INFINITY ASSET MANAGEMENT

Quarterly Update

August 2022

Ben Casley, Portfolio Manager – Quarterly Update

It has been an eventful quarter on the macro side, with inflation and interest rates continuing to increase, however it has been a relatively quiet period on the company front. We have seen certain sectors struggle on the back of changing conditions and macro data. Rising rates and cost of living pressures are expected to hit household balance sheets hard, which has led to consumer discretionary names such as Nick Scali and Beacon Lighting to underperform the index. The fact that we haven't heard from either of these companies suggests to us that they are still on track for their full year earnings guidance and are comfortable with their operating conditions. We see this as an opportunity for active management, where good stock picking within sectors that have performed poorly should be an opportunity to generate alpha.

Another sector that has performed poorly in the rising rates environment is the technology sector, in particular those with longer duration expected cash flows. We have seen technology companies around the world look to reduce the duration of their expected cash flows by bringing forward their cash flow breakeven target dates. Many have achieved this by reducing headcount and marketing costs and raising prices for consumers. We believe technology companies with proven unit economics can whether the storm, while companies that have inflated their growth by subsidizing the cost of their product or service with access to cheap money will be found out and punished accordingly. We look for companies in this sector that are mature and do not require access cheap funding to grow, with a clear pathway to profitability. We believe these companies are well placed to grow throughout the cycle and remain good long-term investments.

We are optimistic that earnings should remain robust however forward guidance may be difficult for management to provide. We expect companies to be conservative with their guidance, should they provide any guidance at all. We will be interested in hearing from our real estate companies such as Goodman Group and Charter Hall, who are expected to deliver record earnings yet again, however it is unclear how inflation and interest rates will affect their property portfolio valuations or their development books. Transaction data suggests that commercial property valuations have held up, however we are less optimistic that these valuations are sustainable in the long term. For property values to remain strong given higher funding costs, we would expect strong rental growth rates and lower vacancies. We are seeing this in Industrial and Residential, however Office seems to be bucking the trend. Office vacancy rates are in the double digits in all major cities, 4 times pre pandemic vacancy rates, rents remain below pre-pandemic levels and incentives remain elevated, yet we are still seeing transactions with capitalisation rates in the 4% range. For context, this is roughly the same as the capitalisation rates for Industrial property, where rents have increased 20% since the pandemic and supply remains constrained. We will continue to monitor this throughout the second half of the year for signs of deterioration and will monitor our exposures accordingly.

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