MARTIN CURRIE AUSTRALIA

MARTIN CURRIE
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For institutional, professional and wholesale investors only

REPORTING SEASON WRAP: SURVIVING THE PROFIT DOWNTURN...

This August, the Australian reporting season revealed critical signals and fundamental information to help investors reposition their portfolios for this contractionary economic environment.

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Chief Investment Officer
Martin Currie Australia

Introduction

Despite continuing strong economic data for Australia, and strong results delivered for Australian companies since our last reporting season wrap six months ago, we continue to *"look over the edge"* of a potential earnings and GDP recession.

Expected forward earnings for the market are now below their post-Covid reopening June 2022 peak, and guidance for expected growth is now more likely to be zero or negative.

Our analysis and one-on-one meetings with company management over August has highlighted the difficult situation for companies in 'Surviving the profit downturn' when more interest rate rises to curb inflation are factored in.

As the world continues to normalise to higher rates and long-term inflation expectations, the market thematic continues to play towards an attractive environment for our investing style.

Within this environment, it is as important as ever for investors to be discerning in their stock picking. We are focussing on companies that can continue to raise prices ahead of inflation and control costs in this environment and not be exposed to valuation risk.

Contents

Our bi-annual reporting season paper will cover the following in finer detail:

Definitions

What we do each reporting season

On top of our fundamental analysis and company engagement on individual stocks, we have a framework to overlay an analytical market wide view of the reporting season's results for the stocks in the S&P/ASX 200 index.

This aggregated review allows us to more logically judge the overall pulse of the market. We can then assess the themes across the market that would be 'hard to see' when looking at each company result in isolation and apply our insight at the stock and portfolio level.

Key definitions used in our top-down analytical review

Surprise: the average difference where there is a >+/-2% difference between company reported results and broker consensus forecasts.

Follow-on Revisions: the average change in broker consensus NTM forecasts after companies have reported their results.

Price reaction: stock price movement of more than +/-3% within the two days after companies have reported their results.

Price to earnings (P/E) re-rate: change in price during the season versus the change in broker consensus earnings forecasts over the same period.

-12m: prior 12 month actual.

LTM: last 12 months actual.

NTM: next 12 months actual.

Data is calculated using the weighted average of broker consensus forecasts of each portfolio holding – because of this, the returns quoted are estimated figures and are therefore not guaranteed and may differ materially from the figures mentioned. The figures may also be affected by inaccurate assumptions or by known or unknown risks and uncertainties.

For broker consensus data, the number of brokers included for each individual stock will depending on active coverage of that stock by a broker at any point in time. A median of brokers is typically utilised. All estimates avoid stale forecasts which are removed after a certain number of days.

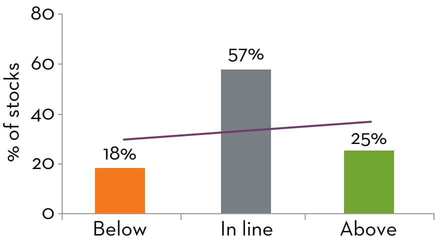
Analytical review of results

Results were good/better than expected, with more beats than misses.

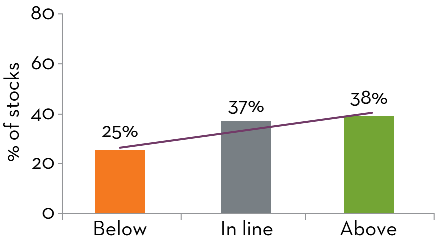
As always, let us begin our Reporting Season analysis by looking at the market "surprise", or how actual results came in versus broker consensus forecasts.

The results were actually quite good, but were off a base of poor expectations in the lead-in. Companies talked about how the economic conditions over the last six months had held up much better than expected, and we saw a positive skew for the number of companies that beat consensus forecasts versus missed across sales per share (SPS), earnings per share (EPS), and dividends per share (DPS).

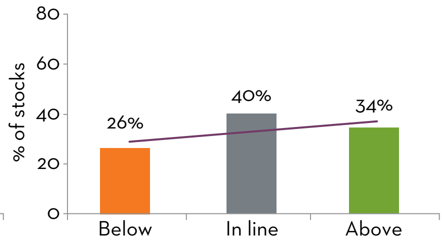
SPS surprise



EPS surprise



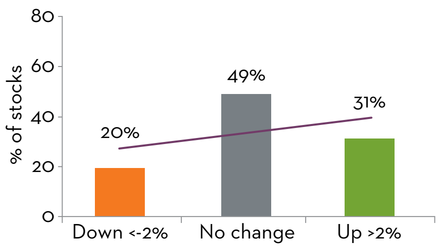
DPS surprise



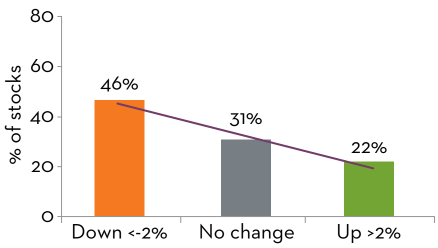
But the outlook for cost pressures outweighed a resilient revenue environment.

However, in terms of how brokers updated their forecasts after digesting the results, we saw a different picture. Forward expectations were not as positive as company results, and we saw a strong negative skew to earnings and dividend revisions. We did see that more companies received upgrades than downgrades at the sales line given inflation is still driving up underlying prices.

