Equity Fund

Harbour Australasian Equity Focus Fund

31 AUGUST 2023

1 month performance	1 year performance	Fund size	Performance since inception
-1.66%	**1.33%**	**$87,691,683**	**11.62%**
Before fees & tax	Before fees & tax	NZD	Annualised, before fees & tax. Inception 10/4/2014

Fund performance was negative but ahead of its benchmark over the month. The New Zealand share market delivered one of its weakest monthly returns in recent history reflecting the negative impact of higher long term government bond yields on valuations, conservative guidance and forecast earnings downgrades from companies through the profit reporting season for the June period, negative global share index weight changes for several New Zealand shares, block sell down overhangs (Auckland Airport) and increased uncertainty around Government policy change with political parties announcements in advance of the general election. The Australian share market also fell as consensus earnings forecasts were cut post a profit reporting season that saw cautious guidance from companies.

Portfolio performance was enhanced by positive returns from investments in secular growth companies including Goodman Group (positive guidance), Xero (positive annual shareholder meeting update), CSL (result better than cautious expectations), Infratil (positive annual shareholder meeting update) and Macquarie Group (energy market volatility) Portfolio performance was impacted by negative returns from investments in Volpara (higher bond yields), Vista Group (cautious profit guidance), Auckland Airport (ok result, overhang of Auckland City Council sell down), Pacific Edge (pending global index weight reduction) and Mainfreight (soft economic data).

Performance	1 MONTH	3 MONTH	1 YEAR P.A.	2 YEAR P.A.	3 YEAR P.A.	5 YEAR P.A.	10 YEAR P.A.	SINCE INCEPTION P.A.
Return before fees & tax, inc. IC	-1.66%	0.62%	1.33%	-6.38%	4.02%	6.02%	-	11.62%
Benchmark return, inc. IC	-2.30%	1.16%	4.62%	-0.59%	5.32%	6.40%	-	9.21%

Inception: 10 April 2014. IC= imputation credits. Benchmark: 50% S&P/NZX 50 Index & 50% S&P/ASX 200 Index (50% hedged to NZD). Past performance is not indicative of future results.

Key market movements	1 MONTH	3 MONTH	1 YEAR P.A.	3 YEAR P.A.	5 YEAR P.A.	10 YEAR P.A.
S&P/NZX 50 Gross Index with Imputation (NZD)	-4.16%	-2.10%	0.43%	-0.37%	5.22%	10.92%
S&P/ASX Total Return 200 Index (NZD)	-0.28%	4.68%	6.57%	10.46%	7.04%	7.36%
S&P/ASX Total Return 200 Index (AUD)	-0.73%	3.92%	9.56%	10.68%	7.01%	7.97%

Source: S&P/NZX, Bloomberg.

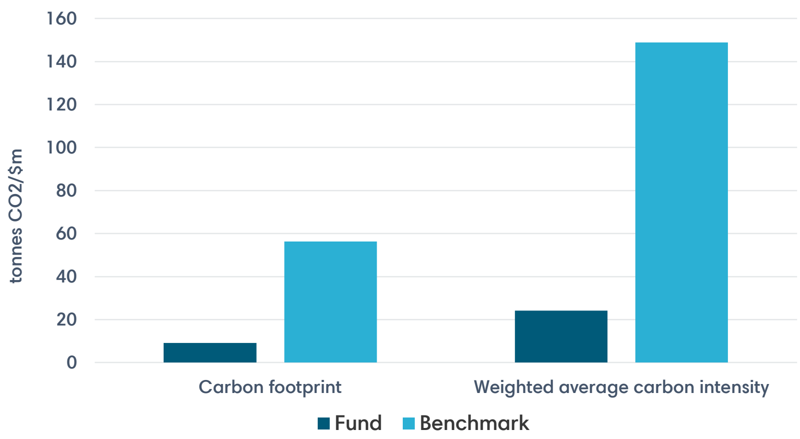
Fund characteristics

	FUND
Return on equity	11.59%
PE ratio forward 12 months	24.0x
Gross yield	2.13%
Expected volatility	14.84%
Hedge on AUD exposure	12.43%

Top 10 holdings

	POSITION
Summerset Group	8.41%
Infratil	8.07%
Mainfreight	7.19%
Xero	6.62%
CSL	6.41%
Goodman Group	6.07%
Macquarie Group	4.67%
Ryman Healthcare	4.58%
IDP Education	4.31%
Auckland International Airport	4.28%

Carbon statistics



Carbon Footprint tonnes CO2e emissions per million NZD invested.
Weighted Average Carbon Intensity tonnes CO2e emissions per million NZD revenue.

