MARKET INSIGHTS

June 2020 Quarter

THE FASTEST SELL OFF, THE FASTEST RALLY – UNUSUAL TIMES

Frank Jasper, Chief Investment Officer

If like, Sleeping Beauty, you had fallen into a slumber at the start of the year and been woken by love's true kiss six months later, fired up your Bloomberg and checked out your share portfolio you might be forgiven for thinking that nothing much has been going on. You would, of course, be wrong.

We have lived through one of the most unusual periods in global financial markets, ever. One of the scariest health crises I hope we ever have to witness. And economic destruction on a scale not seen since the Great Depression.

At its depths the US Standard and Poor's 500 index had fallen over 33%. Since then shares have rallied and rallied strongly. Markets are almost back to all-time highs. The pace of the turnaround from despair to euphoria has been neck snapping to say the least.

While our portfolios were not immune from the dramatic falls in February and March our investment approach did its job helping to mitigate the size of the fall. The companies we favour that are best in class, have wide economic moats that protect them from competition, are in structurally growing industries and are run by leaders with clear strategic vision, clearly outperformed the average, and more economically sensitive, firms.

The rally in markets, that began March 23, has been unusual. It is not typical that companies that outperform on the way down, are the strongest on the way back up. But that is exactly what has happened in this time. In many cases these companies, like Fisher and Paykel Healthcare or Amazon.com or CSL, are well positioned for the post COVID economic environment and have, if anything, extended their strategic leadership.

This has resulted in one of the strongest periods of excess returns, which is the return you have earned over and above the market, ever delivered by Fisher Funds. I could not be more proud of the work done by the team.

As the team highlights on the following pages, we were able to take advantage of volatile prices over the past few months to identify some real bargains at the depths of the crisis.. In many cases these were companies that we have long admired but had felt were overpriced. Being able to buy them at sale prices, not only helped enhance returns in the second quarter rally but, most importantly, enhances overall portfolio quality, adding market leaders that will grow earnings, and hence share price, for many years to come.

Market poses as many questions as answers

Of course the dramatic rally in markets is at odds with worsening economic news. It poses more questions than answers. Why has the market rebounded so strongly, is it sustainable, how can shares rally when unemployment keeps getting worse?

These are all very legitimate questions.

At Fisher Funds we used a four step framework to help us navigate markets during the COVID pandemic.

Sell off → Stability → Reality → Recovery

We felt that we were in the reality phase of the COVID pandemic journey. The reality phase was characterised by investors accepting the reality of the post COVID environment and the long run impact that would have on company earnings power.

As we all know the pandemic has had a fundamental impact on the global economy. Millions have lost their jobs, entire industries, like New Zealand tourism, have profoundly changed and there was, and is, the ongoing risk that secondary virus outbreaks impose a social distancing drag on economic activity. The likely long lived impact of the pandemic and the possibility of further outbreaks left us cautious on markets.

Our perspective has turned out to be both right and wrong. Right in that the long term impacts of the pandemic have become more apparent every day and in some sectors and for some people will persistent for a long time. But we won the battle and lost the war.

Governments and central banks become important market participants

We were wrong in two very important ways. The first blush of economic activity as economies came out of lock down, has been more robust than expected, surprising analysts and market participants, including ourselves, and putting a bid under asset prices.

We also under estimated the impact of government and central bank policy. Governments around the world have borrowed over US$11 trillion since the start of the pandemic and have pumped this into the economy through a raft of fiscal programmes. Similarly central banks, through quantitative easing (QE) programmes, have bought more US$10 trillion of government and corporate bonds since the coronavirus crisis hit, driving down interest rates.

These actions have not only protected the downside risk for global economy but point to a paradigm shift in government and central involvement in financial markets.

Ever since the Global Financial Crisis the global economic machine has become increasingly reliant on central bank support to function. We have seen this most notably in Japan and China but also in the United States through a raft of QE programmes.

As the Eagles would say, with a hat tip to Hotel California, checking into these programmes is easy, leaving is next to impossible. The QE programmes in both Japan and the United States have been a case study in this, with attempts to shrink central bank balance sheets invariably leading to financial market stress and requiring new initiatives to dampen volatility.

The pandemic has made this an even more intractable problem and added fiscal policy to the mix. The global economy and financial markets are increasingly addicted to government largesse. And asset prices, principally interest rates, are, as a result, more a reflection of government policy than economic fundamentals.

While this experiment may not end well, this is a driver of markets that we increasingly need to take into account in our thinking.

Bad news becomes good news

If the "reality" phase of the pandemic continues to be troubling, governments will continue to spend money to spur economic growth and central banks will continue to pin interest rates at ever lower levels. Bad news becomes good news. Perversely, risk for financial assets is likely to rise when things settle and governments seek to withdraw the punch bowl, although we think it's likely that the resultant financial market volatility will make them realise that it is impossible.

While this has been good for markets it has long run implications both positive and negative.

Thank you

In the pages that follow the team will give you a good insight into how they have been approaching markets over the past quarter and their thoughts about the outlook. I hope you enjoy the read.

And from me, thanks to all of you for hanging in there during a tough time, for your faith in us and for the great questions, emails and comments we receive. It makes this job a real joy.

