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Wilson Asset Management

WAM Leaders FY2022 Interim Results Webinar

Geoff Wilson: Thank you for joining the WAM Leaders (ASX: WLE) FY2022 Interim Results Webinar. This is your company and thank you all for sending in a lot of questions. We really appreciate it. Any questions that we won't be able to cover on this webinar, we will get back to you or invite you to contact us. I will give you a little bit of a precis of the result and then we will really go to the WAM Leaders A-Team, and that is led by Lead Portfolio Manager Matt Haupt, Portfolio Manager John Ayoub and Equity Analyst Anna Milne. They are the ones who do all the hard work. They manage the money on your behalf. The fantastic performance over the last three or so months is really a total credit to that team.

In terms of the result for the six months just gone, that is the period to 31 December 2021, the portfolio was up 9.6%. Again, very, very strong outperformance, and that is an outperformance of 5.8%. It is incredibly difficult to outperform in any market, but also outperform when you are focusing on the large-cap, undervalued growth companies. It is a big challenge and I take my hat off as a shareholder, like yourselves, to the team that I just talked about earlier that has delivered this performance. In terms of the performance for the 12-month period, that is the 2021 calendar year, again a solid performance, up 28.3%, outperforming the index by over 10%, actually a little over 11% outperformance. Over that period, the team was well exposed to the equity market, nearly over 96%, holding just a little under 4% in cash.

In terms of the dividends, the great thing is the team has delivered strong performance over a good period of time, which has really built up the profit reserve. The ability to pay dividends is a combination of profit and also, for those dividends to be fully franked, it is what tax we paid or what dividends we received that are fully franked. In terms of the profit reserve, we have a little over four years of this current dividend rate in the profit reserve – that is a little over 32 cents, 32.6 cents, which is fantastic. You would have seen the interim dividend, a really solid increase. A couple of years ago, a lot of companies were cutting dividends. WAM Leaders didn't; it kept increasing them. So, it is off a higher increased dividend base, but because of the strong performance by the investment team, the Board has been able to increase the dividend by a little over 14% to give a fully franked interim dividend of 4.0 cents per share fully franked. Normally, what we pay in the interim, you assume in the full year. As you would see, that obviously depends on market conditions, but we are in a very strong position to do that.

What I would like to do now is just to pass over to Matt, who will take you through what he's looking at, what he is doing. Obviously, it has been an incredibly challenging period. Let me pass over to Matt. Thank you.

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Matthew Haupt: Thanks, Geoff, and thanks to all the shareholders on the call for your continuous support. WAM Leaders is approaching our sixth-year anniversary, so I would just like to extend our thanks for the continued support of all our shareholders.

There is a lot going on at the moment, but this year really can be categorised as a tightening year, as we move away from that incredible policy support we saw during coronavirus. This year is all about the path of interest rates, how fast will they go up and where does the terminal rate or the neutral rate or, put more simply, where do the central banks stop when they raise their rates this time around?

We think the forward rates into the market will come down. So, especially in Australia, there are over four interest rate hikes in the forward curve over the next 12 months. We think this is unlikely to eventuate. In the US, which is predominantly the biggest driver of all equity markets and all asset classes, the interest rate hikes are probably a little bit aggressive too. What the effect of the interest rate hikes are, is they push the discount rates up and put pressure on equity prices.

The other thing we have seen is a flattening of those interest rate curves. Rather technical when you look at it, but the one year one-year rate and the one year ten-year rate, which is basically the one-year rate in one year's time and the ten-year rate in one year's time, they have actually inverted. The bond market is saying the interest rate path the US Federal Reserve (the Fed) are on is too tight and really, growth will falter.

We think the conditions for equities are pretty tough. With the Ukraine into the mix, obviously putting aside the humanitarian issues, the financial implications, what are they? The initial thoughts are inflation will be higher, so the commodities you would have seen have run up, and John will touch on those later. Also, growth will probably slow down too. It is more of a stag-flation environment. When you throw that into the mix, the risk is a dovish tilt from central banks. So far, the Fed members are remaining hawkish. The ECB overnight, the European Central Bankers, they are slightly tilting dovish. In the short-term, there is a potential for a dovish tilt before we get back to the more hawkish environment.

Overall, our take for equities in 2022 is that it is going to be pretty tough. The things driving equities are risk-free rates, which should go up; growth rates, they should decline; and the equity risk premium is probably going to hovering around the same level as we have seen. A couple of the factors are going to be negative, but even in this environment, we think there are great opportunities. The process we have in WAM Leaders allows us, or gives us a framework, to perform in all market environments. We don't care whether it is value or growth. The framework we have is really flexible, so we are quite confident in any market environment to continue the outperformance. I will hand over to John now, who will touch on some of the portfolio positioning and how it's moving, with all those moving parts I have just touched on.

John Ayoub: Thank you, Matt, and thank you to all our shareholders. I would characterise the state of the portfolio as a game of 3D chess right now. I say that because we are juggling rate movements, we are juggling coronavirus and now we are juggling more on the Ukraine and Russia. From that perspective, it makes it awfully difficult to get a clear and confident path as to the shape of the portfolio for the next month, let alone for the next six to twelve months. What we do best, is we are at the coalface daily, and managing the risk and adapting as we get new information. That is what we are really focused on right now. When there is not a clear path, we have to adapt and we have to be ready to change as new information comes. That is really our focal point today.

