Issue #09 January 2021

KAURI ASSET MANAGEMENT

Kauri Communiquê

Keeping you up to date with Kauri Asset Management and the Markets

Will the Market Extend its Rally in 2021?

After a strong finish to the year, expectations are high for the stock market in 2021. Will there be enough tailwinds for the market to continue rising?

+

Monthly Portfolio Reports

Our portfolio managers take you through the main contributors and cover any changes across both the Australian and US markets.

MICHAEL SMITH
Head of Research and
Senior Investment advisor

Will the market extend its rally in 2021?

After a strong finish to the year, expectations are high for the stock market in 2021. Will there be enough tailwinds for the market to continue rising?

With 2020 now out of the way, and some optimism building across the world for a more positive year ahead, there is also good reason to believe that the market will continue to reward investors throughout 2021.

First, however, it's worth touching on the magnitude of exactly what we witnessed last year across financial markets.

Despite the deadly Coronavirus pandemic resulting in an enormous health catastrophe, and forcing the hand of governments everywhere to lock down their economies, the market defied all the odds to deliver strong returns.

The S&P 500 overcame a drop of more than one third at the height of the initial panic in March before ultimately finishing the calendar year over 16% higher than where it started, while the Nasdaq gained over 40%.

With that, we really need to put into perspective that the results of the year gone by are more likely to be the exception rather than the norm.

Our forecast for the year ahead sees markets continue their upwards trajectory, but we do want to keep expectations in check and should we see another bumper year, we'll treat that as a bonus.

There are five key reasons we see the stock market grinding higher over the course of the coming months in 2021.

Vaccine deployment to bolster economies

As we touched on in our last newsletter, we anticipate that the rollout of vaccines will help steer global economic growth back on track, led by the world's developed economies.

Thus far, it must be said that the rollout of the vaccines have been disappointing due to missed targets, timelines slipping and some production issues also.

Nonetheless, we predict that improvements will be made in these areas, while it is also likely that other vaccines may be approved across the first half that in turn help provide a buffer to meet global demand.

The energy market has already started to show early signs of positivity amid a surprise production cut from Saudi Arabia, and once vaccine deployment picks up momentum, and travel can safely resume, there will be further tailwinds to support this sector.

More broadly, however, we believe consumer sentiment will also be given a much needed boost, underpinning economic growth.

Federal Reserve to maintain fiscal support

Perhaps the clearest turning point in the market recovery last year was the moment where the Federal Reserve effectively stepped in to provide fiscal support that would prop up the economy.

Since then, the central bank has not just maintained the pace of this support, but at times it has even accelerated its bond buying activity and extended its support mechanisms far greater than anyone would have anticipated.

The Fed has also telegraphed that it is likely to offer this support for as long as it takes to help the economy revert back to where it was prior to the pandemic.

With this confidence in place, investors have been all but assured that the Fed will effectively backstop the market in the event that there were to be another event that catches investors off guard, like a double-dip recession.

Low rates are here to stay

Tying in with the Federal Reserve's efforts to prop up the economy, interest rates are at rock bottom levels.

There is little prospect that this is about to change any time soon. In fact, the central bank has even gone as far as to indicate that rates are not set to rise until at least the end of 2023, if not later.

As far as the economy goes, we can expect that coming out of the pandemic, this is where we will really start to see the effects of interest rates at zero.

Given the likelihood of pent-up demand, as well as less uncertainty, we believe businesses will be well-placed to invest more aggressively to support their underlying growth.

Another round of stimulus cheques

After Congress finally reached a deal to put together a second round of direct support to American households across the country, there was some dejection within the investment community that it didn't go far enough.

After all, negotiations prior to the election had suggested more than US$2 trillion was on the table at one stage, before a significantly scaled-back deal was struck. There was as much attention placed on the accompanying government spending package, which in itself was criticised in many quarters for various 'wasteful' allocations.

In any case, with President-elect Joe Biden set to take office in a matter of days, and a clean sweep of Congress following the Democrats two wins in the Georgia Senate runoffs, expectations are on the rise once again.

Yes, there are some concerns around policy governing higher corporate taxes, which would hit mega-tech companies, an integral part of the market rally, the hardest.