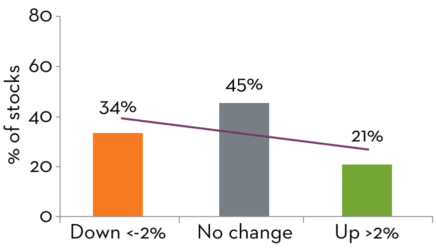
SPS revision



EPS revision



DPS revision

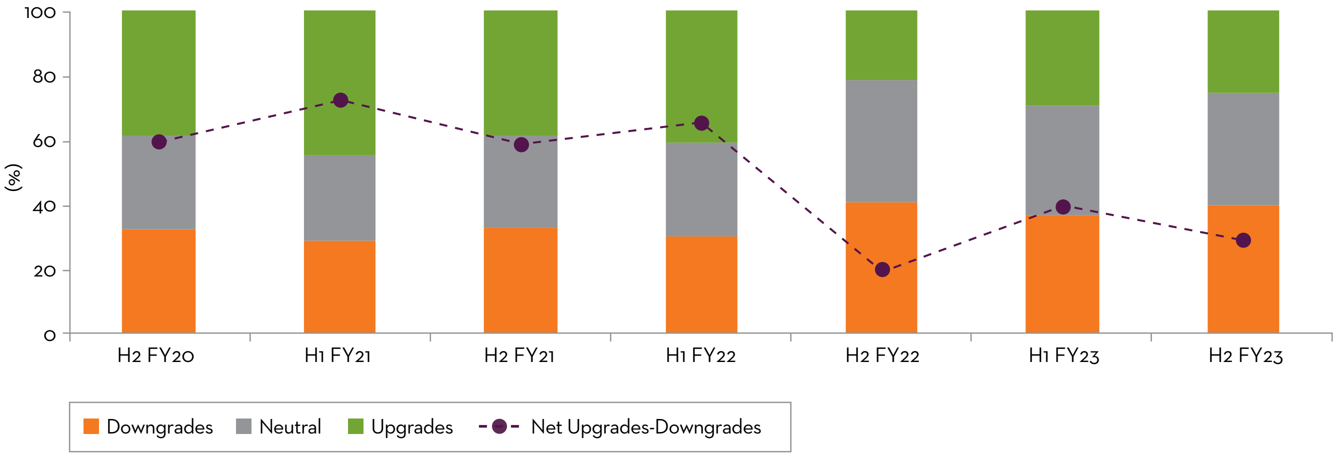


It is not surprising that broker consensus of forward EPS estimates were downgraded given that management commentary typically pointed to expectations of a slowing economy. Around half of the companies provided guidance in some form for FY24, but this had a strong negative skew. This was in fact even more negative than reflected in the broker revisions skew.

> Companies talked about how the economic conditions over the last six months had held up much better than expected, and we saw a positive skew for the number of companies that beat consensus forecasts versus missed across sales per share (SPS), earnings per share (EPS), and dividends per share (DPS).

Putting August 2023 into context of recent reporting seasons, we have continued to be in net downgrade mode since H2 FY22 results, and much weaker than what we had in the initial Covid-recovery period.

EPS revision during reporting month

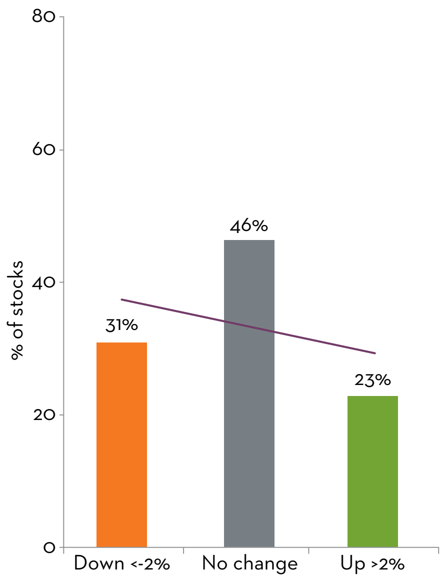


Up: upwards revisions after company reported results of >+2%; Down: downward revisions of >-2%.

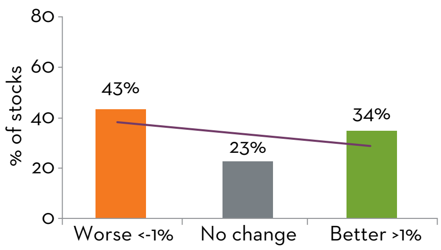
The devil has been in the P&L detail.

We have broken revisions further down into the main elements of company profit and loss (P&L). While most of the broad sector groups either had sales maintained or upgraded, especially for the cyclicals and industrials where inflation is helping prices, we can see that the damage for most sectors is being done below line through higher interest, tax, and depreciation costs.

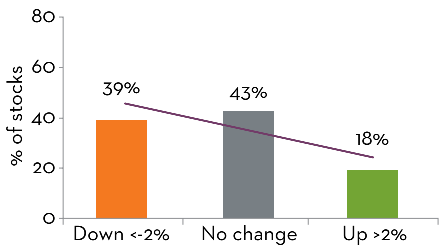
EBITDA revision



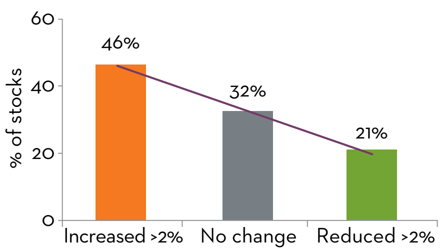
Debt revision



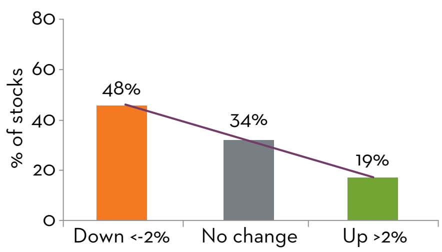
Profit margin revision



Capex revision



Free cash flow revision



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Profit and growth environment

The damage is to profit margins.

The inability to pass costs through to higher prices is putting the profit margins of many businesses under more pressure. This begs the question as to whether it is the end of the profit cycle for some companies and how long can they hold onto their gross profit margins, noting that there are wide differences between similar stocks from this impact.

Companies keeping ahead of the pack include **Wesfarmers** (through their cheaper Bunnings and Kmart channels). **Telstra Group** and **TPG** have been able to pass through costs in higher mobile pricing plans. REITs such as **Scentre Group** and **Vicinity Centres** who have implemented CPI+ rent increases are also keeping revenues ahead of costs.

However, for many other REITs, higher interest rates (and cap rates) are leading to pressure on leverage and an inability or unwillingness to invest in development growth. It is evident that many companies have not hedged their interest rate positions adequately.

Travel is one of those sectors that continues to stay positive from ongoing pent-up demand. While interest rates are hurting younger mortgage holders, the older demographics are benefiting from higher rates. In this environment, **Flight Centre** has done a good job at repositioning itself. **Medibank Private** has cited the return of international students as a driver of growth given their need for health insurance as part of their visa requirements. **Spark New Zealand** is also seeing growth from mobile roaming charges as tourism resumes.