With saying that and since our last update, our portfolio has performed extremely well, so we have taken the opportunity that the dislocation in the market, particularly over the last month, has provided to rotate the portfolio to where we see there are some opportunities, not only from a stock specific perspective, but also from a sector perspective. Two clear characteristics that the portfolio is now demonstrating a lot more than previously is quality and defensive earnings attributes. That is really where we see our safe haven within the portfolio to ride out this volatility over the next little while, so, stocks like Brambles (ASX: BXB) , Endeavour (ASX: EDV), Tabcorp (ASX: TAH), Wesfarmers (ASX: WES) and Treasury Wine (ASX: TWE) are positions that we have built recently where we see their earnings, their ability to withstand the volatility of global events, particularly in the short-to-medium-term, as key drivers within the portfolio.

Elsewhere, you have heard previous updates, we have been fairly resolute in not owning any over-valued tech stocks. What we have seen recently is a slight change to that outlook. The sell-off has provided some opportunities within those sectors where we think individual stocks who have the ability to demonstrate superior earnings can grow into their multiples, and it presented opportunities over the recent past. Names like REA Group (ASX: REA), Seek (ASX: SEK), ResMed (ASX: RMD) and James Hardie (ASX: JHX), where we think they are market-leading franchises, extremely well positioned, no matter what the macro backdrop provides, where there is somewhat more valuation support today. We think these stocks can also be drivers of the portfolio, so we have put positions within the portfolio with those, some larger than others, and we will continue to build on those positions over the next six to twelve months.

With the broader shape of the portfolio, to characterise some of the changes that we have done, there is probably slightly less financials than when we last updated everyone and that was late last year. We still like insurers and we still think they provide those defensive earnings streams, and Anna will touch on some of those. Healthcare is probably a larger weighting more broadly within the portfolio and again, Anna can touch on those in a moment, some of the stocks we like there. But staples, inflation beneficiaries are the other areas of the portfolio which have become more present and more prominent, I should say, to withstand the backdrop that Matt presented.

Touching on commodities, and this is probably very much a focal point of the markets right here right now given what is happening within Russia and the sanctions that have been imposed on Russia recently, the first question we need to turn to is, how long these sanctions will take place and what is the outlook for commodities from here? The first point of call that we need to touch on is oil and gas. 40% of Europe's oil and gas supply comes from Russia. That is going to change and it is going to change materially going forward. 11% of the world's oil supply comes from Russia, or Russian linked companies. We think going forward, the Australian oil and gas sector is going to be a major beneficiary of this change. Woodside (ASX: WPL) and Santos (ASX: STO) are very well positioned to benefit from that.

The next few sectors, so aluminium, nickel, coal stocks, those commodities, in particular nickel, which is 20% of battery grade material, security and supply becomes a clear issue. As we start to ramp up more and more to green energy and battery materials, Australia again is extremely well positioned to supply and provide that security supply, so we are extremely well positioned from a natural standpoint to become a dominant player in that space.

In wheat and fertiliser, Russia is the largest wheat exporter. Undoubtedly, we are going to see that come through in food inflation, as the world scrambles to sure up their wheat supplies and fertiliser which is used in the process of food. There is going to be some significant change coming forward. I think what it does potentially do is accelerates a shift to green energy a little bit quicker as coal prices start to spike and oil and gas prices start to spike. Security of supply and sovereign risk, geopolitical sovereign risk becomes more and more prominent, and Australia should be a beneficiary from there.

The last thing I will mention is food price and food inflation. We are going to see it, Woolworths (ASX: WOW) and Coles (ASX: COL) have called it out, and there is no way of avoiding it, so that is going to be something that we are going to be focused on for the near term. I think that is probably a comprehensive wrap-up of how the portfolio is positioned. Maybe I will pass over to Anna, who can take us through some stock stories.

Anna Milne: Thanks, John. As John mentioned, one of the sectors that we like at the moment is consumer staples. We have run a number of event studies looking at previous periods of high inflation, periods before rate hikes, when central banks were signalling rate hikes, and following rate hikes. In all of these situations, consumer staples outperform the market. Within consumer staples, we like the supermarkets. It makes sense that when inflation is high, consumer balance sheets and budgets are stretched and people eat out less and at home more. Clearly, that is good for supermarket revenues.

Our preferred exposure within supermarkets is Coles. Coles delivered a really good February result. In particular, it showed extreme cost discipline in what was a challenging period, with Omicron combined with Christmas. Previously, Coles has not been as good as Woolworths at managing its costs and that's one of the reasons why there is a valuation differential between the two. However, delivering the result it just did, it brings a differential into question, which is one of the reasons why we prefer Coles over Woolworths currently.

Another stock I wanted to mention is the largest health game on the ASX, that is CSL Limited (ASX: CSL). In December, CSL carried out the largest capital raise to ever occur on the ASX, to buy Vifor Pharma, which is a Swiss pharmaceutical company, specialising in iron deficiency and kidney disease. As you can see from the share price, it has been received with a little bit of scepticism from the market. However, going into January, into the start of February, we saw a few green shoots across the business, which suggested that the result might be better than the market was expecting. We have since met with management and have even more confidence in the medium-term outlook for the business. They have a number of initiatives in place, the plasma collections, which will benefit over the medium term. They are rolling out new devices to collect the plasma, which will have significant productivity benefits, and their Seqirus, which is their flu benefit business, continues to go from strength to strength. I think more importantly than that, it is one of the most high-quality names on the ASX, with a great management team, so it remains a core holding of ours.