However, the prospect of another round of stimulus cheques and broader relief measures from the government looks increasingly likely.

We may even reach an outcome where the Democrats are able to pass a package equal to or greater in value than that discussed months ago. Already, Biden has committed to a third round of cheques for Americans, expected to be US$2000 each.

This would prove to be a sugar hit for the economy, and much like the first round of support, our view is that this would support consumer spending and reignite retail sales growth.

Opportunity cost, what choice is there?

When we consider the sum of all moving parts, including the particular fact that interest rates are zero, there is a stark question that investors are confronted with. What alternative is there?

With cash offering nothing in the way of returns, and other asset classes like bonds yielding little reward, the stock market has proven to be an opportunity too good to pass up.

Sitting on the sidelines throughout the market rally, or even selling amid the market crash, would have resulted in a significant opportunity cost. Compounded, missing out on these sort of returns can have a monumental impact on one's savings by the time they reach retirement.

Keeping tabs of all these factors at play, we maintain the position that investors really have no option but to invest in the stock market.

Sitting on the sidelines is not an appropriate consideration for us at this time, particularly when we feel the market has shown resilience amid the most turbulent of times. We look forward to what we expect will be a rewarding year for investors.

International

MICHAEL SMITH
Head of Research and Senior Investment advisor

Performance:

Index	December Performance	2020 Performance
Dow Jones	3.3%	7.2%
NASDAQ	5.1%	43.6%
S&P 500	3.7%	16.3%
Global Growth Portfolio	-0.2%	27.5%

Top 10 Holdings:

Code	Company Name	Weighting %
PYPL	PayPal	5.65%
SQ	Square	5.07%
TSM	Taiwan Semi	5.02%
MSFT	Microsoft	4.55%
ISRG	Intuitive	4.51%
AAPL	Apple	4.42%
ADBE	Adobe	4.30%
BIDU	Baidu	4.17%
V	Visa	4.01%
TEAM	Atlassian	3.99%

International Growth Portfolio

Foreign exchange movements weighed on the portfolio last month, which meant that NAV declined 0.2% across December.

For the second month in a row, unfavourable currency movements worked against us with the USD/AUD forex rate continuing to ease. From the start of December, through to the end of the month, the USD/AUD rate fell from 1.3618 to 1.2999.

This headwind proved challenging to overcome, ultimately having a negative impact on portfolio NAV to the tune of 4.6%. Some of this loss was mitigated through our options hedging, a strategy that we are also replicating at a higher threshold in the new year to further protect the portfolio.

Notwithstanding the negative return for the portfolio, which trailed each of the market indexes, the underlying performance of our core holdings actually outperformed the S&P 500 and the Dow Jones, growing 4.3% in constant currency terms.

Baidu (BIDU), which gained 55.6% last month, was not just the best-performing stock in the portfolio in terms of its percentage gain, but it was also the biggest contributor as far as overall NAV growth. The stock was spurred on by rumour that the business may seek to extend its technology to the fast-growing electric vehicle market.

Elsewhere, there were also robust performances from some of our long-term names like Apple (AAPL), PayPal (PYPL), Intuitive Surgical (ISRG) and Taiwan Semiconductor Manufacturing Co (TSM). Losses were mostly contained, albeit Alibaba (BABA) and our new position in Pfizer (PFE) underperformed, but we are prepared to look past near-term volatility for an expected improvement across the mid-term.

We took the opportunity to exit our position in Slack Technologies (WORK) following the company being subject to a takeover bid from Salesforce. We anticipated that it would be more beneficial to divert our funds elsewhere, with the stock trading flat after we sold anyways.

Closing out December's action, we officially 'booked' a small profit to the value of 1.1% of the portfolio's NAV as at the close of the prior month.
In addition, our unrealised profits eased slightly to represent 20.3% of December's closing NAV for the portfolio.

