CI AUSTRALIAN EQUITIES FUND
QUARTERLY COMMENTARY REPORT

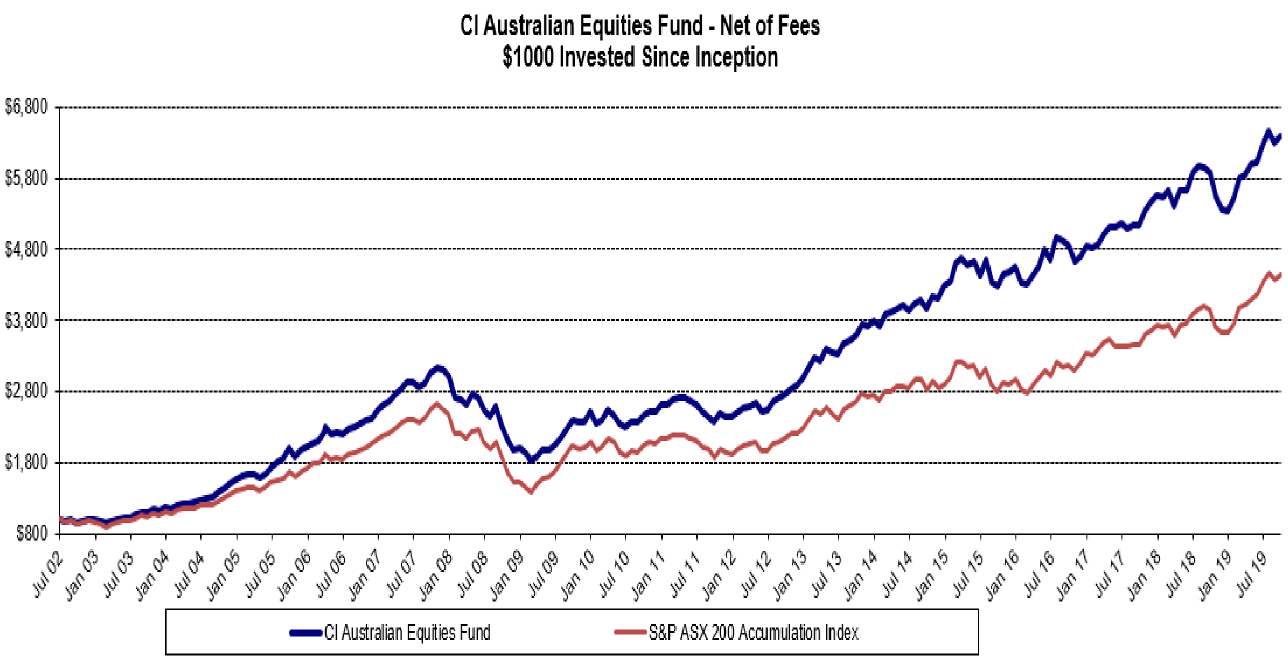
Cooper Investors Pty Limited AFS Licence Number 221794 ABN 26 100 409 890

For current performance information please refer to the Monthly Performance Report.

SEPTEMBER 2019

	**PORTFOLIO	#BENCHMARK	VALUE ADDED
ROLLING 3 MONTH	2.06%	2.37%	-0.31%
ROLLING 1 YEAR	9.43%	12.47%	-3.04%
ROLLING 3 YEAR	10.60%	11.88%	-1.28%
ROLLING 5 YEAR	11.13%	9.50%	1.63%
ROLLING 7 YEAR	13.99%	10.97%	3.02%
ROLLING 10 YEAR	11.36%	8.15%	3.21%
SINCE INCEPTION*	12.51%	9.03%	3.48%
SINCE INCEPTION^	663.60%	343.93%	319.67%

*Annualised
^Cumulative (4 July 2002)
**Before fees and expenses
#S&P ASX 200 Accumulation Index



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"Facts do not cease to exist because they are ignored." Aldous Huxley

"I sincerely believe that banking establishments are more dangerous than standing armies, and that the principle of spending money to be paid by posterity, under the name of funding, is but swindling futurity on a large scale." Thomas Jefferson

"Credit is a system whereby a person who can't pay, gets another person who can't pay, to guarantee that he can pay." Charles Dickens, Little Dorrit

"Suckers think that you cure greed with money, addiction with substances, expert problems with experts, banking with bankers, economics with economists, and debt crises with debt spending"
Nassim Nicholas Taleb, The Bed of Procrustes: Philosophical and Practical Aphorisms

Market and Portfolio Performance

The ASX200 Index rose 2.37% over the quarter, again pushing past numerous global areas of concern, and following the lead of the Dow Jones and S&P500 indices which both rose by a similar amount. Bond yields fell in Australia and the USA as markets anticipated further rate cuts which duly occurred. The Federal Reserve cut rates by 25bps, its second cut in the space of three months, while the RBA cut rates in both July and on 1st October by 25bps on each occasion to leave rates at a historic low of 0.75%. Inflation is seemingly not a risk and there are growing worries about the global economy in light of a litany of uncertainties.

