



# MONTHLY PERFORMANCE REPORT

## February 2021

The portfolio returned -0.17% for the month, compared with 1.45% 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: 30<sup>th</sup> June

Dealing: Daily

PERFORMANCE (Inception JUL-2018)	Arminius Capital ALCE Strategy	S&P/ASX200 Accumulation Index (AUD)
1 Month *	-0.17%	1.45%
3 Months	-0.98%	1.71%
Calendar YTD	-0.90%	0.32%
1 Year	-4.85%	3.03%
3 Years	N/A	N/A
5 Years	N/A	N/A
Cumulative since Inception July 2018	0.03%	6.73%

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

\* 1 Month data taken from HUB24 which uses the COB value of the 1st calendar day of the month as the starting point.

### 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%	0.34%	3.59%	-1.70%	3.47%	6.49%	0.78%	-4.68%
2021	-0.72%	-0.17%	-	-	-	-	-	-	-	-	-	-	-0.90%

### INVESTMENT MANAGER

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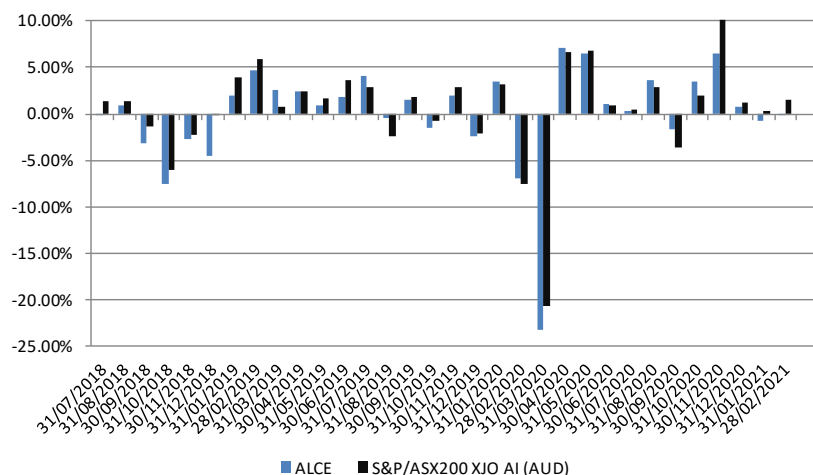
### STRATEGY OBJECTIVES:

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 negative 0.17% in February, 1.62 percentage points lower than the positive 1.45% return from its benchmark, the S&P/ASX200 accumulation index.

Share market volatility remains well above average, which means that the prices of individual stocks are moving up or down by much bigger percentages than usual, as can be seen from the portfolio's largest positive and negative performers listed below. In February, company results triggered unusually large share price moves as investors over-reacted – positively or negatively – to each company's report on the December 2020 half-year.

The ALCE portfolio underperformed slightly in February because it is overweight retailers and property stocks, which had a down month. Resource stocks, which ALCE very rarely holds because of their high volatility, had an up month, led by BHP, Rio and Fortescue.

February was a strong month for world share markets, as equity investors decided that the Biden Administration's USD1.9tn stimulus proposal would fuel rapid US growth. The US S&P500 price index hit a new high of 3934 on 12 February. Then bond investors concluded that rapid growth meant higher CPI inflation and pushed bond yields up sharply, provoking a correction in the US share market. Nonetheless the S&P500 price index gained 2.6% in the month.

Japan's Nikkei 225 price index jumped 4.7% as investors looked past the sluggish Japanese economy, focusing instead on the recovery potential for Japan's big companies, which have global businesses and minimal debt. The Japanese share market has now reached its highest level in thirty years. Europe's Stoxx 600 price index rose 2.3% on similar sentiments. The index is now almost back to its February 2020 record. The Shanghai Composite price index peaked at 3696 on 19 February – its highest level since 2015 – before correcting to end the month up 0.7%.

The five largest positive movements in the ALCE portfolio during the month were **Nine Entertainment (+21.1%)**, **Lend Lease (+10.8%)**, **ANZ Bank (+8.0%)**, **Macquarie Bank (+6.8%)**, and **Sims (+6.0%)**. The five largest negative movements were **Coles (-13.7%)**, **Charter Hall (-12.7%)**, **BWP Trust (-11.2%)**, **Wesfarmers (-8.5%)**, and **Mirvac (-8.2%)**. There were no portfolio changes during the month. At month-end the Fund's five largest holdings were National Australia Bank, ANZ Bank, Macquarie, Wesfarmers, and Nine Entertainment.

## MARKET OUTLOOK

The combination of good economic data and a generally positive results season suggests that the Australian share market will keep on rising strongly in coming months. But – even if population-wide vaccination is accomplished without major setbacks – in the longer term there are three strong headwinds. The first is already obvious: rapid GDP growth plus ultra-low interest rates have raised the risk of resurgent inflation, provoking a rise in bond yields.

We expect CPI inflation to rise in the US because of country-specific factors, but this does not mean that inflation will immediately rise everywhere else in the world. For Australia, the biggest barrier against imported inflation is the rising Australian dollar (AUD). Last year, back when the AUD was worth USD70c we forecast that the AUD would rise to at least USD84c. Since then, the AUD has touched USD80c and the factors pushing up the AUD have strengthened, so we have increased our forecast to USD102c. The same factors are pushing up most East Asian currencies against the USD.