The last stock I wanted to mention is insurer IAG (ASX: IAG). Insurance isn't the first sector you think of when you think of defensive sectors. However, insurance is actually one of the last things that will be cut from the budgets of households and businesses in times of heightened uncertainty. It is a safety blanket. IAG reported a really good February result. We have since met with the management team and we are confident that the legacy issues are behind them and they are now focused entirely on the future of the company, earnings growth and the outlook. They are benefiting from strong rates in the insurance cycle. They benefit from rising rates in the financial market. They have a cost-out program and capital management on the way. We don't think any of this is reflected in the share price, so that is another core holding of ours – IAG Limited.

Geoff Wilson: Thank you very much, and thanks, everyone. I know there is already been some great questions sent in. I will pass over to Camilla Cox. She is our Senior Corporate Affairs Advisor. If anyone has any additional questions, please send them in now, but we do have a lot of questions and let's start working through that. Thank you, Camilla.

Camilla Cox: Thanks, Geoff. The first question is actually for you. It is from Jennifer. She says thanks for the great work, Geoff and team. What do you believe have been some of the factors in listed investment companies (LICs), and in particular Wilson Asset Management companies, in moving from a discount to a premium to net tangible assets (NTA)?

Geoff Wilson: Thanks, Jennifer. The good thing is, you shouldn't thank me. You should thank the people, Anna, John and Matt, for all their hard work, and everyone who has been working with them since WAM Leaders was set up. I am the old guy who is there as Chairman; they are doing all the hard work, so thank them.

In terms of a listed investment company, the interesting thing is there is a little over a hundred listed investment companies and a number of them trade at premiums to their NTAs, and that is the net tangible assets; in theory, what the assets are worth. A number of them trade at discounts. What we think is there are four main ingredients for listed investment companies to trade at NTA, if not at premium. One is performance. You would say with like WAM Leaders, it is a big tick, exceptional performance. Another one is a growing steam of fully franked dividends, and with WAM Leaders, that has been the case. I talked about the profit reserves, so that will continue to be the case for the foreseeable future. Another one for all listed companies, you have to treat all shareholders with respect. That is what we do. As I said at the very start, you own this company, so we are here reporting to you. The fourth thing is shareholder engagement, communication and marketing. We have nearly ten people in that area. In our competitors in that space, the ones that are larger than us, some of them have a tenth of that capability. So, we have really a significant group there. I did sneak a peek at the questions, so you ask the next question, Camilla, and this sort of ties into the first question as well.

Camilla Cox: Thanks, Geoff. With you again, Gary has asked: WAM Leaders has obviously posted strong investment portfolio outperformance, but he notices that the total shareholder return is down year-to-date. Can you explain why this is?

Geoff Wilson: Yes, and this is for Jennifer and Gary. With WAM Leaders, six months ago we were trading at quite a good premium to NTA. We had gone from trading at a discount to NTA over a number of years, really after getting that dividend up, the performance, tightening up the share register, and WAM Leaders went to good premium. It was trading at 10% plus premium to NTA.

What has happened over this last little period, the last six months, it has actually gone from that big premium to NTA, to be trading just around NTA. If you are looking to buy WAM Leaders, it is obviously good value around here because you are paying NTA. I like paying NTA or below NTA. Gary, that is why the share price performance has gone from a premium to be trading at around NTA, even though the underlying performance has been very solid. My view is, it will trade back to a good premium to NTA. We just need to settle the share register. There have been various people where we have raised some capital and people put money in and then for some reason they change their mind in a month or two's time and they are sellers, so it just takes time for the share registers to tighten up.

You will see WAM Research (ASX: WAX) is probably the largest premium. The other day, I think it was close to a 50% premium to NTA. We did have a period where we traded at a 20% or 30% discount with WAM Research and for seven years that occurred. It just took a long time for that share register to tighten up, but eventually that happened and then they get to NTA if not a premium. I would have thought, you have all this extremely good performance and you are looking at some of the competition, the AFICs (ASX: AFI) and the Argos (ASX: ARG), you really don't have the performance that WAM Leaders has. WAM Leaders can be a lot more nimble in terms of moving the portfolio around, but looking at a similar investment universe, those larger companies, those two I mentioned, they are trading at very large premiums at the moment. I am very confident that the premium will come back, but sometimes it just takes time.

Camilla Cox: Thanks, Geoff. Matt, this next one is for you from a shareholder named John. He says: with oil at these high levels and the price of fuel starting to bite into consumers' wallets, people may be looking around for alternatives, such as electric vehicles (EVs). Do the WAM Leaders team have lithium and nickel on their radar at all?

Matthew Haupt: Great question. Obviously, we are pretty supportive for the oil and gas sector and think there is incredible value there. But we do have lithium/nickel exposure and copper. Copper is probably the one with the less flare around EVs, but copper is highly intensive in EVs. I think copper is a great way to play it, but we do have lithium. We have Pilbara minerals (ASX: PLS), we have IGO (ASX: IGO), Independence Group for nickel, obviously BHP (ASX: BHP) have nickel and copper as well, and we have OZ Minerals (ASX: OZL) too. The other company as well, South32 (ASX: S32) has manganese. So, we are definitely playing it, not in a huge way because I think it will be a long process to transition, but we are definitely there in some of those stocks.

Camilla Cox: Thanks, Matt. John, this next one is for you. It is from Andrew. He asks: how will fund managers respond if or when they believe that the materials or energy sectors have run their course or are fully valued?

