

## MONTHLY REPORT: FEBRUARY 2020

### Better Governance Required at the Top

This month's interest piece is an article written by our Chairman, Paul Glass. As you will be aware, corporate governance is an issue that we take very seriously at Devon, and we believe that good governance standards should also apply to the New Zealand Government.

However, before we examine these governance matters, we felt it appropriate to first comment on the evolving situation in respect of Coronavirus (Covid-19). We believe that we have positioned our portfolios appropriately for current market developments. We have an investment style which focuses on owning high quality businesses that are supported by attractive valuations. This approach, together with careful sector selection, has minimised our exposure to those companies which are most directly exposed to the effects of the virus, such as Retail and Tourism, and should ensure that we can navigate the volatility currently being seen. As is often the case in situations such as this, the first stage of response in the markets is one of indiscriminate selling (where all stocks are sold down) but eventually a more rational approach to pricing typically emerges and it is in this environment where we expect our active approach to be rewarded...[READ MORE](#)

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### MARKET INDICES

Index	Region	Monthly Return	1 Yr. Return
S&P/NZX50G	NZ	-3.9%	20.8%
S&P/ASX200G	AUSTRALIA	-7.7%	8.6%
MSCI World Index	GLOBAL	-8.4%	5.2%
S&P500	USA	-8.2%	8.2%
FTSE100	UK	-9.0%	-2.7%
NIKKEI 225	JP	-8.8%	1.0%
NZ 90 Day Bank Bill NZ		0.1%	1.6%

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### AT A GLANCE

Prices as at 29 February 2020

DEVON ALPHA FUND	\$1.8311
DEVON AUSTRALIAN FUND	\$1.4219
DEVON DIVERSIFIED INCOME FUND	\$1.5627
DEVON DIVIDEND YIELD FUND	\$1.8885
DEVON TRANS-TASMAN FUND	\$ 4.1587
GLOBAL THEMES FUND	\$2.9055

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## DEVON ALPHA FUND

## FUND OUTLINE

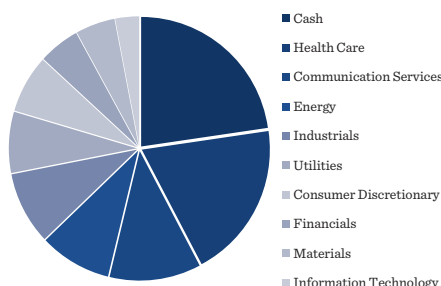
The **Alpha Fund** invests in a concentrated portfolio of approximately 10 to 15 select companies predominantly listed on the NZ and Australian share markets.

The Fund does not follow any index, is actively managed and aims to generate capital growth over the long term. Currency exposure is actively managed.

## KEY HOLDINGS



## ASSET ALLOCATION



## ALLOCATION

New Zealand Equities	29.5%
Australian Equities	47.8%
Currency Hedge	29.4%

Cash	22.7%
<b>Total</b>	<b>100.0%</b>

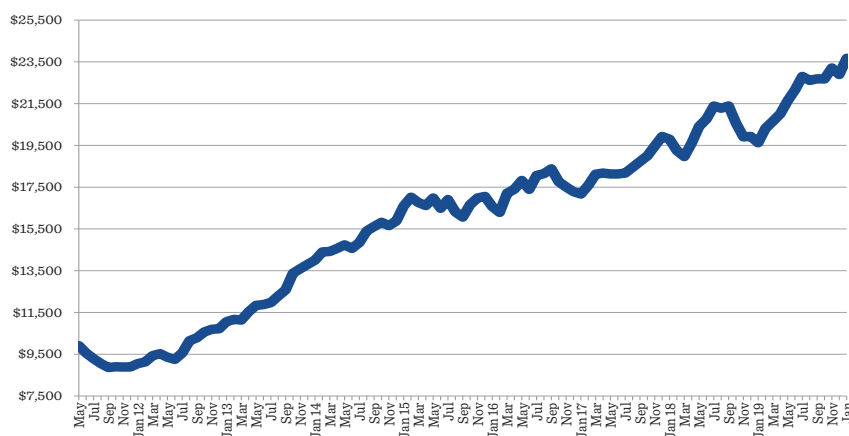
## PERFORMANCE

	1 Mth	3 Mth	1 Yr	3 Yr p.a	5 Yr p.a
Devon Alpha Fund	-4.0%	-2.1%	11.9%	8.9%	5.8%
OCR	0.1%	0.2%	1.3%	1.6%	2.0%

Devon Alpha Fund returns are after all fees and expenses, but before tax which varies by investor.