Best regards,

Frank Jasper | **Chief Investment Officer**

NEW ZEALAND EQUITIES

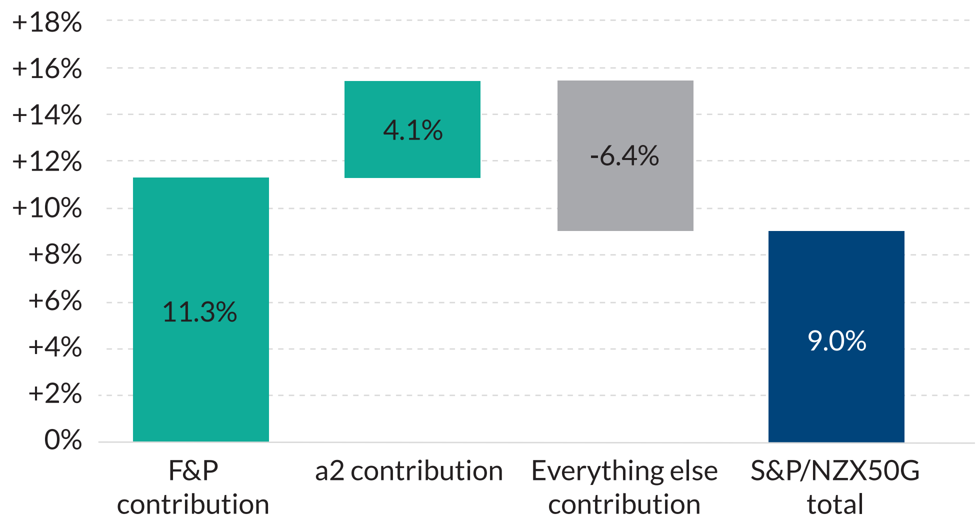
Sam Dickie, Senior Portfolio Manager

Solid returns through a crisis thanks to active management

Our tried and tested investment process, coupled with some enhancements, stood up well during COVID

The local stock market appears to be defying the effects of the COVID-19 pandemic. But on closer inspection the solid performance of the benchmark S&P/NZX50G Index has been driven by only a handful of companies, and **Fisher & Paykel Healthcare** and **a2 Milk** in particular. Over the last twelve months they have delivered all of the gains of the benchmark, as shown in the chart below. This is extraordinary and masks the inferior performance of a lot of other companies. What this tells us is how critical active management is. In an uncertain and lower growth world, it is critical to invest in just the highest quality companies.

Performance over the 12 months to 30 June 2020



Returns are after fees and before tax

Sticking to and enhancing a successful process was vital during the crisis

We continue to think about the companies in our portfolio being in one of the four broad "buckets" that we discussed last quarter:

» 1. Companies that should trade well through the COVID-19 crisis ("beneficiaries")

» 2. Companies that have more defensive earnings streams ("defensives")

» 3. Companies that have economically sensitive earnings streams ("economically sensitive")

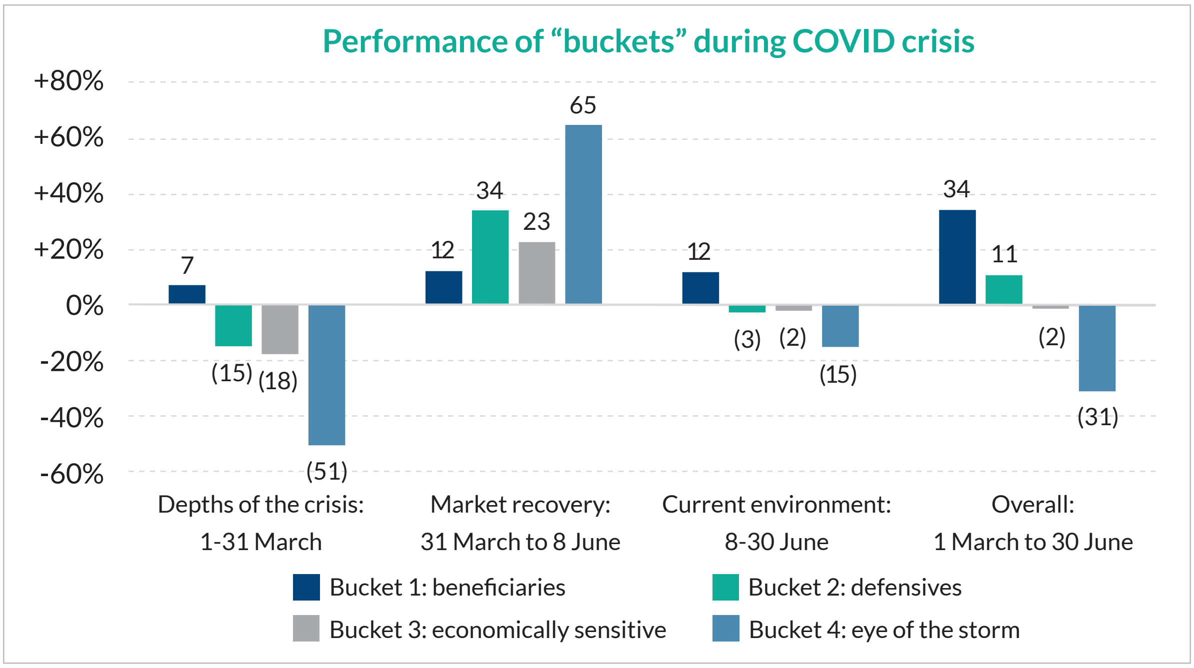
» 4. Companies that are in the eye of the storm ("eye of the storm")

We owned less of buckets 3 and 4 and more of buckets 1 and 2 into the teeth of the pandemic related market panic in March. We maintained a small position in **Auckland Airport** right until the share price fully captured all the obvious risks. We had cut our weighting in **Summerset** in late January and we ran our very large positions in Fisher & Paykel Healthcare and a2 Milk right into the trough of the crisis on 23 March.

We switched gears in late March by trimming some of our positions in buckets 1 and 2 and buying positions in buckets 3 and 4. We trimmed **Fisher & Paykel Healthcare**, **Meridian** and some **a2 Milk** near the worst of the crisis and switched that into **Auckland Airport** and **Vista,** especially via their equity issuance. We were also adding to our heavily oversold positions in **Summerset** and **Mainfreight.** Starting March 23rd, global stock markets staged their fastest 30% bounce ever. And in that environment we saw almost the mirror image of the March carnage, with some of the most impacted companies rebounding strongly.

In the last three weeks we have seen markets pause for breath as COVID-19 and the economic fall-out remains a key risk. After the strong market rebound, we have again reduced our holdings in "eye of the storm" companies and increased our weightings in the COVID "beneficiaries".

The combination of our existing tried and true process, plus the enhancements made by actively managing the portfolio during the crisis have been critical to our performance.



