Mid-Semester Report – Semester 1, 2019

ANU Student Managed Fund

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# Glossary

**AA** – Asset Allocation

**AAE** – Active Australian Equities

**ACCC** – Australian Competition and Consumer Commission

**ANU** – The Australian National University

**BIN** – Bingo Industries

**CIO** –Chief Investment Officer

**CRO** –Chief Risk Officer

**DADI** –Dial-A-Dump Industries

**ESG** – Environmental, Social and Governance

**ETF** – Exchanged-Traded Fund

**IAC** – Investment Advisory Committee

**IP** – Investment Process

**LTIP** – Long Term Investment Pool

**NSW** –New South Wales

**R&C** – Risk and Compliance

**RIO** – Rio Tinto Limited

**SMF** –Student Managed Fund

**SRI** –Socially Responsible Investment

**TLS** – Telstra Corporation Limited

**VIC** – Victoria

# About this Report

The ANU Student Managed Fund (SMF) is pleased to report on its progress and achievements over the first half of Semester 1, 2019. The report features a Chief Investment Officer (CIO) update, an introduction to the new SMF team members and an analysis of the Fund’s portfolio. We report on performance, including a stock performance summary and an attribution analysis of Fund returns versus the benchmark. We also provide a statement of SRI compliance.

The SMF team produces a shorter report at mid-semester, with a more in-depth report provided at end-semester that includes commentary by all team leaders and the Course Convenors.

We would welcome feedback and the opportunity to address any further enquiries, which can be directed to the SMF email address (smf.rsfas@anu.edu.au).

*Sophie Lebang & Alisha Nath*

*Relationship Team*

# Chief Investment Officer Report

The SMF team consists of 18 members in Semester 1, 2019. It is with great pleasure I have been able to welcome our new cohort of students for what is already proving to be another semester of significant learning, development and challenge.

On an individual level, taking over as CIO has seen a dramatic shift in the type of work I am completing and the demands of my role. Indeed, many of our now senior members have also reflected on this transition and the new ways in which we are all being tested. I believe this is a tremendous opportunity for personal growth for us all. It reaffirms the benefits of our *Legacy* value, in which we prioritise the ongoing cycle of learning (junior members) and leading (senior members).

Across our sub-teams, I see the significant work our individual teams are producing, and the exciting progress being made. Our Active Australian Equities (AAE) team have completed their candidate stock analysis, presented it to the SMF team, and are now undertaking further in-depth research. Our Asset Allocation (AA) team are progressing towards the challenging task of finalising their Investment Process (IP). Our Risk and Compliance (R&C) team continue to advance the reporting and performance attribution processes that underpin this report, while also developing a risk management framework for the Fund. Lastly, our Relationship team is at the centre of much exciting activity, including the establishment of a website and social media platforms. We believe these actions are vital for the development of the Fund and our commitment to engaging with parties within and outside of the ANU. An example of this engagement is the Fund’s participation in the College of Business and Economics (CBE) Student Information Market in February. We will participate again in May and attend various Finance classes to raise awareness of the Fund and engage with potential applicants.

I am pleased to report that the Fund is achieving our return objectives. One year since funds were invested into the SMF reference portfolio we have generated a return of 8.83% against the nominal target return of 7%. The Fund’s holdings in Rio Tinto (RIO) and Telstra (TLS) have provided positive contributions, while Bingo Industries (BIN) has proved more challenging. Although covered in a ‘Spotlight’ within this report, I would like to address the Fund’s Bingo position. Bingo has performed significantly below our expectations, and errors were made during our initial evaluation. We have devoted countless hours, both during SMF meetings and outside, to discussing the future of the company, our revised valuation and the way we should proceed. The SMF will soon finalise the direction from here, and seek the endorsement of the Investment Advisory Committee (IAC) in coming weeks. While Bingo has impacted us all, we remain committed to our underlying processes, overarching objectives and long-term nature of the Fund. I strongly believe we have learnt invaluable lessons, and our future investment recommendations will benefit from the experience.

