BEULAH CAPITAL

Beulah Conservative Portfolio

Quarterly Fact Sheet | March 2020

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Investment Approach

The portfolio aims to achieve a rate of return that matches inflation (CPI) plus 3% over a rolling 5 year period.

INVESTMENT STRATEGY

The portfolio targets a 70% investment in income assets (cash and fixed income) and 30% investment in growth assets (shares, property and international) either directly or through specialist wholesale fund managers. The allocation to individual asset classes is managed on a dynamic basis and may vary within nominated ranges.

Universe

The portfolio is invested across a mix of shares, property and fixed income securities. The targeted use of specialist managers also allows access to investment expertise and a diverse range of securities not readily available in an individual portfolio of this size.

RISK PROFILE
Low to medium: The estimated frequency of an annual negative return being less than 1 in 8 years.

MINIMUM INITIAL INVESTMENT
$100,000 on a standalone basis

MINIMUM SUGGESTED TIME FRAME
4 Years

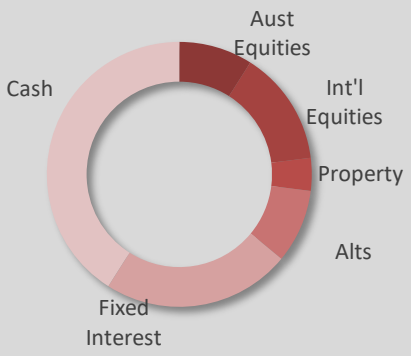
Performance

Beulah Conservative Portfolio

	3 Month %	6 Month %	1 Year %	3 Year %	5 Year %	Incept %
Portfolio Return	-11.13	-9.36	-6.01	-0.48	0.98	4.11
Peer Returns	-3.79	-3.92	-0.26	2.24	2.11	
Relative Return	-7.34	-5.44	-5.75	-2.72	-1.13	
Investment Objective (CPI +3%)						5.15

Performance Notes:
1: Peer returns are based on Morningstar Category peer averages that most closely reflect Beulah asset allocations.
2: Model portfolio return includes dividends and income, but does not assume reinvestment.
3: Returns greater than 12 months are annualised.
4: Returns are calculated after Managed Fund and other transaction costs, but before portfolio and MDA fees.
5: Returns are rounded to two decimal places.
6: Returns and holdings may vary between investors given the nature and timing of beneficial ownership under an MDA structure.
7: This document is for marketing purposes only.
8: Past performance is not an indication of future performance.

Asset Allocation



Asset Class	Actual %	Range %
Australian Equities	9	0-30
International Equities	14	0-25
Property Securities	4	0-10
Alternatives	9	0-20
Fixed Interest	23	20-50
Cash (inc. Tactical)	41	10-60

Contribution to Performance

Asset Class	Contribution to performance %
Australian Equities	-4.51
International Equities	-1.01
Property Securities	-0.88
Alternatives	-2.08
Fixed Interest	-2.74
Cash	0.10

Market & Economic Review

Risk assets around the world tumbled in the March quarter as governments instituted unprecedented shutdowns in many parts of the global economy to combat the spread of Covid-19. A strong start to the quarter saw equities regularly forge new highs throughout February. This was followed by an extraordinary market meltdown, but a catastrophe was avoided thanks to a relief rally in late March.

Against global peers, the ASX was comparatively weak as the falls overseas were cushioned by a decline in the Australian dollar. To put this in a historical context, total investor losses for the S&P/ASX 200 including dividends for the March quarter were the worst since the December quarter of 1987, and losses in the month of March were the worst since October 1987. It was also the worst March on record, eclipsing the same month in any of the depression years during the 1930s.

The theme of record losses also played out in global equities as investors struggled to quantify the impact on earnings from the Covid-19 pandemic in terms of depth, duration and restoration. In the US, for example, the blue-chip Dow Jones Industrial Average fell in the March quarter by a quantum not seen since 1987. Only one of its thirty constituents, being Microsoft, finished (slightly) higher.

The broader S&P 500 fared little better, while the Nasdaq 100 fell least among major US indexes, as "buy the dip" investors targeted the cash-rich tech mega-caps that make up its core. This occurred in a month that saw volatility spike higher and remain well above the levels seen in more recent times. At the smaller end of the market, underperformance was larger still. While the ASX Small Ordinaries was battered, the US Russell 2000 plunged the most since 1979 (in USD terms).