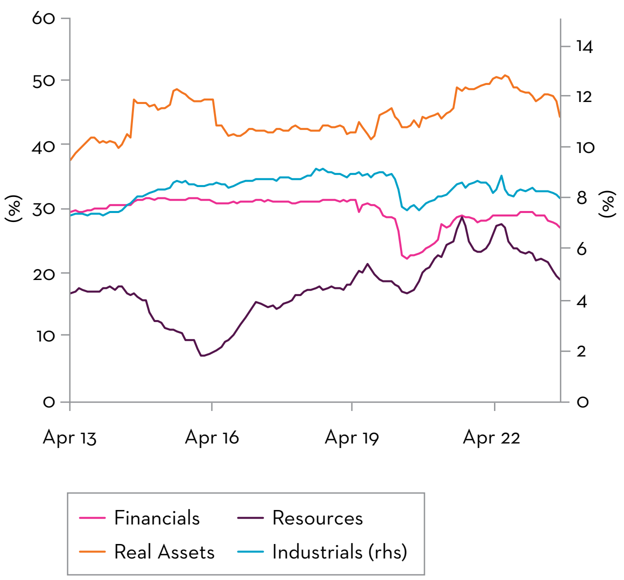
Resource companies are a special case, as they have been suffering big margin declines over recent periods, but this is stemming from the weak outlook for China property policy and the impact of lower forward commodity price expectations and higher costs feeding into weaker EPS expectations.

Given much-publicised concerns over the capacity of borrowers to navigate the transition from low fixed-rate mortgages, bank sector earnings growth risks are also skewed to the downside.

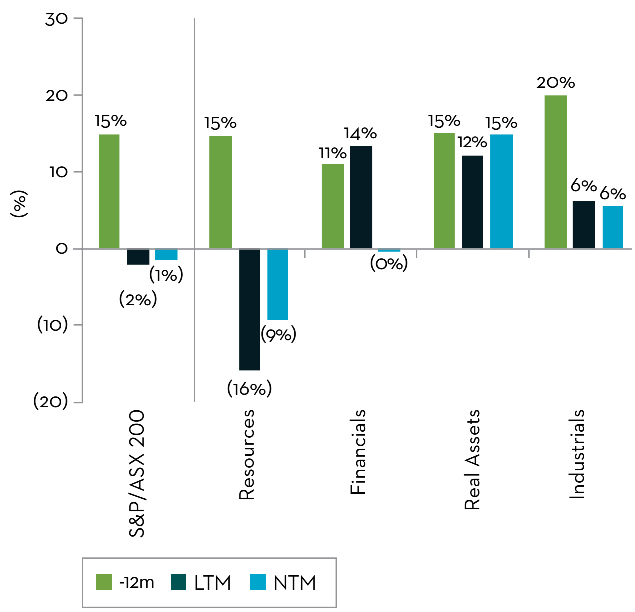
Margin squeeze impacting the growth outlook.

What it all means at the aggregated market-weighted level is another year of negative earnings growth, dominated by the ongoing decline in expected profit margins for the Resources names. Pockets of positive earnings growth reside in the Real Assets, Industrials, and the Insurers (but not the Banks) within Financials.

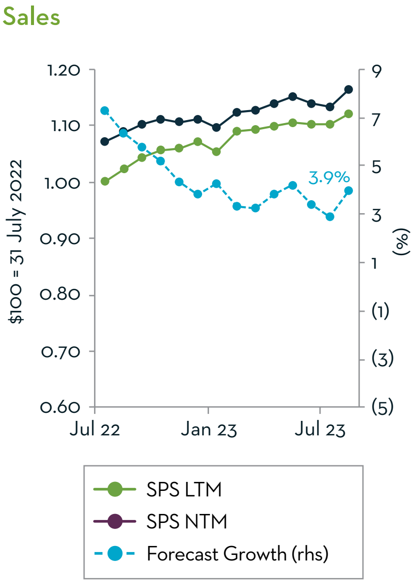
Profit margin evolution

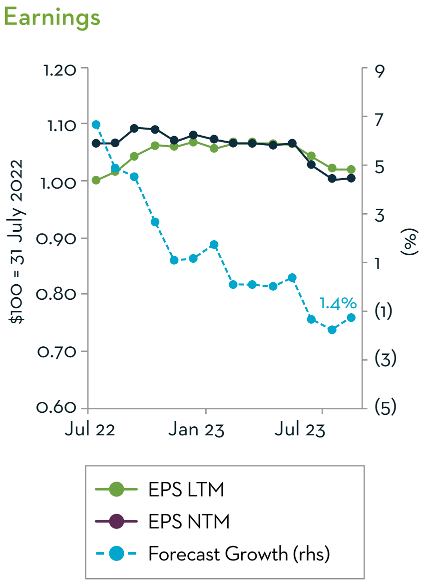


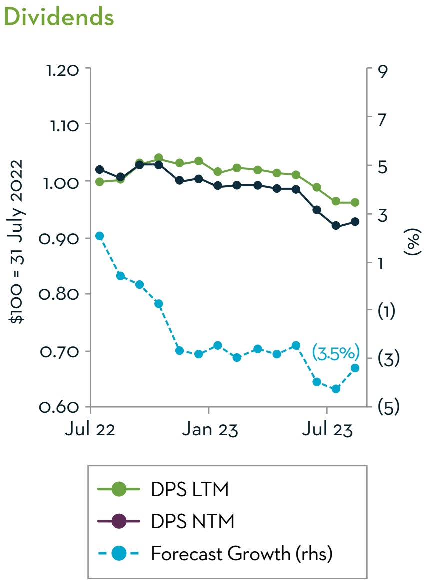
EPS forecast growth vs. actual results



In aggregate, broker consensus forecasts show that sales are expected to continue to grow 3.9% in the next 12 months, but EPS is now expected to fall -1.4%, and DPS even further by -3.5%. Despite the negative skew for revisions by number, this negative picture is slightly up on the low point of for EPS and DPS growth forecasts in July's lead-in.







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Disaggregating price performance against themes

Insight gained through company interactions.

While the analytical and aggregated view of the reporting season's results provides a broader framework to judge what the street is thinking and doing, our fundamental analysis and company engagement of individual stocks allows us to do a deeper dive into the issues and strategies of each business.

