THE SIX-MONTHLY BEANSTALK GLOBAL 15 REPORT

Report No. 20
Period: Jan-Jun 23

Performance: 30 June, 2023	Qtr	6 mnths	1 year	2 years	3 years	4 years	5 years	7 years	10 years	Since * inception
Beanstalk Return %	4.4%	10.7%	23.8%	20.3%	26.9%	14.4%	12.5%	14.1%	15.0%	16.7%
MSCIACWorldF %	6.8%	16.1%	20.4%	5.2%	12.2%	10.1%	10.4%	11.7%	12.3%	13.7%

* Inception date 1/1/2013. Returns net of costs but not fees. Returns unaudited. Returns greater than one year are annualised. The MSCIACWorldF is the MSCI All Countries World Free Index in $A.

The Underlying Beanstalk Global 15 Portfolio rose for the 6 months to June 30, 2023. It returned a gain of 10.7%. These returns are net of costs but not fees*. Below, a table sets out the best and worst performing stocks in the portfolio over the period.

Best and Worst Performing Stocks	
Best Performing Beanstalk International Shares	Marks & Spencer (up 61.1%) JFE Holdings (up 27.5%) Orange (up 20.7%)
Worst Performing Beanstalk International Shares	Walgreens (down 21.9%) Adecco (down 10.9%) Shinhan Financial Group (down 4.8%)

Economic comment

Lower bond yields early in the year, a perceived end to the US rate hiking cycle and a boom in AI-related technology stocks led most developed markets higher. The NASDAQ index rallied over 29% and the undervalued Japanese market rose 27%. The Australian dollar fell against most currencies and commodities declined as issues of systemic risk heighted fears of lower growth. Thermal coal declined 67%, Oil fell 13% and Zinc slumped 41%. Gold, seen as a safe haven, rose 4% in response to these concerns. Australian 10-year bond yields swung wildly recording a low of 3.18% then rising to close at 4.03%, just below December levels of 4.05%.

The start of 2023 marked the first signs of serious systemic risk emerging in response to higher interest rates. Silicon Valley Bank failed as losses from holdings of treasury securities, held to back the deposits, meant the bank no longer had sufficient funds to satisfy burgeoning withdrawal requests. Similar bank runs on other regional players in the US forced the closure of crypto-linked Signature Bank of New York and wild share price movements for others. Later, JP Morgan acquired the troubled First Republic Bank stabilising funding conditions for US regional banks. On a separate funding issue, the US administration reached agreement with Congress to raise the debt ceiling and avoid default. Moderating inflation numbers and bank failures were not sufficient to prevent further hikes in the Federal Reserve Board’s (FED) funds rate. The FED raised rates 0.25% in February, March and May to take the cash rate to 5.25%. The FED’s focus shifted to services inflation and long-term inflation expectations which reached 3.2%, the highest level in 12 years. A 2.7% decline in US non-farm productivity levels reinforced the persistent outlook for inflation.

The US economy has slowed somewhat. Unemployment levels have risen only slightly, from the very low levels of 3.5%, to 3.7%. St Louis FED president Bullard echoed the sentiment of underlying strength saying ‘…the labour market just seems very, very strong…’. He was not expecting a recession in the second half of 2023. An inventory drawdown early in the year provides possible support, in the form of a rebuild, as the year progresses.

Chinese growth surprised to the upside in the December quarter, rising 2.9%, as the economy exited covid-zero. A necessary intention of authorities is to achieve more sustainable growth. This was evident early in the year with high-tech manufacturing investment growing, from a low base, at more than double overall manufacturing levels. Nevertheless, growth rates for the economy are below levels expected by the government. There has been weakness in lending to households in April. New orders also declined. Developing nations have begun to spend more on services than goods, impacting exports. Authorities look to be embarking upon a contained stimulus program. There was a cut in the reserve requirement ratio for banks in March and the 7-day repo rate was reduced from 2.0% to 1.9% in June. An easing of other rates is also afoot. Fixed asset investment, driven by state-owned enterprises, rose 5.6%. Adjusting for covid, the property market is still weak. China’s strategy appears to be to prop-up the economy while accepting that lower overall growth rates are unavoidable.

