

Defensive Australian Equity investing in the era of the *“new abnormal”*

Lazard Australian Equity Team

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Agenda

- **Valuations – Where are we now?**
- **Residential Property Declines – What does it mean?**
- **Investing for Today's Markets**

Valuations – Where are we now?

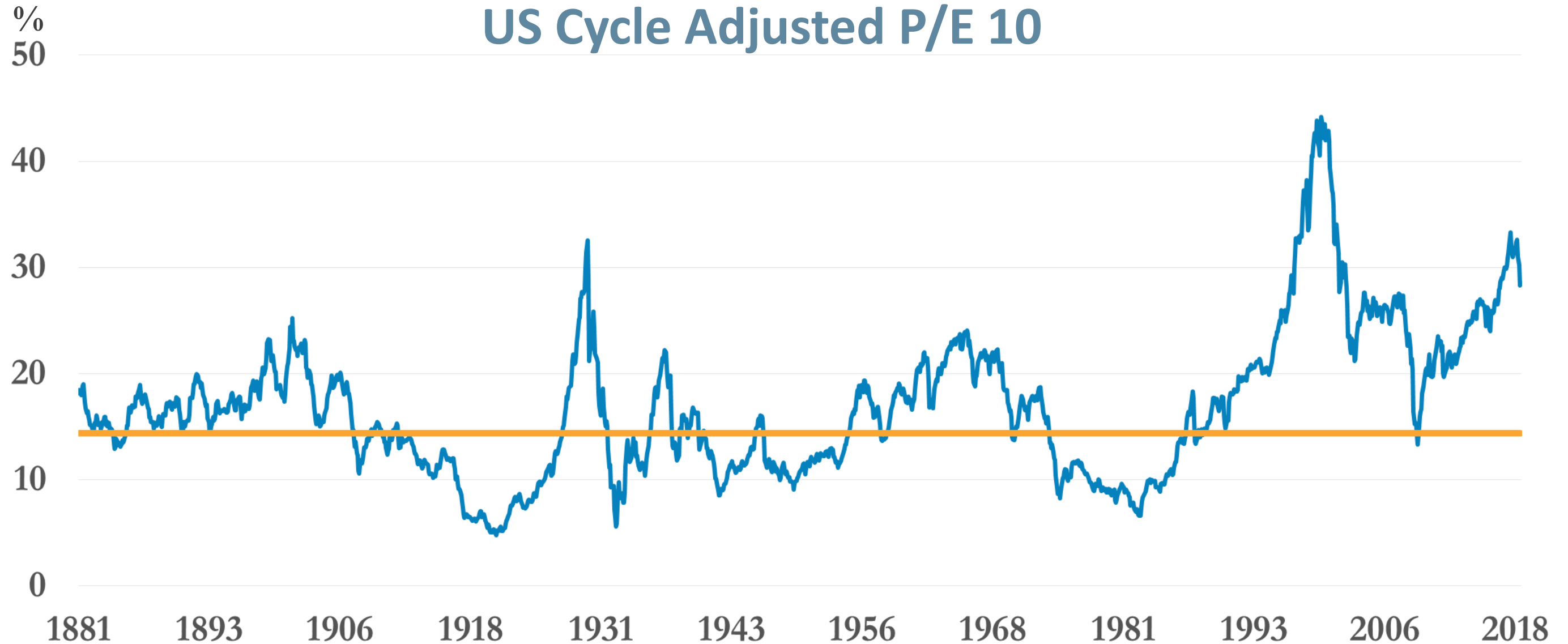
The Cycle Adjusted Price to Earnings Ratio (CAPE)

A definition

The **Cycle Adjusted Price to Earnings Ratio (CAPE)** CAPE is today's price relative to the average earnings across the cycle in today's dollars. In order to average both booms and busts, a 10 year average is often used (CAPE10).

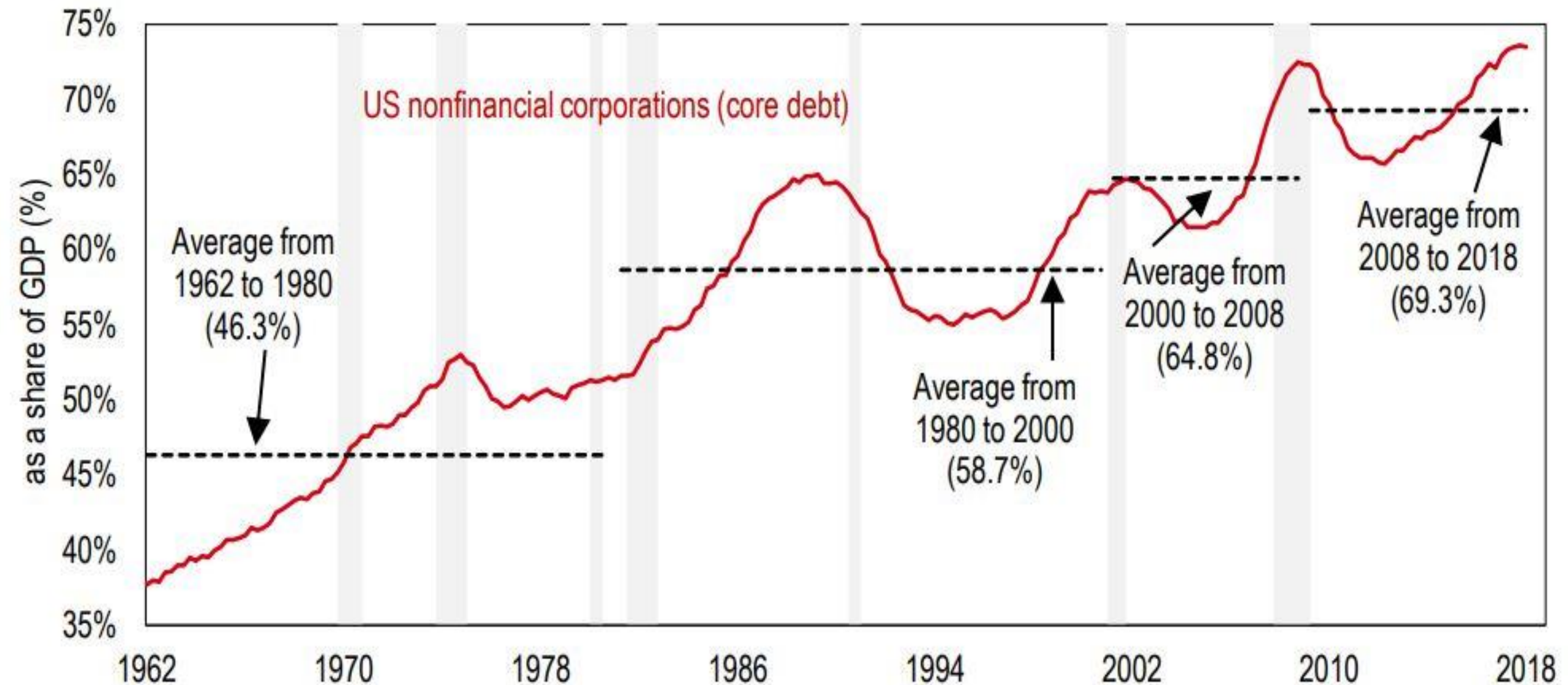
Record High Multiples on a Cycle Adjusted Basis