Over the four-week reporting period, the MCA investment team conducted extensive meetings with company management teams following the release of results, and this has helped us to refine our investment views and outlook.

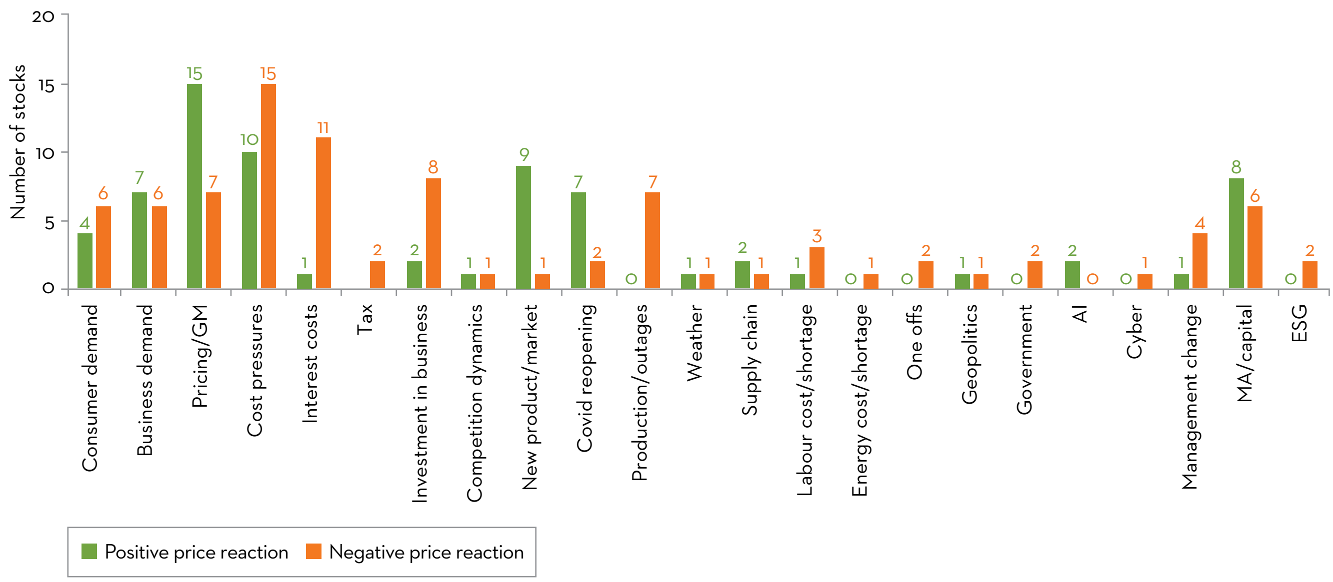
Top issues cited by companies.

Based on our interactions with company management over the past month, we have categorised what we think are the specific themes impacting each company, and tracked whether these themes have had a positive or negative impact on their share price.

While we can make some general assertions about positive and negative themes, we have found that what's helping (or hindering) one company isn't necessarily the same for another, and this often comes down to that company's business strength and quality.

We were generally able to attribute that companies with strong pricing power / better gross margins had a positive impact on their share price during reporting season. However, those with cost pressures and higher interest cost have generally received negative price reactions. Interestingly, issues such as Weather/Labour/Supply Chain and Cyber that were a key focus in February received little mention, while Covid reopening remained a positive theme, as did M&A/ Capital management.

Number of stocks with price reaction by issue

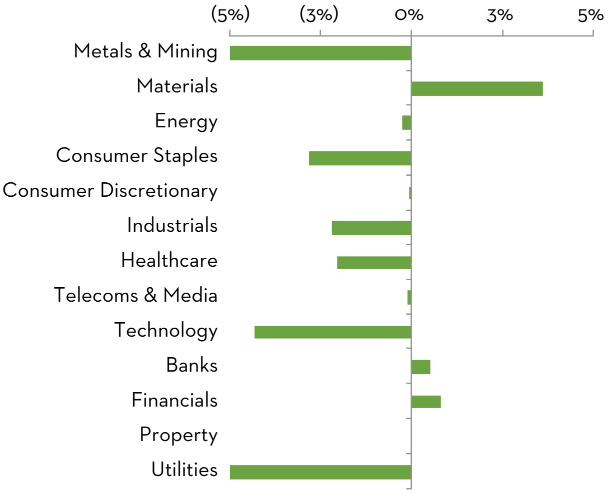


Positioning mattered for price reaction.

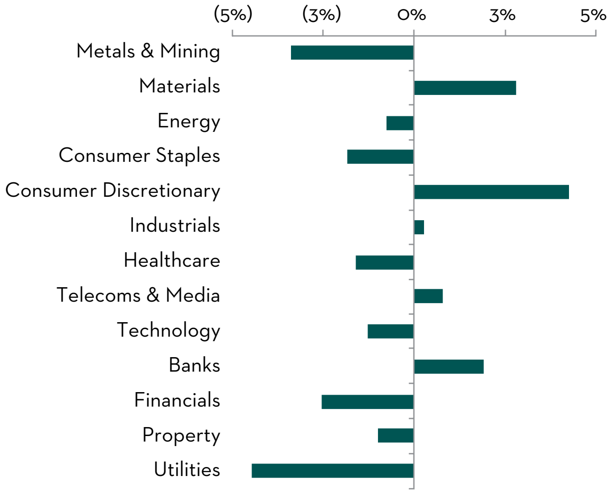
Looking now at the market's overall reaction to results across the sectors, the charts below highlight that while revisions in the Materials sector were strong, and Mining, Technology and Utilities were particularly weak, this didn't correlate completely to the share price reaction. In particular, the price reaction following results reflected a strength in Consumer Discretionary names, despite little change on their earnings.

This dispersion appears to be more about investor's 'positioning' going into results. Consumer Discretionary companies had some of the largest 'short interest' in the market. With results no worse than expected, we believe that contributed to a more positive price reaction for these stocks.