Metrics are calculated according to the methodology of the Task Force on Climate-Related Financial Disclosures (TCFD) Implementation Guide. Data is the latest available and represents the portion of the fund invested into public equities. Additional information on screening thresholds and processes are outlined in the exclusions section of our ESG Policy
Carbon data source: Harbour Asset Management, ISS ESG, Bloomberg, underlying fund managers

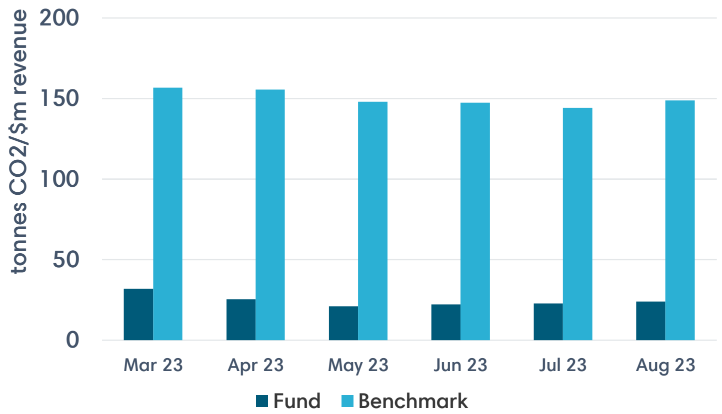
Note: The carbon statistics presented have been adjusted for the extraordinary circumstance of the Channel Infrastructure holding based on data from its latest sustainability report which includes the decommissioning of its refinery operations.

ESG metrics summary

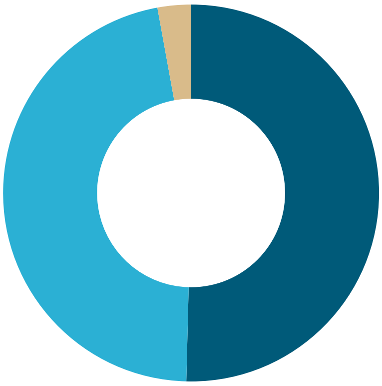
	FUND
Gender diversity (workforce >40% female representation)	44%
Modern Slavery Statement	58%
TCFD Reporting	41%
Majority Independent Board	72%
Science Based Target	13%

Source: Bloomberg, Harbour Asset Management

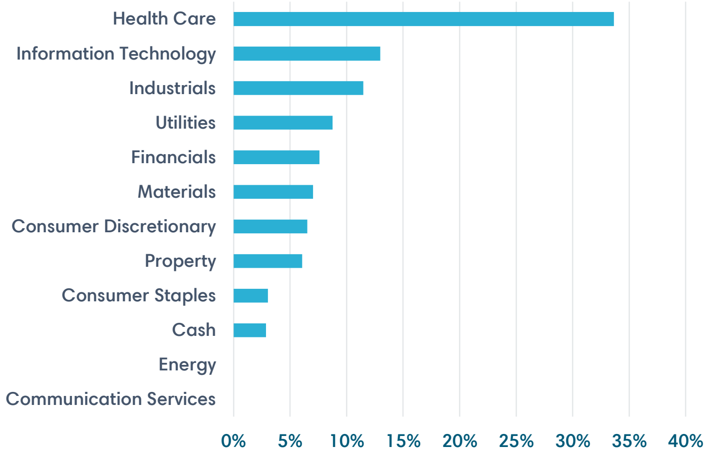
Weighted average carbon intensity



Investment mix



Sector weights



Source: MSCI

Largest contributors	AVE. POSITION	TOTAL CONTRIB.	STOCK RETURN
Goodman Group	5.56%	0.81	14.17%
Xero	6.40%	0.20	2.89%
CSL	6.49%	0.15	2.32%
Infratil	7.82%	0.11	1.41%
Macquarie Group	4.68%	0.09	1.92%

