Airlie Australian Share Fund
(Managed Fund)

A concentrated, active portfolio of Australian equities.
Accessing the Airlie investment team and Magellan's operational and client service capabilities.

Airlie Funds Management

Ticker:AASF

Fund Update: 30 June 2020

ARSN: 623 378 487

FUND FACTS

Investment Objective: To provide long-term capital growth and regular income through investment in Australian equities.

Investment Strategy

- Long only, bottom up specialised and focused Australian equities fund
- Concentrated portfolio of 15-35 stocks (target 25)
- Active, high conviction approach - Airlie's 'best ideas'

Inception Date	1 June 2018	
Benchmark	S&P/ASX 200 Accum. Index	
Portfolio Size	AUD $27.6 million	
Distribution Frequency	Bi-annual	
Management Fee	0.78% p.a. (inclusive of net effect of GST)	
Ticker	AASF	
Tickers	**Security**	**iNAV**
Bloomberg	AASF AU Equity	AASFIV Index
Thompson Reuters	AASF.AX	AASFAUiv.P
IRESS	AASF.AXW	AASFINAV.ETF
APIR	MGE9705AU	
Minimum Initial Investment#	AUD$10,000	
Buy/Sell Spread	0.14%/0.14%	

 # only applicable to investors who apply for units directly with the fund

WHY CHOOSE THE AIRLIE AUSTRALIAN SHARE FUND?

- Access to an experienced, proven investment team specialising in Australian Equities, with a long track record of prudent common-sense investing
- A conservative and robust investment process that focuses the team's energies on their best ideas
- The strategy is now available to retail investors for the first time through the partnership with Magellan

PORTFOLIO MANAGERS

Matt Williams
Over 25 years investment experience.
Formerly Head of Equities and portfolio manager at Perpetual Investments.

Emma Fisher
Over 9 years investment experience.
Formerly an investment analyst within the Australian equities team at Fidelity International and prior to that Nomura Securities.

Visit www.airlieaustraliansharefund.com.au for more information, including: fund performance, unit prices and iNAV, investment insights, PDS & forms

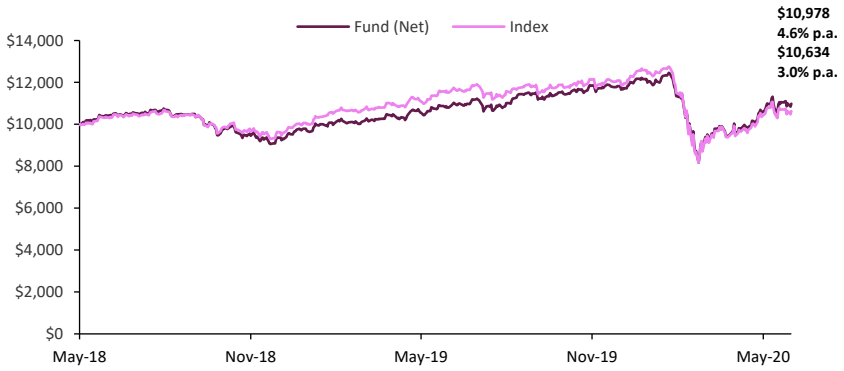
PERFORMANCE*

	Fund (%)	Benchmark (%)	Excess (%)
1 Month	4.1	2.6	1.5
3 Months	19.5	16.5	3.0
6 Months	-5.8	-10.4	4.6
1 Year	1.6	-7.7	9.3
2 Years (% p.a.)	2.7	1.5	1.2
Since Inception (% p.a.)	4.6	3.0	1.6

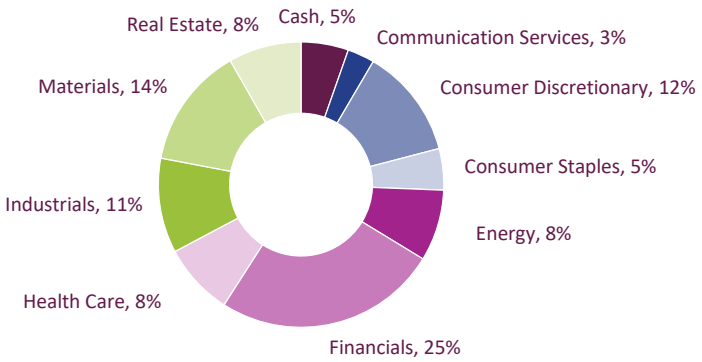
TOP 10 POSITIONS (BY WEIGHT)

Company	Sector**
BHP Group Ltd	Materials
Commonwealth Bank of Australia	Financials
CSL Ltd	Health Care
Wesfarmers Ltd	Consumer Discretionary
Mineral Resources Ltd	Materials
Origin Energy Ltd	Energy
Ampol Ltd	Energy
Aurizon Holdings Ltd	Industrials
Aristocrat Leisure Ltd	Consumer Discretionary
Westpac Banking Corporation	Financials

PERFORMANCE CHART GROWTH OF AUD $10,000*



PORTFOLIO POSITIONING**



* Calculations are based on exit price with distributions reinvested, after ongoing fees and expenses but excluding individual tax, member fees and entry fees (if applicable). Returns denoted in AUD.
** Based on GICS Sector classification, may not sum to 100% due to rounding.