MICHAEL SMITH
Head of Research and Senior Investment advisor

AFIQ MALEK
Research Analyst and Senior Client advisor

Performance:

Index	December Performance	2020 Performance
ASX 200	1.1%	-1.1%
ALLORDS	1.6%	0.7%
Aus Yield Portfolio	2.2%	1.5%

Top 10 Holdings:

Code	Company Name	Weighting %
HUB	Hub24	12.31%
ANZ	ANZ Bank	10.38%
BBN	Baby Bunting	9.74%
WES	Wesfarmers	8.69%
CBA	Comm Bank	8.66%
NWL	Netwealth	7.59%
BHP	BHP Group	6.83%
KKC	KKR Credit	6.58%
TLS	Telstra	5.72%
MFG	Magellan	3.97%

Australian

Australian Yield Portfolio

NAV for the Australian Yield Portfolio increased by 2.2% in December, capping off a strong finish to the year and a month where we outperformed the ASX 200. In comparison, the benchmark index for the local share market grew by just 1.1%.

There were strong results from a host of our holdings, with BHP (BHP) being one of the standouts. As the price of both iron ore and oil surged last month, the stock posted a gain of 11.5%.

Since then, BHP shares have continued to increase, supported by the same tailwinds in the commodities space, despite the rising Australian dollar.

Another leading stock in the portfolio last month was Baby Bunting (BBN), which also happened to be one of our best performers right throughout 2020.

There was no specific news that acted as a catalyst for the stock, however, we do note that consumer spending and sentiment have fared largely better than expected, in turn supporting omni-channel retailers like Baby Bunting with a strong ecommerce offering.

A2 Milk (A2M) was a setback for us last month, with the stock falling 17.2%. The company was forced into an earnings downgrade as the toll of international border closures continues to dampen the company's daigou channel.

Despite the slump, we still hold an upbeat view for A2 Milk moving forward, as we view the issues at hand currently being temporary amid the pandemic. We anticipate that these headwinds will ease as the vaccine rollout takes place in 2021, and in the meantime, there is still strong underlying growth in other parts of the business.

By the end of December, unrealised profit for the Australian Yield Portfolio had reached 8.3% of the closing NAV for the month. We are particularly pleased with the strong finish to the year, and ultimately, the returns that are now available to us amid what has at times been a significantly challenging environment.

The Australian economy is continuing to exceed our expectations. While outbreaks of COVID across New South Wales and Victoria have shuttered borders, we believe the effective management of the pandemic will flow through to potential earnings upside in a couple months, in turn supporting a gradual rise in the market.

DANIEL WONG
Research Analyst

ALEX NEGROH
Research Analyst

Performance:

Index	*December Performance*	*2020 Performance*
ASX 200	1.1%	-1.1%
ALLORDS	1.6%	0.7%
Balanced Portfolio	6.0%	9.6%

Top 10 Holdings:

Code	*Company Name*	*Weighting %*
HM1	Hearts & Minds	8.1%
FANG	Fang ETF	4.6%
Cash	Cash	4.2%
CBA	Comm Bank	3.7%
NABPD	NAB note	3.5%
BHP	BHP Group	3.0%
DRR	Deterra	2.9%
APT	Afterpay	2.8%
CBAPH	CBA Note	2.7%
CCP	Credit Corp	2.7%

Hub 24 - Super

Balanced Portfolio

Portfolio NAV grew by 2.6% in the final month of 2020, which represented an outperformance of 1.5% against the ASX 200 index.

Iron ore stocks continue to be one of our major conviction plays, with the nation's largest miners all seeing a bumper month.

BHP (BHP) gained 11.5%, Rio Tinto (RIO) surged 12% and Fortescue Metals Group (FMG) leapt 28.5%. Since then, each company has continued higher and managed to chalk up a new all-time high.

The driving force for these stocks has been heightened iron ore prices. During the month we had news Brazilian miner Vale had seen another incident at one of its sites, further constraining its production capabilities that were already taking far longer to come back online than expected.

In addition, the demand for iron ore out of China has topped the most optimistic of predictions, with steel production hitting significant levels. With iron ore prices still elevated, we believe the prospect of special dividends and/or buyback programs is very much on the table.

One of our new additions to the portfolio was Race Oncology (RAC), which is a pharmaceutical business working on cancer treatments. Unfortunately our timing here was slightly awry, with the stock seeing a poor showing in December and down nearly 16%.

However, it is still quite early days here as far as allowing our thesis to play out, and at the moment, the healthcare sector has been rather unloved and trailed the broader market as investors pile into more growth-oriented stocks. We expect to see some interest pick up in health stocks in the first quarter as international attention starts to focus on key drug results from major biotech players.