## NET PERFORMANCE

Based on \$10,000 invested at 1 January 2011



NOTE: Further information on the Devon Alpha Fund can be found in our Quarterly Fund Updates by visiting <https://devonfunds.co.nz/alpha-fund> or by clicking [HERE](#)

## COMMENTARY

Our position in a2Milk (+8.7%) was our best performing investment for the month after its financial results exceeded market expectations. Cash flows and margins were once again extremely robust and contrary to its peer group, this business is successfully navigating the COVID-19 outbreak and the declining Chinese birth rate. The spectre of a Tiwai smelter closure undermined the NZ electricity sector, making Contact one of our more disappointing performers. At present this sector is being sold down on the concern that the New Zealand aluminium smelter will close, trapping electricity in the South Island. Our base case is that a deal will be done with Rio Tinto, the smelter's owner. Rio's position is highly rational, bargaining for cheap electricity in an election year and therefore forcing the government to think of the impact on outlying regions. Already they have secured \$50m in annual savings.

Our investment in CSL substantially outperformed both the New Zealand and Australian markets. Whilst not a direct beneficiary of the coronavirus, it is expected that its flu vaccine division will have a bumper year in 2020.

## PORTFOLIO MANAGER

## Mark Brown



Mark has primary responsibility for stock selection and portfolio construction for the New Zealand Equity and Alpha funds. Mark is also responsible for overseeing the overall research and investment process at Devon.

Prior to joining Devon, Mark was the Australasian Head of Equities at ANZ New Zealand Investments.

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## DEVON AUSTRALIAN FUND

### FUND OUTLINE

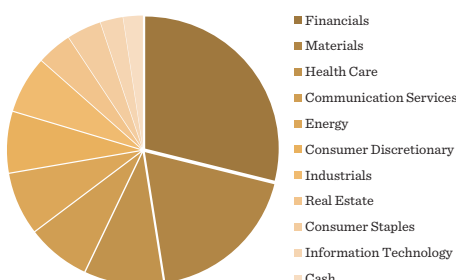
The **Australian Fund** is actively managed and invests in a select portfolio of approximately 25 to 35 companies which are primarily Australian listed companies

The Australian market is much larger than the NZ market and offers exposure to a number of sectors that are not available in NZ. The Australian dollar currency exposure of this Fund is typically unhedged.

### KEY HOLDINGS



### ASSET ALLOCATION



### ALLOCATION

New Zealand Equities	2.7%	Cash	2.4%
Australian Equities	94.9%	Total	100.0%

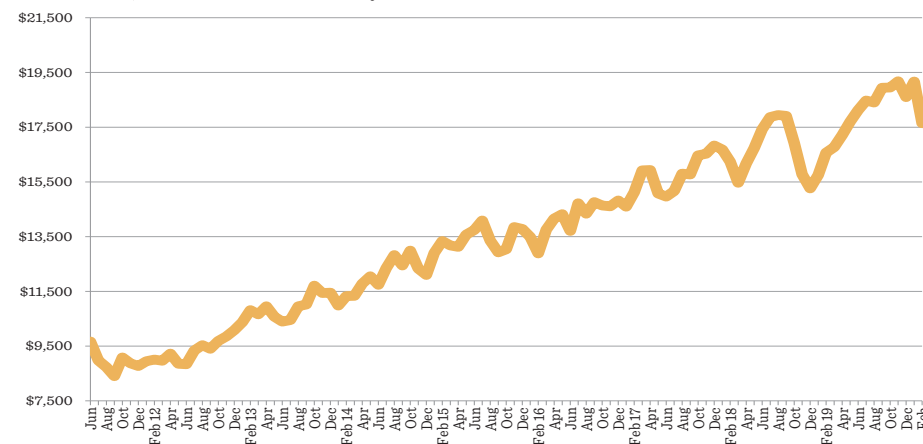
### PERFORMANCE

	1 Mth	3 Mth	1 Yr	3 Yr p.a	5 Yr p.a
Devon Australian Fund	-8.0%	-8.0%	6.5%	5.3%	5.7%
ASX200 Index Gross (NZD)	-7.2%	-6.5%	8.2%	7.8%	6.3%

Devon Australian Fund returns are after all fees and expenses, but before tax which varies by investor.

