

Intelligent Investor Ethical Share Fund

(Managed Fund) (ASX:INES)

“The greatest danger in times of turbulence is not the turbulence. It is to act with yesterday’s logic.”

— Peter Drucker

“... what he desires is to be told specifically which particular stock to buy or sell. He wants to get something for nothing. He does not wish to work. He doesn’t even wish to have to think.”

— Jesse Livermore

The bill for a decade of Frankenstein monetary policies is falling due. Sovereign debt issues are threatening some emerging and European countries and UK pension funds have been exposed in a classic case of reaching for yield.

UK pension funds thumbed their noses at zero interest rates trading their conservative reputation and financial promises for leveraged bets on bonds.

The margin calls on these soured bets are so large that a range of rescue measures from the UK government have reduced the British economy’s standing to comparisons with emerging markets.

Performance (after fees)

	3 mths	1 yr	2 yrs (p.a)	3 yrs (p.a)	S.I. (p.a)
II Australian Ethical Share Fund	-0.7%	-12.2%	7.1%	9.9%	9.4%
S&P ASX 200 Accumulation Index	0.4%	-7.7%	9.8%	2.7%	3.6%
Excess to Benchmark	-1.1%	-4.5%	-2.6%	7.3%	5.8%

Inception (S.I.): 11 Jun 2019

RIAA’s RI Certification Symbol signifies that a product or service offers an investment style that takes into account environmental, social, governance or ethical considerations. The Symbol also signifies that Intelligent Investor Australian Ethical Share Fund (ASX: INES) adheres to the strict operational and disclosure practices required under the Responsible Investment Certification Program for the category of Product. The Certification Symbol is a Registered Trademark of the Responsible Investment Association Australasia (RIAA). Detailed information about RIAA, the Symbol and Intelligent Investor Australian Ethical Share Fund (ASX: INES) methodology, performance and stock holdings can be found at www.responsibleinvestments.com.au, together with details about other responsible investment products certified by RIAA.



Fund overview


The Intelligent Investor Australian Ethical Share Fund is an Active ETF designed for investors seeking a diversified selection of Australian companies that produce growing, sustainable profits at low risk of interruption from the increasing threats associated with Environmental, Social and Governance (ESG) factors.

 **5+ yrs**

Suggested investment timeframe

 **10 - 35**

Indicative number of securities

 **Risk profile: High**

Expected loss in 4 to 6 years out of every 20 years

 **S&P/ASX 200 Accumulation Index**

Benchmark

 **Investment fee**

0.97% p.a.

 **Performance fee**

Nil



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Confidence is evaporating, the pound is collapsing and it's just the start as increasing interest rates lift the veil on the full extent of risk taking over the past decade.

With the RBA losing \$37bn on its own bond sales recently as it reverses QE purchases, the final bill from this epic everything-bubble promises to be monumental. US interest rates are still increasing and it could be years before the full impact is known.

We don't normally say much about the economic environment unless it's directly impacting our stocks. But amidst the fear and whining about higher interest rates, it's worth highlighting that appropriate interest rates maximise the efficient use of our limited resources and help avoid speculative manias and their aftermath.

In recent years, central banks have been fuelling asset bubbles experimenting with zero interest rates and quantitative easing to paper over fundamental problems exposed by the GFC. They're now resurfacing, creating new problems as well.

Getting the official US interest rate past 2% was recently considered almost impossible in a world drowning in asset bubbles and debt. If 4-5% is achieved, as is looking more likely, it would be a major success.

Savers wouldn't need to take large risks to earn a decent return. Much of the current misallocation of resources would end as the economy adjusts, and fundamental investing would reassert itself.

The upshot would be a healthier, more stable and sustainable economy hopefully more focused on productivity and long-term investment rather than speculation and flipping houses.

It would've been better if central bankers had started this process years ago – or never

needed to at all – instead of being forced to by the inflation caused by their own risky, naive policies. But we welcome the emerging opportunities.