John Ayoub: Thank you, Andrew, for the question. The short answer to that is obviously they will sell, but I'll answer in a bit more detail. First, I think there is a long pathway here for those sectors. Firstly, you consider the Australian energy sector. It has underperformed its global peers for a number of reasons over the past six to twelve months. The first I think is a material catch-up trade for the Australian energy sector, something we touched on earlier around geopolitical risk and security of supply. I think Woodside and Santos in particular, there is a material catch-up play as you start to see a lot of the global majors divest assets that have any sort of association with Russia.

You would start to see Australia and Papua New Guinea become a safe haven for oil and gas. Although the commodity themselves may drift back over the next six to twelve months as stability emerges in Russia and Ukraine, I think you will start to see the Australian energy sector garner a higher re-rating from a multiple perspective. So, we have a little bit more confidence around the energy sector in particular. Around commodities, again, the million-dollar question is how long do these sanctions last and do they come on at any time?

Same answer again around security supply for green energy. I think nickel is already tight and aluminium as well. Supply on both those two commodities is particularly tight, so RIO (ASX: RIO), Alumina (ASX: AWC), some of the stock they talked about, Independence in particular, we think there is still some protection to the multiple and the valuations of those stocks for some time. I think some of the non-producing guys are

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probably more susceptible to a sell-off if the commodity prices start to pare back. I think for us, it's finding the lowest cost producers in the sectors and hold onto those. We do certainly expect commodity prices to kind of pull back at some time, but we think China, the news there continues to be slightly soft. When you get soft news out of China, they stimulate, so think BHP and Rio, South32 have some particularly long runways in those sectors. Short answer is people will sell them, but I think there is a way of insulating yourself from any pullback quickly.

Camilla Cox: Thanks, John. We will stay with you again. This is from Jill and Chris. They have asked: what is your opinion on Woodside and who wins from the sale of oil and gas assets of BHP to Woodside?

John Ayoub: The answer to that, everyone will be happy, it is a win/win for both companies. Short-term, it is a win for BHP shareholders, but longer-term, it is a material win for Woodside. Let me unpack that a little bit.

Woodside's assets, there were some questions in the market around the quality of their assets and the production profile of those assets for the next 18 months. What BHP's assets do is provide Woodside with some market leading assets, some liquids producing and some gas producing assets globally. From here on, Woodside will probably have some of the highest quality assets of any oil major and gas major in the world. What it does, it certainly puts Woodside on that global scale as one of the top five players, albeit maybe higher. From that perspective, Woodside is a longer term winner.

From a BHP shareholder perspective and as our largest holding in our portfolio, it is a great way to actually address some of the year's Environment, social and corporate governance (ESG) concerns that many market participants have. So, your clean-up of BHP's portfolio becomes a future metals focused business, gets rid of any oil and gas concern or ESG concern from that perspective, and then you get a re-rate. Again, it's really a win/win for BHP in the first instance and for Woodside shareholders in the long run.

Camilla Cox: Great. One more for you; this one is from Graham. He says: will you be buying any stocks with the name Charter Hall in it?

John Ayoub: There are about 16 of them! The main stock Charter Hall (ASX: CHC), they have made some interesting moves recently. If we take a step back and consider what the Charter Hall businesses do provide, they have over-earnt, and I use this word carefully. They have over-earnt over the last few years as the interest rate cycle has worked in their favour. Their ability to mark-to-mark assets up and generate performance fees from the interest rate environment is something that won't be able to be replicated over the next two to three years. They have stepped outside of their comfort zone and in making an acquisition of a fund manager, and various market participants have different views on it. But what it does, it is a diversification from their traditional investment base.

Our biggest concern – and we don't own any Charter Hall today – is how they are going to replicate those performance fees that they have generated over the last two to three years and what happens when the rate environment does steepen slightly. We have stayed out of Charter Hall. It has sold off a lot and it is something that we have consciously looked at a fair bit. Some of the other assets of the Charter Hall Long Wale REIT (ASX: CLW) and a few of those other ones, they are very defensive businesses. As Matt was pointing out, if the rate cycle is a little bit flatter than what we have seen, if these things sell off, then potentially it does provide an opportunity, but we are not there at the moment.

Camilla Cox: Thanks, John. Geoff, we will turn back to you now. Peter has asked what the current cash position of the portfolio is, and do the WAM Leaders team see this changing any time soon?

Geoff Wilson: Thank you, Peter, for asking me, but really, the team are the people that are driving this boat – I am just sitting at the back, relaxing, like yourself as a shareholder! Why don't I pass to Matt, who can take you through that?

Matthew Haupt: Thanks, Geoff, and thanks for the question. The way we see the WAM Leaders portfolio is we think we can invest through the cycle, so our cash lever is fairly well not used as a defensive tool; we can position through sectors. What would get us to a cash position higher than traditional levels, we would really need to see something that would break equities in a very clear manner. What happens is when markets fall, you get the sector rotation. To make us move to higher cash would have to be an asset allocation decision, a broad one across the industry or financial market participants. That would have to be a very large event.

Looking forward this year, we have a couple of large events. We have a Fed rate cycle and we have quantitative tightening, which will probably be announced probably in May from the US Central Bank, for a June lift-off on quantitative tightening. They are two pretty major events. Will it be enough for an asset allocation decision? Undecided at this point. Yes, our cash level will be around that 4-5%. A lot of it, we touched on at the start. There is a chance of a dovish short-term tilt, so we could wind our cash down a little bit lower, to try and capture some of that dovish tilt. I think you should expect us to invest through the cycle.

