Australian Equities Update

January 2021

This report has been prepared by Northcape Capital, the underlying investment manager for the Warakirri Ethical Australian Equities and Warakirri Concentrated Australian Equities Funds.

Market Review

Australian shares were flat over the first month of the year with a return of 0.3% for the ASX300. During the month we saw continued rotation towards value and cyclically led opportunities. However, the strength and direction of the rotation faded into month- end. Markets were primarily driven by continued vaccine optimism and positive macro sentiment.

From a sector perspective, banks (4%) were amongst the strongest performers in Australian equities, supported by the 12 bps rise in bond yields over the month, as well as earnings upgrades, mostly due to lower bad debts. All the big 4 banks outperformed with Westpac (9%) leading the gains.

In the consumer space, some of the COVID winners posted strong trading updates in January and the stocks outperformed as a result – Harvey Norman (14%), Breville Group (14%) and Wesfamers (8%) were among the top performers in this sector. Technology stocks also continued to perform well, led by Afterpay (+15%).

On the flip side, the rise in in bond yields saw REITs (-4%), the transport sub-sector (-5%) and other yield plays underperform over the month. The recent COVID wave and the subsequent border closures in January caused the travel related names to also underperform over the month.

Market Outlook

For the upcoming reporting season, we expect the majority of companies to report robust profit growth and higher dividends. Mining companies and retailers are doing especially well in the current environment and conditions have improved in most sectors. In general, we expect economic conditions to remain buoyant this year due to high levels of fiscal stimulus, very low interest rates, and improved household balance sheets.

Our focus is on the extent to which conditions will normalise over the next few years, both for beneficiaries of the current environment and for those companies still dealing with substantial disruption from COVID such as the travel sector. In the case of travel, we expect demand will recover quite rapidly once a vaccine is rolled out and border restrictions are relaxed. In the case of mining companies and retailers, we are careful not to capitalise abnormally favorable conditions into our assessment of valuation.

Certain parts of the market have displayed clear signs of speculative behaviour in recent months, with share prices becoming spectacularly detached from fundamental value in some cases.

In our view, this behaviour is confined to limited pockets of the market and does not reflect a bubble in equity valuations more broadly. Our assessment is that valuations of high quality businesses are generally not excessive, especially in the context of near-zero interest rates. We currently see the best opportunities in businesses with defensible earnings, which have been left behind by the recent rally in cyclical names.

Stocks in Focus

IDP Education was one of the standout contributors for the month. The company's share price has been strong off the back of a clearer path to normalising international student movements as well as news flow indicating potential strategic interest from a student accommodation group. We remain positive on IDP's longer term prospects and improving competitive position, and whilst valuation has become more expensive, we remain constructive given IDP's superior quality (especially relative to other high growth peers).

Both of our aviation exposures (**Qantas and Sydney Airport**) underperformed the market during January. State border closures in response to the risk of community transmission of COVID delayed the anticipated recovery in travel activity. Whilst meaningful to the near-term outlook, we do not view these events as material to long term valuations for either company. As the global roll out of vaccines progresses, we expect demand for travel to rebound substantially. Importantly, both companies are well capitalised and have access to ample liquidity. This allows us to retain a long-term investment horizon in businesses we perceive to be fundamentally undervalued.

The Warakirri Ethical Australian Equities and Warakirri Concentrated Australian Equities Funds are long only, low turnover, concentrated and benchmark unaware. As such they will typically hold no more than 40 stocks. These stocks will come from a concentrated Approved List of about 60 stocks based on Northcape's research of selected stocks comprising of resilient businesses with clear opportunities for growth.

For more information, please contact us on 1300 927 254 or visit warakirri.com.au