Semester 1, 2019 saw the inaugural award of the RSFAS Student Managed Fund Equity Scholarship to Maliha Hoque. Amidst the ongoing development of the SMF, our philanthropic purpose has always remained central. It is with great pride that we invited Maliha to attend our Week 5 meeting. Seeing the tangible impact that the Fund provides was a rewarding moment for us all. We feel lucky to be part of the cohort that delivered this outcome. We wish Maliha the very best with her studies and personal endeavours.

I am extremely pleased with the start we have made to the current semester, and look forward to writing about the work we have completed by semester end.

*Saurav Patel, CIO*

# Team Updates

The 18 team members for this semester include 7 senior members carrying over from the previous semester and 11 new members. Across our teams, we have seen senior students take leadership positions and mentor our junior members to ensure their knowledge, experience and understanding is passed on. Although there is a steep learning curve for our new members, the fresh insights and new perspectives gained are invaluable to the Fund. Meanwhile, the leadership provided by senior members facilitates continuity in our operations. A brief introduction to the new team members and an indication of the tasks allocated to each is presented below.

## AA Team

Joining the AA team as junior analysts are Alaina Warwick, Jiaqi (Karen) Mao and Dalton Tham. The junior analysts are working hard under the guidance of AA Team Leader Jak Carty and Research Manager Hongyi Xu to finalise the asset class models and the development of the AA IP. The junior members have demonstrated their understanding by presenting the core concepts that will underpin the AA IP to the entire SMF team. The absence of conventional courses to support the work of the AA team is a key reason for many of the challenges the team faces. Nevertheless, the associated learning is something that cannot be gained elsewhere.

## AAE Team

The AAE team has welcomed Sahibjeet Bains, Luke Farrar, Harrison McKenzie-McHarg, Lachlan Phillips and Khurshed Mehta as junior analysts. The junior analysts are being mentored by the senior team members – Aiyun (Stephanie) Li, Chengxuan (Charles) Zhang and Chuxuan (Jessie) Jiang – in undertaking stock analysis and writing and presenting stock reports. Senior Analyst Stephanie and Portfolio Manager Charles have been taking lead roles in evaluating the Fund’s existing investments, including Bingo Industries, while also researching other potential investments. This has been a challenging but educational task for the AAE team. As Head of AAE, Jessie has been heavily involved in the assignment and review of all AAE tasks conducted.

## R&C Team

Chaoqi (Shawn) Lin and Alisha Nath (50%) have joined the R&C team as junior analysts, to assist in furthering progress regarding risk management and compliance with Fund policy. Under the oversight of Chief Risk Officer (CRO) Azmina Hossain, both have been performing risk and SRI evaluation on the stocks selected by the AAE team for further analysis. Azmina has enhanced the Fund’s performance attribution model, and this has been an important step in progressing the performance reporting procedures. A large focus for R&C has been increased collaboration with other teams to ensure a shared responsibility for risk management. Shawn has been working with the AA team to assist with incorporating risk management into the AA IP and models. Azmina and Alisha have been attending AAE team meetings to help ensure that the stocks owned comply with investment policy. Additionally, Azmina and Alisha have been advancing the idea of identifying and managing behavioural risks that might arise during the stock selection process.

## Relationship Team

The Relationship team has welcomed Alisha Nath (50%) and Sophie Lebang, who operate under the guidance of the CRO, Azmina Hossain and CIO, Saurav Patel (who was previously in both the Relationship and R&C team). The team is working hard to broaden the scope of the SMF’s external communications, which they plan to advance with the launch of a website and the establishment of social media platforms. The Relationship team also provides ongoing administrative support by preparing weekly meeting minutes, portfolio updates and SMF Reports.