EPS revisions by sector (median)

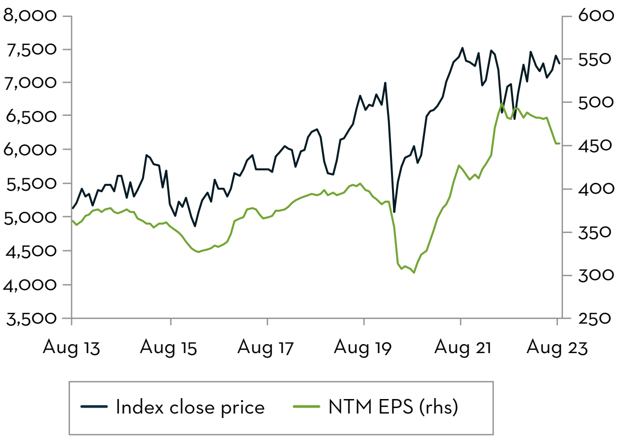


Price reaction by sector (median)

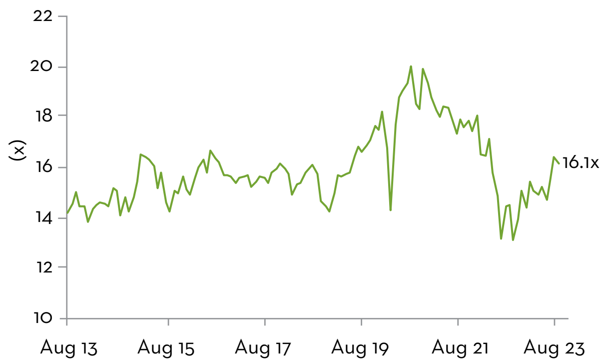


All in all, as forward EPS expectations remain poor but share prices expanded, we saw an upward P/E re-rate for the S&P/ASX 200. As Value-style investors, this is of concern as it is being driven up by non-earnings Growth stocks. We discuss our views on valuations further in the outlook section.

Prices and earnings



Next twelve-month P/E ratio



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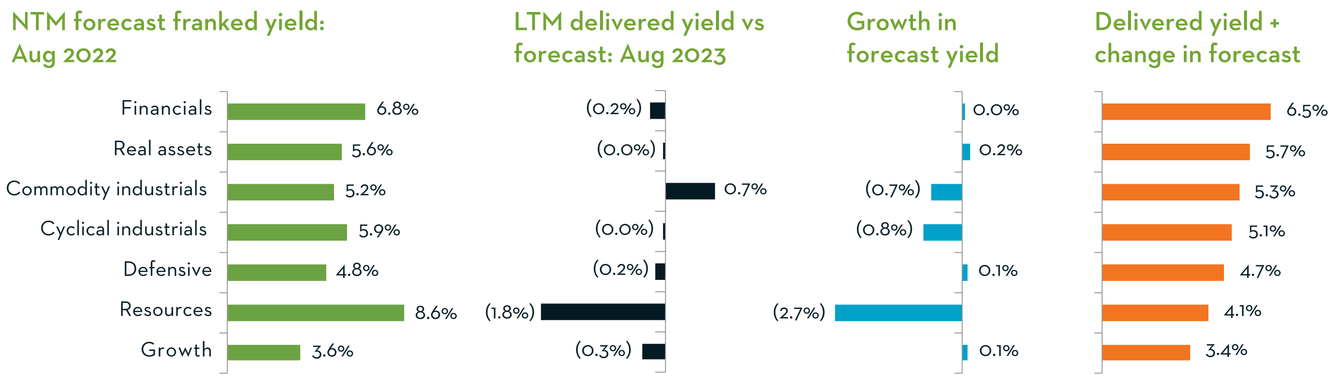
Dividend winners and losers

This season we have introduced a new 'Income Scorecard' to look more closely at the income outcomes across the S&P/ASX 200 super sectors. This looks at winners and losers from a pure income perspective, rather than stock performance, and reflects how we think about portfolio construction for our retirement income-focused portfolios.

In this scorecard we are tracking how companies in our income universe (i.e., need to have at last 2% dividend yield to qualify) have delivered on the market's forecast dividend expectations over the last 12 months. We have also looked at how well they have been able to protect their dividends against inflation through dividend growth over the period, stripping out the impact of share price change on yield.



In terms of the income results across the broad sectors,

- The Financials have fared best, broadly delivering on the franked yield expectation set in Aug 2022, and with no reductions in dividend growth. Within the sector, **Bendigo and Adelaide Bank** was a standout as a stable player benefiting from higher rates and Net Interest Margins (NIMs).
- For the Real Assets, we saw strong income winners in the electricity generators **Origin Energy** and **AGL Energy**, with higher dividend growth expected from higher electricity prices. Within REITs, being discriminatory was important, **Scentre Group** was a standout, delivering CPI+ rental increases. This varies with many other REITs (such as **Region Group**) who have fixed rate increases despite rising costs. Debt tenure is also important as those with shorter debt books are now paying higher interest costs.
- In the Commodity Industrials, petrol retailers such as **Ampol** and **Viva Energy Group** have helped the sector to deliver higher dividends than expected 12 months ago through improved margins in refining, but growth is expected to be muted going forward.
- Within Cyclicals, discretionary retailers such as **Super Retail Group** and **JB Hi-Fi** stood out due to super profits translating into strong dividends and strong balance sheet positions. The next 12 months will be harder as interest rates continue to normalise, but as dividends have been conservative, there is still a good buffer.
- Defensives as a whole have not done as well as expected in a downturn, as revenue has not grown with inflation. However, **Lottery Corporation** delivered both a good dividend and growth in a tough environment as it continues to move ticket sales online away from newsagents and raised prices. **Telstra** has good inflation protection in its revenues through mobile plan price rises. **Coles Group** disappointed as higher costs from its Ocado delivery system dragged on dividends payouts relative to **Woolworths Group**.
- The Resources, while seen as strong dividend payers on an absolute basis 12 months ago, have started to fail to deliver versus expectations. Commodity prices have fallen and high capex programs for mine replacement and net zero have impaired dividend payments. Forward dividend growth has been severely reduced on negative profit growth expectations on China steel demand. Fundamentals for iron ore look the worst among the commodities.
- The Growth bucket is small for income stocks given poor dividend yields, but within the qualifying names, **Carsales.com** did better than most.

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Will Baylis, GAICD
Portfolio Manager

Sustainability themes in results and outlooks

Engagement is an important source of fundamental information that helps us improve our understanding and conviction in investee companies. We have cultivated strong relationships and established open dialogues giving us the opportunity to express any areas of concern and encourage greater transparency on their management of Sustainability risks.

