2024 Annual General Meeting

Managing Director's Address

Delivered by Mr. Jason Beddow at the 78th Annual General Meeting of Argo Investments Limited (Argo or Company) held at the Adelaide Convention Centre on Monday 21 October 2024 at 10.00am (Adelaide time).

Market review

For most of this year, investment markets globally have been fixated on when the US Federal Reserve would begin cutting interest rates. After much anticipation, the central bank started its easing cycle last month with a larger-than-expected 50 basis point cut. In doing so, it alleviated concerns, at least for the moment, of a hard landing for the world's largest economy.

Announcing the decision, US Federal Reserve Chairman, Jerome Powell, was upbeat in his outlook commentary and in his assessment of the labour market. In response, global markets have become even more positive. US markets hit a record high last week for the 46th time this year.

Following the strong lead from the US, Australian equities have also advanced and are currently trading around all-time highs. The local market hit an all-time high of 8,384 points on 17 October.

However, the record-breaking rallies have masked some of the volatile market moves. For instance, in the first week of August, the S&P/ASX 200 Index fell more than 5% as US recession fears rose and the Japanese Yen carry trade unwound, sparking a global market sell-off. On 5 August 2024, the Australian share market fell 3.7%, marking its largest single-day decline since May 2020. However, positive sentiment soon returned and Australian shares rallied to end the month up.

Domestically, rate cuts seem some way off, as inflation remains elevated, and the jobs market continues to be strong. However, inflation is showing signs of easing and discussion of further rate hikes was notably absent from the latest Reserve Bank of Australia meeting. This was a marked change from the central bank's prior commentary.

Commodity prices have been weak amid ongoing concerns about China's economy. However, in the last week of September, Chinese financial regulators announced a series of stimulatory monetary policy initiatives including, interest rate cuts, housing finance initiatives and support for the stock market. Optimism that these measures will boost the flailing Chinese economy has triggered a rotation into resources stocks, at least temporarily. However, the scale and effect of this stimulus remains unclear, as China's economy continues to face many structural issues.

Over the financial year to 30 June 2024, Australia's share market performed strongly despite a mixed global economic outlook, to deliver an above-average return of +12.1%. Technology stocks were again the stellar performers, as the sector surged more than 26% after gaining 30% in the previous financial year. Only Financials, led by the banks, performed better, gaining 29%. In contrast, Telecommunications and Utilities were soft, both declining.

In the current financial year to date, Technology continues to rally, up over 15%. Following the US Fed rate cut, property stocks have also rallied, gaining around 15%. Despite escalating events in the Middle East, oil prices remain under pressure and Energy is the worst performing sector, down 6%. Utilities and Health Care also continue to struggle.

Investment portfolio

Argo diversifies its portfolio to maintain balanced performance over long-term periods and to deliver shareholders a relatively smooth dividend profile through market cycles.

With this in mind, our recent acquisitions have focused on companies with strong and growing cashflows, that are predominantly paying fully franked dividends. These have mainly been among existing holdings, although we did recently add two new stocks to the portfolio, professional services consultancy Worley and a small initial stake in Imricor Medical Systems.

We exited two takeover targets: QANTM Intellectual Property for cash and Alumina after its takeover bid by Alcoa. We also sold down a small parcel of Commonwealth Bank shares after its share price reached a record high. We used the proceeds to buy National Australia Bank and Westpac Banking Group shares, which will soon report their results.

August company results reporting season

The recent company reporting season was positive for Argo, particularly from a dividend perspective. However, brokers had a more varied interpretation of company results. In aggregate, 38% of companies failed to meet consensus expectations, referred to as 'misses', while 32% exceeded or "beat" expectations. The ratio of beats to misses was 0.8, which is well below the long-term average ratio of 1.4.

Earnings misses were more common across Health Care, Energy and Resources firms where higher costs continue to impact earnings.

Much like recent reporting seasons, companies experienced considerable share price volatility on the day of their result, with 35% of stocks moving up or down by more than 5%. It seems there is little interest in turnaround stories and limited investor patience for underperforming companies. Earnings and share price momentum still appear to be strong indicators of future performance.

