EPOCH GLOBAL EQUITY SHAREHOLDER YIELD FUNDS: QUARTERLY FUND UPDATE

EPOCH

30 September 2020

Performance

Unhedged

	1 month %	3 months %	1 year %	3 years % pa	5 years % pa	7 years % pa	10 years % pa	Since inception[1] % pa
Distribution[2]	0.50	0.50	4.28	7.39	7.14	7.65	6.54	5.46
Growth	0.11	(0.07)	(16.51)	(5.01)	(3.84)	(0.36)	2.76	0.80
Total Return[3]	0.61	0.43	(12.23)	2.38	3.30	7.29	9.30	6.26
Benchmark[4]	(0.31)	3.78	4.30	11.21	10.10	12.74	12.90	8.06

Hedged

	1 month %	3 months %	1 year %	3 years % pa	5 years % pa	7 years % pa	10 years % pa	Since inception[1] % pa
Distribution[2]	0.14	0.14	2.30	3.41	7.25	8.50	8.90	9.12
Growth	(1.82)	2.79	(12.97)	(3.93)	(3.12)	(3.15)	(0.47)	(2.87)
Total Return[3]	(1.68)	2.93	(10.67)	(0.52)	4.13	5.35	8.43	6.25
Benchmark[5]	(2.94)	6.42	6.38	6.97	10.36	10.11	11.70	7.59

1. Inception date: 15 May 2008
2. Distribution may include income, realised capital gains, and any return of capital
3. Fund returns are calculated net of management fees and assume distributions are reinvested
4. MSCI World ex- Australia Index in $A, net dividends reinvested*
5. MSCI World ex- Australia Index, Net dividends reinvested, 100% hedged into $A*

Past performance is not a guide to future performance

Fund facts

Sector allocation	Fund%	Index%[1]
Communication Services	7.8	9.0
Consumer Discretionary	6.4	11.9
Consumer Staples	12.2	8.3
Energy	3.7	2.5
Financials	12.1	11.5
Health Care	14.8	13.7
Industrials	8.2	10.4
Information Technology	14.5	22.3
Materials	3.3	4.1
Real Estate	2.5	2.7
Utilities	11.3	3.3
Cash	3.1	--
Unassigned	--	0.4
TOTAL[2]	**100.0**	**100.0**

1. MSCI World Ex-Australia Index in $A*
2. May not total 100 due to rounding

The data presented in these tables and graphs is unaudited and may change at any time. The data is shown for informational purposes only and is not indicative of any future portfolio characteristics.

Regional allocation	Fund%	Index%[1]
US and Canada	62.9	71.0
United Kingdom	6.7	4.1
Europe ex-UK	21.0	15.2
Asia ex-Japan	3.6	1.4
Japan	2.3	8.0
Australia and New Zealand	0.5	0.1
Other	--	0.2
Cash	3.1	--
Total[2]	**100.0**	**100.0**

Top 10 holdings	Sector	Dividend yield%
Microsoft Corporation	Information Technology	1.0
Verizon Communications	Communication Services	4.1
Taiwan Semiconductor	Information Technology	1.6
KLA Corporation	Information Technology	1.8
Takeda Pharmaceutical	Health Care	4.8
Unilever PLC	Consumer Staples	3.0
Snam S.p.A.	Utilities	5.4
AbbVie, Inc.	Health Care	5.3
Allianz SE	Financials	5.9
AT&T Inc.	Communication Services	7.3

In the Hedged Fund, the foreign currency exposure of the Fund is substantially hedged back into Australian dollars using foreign exchange contracts. While hedging activities undertaken in the Hedged Fund may protect investors from depreciations in the currencies in which the Fund invests (relative to the Australian dollar), they may also limit the benefit investors may receive, should those currencies appreciate in value relative to the Australian dollar.

The Hedged Fund gains exposure to global equity markets by investing its assets in the Unhedged Fund. References to the Fund in this Quarterly Update are to the underlying Unhedged Fund.

Market Review

Stocks had a strong quarter as the economy began to recover from the coronavirus lockdown, with workers trickling back to factories and offices. Global trade also rebounded. Ongoing support from central banks, resilient corporate earnings and optimism on progress toward a COVID-19 vaccine also helped lift equities. In July and August, markets were led by a handful of U.S. mega-cap stocks in the information technology, consumer discretionary and communication services sectors. Stocks cooled off in September as an additional coronavirus relief package in the U.S. remained bogged down in congressional gridlock. In Europe, a rise in new coronavirus infections heightened already growing worries over the economic outlook. Nevertheless, stocks ended the period with solid gains.

