, we will find out which businesses have survived and how many people really have jobs. This will be the time when the banks end their deferrals on loans and begin the mortgagee-in-possession sales.

We expect that in twelve months' time the Australian economy will be about 95% back to normal, even if there are no mass vaccinations. Some sectors – e.g. airlines, hotels, travel agents – will still be far below normal. Other sectors – such as shopping centres and commercial offices – will still be adjusting to the new normal. But most businesses will learn to live with COVID-19 as an endemic disease.

For Australia's big four banks, the COVID-19 recession will not be as bad as the last two recessions. This is not due to brilliant management by bankers, but rather to the forced clean-up of loans and lending practices in the wake of the GFC, as well as the strengthening of bank balance sheets mandated by the regulators, not to mention the salutary effect of the public humiliation of bank boards and CEOs by the Hayne Royal Commission. As we stated in our bank analysis last month (See our Geldzug article of 18 June 2020 http://arminiuscapital.com.au/will-covid-19-cripple-the-4-banks/), we expect that the current rate of bad loan provisioning (0.42% of gross loans) will be close to adequate, which means that bank profits should be on the road to recovery in 2022.

Figure 14. Bank Profitability and Economic Growth Forecasts



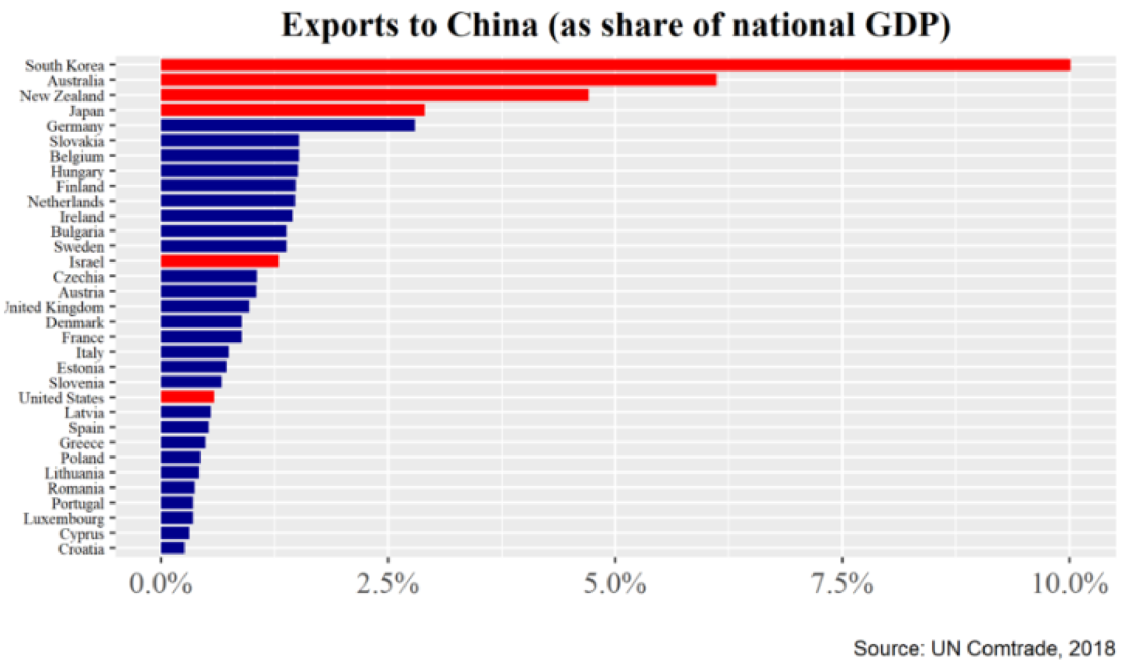
Sources: Bloomberg Finance L.P.; IMF, World Economic Outlook database; and IMF staff calculations.
Note: The vertical axis shows the median return on equity forecast for a sample of listed banks in each economy. Data labels use International Organization for Standardization (ISO) country codes.

The IMF chart above shows that Australian banks are well placed relative to the rest of the world. The horizontal axis measures the forecast fall in 2020 GDP for each country: left side means worse, right side means better. The vertical axis measures the return on equity of each country's banks: down means low return, up means high return. The banks which will suffer the biggest profit falls are the ones in the bottom left-hand corner, because they face a worse 2020 recession and they have low returns on equity to start with. These are the banks in France, Spain, Italy, the UK, Germany, the Netherlands, and the US. The bad news that you hear about these banks will not apply to Australian banks. (Ignore the Chinese banks at the top right, because their bad loans figures are wildly understated.)

What could derail Australia's economic recovery? Domestic outbreaks of COVID-19 make dramatic headlines, but they are small and controllable, provided that State governments respond quickly and intelligently. The city government of Beijing (population 20 million) got its recent COVID-19 outbreak under control by putting 20,000 of its civil servants on the streets – testing everyone, tracing all contacts, enforcing isolation, and disinfecting everything in sight.

Australia's main economic engine is China, where the economy is recovering (See our Geldzug article of 6 June 2020 http://arminiuscapital.com.au/hotwiring-the-chinese-economy/). The US has failed to contain coronavirus, so its infection rate and death toll will keep rising, leading to a prolonged recession. But Australia is an importer of US goods and services, so a US downturn does not have a serious direct effect on the Australian economy. As long as China, East Asia, and Europe have COVID-19 under control, the Australian recovery will continue.

The chart below shows that Australia's exports to China are equivalent to 6% of our GDP. Being dependent on China is a very good thing when the Chinese economy is recovering faster than the rest of the world.



Because of local outbreaks and overseas deaths, the recovery will be W-shaped. The lifting of restrictions encourages many consumers to go out and spend, but when a surge in COVID-19 occurs, State governments will re-impose restrictions and even return to lockdowns, causing a pullback in spending. There is also a seesaw effect among consumers themselves. For employees with secure jobs, the lockdown meant enforced saving, but their savings constitute pent-up demand, which will boost the economy. For people who have lost their jobs or their businesses, any saving they can manage is a precaution for the future, for fear that they may not be able to find a new income quickly. These savings will not be spent in a hurry. Thus the swings between pent-up demand and precautionary savings also encourage a W-shaped recovery.

The ALCE portfolio remains defensively positioned. We have incorporated our own forecasts which, because they are based on a W-shaped recovery over the next six months, are more pessimistic than the consensus forecasts. At end-June, the ALCE portfolio had a FY2021 forecast P/E of 15.9x and a dividend yield of 4.3%. By comparison, the consensus forecasts for the S&P/ASX200 imply a P/E of 16.5x and a dividend yield of 4.7%. The August reporting season will not throw much light on the outlook for FY2021 because, when it comes to coronavirus, companies are in the same state of ignorance as the rest of us.