The second headwind is more subtle. We need to remember that the Australian economy is growing fast because it is still in recovery mode. This is why we enjoyed 3%-plus GDP growth in the September and



December quarters – because the first half of 2020 was a recession. Once the economy gets back to its pre-recession level, growth will slow down.



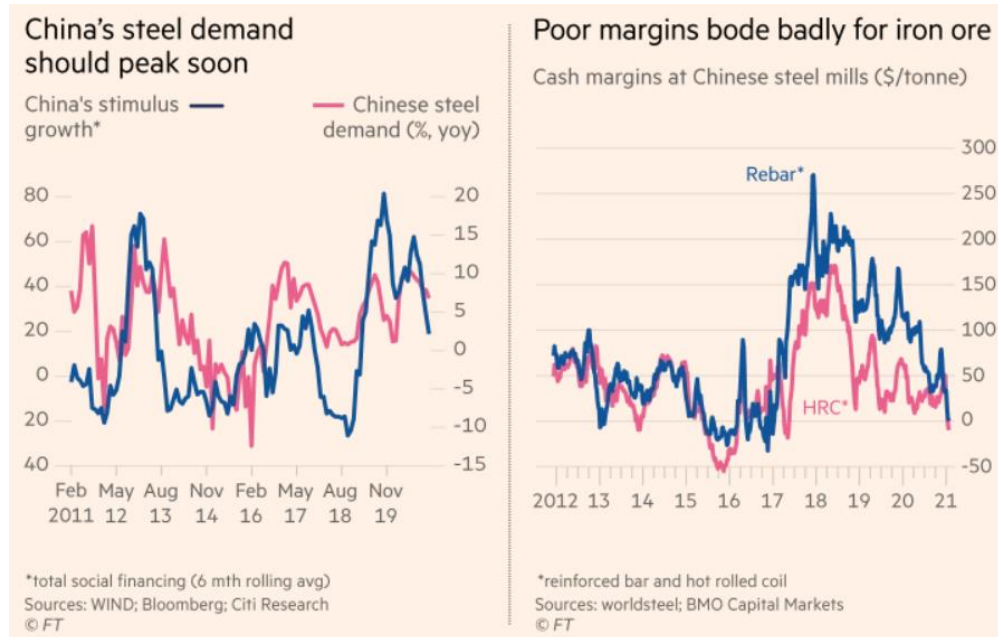
In fact, for the six years before the 2020 recession the Australian economy was pretty ordinary. The RBA chart above shows wages growth over the last two decades. The China-driven resources boom brought strong wages growth from 2000 until the GFC, then falling commodity prices ended the boom, and wages went down with them. The point we are making is that, once we get back to the old normal, we need to find new and lasting sources of growth if we are to break out of our low-growth path.

The third headwind is China. In recovering from the COVID-19 lockdowns, the Chinese government did not unleash massive fiscal and monetary stimulus packages like Australia and the US. Its stimulus packages were much smaller, and they are already being wound down because they are no longer needed. The chart below shows retail sales growth in China: it is clear that the economy is almost back to normal.



In 2021, China's GDP will grow at about 8%, but half of this growth is merely recovery from the very low base set in 2020. Over the next five to fifteen years, the official forecast for GDP growth is less than 5%pa - much lower than in recent history. We explained why in the article "China's 14<sup>th</sup> Five-Year Plan", posted on the Arminius website on 25 February. <https://arminiuscapital.com.au/chinas-14th-five-year-plan/>

In reaction to the US-China trade war, Chinese economic policy is turning inward, focusing on stimulating domestic demand, cleaning up its environment, and building up its own high-tech industries. This means that Chinese demand for Australian coal and iron ore has peaked. China will continue to build houses and offices and roads and railways, but not as much as it did over the last thirty years. It will still need to import minerals, but the growth sectors will be the technology related minerals such as copper, lithium and the rare earths.



The two charts above indicate that the current peak in iron ore prices will not last. The first chart shows how monetary stimulus (red line) leads steel demand (blue line). Because the Chinese authorities have already begun to rein in the money supply after last year's policy-mandated surge, steel demand will decelerate later this year.

The second chart shows margins at Chinese steel mills for rebar and hot rolled coil. Margins were already under pressure before the 2020 rise in iron ore prices. If iron ore prices do not fall soon, large sections of the Chinese steel industry will be shutting down.

In summary, calendar 2021 should bring strong equity returns in Australia – our best estimate is 12%, and if the rest of the world is favourable, possibly 20%. But from 2022 on, things get harder, because we face three strong headwinds:

- Rising US inflation and higher global bond yields
- Once the Australian economy gets back to “normal”, it will back on a low-growth path.
- China's change in economic direction means that GDP growth will be slower and will need less Australian coal and iron ore.

## PORTFOLIO POSITIONING

At end-January, the ALCE portfolio had a FY21 forecast P/E of 21.2x and a dividend yield of 3.3%. For comparison, the consensus forecasts for the S&P/ASX200 imply a P/E of 20.5x and a dividend yield of 3.3%. Looking out to FY22, the ALCE portfolio has a prospective P/E of 17.9x and dividend yield of 3.6%, compared to consensus forecast P/E of 18.8 and dividend yield of 3.6%.

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