US Equity Market Valuations



Corporate Credit Standards More Lax Than in 2007

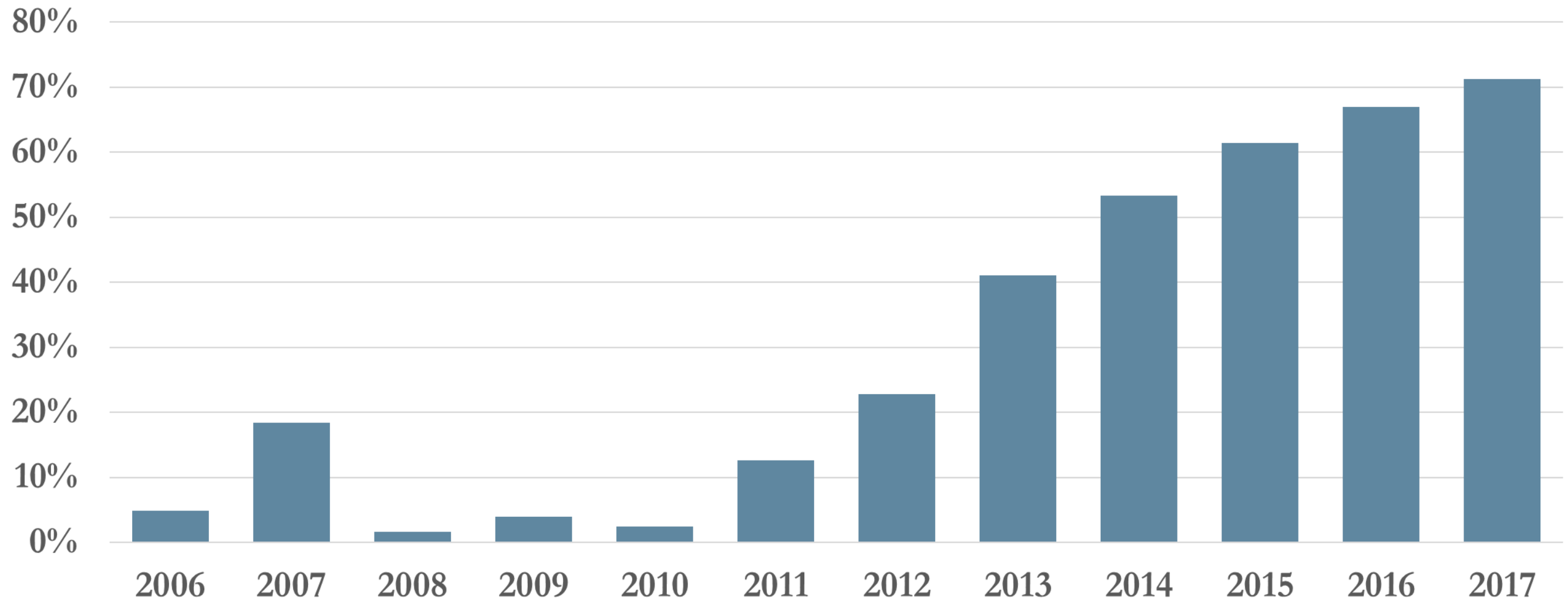
US Credit Markets Are a Growing Risk



Corporate Credit Standards More Lax Than in 2007

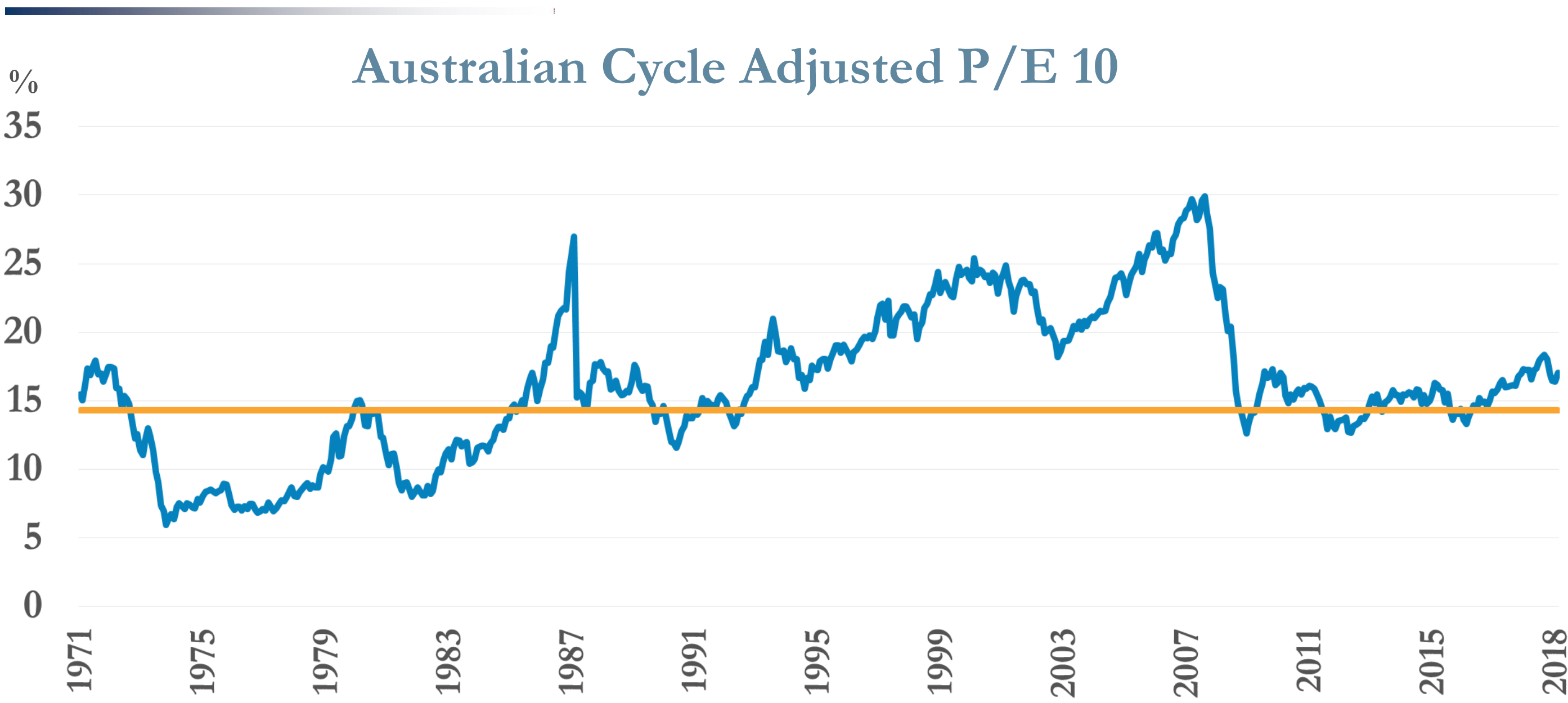
Credit Markets Are a Growing Risk

Covenant Lite Lending (% of new loans, average of US and Europe)



Australian CAPE Slightly Above Average

Australian Equity Market Valuations

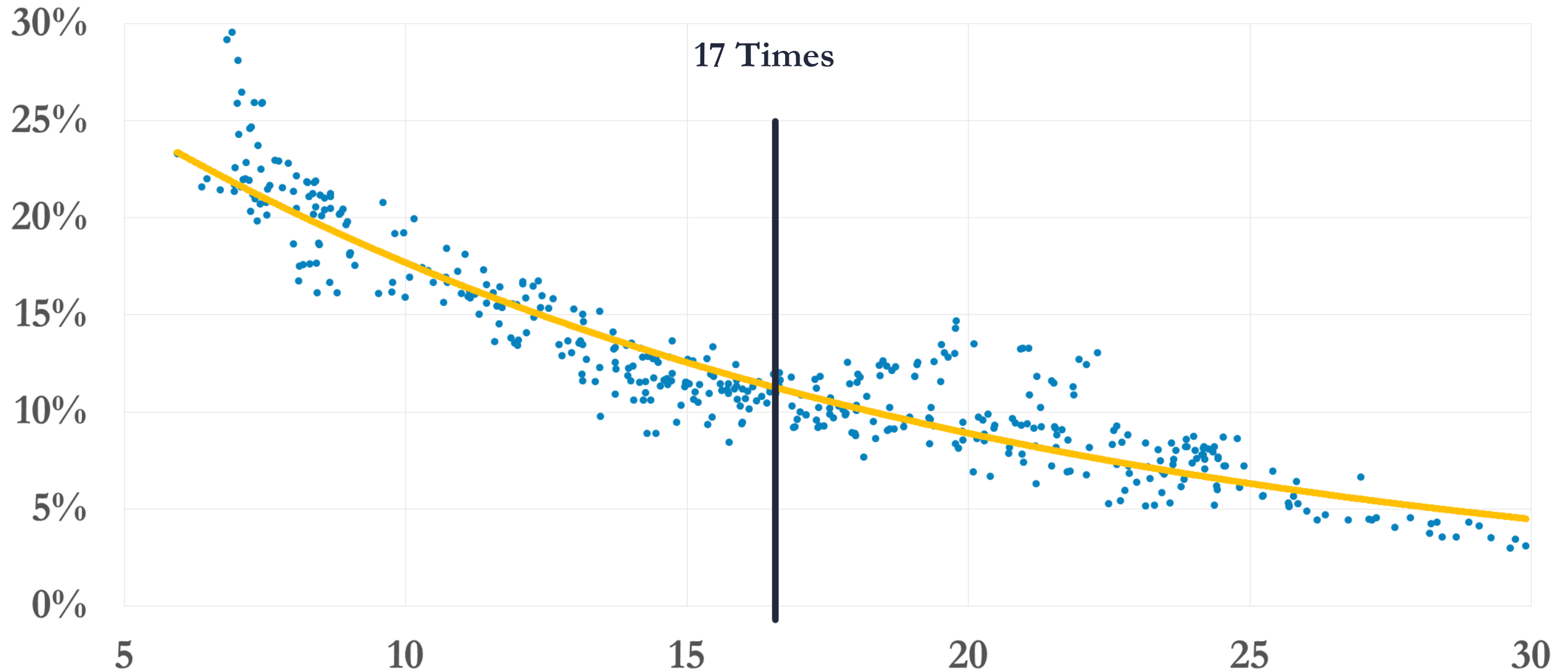


Australian CAPE 10 (Blue) and Harmonic Mean (Orange) As at 31 December 2018. This information is for illustrative purposes only and does not represent any product or strategy managed by Lazard.
Source: GFD, FactSet, Deutsche Equities