The Japanese economy barely grew in the December quarter. Into the March quarter, post-covid economic activity, business investment and pent-up consumption outweighed weaker global growth and its impact on exports. Momentum has continued, setting up the year for more favourable growth than 2022.

The Bank of Japan (BOJ) has maintained its accommodative policy settings. As the BOJ undertakes a review and inflation emerges, this might change. The base pay increase at the spring wage negotiations at 3.8% was the highest in 30 years. Low productivity growth and other inflationary pressure will also be at play for future BOJ decisions. Such wage increases will be positive for growth as stimulus subsides.

The UK and Europe remain stagnant, barely growing over the March quarter at 0.1%. Services growth compensated for weak manufacturing. These economies are facing inflationary headwinds and higher interest rates. The European Central Bank (ECB) and the Bank of England (BOE) both raised rates to 3.50% and 5.00% respectively.

Following on the heels of the regional banking crisis in the US, European, and indeed global markets, were rocked by significant instability within the globally and systemically important bank, Credit Suisse. A string of scandals, CHF 110 billion of fund outflows, a CHF 7.29 billion loss and a 75% decline in the company's share price finally led to a forced merger with another Swiss bank, UBS.

Global Equities

Global equity markets rose 14.2% in local currency terms (source: FTSE All-World Review*) to June 30, 2023.

International equity markets are marginally expensive on historical measures. Relative value can be found in Oil & Gas, Mining, Chemicals, Tobacco, Household Goods & Home Construction and Banks. Aerospace & Defence, Automobiles & Parts, Travel & Leisure, Technology (Software & Hardware), Industrial Engineering, Support Services, Consumer Goods, General Retailers and Electronic & Electrical Equipment are expensive. Japan, Austria, Poland, Spain, Korea, Brazil, Germany, Singapore and Hungary offer value. The US, New Zealand, the Netherlands, Denmark and Norway are overvalued.

Japan, Austria and Korea trade at relative discounts of 61%, 186% and 43% respectively, including Beanstalk currency assumptions.

Notable Regional Index performance for the last 6 months is outlined below.

Performance (local currency)	6 months	Portfolio Holding
Europe	up 11%	See France
Italy	up 22%	NIL
India	up 6%	NIL
Brazil	up 7%	NIL
Ireland	up 9%	NIL
China	down 5%	NIL
Singapore	up 2%	NIL
Indonesia	up 6%	NIL
Korea	up 18%	10%
Japan	up 23%	23%
France	up 17%	35%
Switzerland	up 8%	10%
Austria	up 5%	NIL
USA	up 17%	10%
UK	up 4%	12%
TOTAL		**100%**

The Australian dollar fell against the dollar (3%), the pound (7%), the Swiss franc (5%) and euro (4%). It rose against the yen (7%) and won (2%). Japanese and Korean shares comprise 33% of the portfolio. As the international holdings of the portfolio are un-hedged for currency movements the net effect of currency on the portfolio was slightly positive.

Beanstalk International equities – Portfolio changes

The **Global 15 Portfolio** generated turnover well above average levels. This reflected the liquidation of three long-term and out-performing positions in the portfolio to purchase an equivalent number of new investments. Energy, conglomerates and shipping were reduced in favour of staples, steel and employment service companies. In addition, banking and telecommunication investments were reduced. Japanese exposure was marginally reduced with increases recorded in Europe.

A large position in **Sumitomo Mitsui Financial Group** was reduced at the beginning of the year.

The company's share price rallied almost 30% as the Bank of Japan announced that it would be adjusting upwards the rate allowance in its yield curve control program. After many years of flat- to declining- net interest margins, investors embraced the real prospect of expanding margins at **Sumitomo**.

Some of these proceeds were invested into **Societe Generale**. With a strong focus on cost and business efficiency this was seen as appropriate. **Societe Generale** generates a return on shareholder funds of above 10% and was acquired at a price of 0.3 times book value compared to **Sumitomo Mitsui Financial Group** at 0.6 times.