Our meetings with companies and analysis of outlook guidance this reporting season have highlighted several important topics in this space.

Decarbonisation pathways are looking unstable.

Around 9% of the ASX 200 companies by market cap already have Science Based Targets (SBT) for reaching 'Net Zero greenhouse gas emissions by 2050', and around 12% have committed to setting an SBT[1].

We are however seeing some wavering in the trajectory for these SBTs and other non-verified net zero targets. There are also signs that it is getting difficult for heavy industry to achieve significant short-term reductions without viable new technology and a transmission system that can cope.

BHP Group discussed how it is still on track for its 2030 Scope 1 and 2-based targets, while Rio Tinto has now walked away from it 2025 targets. It did however hold firm on its 2030 targets. Boral was another company that reduced its net zero ambitions to 2030.

BlueScope Steel remained very committed to their goals and will still put significant investment into the reline of its coal-fired blast furnace at Port Kembla as a more sustainable technology (such as hydrogen) that could maintain the plant's output is not yet available. They have accepted that they will still require met coal for some time, but profits will allow them to invest more in lower emissions steelmaking technologies as they emerge.

Telstra confirmed they will have enough Purchasing Power Agreements (PPAs) by the end of FY 2025 to cover group energy requirements with renewable energy. They currently use PPAs and offsets to get to neutral emissions. They can also sell excess PPAs back into the market for a profit so higher energy costs have no impact on earnings.

Energy transition work continues, nonetheless.

Despite the issues mentioned above, large amounts of capital are being invested in the energy transition across the carbon emitting sectors.

APA Group announced an equity raising and a big acquisition of Alinta Energy Pilbara. This business is underpinned by contracted operational assets (gas and solar power generation, gas transmission, battery energy storage systems (BESS) and electricity transmission), together with an extensive development pipeline of projects (wind, solar, gas reciprocating engines, BESS, and associated electricity transmission).

Worley also reported strong growth in their sustainable revenue, and a significant pipeline of work from new customers coming from carbon capture and storage (CCS), low carbon Hydrogen, other low carbon fuels, battery materials processing and bio plastics etc. Worley estimates the backlog for renewable energy projects is approximately A$14 billion, due in part to a lack of engineers.

The New Zealand (NZ) electricity generators such as **Contact Energy**, **Genesis Energy**, **Mercury NZ**, and **Meridian Energy** are already predominately renewables, but much of the NZ industry (such as milk) still rely on coal-fired power. Big investment in electrification by industry is a positive for the generators.

Progress is also being made in sustainable aviation fuel, with the **Qantas Airways** partnership with Boeing and Airbus announcing that it has identified a pathway to ~9% Sustainable Aviation Fuel by 2030.

[1]Source: Martin Currie Australia, Macquarie Research; as of 30 June 2023.

Focus on RAPs, indigenous procurement.

We acknowledge that many Australian companies have operations that impact First Nations people and their lands. Often, these outcomes are also at odds with the Community's cultural values, specifically, the Community's intent to ensure the use of their land minimises any detrimental impact on their cultural and traditional connections to that land.

We are building a solid understanding of the perspectives of First Nations people into our work. In 2023 we began work to record and assess the status and effectiveness of the Reconciliation Action Plans (RAPs) of the companies we invest in and are committed to engaging with companies to build awareness and ensure that they are working to build respectful and constructive relationships with First Nations people.

Several companies used their results to highlight progress in this space. **BHP** recently released its sixth RAP, which included a new Indigenous employment target of 9.7 per cent, and a commitment to spend $1.5 billion with Indigenous businesses by 2027. **Stockland** has also set an Indigenous businesses social procurement target of 3% of total spend by 2025. Data from Supply Nation's Social Return on Investment Report suggests that $4.41 of economic and social value is generated for every dollar spent through Indigenous businesses[2]. **Wesfarmers** employ over 3600 Aboriginal and Torres Strait Islanders. with significant group wide efforts to maintain Indigenous employment parity.

Intervention in industry competition.

Improving competition for consumers has been in the spotlight during reporting season.

The Australian Competition and Consumer Commission (ACCC) rejected **ANZ Group Holding's** takeover of **Suncorp Bank** due to the importance of second-tier banks on the "competitive pressure on the major banks". Both companies have vowed to challenge the order through an appeal to the Australian Competition Tribunal as they believe it is in the best interests of customers, shareholders, employees, and the Australian economy.

The ACCC is also likely to pose a challenge to the Brookfield takeover of **Origin Energy** given Brookfield's ownership of AusNet, Victoria's electricity transmission lines, poles, and wires company.

Qantas has also been picked up by the ACCC for selling tickets for flights that were already cancelled. The company faces fines in the hundreds of millions of dollars if the case succeeds. This is occurring at the same time as the company announced record profits, and the Government blocked Qatar Airways' bid for 28 more flights a week.

Elsewhere, **IDP Education** has seen increased competitive pressure, especially regarding its English IELTS (International English Language Testing System) monopoly for visas into Canada. The Canadian government will accept four other English tests for the 'Student Direct Stream' visa class, which will likely result in lower sales volumes.

> "We are building a solid understanding of the perspectives of First Nations people into our work. In 2023 we began work to record and assess the status and effectiveness of the Reconciliation Action Plans (RAPs) of the companies we invest in."

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[2]Source: Supply Nation, 2019. "Connecting corporate and government buyers with Indigenous businesses". Available from *https://supplynation.org.au/wp-content/uploads/2019/11/Supply-Nation-Member-Brochure-emailable.pdf*