Valuation Matters Over the Long-Term

Strong Correlation Between Valuation Level and Returns

10Yr CAPE and Subsequent 10 Year Nominal Returns

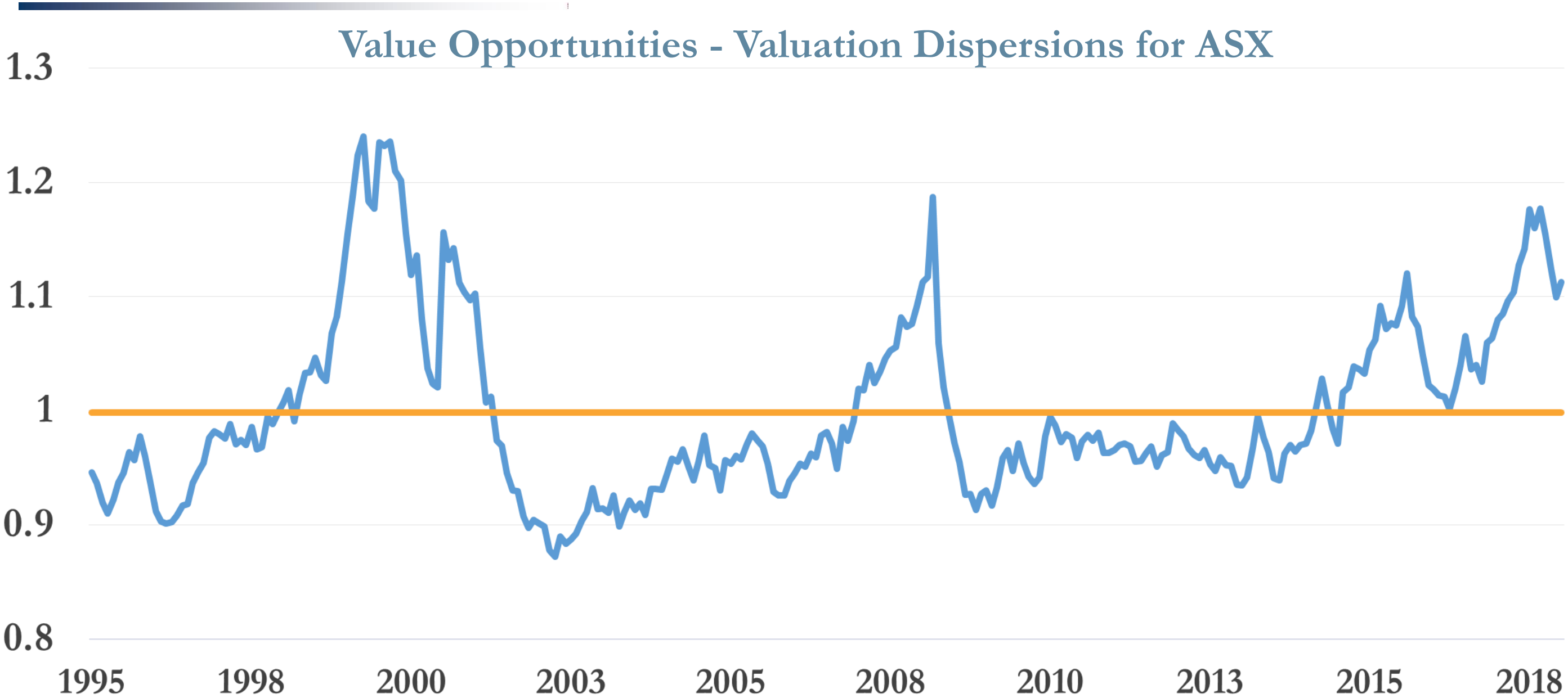


As at Dec 2018. This information is for illustrative purposes only and does not represent any product or strategy managed by Lazard.

Source: GFD, FactSet, Deutsche Equities

Tech Boom Mark II: The Market is Getting Frothy

Value Opportunities are Above Average



Source: Lazard Asset Management and Macquarie. As at 31 December 2018. Source: Average for normalised deviations from trend for six series. 1. Relative P/E multiple of top quintile growth firms (ASX200, GS). 2. Number of ASX200 stocks trading on >40x trailing P/E (GS). 3. Ratio of 20th to 80th percentile P/E (UBS, ASX200). 4. Ratio of P/E of highest quintile P/E stocks relative to Avg Industrial P/E (UBS, ASX200). 5. Relative P/E of Australian "Darling" stocks compared to average (CSFB definition of "Darlings" includes PE and price momentum, ASX200). 6. Lazard's weighted standard deviation of expected returns.

**After a long bull market,
risk assets are generally
expensive**

Australian Residential Property Prices are Falling – Why and What Does it Mean?

Why We Have Been Concerned About This Risk

Australian Housing Market

‘Crash’ Vulnerability

Three criteria to assess ‘crash’ vulnerability:

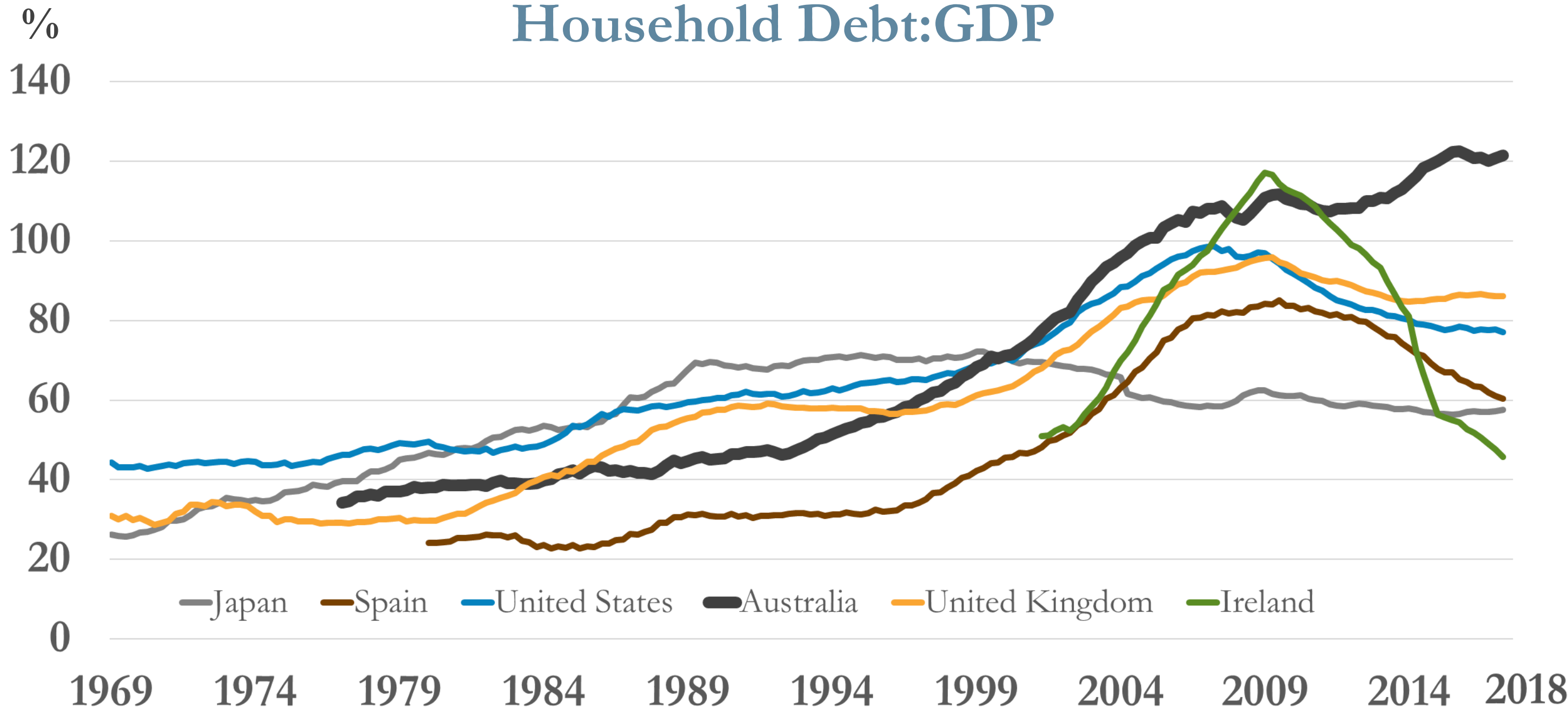
- 1 - The level of mortgage debt;
- 2 - The level of home prices, and
- 3 - Mortgage loan underwriting standards.