## SMF Team Photo

*Bottom Row (L-R): Anna von Reibnitz (Course Convenor), Harrison McKenzie-McHarg, Alaina Warwick, Luke Farrar, Azmina Hossain.*

*Middle Row (L-R): Geoff Warren (Fund Convenor), Hongyi Xu, Jak Carty, Khurshed Mehta, Dalton Tham, Lachlan Phillips, Aiyun (Stephanie) Li, Jiaqi (Karen) Mao.*

*Top Row (L-R): Sophie Lebang, Alisha Nath, Chengxuan (Charles) Zhang, Chuxuan (Jessie) Jiang, Saurav Patel, Sahibjeet Bains, Shawn Lin.*

# Active Stock Positions

The AAE team has continued to research new stocks with potential to advance the Fund’s core investment objectives and improve the long-term risk-return trade-off of our portfolio. The SMF is pleased that two of our active investments in Rio Tinto and Telstra are performing exceptionally well. The contribution of Rio Tinto and Telstra to the AAE portfolio against the benchmark S&P/ASX200 Exchange-Traded Fund (ETF) has been 0.83% and 1.42% respectively. One of our active investments, Bingo Industries, has performed below expectations. This has proven to be an invaluable learning opportunity. The AAE team provides further insight into the Bingo position in our Stock Spotlight section below. There are no new acquisitions or disposals to report at this stage, although we anticipate presenting stock recommendations to the IAC during the second half of the semester.

## Stock Spotlight: Bingo Industries

Bingo was purchased by the SMF on 8th October 2018 at $2.90, and was trading at $1.62 on 8 April 2019. This spotlight provides background on the Bingo position, the developments since we purchased it, our intentions going forward, and the learnings from the experience.

Bingo stock went public in 2017. It is a relatively young company in the waste management industry, focusing on the collection, recycling and disposal of building and demolition waste in New South Wales (NSW) and Victoria (VIC) while also providing commercial and industrial waste services. The Fund established its position with an investment thesis based around the company’s experienced management, superior operating efficiency, a successful tendering rate and growth achieved through successful acquisitions of similar businesses. Our contention was that these factors would combine for a promising and valuable long-term investment. In addition, the investment was initially evaluated with a high margin of safety, and allowed the Fund to diversify into the waste management industry.

A series of events have caused Bingo’s share price to drop significantly since making the investment. On the 29th of November 2018, the Australian Competition and Consumer Commission (ACCC) expressed concern over the planned acquisition of Dial-A-Dump Industries (DADI), triggering an initial share price decline. This cast some doubts over the Bingo growth-by-acquisition strategy, although the ACCC has now allowed the acquisition to proceed. Perhaps more important was an announcement leading to downward revision of earnings forecasts, which caused a further share price spiral. This was partly due to a reduced amount of new construction projects in NSW and VIC over the next 5-10 years and Bingo’s decision to postpone raising its prices charged to customers.

In response, the AAE team has been researching, analysing and evaluating whether Bingo has suffered a sustained reduction in profitability and hence permanent loss in value. The AAE is currently finalising an updated valuation model, which will assist to put forth a recommendation to the IAC over the coming weeks.

The performance attribution analysis provided below reveals that Bingo’s poor return has detracted significantly from the Fund’s performance versus the return target and the reference portfolio. However, this experience is not without merit, as it has brought some invaluable lessons. The first lesson is that the Fund should expand the scope of research beyond company produced information. We now understand that relying solely on company material can provide a biased view of the company and may fail to provide a reliable perspective on the industry. In response, the AAE team is expanding the range of material used during analysis, and increasing collaboration with R&C to better identify risks and suitability of investments given the objectives of the Fund. The second lesson is that investment recommendations should be driven predominantly by conservative assumptions based on sound evidence, rather than opportunistic assumptions of future growth. Our Bingo model placed a significant weight upon future acquisitions, which resulted in a high valuation and implied margin of safety. The final lesson is that analysts should consider possible scenarios more deeply, both positive and negative, and incorporate this into the SCENSCENARIO analysis procedure under which a valuation range is generated. Our subsequent investment recommendations will benefit from the lessons learnt from the Bingo experience. As students, we have certainly been exposed to a significant opportunity to deepen our understanding of investing.