Bucket 1 – Beneficiaries: Fisher & Paykel Healthcare, a2 Milk, Pushpay, Delegat

Fisher and Paykel Healthcare and **Pushpay** have seen their customers embrace their products like never before as a result of COVID. We believe this has structurally increased the value of these companies as higher sales milestones are achieved earlier and their products gain traction with a wider set of customers.

Fisher and Paykel Healthcare's nasal high flow therapy is proving a more effective treatment for COVID patients that traditional invasive alternatives such as intubation (an 'endotracheal tube' physically inserted down the throat and into the airways). Longer term, this experience could prove a powerful proof point for practitioners, driving the use of the company's products for the treatment of far more respiratory patients.

Pushpay has also experienced a strong acceleration in growth. Our recent calls with church administrators has confirmed that digital giving has remained at elevated levels in recent weeks, and is not expected to revert to prior levels when congregants can physically return to church. COVID has driven permanent behaviourial change.

Bucket 2 – Defensives: Xero, Meridian, Infratil
Xero is using the crisis to take market share from competitors, deferring price increases to help customers and maintaining its investment in development to continue improving its product and widening its moat. Xero is doing this at the same time that competitors are laying off staff and reducing spending. The company has seen strong engagement with existing customers by tracking usage rates through the pandemic. In the US, the company has built out its partner channel and is becoming more confident about increasing subscriber numbers at a strong rate once key product developments are released.

Bucket 3 – Economically sensitive: Port of Tauranga, Mainfreight, Freightways, Ryman, Summerset
Mainfreight provided a granular assessment of the impacts on each business for the first seven weeks of the 2021 fiscal year. The Australian business is performing very strongly and growing at a double-digit rate despite the pandemic. This is driven by market share gains from competitors. The NZ domestic transport business is also bouncing back nicely. For example, volumes shrunk 40-45% during April, but in recent weeks it has been growing 5-7% year-on-year. The key disappointment has been the United States, where sales growth momentum has stalled and it is taking time to rebuild given the current challenges.

Ryman and **Summerset** moved early to implement strict measures to protect their vulnerable elderly residents and prevent COVID from entering its villages. This and other initiatives like “happy hour in a bag” have helped reinforce their strong reputations and brands. We believe the way they have looked after their residents during lockdown will likely accelerate the demand for retirement villages in New Zealand and Australia and also drive share gains from independent and lower quality operators. Interest levels and resales have increased significantly following New Zealand’s move to less restrictive COVID Alert Levels. Potential new residents’ children have often seen their parents as being more vulnerable than expected post COVID seek out a provider “good enough for mum”.

Bucket 4 – Eye of the storm: Auckland Airport, Vista, Serko
Most cinemas globally are shut and many cinemas have paused paying their fees to **Vista**. This put the company’s liquidity position under stress. We participated in the company’s equity raising at $1.05, which ensures Vista has sufficient liquidity for an extended period. COVID-19 aside, Vista has continued to grow its market share to 50% for its core cinema product globally outside of China. It is multiple times the size of its next biggest global competitor. The company will return to growth when cinemas inevitably re-open.

AUSTRALIAN EQUITIES

Robbie Urquhart, Senior Portfolio Manager

In the depths of the share market sell-off in March, governments and global central banks came to the rescue. They unleashed a counter-attack for markets in the form of large fiscal and monetary stimulus programmes.

In Australia, the fiscal stimulus alone has totalled A$165bn or a whopping 9% of GDP, most of which is being dispensed over the six months to September. A lot of it is being used to help businesses pay salaries of employees. The Reserve Bank (RBA) has grudgingly added to this firepower by embarking on quantitative easing measures for the first time. This has lowered interest rates, reducing the mortgage and borrowing costs for households and businesses. We have not witnessed policy stimulus of this magnitude in our lifetime.

These actions have laid a foundation for an economic recovery in Australia. It is too early to judge whether these efforts are enough to 'win the war'. After all, we have more recently seen signs of a resurgence in COVID-19 cases in pockets across the world. This includes an unsettling surge in Victorian cases in Australia.

However we have continued to see increasing signs of an economic recovery underway. This has underpinned the broad based +18.0% increase in the benchmark ASX 200 Index (70% hedged into NZ$) in the period. All ASX 200 Index sectors rose in the period.

High Quality & Growing Companies Have Performed Well

Feedback from a number of our companies suggests the early signs of recovery seen in April has contiued to broaden out and strengthen in May and June. Offsetting this good news is the expectation that individual company fortunes will likely continue to be buffeted to varying degrees by localised virus outbreaks as they take place.

Sound, sensible leadership is critical in this environment and this has been no more evident than at **AUB Group (+51% in A$ over the quarter).** AUB was in the midst of completing an acquisition of one of its insurance broking partners when the COVID-19 crisis hit in March. AUB acted decisively in terminating the acquisition. This enabled them to retain millions in cash which would otherwise have been paid out, and enabled both parties to focus on their own businesses and not be distracted by the transaction. AUB also withdrew earnings guidance given the uncertain environment.

Since then, feedback from AUB and the insurance broking industry indicates that broking activity has been resilient, and insurance premiums have continued to tick higher through the quarter. In a trading update in late June, AUB reinstated earnings guidance and now expects profit growth of 12-14% for the year ending June 2020.

Given the improved and more settled conditions we may soon hear more about a resumption in acquisition discussions with its partner.

Improvement in consumer spending has driven a strong rebound in Australian house and car sales activity. We've also seen job advertisements starting to pick up in Australia. This has buoyed the share prices of our classified advertising companies, **Carsales (+51%), SEEK (+48%)** and new addition to the portfolio, property advertiser **REA Group** which rose 40% in the quarter. In fact REA had 109 million visits to its website in May, an all time monthly record for the company. By REA's measure this included a significant uptick in active buyer enquiry.

