selector

Selector High Conviction Equity Fund

Monthly report – December 2018

Market insights

Our main index, the All Ordinaries Accumulation Index continued its steep descent of recent months, although a late rally in December stemmed its fall to just 0.45% for the month. Overall, the market delivered a negative performance for the 2018 calendar year, dropping 3.53%, driven in large part by the 8.98% fall recorded in the final quarter. U.S. equity markets traded in a similar fashion, delivering strong returns for the first nine months of the year before giving up those gains in the last quarter. The S&P 500 fell 6.24% over 2018 despite falling 13.97% in the final quarter. The Chinese Shanghai Composite was one of the worst performers, falling 24.59% for the year.

The U.S. Federal Reserve confirmed the fourth increase in interest rates in 2018, raising the target range to 2.25%-2.50%. Minutes from the December meeting indicate the Fed's plans for future increases have moderated in light of a variety of risks to the U.S. economy. However, despite strong criticism from President Trump regarding the Fed Chairman's handling of the rate increases, economic conditions in the U.S, remain healthy. GDP is growing at 3%, unemployment is holding steady below 4% and the latest inflation reading of 2.2% is close to the Fed's objective of 2.0%.

A confluence of events has seen the oil price fall sharply since September and this trend continued during the month. Brent crude fell to around US$50 a barrel, down 42% from the recent high of US$86.69. Higher production in the U.S. and Iran pushed the market towards a position of excess supply while concerns surrounding the potential for reduced global growth weighed on demand forecasts. Commitments from the OPEC cartel to cut production by 1.2m barrels a day did little to arrest the fall. Supply responses from the marginal cost U.S. shale producers are unlikely to kick in with full effect until hedge books roll off over the next 12 months.

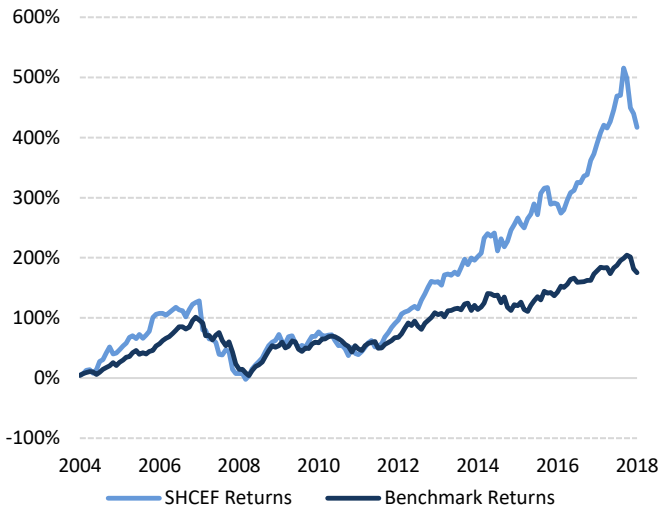
The fallout from the Financial Services Royal Commission has continued with three of the big four banks receiving strikes against their remuneration reports at annual general meetings. Bonuses paid during FY18 suggest the financial implications for Australia's leading executives have been muted despite acknowledged admissions of failures to act in the best interest of customers.

The Australian Prudential Regulation Authority announced it would remove its 10% interest only residential mortgage growth limit originally established in March 2017. Residential property prices in Sydney and Melbourne have softened in the wake of the restrictions which coincided with a marked increase in residential developments. Banks have been applying a greater level of scrutiny to residential mortgage applications, exacerbating the tightening of credit and the corresponding fall in property prices.

We continue to seek businesses with:

1. Competent management teams
2. Business leadership qualities
3. Strong balance sheets
4. A focus on capital management

Cumulative returns since inception



Inception Date: 30/10/2004
Before fees, costs and tax, and assuming reinvestment of distributions

Top holdings

Company name	Code	Weight (%)
ResMed	RMD	5.53
Aristocrat Leisure	ALL	5.44
Jumbo Interactive	JIN	5.00
Altium	ALU	5.00
Reliance Worldwide Corporation	RWC	4.58
Oil Search	OSH	4.51
CSL	CSL	4.08
Infomedia	IFM	3.95
Flight Centre Travel Group	FLT	3.83
Technology One	TNE	3.78