MARKET COMMENTARY

The quarter to 30 June was very strong quarter as the S&P/ASX 200 rose +16%, recovering firmly off the lows reached in late March. All the S&P/ASX sectors produced a positive total return over the quarter with Information Technology the best performer (+30%) whilst Consumer Discretionary (+30%) and Energy (+28%) were also strong. However, when we combine the last two absolute historically remarkable quarters - over the six-month period (CYTD) - the market has fallen 12% and only three sectors, out of the eleven S&P/ASX 200 sectors, produced a positive return:

Consumer Staples	+4%
Healthcare	+4%
Information Technology	+12%

All other sectors, over the six-month period, were in the red, with the worst being Real Estate -21%. Surprisingly the Materials sector was also down, albeit marginally -1%, despite the strong iron ore and gold price. Base metals and coal have been weak over the six-month period. The A$ rose strongly against the USD (+13%) during the quarter, as the greenback weakened generally across most major currencies.

The Buy-Now/Pay Later ("BNPL") sector has driven the bulk of the gains in the IT sector, and as a combined group have a market capitalisation +A$20bn. The Federal government stimulus which is scheduled to be withdrawn later this year has boosted consumer spending and has produced remarkable sales figures in some categories. Meanwhile the banks have approximately 10% of their mortgage books, and approximately 15% of their SME loans, on deferral. The collision of these competing factors (the withdrawal of government stimulus and the more challenging conditions the banks are experiencing) will most likely have significant impacts on the market over the next quarter.

Globally, tensions with China, social unrest, covid-19 spikes, and market implications of a potential Biden Presidency (with potentially higher taxes) – proved no impediment to strong market performances over the quarter. In particular, the NASDAQ posted a return in excess of 30% and the broad S&P 500, more than 20%.

FUND COMMENTARY

The Airlie Australian Share Fund had a solid quarter, returning +19.5% and outperforming the S&P/ASX 200. Stocks that contributed significantly were Mineral Resources, BHP (both up on the strong iron ore price), Wesfarmers (strong sales for Bunnings, Kmart, Officeworks), and Origin Energy (oil price recovery).

Stocks held that detracted from performance include; CSL (concern over plasma collection during covid-19), and Reece (which raised capital ahead of many other companies). Thematically holding stocks exposed to strong consumer spending, such as Wesfarmers, and Coles was a great benefit however the caution we showed to the BNPL sector kept us away from holding those companies and they performed well over the period. We find the BNPL stocks hard to fit through our process, and so remain on the sidelines. Exposure to iron ore through holdings in Mineral Resources and BHP worked well although not having more exposure to gold over the period detracted from performance.

Financial stocks recovered somewhat from their poor March quarter performance. Macquarie Group, which is held in the portfolio, was best of the sector. Currently we are happy to own CBA and Westpac as we work through different scenarios. The scheduled removal of government stimulus later this year, plus the extent of the mortgage and SME loan deferrals, make the major banks a tricky proposition as operating conditions are more challenging than the banks are used to.

Capital raisings were prevalent during the quarter. However, reflecting our focus on the quality of a company's financial strength only three of our holdings have raised capital thus far (Reece, Credit Corp, and Qantas). We also participated in the Flight Centre, Bapcor, Shopping Centres Australasia, and Iress raisings. There is potential for further capital raisings, particularly as management and boards take stock of the outlook ahead of the upcoming reporting season.

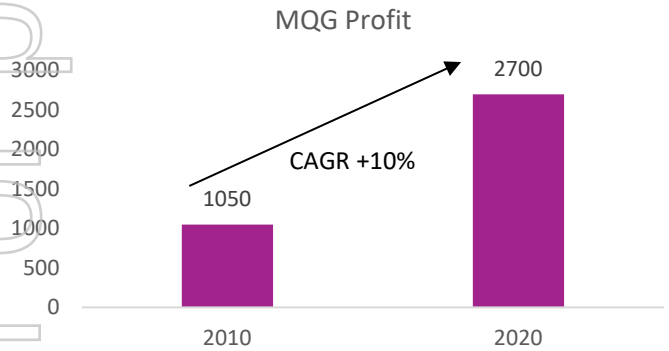
Stock Story: Macquarie Group

Over the past decade, Macquarie Group has transformed itself from an investment bank to a world-class asset manager, specialising in infrastructure and renewable energy. It is also one of the few Australian companies to have a long history of success abroad.

Today about two-thirds of Macquarie's earnings is generated from its annuity-style businesses (funds management and banking and wealth products) that produce recurring revenue year in, year out. The other third of the group's earnings is generated from market-facing activities (investment banking, etc.) and hence are more volatile. The annuity-style businesses contributed less than 30% to group earnings 10 years ago. This transformation to a more predictable earnings stream is why we think the quality of Macquarie's earnings is much higher today than a decade ago. Higher-quality earnings equal higher valuation multiples.