### NET PERFORMANCE

Based on \$10,000 invested at 1 January 2011



NOTE: Further information on the Devon Australian Fund can be found in our Quarterly Fund Updates by visiting <https://devonfunds.co.nz/australian-fund> or by clicking [HERE](#)

### COMMENTARY

Some of our more positive contributors during the month included Goodman Group (+0.6%), CSL (down only -0.8%) and Atlas Arteria (down only -1.4%). Key detractors for the strategy included Rio Tinto (-12%), News Corp (-11%) and Suncorp (-10%). Outside of the global focus on the coronavirus, investors in Australia had the opportunity to dig deep into the current performances of the listed stocks as part of the February reporting season. Given the macro backdrop, there was a reasonably cautious tone to many of the management views with the bushfires also particularly relevant. However the Australian market does benefit from having a diversified set of sectors, including Healthcare and Utilities, which are both reasonably well positioned for the current volatility. This market will also provide some very exciting leverage to a recovery in economies and markets when central bank and government stimulus takes effect. The Energy and Materials sectors are good examples of this opportunity set.

### PORTFOLIO MANAGER

Tama Willis



After a long period in international investment markets, Tama returned to NZ after a very successful career in London and Singapore to join

Devon's investment team and holds responsibility for Devon's Australian and Trans Tasman Funds. Tama is widely regarded as a leading expert on resource and mining stocks.

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## DEVON DIVERSIFIED INCOME FUND

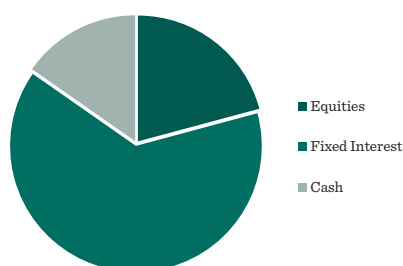
### FUND OUTLINE

The **Devon Diversified Income Fund** aims to give New Zealanders access to a diverse and good quality portfolio of high yielding investments. The Fund aims to generate better-than-bank income rates by investing in a carefully selected portfolio of government and corporate bonds, cash, listed property, infrastructure, utility companies, high yielding equities, credit securities and other yielding financial assets.

### KEY HOLDINGS



### ASSET ALLOCATION



### ALLOCATION

New Zealand Equities	12.0%
Australian Equities	8.5%

Bonds	63.9%
Cash	15.3%

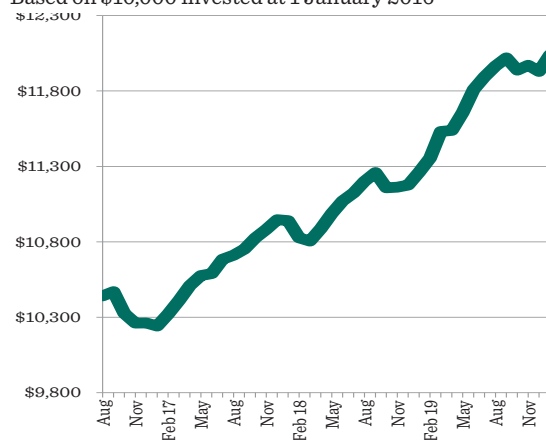
### PERFORMANCE

	1 Mth	3 Mth	1 Yr	2 Yr p.a	3 Yr p.a
Devon Diversified Income Fund	-1.4%	-0.8%	4.6%	4.8%	4.8%
OCR + 1.5%	0.2%	0.6%	2.8%	3.0%	3.1%

Devon Diversified Income Fund returns are after all fees and expenses, but before tax which varies by investor.  
Inception date for the Fund is 1 January 2016.

### NET PERFORMANCE

Based on \$10,000 invested at 1 January 2016



NOTE: Further information on the Devon Diversified Income Fund can be found in our Quarterly Fund Updates by visiting <https://devonfunds.co.nz/diversified-income-fund> or by clicking [HERE](#)

### COMMENTARY

Global bonds rallied very strongly over the month with the interest rate on US 10-year Treasuries falling from 1.50% in January to finish February at 1.15% (as we moved into early March this rate fell below 1%, its lowest level ever). The reason for this move was the developing concern over the coronavirus and its implications for economic growth. The first surveys out of China since the virus outbreak identified that their factory output had plunged, and their service sector contracted. As a consequence of this downturn, and as evidence emerged of infections in other countries, fears of a global slowdown intensified. In response to these challenges the US Federal Reserve surprised investors with an interest rate cut of 0.5%, its first emergency cut since the GFC. In Australia the RBA also reacted by cutting their official interest rate by 0.25%, to a fresh record low of 0.5%.