Largest detractors	AVE. POSITION	TOTAL CONTRIB.	STOCK RETURN
Volpara Health Technologies	3.35%	-0.47	-13.23%
Vista Group International	2.39%	-0.39	-15.30%
Auckland International Airport	4.20%	-0.30	-6.97%
Pacific Edge	1.32%	-0.30	-21.20%
Mainfreight	7.56%	-0.26	-3.39%

Outlook and strategy

New Zealand and Australian share market returns over the month were dominated by profit results, earnings downgrades and a sharp move up in long term US and New Zealand Government bond yields (US 10 year bonds up +0.15% to 4.11% and NZ 10 year bonds up +0.19% to 4.87%) which increased the return hurdle required by investors and dragged on returns for defensive shares (including electricity utilities Mercury and Meridian) and pre-profitability growth shares (including Volpara Health). While actual profit results for the June period were generally ahead of conservative expectations, weak earnings guidance from company management contributed to a higher-than-normal number earnings forecast downgrades relative to upgrades. There was significant dispersion between individual share returns over the month - this was a market environment where being selective enhanced portfolio performance.

New Zealand share market weakness was widespread with only eight shares in the S&P/NZX50 Index generating positive returns over the month. At a sector level the consumer discretionary (led by Sky City which benefited from potential online gambling tax changes), utilities (driven by Contact Energy which delivered a strong result) and communications (ok result from Spark) sectors outperformed the broad market. The consumer staples (weak guidance from a2 milk), real estate (potential removal of depreciation tax shield) and information technology (cautious movie release outlook comments from Vista Group) sectors underperformed.

New Zealand share market earnings forecasts were cut post the reporting season for the June period reflecting higher operating costs including labour, insurance, rates, rent, energy, transport and technology spend and higher interest costs. Company management were conservative in their outlook statements, best summarised by one Chief Executive Officer describing current conditions as being a "crucible of unknowns". Dividend forecasts were cut more than expected (or rather not increased as much as expected), with cautious management teams perhaps aware of a higher return hurdle in the wake of higher interest rates and potential for a further slowdown in economic activity.

At an individual company level profit outlooks from Fletcher Building, a2 milk, Chorus and Genesis were disappointing relative to consensus market expectations. Fletcher Building continues to be impacted by legacy issues (NZ Convention Centre fire, silicosis risk and now iplex plastic piping failure concerns) and faces a slow residential demand environment in New Zealand. Fletcher Building, Chorus and Genesis all provided lower than expected dividend guidance reflecting lower profit expectations which contributed to share price weakness. While performing well versus its competitors, a2 Milk provided very cautious outlook statement with no signs of a lift in the Chinese birth rate required to see demand for its infant formula stabilise let alone increase. The portfolios' investment in a2 was trimmed during the month reflecting the soft near-term outlook. Profit forecasts for Fisher & Paykel Healthcare were reduced after conservative statements at its Annual Shareholder Meeting saw profit margin expectations cut on higher operating expenditure costs.

In contrast **Contact Energy** (strong profit result, with geothermal investment boosting returns), **Summerset** (strong demand and development margins) and Tourism Holdings (better profit margins, strong demand) reported solid results that contributed to outperformance. **Infratil** provided a positive update at its

Annual Shareholder Meeting, with attractive opportunities to increase investment in its renewable energy and digital infrastructure businesses (including data centres). The portfolio increased investment in Infratil, Contact and Summerset with all three businesses benefitting from secular growth trends (growth in digital infrastructure, sustainable energy transition and aging demographics) which may continue to support shareholder returns for some time.

Changes to global share market benchmark index weights also impacted on the New Zealand markets performance. Genesis Energy was removed from a global index in late August with the fall in the Genesis share price influencing returns for the wider electricity generator/retailer sector as investors rebalanced over the month in advance of its removal. **Pacific Edge** is set to be removed from a global share index in mid-September and its share price fell during the month to reflect this risk. During the month key opinion leaders in the US Urology sector spoke publicly in favour of the US Medicare/Medicaid organisation reconsidering insurance coverage of Pacific Edge's products given its high clinical efficacy.

Potential for the current New Zealand Labour Government and the New Zealand National party to remove the current tax depreciation shield on improvements/structures for commercial property hit returns for New Zealand real investment trusts and property heavy companies hard over the month. Removal of the ability to claim depreciation on improvements reduces forecast earnings forecast for New Zealand property shares by approximately 5% on average, with higher improvement real estate owners hit harder. The share market priced in a large proportion of the potential reduction in earnings during the month with the New Zealand real estate sector down -6.4%.