Among developed markets the best results came from the Nordic region. The consumer discretionary sector had the best returns by far while the energy sector saw severe negative returns, falling sharply as demand remained subdued. The U.S. dollar weakened against other major currencies after the Federal Reserve announced a new inflation-targeting strategy, where it will tolerate periods of inflation above that target to compensate for spells when it undershoots that target. Many investors interpreted this as a promise to hold rates low indefinitely.

The U.S. economy appeared to be reviving from its unprecedented 31.4% rate of decline in the second quarter. U.S. home sales surged, helped by low mortgage rates. PMI data moved from contraction to expansion. Initial jobless claims, however, remained elevated. In Europe, optimism about a fast recovery dimmed as the quarter progressed, with growing concern over the potential for the economy to stall. PMI data for the euro zone appeared to recover for manufacturing, but services rose and then slipped back into contraction. PMI data for Japan improved but failed to cross into expansionary territory. Japan's longest serving prime minister, Shinzo Abe, announced he would step down for health reasons, stoking fears of a return to "revolving door" politics. While his aggressive economic policies did not achieve his goal for inflation, growth and employment both improved under his watch.

Portfolio Review

The portfolio generated a positive absolute return of 0.7% in the third quarter. We remain committed to maintaining a portfolio of high-quality companies that are well-positioned to deliver their shareholder yield characteristics during these volatile markets. We are happy with the positive return but acknowledge that the strategy may lag during strong market rallies.

From an absolute standpoint, strong returns for portfolio holdings in industrials and consumer discretionary led to some of the largest contributions on the sector level. Information technology was another top contributor. Energy was the largest detractor as demand remained subdued. By country, the U.S. followed by Taiwan contributed whereas France detracted.

The portfolio underperformed the broader market, participating in the rally during the beginning of the quarter and providing downside protection in September as markets reversed course. Information technology was one of the main detractors during the quarter, driven by stock selection and an underweight, as growth stocks continued to dominate the market up until September. An overweight to utilities and stock selection in the sector also weighed on results, as did stock selection in health care and communication services as pharmaceuticals and telecommunications companies were pressured. On the positive side, stock selection in industrials was the strongest contributor to relative performance, as the outlook for a recovery started to improve. On a country basis, the U.S. was the largest detractor, followed by France, while an overweight to Taiwan modestly contributed due to a semiconductor holding in the country that had strong returns.

Among the largest individual positive contributors to absolute performance were United Parcel Service (UPS) & Apple. UPS is the world's largest package delivery company. The company also provides supply chain and logistics services, freight forwarding and truck freight transportation services. Shares traded higher on a surge in international demand as economies reduced Coronavirus-related restrictions and held up well during the height of the stay at home orders. The growth of direct business-to-customer deliveries supported strong profit growth internationally with management also matching cost increases to its shifting business mix. The company pays an attractive, growing dividend and regularly repurchases shares. Apple outperformed on strong underlying demand both on its service and accessories side as well as return of iPhone sales growth. Customers have shown strong adoption of its current handset line-up despite anticipation of a 5G variant later this year. Additionally, service adoption has expanded to provide a strong growth driver regardless of iPhone demand. Apple returns cash to shareholders through dividends and share repurchases.

Among the largest individual detractors were FirstEnergy and Cisco Systems. FirstEnergy is a U.S. utility holding company that serves customers in the states of Ohio, Pennsylvania, New Jersey, West Virginia and Maryland. It generates most of its earnings and cash flows from regulated utility operations that are involved in the generation, transmission and distribution of electricity. Shares declined as the company received subpoenas in connection with the investigation surrounding Ohio House Bill 6 and the arrest of several politicians and lobbyists on bribery charges. FirstEnergy is cooperating with the investigation. The company remains focused on delivering rate base growth through investment in projects such as transmission reliability and grid modernization. FirstEnergy returns cash to shareholders with an attractive and growing dividend. Cisco is the world's largest supplier of routers and switches. Shares underperformed on second quarter earnings, although the quarter's results were above expectations, forward guidance was lighter than expected. Demand for networking products from Enterprise customers remains weak given the current remote work being performed in many industries. This demand should return as companies' campuses reopen and workers return. The company has a policy of returning in excess of 50% of cash generation through a progressive dividend and share repurchases.