All three criteria seem to be met.

The Lessons of History

Australia Compared with Other Markets

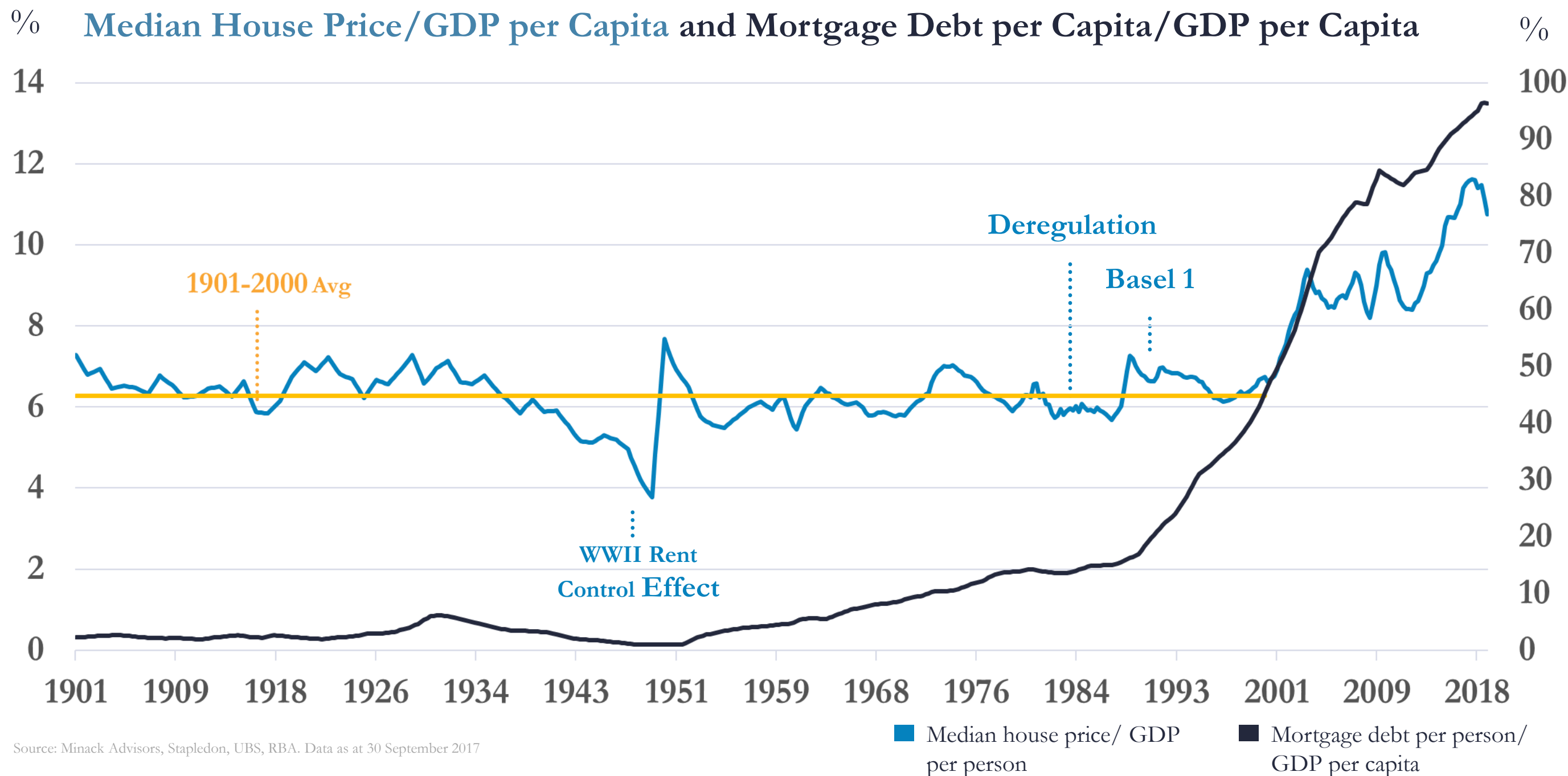
Household Debt:GDP



Source: Bank for International Settlements (BIS). End-date: Jun 2018

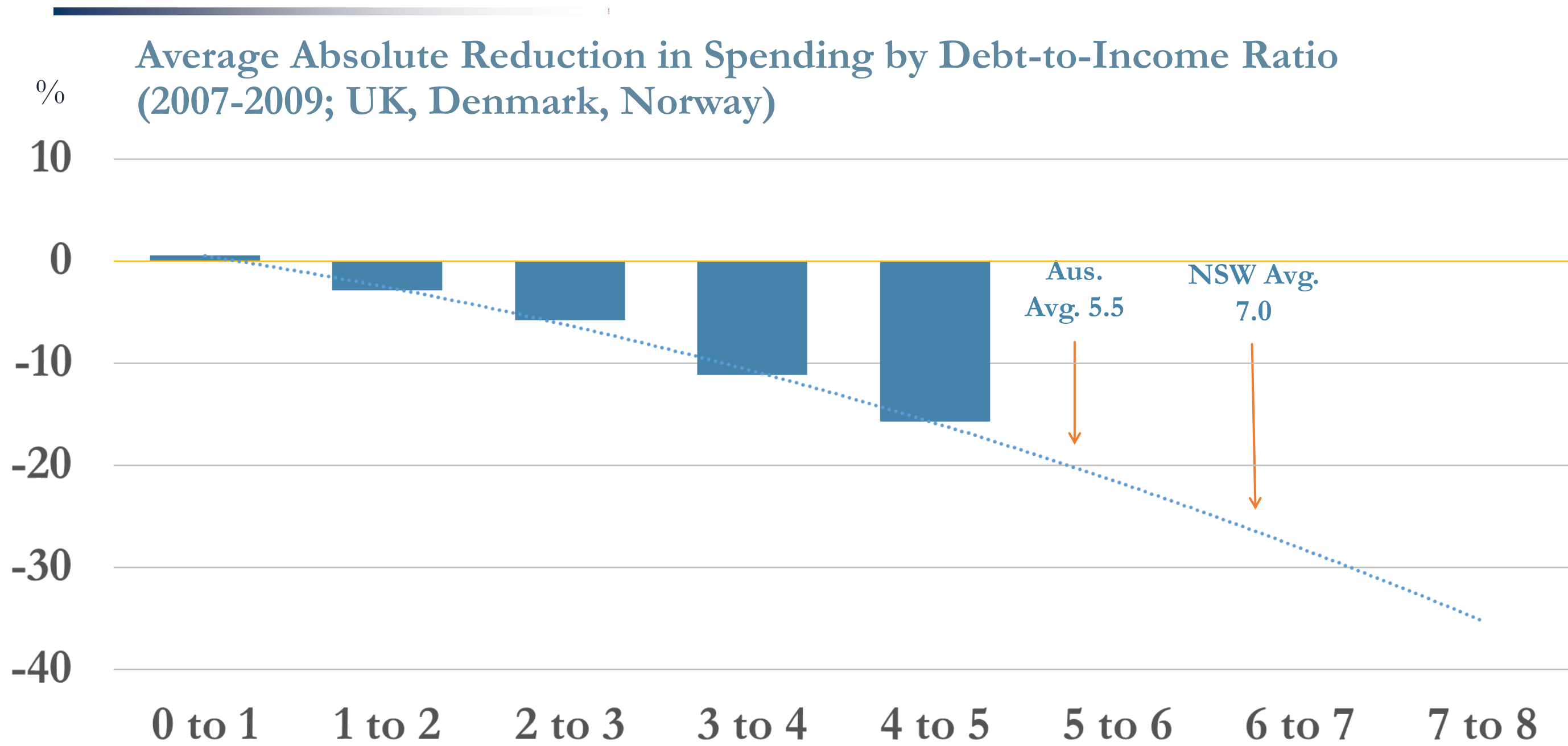
Debt Drives Asset Prices

Australian Housing Market Since Federation



How Households Have Reacted to a Shock to Confidence

European Data



Source: Bank of England, Financial Stability Report November 2016 | Issue No. 40 (<http://slideplayer.com/slide/12044439/>) drawing on various national sources. DTI ratio includes all debt, mortgage and personal.
Australian DTI Ratios from Digital Finance Analytics include only mortgage debt gross of off-set accounts