The potential for the Auckland City Council to reduce its investment in **Auckland Airport** post the Auckland Airport profit result weighed on returns for the Auckland Airport share price and the New Zealand share market as investors held cash back or sold down other investments to participate in the potential sell-down. Early in September the Auckland City Council sold 2.5% of Auckland Airport to strategic investors at an average of $8.12 per share and sold another 4.5% at $8.10 per share, removing the sell down risk. The portfolio increased its exposure in the sell down as Auckland Airport offers a reasonable risk adjusted investment providing exposure to the robust recovery in travel and upside from Auckland Airports' extensive investment programme.

The Australian share market was dragged lower by weakness in the Utilities, Consumer Staples and information technology sectors. Consumer Discretionary, Real Estate Investment Trusts/Property and Healthcare were the best performing Australian share market sectors over the month. Australian companies posted a solid set of profit results for the June half given headwinds from a slowing economy and rising costs, especially labour and interest costs. Company profit results through August saw earnings (net profit after tax) beats against expectations outnumber misses by a ratio of 5:3, which highlights the underlying strength the domestic Australian economy has enjoyed for much of the last six months.

Amongst sectors, Materials (ex-mining) and Communication Services saw the strongest beat rate, while the Consumer Staples and Information Technology sectors saw the biggest skew towards earnings misses. Key themes that came out of the Australian market reporting season included better cash flow, but an increased focus on balance sheet strength with higher interest expenses and higher capital expenditure. We also observed some reversion in sector performance reflecting crowded trades. With earnings weakness already expected and positioned for, shares in the consumer discretionary sector generally beat conservative expectations and outperformed the market after results. Bank results and updates were 'less bad' with solid balance sheet settings supporting returns. In contrast defensive shares with lower economic sensitivity that should do well amid market earnings downgrades did not do well. Our research suggests the earnings beat and positive share price performance by more cyclical shares may not be sustainable as economic activity continues to slow.

Australian company management forward guidance was conservative, generally missing consensus market expectations and driving consensus earnings forecasts down by 2.4% post results during the month. The Australian market saw forecast upgrades for 17% of companies , while 41% of the market saw forecast downgrades. During the month, Utilities (+4.0%) was the only sector with positive earnings revisions. Materials (-4.3%), Health Care (-4.1%) and Information Technology (-3.9%) sectors had the most negative revisions. There were more dividend forecast downgrades than upgrades as Australian companies protected their balance sheets in the face of higher interest costs.

Portfolio performance benefited from solid returns from Australian secular growth companies Goodman Group and James Hardie. **Goodman Group** reported a 16% year on year increase in earnings, but this was positively eclipsed by the disclosure of a 3-gigawatt Data Centre pipeline, estimated by Goodman Group to have a A$30bn-A$60bn end value. This disclosure contributed to a 7% increase in consensus earnings forecasts with the Data Centre pipeline providing line of site for earnings growth for the next 5 plus years. Growth in artificial intelligence is driving Data Centre demand to new heights according to property research group JLL's North America Data Centre Report for the first half of 2023. According to JLL Data Centre space is in such short supply that users should have it lined up long before they plan to go live, even as prices rise. "Most of the supply expected to be delivered in the latter half of 2023 and 2024 has been preleased or is under exclusivity, resulting in limited options for users," the report stated.

Fibre cement wallboard manufacturer **James Hardie** delivered a strong first quarter which drove 10% plus financial year 2024 earnings forecasts upgrades. The result reflected margin resilience (costs lower) and volumes 'a whole lot less worse' than expected. US home repairs and remodeling remains soft, however a rapidly improving single family market has James Hardie now talking to a US total addressable market down -5-18%, whereas it was expecting -14—19% previously. The portfolio's investment in James Hardie and Goodman Group was increased during the month with both shares offering attractive longer-term growth potential not reflected in their share prices.

In contrast the combination of a weak profit update and slower than expected Chinese economic activity hit returns from diversified miner **BHP**. Although BHP's full year 2023 profit results and operational performance was broadly in line with expectations, forward guidance disappointed against consensus expectations with medium-term copper volumes trimmed and unit costs and capital expenditure (capex) lifted. BHP is pivoting more towards growth, both organic (higher capex) and merger and acquisitions (e.g., OZ Minerals). Returns to shareholders are moderating and net debt has lifted with OZ Minerals acquisition. While BHP management have sought to reassure investors they will be disciplined their historic track record is mixed. With iron ore prices potentially falling over the next 6 months as demand in China to slows further and, there is potential for global supply to lift, we reduced the portfolio's investment in BHP during the month.