Our investment process is very nimble and allows us to invest through the cycle. You can really invest through sectors to position more defensively or position more aggressively. I think that is a big decision. If we can see a clear catalyst about an asset allocation decision being made within equities, then we will pull that trigger. We are watching that quite closely this year. So far, our cash levels are largely unchanged.

Camilla Cox: Thanks, Matt. Anna, we will turn to you. We have a question from David. He asked: based on the current flight of fire and the increasing effect of climate change, is owning insurance companies a wise decision at the moment?

Anna Milne: It is a really good question, and we actually often joke between ourselves that since we have had a few insurance companies in the portfolio, we have become weather watchers! But the reality is, it is a lot more sentiment-based than it is actually on their financial performance. The last couple of days, the insurance has taken a hit, as we have seen the devastating footage out of Southeast Queensland and northern NSW, which is understandable.

But the reality is, insurance companies are in the business of paying claims. If there are no claims, it incentivises people to stop paying their premiums or downgrade their covers. There is going to be a lot more people going home, logging into their insurance portal and checking that their premiums are paid, that their sum insureds are adequate, and they might be upgrading their cover.

From a financial perspective over the longer term, you actually do need events to keep insurers in business. From an IAG perspective, they came out this morning on the ASX and said that their total exposure to the weather events is $95 million. Beyond that, their reinsurers have to stump up for the cost, so they have a quota share arrangement with Berkshire Hathaway, Swiss Re, Munich Re, which smooths the earning profile, and then they have reinsurance arrangements on top of that. Their actual exposure is quite limited. It is $95 million, so it sounds like a lot of money, but it is still within their allowances for the year, so there is no change to the actual fundamentals and the earnings of IAG at this stage.

Camilla Cox: Thanks, Anna. Just staying on the topic, Martha and Neville have asked: what exposure does IAG have to the current Queensland floods?

Anna Milne: That is the $95 million. They are on the hook for $95 million. Beyond that, their reinsurers pay. It is within their allowances – no change to earnings. They are on track for their full-year result.

Camilla Cox: Thanks. Matt, we will turn to you. This one is from Anders. He says: there seems to be renewed merger and acquisition (M&A) activity in the energy industry at the moment. Does this make Origin Energy (ASX: ORG) and AGL Energy (ASX: AGL) type stocks more attractive?

Matthew Haupt: Great question. AGL obviously have had an indicative non-binding bid from a consortium. We probably think Origin is the likely one. That is a very attractive business with two distinct paths. They have the APLNG which is linked to the rise in LNG prices and then the energy markets business again, which is quite valuable. What makes it hard for acquisitions in this space is government policy because government policy will ultimately dictate the course of all these companies. If we get some clarity around that, these companies are trading at very, very cheap multiples and we think Origin is a much better company forward facing versus AGL. Yes, one hundred percent expect to see activity. Origin have some great businesses which are growing very fast. Expect more action in this space, one hundred percent.

Camilla Cox: Thanks, Matt. John, this one is from Jen. She asks: what are your views on companies which are suppliers of building materials?

John Ayoub: Thanks, Jen, appreciate the question. There are probably two schools of thought to take into consideration here. Are they exposed to new builds, or are they exposed to renovations and remodels?

We have recently taken the sell-off to get a little bit more exposure to James Hardie. Other stocks like Reliance (ASX: RWC), Adelaide Brighton (ASX: ABC), Boral (ASX: BLD), they have all had some significant pullbacks as people expect that new builds slow down over the next 12, 18, 24 months, as that rate cycle steepens, as Matt was discussing earlier.

What we do know is that demand is still strong in the building sector. We think the cycle will be a little bit more protracted than others. Also, we think over the next 12 months in particular, we should still see strong results out of James Hardies. For us, what we do focus on is who has the best cost control mechanisms as inflationary pressures do come to that sector, and how is their ability to pass on that price to the consumer or to their retailers. What we focus on there, what you have to consider is, is there switching of products and where do they sit in the cost curve?

For us, James Hardie is a standout because it is cheaper than a lot of the alternatives, and their cost control is superior to the vast majority of their competitors, particularly in the US. So, Hardies for us is a clear winner in that sector. Traditional Australian names like Boral have shown that they had an inability to make money in the last cycle, so we question their ability to make money in this cycle. Adelaide Brighton came out recently with a really good result and we are actually going to catch up with them in the not-too-distant future, so we will be able to provide a bit more perspective there at a later date. Where we sit, James Hardie will do well, and Reliance at the current levels is looking cheap and it is one that we are doing work on, given their exposure to the repair and remodel market. It is buyer beware. Make sure you do your work on each of the individual companies. That is probably our view on building materials right now.

Camilla Cox: Thanks, John. Anna, we have one for you from Alexander. He has asked: have you any thoughts on Ramsay Healthcare (ASX: RHC) and ProMedicus (ASX: PME)?

Anna Milne: I will start with ProMedicus. We don't hold ProMedicus in our fund. We tend to focus on the larger, more liquid healthcare names and also the profitable names that have earnings multiples. We really like Ramsay. Ramsay is a holding of ours in the WAM Leaders portfolio. They are firmly in the re-opening or opening bucket of the portfolio. They have had a really tough couple of years with the one and off restrictions of elective surgeries globally, but there is light at the end of the tunnel. Volumes are improving, coronavirus costs are reducing, and we think their earnings growth over the next few years is certainly robust. They have also recently acquired a company called Elysium, which is a mental health company in the UK and that is a really big growth area. We like their foray into that space as well.