Performance

The Fund fell 0.7% during the September quarter compared to the market's 0.4% return.

Largely being in line with the market recently is no mean feat. The Fund can't own resources stocks, which have performed well recently, and most other industries are suffering multiple compression as growth expectations fall. Particularly our smaller and mid-sized companies that will drive the Fund's performance over the next decade.

During the quarter we sold several illiquid stocks including **Vista International**, **Servcorp**, **Equity Trustees** and **Infratil** to make room for new opportunities.

We have very limited room for illiquid stocks due to the ASX liquidity rules we abide by as an actively managed listed ETF, and more stocks are filling the bucket as their share prices fall reducing our flexibility further.

Although Infratil is a multi-billion dollar New Zealand-based company, few of its shares trade on the ASX and are captured by the liquidity rules.

We started small positions in **MA Financial**, **Carsales** and **James Hardie Industries** during September. MA Financial's share price has fallen 55% from its highs due to its unsustainable earnings from slowing M&A activity, for example, and the likely end of special investment visas, which may account for as much as a quarter of the company's earnings.

We've considered any profits from this business a bonus and left plenty of room to build a large position should the price get closer to \$3,

which would provide a greater margin of safety against a prolonged slump in financial markets and activity, outflows and falling valuations.

Carsales is recovering from Covid shutdowns that impacted second hand and new car sales. More recently it has successfully increased its prices. While the competitive advantages of online classifieds businesses are well known, auto classifieds businesses are inferior to property classifieds businesses.

Longer term the company must be careful it doesn't gouge customers, as competitors are pursuing new methods of buying and selling cars. While Carsales has diversified abroad, including successfully in South Korea so far, Australia remains its most important business.

James Hardie is unlikely to maintain its current profit margins as US and Australian property markets slow, but the almost halving of its share price has reflected some of that already.

Most of its profits come from maintenance and repairs, which can't be put off forever, but the operating leverage in this business can be painful when volumes fall. Again, we've left plenty of room to increase our stake, as it's a stock we want a large position in at the right price.

On the flipside, we sold **LendLease** after learning more about a large potential tax liability relating to the historical accounting treatment on the sale of some retirement villages.

The stock is potentially very cheap. But a bad outcome following the current investigation by the Australian Tax Office combined with a potential recession and another capital raising if there's a cost blowout on the Melbourne Metro Tunnel would gut the stock's potential.

Also, learning more about both prior and current management's attitude toward legal

advice on the matter reminded us of other companies that have recently been in the headlines for all the wrong reasons, such as the banks, the casinos, **Qantas** for its outrageous share buyback and **Rio Tinto** after blowing up an indigenous site.

The disastrous financial and reputational damage from these decisions is clear, and Lendlease is particularly vulnerable given its cyclical, low-margin business. It also has a large exposure to the UK, whose economy is in dire straits.

The share price of recent inclusion **Aussie Broadband** has bounced around recently as the market grapples with the company's growth. While it's delivered in spades in recent years, large investment, a major acquisition, and a range of other issues have shaken the market's confidence.

For now, at least, we're backing management and expect today's investments to eventually pay off.

US financial giant KKR has withdrawn its \$88 per share bid for **Ramsay Healthcare** citing its inability to analyse Ramsay's French business. We expected a revised bid to get a deal done, but things have reportedly turned acrimonious and KKR have walked away in a bad result for shareholders.

We've kept our small position but it's one we'd love to replace at the current price when we find an opportunity.

Frontier Digital Ventures reported another set of excellent numbers, showing rapid growth across its businesses and increasing profitability at its most mature business, Zameen. But fears of a sovereign debt crisis, particularly in Pakistan, are smashing the share price.

Rapidly increasing costs of food and energy for large importers like Pakistan with large overseas borrowings is a toxic mix when the US dollar is surging. Pakistan is receiving financial assistance but there are no guarantees the currency won't eventually collapse.

