

# Lonsec Income mandate (LI)

31 December 2009



## Investment manager

Lonsec Limited

## Mandate objective

To deliver strong absolute returns, over the medium to long-term, through a diversified 'blue-chip' portfolio invested across a number of industries. The stock universe is the S&P/ASX Top 150 companies.

## Designed for Investors who:

- A fully invested active manager of "blue-chip" stocks.
- An attractive fully franked yield with some capital growth.
- To invest for the medium to long-term.

## Lonsec Core

Lonsec Limited is a leading equities and managed funds research house, providing equities and managed funds research to stockbrokers and financial planners. Lonsec has assembled a team of around 29 analysts.

## Investment process and strategy

Lonsec takes an active approach to investing and focuses on generating absolute returns, over the medium to long-term, through concentrated portfolios. Lonsec employs a four-step investment process. Portfolios are heavily influenced by 'top-down' themes at the Portfolio Construction level. They then employ four stock filters (industry, company quality, valuation and risk) to select their stocks at the Stock Selection level. Risk is managed at both the Portfolio Construction level and the Stock Selection level. The final step involves managing the portfolios and regularly reviewing their top-down themes and stock selections.

## Inception date

31 May 2007

## Mandate commentary

### Relative Portfolio Performance

The Income Portfolio has been tracking close to benchmark over the past six months and is narrowing its level of underperformance over longer timeframes. Financial stocks make up nearly 50% of the S&P/ASX Top 100 Industrial Index whereas the Income Portfolio has only a 30% weighting, with the balance in mostly defensive industries. Accordingly, the portfolio will tend to outperform when market sentiment is neutral or negative.

The current portfolio yield is 5.0% ff (7.2% gross), which Lonsec believes is sustainable and should grow over time. Investors looking for capital growth should follow the Lonsec Core portfolio.

### Stocks contributing to relative performance

- **CSR Limited - CSR (+1.1%)** was resilient during January ahead of its proposed demerger of Sugar. Unfortunately, at the time of writing, the Federal Court has rejected CSR's de-merger application which has forced CSR to re-think its plans. CSR has a number of options including appealing the decision, restructuring the proposal, conducting a trade sale of Sugar or maintaining the status quo. China's Bright Foods remains interested in acquiring the Sugar business which ironically would not require court approval.
- **AGL Energy - AGK (-1.5%)** held up well during January due to its defensive qualities as a vertically integrated energy company. AGL is Australia's largest energy retailer, selling gas and electricity to more than 3 million customers. To balance the risk between the cost of obtaining energy in wholesale markets and retail distribution, AGL has, for some years now, been pursuing a strategy of vertical integration.

### Stocks detracting from relative performance

- **Wesfarmers - WES (-12.0%)** retreated sharply after a strong run from \$15 to \$32 over 2009. After conducting a \$4.6bn capital raising to reduce net debt to \$4.4bn, and gearing (ND/E) to 18.3%, the outlook is now starting to improve for the key Retail and Resource divisions. These two divisions dominate earnings, contributing 62% and 28% of FY09 EBIT, respectively. Resource earnings will dip significantly in FY10 but should then recover as coal prices rebound.
- **Healthscope Limited HSP (-7.7%)** retreated sharply for no apparent reason apart from negative market sentiment in January. Ramsay Health Care, Australia's largest private hospital operator (HSP is the second largest) recently upgraded its FY10 profit growth forecast from 12-14% to 18-20%. Ramsay cited better than expected conditions in the UK and Australia. This suggests HSP should also be experiencing a good year. HSP reports its interim results on 15 February 2010.