The Current Debate

Addressing Some Misconceptions

1 - A deliberate and controlled adjustment?					
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- Some busts just needed confidence as catalyst (Ireland)
- Any decline greater than 1% per month is substantial

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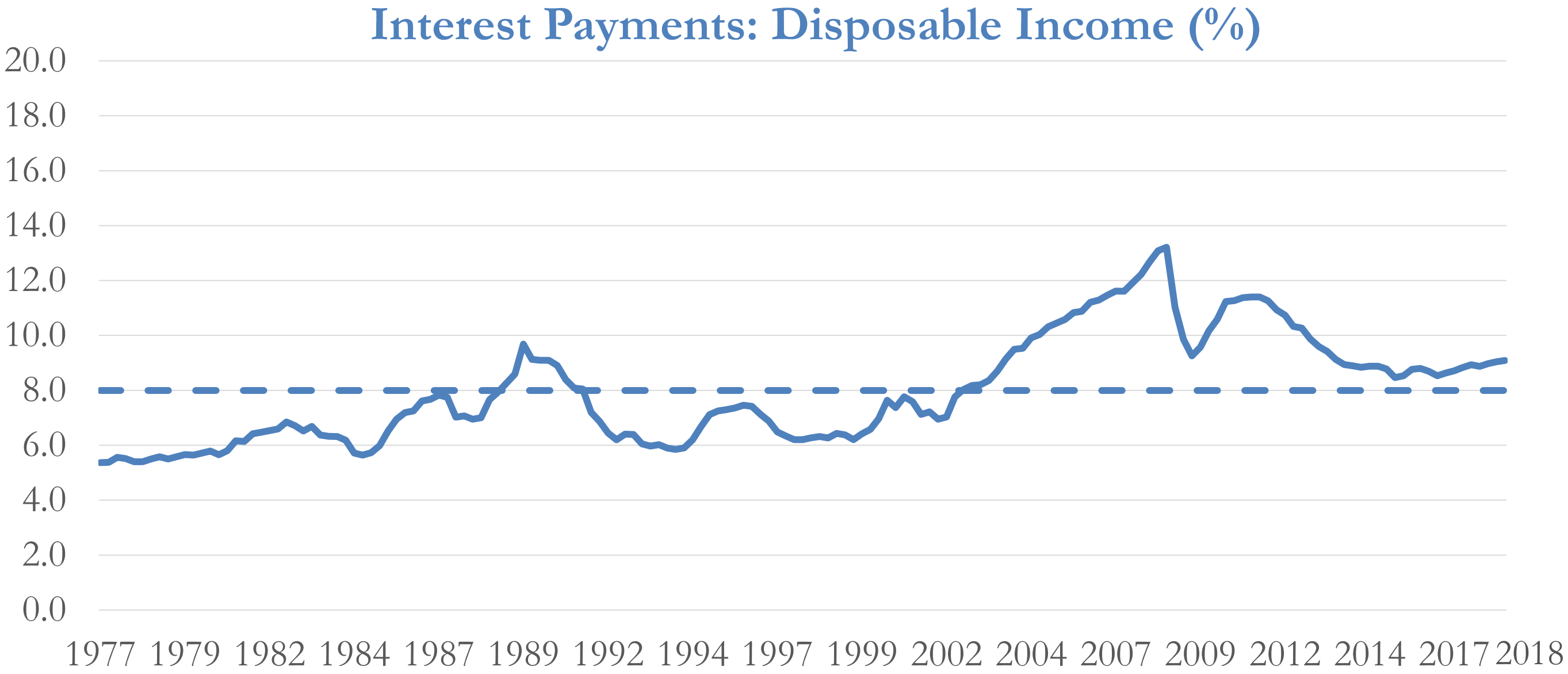
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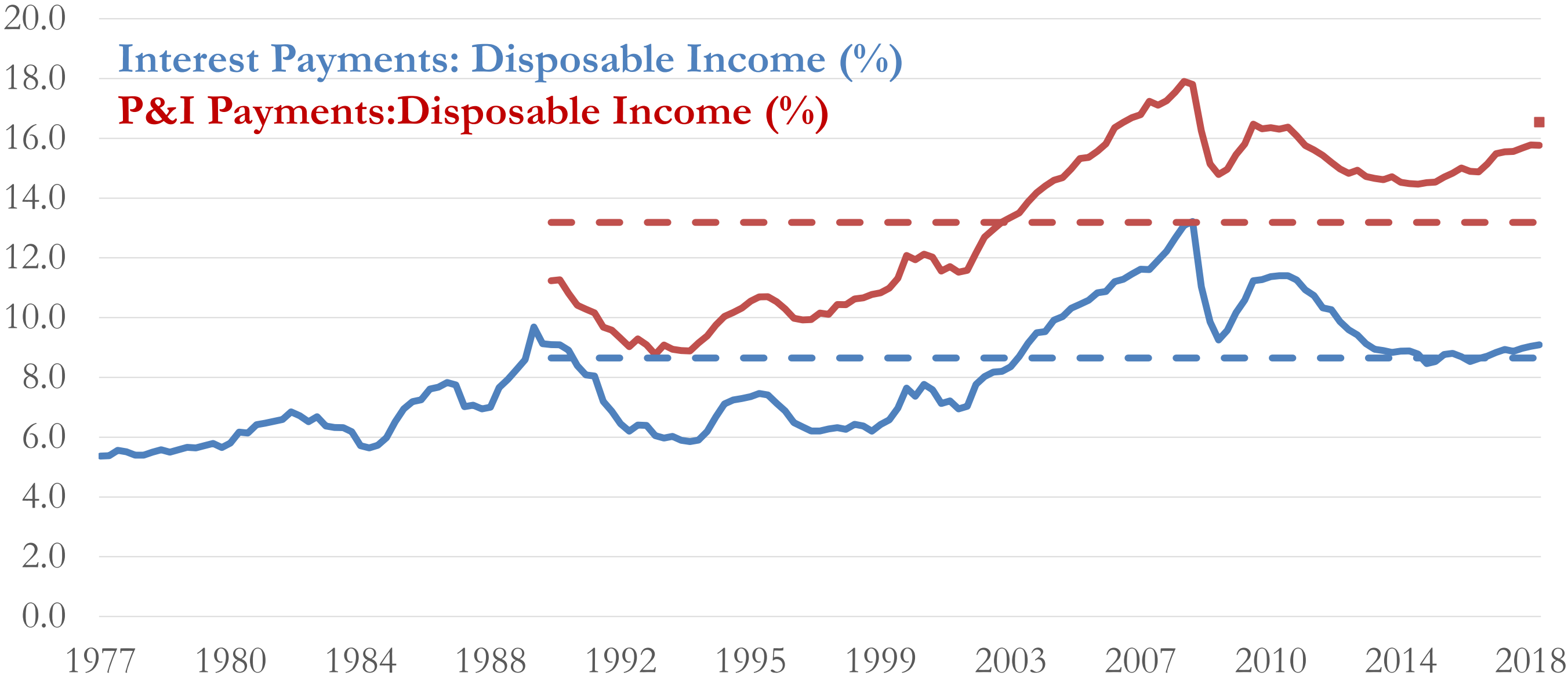
Serviceability



Source: Minack Advisers, as at 30 September 2018

The Current Debate

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Source: Minack Advisers, as at 30 September 2018

