

Is now a good time to invest with Dundas?

Performance for the Apostle Dundas Global Equity Fund (ADGEF) for the three years to end October 2015 is as follows –

	<i>3 years (pa)</i>
<i>ADGEF</i>	22.9%
<i>MSCI ACWI ex Aus</i>	25.0%
<i>Relative Return</i>	- 2.1%

Source State Street – performance in AUD

Whilst an annual return of 20% since inception is a pleasing result for Australian investors, the Fund has nonetheless underperformed its benchmark and has therefore underperformed its objective of achieving a return premium of 2.5% per annum. Before examining the reasons behind lagging the benchmark, let's revisit the Dundas philosophy.

Fundamentals – the pillars upon which the Portfolio is built

Dundas builds the portfolio of stocks from the bottom-up – companies with higher margins, strong balance sheets, retaining around two thirds of profits to reinvest in future growth resulting in long term wealth generation and growth of 10-12%. The metrics today are consistent with those of the past three years suggesting a 4.5% premium in growth over that of our investment universe.

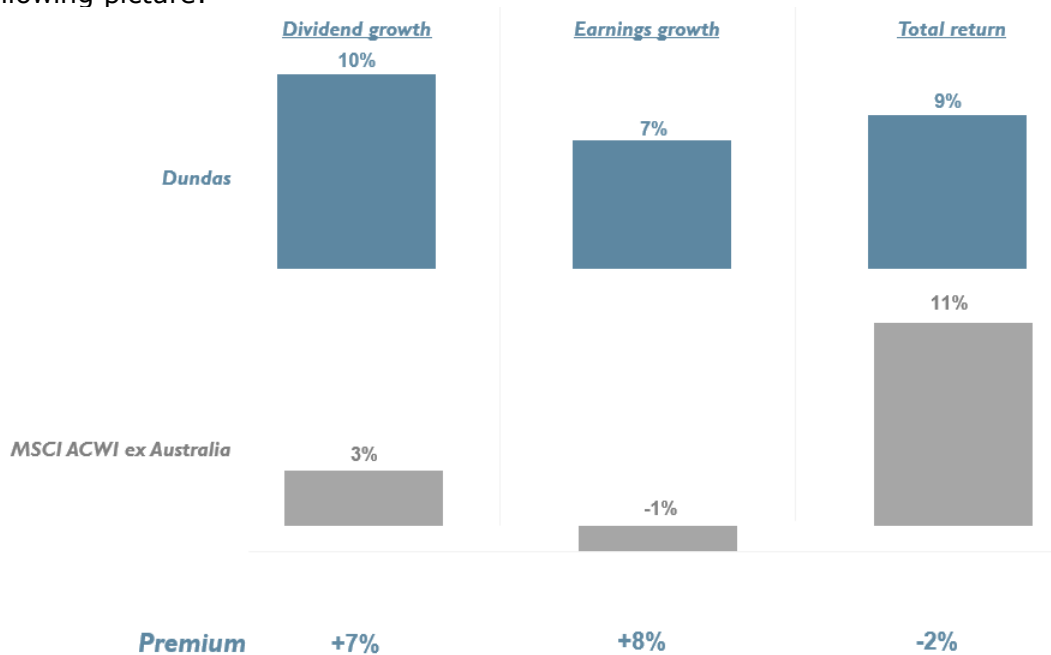
$$\text{Return on equity} \times \text{retained earnings} = \text{Long term growth}$$

	<i>Net income as % of sales</i>	<i>Asset turnover</i>	<i>Financial leverage</i>	<i>Return on equity</i>	<i>Retention rate</i>	<i>Implied growth rate</i>	<i>Implied premium</i>
<i>Dundas</i>	(10.73	X 0.76	X 2.25	= 18.35%	X 63%	11.56	4.72 % p.a.
<i>MSCI ACWI</i>	(7.08	X 0.66	X 2.1	= 12.66%	X 54%	6.83	

Source: Bloomberg, Dundas. 30 October 2015.

Business Fundamentals and Market Returns

The fall in the Australian Dollar has considerably boosted returns, if we look instead at the US dollar returns from the Fund and the benchmark – comparing both with earnings and dividend growth gives the following picture:



The Fund has delivered US dollar total returns of 9% per annum against 7% earnings growth for the stocks held and 10% dividend growth. For the benchmark returns of 11% per annum compare with no growth in earnings and dividends up 3% per annum.

Possible culprits

The considerable premium in terms of fundamental growth against the benchmark has not been rewarded by superior returns - in fact quite the reverse – a 4.5% growth premium has become a 2.1% performance shortfall. How so?

Avoidance - We seek to avoid overpaying for future growth, this has led us to avoid many of the top 20 stocks driving the US market such as Amazon and Facebook. Although these firms have seen large valuation expansion, overall this has not affected relative performance.

Stock selection – Our exposure to industrial stocks largely caused the underperformance versus the index. This was principally due to exposure to stocks whose customers were significantly affected by the lowering energy prices.

Dundas' Management Style

Dundas' focus is always to buy companies with strong underlying fundamentals. We are concerned more with company behaviour rather than market behaviour, and investments have been made in anticipation of revenue, profits and dividend growth – not for the market's willingness to pay higher multiples on those businesses.

We would expect to have lower volatility and perform better in tough market environments - those tougher environments have been largely outside the US market for the past few years.

Lifeboat or speedboat?

We are aware that predicting the future is fraught with the danger of too many unknowns. A few points to consider however –

- 22% p.a. return is not sustainable.
- Global equity markets returns have not been driven by fundamentals, but by valuation expansion in technology, biotech and to some extent telecoms. Dundas has largely been absent from these companies.
- Based on the breadth of research, Dundas predicted that dividend growth would be a dominant factor in long term returns. This has not been the case for the index over the past three years.
- The Fund has operated in a period of predominantly low and falling bond yields. If and when bond yields rise, companies with strong balance sheets and low levels of debt will be the best positioned.
- The fundamentals of the Dundas portfolio give us confidence that the Fund is extremely well placed to cope with any market uncertainty – ultimately it is company fundamentals which underpin returns to shareholders.



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