Glove and protective equipment manufacturer **Ansell (+35%),** has done an exceptional job navigating the crisis. It has successfully kept its employees safe while its manufacturing facilities have largely remained open throughout. It has continued to source the raw material inputs required for protective equipment production despite disruption to supply chains.

And it continues to benefit from the sustained focus on hygiene standards globally across the industrial sector and particularly within healthcare. This is likely to drive increased demand for its gloves and protective equipment for a long time to come.

Portfolio Changes

Our investment philosophy is grounded in investing in high quality companies, run by sound management teams that have favourable long term growth prospects. This stood us in good stead going into the COVID-19 crisis. It has also served our investors well as the economic recovery has taken root.

As we wrote about in the March quarterly, during the sell-off we tilted the weighting of our portfolio positions in favour of our highest quality businesses, strengthening the mix of our portfolio. As part of this we added REA Group to the portfolio in March. It has had a good start for our investors, rising +40% in the quarter.

We have continued this process by adding **Woolworths** to the portfolio in May. Since then it has returned +9.1% (A$), ahead of the ASX 200 Index. Woolworths is not as fast growing as some other portfolio holdings. But Woolworths is a high quality dominant supermarket operator in Australia and has a strong presence in New Zealand. It benefits from a broad scale advantage. Along with a rational, duopolistic competitive structure in both countries, this is supportive of the company's pricing power and profitability. Under CEO Brad Banducci, Woolworths has developed a credible track record over a number of years.

An economic recovery does seem to be underway in Australia. But the journey is likely to remain volatile and uneven. Being invested in high quality businesses with defensive earnings streams like Woolworths is important in building an all weather portfolio for this environment.

In May, we also exited our position in **Technology One.** In this instance, we like the Technology One business and business model. It provides mission critical software to its customers including local council and government, and higher education organisations. Revenue from these customers is recurring and reliable.

However, the company's growth is slow relative to what is required in order to meet management's stated longer term growth objectives. Linked to this, its valuation is stretched in our view. Should management execution improve and/or valuation adjusts to be reflective of this lower growth, we could well see Technology One back in the portfolio in the future.

SELECT INTERNATIONAL EQUITIES

Ashley Gardyne, Senior Portfolio Manager

The surge in global share markets in the second quarter provided a stark contrast to the steep COVID-19 driven declines in the first quarter. The US markets led the bounce and posted its best quarter since 1998. The flagship US S&P 500 Index climbed 20.0% for the quarter – but 39% from its lowest point on 23 March. Most global markets followed the US higher, with MSCI Europe up 11.1% and MSCI China up 14.4%. The sharp rebound was driven by record monetary and fiscal stimulus, which coincided with economic reopening in most markets.

The strong get stronger, the weak get weaker

Unprecedented economic shutdowns have impacted some businesses far more than others. In many instances this has led to strong companies getting stronger, and weak businesses getting weaker. Some have failed altogether, like rental car company Hertz and US retailer J.Crew.

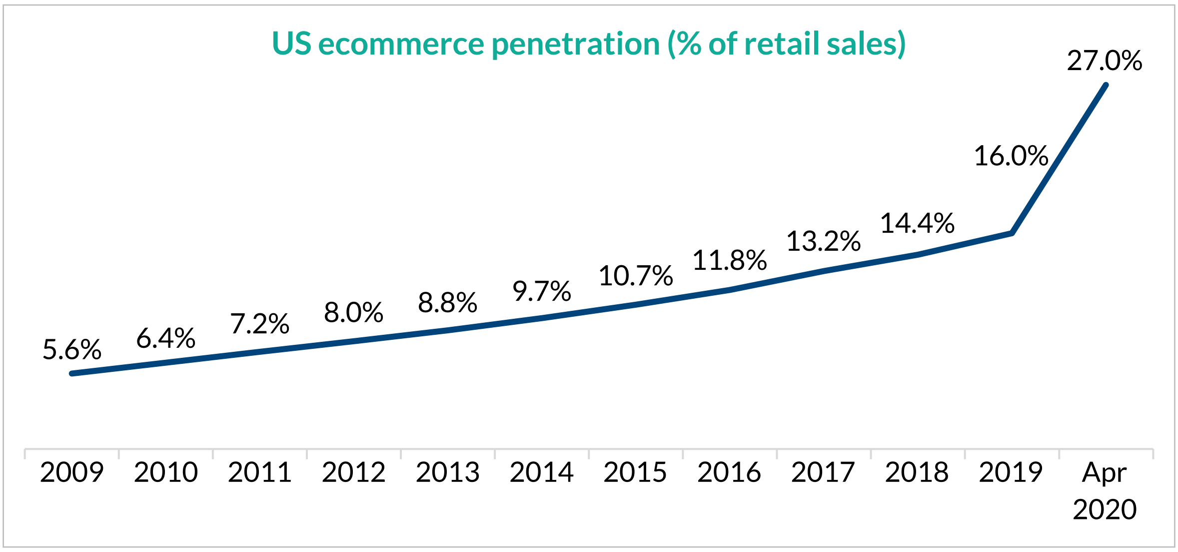
In our last quarterly update we gave the example of how COVID-19 would hasten the demise of many traditional retailers, while strengthen ecommerce and online payments companies including our portfolio holdings **PayPal** and **Amazon.** However, when markets are falling and investors are panicking, stocks often get sold off indiscriminately and drag down the prices of even the most resilient businesses. We saw this in March, which gave us a good opportunity to add to our positions in companies like PayPal, Amazon and Facebook.

We are now beginning to see real data on how lockdown has impacted a wide range of industries, and this concept of the strong getting stronger has played out even more abruptly than we anticipated.

The percentage of commerce conducted online took 10 years to go from 6% to 16%, but jumped to 27% in April. 10 years worth of change in just eight weeks. This has provided rapid growth for **Amazon,** who had to hire over 175,000 new employees just to keep up.

All of this ecommerce growth is also driving demand for digital payments, as consumers look for a secure and simple way to pay. This saw **PayPal** add a record 10 million new users in the first quarter. The surge in ecommerce has led to an acceleration in digital payments adoption, driving new users and increased engagement. Despite the slump in global consumption in recent months, PayPal had its best day ever for payments volume in May and the business continues to grow rapidly.