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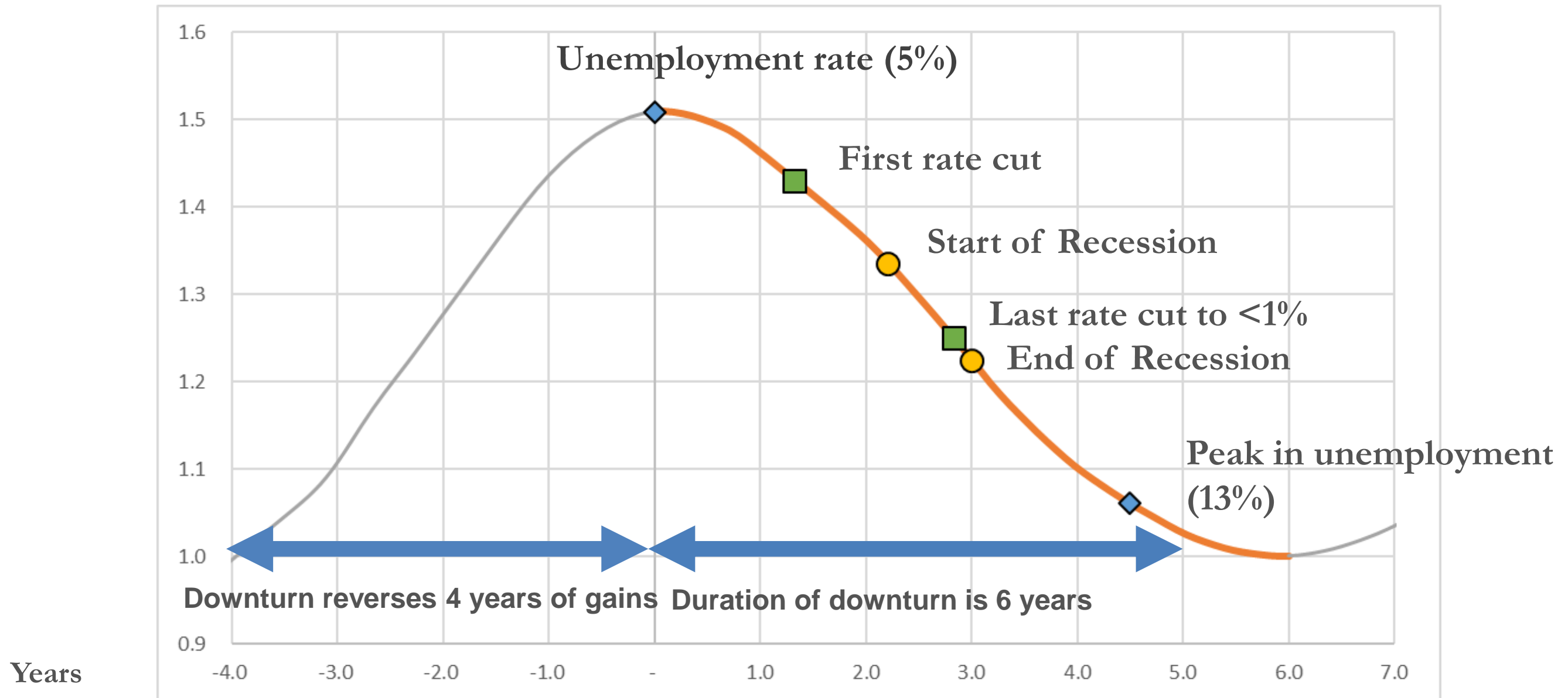
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Lessons from History

Schematic based on averages from Japan, US, Ireland, UK and Spain

Home Price Index



*Annual data for Greater Tokyo and quarterly data for Spain. Monthly data for US, Irish and English home prices. Source: FRED, Federal Reserve Bank of St. Louis, Haver, Irish Central Statistics Office, StatBank, HM Land Registry at Gov.UK, Instituto Nacional de Estadística, The Nikkei Shimbun via Japan Property Central.

Balance Sheet Recessions have been long and result in low interest rates

Rates at Historic Lows

	In this cycle rates reached a	Latest Change in CPI (yoy)	Inflation Target	Today's Cash Rate	Today's 10Yr Bond Yield
US	>220 yr low	2.2%	About 2%	2.50%	2.63%
Japan	>1,000 yr low	0.9%	2%	-0.10%	-0.04%
Euro Zone	>500 yr low	1.9%	Under 2%	0.00%	0.08%
UK	>500 yr low	2.2%	2%	0.75%	1.15%

Source: FactSet, GFD, Haver. As at 31 Dec 2018

Lessons from History

Our Observations

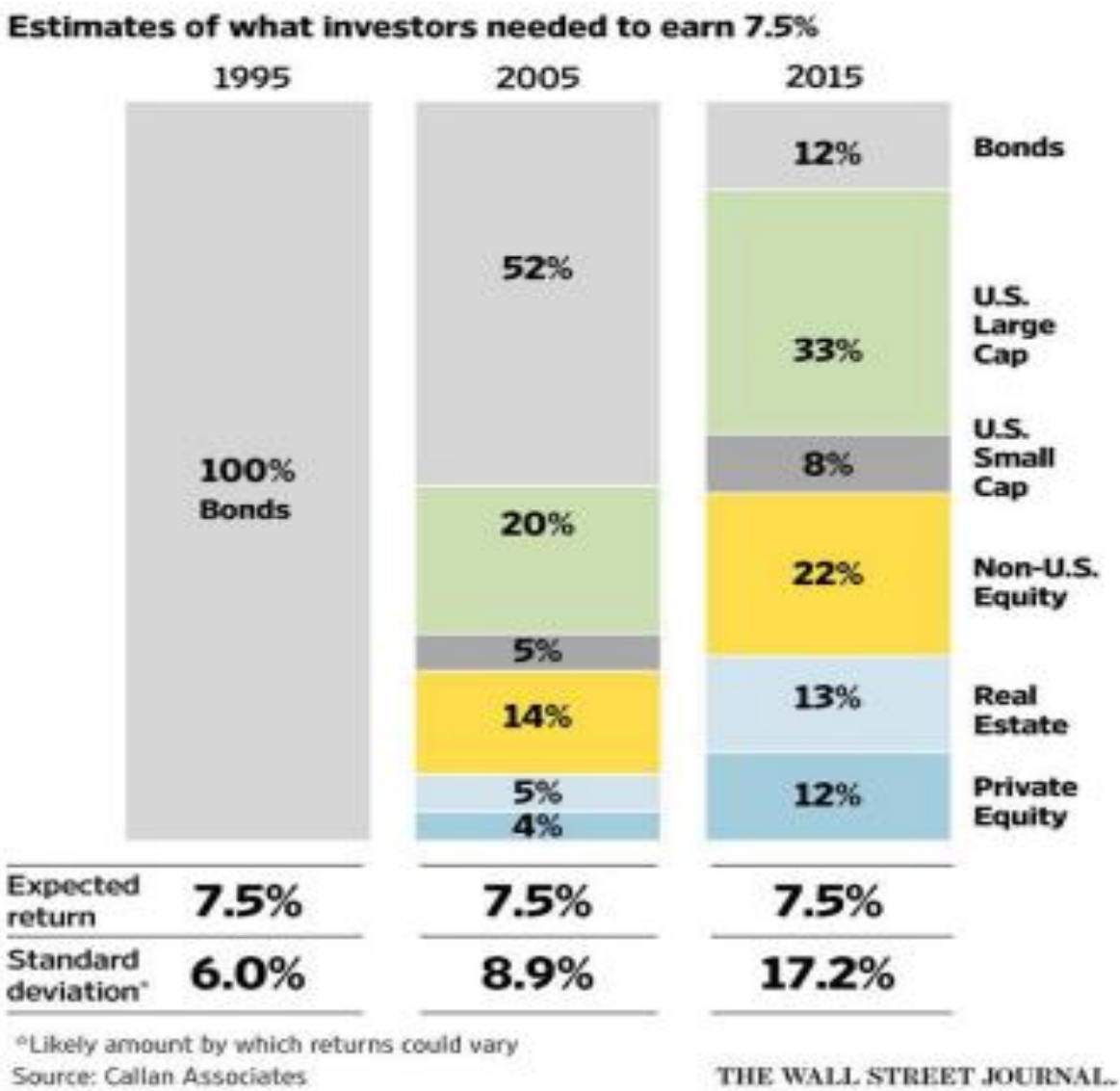
- Lesson 1:** Debt financed property speculation can end in a Balance Sheet Recession, as HHs change their expectations and thus behavior.
- Lesson 2:** Residential markets move in slow motion.
- Lesson 3:** Monetary policy can become ineffective as HHs want to de-gear, with fiscal policy the remaining option.
- Lesson 4:** The Economic Damage is Front Loaded and Long Lasting.

**The tail risk of a house
price recession has
increased significantly**

Investing for today's markets

What is the Problem?

Investors May Have to Take Bigger Risks to Match Historic Returns



- In 1995, a portfolio made up of all bonds would return the desired 7.5% p.a. with the expectation that returns could vary by around 6.0%
- In 2015, the same expected return outcome could only be achieved by investing in new asset classes, and investors accepting a standard deviation of 17.2%
- Diversification across multiple asset classes requires a lot of planning, analysis, and rebalancing over time.

