Harbour ASSET MANAGEMENT

Equity Fund
Harbour Australasian Equity Focus Fund

31 JULY 2023

1 month performance	1 year performance	Fund size	Performance since inception
2.24%	**1.40%**	**$90,423,433**	**11.93%**
Before fees & tax	Before fees & tax	NZD	Annualised, before fees & tax. Inception 10/4/2014

Fund performance was positive and ahead-of-benchmark over the month. Equity markets rose as concerns about central bank interest rate rises and economic slowing continued to moderate. Increasing acceptance of a 'soft economic landing' and better-than-expected earnings results globally contributed to a broadening in equity market performance. Locally, updates from several companies showed a rapid slowdown in activity which contributed to earnings forecast downgrades. However, positive updates from some defensive growth companies provided an offset, meaning the overall pre-June New Zealand profit results earnings 'confession' season was not as bad as expected. The Australian share market delivered a solid return over the month driven by the energy, financial and information technology sectors.

Portfolio performance continued to be enhanced by investments in structural growth companies. During the month portfolio performance was boosted by positive returns from investment in outperformers Summerset, Volpara, IDP Education, Pacific Edge and Serko. Portfolio performance was impacted by negative returns from investments in Mainfreight, Kathmandu, CSL, Infratil, and Aroa which delivered negative returns over the month.

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	2.24%	4.10%	1.40%	-1.63%	6.44%	7.27%	-	11.93%
Benchmark return, inc. IC	1.98%	1.64%	8.38%	2.27%	7.11%	7.51%	-	9.57%

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)	1.20%	0.42%	5.79%	1.66%	7.05%	11.40%
S&P/ASX Total Return 200 Index (NZD)	2.53%	3.26%	8.65%	12.20%	7.30%	7.90%
S&P/ASX Total Return 200 Index (AUD)	2.88%	2.04%	11.67%	11.99%	7.47%	8.32%

Source: S&P/NZX, Bloomberg.

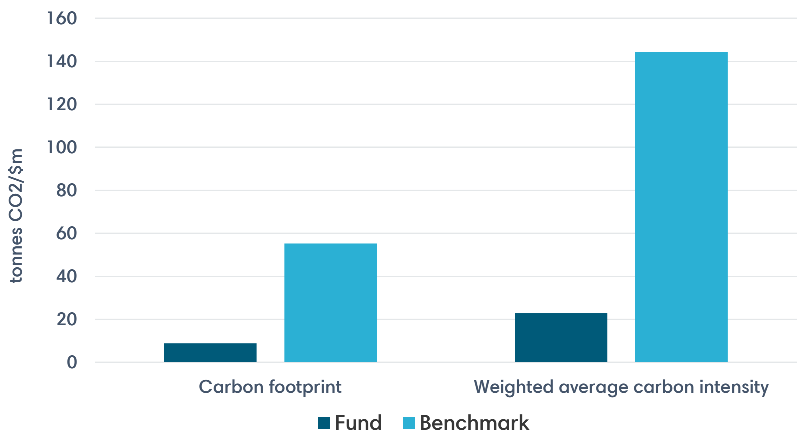
Fund characteristics

	FUND
Return on equity	11.61%
PE ratio forward 12 months	23.9x
Gross yield	2.16%
Expected volatility	15.30%
Hedge on AUD exposure	9.86%

Top 10 holdings

	POSITION
Summerset Group	8.39%
Mainfreight	7.72%
Infratil	7.42%
CSL	6.27%
Xero	6.21%
BHP Group	5.48%
Goodman Group	5.01%
IDP Education	4.67%
Serko	4.61%
Macquarie Group	4.52%

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

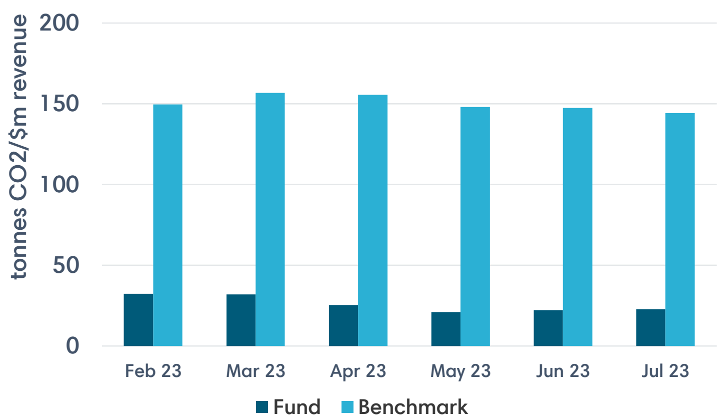
Note: The carbon statistics presented have been adjusted for the extraordinary circumstance of the Channel Infrastructure holding based on data from its latest sustainability report which includes the decommissioning of its refinery operations.