Unit prices as at 31 December 2018

Entry price	$2.4456
Mid price	$2.4395
Exit price	$2.4334

Performance as at 31 December 2018*

	FYTD	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	Since Inception
Fund (net of fees)	(9.82)	(4.37)	(13.95)	(9.82)	3.97	10.57	12.93	15.01	10.24
Fund (gross of fees)	(9.15)	(4.25)	(13.63)	(9.15)	5.47	12.17	14.70	17.01	12.28
All Ords Accumulation Index	(7.28)	(0.45)	(8.98)	(7.28)	(3.53)	6.60	5.71	9.14	7.37
Difference (gross of fees)	(1.87)	(3.80)	(4.65)	(1.87)	9.00	5.57	8.99	7.87	4.91

*Performance figures are historical percentages, calculated using end of month redemption prices, and do not allow for the effects of income tax or inflation. Returns assume the reinvestment of all distributions. Performance can be volatile and future returns can vary from past returns.

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Portfolio commentary

IOOF Holdings (IFL:ASX)

On 7 December 2018 APRA announced it would be seeking disqualification of five directors and executives of IOOF Holdings alleging breaches of the *Superannuation Industry (Supervision) Act 1993 (Cth)*. (SIS Act). The notice came without warning for investors, particularly given Chairman George Vernardos' comments at the Annual General Meeting, held less than two weeks earlier.

The core issue is a perceived conflict of interest arising from IOOF's dual roles as the Responsible Entity (RE) and the Registrable Superannuation Entity (RSE) of various subsidiaries. At the AGM the chairman noted that this separation is under way and is being addressed in agreement with APRA.

IOOF's actions in compensating superannuants for a number of historical administrative errors falls under "Best Interests", a somewhat grey area of the SIS Act. The use of reserves is at the heart of this issue. Here APRA wanted IOOF to acknowledge they had broken the SIS Act. IOOF's legal counsel refutes this premise. This sticking point will now be tested at law for the first time.

CEO Kelaher's appearance at the Hayne Royal Commission was heavily criticised in the financial press. This scrutiny, along with the exposure of APRA's own poor supervisory track record, appears to have been a catalyst for this rapid, heavy handed public response.

Vernardos and Managing Director Chris Kelaher have stepped aside pending the resolution of these matters with APRA. Allan Griffiths and Renato Mota have been installed as Acting Chairman and Acting CEO respectively.

IOOF has a market capitalisation of $1.78b and net cash (including term deposits) of $529m as at 30 June 2018 pending the acquisition of the ANZ Wealth business.

MYOB Group (MYO:ASX)

Leveraged buyout specialist KKR returned following due diligence with a bid of $3.40 per share for accounting software provider MYOB Group. The offer is 37 cents lower than the original proposal supported by the board, that enabled access to the company's books.

While the revision is a disappointing turn of events, it is not altogether surprising. The collapse in equity markets during the due diligence process and the 17.6% holding KKR had earlier acquired, placed the MYOB board in a weak negotiating position. Ultimately the board and its advisors managed to extract some conditions from the KKR team, who agreed to allow MYOB to solicit for competing bids as well as agreeing to on sell their stake into a superior proposal, should one emerge.

The MYOB board have recommended shareholders accept the bid. The shares are now trading at a narrow discount to the $3.40 offer, suggesting merger arbitrage hedge funds are either confident the proposal will be successful or believe there is a chance of a superior bid emerging.

MYOB has a market capitalisation of $1.97b and net debt of $406m.

About Selector

Selector Funds Management ("Selector") specialises in high conviction, index agnostic, concentrated portfolio management (AFSL 225316). The investment team have a high level of experience, are owners of the business and invest in the funds alongside clients. Selector has a long-term track record of performance. We offer the Selector High Conviction Equity Fund and the Selector Australian Equities Fund in addition to institutional mandates.

Performance contributors

Top five	Contribution (%)
ResMed	0.32
CSL	0.17
NIB Holdings	0.14
Infomedia	0.09
The Star Entertainment Group	0.09
Bottom five	**Contribution (%)**
IOOF Holdings	(0.91)
Jumbo Interactive	(0.67)
Flight Centre Travel Group	(0.52)
Aristocrat Leisure	(0.38)
Domino's Pizza Enterprises	(0.37)

Industry exposure

Industry group	Weight (%)
Consumer Services	21.42
Software & Services	21.29
Health Care Equipment & Services	12.77
Capital Goods	8.33
Diversified Financials	5.46
Materials	4.83
Commercial & Professional Services	4.68
Energy	4.51
Pharmaceuticals, Biotechnology & Life Sciences	4.08
Cash & Other	3.96
Household & Personal Products	3.30
Insurance	2.78
Media & Entertainment	1.94
Retailing	0.65

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