Perpetual

MARATHON, NOT A SPRINT, FOR STALWART ETHICAL FUND

PERPETUAL ASSET MANAGEMENT
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The Perpetual Ethical SRI Fund has a 19-year history as one of the first socially responsible funds launched in Australia. Portfolio manager Nathan Hughes looks at the opportunities he sees for the fund over the next year.

Tell us a bit about the Perpetual Ethical SRI Fund.

The Ethical SRI Fund is a fund with a 19-year history here at Perpetual. It is one of the first funds that was launched in the Ethical SRI space in Australia. It's an extension of our core investment process here at Perpetual with some additional screening and overlays on top of that.

How do you select companies to invest in?

Our screening process for the fund is an extension of our Perpetual screening process. There are four quality filters that we must look out for each company to be assessed for inclusion in our funds. They are quality of business, good balance sheet, good management team, and recurring earnings. Beyond that, there are two additional screens for my fund. They are based on the activities of a business and we apply a 5% revenue materiality threshold for things like alcohol, manufacture and distribution, fossil fuel production, gaming, and tobacco. Beyond that, there's as a second screen where we're looking for positive performance across a range of E, S and G issues, companies that score positively on these matters will be assessed for inclusion into our fund.

Doesn’t this remove a large number of companies?

It's important to remember that we're not looking to penalise companies, we're looking for a net positive aggregate score. The screens remove a large percentage of market capitalisation in the ASX 300, but not necessarily a large number of stocks. So, I believe there's more than enough opportunities for this particular product. The fund can also invest up to 20% of its holdings in an offshore security, which enables me to look into far broader and deeper markets and therefore there are plenty of opportunities for this product. I also think the long-term returns attest to the fact that the screens aren't too restrictive for this fund.

Where are you currently seeing opportunities?

Of the opportunities in the market at the moment, I think are most interesting are in financials; whether that be banks or, in particular, general insurers. IAG is a stock that we really like at the moment. Anything that could go wrong did go wrong for the company in 2020, whether it was natural peril claims, whether it was interest rates coming down affecting their investment income on technical reserves and shareholder equity. But we think there's a great opportunity to buy the company at the bottom of the cycle earnings at the moment. The core consumer franchises are very strong, there's an opportunity to reprice the commercial insurance book and drive returns and we think that's a stock that's trading at a really compelling valuation.

Did COVID make the investment process harder?

In terms of adapting and responding to COVID, I think it was more just a reiteration of some key investment tenets rather than looking to do anything differently. I think it was really a reiteration of how hard it is to time investment markets and therefore that it's better to stay relatively fully invested in good quality companies. It also highlighted to me the importance of backing good management teams. Good management teams acted decisively during the COVID pandemic whereas some others didn't. And lastly, just reiterating the strength of balance sheet. Balance sheet is a strong part of our investment process and for many years it didn't seemingly matter and then in 2020 in the blink of an eye, it mattered a whole lot. Companies that avoided doing dilutive equity raises at the bottom of the cycle have preserved equity for their shareholders.

You mentioned IAG, is there another stock you'd like to analyse?

In terms of another favourite stock – and I would caveat this with saying that everything is related to price and valuation – so I wouldn't say it's a never sell, but certainly a stock that I particularly love is Nick Scali and why I love that is the business model itself. It carries minimal inventory, which takes away a lot of downside risk if cycle turns against them but it's also a very cash generative model with great returns on capital. I still think there's a long runway ahead for the company, whether it's rolling out new stores, improving their online offering and taking market share or selective M&A. I think that's a business with a great runway ahead of it, and probably never gets the multiple that it deserves for the quality of the company.

How have you done against your benchmark?

The Ethical SRI Fund is benchmarked to the ASX 300 and the performance over the last 12 months has been quite strong, which is very pleasing. But investing, I like to say is a marathon, not a sprint. It's only early days in my tenure as I've been running the fund for a little over two years now. Having said that though, I believe that the portfolio is really well-placed moving forward. Whilst we've enjoyed some great returns of late, I think there's a lot of value appeal in the fund and I expect it to provide good returns to unit holders for the foreseeable future.

Find out more about Perpetual's Ethical SRI Fund.