ESG metrics summary

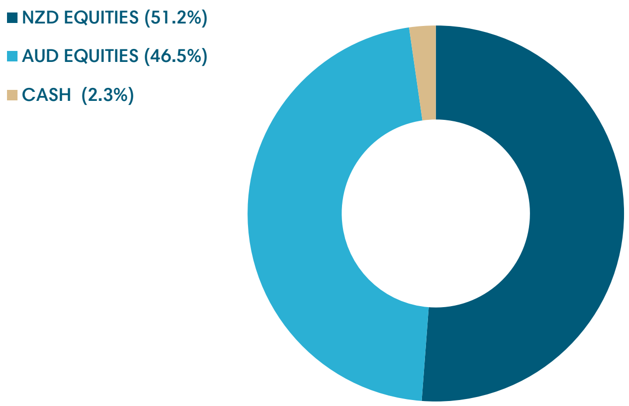
	FUND
Gender diversity (workforce >40% female representation)	48%
Modern Slavery Statement	69%
TCFD Reporting	52%
Majority Independent Board	90%
Science Based Target	12%

Source: Bloomberg, Harbour Asset Management

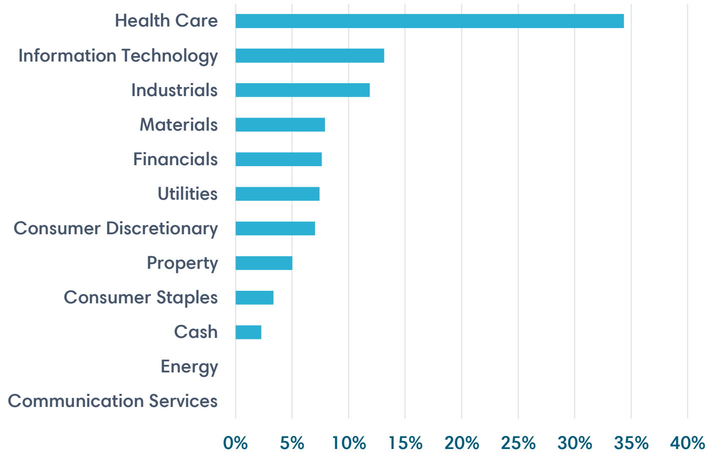
Weighted average carbon intensity



Investment mix



Sector weights



Source: MSCI

Largest contributors	AVE. POSITION	TOTAL CONTRIB.	STOCK RETURN
Summerset Group	8.43%	0.61	7.40%
Volpara Health Technologies	3.63%	0.53	16.98%
IDP Education	4.41%	0.53	12.20%
Pacific Edge	1.75%	0.45	51.96%
Serko	4.63%	0.30	6.68%

Largest detractors	AVE. POSITION	TOTAL CONTRIB.	STOCK RETURN
Mainfreight	8.08%	-0.33	-4.15%
KMD Brands	2.65%	-0.24	-9.00%
CSL	6.13%	-0.24	-3.55%
Infratil	7.36%	-0.14	-1.87%
Aroa Biosurgery	3.07%	-0.09	-3.01%

Outlook and strategy

Equity markets rallied globally as investors embraced the 'soft landing' economic scenario on easing inflation concerns and lower terminal central bank official rate expectations. The reduction in peak rate concerns dragged some investors back into equities. The earnings confession season that precedes the formal profit results season for the June period was generally better than expected across New Zealand and Australia. While some companies reported earnings pressure, it was generally in the sectors that were expected to face pressure from slowing economic activity and slowing consumer demand. The combination of a lower risk of rising interest rates, reasonable economic activity and better-than-expected earnings updates, all contributed to an increased risk appetite across share markets.

In New Zealand the S&P/NZX 50 rose a further 1.2% in July. A less bad New Zealand economic backdrop supported the performance of the New Zealand share market, but ultimately individual companies drove the market up. The Reserve Bank of New Zealand remaining on hold provided some support for returns. Economic data released over the month provided a better balance for equity returns. New Zealand business surveys showed a small lift in confidence from low levels, with the easing difficulty of finding labour perhaps providing relief to some firms. The proportion of firms intending to raise their prices also fell slightly, but the number of firms expecting rising costs and wages to continue to increase points to a tougher time for profitability.