Camilla Cox: Thanks, Anna. Geoff, back to you. James has asked: what is your view on Magellan (ASX: MFG)?

Geoff Wilson: James, I am giving you that view as another fund manager, not as an analyst doing detailed analysis and working out whether it is cheap or not. Obviously, there has been a lot of disruption. The market doesn't like uncertainty. You would assume the negative impact on their fund flow I would say will probably take six months to run through. If I was looking for a buying opportunity, to me, that is what I have in the back of my mind, whether I need to be a little bit earlier than that. If you see funds growing again, then obviously everyone is going to extrapolate what the growth will be.

To me, it is more a bit of a timing thing. You just really want to see how their funds perform, but also what the level of redemptions are, and see that work its way through the system. As I said, I think in about six months' time, that would have occurred. If you are going to buy Magellan, you want to buy them before you start seeing their funds increasing again. There has been a lot of dislocation.

You have to remember again, and I think I was quoted in one of the papers about Magellan, the funny thing is, at Wilson Asset Management everyone thinks I am picking the stocks. This is a great example of just showing you, you are meeting the people who are investing the money for WAM Leaders. The same is the case for WAM Global (ASX: WGB), WAM Capital (ASX: WAM) and WAM Alternative Assets (ASX: WMA). The place I am picking the stocks is WAM Strategic Value (ASX: WAR). That is when we are buying listed investment companies or undervalued assets, but at a discount to NTA.

With Hamish, I know everyone would have thought Hamish did all the work, but they have 35 investment professionals. We have 14, soon t be probably 15 or 16 investment professionals, managing all that money. If you look at it from a ratio, they are running about $1 billion dollars with 35, and we are running say $5.5 billion with 15. You could argue, in terms of investment power per billion, we have significantly more investment power per billion. To me, with Magellan, you would probably want to give it a little bit of time.

Camilla Cox: Thank you, Geoff. Matt, we have one for you from Gary. He has asked: did WAM Leaders increase its shareholding in BHP following the London delisting?

Matthew Haupt: Thanks, Gary. BHP, we actually were very, very heavy overweight pre to listing because we knew there was a big index change to happen. Luckily, it coincided with our changing view on China as well. They went through a very tight period in 2021 and we knew they would be unwinding that. All the stars aligned and we were holding around 12% of the portfolio in BHP pre the listing. We were very well positioned. We saw in a lead-up a lot of scrambling by fund managers buying BHP. In the end, we were overweight pre to listing. We gradually sold down during that process and now it is back up around that level again, because we are quite constructive on the iron ore sector, in particular in China. They really changed the narrative around tightening to loosening in their economy. It is back up at that level now.

Camilla Cox: Thanks, Matt. Another one for you. Stefen has written in again. He has asked: what investments are you focusing on to hedge against inflation risk?

Matthew Haupt: Thanks, Stefen. Inflation is generally not great for equities. It is hard to get good inflation hedges in equities. Generally, you focus on precious metals, but unfortunately for precious metals, we were in this abnormal period of really negative real rates, which is a great driver of valuation or price for precious metals. That would be your normal place to hide, but in a hiking cycle, you probably don't want to go near gold in any great deal as an inflation hedge. That could change if there is a dovish tilt by central banks. At this point, you would probably leave precious metals alone. There is a bit of a war premium in there as well at the moment, due to the conflict.

You would look for companies, generally staples do pretty well in an inflation environment and also, companies which are linked or have inflation-linked contracts in them. One that stands out is Transurban Group (ASX: TCL), even Telstra (ASX: TLS) with the NBN payments that are inflation-linked. We are trying to find those gems which really have that protection. Generally, industrials do pretty poorly in an inflation environment, so you have really to hunt around and probably stay in those ones I mentioned. I guess the biggest one as well is straight commodities. Straight commodities are a great inflation hedge and we have quite a few of those; in particular, BHP, Rio, more in iron ore there, then South32, Oz Minerals as other big holdings. They are generally your best bets and best places to hide.

Camilla Cox: Thanks, Matt. John, a question for you from Warren. He has asked: what is your view on Telstra's current share price and future dividend earnings upside? Does WAM Leaders hold any other names in this sector?

John Ayoub: Thank you, Warren. I might actually get Anna to help me with this one, because she recently caught up with Telstra. We do own Telstra and we think it is the standout in the sector. They continue to take market share. Their product offering is second to none in the market, even though others are trying to play catch-up. They have a jump on the entire market. We think at sub $4, it is incredible value. Maybe Anna can talk a little bit more about the pricing and the strength they have in the market.

Anna Milne: Yes, I think those are the main points. Telstra has really gone from being a dividend yield story to a growth story as the RPU market or the mobile market has bottomed and RPU is increasing; that is the pricing per unit. As well as there being rationality in the mobile market, they have ongoing sell-downs of some of their infrastructure businesses, which are gaining really high multiples. There are a few catalysts for Telstra.