Recent results in December showed **Societe Generale** faced some slippage in ROE and profitability as cost of risk rose. Nevertheless, the increased level of provisioning was better than guidance and within what might be expected at this stage of the cycle. Capital levels remain 420 basis points above regulatory minimums. **Societe Generale** suffered considerable contagious price depreciation during the recent bank liquidity crisis in the US and subsequent Credit Suisse turmoil in Europe. The business remains well capitalised and represents attractive value at such a large discount to book value.

Surplus proceeds from the **Sumitomo Mitsui Financial Group** sale were invested into **Orange**, the incumbent French telecommunications provider. Already a member of the portfolio, incremental purchases provided diversification at very low entry levels.

In the space of a few months, **Orange** had rallied 18% against **Sumitomo Financial Group** leading to a 26% total gain through to May. The company reported results which showed a strong cost discipline, increased prices, a lower capex outlook and higher base dividend. Holdings in **Orange** were reduced twice to purchase positions in **JFE Holdings**, **Societe Generale**, **Adecco** and **Shinhan Financial Group**.

Like **Societe Generale**, **Shinhan Financial Group** became oversold during the April liquidity crisis affecting the regional banking system in the US. **Shinhan** increased countercyclical provisioning at its latest results providing comfort in the balance sheet of the company. The group increased ROE from 10% to 11.5% and paid a respectable dividend over the March quarter.

Later in the year further sales of **Sumitomo Mitsui Financial Group** were invested into three new portfolio positions: **Tesco**, **JFE Holdings** and **Adecco**.

Tesco appears to be dealing with new entrants to its market more keenly and effectively than in the recent past. Further, the supermarket is well positioned to attract more shoppers in the inflationary environment of today. This reflects an increase in the consumption of meals at home to protect the family budget which is otherwise under attack from rising prices and higher interest rates.

Tesco holdings were also funded through the liquidation of positions in **BP**.

BP has delivered strong returns since initial purchases after the Mexican oil spill disaster. This sale leaves **Total Energies** as the remaining energy exposure in the portfolio. **BP** no longer represented compelling value and the portfolio sought to reduce energy exposure given downside risks to such investments from any global slowdown. Returns a likely to remain solid for the company. Possible headwinds could include the dilution over time of higher returning traditional energy profits by lower returning reduced carbon related income.

JFE Holdings, a Japanese steel maker, represented attractive relative value and was purchased for the portfolio. Exposure to inflationary input costs, such as iron ore and coking coal, provided an opportunity to purchase at low levels. The business is working hard to pass through such cost increases to its end customer. A rebound in the Chinese auto sector is helpful though should be balanced against a tough property market. The company's strategy is targeting price relief in a difficult market for volumes. More recently management upgraded guidance and dividend outlooks.

Earlier in the year, the portfolio liquidated its position in **Sumitomo Corporation** to purchase **JFE Holdings**.

Sumitomo Corporation is another long-term position of the portfolio that has performed well. The position was purchased more than seven years ago. The uplift in mineral prices has provide a strong tail wind for the group. In addition, the business has succeeded and benefited through structural reforms and transformations that have been operating for some time now. More attractive value was found in **JFE Holdings**.

The new position of **Adecco** was also funded through the liquidation of the long-term position of **Mitsui OSK Lines**.

A drop in containership rates has not prevented **Mitsui** from achieving record profits as energy and car carrier ships continue to generate steady profits. **Mitsui** delivers a very strong dividend. There are question marks over how long such a payout is sustainable. A more mid-cycle approach to valuing the company reveals some overvaluation at the current share price.

Funds from these sales were invested entirely into **The Adecco Group**. This company provides career and staffing solutions and is based in Zurich. Its share price has come under considerable pressure following the purchase in July 2021 of Akka Technologies for $US2.4 billion, the largest acquisition ever made by **Adecco**. Fears of indigestion and the impact of rising rates on the employment market seem to have plagued the share price ever since. **Adecco's** margins and cash conversion have come under some pressure recently as the business invests and takes market share. The discount offered by the share price is attractive given a building growth outlook.

The Akka acquisition makes **Adecco** the largest provider of temporary staffing globally and the combination creates a stronger presence in the engineering, science and technical industries. In turn, the acquisition is margin enhancing for **Adecco,** it diversifies the business and gives greater exposure to higher growth industries.

