Auscap Newsletter

Auscap Long Short Australian Equities Fund

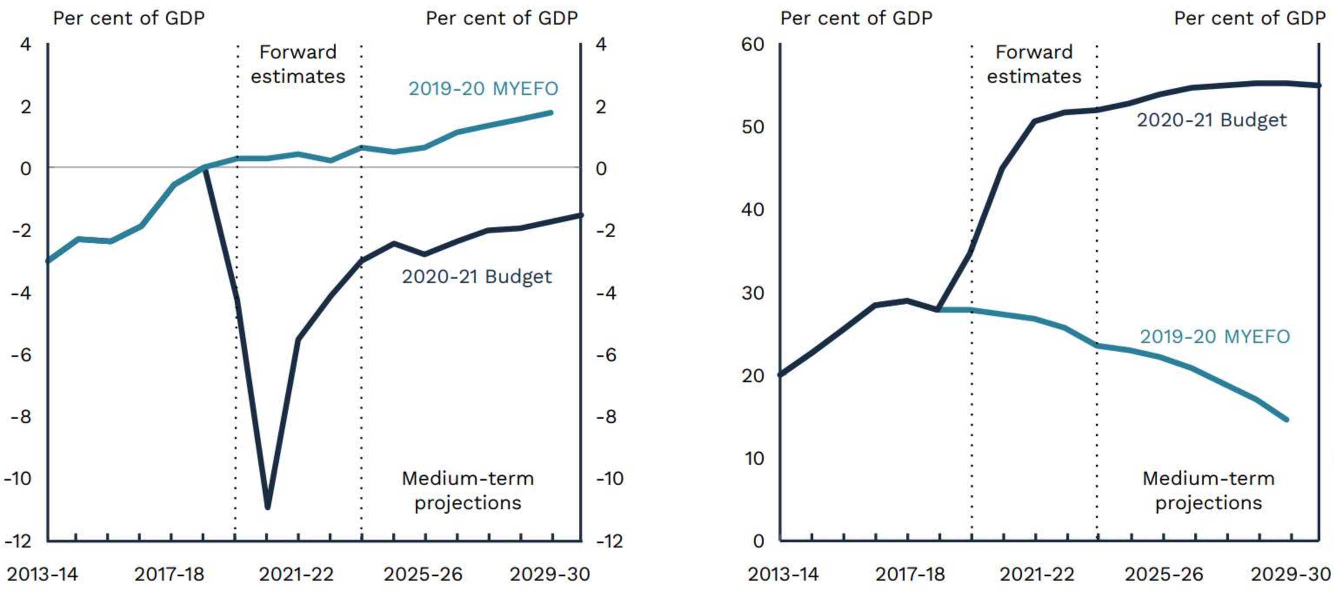
OCTOBER 2020

AUSCAP ASSET MANAGEMENT

Budget Winners Are Grinners

In April 2019, Josh Frydenberg delivered his first Budget as Treasurer. After more than a decade of deficits, Australia was finally on track for a long-awaited return to surplus, with surpluses forecast for the next decade. But the world has changed significantly since April 2019, and this month's Budget reflected the new reality. Budget deficits are now back for the next decade (shown below), with the annual deficit expected to peak at $214bn in the 2020-21 financial year. This is more than three times Australia's largest federal deficit during the Global Financial Crisis (GFC). Multiple new spending initiatives were also unveiled this month, on top of Australia's initial $299bn COVID-19 response. This newsletter outlines some of the significant new initiatives which are likely to benefit certain sectors and the listed equity market more generally.