Faring better was our new position in Cleanspace Holdings (CSX). The business designs, manufactures and sells workplace respiratory protection equipment for industrial and healthcare end users. A relatively recent listing, we believed the company had been oversold, and by way of its solid trading update, the stock added 17% across the course of its first month in the portfolio.

Amid the strength of the resources sector led by iron ore, but also including a rebound in energy and gold prices, we expect the ASX to continue to grind higher despite renewed COVID concerns and border closures.

ALEX NEGROH
Research Analyst

DANIEL WONG
Research Analyst

Performance:

Index	*December Performance*	*2020 Performance*
ASX 200	1.1%	-1.1%
ALLORDS	1.6%	0.7%
Growth Portfolio	6.3%	3.9%

Top 10 Holdings:

Code	*Company Name*	*Weighting %*
HM1	Hearts & Minds	7.4%
FANG	Fang ETF	4.6%
LYC	Lynas Corp	3.8%
CBAPE	CBA Note	3.6%
Cash	Cash	3.6%
XRO	Xero	3.5%
GXY	Galaxy	3.3%
MHH	Megallen High	2.8%
MQG	Macquarie	2.8%
CBA	Comm Bank	2.7%

Hub 24 - Super

Growth Portfolio

The Growth Portfolio had a great month in December, not only outperforming the ASX by a significant amount, but comfortably bettering the Balanced Portfolio that we also manage. In total, NAV gained 2.8%, which we were very pleased with.

Afterpay (APT) had a spectacular month, soaring 25% as the company continues to cement its position as the undisputed frontrunner in the buy-now pay-later segment. While other stocks from this sector have traded sideways or even retreated, Afterpay shares tore through the $100 mark and hit as high as $123.40 per share.

One of the key differentiators between the Growth and Balanced Portfolios was the higher allocation of the portfolio dedicated to tech stock Xero (XRO). The cloud-based accounting software business put on 10.8% across the month, setting a new all-time high in the process.

Meanwhile, after a wild November, December proved to be a relatively solid month for one of our more recent contributions to the portfolio, RedBubble (RBL).

The stock gained 6.2% last month with its sales building leading into the Christmas period. We anticipate that the transition to ecommerce will continue into the new year and thereafter, providing a long-term tailwind for the global online marketplace.

In terms of underperformers, Magellan Financial Group (MFG) defied our expectations and shed 10% of its value throughout December.

Despite being quite active, the market didn't quite respond as we would have anticipated with respect to the fund manager's restructuring efforts. In addition, foreign exchange movements have also hurt the company's funds, with the US dollar sliding quite sharply against the Aussie dollar, and the likelihood being that the trend continues.

Like the Balanced Portfolio, iron ore miners also played a mighty hand in helping us outperform the broader market. Similarly, our stake in Credit Corp Group (CCP) also helped, surging 25% on the back of an upgrade to its earnings forecast following an acquisition of Purchased Debt Ledgers (PDL) from a listed peer.

We are quite confident heading into 2021 that some of the key themes supporting the market's recovery will continue to play out. Our view is that the vaccine rollout will also facilitate further confidence across the market.

KAURI ASSET MANAGEMENT

Level 8
25 Bligh Street

GPO Box 2348
Sydney NSW 2001
Australia

PH 02 8379 1868
E info@kauriam.com.au

www.Kauriam.com.au

Disclaimer:

This document and any information or advice has been prepared by Kauri Asset Management without taking account of your objectives, financial situation and needs. Because of this, you should, before acting on any advice from Kauri Asset Management, consider the appropriateness of the advice, having regard to your objectives, financial situation and needs. Kauri Asset Management strongly recommends you seek accounting, financial, taxation and legal advice, tailored to your specific situation and needs prior to making any investment decision. The investment manager certifies that all the views expressed in this document accurately reflect their views about the companies and securities referred to in this document and that their remuneration is not directly or indirectly related to the views. Kauri Asset Management, its directors, representatives, employees or related parties may have an interest in any of the companies and securities in this document and may earn revenue from the sale or purchase of any financial product referred to in this document or any advice. CAR 1275519