Big picture outlook

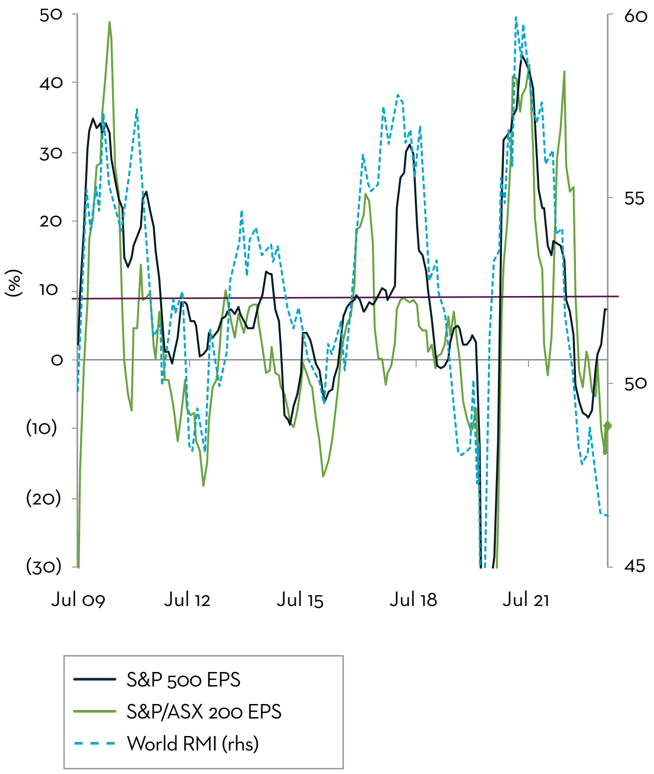
So, what does all of this mean for investors in Australia equities, particularly across the Value-style spectrum that we work in?

It is not an easy time in the cycle.

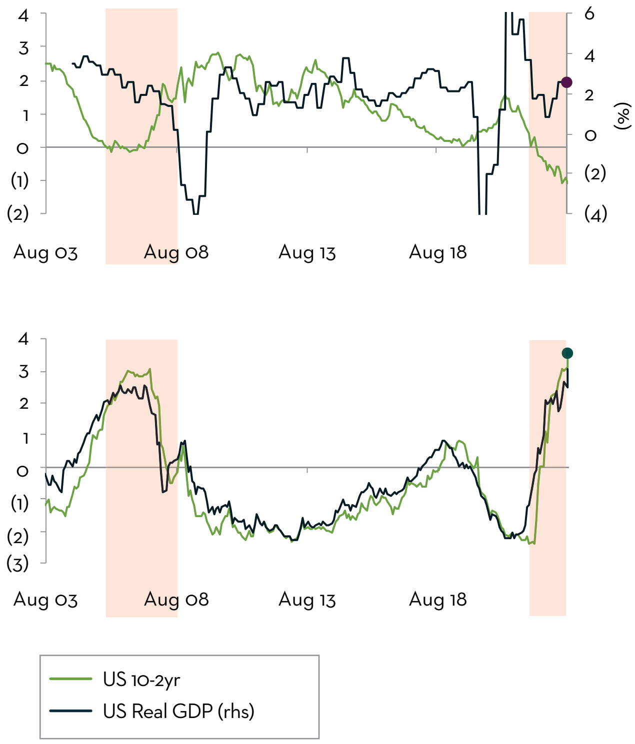
The World Purchasing Managers Index (PMI) has been in decline over the last 12 months, and we believe that this is one of the best forward profit cycle indicators. In keeping with this, the Australian (and US markets) have been seeing profit downturns since June 2022. While the Artificial Intelligence (AI) bounce has seen a small uptick in the US EPS data, broadly, conditions remain difficult.

We think that it is important to not underestimate the risks to the economy from rising interest rates, as real rates are now above the pre-GFC period. While we have seen an inversion of the yield curve, it can take 18-24 months to see the impact flow through, so we are still in the early days to see how it will play out fully in company profits (and share prices).

Expected NTM EPS growth and World PMI



US yields (%) and US GDP growth (YoY)



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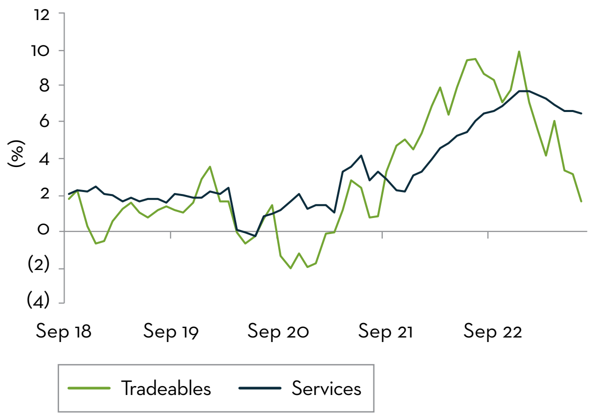
It is important to beware the inflation 'jaws'.

Data from the ABS suggests that while Australian 'tradable' (goods) inflation is slowing rapidly, 'services' inflation is holding or even rising, making it difficult for the RBA to get total inflation back with the 2-3% band.

While we are seeing signs of stress in younger people and families as consumers work through savings, the older generation is less impacted from rate rises. We are yet to see a slowing in services-based inflation, so rates may yet go higher, or we will see further slowing as prior rate rises flow through to the economy.

But what this means for companies (especially consumer facing) is that the boom period for gross profit margins is over. Selling prices are no longer rising to offset falling volumes as consumers hold back. At the same time, the cost of doing business is rising, and rising faster into FY24 than FY23. Companies are starting to suffer from the wage rises, accelerating rent rises, and other things like higher insurance, electricity costs and tech spend.

Components of Australian inflation (year on year change)



Past performance is not a guide to future returns.

Source: Martin Currie Australia, FactSet; as of 31 August 2023.

Weak China steel demand a concern.

For the Australian market, one indicator that we have also been closely monitoring is China steel production as it is a key driver of the iron ore price and EPS forecasts for **Rio Tinto**, **BHP**, and **Fortescue Metals Group**.

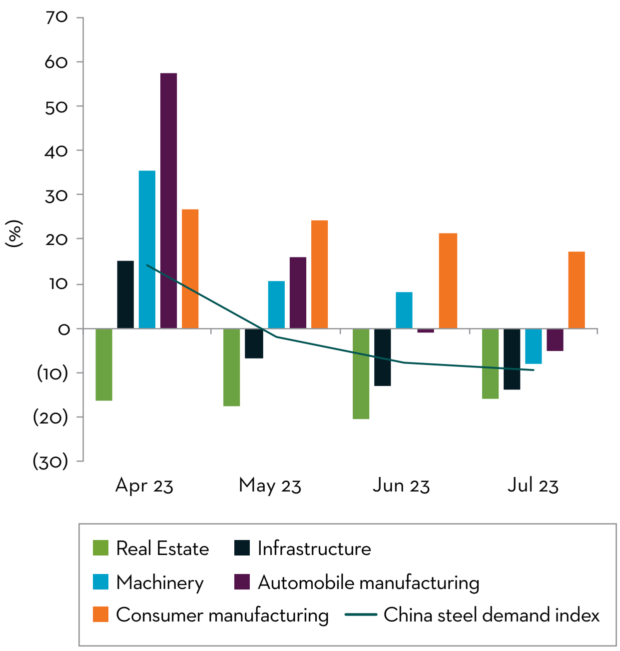
We have built a demand model for China steel based on real world monthly inputs, which has highlighted that China's growth dominoes are collapsing. We are now seeing the key drivers of steel demand falling significantly since April:

- ongoing weakness in property;
- infrastructure growth rolled over from April;
- Machinery demand turned negative in July;
- Autos slowing in July;
- but Consumer goods holding out.