Australia's Forecast Underlying Cash Balance and Gross Debt



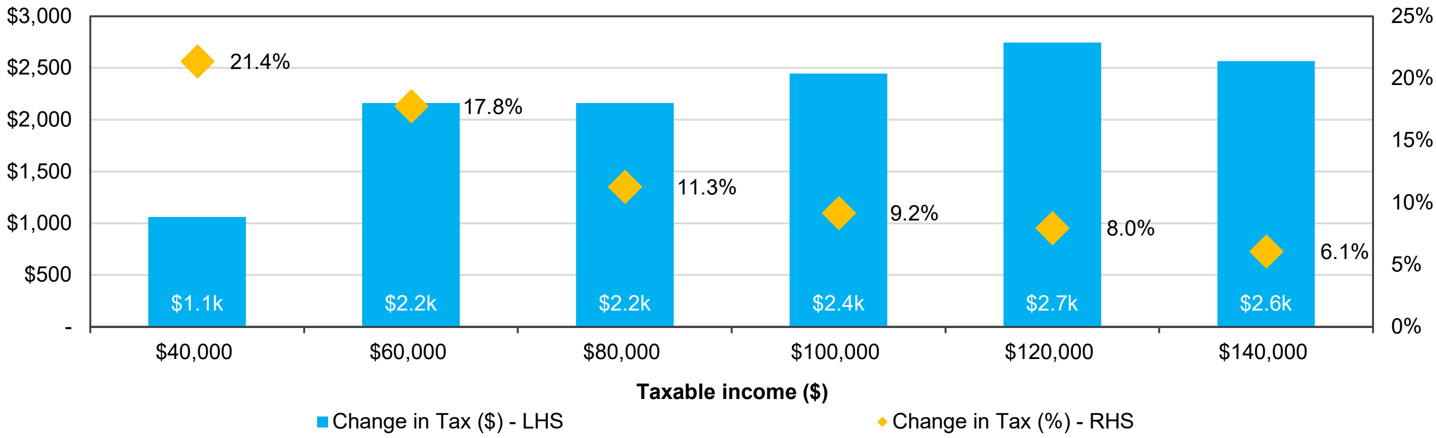
Cash Balance **Gross Debt**

Source: Australian Federal Treasury Estimates

Personal Income Tax Cuts

The Budget announced the bringing forward of the Stage 2 Personal Income Tax Plan to 2020-21. This $17.8bn initiative provides 11.6m individuals with a tax cut, with the majority of the benefit flowing to Australians on incomes below $90,000. This represents an income tax cut of between 6.1% and 21.4% for the majority of Australians compared to FY18.

Changes to Tax based on Taxable Income (2020-21 vs 2017-18)



Source: Australian Federal Treasury Estimates

This tax cut is likely to further strengthen household balance sheets, and benefit companies exposed to discretionary spending. Likely beneficiaries include discretionary retailers, automotive companies, hospitality providers and potentially economically exposed financial institutions such as the major banks.

JobMaker and Apprenticeship Initiatives

The Budget includes two initiatives which we expect to benefit businesses with large entry-level workforces. Firstly, the Budget includes a $4bn “JobMaker” hiring credit, which provides businesses with weekly credits for hiring 16-35 year olds ($200 for hiring 16-29 year olds or $100 for hiring 30-35 year olds). Secondly, the Budget announced a $1.2bn “Boosting Apprenticeships Wage Subsidy”, which is a 50% wage subsidy (up to $28,000) for newly commencing apprentices and trainees. Clear beneficiaries of these two initiatives are businesses involved in the building and construction industries as well as sectors involved in hiring young people, such as retail and hospitality. Such businesses often operate with modest operating margins, meaning small changes in their cost bases can have a magnified impact on their profitability.

Housing Construction Initiatives

The Budget also announced two initiatives in relation to the housing market, on top of the large number of initiatives already announced (discussed in Auscap’s June 2020 newsletter). Firstly, an additional 10,000 places have been added to the First Home Loan Deposit Scheme, which allows eligible buyers to purchase a property with a deposit as low as 5%. Secondly, the Government has provided a further $1bn guarantee to the National Housing Finance and Investment Corporation, to help stimulate investment into affordable housing. Direct beneficiaries of housing stimulus include property developers, building materials companies, household product retailers as well as companies with exposure to housing market trends, such as online property portals and the major banks.

Infrastructure Initiatives

Since the start of COVID-19, the Federal Government has committed to $14bn of new and accelerated infrastructure projects over the next four years. This has included projects in every state and territory, with a mix of large and small projects. This funding has been provided to state and local governments on a “use it or lose it” basis, which means activity in the building and construction sector is likely to remain supported. Beneficiaries include building materials companies and contractors.

Business Investment Tax Incentives

The Budget includes two measures, together costing $31.6bn, to support business investment. Businesses with turnover of up to $5bn will be able to deduct the full cost of eligible depreciable assets (or improvements to existing depreciable assets) in the year that they are installed. In addition, companies can offset new losses against previous profits on which tax has been paid. These two initiatives improve the cash flow profile associated with new capital expenditure. Any company planning capital expenditure will see a benefit.

Impact of Budget Stimulus

Economic uncertainty remains but a few observations can be made regarding the current expansionary fiscal environment:

- Whilst the economic shock has been large, the fiscal policy response has been unprecedented.
- Many listed companies are direct beneficiaries of the current level of fiscal stimulus, with very few companies being negatively affected by the announcements.
- Although some fiscal initiatives are short-term, many listed companies will experience long-term benefits arising from the income tax cuts for customers, balance sheet repair and cost savings.
- The stimulus has dramatically improved household balance sheets in the last six months (as discussed in our September newsletter).
- The performance of the Australian economy to date appears to be positively surprising economists, despite Victoria’s challenges with its extensive period in lockdown.
- Whilst equity market participants are gradually becoming less pessimistic about the Australian economy, the ASX200 continues to trade approximately 14% below its February 2020 high and 10% below its November 2007 high.