The health care (positive updates from Pacific Edge and Summerset) and real estate (falling interest rate risk and better property fundamentals) sectors were the top positive contributors to the New Zealand market over the month, while returns from the industrials (weak update from Mainfreight) and consumer discretionary (weak update from Kathmandu) sectors held the New Zealand market back. Technology was the best performing sector driven by better updates from Vista and Serko. Financials were also strong, with dual listed bank ANZ benefitting from improved sentiment towards banks in the month.

The Australian share market also delivered a solid return with the S&P/ASX 200 benchmark index up 2.9% (in Australian dollars) over the month. Energy and financials were the best performing sectors, while health care and consumer staples were the worst performing sectors. The variance reflected an increase in investor risk appetite and company specific drivers. Energy was driven by stronger oil prices, with the WTI crude oil price up nearly 16% over the month. Banks also had a strong month, after underperforming in the prior month, as reduced rate hike expectations lower the risk of policy being overtightened driving loan losses. Health care was the worst sector with further weakness in the CSL share price after the potential for a new competitor product added to the companies disappointing/conservative financial year 2024 profit guidance released in June.

Expectations of stimulus from Chinese authorities continued to support market sentiment towards the resource sector. The stimulus is being drip-fed by Chinese authorities and risks requiring more news given weakening Chinese economic data. A raft of stimulus measures were announced over recent weeks with a large proportion aimed at stimulating Chinese domestic consumption.

Portfolio performance was boosted by positive updates from a range of structural growth companies. Cancer diagnostic company **Pacific Edge** provided additional detail during the month which contributed to a recovery in its share price. Early in the month the Pacific Edge share price jumped after the (at least temporary) suspension of a decision that would have seen its reimbursement dropped for US Medicare patients using its Cxbladder tests, and the announcement that Pacific Edge will be afforded an opportunity to comment as part of the decision-making process. At its Annual Shareholder Meeting (ASM) Pacific Edge management emphasised they expect to manage cash reserves, in the event of an adverse Medicare coverage decision, until it regains coverage — a process that could take four years.

Retirement village operator **Summerset** reported strong second quarter financial year 2023 sales metrics during the month. **Ryman** also provided a sound update at its ASM which saw Ryman maintain the profit guidance it provided at the time of its capital raising and retain its focus on improving cashflow and returns. While demand for retirement living remains high, the weak New Zealand residential property market continues to contribute to slower-than-normal settlement of sales cashflows for retirement operators. But the number of days to sell a residential property in New Zealand may be nearing a peak, which has been a contributor to slower retirement village cashflow realisation. New Zealand house prices posted their smallest monthly decline since January, adding to signs that an 18-month property market slump could be in its final stages. Data from CoreLogic New Zealand showed values fell 0.3% in July from June, when they slumped 1.2%. From a year earlier, prices dropped 10.1% — the slowest annual decline since February. A fall in days to sell, when combined with other strategies being implemented by retirement village operators, has the potential to lift retirement sector profitability.

Film industry software company **Vista Group** provided a positive update during the month that may see it generate positive free cashflow earlier than previously announced. Vista announced a business transformation which will culminate in a more unified business model, with lower capital investment and staff headcount. The strategy, if successful, will drive greater client alignment, and deliver improved financial performance. Vista is also benefiting from a lift in cinema industry profitability.

Student placement company **IDP Education** saw a lift in its share price on evidence of strong student placement volumes, which is a higher profit margin part of IDP's business.

Breast cancer detection software company **Volpara** delivered a positive quarterly update which included better than expected cashflow and a reduction in debt levels.

But portfolio performance was hit over the month by negative company specific announcements from several more economic cyclical sensitive companies. Transport and logistics company **Mainfreight** provided a weak trading update at its ASM. Managing director Don Braid spoke of weakness in all the markets it operates in during the latest June quarter, including a sharp drop in New Zealand profitability and a notable drop in revenue in Asia and the US, with overall group revenue down -19%. Managements guidance of profit before tax was down -43% for the June quarter, worse than the market had expected. Breaking the update down, while a cyclical slowdown is impacting on near-term activity, Mainfreight continues to invest for long term growth in business streams such as warehousing which incur upfront costs before generating attractive returns over the medium term. Mainfreight indicated it was focusing on reducing costs in the near-term. Mr Braid subsequently bought 10,000 Mainfreight shares on market for $677,000, confirming his conviction in the long-term return prospects for the business.

Lifestyle retailer **Kathmandu** provided a weak fourth quarter trading update. Kathmandu management pointed to sales and operating earnings coming in -6% and -17% below consensus market estimates, as deteriorating Australian consumer sentiment and a warmer start to winter weighed on Kathmandu's key winter sale period. Kathmandu management guided to a ~24% earnings before interest depreciation and amortisation (EBITDA) decline, reflecting higher promotional activity and a higher cost of doing business. Metals distributor **Vulcan Steel** also reduced financial year 2023 earnings guidance by more than 10% reflecting weakness in its New Zealand distribution business and higher integration costs associated with its Ullrich Aluminium acquisition.