While some volumes may move back to brick and mortar retailers once COVID-19 fears subside, ecommerce and digital payment trends have remained remarkably strong despite the end of lockdown. It appears that the new online shoppers have found ecommerce to provide both value and convenience, and have continued to shop online.



The theme of the strong getting stronger has undoubtedly helped our portfolio this year and we think it will play an important role in the years ahead. Economic growth is likely to be anaemic over the next few years. Unemployment caused by lockdowns and the build-up of debt in the economy will take a number of years to work through. In this environment we believe businesses with their own secular growth drivers are well positioned to thrive, which should favour many of the companies in our portfolio.

Never let a good crisis go to waste

The last few months has seen us make more changes to the portfolio than usual. We generally subscribe to the theory that you should simply invest in a portfolio of great businesses, sit back, and let compounding do the work. That said, every 5 to 10 years there is a market event that presents compelling investment opportunities – which investors shouldn't let go to waste.

We added a handful of new companies to the portfolio this quarter. They include a combination of smaller growth companies that we have followed for a number of years (Floor and Décor and Stone Co) and more cyclically exposed businesses (HEICO and Hilton) that sold off significantly in February and March.

Stone Co (+50% since addition) is a rapidly growing payment service provider in Brazil that allows small merchants to accept digital payments in-store and online. Stone was founded in 2012 by Andre Street in response to deregulation in the Brazilian payments market, which allowed competition with the two bank-owned payment providers for the first time. Stone's technology, service and unique business model has proven disruptive and enabled them to gain market share. It is now the largest independent payment service provider in Brazil with 7% market share and it grew payment volumes by 55% in 2019. Digital payment penetration is still low in Brazil, but is increasing rapidly due to the shift away from cash and growth in ecommerce - two trends that have accelerated due to COVID-19. All considered we believe Stone is an attractive founder-led business with many years of growth ahead.

HEICO (+21% since addition) is a leading manufacturer of niche parts to the aerospace and defence sectors. Its main focus is on the aftermarket where it has 50% market share in third-party regulator-approved parts (or 'PMA parts' using industry terminology). These parts can be used in place of expensive Original Equipment Manufacturer components, but are often 30% to 50% cheaper. This is an attractive proposition for airlines, particularly in the current environment, and it has allowed HEICO to outgrow the wider aerospace aftermarket for many years. We believe HEICO will continue to outgrow the aerospace market longer-term as penetration of PMA parts increases. The company has been led by the founding Mendelson family for almost thirty years, who have created an enviable track-record of consistent growth over this period.

Floor and Décor (+57% since addition) is a fast-growing US retailer, with large format warehouses (roughly the size of a Bunnings) and an exclusive focus on hard surface flooring. The company's scale relative to independent retailers and its direct procurement organisation allows it to offer the industry's broadest in-stock assortment at low prices. We believe the company has the potential to dominate the niche hard flooring category and we see a significant runway for future growth. They have 123 stores currently, but the potential for more than 400 stores in 10 years. Mom and pop retailers (50% of the market) cannot compete on price or service and are likely to continue losing market share.

Hilton (+9% since addition) is one of the largest hotel brand owners globally. There are 6,000 hotel properties associated with one of company's fifteen hotel banners, which includes Garden Inn, Hampton and Doubletree. As an asset-light franchisor Hilton typically takes a percentage of the revenue from hotels that use their brands, as opposed to owning the hotel properties themselves. This model helps insulate Hilton in the current environment. Longer-term we see a long growth runway as independent hotels increasingly look to join branded chains like Hilton. Being part of a chain allows the hotel owner to charge higher room rates and helps boost occupancy (via loyalty programmes and more marketing clout). Hilton has 5% market share of global hotel rooms, but 20% share of new hotel openings, highlighting that Hilton should continue to outgrow the market as small independent operators lose share.

These are all high quality businesses. They have long-term structural growth drivers and are gaining share in their respective industries. When we added these companies to the portfolio we felt that the market was focussing too much on the near-term challenges posed by lockdown, which allowed us to acquire these businesses at what we consider attractive valuations.

Navigating in a lower growth world

We are always cautious making market predictions. After all, no one was picking that global markets would recover nearly all of the COVID-19 driven losses and rebound over 39% from March lows.

Caveats aside, we believe the combination of a weak economic backdrop and elevated market valuations are likely to weigh on future market returns. While equities are still likely to provide a material premium to the returns from cash and bonds over the long term, investors should expect lower than historical returns in the years ahead. In this environment, active management and selecting the right companies will play an even more important role than it has in the past.

PROPERTY & INFRASTRUCTURE FUND

Sam Dickie, Senior Portfolio Manager

A testing time for long term essential infrastructure

COVID has seen diverging performance of infrastructure assets in the short term, but it is worth remembering these are long term assets

Market observations

Interest rates near all-time lows would normally be positive for property and infrastructure stocks, making the recent underperformance of global infrastructure a little perplexing. Recall that low interest rates mean long-dated infrastructure cash flows are more highly valued. But global investors are currently chasing growth companies, and the performance of these growth companies is dominating stock market returns. Why are investors chasing growth companies? Because in the current low growth world we live in, any company with superior growth prospects is considered scarce and hence valuable.

The infrastructure companies we are invested in are going to be highly relevant for the next 50 to 100 years and a short term crisis does not dramatically alter their fundamental long term value.