John Ayoub: Broadly elsewhere in the sector, the only one that we have given some consideration to, WAM Capital (ASX: WAM) own it but we are still not quite there, is TPG Telecom (ASX: TPG) or Vodafone (ASX: VPG) in its current form. We think they are a lot more heavily exposed to inbound tourism as a big segment of their earning driver. As that starts to rebound, it will be interesting to see what Optus do to respond, or even Telstra to kind of capture that share. It probably represents somewhere between 3% and 5% of their earnings. They have had to invest heavily into infrastructure investment, which has kind of crimped their concerns. It is getting more interesting, but we think the easy way to play it right here, right now is Telstra. There is a bunch of others, like Uniti Wireless (ASX: UWL) and the like, where we just think the valuation relative to Telstra, it doesn't have the appeal for us, so we will just stick to the best in class and focus on quality.

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Anna Milne: I think the other thing about Telstra as well is the roaming revenues. I don't think that is really taken into the share price at the moment and that is inevitably going to come back. Another factor.

Camilla Cox: Thanks, Anna. Thanks, John. Geoff, we will turn to you for this question from Cameron. He has asked: can you please explain why we keep such a large profits reserve and carry dividend coverage for several years? What is stopping us from paying this out and releasing franking credits via a special dividend?

Geoff Wilson: Really good question, as a fellow shareholder and all the hard work we did at the last election in terms of making sure franking stayed as it is, as Paul Keating wanted it to be, as a great structure for Australian capital markets. The situation is we have the profit reserve, but we usually haven't paid the tax on that profit. That profit reserve we have at the moment, that is an after-tax, but it is not a tax-paid profit reserve. We actually couldn't pay a big fully franked dividend. Hypothetically, if it was 30 odd cents, say if we paid a 30 cent dividend, I think at the moment we have a little bit of franking, so you might get a couple of cents franked and the rest is unfranked. What happens is as we turn the portfolio over, then we realise the tax and then we pay the tax. Then obviously the tax we pay plus the dividends we get that are fully franked allows us to pay the other fully franked dividends. Yes, if we had 30 cents of franking, then it is another question. The fact is, we don't have that amount of franking, so it wouldn't be in your interests.

Camilla Cox: Thank you, Geoff. Just staying with you, a comment from Jill. She has recently read that some people consider LICs as more of a risk when they get bigger, as they can't be as agile and it excludes them from certain investments. Do you have any comments on this?

Geoff Wilson: It is an interesting scenario. To me, in the funds management world, it is general that if you are managing a million dollars, it is probably easier to perform with a million dollars than if you are managing ten million dollars. The thing is, what we have found is, and you have to remember when Wilson Asset Management started and it was only me, we actually were managing a million dollars. Each time it doubled, to two million, to four million, etc, we had to work out what the best way of managing that money was. As I said, we are managing $5.5 billion on behalf of 120,000 shareholders that we are indebted to because they allow us to manage money on their behalf. We have had to really focus on how we manage that money as we have grown.

What you find is when you get bigger, you actually get some significant benefits. One of the big benefits, you look at AFIC and Argo, one of the things about being large and here you are talking about AFIC which is a $9 billion listed investment company, when I looked a few weeks ago it was trading at 15% plus premium to NTA. When we saw Soul Pattinsons (ASX: SOL) take over Milton, the interesting thing was it was just taking over an unlisted investment company, you would think Soul Pattinsons, nothing would happen to the share price, but it rallied about 10%. There actually are some significant benefits for investors investing in large listed investment companies. There is a little bit of a premium for that and if you look at a lot of research that is undertaken, they say those smaller listed investment companies have a bit of a discount because they are smaller, which is interesting.

In terms of how you manage that money, it is really up to the skill of the individuals. What we have found is as our funds have grown, then our relevance in the market, not only from the investors, the financial planners wanting to invest and wanting liquidity, but also to the investment banks, the companies and the brokers we deal with. Back when I started 23 odd years ago, I would get the last call when there was capital being raised because we were the smallest. Now we get one of the early calls, so our quality of information has grown exponentially, as our funds have grown exponentially. It is not that simple just to say you are a little bit bigger. Like everything, there are always some pluses and minuses.

Camilla Cox: Thanks, Geoff. John, we will turn back to you. This question is from Elena. She asks: do you have a view on the SOL conglomerate?

John Ayoub: Thank you, Camilla. Geoff just touched on Soul Patts then and maybe I will just add quickly to what Geoff just said. We feel at WAM Leaders, as we have become bigger, our performance has become better; as we focused more, our liquidity has become a bit more of a strength for us. We agree exactly with what Geoff said and look forward to continuing to grow the fund.

Just on Soul Patts, maybe touching on what Geoff said earlier about the acquisition of Milton, I will be fairly direct on this one – it doesn't really attract much institutional investment. Soul Patts, the team over there, they are a wonderful team. They have shown a tremendous track record of actually finding little gems over the years and riding them until they get to big gems. But from our perspective, it is a conglomerate of small-caps and it makes it very difficult to invest in for a number of reasons; firstly, liquidity; secondly, transparency; then also there are some ESG concerns in a couple of their investments in the portfolio. Like I said, they are a great organisation, so it would be very difficult for Soul Patts to close its discount to the underlying assets, and a lot of conglomerates have that issue; Seven Group Holdings (ASX: SVW) is one and Wesfarmers for a long time. As they get bigger and the underlying companies get bigger and your ability to value those underlying companies gets better, you should start to see a re-rating.

One anomaly with Soul Patts last year was included in the ASX200 index and saw it spike to $40 and then quickly revert back down to where it is today, and that was driven from liquidity. The index managers were forced to buy it. They sent it to $40 and as that buying subsided and some of the more opportunistic hedge funds and the like sold into it, it kind of caused this quick, rapid de-rating. What we look for is probably a little bit more granularity around Soul's underlying assets, what they continue to do with Milton and a few of the other investments. What we struggle with is that conglomerate discount and conglomerate of smaller-cap companies makes it difficult for us.