During the September quarter stocks which performed well included Woolworths (good result and decision to demerge its drinks business), Wesfarmers (solid result and ongoing rerating post Coles demerger) and Aurizon (result meeting expectations and corporate restructure).

Portfolio holdings which did not do so well included Cleanaway (earnings missed expectations for the first time under current management as the impact of the China National Sword program which restricts the importation of waste was felt), Amcor (falling back post a strong run up into the completion of the Bemis merger, and concerns around the future of plastic packaging) and Brambles (earnings shortfall as a result of issues with the pallet pools in both Canada and Latin America).

Economic data in Australia is showing a sluggish economy (low retail sales, falling building approvals and starts) while in the USA the latest consumer confidence fell sharply. In Germany figures revealed that GDP actually contracted in the June quarter, suffering from weak industrial and auto exports and impacting on the rest of Europe. The rate cuts to date have had little to no impact – to quote John Mauldin "it is increasingly obvious that conventional monetary policy is useless now that rates have been so low for so long, and everyone believes they will remain low. Nothing the central banks do incentivises anyone to make immediate growth generating decisions. If you need to borrow money, you likely did it long ago." We concur with Mauldin and are of the view that trying to stimulate growth by pouring ever more debt onto what is already a very large pile is doomed to failure.

In this environment we remain attracted to companies with management capable of taking advantage of opportunities in spite of a generally tough environment, and with balance sheets which offer latency. We expand on a few examples below.

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SEPTEMBER 2019

The Portfolio

During the quarter we added **Seek (SEK)** to the portfolio. SEK owns leading online jobs classifieds businesses in Australia, New Zealand, China, and a number of other markets across both Asia and Latin America. Outside of the core jobs classifieds businesses, SEK is also investing in online education, contingent marketplaces that are looking to capitalise on the growth of casual/temporary labour pools, and software solutions for the human resources sector.

We believe there is still a significant opportunity to increase yield in its core domestic business by increasing depth penetration and moving to market based pricing. SEK have demonstrated the value it provides to both recruiters and corporates by taking the lion's share of job placements. SEK have also invested heavily on improving its products for both its customers and job seekers. Compared to realestate.com.au (REA), SEK have been conservative in its pricing approach. REA have executed well on market based pricing (differential pricing based on suburbs) and growing depth revenue. Depth revenue for REA now represents 76% of total revenue compared to 26% for SEK. With the technical solution in place, SEK's move to market based pricing will better align price to value and offset some of the near cyclical weakness in job listings.

Through its 61.1% stake in Zhaopin, the company has exposure to a leading jobs classifieds business in China. The market opportunity is large with strong industry tailwinds over the medium term. Zhaopin is already leading in a number of operating metrics, and the focus near term is to drive further improvement and grow market share by adopting a freemium model. If executed well, there is a large revenue opportunity over the medium term and along with this margin expansion.

We believe the Asia and Online Education Services businesses are under appreciated and there are large latencies. SEK moved to 100% ownership of the Asia business in early 2018 and is a combination of JobsDB and JobStreet. The business has #1 positions in mature markets (HK, Malaysia and Singapore) and developing markets (Philippines, Indonesia, Thailand). SEK have spent the last few years integrating the two businesses and continues to invest in products and platforms. The opportunity in Asia is that the labour pool is much larger than Australia, and the business is now in a better position to leverage the products and learnings from Australia. The online education business albeit relatively small today, is leveraged to the medium term growth in online tertiary courses both domestically and offshore, and short online courses as they get more formal recognition by employers over time.

Lastly and importantly, we are confident that the strong management team led by co-founder Andrew Bassat are well positioned to execute on the opportunities in front of them given their deep industry knowledge and track record.