A few positions were initiated during the period, including Bayer and T. Rowe Price. Bayer is a global life science company based in Germany with market leading crop science, pharmaceuticals, and consumer health care businesses. Cash flows are sustained by relatively inelastic demand for Bayer's essential products in highly regulated health and nutrition markets with high barriers to entry. Cash flow growth drivers include a growing and aging global population that will require more food and medical care, innovation-led opportunities to grow share, and margin expansion from synergy and efficiency programs. Bayer returns cash to shareholders through an attractive dividend and debt repayment. T. Rowe Price (TROW) is a global asset manager overseeing ~$1.2T in assets under management (AUM). The company generates strong, recurring cash flows from management fees on the average AUM levels during each year. TROW is an exclusively active manager, with consistent alpha generation that has led to strong relative performance against peers and benchmarks. Cash flow growth is driven by organic growth (net flows) and market appreciation. Over half of TROW assets are held in the defined contribution channel (401ks), which creates a stickier asset base and therefore more recurring and sustainable cash flows. The company has a capital light business model that generates strong FCF and results in an operating margin of >40%. The company pays an attractive, growing dividend, regularly repurchases shares and has no debt on its balance sheet.

A few positions were closed during the period, including People's United Financial and PPL Corporation. People's United is a regional bank operating in the U.S. Northeast, providing retail and business lending and deposit services, trust, wealth management, insurance, and securities brokerage services. Shares underperformed regional U.S. bank peers in the beginning of the quarter despite reporting in-line earnings, reflecting management's downbeat commentary on the near-term outlook. The company's predominately spread based revenue mix in a low interest rate environment and concentrated U.S. Northeast client exposure raised concerns about future cash flow growth sustainability. As a result, we decided to exit the position in July in favor of other opportunities. PPL Corporation is a global utility company that provides power generation, electricity transmission, and electricity distribution services to customers in the U.S. and U.K. The company's U.K. business is facing a challenging regulatory review in the upcoming years, which is likely to lead to lower growth going forward. We exited the position to fund better opportunities.

Outlook

The macro outlook continues to improve, although the pace of recovery has slowed during the last few months. Since March we've expected the economic recovery to trace out the Nike swoosh. However, no single letter or shape fully encapsulates the complex recovery taking place. While a few sectors are experiencing a "V" (e.g., housing), the Fed worries that some industries face an "L" (e.g., commercial real estate). Moreover, we believe "K" in many ways has become an apt metaphor for this cycle, with college-educated workers in digital industries thriving, while less-educated workers in some services sectors still struggling.

Overall, we expect a 90% economy to emerge, with an exceptionally long road back to normal. The COVID-recession has hit the service sector particularly hard, and we believe consumers and employees will only gradually return to malls, restaurants, cinemas, offices, and airports. This is particularly true for work and other activities where public transit is required. Further, even a month after Labour Day, there remains much debate and uncertainty regarding schools and universities.

Further, the COVID shock has acted as an accelerant for several long-standing trends. One is lower for even longer interest rates and a world of yield starvation. The Fed has made it clear that they are "not even thinking about thinking" about hiking rates. The COVID-19 shock has also acted as an accelerant for technology and the digitisation/virtualisation of the economy. This is being reflected in the shift to working-from-home, EdTech, e-fitness, telehealth, e-Commerce, and so on.

Regarding the U.S. presidential election on November 3, market volatility typically rises ahead of elections, and this year is proving to be no exception. During periods of rising volatility, high-quality companies with strong earnings visibility and sustainable free cash flow, typically outperform.

Given this challenging backdrop, the consensus expects MSCI World EPS to decline by 19% this year, and then to rise by 30% in 2021 and 16% in 2022. Valuations imbed aggressive earnings growth expectations, and lower for longer interest rates, leaving little room for error. This is especially important as we begin Q3 earnings season. Last quarter the vast majority of companies announced above consensus, but most also emphasized the elevated level of uncertainty, a perspective that was reflected in the relative lack of guidance for the remainder of the year and into 2021.

Finally, it is especially crucial in this environment to identify companies that have sustainable cash flows and are focused on maintaining their dividends. Moreover, the yield from equities is likely to be far superior to that attainable in fixed income markets. As a result of the above points, we believe the best-positioned companies are those that have a demonstrated ability to produce sustainable FCF and allocate that cash flow effectively between return of capital options and reinvestment/acquisition opportunities.

Distributions

The Fund aims to pay distributions on a quarterly basis. A distribution of 0.555825 CPU for the Unhedged Fund and 0.100000 for the Hedged Fund will be paid for the quarter ended 30 September 2020.

Fund disclosure

The Fund has certain regular reporting and continuous disclosure obligations pursuant to the Corporations Act. All continuous disclosure notices are available at gsfm.com.au

See **gsfm.com.au** for more information about the Epoch Global Equity Shareholder Yield Funds.