Camilla Cox: Thanks, John. Matt, a question from David. He has asked: what macro conditions are you readying for this year?

Matthew Haupt: Thanks, David. Great question. This could change within 24 hours or maybe within two hours but, anyway, I will give it a go. Our base case this year, obviously we are in a tightening phase, we think the forward market, so the amount of interest rate hikes in the next 12 months, is a little bit too aggressive. We think that will pare back in the short-term, but we think the dominating theme will be a tightening and withdrawal of liquidity, which is generally negative for equities. But we know how to position for this and we can move it quite quickly. I categorise it as a slow in growth environment, a high inflation environment, a tightening environment and a withdrawal of liquidity. Obviously, the Ukraine conflict could change all of that. So far, it hasn't yet. It is probably put some higher inflation into the forward curve, into the break-evens when we look out. The market is saying inflation is going to be higher and interest rates are paring back a little bit on the front end. The macro environment looks tough. There is no question about it. It really does look quite tough this year from a macro point of view. Like I said, macro is one of my great loves. Hopefully my wife isn't listening! Obviously, she is my greatest love, but macro would be right up there!

John Ayoub: And your kids!

Matthew Haupt: Oh, my kids too!

Geoff Wilson: Geez, Matt! Matt works hard. Work is your great love!

Matthew Haupt: I haven't been sleeping that well. As you know, all of us here, we take this job very seriously. We have been up watching markets all night, getting up at four in the morning, watching markets, because we live and breathe this. We hope we can do the best job for you. It is a full-time commitment for us, but the macro environment is challenging. There is no way around it.

There are two things: the path of interest rate hikes and where they settle, the neutral rate. We just watch those by the hour and just try to manoeuvre the portfolio around these events and movements in all the underlying assets, which some people don't focus on in equities. They are a great signal to try and position your portfolio. That is the macro call at the moment.

Camilla Cox: Thanks, Matt. For our final question, I will pass to John and Anna. Harvey has asked: he notices in your top holdings and recent results that financials are 30%. He has asked what opportunities you are seeing here. In the same sector, Janet has asked: what are your outlooks on banks?

Matthew Haupt: Thank you for both those questions. We will maybe do all three in this one. As we discussed earlier in the outset around the portfolio, a lot of our positioning did particularly well in December, January and February and financials was a big driver of our performance. Recently, we have recycled some of those names into a few other sectors, like staples and some of those quality defensive names and some of those stock specific stories. Financial weighting has come down within the portfolio, but that is not to say there isn't opportunities there. It is more stock specific. Maybe Anna can talk about the banks, National Australia Bank (ASX: NAB) in particular?

Anna Milne: NAB is still a clear standout for us. They have a great management team, cost initiatives and a business banking focus. Particularly, that business banking side we think is key in calendar year 2022, as we think credit growth will be more muted, given that the steam is coming out of the housing market.

Matthew Haupt: Yes. I guess the thing with the banks is everyone was how far are net interest margins (NIMs) going to fall? We saw for the first time in maybe three quarters a clear path out where NIMs are going to increase at the back end of this year. Banking NIM decline is over. We are underweight banks at the moment, but I would probably bet we would start turning overweight in the next few months, but we need to wait and see. Loan growth is quite strong, the embedded property prices within the books of the banks are so strong, a house price correction 5% or 10% wouldn't touch the side. Bank NIMs will get better this year, so we could go overweight later, in the next few months potentially.

John Ayoub: And we still have material overweight positions in IAG, as Anna talked about, and QBE (ASX: QBE). We kind of lightened QBE into the result and as the sell-off kind of presented another opportunity, so we got back in there. IAG went down to the low $4.20s and we didn't really have too much of a position. Now it is a sizeable position following that opportunity. Some of the names that we exited were Computershare (ASX: CP) and Challenger (ASX: CGF), which we haven't exited fully, but it is a lot smaller than what it was, just because of the share outperformance and good, strong results those guys had. They hit valuation targets for us and we just recycled that cash into other opportunities. It is stock specific now, so NAB, QBE, IAG are probably where we have our bets laid. If there is any sort of opportunities, we will be looking at those quickly.

Camilla Cox: Thanks, guys, and thanks to everyone who wrote in questions. I will pass to Geoff for any closing words.

Geoff Wilson: Thanks, everyone. As Matt and the guys said earlier, they are passionate about managing your money. We all are passionate about that. My wife said to me last week, "you seem to be up in the middle of the night. What were you doing at 3 am?" I said, "well, I just went upstairs and I was watching coverage of the invasion". That was the first night of the invasion. Obviously, it is a 24-hour job and we have a lot of responsibility in terms of managing a significant amount of capital on all your behalves.

Thank you again for Matt, John and Anna for doing all that hard work. Thank you, Camilla, for really helping on that shareholder engagement communication and doing a fantastic job with the questions today, taking over from Olivia. I think Olivia will have to elbow you out to get the position back!

Shareholders, please, if you do want to listen to this in a bit more detail, the webinar will be on our website shortly. Always be in touch. This is your company. Any ideas, suggestions or any feedback or questions, please contact us. Great to speak to you. Stay safe. Let's hope that everything that is happening in Eastern Europe gets sorted out incredibly quickly. Thank you.