That would smash FDV's share price, but we'd likely consider it an opportunity as the future of the business is Latin America and the share price is already reflecting a dismal outlook. Though some of those countries may have financing issues, too, in a broad financial crisis, which is why it's not a bigger position.

Litigator **Omni Bridgeway** has been a sleeper in the portfolio, recently increasing over 50% due to several pieces of good news including launching new funds, insuring more of its successful claim payouts, and searching for ways to realise cash from its cases sooner.

Lastly, **360 Capital** announced an eight-cent special dividend, which is a 10% yield at the current share price. However, given the company is now essentially a cash box as CEO and major shareholder Tony Pitt prepares the company for a recession, dividends will fall substantially next year.

No company is better prepared for a recession than 360 Capital despite what the recent fall in its share price suggests.

Most of the commentary this year has speculated that at worst, we'll have a short and sharp recession due to the higher interest rates needed to quell inflation. But we believe these commentators are focused on the wrong thing.

The giant US equity bubble is deflating and it's likely to be slow and painful for those that aren't excited about buying cheap assets for the long term. The portfolio is as well prepared as it's ever been for what lies ahead, and any outperformance right now is a bonus.

Our best returns come when we emerge from tough periods after most investors have long given up. The opportunities are getting better but the earnings downgrades are only beginning.

This time next year we expect to have the best portfolio we've had since launching the Fund. With a bit of luck, we won't have to wait that long.

Please get in touch if you have any questions on **1300 880 160** or at **info@intelligentinvestor.com.au**

Appendix

How to buy ETFs: 4 tips for beginners

ETFs are a great way to diversify your portfolio. Here are four tips to get you more bang for your buck.

Investing in exchange-traded funds (ETFs) has never been simpler – you can now own a portfolio of dozens of stocks within minutes and with as little as \$500.

Last year, the Intelligent Investor Ethical Share Fund (ASX:INES) listed on the ASX and it's important to us that you get the most value out of it. If you've never bought an ETF before, the following tips will set you up for success.

No. 1 – Know what you're buying

ETFs can seem intimidating at first, but they're actually quite simple – rather than buying a single stock, you're buying a basket of stocks instead. Someone else chooses which stocks go into the basket, but you can buy and sell the basket whenever you like and set the price at which you're willing to trade.

The important thing to remember is that because individual investors set the price at which they choose to buy or sell, the ETF's share price doesn't automatically reflect the value of what's in the basket. An ETF's share price can be wildly different to the collective value of the individual stocks inside it.

What's more, you don't always know when the last transaction occurred – for infrequently traded ETFs, it may have happened days ago,

causing an even larger discrepancy between the share price you see on your trading screen and what the basket is worth.

For this reason, before purchasing any ETF, we recommend checking its 'indicative net asset value,' or iNAV, on the ETF provider's website. This figure represents what the fund is worth if you added up the market value of all of the individual stocks inside it. In most cases, it's updated every minute or so.

For the Ethical Share Fund, you can find the iNAV under 'Key Facts' on its information page.

It's unlikely (though not impossible) that you'll be able to buy an EFT at a large discount to its iNAV, but avoid paying too much more. Otherwise, it's a bit like buying a 6-pack of beer for \$20, when you can buy the individual cans for \$2 each.

No. 2 – Use limit orders

When you go to buy or sell an ETF, you will need to put in a trading order with your broker, typically through your online brokerage account.

On the main trading screen, you will be asked for a few bits of information, such as the ETF's ticker symbol (INES, in the case of the Ethical Share Fund) and how many units you want to buy.

You'll also be given the option to choose between a 'limit' or an 'at market' order. With Tip No. 1 in mind, *always* choose the 'limit' option and enter the maximum price you are willing to pay per unit.

The 'at market' option is essentially saying to your broker that you want to buy the ETF at the best available price – whether its \$1 or \$100 – so you're more likely to be caught overpaying.

For example, at the time of writing, the Ethical Share Fund has a net asset value of \$3.18 per share. It's ok to put in a limit price a cent or two above this to ensure you get matched quickly, but don't go much higher than that or you're leaving money on the table.