### PORTFOLIO MANAGER

**Nick Dravitzki**



Over the last decade Nick has specialised in investing in high yield equities and is Portfolio manager for the Devon Diversified Income and

Dividend Yield Funds. At Devon, Nick has responsibility for the analysis of consumer staples, IT, consumer discretionary and property sectors. Nick is also responsible for our quantitative screening process.

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## DEVON DIVIDEND YIELD FUND

## FUND OUTLINE

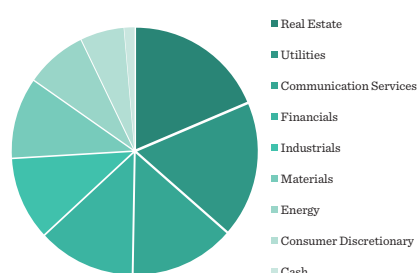
The **Devon Dividend Yield Fund** consists of a select group of up to 25-35 New Zealand and Australian listed companies.

These stocks are chosen for their attractive dividend yields and growth prospects with the aim of maintaining the dividend yield and capital value in real terms. The Australian dollar currency exposure is typically fully hedged.

## KEY HOLDINGS



## ASSET ALLOCATION



## ALLOCATION

New Zealand Equities	57.8%
Australian Equities	40.8%
Currency Hedge	102.2%

Cash	1.4%
Total	100.0%
Yield	5.8%

## PERFORMANCE

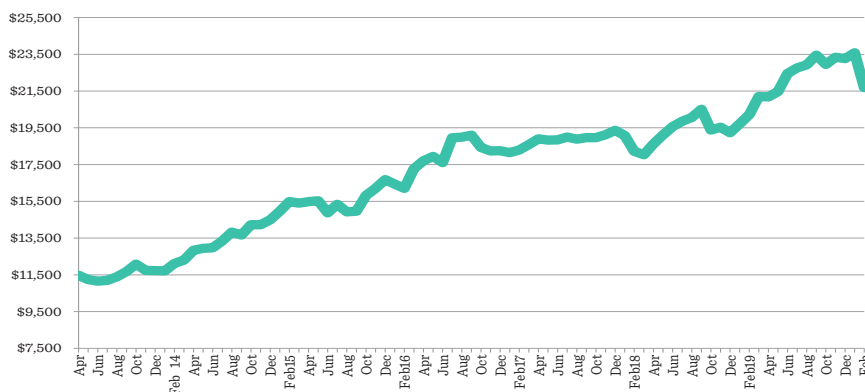
	1 Mth	3 Mth	1 Yr	3 Yr p.a	5 Yr p.a
Devon Dividend Yield Fund	-8.0%	-7.1%	7.2%	5.7%	6.9%
TT Index (Hedged)	-5.8%	-2.8%	14.7%	12.4%	10.0%
Australasian Dividend Yield Index*	-7.8%	-5.8%	7.7%	7.2%	6.2%

Devon Dividend Yield Fund returns are after all fees and expenses, but before tax which varies by investor.

\*The Australasian Dividend Yield Index is provided for reference purposes only and is a composite yield index comprised of 50:50 NZ Yield Index and the FTSE Australian High Div Yield Index.

## NET PERFORMANCE

Based on \$10,000 invested at 1 January 2011



NOTE: Further information on the Devon Dividend Yield Fund can be found in our Quarterly Fund Updates by visiting <https://devonfunds.co.nz/dividend-yield-fund> or by clicking [HERE](#)

## COMMENTARY

The Dividend Yield Fund was unable to escape the indiscriminate selling that seized control of the market in the last week of February as fears around COVID-19 took hold. Some of the stock selling was surprising with some of the largest negative movers in the Fund including Telstra, Z Energy and Amcor, all of which one would expect to have solidly defensive earnings streams in the event of a global pandemic. We expect these stocks to benefit from a more appropriate recognition of their risk profile over time. Much more explicable was the decline of Air New Zealand. We reduced our exposure to this company substantially at the beginning of the month (largely before the stock price weakened) due to the leverage that they have to any material decline in traveler demand. A positive contributor was Chorus which rose 2.3% following a solid result and management comments about the path the company will take to distribute higher cashflow as it comes to the end of the fibre roll-out.