Shares in Pharmaceutical company **CSL** came under further pressure after biotech company Argenex announced the trial 'success' of its efgartigimod product aimed at the treatment of chronic inflammatory demyelinating polyneuropathy (CIDP), a neurological disorder that involves progressive weakness and reduced senses in the arms and legs, which is currently treated using CSL's immunoglobulin (Ig) products. Efgartigimod may represent competition for CSL's Ig for some patients. If successful, research indicates this alternative treatment could reduce CSL's revenue by 3% + from financial year 2024 onwards, and CSL's earnings forecasts have been reduced to reflect this risk. Updates from CSL's peers (including Takeda, Grifols and GSK) indicated Ig demand and growth remain solid (high single digit), plasma collections are improving, and plasma donor fees are reducing. With CSL's earnings rebased, Ig demand remaining solid and cost growth moderating, CSL has the potential to get back to its historic double digit earnings growth track record over the medium term.

Diversified infrastructure investment company **Infratil** announced a conditional acquisition of 80% of HKT Limited's Console Connect software platform that enables customers to self-provision private and secure connections. Infratil is paying US$160m and plans to invest a further US$200m–US$250m to fund growth. The Infratil share price fell post-the announcement, with some investors sceptical of the risk and return attached to this investment. The pull back in the Infratil share price was equivalent to writing back the value of the Console investment to zero.

Diversified financial **Macquarie Group** provided a first quarter 2024 update that was well below the previous corresponding period (PCP). While consensus expectations had been for a lower result given some unusual strength in the PCP, the update was below expectations. Both Macquarie's annuity-style businesses and capital markets-facing businesses were substantially down on the PCP. Management attributed this primarily to weaker trading conditions, and while no group guidance was provided, management did update some divisional guidance, which implied weaker outcomes versus market expectations and contributed to consensus earnings downgrades for the 2024 financial year. Macquarie remains well positioned medium-term to benefit from both the global push towards decarbonisation and investment requirements in infrastructure.

An investment in building products manufacturer **James Hardie** was added to the portfolio during the month. James Hardie has the potential to continue to deliver attractive compound earnings growth as its ColorPlus wall board product increases market penetration in the US. ColorPlus is a pre-painted board product that JHX launched in 2002 to take share from vinyl in the Northern US repair and renovations (R&R) market, where painting installed siding is less common due to labour availability challenges. ColorPlus has three key growth opportunities including ongoing penetration in the US Northeast, and substitution of Prime for ColorPlus in the US Pacific Northwest and US Mid-South.

Outlook – Inflection Point?

Capital markets may be near a key inflection point for interest rate settings and for company earnings. A point of inflection is the location where a curve changes from sloping up or down to sloping down or up. With inflation near its peak interest rates may also be near their peak, reducing equity market valuation risk. If the rate of economic slowdown is near the end, we may be at a point where company earnings risk becomes more balanced, if not positive. In this environment equity market returns may be attractive. But we are not there yet.

After a solid recovery in equity markets, we are in the 'twilight zone' between economic frameworks. Investor sentiment and positioning has moved to being positive towards equity investments – this does not mean equity markets can't keep delivering positive returns near-term, but it needs a not too hot, not too cold 'goldilocks' environment to keep emerging. We continue to expect equity markets to grind higher, but with some pullbacks and volatility as capital markets move through the inflection point. In this environment we continue to favour quality investments and those investments that benefit from structural tailwinds.

Inflation indicators continue to fall, taking pressure away from central banks to aggressively lift official interest rates. Capacity pressures are easing, and wage growth may have peaked, but parts of the labour market remain sticky with wage increases continuing to come through. While central banks maybe close to finishing their current rate increase cycle, they remain data-dependent with employment and wage inflation remaining a key point of focus. Capital markets have begun to price in central bank official interest rate cuts from mid calendar year 2024. It may be too early to consider an official interest rate cutting cycle – inflation is still above central targets, and it may take time for interest rates increases to deflate economies. The ongoing normalisation of supply chains may support a faster reduction in inflation rates. While we may be near the end of central bank official interest rate increases, central banks are quantitative tightening, reducing their investment in assets including Government bonds, right at the time when Government bond issuance is increasing in some economies. As a result, overall financial conditions could remain tight providing a headwind for equity market returns.

