



## ARGO INVESTMENTS LIMITED

ABN 35 007 519 520

# 2017 Annual General Meeting CHAIRMAN'S ADDRESS

*Delivered by Mr. Ian Martin AM at the 71st Annual General Meeting of Argo Investments Limited (Argo or Company) held at the Adelaide Oval on Monday 23 October 2017 at 10.00am.*

### Financial results

I am pleased that Argo's business model and investment philosophy have continued to deliver strong outcomes for shareholders in 2016-17. We have been able to increase our fully franked dividends to shareholders for the fifth year in a row, after recording a profit of \$211.5 million for the year ended 30 June 2017. This was particularly pleasing as at last year's AGM we feared that tougher times were ahead. Indeed, the first half of the year was softer due to dividend cuts from a number of the larger companies in the portfolio, but in the second half, our profit rebounded when business conditions and consumer confidence improved as concerns abated about fallout from the major political surprises in the UK and US and further political upheaval.

Portfolio income for the year was slightly lower than in the previous year, following dividend cuts from Rio Tinto, BHP Billiton, Woolworths, Origin Energy and ANZ Banking Group. These cuts were partly offset by increased dividends from Macquarie Group, AGL Energy and Sydney Airport, and a special dividend from Asciano due to its takeover. Income from option writing and trading declined, although interest received on cash deposits was higher, reflecting higher cash balances on hand.

Expenses increased by only 0.5% on last year, and included the costs of managing the external listed investment company, AGLI, for which Argo received \$1.7 million in management fee income. The management expense ratio was reduced to 0.16% of average assets held over the year, confirming Argo's position as one of the very lowest cost investment vehicles available in Australia.

### Dividend growth

We know that delivering and growing a tax-effective dividend income stream is very important to most Argo shareholders, particularly when interest rates are at historically low levels. Argo's closed-end corporate structure allows the flexibility to smooth dividends paid to shareholders over time to a greater extent than the managed fund trust structure which distributes all profits to unit holders every year. This flexibility has helped us to maintain steadily growing dividends in recent years.

It is also important to note that Argo's dividend is generated from a diversified range of industries via its portfolio of investments. This helps to reduce the volatility of dividends from individual investments through fluctuating economic cycles.

A feature of the latest dividend was that it included a 5 cents per share 'Listed Investment Company capital gain component'. This occurred because during the year, two significant holdings in Argo's portfolio were taken over, being Asciano and DUET Group. As a result, we made large capital gains which are taxable. Argo pays the tax on these gains, but as a qualifying long-term listed investment company, a special tax rule allows us to pass on the capital gains tax discount for holding a stock for more than a year to our shareholders, as though you made the capital gain yourself. Your dividend statement provides the details, including the total amount of your tax deduction, which depends on your tax status. This benefit is in addition to your franking credits, as the entire dividend is fully franked.

I am also pleased to report that Argo has recently received another two industry awards, being the Core Data Self-Managed Super Fund (SMSF) Service Provider awards for listed investment companies, as voted by both SMSF members and advisers. This is the second year in a row that we have won both categories.

We also hold 'highly recommended' ratings from two independent research groups, Lonsec and Independent Investment Research.

### **Investment performance**

Argo's most recent performance figures, updated to 30 September, show an NTA return of +7.7% over the past 12 months. Although this figure is less than the benchmark S&P/ASX 200 Accumulation Index return of +9.1%, bear in mind that Argo is internally managed, so our NTA performance figures are calculated after deducting all administration expenses and tax, whereas the share market index does not take account of any costs. Argo's share price return was stronger at +12.0%, outperforming the Index as the Company's share price has moved to a premium to NTA. The share price return has also exceeded the Index and the NTA performance over 5 and 10 year periods.

Argo's underweight position in the materials sector, and more particularly the smaller and mid-size resource companies, hampered our performance relative to the broader market. This portfolio positioning reflects Argo's preference for companies that can generate growing dividend income, and does occasionally result in underperformance when mining stocks are in favour.

### **LIC industry expansion**

Before I make some comments about the economic outlook, I would like to talk briefly about the rapid growth of the listed investment company (or "LIC") sector. Over the last five years, the number of LICs listed on the Australian Securities Exchange has doubled to over 100. One catalyst for this increase in issuance was the FOFA (or Future of Financial Advice) reforms introduced in 2012, which levelled the playing field for LICs by abolishing conflicting commission structures in the financial planning sector.