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SEPTEMBER 2019

Stock News

During the quarter **NAB** announced that its new CEO would be Ross McEwan, former Group Executive for Retail Banking Services for CBA and more recently CEO of Royal Bank of Scotland (RBS). His experience at RBS post the global financial crisis where he led the organisation through significant change and recovery should serve him well for his role at NAB. For NAB this is a key appointment and we expect McEwan and chairman Phil Chronican to be the best and most experienced management team to have been at NAB for many years. At the time of writing Chronican has cut the dividend to a sustainable level, taken the software and remediation write off we expected, and thus cleared the decks for the incoming CEO.

While we have an overweight position in both CBA and NAB, we retained an underweight exposure to the banking sector as a whole. With the exception of NAB, we see limited valuation upside: the sector is trading near the top of historical averages, with few identifiable positive latencies. Operating trends remain skewed to the downside: lending volumes are still weak, margins under pressure, remediation charges and investment requirements dragging on costs, and proposed RBNZ changes impact capital. Competition is high as both incumbents and new entrants fight for volume in a low-growth environment.

Although the RBA's recent interest rate cuts make their dividend yields more appealing, low interest rates are fundamentally negative for banks. As rates approach zero, it becomes increasingly difficult to re-price deposits to offset the pressure on mortgage rates, and returns on replicating portfolios and equity hedges decline. We also question how effective monetary policy will be in stimulating credit growth given high household indebtedness and a more cautious approach from the banks following the Royal Commission.

Woolworths (WOW) announced that their drinks and hotels divisions would merge Endeavour Drinks and ALH (including the well-known retailer Dan Murphys) and then be spun off or sold under the name Endeavour Group. This transaction will de-gear the balance sheet even further and is likely to result in a further capital return in early 2020. We believe WOW are progressing well with their strategy towards incorporating online and customer centric offers and the turnaround of Big W.

As we had expected, and part of our investment thesis, **Aurizon (AZJ)** completed the internal restructure of the above rail and network businesses. While deciding to remain an integrated business for the time being, the restructure will essentially allow the network business to be geared more in line with other infrastructure businesses and enable circa $1.2B of further debt capacity. We expect these funds will be deployed into capital returns to shareholders or other value accretive opportunities.

As part of management's efforts to simplify the company, **Newscorp (NWS)** announced a strategic review of its News America marketing business. We believe NWS will look too sell this business which is a step along the path to unlocking in the share price the value of its individual businesses.

The telco sector has been going through a period of significant change as customers migrate from the old copper network to the NBN network (be prepared for a painful experience if you are still yet to migrate). For Telstra, the adverse financial impact on a net basis is now expected to be over $3bn, which the company is trying to offset with a significant cost-out programme and growth in other parts of the business. For resellers, the proposition is much less attractive given the much higher access costs the NBN charges. Although the recently announced changes to NBN access pricing does provide some relief to resellers (especially at the entry level product), it is not enough to change the outlook for reseller margins materially.

SEPTEMBER 2019

Mobile is still key for the Telco's – it offers differentiation, growth and is the most profitable division. You will have most likely come across the term "5G" now with the recent ramp of advertising campaigns. From a technical standpoint, this technology uses more advanced radio equipment, which is compatible with higher frequency spectrum. As a consumer, you will experience much higher download and upload speeds, higher capacity (your data allowance on your mobile will continue to increase) and lower latency (important for mission critical applications). The 5G rollout approach currently being undertaken globally varies from region to region depending on the type of spectrum available.

In Australia, Telstra and Optus are leading the way while Vodafone is hamstrung by the merger process with TPG Telecom. Current 5G coverage is limited but will improve over time. Optus have gone down the path of offering 5G fixed wireless in an attempt to migrate some of their existing NBN customers onto their own mobile network, which is higher margin for Optus. In New Zealand, Spark Telecom have migrated a lot of their low data fixed customers onto their mobile network using existing spectrum for 4G. Network capacity on 5G will only increase with the availability of higher frequency spectrum. Telstra, while they are still receiving disconnection payments from the NBN as customers transfer off the Telstra network onto NBN, are promoting 5G for mobile handsets. The 5G mobile service is offered free currently but the intention is to charge $15 per month for the lower tier plans starting July 2020. While there is an opportunity to increase prices as we move across to 5G, it will ultimately depend on industry rationality. There is also a large opportunity in the enterprise market (think automation of factories, healthcare, autonomous vehicles), but the economics remain unclear given the additional network investment required. So while we are excited about what 5G has to offer, our expectations are tempered a little bit by the track record of Telco's competing away the benefits in previous generations of mobile technology.