If you aren't matched by the end of the day, you shouldn't leave your order overnight (look for the 'good for 1 day' option when you place the trade). If something major happens overseas while you're asleep, it could mean that the market moves significantly the next morning, and you could be caught overpaying or selling for less than the fund is worth.

No. 3 – Do your trading at lunchtime

Unfortunately, investors often forget or don't realise that early trading can be a time of major price swings for ETFs. There's often an imbalance between buy and sell orders, causing some people to buy at a much higher price than the ETF is worth. This ultimately reduces their long-term returns.

We recommend you give the market some time to settle before making any ETF trades. Normal trading on the ASX takes place from 10:00 am to 4:00 pm, Sydney Time, so it's a good habit to place your orders after 10:15 am and before 3:45 pm to ensure the fund's iNAV has settled and the fund's share price reflects it.

No. 4 – Be patient

Patience is just as important for holders as it is buyers. In one study, researchers found that those who trade the most lagged the overall market's performance by 6.5%, partly due to 'frictional costs' like excessive brokerage commissions and taxes (see Why patience pays off).

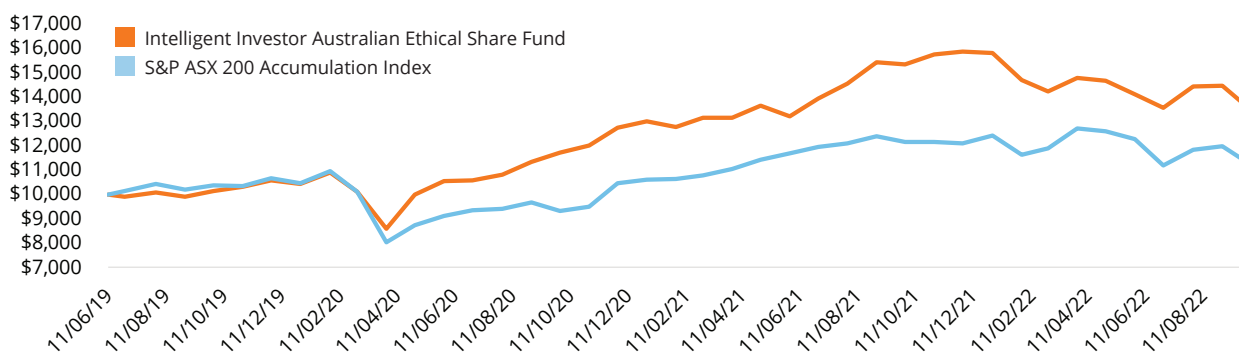
Historically, stocks and funds have outperformed most other asset types over the long term, but volatility in the interim can be gut-wrenching.

When you buy the Ethical Share Fund or any other, you should go in expecting there to be bumps in the road and have a commitment to ignore the short-term fluctuations. Investment ideas can take a while to play out.

When buying any sort of fund, it's better to focus on the fund's investment strategy, management fees, and long-term performance, rather than how it performed in the past month – or even the past year, frankly. We're pleased to report that our Ethical Share Fund beat the All Ordinaries Index by 18% over the past 12 months, but there will inevitably be years where it struggles too.

'The biggest thing about making money is time,' Warren Buffett says. 'You don't have to be particularly smart, you just have to be patient.'

Performance since inception



Asset allocation

Cash	37.6%
Health Care	16.9%
Communication Services	12.4%
Information Technology	11.0%
Financials	8.5%
Industrials	6.4%
Real Estate	3.3%
Consumer Discretionary	1.9%
Materials	1.9%

Top 5 holdings

Auckland International Airport (AIA)	6.4%
RPMGlobal Holdings (RUL)	5.4%
Telstra (TLS)	4.6%
Audinate Group (AD8)	3.7%
Omni Bridgeway (OBL)	3.7%

Fund Stats

Income yield

Net asset value

Important information

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All tables and chart data are correct as at 30 September 2022.