*Aiyun (Stephanie) Lin, Senior Analyst*

# Portfolio Overview

In providing information on asset allocation and performance, it is worth reiterating the long-term objectives of the SMF. The SMF strives to maximise the long-term trade-off between the expected value of funds invested, against the risk of sustained reduction in the real value of the portfolio. The aim is to support the real value of its philanthropic activities in perpetuity, i.e. maintain the real value of the fund and its distributions over the long run. This report reflects portfolio data as at 8th April 2019, and measures performance since inception on 10th April 2018. The results hence cover only a short initial period in the life of what is a long-term fund.

Asset allocation data for both 10th April 2018 and 8th April 2019 is presented in Figure 1 and Figure 2 respectively.

Figure 1: Asset Allocation as at 10/4/2018

Figure 2: Asset Allocation as at 8/4/19:

Figure 3 details the Fund’s investments and total performance since inception. The performance data represents an important milestone, as we have now reached one year since the funds were initially invested into the SMF reference portfolio. It is pleasing to see the Fund’s return of 8.83% surpass the nominal return target of 7% (made of the 4.5% distribution rate and expected inflation of 2.5%). The long-term significance of this result is that it represents progress towards maintaining the real value of the Fund to support our philanthropic objectives. The Fund paid its first distribution of $27,746.21 on 14th January 2019, comprising $19,762.38 paid out from the Fund itself with the balance met by interest received on cash held by CBE prior to transfer of the funds to the SMF.

**Figure 3: Portfolio Structure and Performance: 10 April 2018 to 8 April 2019**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Portfolio Component** | **Benchmark ETF** | **Opening Balance (10/4/2018)****$** | **Closing Balance (8/4/2019)****$** | **Reference Portfolio****%** | **SMF Portfolio (8/4/2019)****%** |
| **ASSET VALUES AND WEIGHTS** |  |  |  |  |
| ***Australian Equities*** |  |  |  |  |  |
| iShares Core S&P/ASX 200 |  | 372,114 | 324,003 |  | 49.8 |
| Bingo Industries Limited | - | - | 18,211 |  | 2.8 |
| Rio Tinto Limited | - | - | 11,569 |  | 1.8 |
| Telstra Corporation Limited | - | - | 29,548 |  | 4.5 |
| ***Total Australian Equities*** | iShares Core S&P/ASX 200 |  |  | ***60*** | ***58.9*** |
| ***International Equities*** |  |  |  |  |  |
| International Equities, Unhedged | Vanguard International Shares Index | 61,974 | 68,949 | 10 | 10.6 |
| International Equities, Hedged | Vanguard International Shares Index, Hedged | 62,190 | 66,290 | 10 | 10.2 |
| ***Total International Equities*** |  |  |  | ***20*** | ***20.8*** |
| **Total Equities** |  |  |  | **80** | **79.7** |
| Australian Fixed Income | Vanguard Australian Government Bond Index | 92,227 | 96,884 | 15 | 14.9 |
| ***Australian Cash*** |  |  |  |  |  |
| BetaShares Australia High Interest Cash |  | 16,690 | 16,680 |  | 2.6 |
| BT Cash Management Trust | - | 12,832 | 10,897 |  | 1.7 |
| Accrued Interest & Dividends | - | 177 | 6,295 |  | 1.0 |
| Accrued Franking Credits | - | - | 1,981 |  | 0.3 |
| ***Total Australian Cash and Accruals*** | BetaShares Australia High Interest Cash |  |  | ***5*** | ***5.5*** |
| **Total Fixed Income & Cash**  |  |  |  | **20** | **20.4** |
| **TOTAL PORTFOLIO** |  | **618,204** | **651,306** | **100** | **100** |
| **RETURNS** |  |  |  |  |  |
| **Portfolio** |  |  |  | **10.13%** | **8.83%** |
| **Portfolio vs Target (7.0% pa)** |  |  |  |  | **+1.83%** |
| **SMF vs Reference Portfolio** |  |  |  |  | **-1.30%** |