The Auscap Long Short Australian Equities Fund (**Fund**) is invested in a number of sectors which should benefit from the 2020 Budget stimulus, including retail (Nick Scali, Super Retail Group, JB Hi-Fi), automotive (Eagers Automotive, CarSales, Motorcycle Holdings), building materials (Wesfarmers, Reece, Adelaide Brighton), real estate (Stockland, Aventus, Home Consortium) and banking (Macquarie, Westpac, ANZ, NAB). We remain positive on the outlook and valuations of the Fund's portfolio holdings.

Auscap Long Short Australian Equities Fund

Fund Performance*

Period	Auscap	All Ords
September 2020	(2.6)%	(3.4)%
Financial Year To Date	11.1%	1.1%
Since Inception	141.2%	88.8%
Annualised Returns	11.9%	8.5%

Fund Exposures

September 2020 Average	% NAV	Positions
Gross Long	129.8%	53
Gross Short	10.4%	3
Gross Total	140.2%	56
Net / Beta Adjusted Net	119.4%	142.0%

Portfolio Commentary

The Fund returned negative 2.6% net of fees during September 2020. This compares with the All Ordinaries Accumulation Index return of negative 3.4%. Average gross capital employed by the Fund was 129.8% long and 10.4% short. Average net exposure over the month was 119.4%. Over the month the Fund had on average 53 long positions and 3 short positions. The Fund's biggest exposures over the month were spread across the real estate, consumer discretionary and financials sectors.

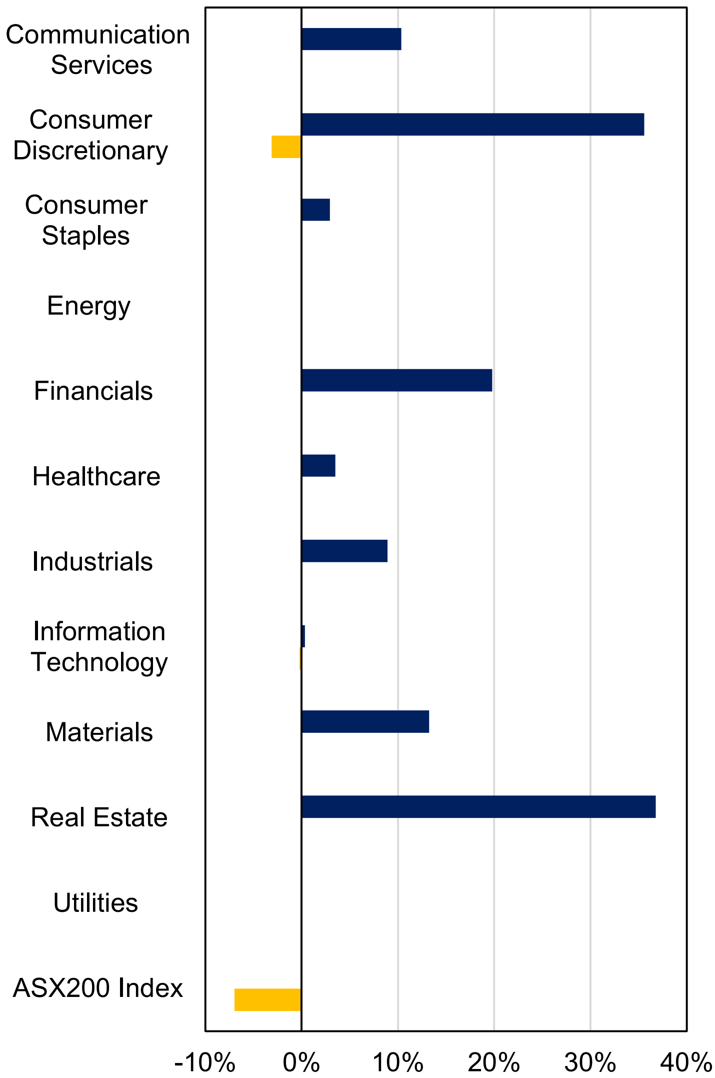
Top 10 Investments^

Aventus Group	Motorcycle Holdings
Carsales.com	Nick Scali
Eagers Automotive	NZME
GDI Property Group	Stockland
Mineral Resources	Super Retail Group

Fund Financial Year Returns*

FY13	19.7%	FY18	12.7%
FY14	46.0%	FY19	(9.2)%
FY15	16.8%	FY20	(19.9)%
FY16	20.1%	FY21	11.1%
FY17	8.0%		

Sector Exposure - September 2020



** Performance figures are calculated for the lead series net of all fees and expenses assuming the reinvestment of all distributions. Past performance is not a reliable indicator of future performance.*
^ Top 10 long investments in alphabetical order as at 30 September 2020.

Newsletter – October 2020

Auscap Asset Management

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