Positions in **Adecco** were also funded through the reduction in holdings of **BNP Paribas**.

BNP Paribas had rallied strongly since last December, creating sizeable gains for the portfolio. This was the case even selling into a falling market courtesy of the Silicon Valley banking crisis. The sale occurred to reduce systemic risk exposure within the portfolio and to reflect better valuation opportunities elsewhere.

Outlook – Global Shares

Inflation, notably services inflation and increased wage claims, remains persistent with upside risks. Elevated price levels are set to endure for some time. Full employment, the reconfiguration of supply chains and the energy transition are a few examples of contributing forces.

Such inflation has implications for interest rates. After a period of ultra-low interest rates, investors need to consider their portfolios in light of notably higher rates that continue for an extended period.

The likelihood of higher interest rates and eventual steepening of the yield curve in this way puts into focus other assets such as long-duration growth equities. These amazing companies of the future must now compete for capital against rising risk-free rates and higher long-term treasury yields. There are many such companies, one to consider is **Microsoft**.

Microsoft is well known. Indispensable to many businesses worldwide, the company has been a profit machine for a long time.

This company has increased operating profit by **two- to four- times** over ten-year periods. In 2022, operating profit rose by 3.9 times compared to 2012. The share price has increased by 11 times from 2012 until today. The average internal rate of return (IRR) for companies in the Beanstalk Global 15 Portfolio is 23%. To reach an IRR of 18%, Microsoft would need to grow operating profit by **seven- to eight- times** over the proceeding decades, more than double previous levels of profit growth for the company. In other words, Microsoft is currently being priced for this level of growth into the future and investors are attributing enormous upside to the company through gains from artificial intelligence.

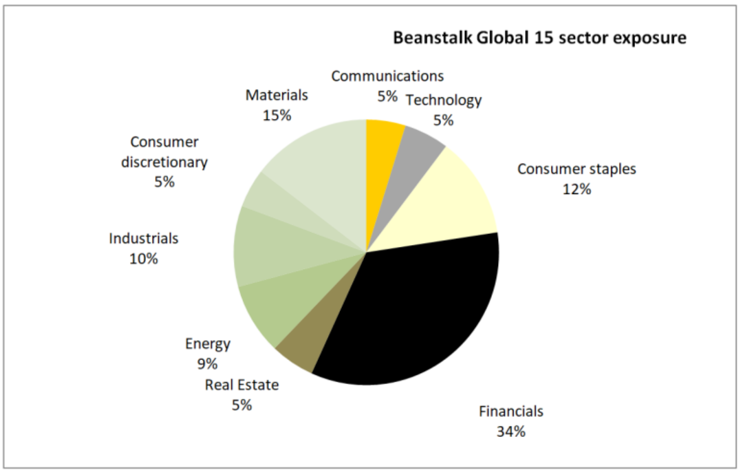
This high, uncertain and unprecedented growth rate assumed in the share price equally applies to the medium- to longer- term forecast cash flows of the business. The inflation outlook and treasury yield curve are suggesting that these longer-term cash flows are perhaps not as valuable as they used to be when rates were low.

Microsoft is only one of several large stocks in the technology sector that are being priced in this way. This suggests that a bubble or over-pricing exists in technology stocks and that the risk of capital loss in this sector is high.

The portfolio seeks to protect returns from inflation through relatively short-duration international equity holdings. These positions are largely assembled with long-term capital preservation in mind. Holdings reflect investments that represent outstanding value, with defensive balance sheets and often in industries starved of capital for some time. These characteristics suggest a return of pricing power and a beneficial investment status in an inflationary environment.

The Beanstalk Global 15 Portfolio

BEANSTALK GLOBAL 15 PORTFOLIO	
Six Month Return	10.7%
Holdings	***Weight***
BNP	6%
AXAHY	6%
5411	9%
4188	6%
SCGLY	10%
8905	5%
MAKSY	5%
IBM	5%
WBA	5%
SHG	10%
SMFG	3%
ORA	5%
ADEN	10%
TOT	9%
TSCO	8%



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