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InFocus

Aberdeen Standard Ex-20 Australian Equities Fund

Key differentiators

Actively avoids market concentration bias	Targets quality stocks with diverse earnings	Opportunistic approach to capture value	Disciplined long-term investment process

"As a rule, financial markets are efficient. In the short term they may be affected by a range of factors, but over time prices can only be supported by sustainable earnings growth."

Robert Penaloza
Head of Australian Equities, Aberdeen Standard Investments

The Fund invests in a concentrated portfolio of 30-50 companies primarily listed on the Australian Securities Exchange (ASX). It excludes the 20 largest securities on the S&P/ASX 300 Accumulation Index by market cap. The Fund aims to outperform this benchmark, excluding the S&P/ASX20 Leaders Index, after fees over rolling three-year periods.

Approach

In Australia, the 20 largest stocks account for 60% of the S&P/ASX300 Index's market cap. Financial and resources firms dominate this top 20. It risks leaving undiscerning investors disproportionately exposed to large banks and miners that are tied to macroeconomic conditions and subject to regulatory intervention out of their control. We seek to avoid this concentration bias. We apply discipline in our investment process to focus on company quality first, then value. We define quality as a strong balance sheet and cash flow, durable earnings and a prudent management team. Our discipline is what differentiates us.

1. Diversification

We have built a portfolio of companies with differing risk profiles and return drivers. We would cite the Royal Commission as an example of why diversification matters. Launched last December to expose misconduct by financial services firms, it examines conflicts of interest in which companies provide financial advice to customers while selling them their own solutions at the same time – a model known as vertical integration.

The probe is putting financial firms under scrutiny and is expected to lead to more regulatory restrictions, potentially raising compliance costs and eating into margins at a time when revenues are already under pressure from lending restrictions and record low cash rates, even as the cost of accessing US dollar funding rises. Our Fund's exposure to financial services firms is diversified. Our holdings include a stock exchange (**ASX**), an insurance broker (**AUB Group**), a private health insurer (**Medibank Private**, **NIB Holdings**), a fund management firm (**Perpetual**) and an independent wealth management platform provider (**Netwealth**). It means our Fund is well placed to prosper irrespective of the Commission.

2. Oil and gas

We have become positive on the outlook for the oil and gas industry as market conditions improve amid rising commodity prices. In anticipation of continued energy demand, we recently added Origin Energy and Oil Search to the Fund – companies with world-class assets and strong earnings profiles. Origin has leading positions in energy retailing, power generation and natural gas production. It also has a joint venture to process coal seam gas into liquified natural gas (LNG), with Australia forecast to become the largest exporter of LNG worldwide in the next decade. Origin has progressed through its high-risk construction phase and started deleveraging. A recovery in its share price has seen it re-enter the ASX top 20 stocks after we had invested. Still, we think the market is under-pricing improvements in its balance sheet. It has copious gas reserves and various renewable energy certificates, which could boost profitability.

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Meanwhile, Oil Search explores for, and produces, oil and gas through its operations in Papua New Guinea (PNG), where it has a track record of largescale LNG development. PNG is well-located to supply Asia, where resources and pipeline access are often insufficient. Oil Search will have ramped up production by the early 2020s, by which time we expect LNG supply to have tightened. With a strong social reputation, it recently acquired acreage for oil exploration in Alaska, which adds to its development options.

3. Performance

We invest in companies based on analysis of their earnings prospects over the long term, identifying those that are industry leaders now or could be in future. Whilst we aim and continue to deliver consistent and steady returns, the Fund has underperformed its benchmark of late as investors focused on short-term growth. As a rule, financial markets are efficient, meaning share prices reflect underlying value. In the short term they may be affected by a range of factors, but over time prices can only be supported by sustainable earnings growth. Sentiment-driven rallies are unsustainable. We believe this cycle is nearing a turning point as developed markets withdraw stimuli, and rates and yields normalise. Even as investors factor in growth, higher rates will raise operating costs for businesses. As companies adjust, so will valuations. We remain faithful to our process. When we find a company we like, run by people we trust and whose shares are trading at a reasonable price, we are happy to invest. We see any short-term dips in price as an opportunity to increase our stake. This is how we add value for shareholders. By way of example, we recently initiated Monadelphous Group, which provides engineering and construction services to the resources and petrochemicals sectors. Falling margins have seen its share price suffer this year. But we believe this business has now largely troughed, with labour rates having bottomed out. Recurring maintenance work accounts for more than half of its revenues now and we feel confident it will continue to win contracts as the nature of its work shifts from iron ore to LNG. Its management team has delivered consistently through cycles.

We hold the companies hightlighted.

Aberdeen Standard Investments is a brand of the investment businesses of Aberdeen Asset Management and Standard Life Investments

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Important Information

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