## Attribution Analysis

Figure 3 reveals that the SMF portfolio generated a return of 8.83% since inception. While this exceeds the target return of 7.0% per annum by +1.83%, the Fund underperformed the reference portfolio by 1.30%. In order to better understand the sources of underperformance, the R&C team has conducted a performance attribution analysis, shown in Figure 4. This analysis firstly decomposes performance relative to the reference portfolio into contributions from asset allocation, security selection and other effects. The second section of Figure 4 displays the contributions of each stock held in the AAE portfolio relative to the benchmark S&P/ASX200 ETF. Positive contributions were made by Rio Tinto (+0.83%) and Telstra (+1.42%), while Bingo significantly detracted from performance with a -4.43% contribution. The calculations include any franking credits received, with the SMF returns and AAE contributions having benefitted from holding stocks that pay relatively high fully franked dividends (notably Rio Tinto and Telstra). The final section of Figure 4 shows the contributions from the cash portfolio relative to the benchmark cash ETF. Holding cash in the BT Cash Management Trust provides for liquidity, with the trade-off being a lower return than that achieved by the benchmark Betashares ETF. The sum of this effect is -0.30% relative to the cash benchmark. This applies to only a small part of the total portfolio, with the overall cash contribution amounting to -0.02%. As any active asset allocation decisions are yet to be made, the targeted asset weights remain broadly in line with the reference portfolio weights. Specific asset contributions have been excluded from analysis as they represent the effect of market movements and the impact of the fund distribution in early-2019, rather than strategic decisions made by the Fund.

**Figure 4: Attribution Analysis**

|  |  |
| --- | --- |
| **Contributions to Performance vs. Reference Portfolio by Sub-Period** | **Cumulative Return** |
| ***Period Start*** | 10/4/18 | 22/5/18 | 8/10/18 | 31/12/18 | 14/1/19 | 10/4/18 |
| ***Period End*** | 22/5/18 | 8/10/18 | 31/12/18 | 14/1/19 | 8/4/19 | 8/4/19 |
|   |  |  |  |  |  |  |
| **SMF Portfolio vs. Reference Portfolio** |  |  |  |  |  |  |
| Asset Allocation | 0.01% | 0.02% | -0.02% | -0.05% | -0.04% | -0.08% |
| Security Selection - AAE Portfolio  | 0.00% | 0.48% | -1.47% | 0.22% | -0.31% | -1.09% |
| Security Selection - Cash Portfolio | 0.01% | -0.01% | -0.01% | 0.00% | 0.00% | -0.02% |
| Contribution from Positions Held | 0.02% | 0.49% | -1.50% | 0.16% | -0.35% | -1.19% |
| Interaction, aggregation, trading effects | 0.00% | -0.01% | 0.00% | 0.00% | 0.04% | 0.02% |
| **Total Relative Performance** | -0.02% | 0.39% | -1.51% | 0.16% | -0.31% | -1.30% |
|   |  |  |  |  |  |  |
| **AAE Portfolio vs. S&P/ASX200 ETF** |  |  |  |  |  |  |
|  iShares Core S&P/ASX 200 ETF  | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
|  Bingo Industries Limited  |  |  | -2.81% | 0.45% | -2.10% | -4.43% |
|  Rio Tinto Limited  |  | -0.20% | 0.17% | -0.03% | 0.89% | 0.83% |
|  Telstra Corporation Limited  |  | 1.15% | -0.36% | 0.03% | 0.59% | 1.42% |
|  Time Aggregation Effect  |  |  |  |  |  | 0.07% |
| **Total Relative Performance** | **0.00%** | **0.95%** | **-2.99%** | **0.46%** | **-0.62%** | **-2.24%** |
| *Opening AAE Weight in Total Portfolio* | 50.16% | 50.45% | 49.16% | 48.07% | 49.56% |  |
|   |  |  |  |  |  |  |
| **Cash Portfolio vs. Betashares Cash ETF** |  |  |  |  |  |  |
|  Betashares Cash ETF  | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
|  BT Cash Management Trust  | 0.14% | -0.26% | -0.13% | -0.03% | -0.02% | -0.30% |
|  Accruals  | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
|  Time Aggregation Effect  |  |  |  |  |  | 0.00% |
| **Total Relative Performance** | **0.14%** | **-0.26%** | **-0.13%** | **-0.03%** | **-0.02%** | **-0.30%** |
| *Opening Cash Weight in Total Portfolio* | 4.81% | 4.68% | 6.45% | 7.00% | 4.43% |  |