The message to us from this data is that current steel production looks too high and needs to fall ~10% to match demand. This of course has negative implications for Australian Iron Ore prices, which appear to be holding up on the hope of stimulus.

China steel demand and steel production (3-mth moving av.)

Key demand indicators (year on year change)



Past performance is not a guide to future returns.

Source: Martin Currie Australia, FactSet, JPMorgan; as of 31 August 2023.

AI saved the growth de-rate, temporarily.

Speaking of the AI bounce above, hype in stocks such as **Nvidia** has been driving a P/E expansion for Growth stocks around the world in recent months. While **Nvidia** reported strong earnings, this hype has benefited many non, or low-earnings growth companies.

The rising demand and share prices for growth stocks has resulted in the recent poorer performance for traditional Value-style stocks and indices since December 2022. While the absolute P/E level of the market is still lower than during the Covid peak, the Growth/Value spread remains elevated. To us, this level of dispersion is much like during the tech bubble, and is surprising to see at the same time as inflation and interest rates are normalising.

With Growth stocks (led by tech) currently trading at extreme valuations, we believe that there is an advantage for Value-style stocks within this pricing disparity. For our portfolios, we have found real alternatives that offer superior valuation upside potential, more defensive revenues and cost inflation-protected characteristics.

MSCI World: Next twelve month P/E ratio

MSCI Australia: Next twelve month P/E ratio

Past performance is not a guide to future returns.

Source: Martin Currie Australia, FactSet; as of 1 September 2023.

Positioning for the cycle.

Portfolios across our range of Australian active equity strategies are based on MCA's valuation and risk discipline. We continually adjust our portfolios based on the information we are getting from sources, which include reporting season results, company meetings and engagements. These are all a valuable opportunity to gain deeper insight and hone our investment thesis for each company.

For some time, our portfolios have been positioned for a possible earnings or GDP recession. We had lowered the beta of our portfolios and focused on companies that can grow earnings and dividends in the higher rate environment without and not be exposed to valuation risk.

Our ***Value Equity portfolios*** are more defensive in positioning than in recent times, avoiding those Consumer Discretionary sectors that will be impacted by contraction in household budgets and targeting companies with strong balance sheets and robust cash flows that can withstand any capital funding headwinds which may emerge due to tight monetary conditions. We are finding much better valuation opportunities in companies like **ANZ Group Holdings**, **Medibank Private**, **Worley**, **QBE Insurance Group**, **Aurizon Holdings**, and **AGL Energy**[3].

For our ***Equity Income portfolios***, we are looking for companies that can support fundamentally higher franked dividends over time. The highly diversified portfolio includes high-quality names such as **Medibank Private**, **Telstra Group**, **Aurizon Holdings**, **Suncorp Group**, and **Woodside Energy**. On a forward-looking basis, the strategy is expected to provide a franked dividend yield of 6.5% over the next 12 months, which compares very attractively to the 5.2% expected franked dividend yield for the S&P/ASX 200[4].

Our ***Sustainable Equity portfolios*** reflect both our views on a company's valuation and its sustainability attributes, and is one of the few Value-style tilted Sustainability strategies in the Australian market. We are finding good opportunities based on our assessments of Net Sustainability Benefits, Sustainability Risk and Sustainability Pathways, alongside high expected returns, in stocks such as **Brambles**, **Medibank Private**, **Macquarie Group**, **QBE Insurance Group** and **ANZ Group Holdings**[5].

"For some time, our portfolios have been positioned for a possible earnings or GDP recession. We had lowered the beta of our portfolios and focused on companies that can grow earnings and dividends in the higher rate environment without and not be exposed to valuation risk."

Sources and disclaimers this section.

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See further definitions on page 2.

Source: Martin Currie Australia, FactSet; as of 31 August 2023.

[3]Data presented for the Martin Currie Australia Value Equity representative account.

[4]Data presented for a representative Martin Currie Australia Equity Income account.

[5]Data presented for the Martin Currie Australia Sustainable Equity representative account.

Summary

As the world continues to normalise to higher rates and long-term inflation expectations, the environment plays towards stocks with defensive earnings, robust cash flows, strong balance sheets and cost control that can **'Survive the profit downturn'** amid ongoing contraction in household budgets.

Right now, it is more important than ever for investors to be discerning in their stock picking, focussing on the right companies in this environment, avoiding stocks with valuation risk, or issues with poor pricing power, falling volumes and rising costs.

Growth-style stocks remain expensive, while Value stocks are still cheap relative to history. As the large spread between Value and Growth unwinds, and the market refocusses on valuations based on true earnings fundamentals, the conditions for Value-style strategies to outperform remain convincing.

"Right now, it is more important than ever for investors to be discerning in their stock picking, focussing on the right companies in this environment, avoiding stocks with valuation risk, or issues with poor pricing power, falling volumes and rising costs."

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- This strategy may hold a limited number of investments. If one of these investments falls in value this can have a greater impact on the strategy's value than if it held a larger number of investments.
- Smaller companies may be riskier and their shares may be less liquid than larger companies, meaning that their share price may be more volatile.
- The strategies mentioned may invest in derivatives (index futures) to obtain, increase or reduce exposure to underlying assets. The use of derivatives may restrict potential gains and may result in greater fluctuations of returns for the portfolio. Certain types of derivatives may become difficult to purchase or sell in such market conditions.
- Income strategy charges are deducted from capital. Because of this, the level of income may be higher but the growth potential of the capital value of the investment may be reduced.

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