The risk for equity market returns may have moved from inflation risk to economic activity risk. With central banks likely to maintain tight policy for some time global economic growth may slow further in coming quarters, and several economies (including New Zealand and the US) face the prospect of technical recessions. Global growth is running below-trend this year but considering the size and extent of recent headwinds is holding up relatively well. Underneath this resilient global picture there continues to be a marked divergence between strong services and languishing manufacturing sectors.

But there are signs that the rate of economic growth slowdown may be bottoming out, with a slowdown but no collapse providing a more benign setting for company profits. The US Institute of Supply Management (ISM) survey, a lead indicator for economic activity, for July was not as weak as consensus was looking for, with new orders printing less contractionary, the new orders-inventories net balance remaining in positive territory, inflationary components tentatively bottoming out and qualitative commentary mixed.

The New Zealand economy is a long way through its economic cycle, but we run the risk of the economy needing to navigate the 'hard' part of the reset – increased unemployment and business defaults. Business credit defaults have continued to track up, particularly in the construction, retail, hospitality and property sectors. Against this business confidence surveys have improved off a low base, perhaps reflecting a reduction in pressure in labour markets. Easing labour market pressure is positive for stock earnings, but a sharp increase in unemployment over the next 6-18 months as businesses continue to search out efficiencies may continue to weigh on return prospects for consumer facing sectors. The pending New Zealand general election may also see a delay in investment by both businesses and consumers.

After a long period of earnings downgrades, we could be nearing an earnings inflection point for local companies. Earnings per share (EPS) expectations continued to fall in July, and we continue to expect conservative initial guidance over the pending reporting season (for the June period). But a tapering in cost inflation means we may be nearing a point where company earnings have the potential to beat expectations. The US earnings reporting season may provide a guide for our local earnings season - with over 50% of companies having reported earnings, earnings growth (reported and expected) is running at -8% year on year for the benchmark S&P 500 index, but most sectors are seeing earnings beat expectations since the start of July.

In New Zealand, we see potential for improved operating performance as companies rebuild post-Covid disruption and adjust pricing and business models to meet an inflationary environment. We expect a number of companies to announce productivity, efficiency cost out programmes aimed at enhancing returns over the reporting season. The end of the tightening cycle in New Zealand may mean bottoming demand during the period just ended. In Australia we will be watching how companies are managing margin pressure. Raw input prices have typically retraced off 2022's peaks and companies have passed higher input prices on in the relatively buoyant economy, but wages are now catching up putting more pressure on labour intensive firms. Cost out programs could provide some positive surprise given falling labour productivity. We expect the easing in supply chains and associated decline in inventories will allow companies to keep more cash on balance sheets and/or deliver productivity improvements elsewhere. Earnings forecasts in the resources sector have weakened as China macro-economic data has continued to deteriorate, but stimulus in China may lead to better conditions going forward.

A higher-for-longer cost-of-debt environment will continue to weigh on earnings results and earnings forecasts. While central banks are at the end of their hiking cycles, without rate cuts anytime soon interest rates costs will remain a drag on company earnings. While local balance sheets remain in reasonable order (arguably under-geared), we expect higher-for-longer interest rates will continue to weigh on more leveraged business models. Overall, we expect the focus in the pending company reporting season to be on trading conditions, guidance from companies as to whether macro conditions are impacting top-line growth, and the impact of a higher-for-longer cost of debt.

Equity market valuations have now pushed above average. Globally, investors now have a full exposure to equities. But if overall equity market volatility remains modest, and earnings results begin to beat conservative expectations, we see potential for further positive investor inflows into share markets. The potential that New Zealand official interest rates may fall over the next twelve months may see investors increase investment in New Zealand shares, with some investors underweight relative to long term targets reflecting New Zealand's tighter financial settings. The prospect of a soft economic land in the US and broader stimulus in China also have the potential to offset near term liquidity pressure from quantitative tightening.

Overall, while we expect equity markets to grind higher, we believe investors will need to be patient and wait for key inflection points to emerge within capital markets.

Harbour portfolio positioning

Harbour's strategy remains to position for a range of scenarios and to be selective. Within the portfolio, at the margin, we have taken profits in selected shares after sharp positive share price moves, but we will use market volatility and earnings confirmation to rebuild investment. 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 programmes, particularly where business reengineering introduces technology that improves 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

Compliance Certificate

Wholesale Harbour Australasian Equity Focus Fund (the “Fund”)

Investment Mandate Compliance Certificate
for month ended 31 July 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, that the Fund has been managed in accordance with the investment mandate parameters defined in the Conditions of Establishment for the Fund.

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Tim Morrison
Head of Compliance
Harbour Asset Management

03.08.2023
Date