Investing through a crisis:

We continue to think about the companies in our portfolio being in one of the four broad "buckets" that we discussed last quarter:

» Bucket 1. Companies that should trade well through the COVID-19 crisis ("beneficiaries")

» Bucket 2. Companies that have more defensive earnings streams ("defensives")

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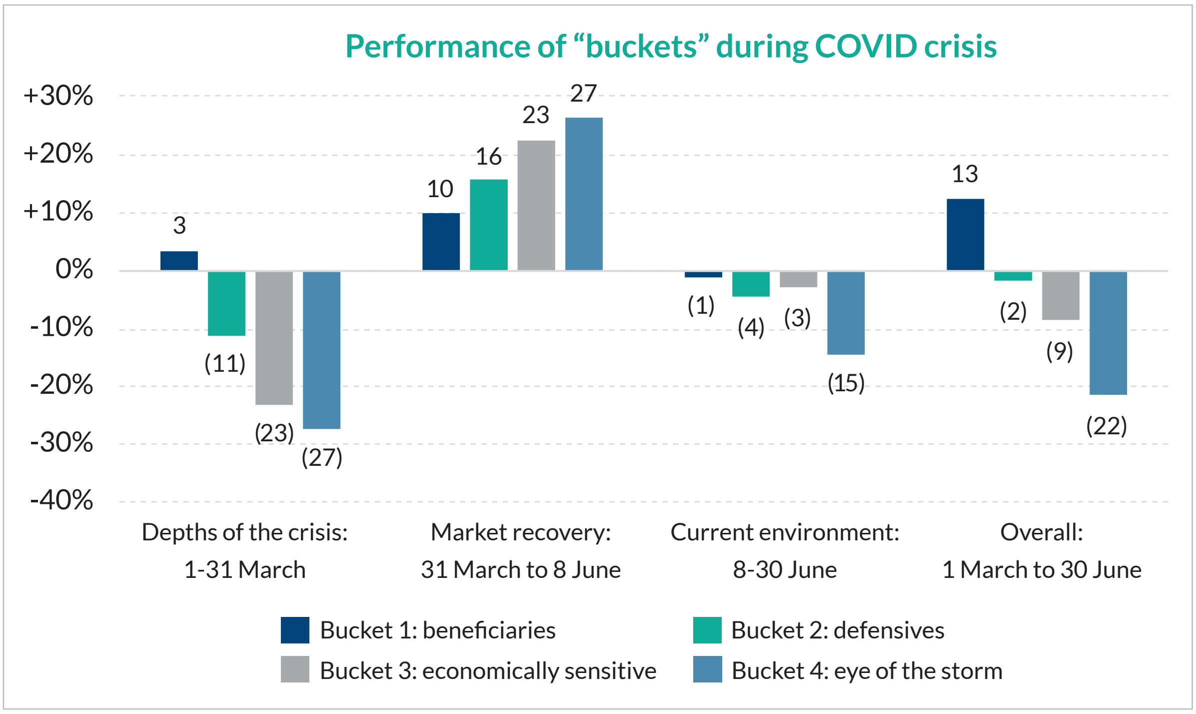


Bucket 1 – Beneficiaries: US mobile towers

US mobile tower companies **American Tower** and **Crown Castle** continue to show great resilience through the COVID-19 epidemic. Early in April the merger between large telcos T-Mobile and Sprint was approved, which is a positive outcome that will see a re-acceleration in network spend towards the end of 2020 and will benefit our companies.

Bucket 2 – Defensives: US utilities, electricity generation, industrial property, toll roads, Infratil

Infratil updated the market on its portfolio businesses, categorising them similarly to how we were thinking -- those broadly unaffected (Tilt, CDC, Longroad), defensive businesses (Trustpower, Vodafone) and more impacted (RetireAustralia, Wellington Airport). Infratil's data centre business CDC has continued to see strong demand and announced it will be establishing sites in New Zealand which is positive given the strong economics of new build expansion and potential long runway for growth from its fundamental demand driver of increased data coupled with higher data security requirements. We participated in the June $300m equity raise. The raising is being used to accelerate investment in several of its growth businesses that are seeing opportunities for attractive returns at present – like CDC.

Tilt announced a significant capital return of A$260m (A$0.55 per share) from the sale of its Snowtown 2 windfarm in late 2019, which still leaves it with ample unrestricted cash on its balance sheet. This benefits us directly but also shores up majority shareholder Infratil's funding position. We had anticipated this prospect and maintain a meaningful position in Tilt due to the low risk cash flows from its existing windfarms plus its long runway for growth from delivering new developments in Australia (and New Zealand) to replace legacy thermal generation over time, which is still underappreciated by the market.

Bucket 3 – Economically sensitive: US railroads, ports, property (apart from industrial)
North American railroads **Union Pacific** and **Norfolk Southern** announced impressive 1Q20 results, delivering remarkable efficiency and cost savings from their Precision Scheduled Railroading (PSR) and demonstrating strong pricing power in excess of rail inflation. This propped up earnings despite volume falls of -8% and -11% respectively, which would normally weigh heavily on margins and profitability. There will be some impressive results in store when COVID-19 is in the rear-view mirror and volumes ultimately return to.

Bucket 4 – Eye of the storm: airports, energy infrastructure
Auckland Airport raised enough equity capital to take any balance sheet funding stress off the table right through until December 2021. The larger than expected $1.2 billion equity raising can sustain the balance sheet even if the current extremely low level of passengers moving through the airport continues through 2021. That is not their base case, but we applauded the prudent approach. Auckland Airport is a long duration, near monopoly asset, and was priced near our long-term bear case valuation. We added to the position including in the capital raising at a discounted price. People will travel again.

We added **Enterprise Products** to the portfolio. This company is a diversified, vertically integrated midstream energy infrastructure business in the US. It has a network of pipelines and other assets like storage facilities and export terminals that operate across the value chain between producer and the end user (e.g. refinery or utility customers). The company's philosophy is to be vertically integrated at scale – this means it controls the whole supply chain from extraction to consumer so it can provide a single solution and earn fees along the value chain. Its customers are mainly high-quality investment grade companies themselves with low credit risk. Enterprise has a long track record of earning solid returns on its infrastructure assets, a history of 22 consecutive years of dividend growth, a conservative management team, and the founding family still remains a 32% cornerstone shareholder. COVID-19 has temporarily reduced global demand for crude oil, refined petroleum products, natural gas liquids, and natural gas which has hit Enterprise's share price. Enterprise is a fundamentally strong business at a temporarily depressed valuation and this is an instance of "quality on sale".