# Socially Responsible Investment (SRI) Report

The SMF conducted a major review into the implementation of the University’s SRI policy within the Fund during Semester 2, 2018. This SRI report represents the first such report since the review was conducted. It is pleasing to see the Fund applying the additional measures that were established as a result of the review. The foundation of the Fund’s SRI policy is built upon the criteria used within the Australian equity portfolio of the ANU Long Term Investment Pool (LTIP), which appear as conditions one through three below. The SMF extends this SRI policy with the addition of conditions four and five:

1. Exclude companies that derive more than 20% of revenues from coal, gambling, tobacco or pornography.
2. Hold a portfolio with 25% less carbon intensity than the S&P/ASX 200.
3. Ensure that the portfolio demonstrates a 10 % improvement in the overall Environmental, Social and Governance (ESG) rating relative to the benchmark.
4. Avoid investments that cause an unacceptable level of ‘social injury’.
5. Take into consideration whether a prospective investment creates ‘social benefit’.

Figure 5 reports on the SRI compliance as at 8th April 2019 with regard to the carbon intensity and ESG scores, which are applied to the active stock investments within the AAE portfolio. The carbon intensity scores for Bingo, Rio Tinto and Telstra are retrieved from Bloomberg. They are calculated based on the annual carbon emission (in tonnes) per $1 million of revenue earned. Carbon intensity for the S&P/ASX200 ETF is sourced from the ANU Socially Responsible Investment Policy 2017 Report, which is the most recent data we have available. The ESG scores are based on analysis performed by Sustainalytics, and remains unchanged from the data presented in the SMF Annual Report 2018. The Bingo score uses an industry average, while the ESG score for the ASX200 uses an equally-weighted average which is consistent with the SMF investment process that targets about 10 broadly equally-weighted positions. The market capitalisation-weighted average is shown in brackets for reference.

Figure 5: Current Position of the AAE Component in regard to SRI Compliance

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **ASX200 ETF** | **Bingo Industries (BIN)** | **Rio Tinto (RIO)** | **Telstra (TLS)** | **Total Active Stock Positions** | **Active Stock Positions vs. S&P/ASX200**  | **Target Improvement**  | **Margin** |
| Weighting in AAE portfolio | 81.3% | 5.7% | 3.6% | 9.3% | **18.7%** | - | - | **-** |
| Carbon intensity | 314.1 | 40.6 | 565.3 | 50.2 | **148.0** | -53.0% | -25% | **28.0%** |
| ESG score(S&PASX200, cap weighted) | 58.8(+65.8) | 58.3 | 68.0 | 74.0 | **68.0** | +15.7% (+3.36%) | 10% | **5.7%** |

The SMF portfolio is in full compliance with the SMF SRI policy regarding holdings in the active investments in Bingo, Rio Tinto and Telstra. This is demonstrated by a -53.0% reduction in carbon intensity against the required -25%, and a 15.7% improvement in ESG score against a required 10%.

Conditions four and five are evaluated on an ongoing basis by the Fund regarding our existing investments, and throughout analysis of prospective stock investments. To this effect, the SMF decided not to pursue some candidate stocks during the current semester on the basis of the combined view of the AAE and R&C teams that the companies may have been causing social injury. Once the AAE portfolio is fully invested in active stock positions, as against its current partial exposure to the S&P/ASX200 ETF, the AAE portfolio will be in complete compliance with all elements of the ANU SRI policy.

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