## PORTFOLIO MANAGER

Nick Dravitzki



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## DEVON TRANS-TASMAN FUND

## FUND OUTLINE

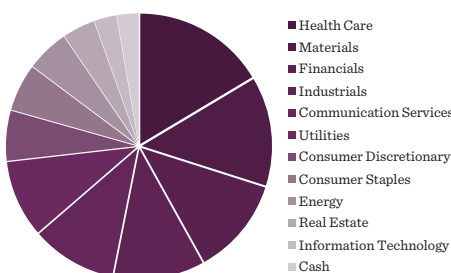
The **Trans-Tasman Fund** provides a broad and actively managed exposure to the NZ and Australian equity markets.

This Fund typically holds 25 to 35 shares listed on the NZ and Australian stock exchanges which have been carefully selected as offering good value and attractive medium term growth prospects. The Australian dollar currency exposure is typically unhedged.

## KEY HOLDINGS



## ASSET ALLOCATION



## ALLOCATION

New Zealand Equities	52.2%
Australian Equities	45.1%

Cash	2.7%
Total	100.0%

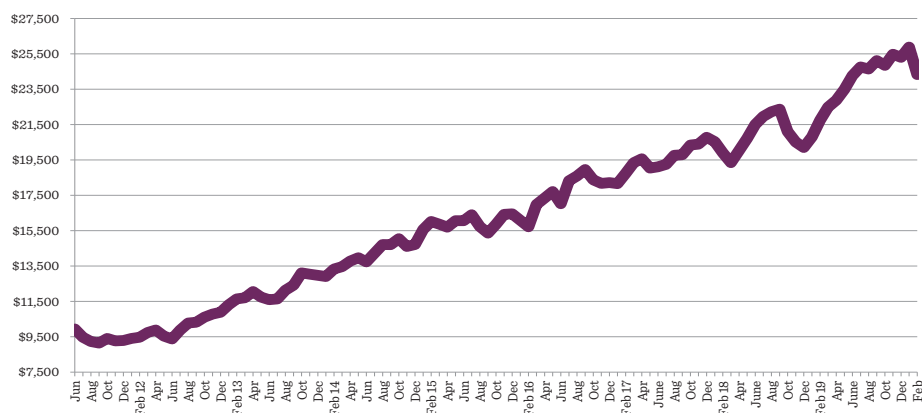
## PERFORMANCE

	1 Mth	3 Mth	1 Yr	3 Yr p.a	5 Yr p.a
Devon Trans-Tasman Fund	-6.0%	-4.5%	11.9%	9.1%	8.0%
Trans-Tasman Index Gross	-5.6%	-3.5%	14.5%	12.0%	10.1%

Devon Trans Tasman Fund returns are after all fees and expenses, but before tax which varies by investor.

## NET PERFORMANCE

Based on \$10,000 invested at 1 January 2011



NOTE: Further information on the Devon Trans-Tasman Fund can be found in our Quarterly Fund Updates by visiting <https://devonfunds.co.nz/trans-tasman-fund> or by clicking [HERE](#)

## COMMENTARY

Key contributors to the absolute performance of this Fund during the month included a2 Milk (+8.7%) and Fisher and Paykel Healthcare (+10.6%) who both confirmed they were benefiting from increased demand for their products due to the virus outbreak. Key negative contributors included the natural resources companies (BHP, Rio Tinto and Oil Search) and US exposed holdings, James Hardie, Amcor and News Corp. We remain positive on these names.

In terms of portfolio changes, the Fund reduced its exposure to Air New Zealand (AIR) during the month. Whilst this business is well managed the outbreak of COVID-19 presents material near term risks. In late February AIR announced it had reduced capacity across Asia, the Tasman and domestic networks and that it expects a net negative impact to earnings in the range of \$35-75m. The Fund also took advantage of the market sell-off and added to some key names across the portfolio.

## PORTFOLIO MANAGER

## Tama Willis



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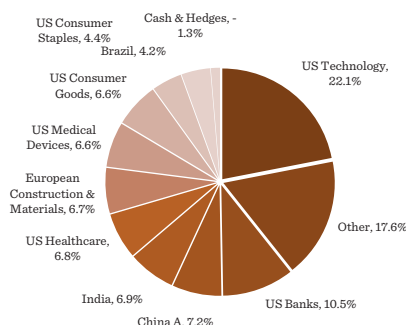