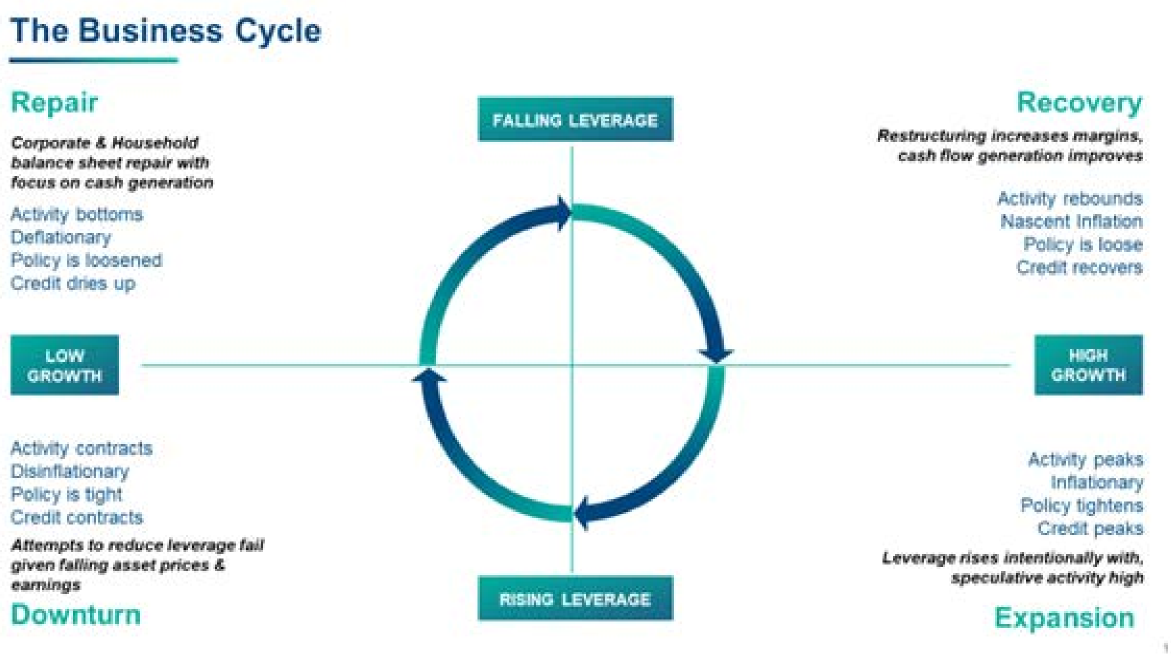
FIXED INTEREST

David McLeish, Senior Portfolio Manager

The importance of the big picture

An important aspect of any investment process is a framework for deciding which type of assets to hold and in what quantities at certain times. This is called an asset allocation decision and academic research has shown these to be responsible for anywhere between 40% and 90% of the return variability across investment portfolios[1].

Our framework for making these decisions is based for our understanding of where an economy is in its business cycle. Those that are regular readers may have seen us refer to this as our cycle-based approach. The very basic premise here is, we believe broad shifts in fixed income values (outside of pandemics and other exogenous shocks) are typically the result of economic outcomes which are encompassed inside the business cycle.



At the end of last year, our framework was indicating an increased likelihood of a synchronised global downturn. However, corporate bond valuations were still priced for a continuation of the expansionary phase. This disconnect provided strong rationale for a much reduced allocation to corporates at the time. Importantly, it was this that afforded us the flexibility to add this exposure back into the Fund when valuations were much more reflective of a downturn.

A long road to recovery

Our cycle-based approach now puts most major economies in the repair phase of the cycle. This stage is typically characterised by economic activity bottoming well below the long-term average. This then usually spurs on companies to cut costs, reduce debt, and generally doing all the right things by bondholders. Because of this, and in lieu of a more sustained recovery phase ahead, this is typically the time when corporate bonds perform their best. The rally corporate bonds we have observed this quarter suggests this cycle is no different.

That said, this is no time for complacency. In fact, quite the opposite. That's because, despite all the government and central bank support we are seeing, corporate bankruptcies are on the rise and aren't likely to peak until later this year. This clearly raises the stakes when selecting the businesses worthy of your capital.

A strong quality bias

The other pillar of our investment process is our deep, fundamental company research. By following a thorough and repeatable process of analysing companies, our aim is to ensure we only invest when we perceive there to be a meaningful margin of safety present. That is to say, things can and will go wrong. So a margin of safety provides confidence that when the unexpected happens, the companies we invest in are likely to be able the weather the storm.

The most obvious and valuable margin of safety is quality. This can take many forms, but is often associated with companies that have stable earnings, strong balance sheets and higher-than-average margins. In such uncertain times we believe this quality requirement must be even higher than usual.

New Zealand Fixed Interest Fund

Only halfway through the year and 2020 will already go down in history as one of the most unusual periods in global financial markets, ever.

The economic destruction we have experienced is on a scale not seen since the Great Depression. Yet there is no historical precedent for the scale of the financial response of governments and central banks to this crisis.

The effect these actions are having, and will continue to have, on financial markets cannot be understated. Worthy of a new chapter in the iconic Friedman & Schwartz, "A Monetary History of the United States", the global financial landscape over the past six months has been reshaped, possibly forever. This brave new world is one that relies on ever increasing intervention in order to ensure the global fiat currency and fractional reserve banking system, in place since 19 71, remain intact.

This is not to say the natural ebb and flow of each economy, known as the business cycle, has become any less important in determining asset prices though. In fact, our framework has continued to successfully help guide our fixed income asset allocation decisions through this highly uncertain time.

At the end of last year, our cycle-based approach indicated an increased likelihood of a synchronised global downturn ahead. At the time, however, inflation expectations remained robust and corporate bond valuations were pricing a continuation of the expansionary phase. This disconnect provided a strong rationale for a much reduced allocation to credit, in favour of sovereign bonds.