We are attracted to Macquarie's superior capital allocation and its proven ability to adapt and shift its business mix according to market conditions. This is not an easy achievement and reflects the unique culture and operating system that has developed over the past 30 years. The result? Higher returns and higher earnings growth versus its financial sector peers – Macquarie delivered an average of 10% earnings growth over the past ten years (see chart 1), a superior return on equity, without excessive leverage. The scars of the global financial crisis, where Macquarie's more fragile business mix and reliance on short-term funding were exposed, have led to a much stronger business and firmer capital and funding underpinnings.

Chart 1. Macquarie's impressive profit growth since 2010



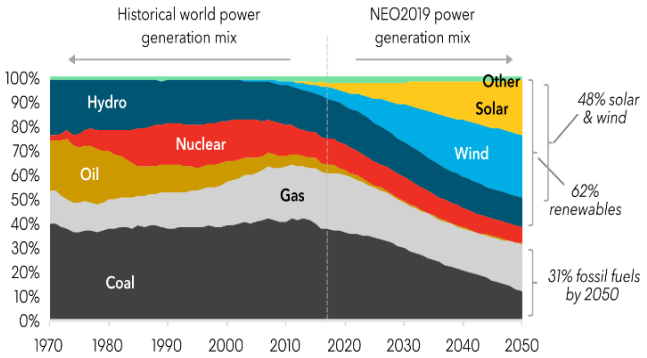
Source: Airlie Funds Management

Structural growth story

Macquarie's main annuity-style business is asset management, which makes up about 40% of group earnings. The asset-management business is leveraged to two strong structural growth stories; namely, demand for infrastructure and renewable energy. Macquarie was early to both sectors and over the past 30 years has developed deep expertise and capability, becoming a world leader.

Globally US$45 trillion is expected to be spent on infrastructure projects by 2030. Macquarie is at the forefront of this trend as the No. 1 manager in the space. The huge demand for infrastructure is being driven by rapid urbanisation, particularly in the developing world. With renewable energy, there is a mega trend unfolding as the international community transitions to cleaner energy sources. As chart 2 shows, wind and solar are expected to go from producing 7% of the world's electricity today to 48% by 2050, growing at a 6.6% annual pace over that time.

Chart 2. The rise of renewable energy



Source: BNEF https://about.bnef.com/new-energy-outlook/

Amazingly, in Australia and Europe, solar and wind penetration in the energy mix is forecast to grow from about 20% today to about 80% in 30 years, and we expect Macquarie will play a key part in this growth.

Table 1. The likely growth of solar and wind power

Solar and Wind Penetration in the Energy Mix

	2020	2050
USA	10%	35%
EUROPE	19%	80%
INDIA	10%	55%
CHINA	24%	48%
AUSTRALIA	20%	78%

Source: BNEF

Low interest rates

Unlike most other financials, where low interest rates are a drag on earnings, low interest rates support real-asset values. We know that pension funds are keen to match their liabilities with real assets. We expect continued strong fund flows into Macquarie products and funds.

Covid-19 risks

While we are obviously positive on the medium- and long-term prospects, Macquarie will not emerge scar free from covid-19.

In the near term, we expect that the annuity-style businesses to be hit by the timing in asset realisations due to the pandemic

imposing some impediments on the asset sale and due-diligence process. Macquarie also has some exposure to air travel through its leasing business.

In the market-facing businesses, while the initial volatility created from the pandemic will have benefited earnings, we expect global activity to be lower in the year ahead.

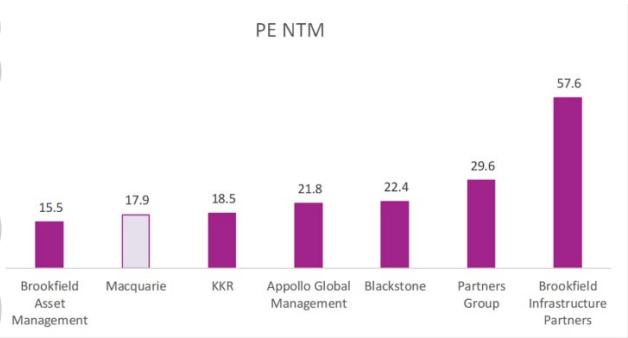
However, Macquarie businesses to date have proven more defensive than in previous economic downturns. As countries emerge from the pandemic-induced shutdown and seek to revive their economies, Macquarie is well positioned to benefit from any fiscal spending on infrastructure assets such as roads and rail.

Additionally, Macquarie is sitting on A$25 billion in potential investing firepower, so can take advantage of any opportunities that arise from market dislocations.

Valuation

Below is a valuation chart that shows that in a relative sense, when comparing Macquarie with other asset-manager peers, its valuation appears reasonable. The median manager is trading on a price-earnings ratio of about 22 times forward earnings versus Macquarie on about 18 times.

Chart 3. Comparing asset managers on valuations



Source: FactSet

This relatively attractive valuation combined with Macquarie's culture of sensible incentivisation, strong capital allocation skills and well-capitalised balance sheet lead us to expect continued strong earnings growth over the medium term. This will be underpinned by the structural growth story in infrastructure and renewable energy. These factors, combined with our expectation that Macquarie should be able to pay out a dividend of about 4% p.a., lead us to conclude that Macquarie remains a good investment proposition.