## DEVON GLOBAL THEMES FUND

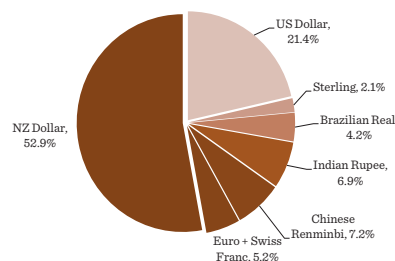
## FUND OUTLINE

The **Global Themes Fund** invests in Global Financial Assets predominantly Global Exchange Traded Funds (ETF's). We identify macroeconomic or thematic investment ideas with a 2-5 year time horizon, and implement the investment ideas through appropriate high quality assets. Portfolio risk is managed by ensuring broad diversification, ample liquidity and close monitoring of tracking variation versus a passive equity benchmark. The Global Themes strategy has been run by JBWere since March 2005. In October 2014 Devon Funds Management created a NZ PIE Fund to follow the Global Themes strategy and has appointed JBWere as the adviser.

## SECTOR ALLOCATION



## CURRENCY EXPOSURE



## PERFORMANCE

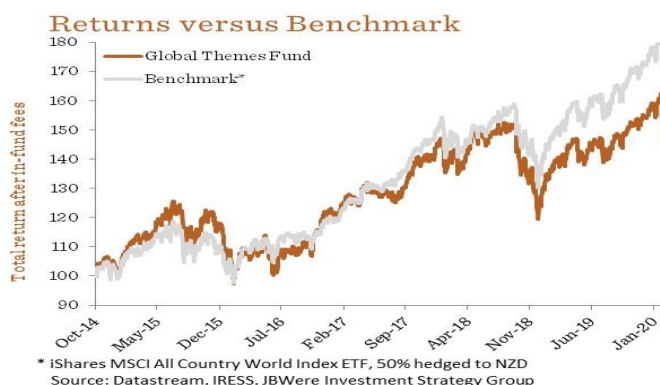
	1 Mth	3 Mth	1 Yr	3 Yr p.a
Global Themes Fund	-5.6%	-4.8%	4.3%	5.5%
I-Shares All Country WI	-6.0%	-4.5%	8.5%	9.9%

Global Themes Fund returns are after all fees and expenses, but before tax which varies by investor.

\*Benchmark is 50% hedged to NZD

## NET PERFORMANCE

Based on \$10,000 invested at October 2014



## PORTFOLIO MANAGERS Andrew Thompson, Philip Borkin &amp; Hayden Griffiths.

**Andrew** joined JBWere's Investment Strategy Group at the start of 2016, with a focus on global strategy and global equity portfolio management.

**Philip** brings more than a decade worth of experience working alongside respected industry participants in roles which encompass economics and strategy.

**Hayden** joined JBWere in 1996 and has over 20 years experience working in financial markets as a quantitative analyst in investment research.

NOTE: Further information on the Global Themes Fund can be found in our Quarterly Fund Updates by visiting <https://devonfunds.co.nz/global-themes-fund> or by clicking [HERE](#)

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## COMMENTARY

## What we own and why we own it

February saw markets largely dominated by one event – the outbreak of COVID-19, and our thoughts are with any readers affected by this terrible situation. Going into February, we had felt that equity investors were being overly complacent about the economic (and market) risks of coronavirus, however the situation has developed beyond what we, and many others, had expected. Our base case remains that there will be a sharp, but temporary, shock to global growth, and not a global recession. That said, we need to be mindful that the driver of this (i.e. the virus) is not fully understood by even medical experts, and as such the situation, and therefore our view on markets, remains highly fluid.

Separately, the US has come through Q4 earnings season slightly better than expected. ~49% of companies beat consensus analyst earnings estimates by more than one standard deviation (led by Technology, Healthcare and Utilities), above the long-term average of ~46%. While consensus expected US earnings to fall by ~1% EPS actually grew by ~2% (~5% excluding Energy). Sales grew by ~6%, in line with expectations. Further, margins beat expectations, however still contracted across every sector. We remain watchful of 2020 earnings expectations. On the back of the coronavirus outbreak, we no longer expect any earnings growth in 2020 (we previously expected mid-single digits), however consensus still expects around 7%. We expect mid-single digits in 2021, compared with consensus of over 10%. As such, we suspect downgrades are on their way. We therefore remain comfortable with our exposure to higher-earnings-growth parts of the market.

## Our currency exposures

The currency hedge level in the fund remains at its benchmark weight of 50%, which we are comfortable with for now given our view that the NZ dollar is still broadly trading within its fair value range. In saying this, at levels approaching 0.62 versus the US dollar, increasing the level of the hedge is becoming more interesting. We continue to keep a close eye on local economic data and movements in the currencies of our key trading partners, and would look to alter the hedging level if appropriate.

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