Lazard Defensive Australian Equity Fund

Our Objectives



Less draw down in negative markets

Reduced exposure to
S&P/ASX200
Accumulation Index
drawdowns



Total Return

A total return that
exceeds the Reserve
Bank of Australia
Cash Rate

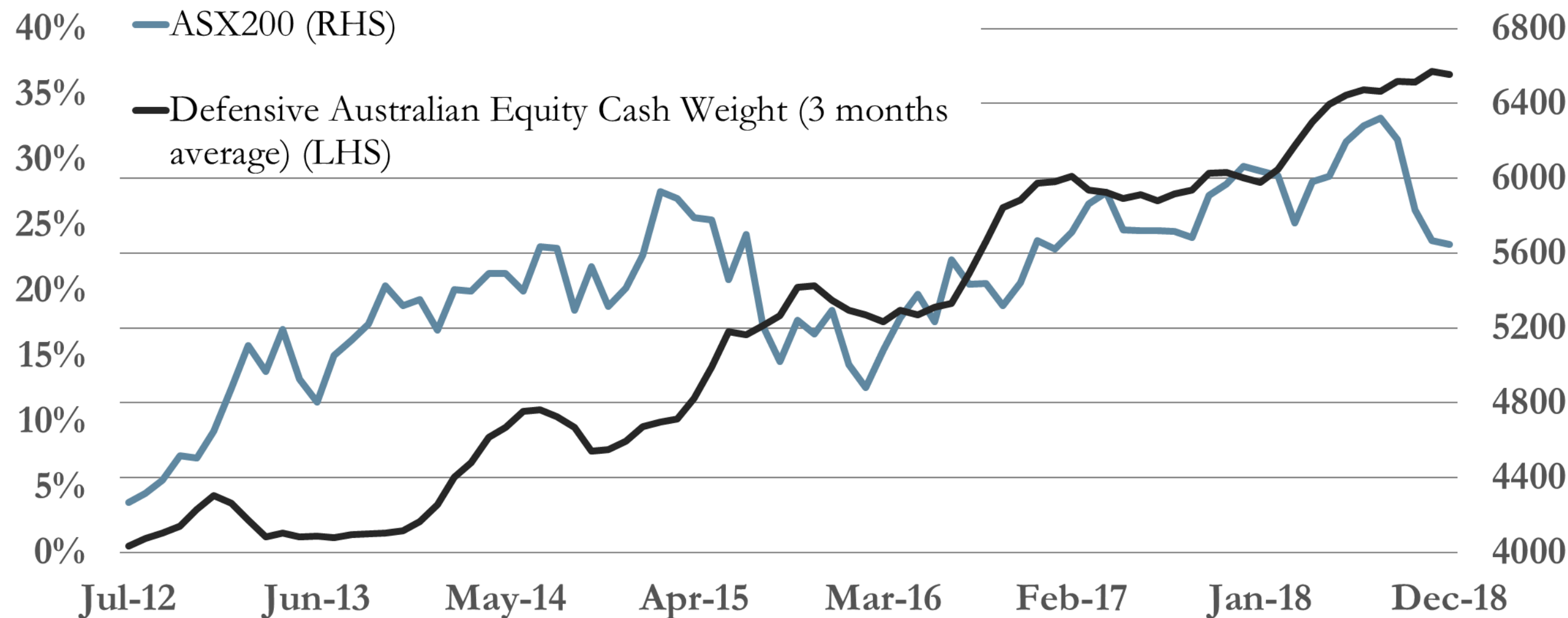


Sustainable and consistent income

An income return at a
premium to the
S&P/ASX200
Accumulation Index
dividend yield

Lazard Defensive Australian Equity Fund

Portfolio Construction



Our Allocation Between Cash and Stocks is Driven Primarily by Quality of Income Opportunities

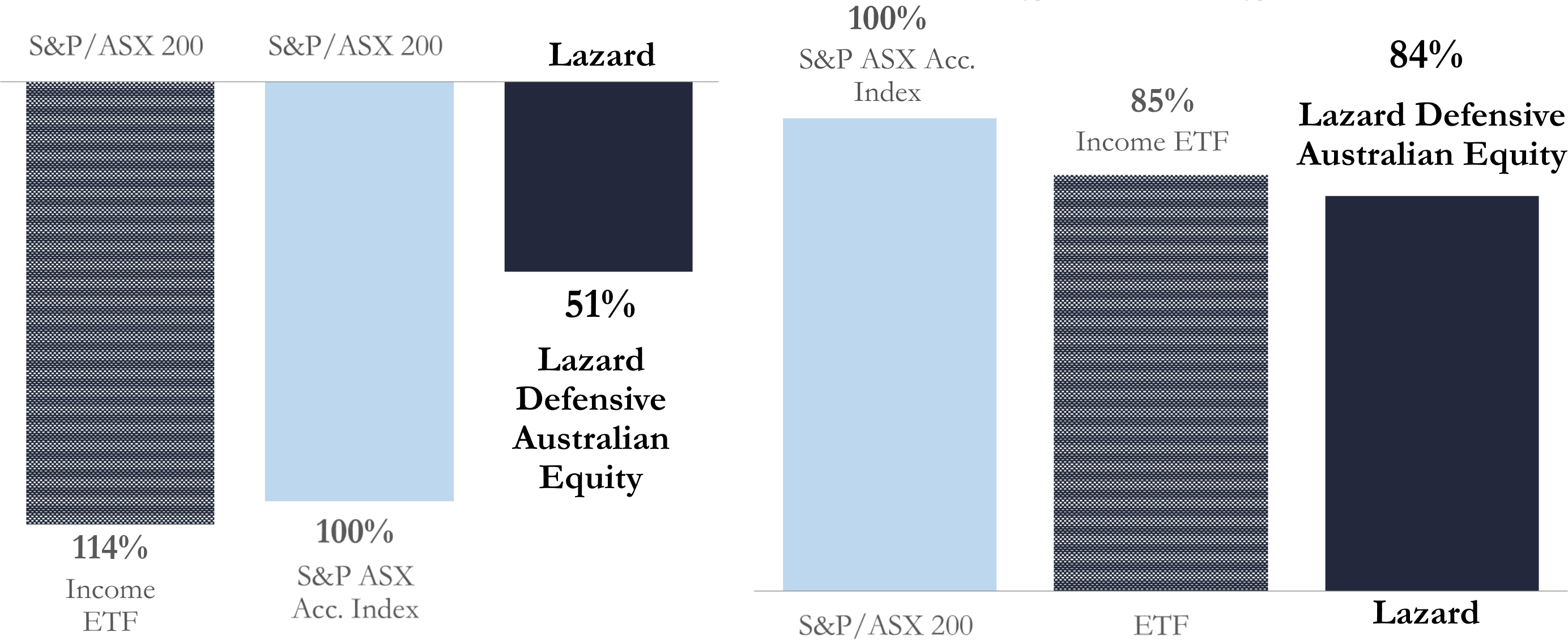
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Source: Factset, Lazard Asset Management Pacific Co.