Dividends paid by a number of companies in our portfolio were above our forecasts. Notably, QBE Insurance, Lendlease, EVT, IGO, Santos and Woodside Energy declared better-than-expected dividends. Woolworths and AUI declared special dividends.

Corporate balance sheets are generally strong, partly due to lower-than-expected capital expenses. Ten companies announced buybacks with their results, totalling $2.8 billion. In our portfolio these included Aurizon Holdings and Brambles. Total ongoing buybacks outstanding in the market now exceed $10 billion.

Costs remain sticky, particularly wages, resulting in margin declines. Interest charges and depreciation forecasts for some companies were revised higher, with the largest increases among the REIT and Industrials sectors.

Despite high interest rates and cost-of-living pressures, consumers have been largely resilient with retail spending continuing to hold up and, in several instances, expected to improve, although this trend varies across age cohorts.

Demand for hospital services remains soft and some supermarket spending is being impacted with evidence of consumers trading down and searching for products representing better value.

Numerous company executives raised concerns about the prevailing regulatory and political environment due to government intervention in various sectors, such as supermarkets and the energy market. Project approvals continue to be delayed by increased bureaucratic red tape and more onerous environmental requirements.

Amid all the hype around artificial intelligence (AI), a number of companies gave less exciting but practical examples of using this technology. For instance, to reduce inefficient manual processes, optimise logistics networks and improve their understanding of customer behaviour. We believe AI will create opportunities to reduce costs over time.

Outlook commentary remained cautious overall, with little forward guidance provided for the coming year.

Forecast dividend yield

Excluding the post-COVID dip, the Australian share market's dividend yield is at a low not seen for a considerable time. The forecast cash yield for the S&P/ASX 200 Index for financial year 2025 is just 3.5%, and the average level of franking is expected to fall to just above 70%.

A company's dividend yield is a function of its dividend and share price. While most companies are expected to maintain, or even slightly increase their cash dividend, their share prices continue to climb, which leads to shrinking yields. On a sector basis, with the exception of Utilities and Energy, most sectors are forecast to provide dividend yields below their historical averages.

Outlook

The key area of focus for investors remains interest rate movements. With the commencement of rate cuts in the US, current expectations are for an extended interest rate easing cycle. Assuming the US economy has a soft landing, markets are reacting positively, and equities continue to reach record highs.

There is increasing focus on the upcoming US Presidential election. With two weeks until election day, the outcome is difficult to predict as polling remains extremely close. Depending on which candidate wins and the composition of the Congress, there are potentially significant geopolitical and economic implications. Chief among them for Australia, are the trade impacts of Trump's proposed punitive tariffs on China. Regardless of which candidate wins, the market will likely welcome some stability following a highly disruptive election process.

In addition to focusing on dividends we are searching for relative value in the market. This is a challenge as most of the upward movement in the market is not supported by material earnings growth. This is further exacerbated by the continued ‘de-equitisation’ of the Australian share market. This dynamic undermines traditional valuation methods with increasing compulsory superannuation inflows inflating prices in a shrinking share market.

The domestic banks' recent performance has been phenomenal, resulting in record valuations. A number of the banks will report their full-year results beginning next week and we expect continued strong earnings results with the potential for further capital management.

One factor driving the bank’s outperformance has been the lack of investor interest in resources stocks due to a weak and uncertain China outlook. However, the recent stimulus announcements in China may see some shift into resources, which would likely be funded from the banks.

With no debt, cash available and a diversified portfolio, we believe Argo is well-positioned to navigate the evolving economic cycle, applying our conservative, long-term investment approach.

Thank you

I would like to acknowledge the efforts of all Argo staff. Our small team continues to be fully committed to the Company’s success across both our Adelaide and Sydney offices.

I would particularly like to thank Andrew Hill for his contribution to Argo for more than three decades and wish him well in his retirement. I would also like to congratulate Stephen Mortimer on his appointment as Chief Financial Officer.

I also acknowledge the contribution by the Chairman and Non-executive Directors, and I look forward to working with them as we best navigate Argo through this next period for you, our shareholders.

I wish all our shareholders well for the remainder of the year. We thank you for your continued support and I look forward to seeing you for our roadshow in 2025.