Outlook – Spring after winter solstice?

With the days getting longer and temperatures warmer spring is emerging in the southern hemisphere. But occasional cold snaps and storms remind us that winter has not quite finished. Capital markets may not yet be in 'spring', but they may be past the 'winter solstice'. We may be past peak inflation and its negative impact on economies and capital market returns, but sticky inflation components and the lagged impact of tighter monetary policy mean it may be some time before official central bank cash rates are reduced to support capital market valuations (even then are they being cut due to economic stress?). Earnings forecasts have been reset lower to reflect slowing activity and higher costs, but the balance of risk is towards further downgrades in the near term. And the local economy may go into a holding pattern with New Zealand facing a general election in October. This backdrop suggests a mixed period of performance for the local share market. In this environment investments which benefit from secular growth trends, and reducing exposure to investments at risk of further economic downturns and financial stress may enhance relative returns.

The New Zealand share market remains fully priced and in need of positive earnings upgrades to support returns. The 12-month forward market capitalisation weighted Price to Earnings (PE) ratio for the New Zealand market is currently 21.8x next year's consensus earnings expectations. This level is +16% above the long run average since 2006 of 18.4X but is in line with its 10-year average (including 2020 & 2021's Covid elevated period) of 21.8X. The 12-month forward market capitalisation weighted prospective cash tax paid dividend income yield for the New Zealand market is currently 3.7% - below its historical 4.0% plus average yield. Three-year compound earnings growth forecasts for the New Zealand share market are now in the low single digit per annum level, which may prove conservative given the defensive nature of the New Zealand share market and the ability of company management to reset business structures to boost returns. The Australian share market valuation while less stretched is still not cheap either. The S&P/ASX200 index is currently trading at 15.1x 12-month forward earnings, a 2.7% premium to its 14.7x long-term (since 2000) average PE. And our research suggests we may not have seen the low in Australian profit expectations.

What could see local share markets deliver better returns? We focus on three key factors. First, we don't see the case for a hard-landing in profits – company management teams will not stand idly by – they will act to lift productivity to improve returns. Second, official interest rate increases are finished or close to finished in the US, New Zealand and Australia – while it is too early to expect a fall in rates share market earnings forecasts and valuations now capture a higher interest rate setting. And third the inflation pressures weighing on profits are already subsiding, although labour costs may remain sticky until company productivity programmes are implemented.

Pricing power, the ability to push through price increases to customers without damaging sales, was on show in the June reporting season with utilities, communications and insurance companies able to push costs through. But our research suggests investors may be being complacent against the challenges faced by more cyclical companies. Being defensively positioned has proved relatively unrewarding over the past 12 months, as many cyclical sectors have bounced off their mid 2022 lows. With the capital market 'winter' yet to pass we continue to favour quality growth investments that can ride through 'winter storms'.

Harbour portfolio positioning

Harbour's strategy remains to position for a range of scenarios and to be selective. We continue to favour investments with structural tailwinds that are less dependent on strong economic activity. We continue to see technology dispersion, de-carbonisation, and demographic changes as supporting company earnings. Businesses exposed to energy transition and the onshoring/nearshoring of manufacturing and storage of goods may face opportunities and threats. We are also favouring businesses with productivity and efficiency 'self-help' programmes, particularly where business reengineering introduces technology that improve both revenue and cost structures. We continue to have a bias to quality, well-capitalised businesses that are less vulnerable to a tightening in financial conditions.

Disclaimer

Data sources:

S&P Dow Jones LLC

Bloomberg

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COMPLIANCE CERTIFICATE

Harbour Australasian Equity Focus Fund (the "Fund") (Wholesale Unit Trust)

For month ended 31 August 2023

Harbour Asset Management Limited certifies that, to the best of our knowledge, after having made reasonable enquiries and except as specified in this certificate, the Fund has been managed in accordance with the investment mandate parameters defined in the Conditions of Establishment for the Fund.

Tim Morrison
Head of Compliance
Harbour Asset Management Limited

Dated 04 September 2023