Portfolio Insights

Historical Performance in Different Markets

Downside Capture

Upside Capture

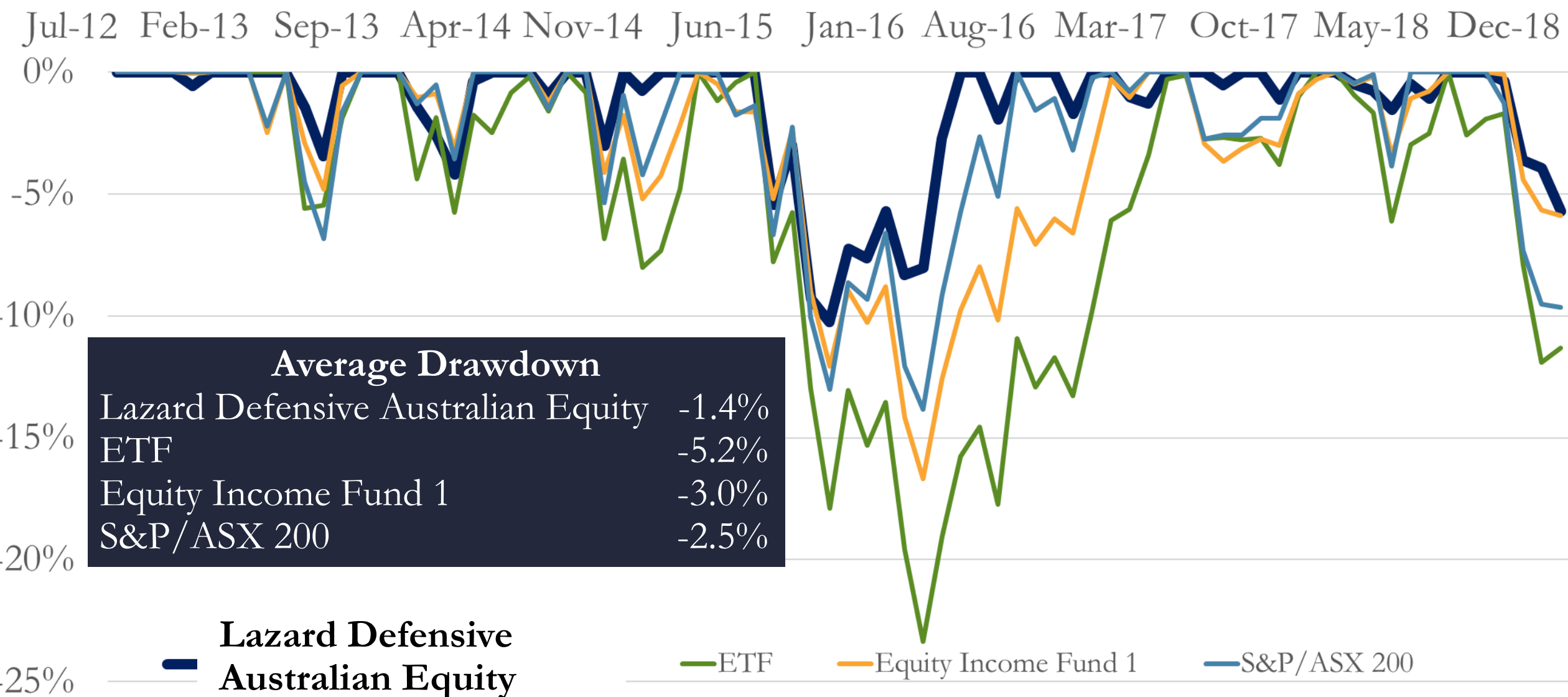


As of 31 December 2018. Upside Downside Capture for the period of August 2012 to December 2018. This information is for illustrative purposes only. Historical Drawdown is calculated since inception and based on performance gross of all fees. Drawdown capture is a statistical measure of an investment manager's overall average performance in down markets, being calendar months where the S&P/ASX 200 Accumulation Index ("Index") experiences negative performance. A drawdown ratio (or percentage) of less than 100 (or 100%) reflects that the manager has outperformed the Index during such down markets. Source: Lazard, Factset.

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Lazard Defensive Australian Equity Fund

Cumulative Drawdown Since Inception



As of 31 December 2018.

Chart shows cumulative drawdown calculated from the first full month of performance, which is August 2012. Competitors have been defined by Lazard. Performance is calculated gross of fees. Past performance may not be indicative of future results. Historical Drawdown is calculated since inception and based on performance gross of all fees. Drawdown capture is a statistical measure of an investment manager's overall average performance in down markets, being calendar months where the S&P/ASX 200 Accumulation Index ("Index") experiences negative performance. A drawdown ratio (or percentage) of less than 100 (or 100%) reflects that the manager has outperformed the Index during such down markets

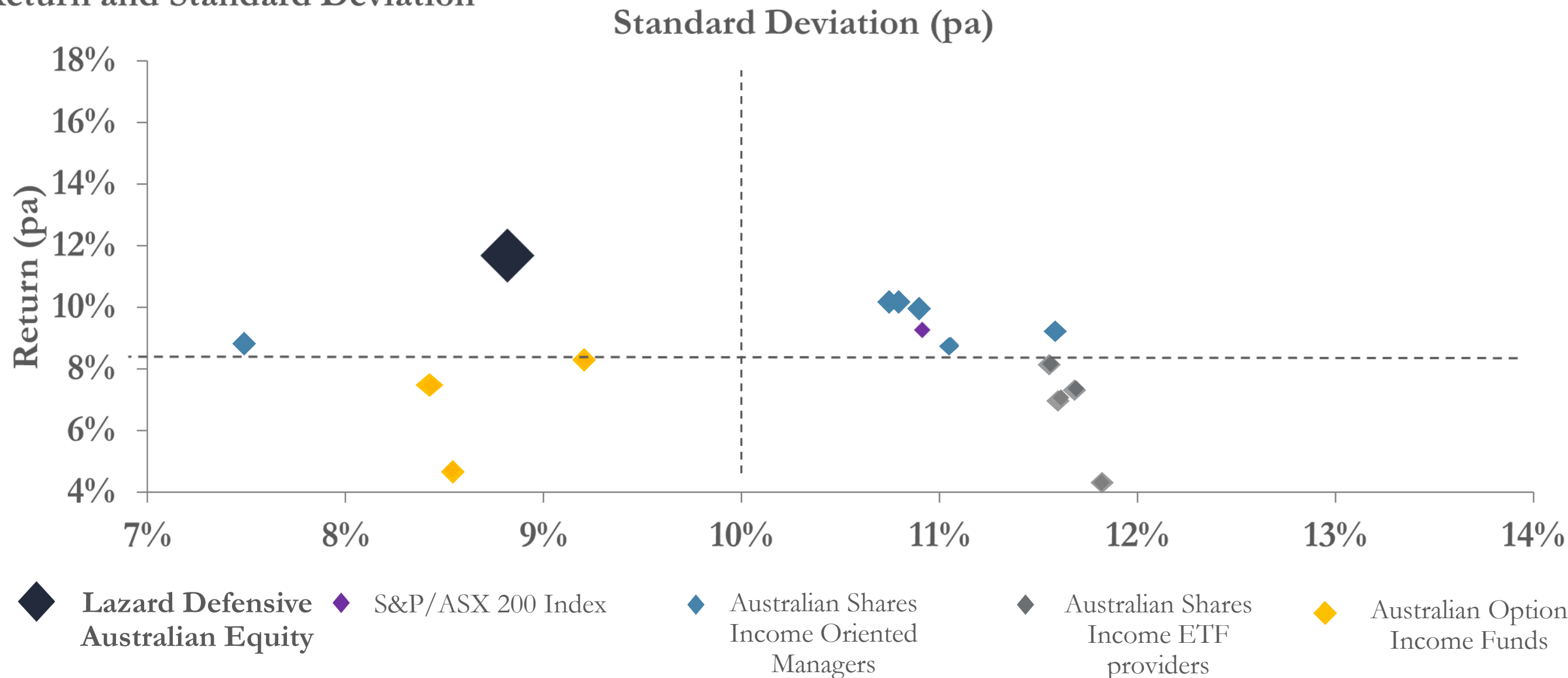
Source: Lazard Asset Management Pacific Co., Morningstar.

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Lazard Defensive Australian Equity Fund

Peer Comparison

Return and Standard Deviation



Source: MercerInsight MPA, Morningstar, Factset, Lazard Asset Management Pacific Co
Return and Standard Deviation in \$A (before fees) over 6 years 3 months ending 31 December 2018 (monthly calculations)
Australian Shares Income Managers sourced from MercerInsightMPA Australian Shares (Income-oriented) universe and Income ETF data sourced from Factset
The performance quoted represents past performance. Past performance is not a reliable indicator of future results Australian Option Income Funds sourced from Morningstar

Performance Summary

Lazard Defensive Australian Equity Fund

Total Return – as at 31 December 2018

	3 Months (%)	1 Year pa (%)	3 Year pa (%)	5 Year pa (%)	Since Inception pa (%) ^
Capital Gains	-6.4	-7.9	1.8	2.5	6.4
Total Return (gross of fees& franking)	-5.0	-2.3	8.5	9.1	13.5
S&P/ASX 200 Accumulation Index (gross of franking)	-8.0	-1.4	8.2	7.2	11.3
Excess	+3.0	-0.9	+0.2	+1.9	+2.2

Performance is calculated gross of fees. Past performance may not be indicative of future results. Unless otherwise stated, Fund performance is gross of fees and assumes reinvestment of all distributions. Income return is calculated on an accruals basis rather than a cash receipts basis. ^ Since Inception is as of 3 July 2012. Monthly franking return represents the yield from franking credits accrued over the month (calculated as a percentage of the Fund balance). Franking returns for periods greater than one month are calculated as the sum of the monthly franking returns. Total return for any period is calculated as the sum of the income return, the franking return and the capital gains. The index is unmanaged and has no fees. One cannot invest directly in an index. Source: Lazard Asset Management Pacific Co., FactSet, ASX.

Lazard Defensive Australian Equity

Independently Rated By:



“... the Fund is considered most appropriate for investors seeking income generation from an equity exposure with a relatively low tolerance for risk”. Zenith

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**Think independently,
focus on valuation,
take the long term
view and act with
conviction.**