Of course Argo has been around for a long time and we would like to remind you of some of the benefits of investing in Argo, which distinguish us from many of the new entrants, particularly:

- Argo's long-term, tax-aware investment philosophy
- Our low cost, internally managed business model with no performance fees
- Our strong balance sheet with no debt
- Our closed-end corporate structure which aids long-term investing
- Also, our shares offer diversification of risk and administrative simplicity, with easy entry and exit on the ASX, as well as
- Fully franked, sustainable dividends which grow over time;
- LIC capital gain component tax deductions; and
- We also provide active management by an experienced team in a strong corporate governance environment.

Clearly these hard-earned qualities have not gone unnoticed, as the arrival of so many LICs and ETFs to the market in recent years has not affected Argo's ability to attract new investors, with the number of shareholders on the register rising from 68,000 five years ago to over 82,000 today.

We note that most of the recently listed LICs are externally managed, often launched by fund managers who already offer unlisted managed funds to the public. It is important to examine the structure of the fees charged by external managers to the LIC vehicles, as often they include both high base fees as well as performance fees which can limit the growth potential and performance of the LIC itself.

It is also important to be aware of differences that are emerging in the disclosure of investment performance figures among LICs. You need to be sure you are comparing 'apples with apples' when deciding on appropriate LIC investments. For example, some managers are quoting LIC performance statistics before deducting costs (including fees) and tax, and calculating their fees on the same basis. Your financial adviser can help with this if the disclosure is not clear to you. Rest assured however that Argo's expense ratio is genuine and encompasses all of our costs. As I mentioned earlier, our total expenses add up to only 0.16% of a percentage point, or 16 basis points.

With all of this in mind, we recently reviewed the wording of our official corporate objective to ensure it captures the most important elements of our investment philosophy. It now reads:

"Argo's objective is to maximise long term returns to shareholders through a balance of capital and dividend growth. It does this by investing in diversified Australian equities portfolio which is actively managed in a low cost structure and in a tax-aware manner."

## **Outlook**

Now a few comments on the outlook.

It goes without saying that geopolitical risks have increased in the past year or so – first of all with Brexit, then the caustic election and political climate in the US, and more recently as tensions have escalated around both the North Korean situation and Iran.

Markets so far at least have remained surprisingly benign and volatility has been at historically low levels. One reason for this is that the underlying global macro economy has actually improved. In the US, employment growth has been strong and growth has become both more broadly based and also accelerated, although it will now be knocked around a bit by the recent hurricanes.

Europe has also picked up steam, as has Japan and many emerging market economies.

One consequence is that we now have what is starting to look like a more conventional synchronized and broadly based economic recovery.

Against that however, monetary conditions in China have tightened in recent months and some respected forecasters are predicting growth will slow there in 2018, as the government moves to address some long term imbalances with more vigour in the wake of last week's Communist Party Conference, particularly in the real estate market and for example the issue of non-performing loans in the banking sector. That said, growth in the 6-7% range still seems more likely than not, especially given the strengthening external market conditions.

Looking at the aggregate numbers, the Australian economy ostensibly continues to perform reasonably well in this environment, although it might not feel like it because when you drill down, it is patchy across sectors and states. In aggregate, our growth rate continues to bump along at 2-3%, unemployment (as reported) is low compared with the experience in the last couple of decades, and the worst of the resources boom/bust cycle now appears to be behind us. Moreover, especially in the Eastern states, infrastructure and construction spending more generally have risen and are now key drivers of growth. However there is little, if any, wages growth and household debt is at very high levels both historically and indeed compared with most other developed economies; and of course housing prices have risen rapidly, especially in Sydney and Melbourne, over a number of years. In this environment our potential and actual growth rate will continue to be constrained.

Taking all of these factors into account, as well as the fact that market valuations across the board look reasonably stretched, investment risk now appears to be somewhat elevated. Central banks in the US and Europe in particular, now face particularly difficult juggling acts as they adjust monetary policy, and in Australia, the combination of high debt, a real estate market at or near a tipping point, low wages growth and fiscal drag, is potentially challenging to say the least.

Jason will talk in more detail shortly about what specific portfolio moves Argo is making in this environment. Suffice to say here we are particularly cautious in our approach, building up our cash balances somewhat recently and we have become even more choosy with our stock selection.

Finally, I would like to conclude by thanking Jason and the entire Argo team for their efforts and would also like to thank my fellow Board members.