Importantly, it was this decision that afforded us the flexibility to add credit back into the portfolio when valuations were much more reflective of a downturn in March and April.

Our framework now puts the New Zealand economy, alongside most major developed nations, in the repair phase of the business cycle. This phase is typically characterised by economic activity bottoming well below average, requiring most businesses to undergo a repair of their balance sheets in order to survive. Given the variable success of these efforts, this makes it the point in which credit investing can be both the most prosperous and the most treacherous part of the cycle.

It is for this reason, recent additions to the portfolio have had a very strong quality bias. These included purchases of bonds issued by the Local Government Funding Authority, Housing New Zealand, Transpower, Westpac, Chorus and Metlifecare.

The natural choice of how to fund these purchases was out of cash and through the sale of various New Zealand government bond holdings. Safe-haven assets have performed extremely well during this crisis, as people have sought the relative safety of government-issued securities. However, with economic activity now well below long term averages, we feel the demand for such low risk, low return assets might be nearing their peak.

New Zealand Cash Fund

The Reserve Bank of New Zealand (RBNZ) has been much less active this quarter. However, the most recent Monetary Policy Review delivered on June 24th did open the door for further monetary policy action in the months ahead.

Improved secondary market functioning did cause the RBNZ to slightly taper their Large Scale Asset Purchase (LSAP) programme during the quarter. But as the Government's employment support packages begin to roll off over the coming months, we expect the RBNZ to pick up the slack, boosting their efforts to stimulate the economy.

Our understanding is that adjusting the size and pace of purchases via the LSAP is the prefer method of stimulus at this stage. But we believe foreign asset purchases (to force the currency lower), a reduction in the Official Cash Rate (to possibly negative levels), and Yield Curve Control (like that undertaken by the Reserve of Australia) are all very much on the table.

Our expectation for sluggish repair and recovery phases ahead are likely to keep growth and inflation muted. In turn this is likely to keep short-term interest rates anchored at or below current levels for the foreseeable future. It is this view that continues to drive our conviction to maintain an overweight duration stance in our cash portfolios for now.

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MARKET MOVEMENTS

As at 30 June 2020

Stock Markets*	Closing Values	Changes over: 1 Mth %	3 Mths %	6 Mths %	12 Mths %
S&P Developed LargeMidCap - (Local Curr)	836	2.4	18.4	-4.9	4.1
S&P Developed LargeMidCap ($NZ)	N/A	2.4	13.3	3.7	12.9
S&P Global LargeMidCap ($NZ)	N/A	-0.7	9.8	-1.4	7.2
USA - S & P 500	6352	2.0	20.5	-3.1	7.5
USA - Nasdaq	11875	6.1	30.9	12.7	26.9
Japan - Topix	2411	-0.2	11.2	-8.2	3.1
UK - FTSE100	5803	1.7	9.1	-16.9	-13.8
Germany - DAX	12311	6.2	23.9	-7.1	-0.7
France - CAC40	13612	5.5	13.5	-16.2	-9.2
HK - Hang Seng	71924	7.4	4.7	-11.9	-11.7
Australia - S & P 300	64102	2.4	16.8	-10.5	-7.6
NZ-S&P/NZX 50 Gross Index (inc imp credits)	13967	5.3	16.9	-0.1	9.9
NZ-S&P/NZX 50 Gross Index (excl imp credits)	11451	5.2	16.9	-0.4	9.0
Market Volatility - VIX	30.4	10.6	-43.2	120.8	101.8

New Zealand Property		%	%	%	%
S&P/NZX All Real Estate (inc imp credits)	1613.5	-0.1	6.8	-14.8	-7.7
S&P/NZX All Real Estate (exc imp credits)	1539.8	-0.2	6.7	-15.1	-8.3

Ten Year Bonds	%	Yield Changes			
USA	0.66	0.01	0.04	-1.26	-1.34
Japan	0.02	0.02	0.00	0.04	0.18
United Kingdom	0.15	-0.04	-0.18	-0.67	-0.80
Australia	0.87	-0.02	0.11	-0.51	-0.45
New Zealand	0.92	0.09	-0.17	-0.75	-0.65

90-Day Interest Rates	%	Yield Changes			
USA	0.16	0.02	0.05	-1.39	-1.96
Japan	0.07	0.00	0.00	0.00	0.00
United Kingdom	0.14	-0.09	-0.45	-0.65	-0.63
Australia	0.10	0.01	-0.26	-0.82	-1.10
New Zealand	0.30	0.04	-0.19	-0.99	-1.34

Bond Indices	Closing Values	Changes over: 1 Mth %	3 Mths %	6 Mths %	12 Mths %
S&P/NZX Bank Bills 90-Day	733.04	0.01	0.11	0.50	1.20
S&P/NZX NZ Government Bond Index	1941	-0.64	2.25	5.80	5.68
Barclays Capital Global Aggregate Index (Hedged NZD)	N/A	0.50	2.40	3.81	5.69

Hedge Funds & Commodities		%	%	%	%
HFRX Global Hedge Fund Index (USD)	1278	1.8	6.2	-1.1	3.1
DJ-UBS Commodity Index Total Return	139	2.3	5.1	-19.4	-17.4
Gold (US$/ounce)	1793.00	3.2	13.2	18.0	27.2
Oil (US$/barrel)	41.27	20.8	177.9	-39.1	-38.9

Currencies		%	%	%	%
NZD / USD	0.6438	4.0	8.6	-4.6	-4.2
NZD / EUR	0.5732	3.0	6.1	-4.6	-2.8
NZD / GBP	0.5210	4.0	9.0	2.3	-1.3
NZD / AUD	0.9350	0.2	-3.5	-2.6	-2.3
NZD / YEN	69.45	4.1	8.5	-5.3	-4.0
Trade Weighted Index	71.60	3.9	4.1	-1.6	-1.3

**Total Return Indices. Indices are net of offshore tax.*
Source: Thomson Reuters Datastream

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