However, the worst was saved for the property sector. Domestic listed property lost more than a third of its value in March alone as some retail

tenants unilaterally announced they would not be paying rent and the government imposed a moratorium on commercial evictions. Unsurprisingly, many A-REITs withdrew distribution and earnings guidance, following the trend that had been set in other sectors.

In traditional fixed interest markets, there was extreme volatility and a general loss of liquidity until central banks intervened with vast injections of liquidity. Credit markets became dislocated and even "risk free" sovereign bond markets exhibited equity-like behaviour. Investors reached for liquidity and tried to comprehend the deluge of coming issuance as governments announced record spending packages. Meanwhile, cash remained the ultimate capital preservation tool and was one of very few asset classes which did not become increasingly correlated with equities.

Most notable among the commodities, oil prices posted the biggest quarterly decline on record after a new supply agreement controlling production among OPEC nations and Russia was abandoned in early March. By offering steep price discounts and increasing production, Saudi Arabia sparked an existential crisis for many oil companies, as rivals Russia and the US fought to protect market share. Upon reflection, the behaviour of oil prices over the past decade now makes concerns about limits to natural availability of supply (termed 'peak oil') look like manufactured hysteria.

As markets tumbled and the domestic economy ground to a halt, the Reserve Bank cut rates to 0.25% and finally commenced unconventional monetary policy with the aim of keeping three year treasury yields at very low levels. It also announced a three-pronged easing package featuring a $90b term funding facility to support bank lending to small/medium sized businesses (SMEs).

At the federal level, several waves of stimulus were announced. The initial fiscal package comprises two separate payments to households of $750 and a new fund to support severely affected regions.

The second phase provides additional fiscal support with policies targeting job seekers and welfare recipients, SMEs, companies that are temporarily trading while insolvent, and allowing some individuals to make tax-free withdrawals from their superannuation, which sent industry funds into crisis mode.

The third phase is a wage subsidy scheme that will pay firms $1,500 a fortnight per employee for the next six months called 'JobKeeper Payment'.

In the US, a substantial fiscal stimulus package was agreed, worth about 10% of GDP, which will include some grants to small businesses. The package also provides government backing for credit to be provided by the Federal Reserve to investment grade companies to help with cash flow. However, some large companies may require grants or bailouts rather than just credit to survive this shock in the longer term.

Portfolio Review

The Portfolio underperformed peers during the quarter as indiscriminate selling spread to more defensive income generating positions. The largest contributor to the decline in overall performance was the Australian equities exposure, even though this slightly outperformed domestic shares more broadly.

During the month of March, almost every company suspended its guidance comments given the economic shutdowns imposed by Covid-19. Stocks are no longer trading on business growth profiles but on strength of balance sheets.

Trading updates have largely focused on liquidity reserves, debt covenant status and the measures taken to preserve the health of employees and customers. Investors are clearly looking ahead to further earnings downgrades or dilutive capital raisings as the multiple decline has thus far been much more significant than the earnings changes.

Given the extreme volatility in the March quarter, we made a number of changes to our domestic equities exposure. On balance we have added to positions in core stocks where we still believe in the long-term investment thesis and have treated the Covid-19 crisis as an opportunity to add to these positions.

These include Afterpay (APT), Sydney Airport (SYD), Qube Holdings (QUB), Amcor (AMC), James Hardie Industries (JHX) and Seek (SEK). Many of these will be impacted severely in the next couple of months during various stages of economic shutdown but we expect each to emerge relatively unscathed.

On the sell side of the equation, we exited Reliance Worldwide (RWC) on poor management execution, while Unibail Rodamco (URW) was removed on Covid-19 impacts, particularly for its exposure to European shopping centres.

Portfolio Review (cont.)

Our international equities exposure has thus far been unhedged with respect to the currency and this cushioned some of the falls seen in local dollar terms overseas. Legg Mason QS Investors Global Equity Trust was disappointing and was the main drag in this asset class as value style investing remained out of favour.

Meanwhile, our exposure to global healthcare delivered a slight positive and limited the damage. During the quarter, we exited positions in Antipodes Global Fund and L1 Capital Long Short Fund in order to raise cash for deployment as new opportunities arise. Areas we are targeting include regulated infrastructure, oversold property sectors, and potentially a tactical position in global oil majors.

Our core property exposure is through the listed QRI – Qualitas Real Estate Income Fund and is supported by satellite exposures to Stockland (SGP) and the broader sector via an exchange traded index approach (SLF). The latter incurred a huge selldown as tenants unilaterally suspended rental payments and government restrictions forced the closure of many stores and venues. To date, many REITs with funding pressures have successfully raised debt and the sector has avoided large-scale dilutive equity raisings such as was seen during the GFC.

In relation to debt security QRI, the stock has traded below NAV even though there have been no defaults and management has stringent measures in place to assist any struggling businesses. Much of its exposure is away from the hardest hit areas of the economy. We expect that QRI will move back towards NAV as time progresses and investor confidence is restored more generally. There is no current indication to suggest that income flows will be hampered in the near term.

In Alternatives, we were disappointed with the performance of listed credit trust MOT – Metrics Income Opportunities Trust. Indiscriminate selling during the month of March saw its security price fall well below net asset value (NAV) even though there is currently no reason to expect that there will be systemic defaults in its portfolio. The trust continues to distribute in line with expectations and management is well positioned to actively manage the portfolio should the need arise. It is our expectation that the current discount to NAV will dissipate over coming months.

In fixed interest, this part of the portfolio was mainly impacted by the fall in the Metrics-operated MCP Master Income Trust (MXT). This operates in the more highly-rated Australian corporate loan market and was indiscriminately sold down during the quarter. At the end of March – during the peak of the crisis – much of the underlying exposure in MXT was independently upgraded by S&P to A- from BBB+. This is a ringing endorsement of the quality of much of the underlying exposures. It reflects the level of risk-adjusted leverage, low underlying credit risk profile relative to peers and solid franchise among its target investor segment. The ability to control redemptions and distributions should assist in meeting potential liquidity challenges during periods of stress.

Outlook

The domestic and global economies are undergoing an unprecedented shock, which has elicited an unprecedented response. Central banks have cut rates to their lower bound and restarted or expanded quantitative easing (QE, which describes financial asset purchase programs).

The US Federal Reserve's commitment to purchase as many government bonds as necessary will weigh on risk free rates such as long term bond yields and boost asset valuations. Its corporate credit program should also prove a significant support for investment grade corporate bonds. The US high yield sector currently looks the most susceptible to default events and this is evident in the sharp rise in the cost of borrowing relative to government-issued securities (known as 'the spread'). Many smaller companies will find it more difficult to raise cheap capital than their larger peers and are likely to face stiff headwinds over the coming months.

On the domestic front, the Australian economy will almost certainly contract in the March quarter as the impacts of the Covid-19-induced partial shutdown reinforce the weakness that emanated from the bushfire crisis.

The federal and state/territory governments have announced multiple phases of stimulus, which comprise a combined ~17% of GDP. This will provide some cushioning to the collapse in activity that will occur in the June quarter and bring about Australia's first recession since the early 1990s.

Outlook (cont.)

Some of the concern by domestic listed property investors is that the sector may need to conduct dilutive equity raisings such as it did during the GFC. However, unlike the GFC, the sector did not enter this crisis with dramatically over-geared balance sheets. The length of the downturn will be key in determining how this plays out, as will the "working from home" experience. Indeed, the latter may help bring to an end the seemingly unending escalation in office rents in Sydney and Melbourne where new supply is also in the offing.

At the global level, numerous countries have announced a raft of stimulus measures. Most notable is the US fiscal package, which significantly increases jobless benefits for the next few months. However, the policy appears less effective than the Australian, UK or German policy of encouraging companies to hold on to staff. Overall, fiscal policy has already delivered a significant stimulus globally but further measures are still likely to be needed to deal with the size of this shock.

The OECD and IMF have downgraded global growth for 2020. Separately, we expect the US economy will experience a contraction in the March quarter followed by a deep slump in the June quarter. The unemployment rate will likely rise to double-digit levels before staging a partial recovery at the end of 2020.

China's economy remains weakened by containment measures introduced in response to the Covid-19 outbreak. China is likely to see its economy contract sharply in the March quarter and again in the June quarter, but at a slower pace. That economy is thought to be back to 80% capacity at the end of March.

Overall, the depth and duration of this recession will strongly depend on the trajectory of the outbreak and the extent to which governments are prepared to fill the demand gaps and prevent unemployment from spiralling out of control. If the latter were to occur this would hurt residential property where households are already highly leveraged and feed into weaker future spending, further threatening business sustainability.