

# Selector High Conviction Equity Fund

Monthly report – October 2018

## Market insights

Markets fell sharply during October, with the All Ordinaries Accumulation Index closing out the month down 6.5%. The selloff was broad-based, with global markets falling 5% to 10%. International trade wars, the impact of a strong U.S. dollar on emerging economies, slowing Chinese growth and the ongoing disruption in Europe all contributed to investors' concerns.

U.S. government bond yields started the month trending higher after the Federal Reserve's decision to lift interest rates in September and the release of a strong unemployment reading of 3.7%. This move reversed as bond markets followed equities lower. Rising rates in the U.S. largely reflect strong economic conditions but some investors have questioned the impact of higher rates on valuations. The point too often lost in this debate is that rates will rise only if economic conditions stay strong.

Another important consideration when determining the impact of interest rates on markets is an economy's sensitivity to higher borrowing costs. Increases in interest rates today cost households far more than the same increase 10 years ago. With rates so low, households have been able to take out larger loans relative to their income. In short, households and the economy are more sensitive to rate adjustments today than in the past. Central banks won't need to put through very large increases in rates to cool economies if they start to overheat.

Despite the volatility experienced in markets, heightened corporate activity was apparent. Private equity investors are certainly not immune to economic or market cycles. Many of these players received burnt fingers or worse, from holding highly geared investments during the GFC. However, their views on the prospects of businesses, including university pathway operator Navitas, accounting software vendor MYOB, and hospital operator Healthscope, obviously exceed those of listed market participants. The bids for these companies are examples of the short-sightedness of markets. It is fair to say some have surfaced because of the near-term pressures these businesses face, despite their positive long-term outlooks. It's interesting to us, however, that these private equity managers appear to be more capable of investing for the long-term than investors in listed markets. This question goes to the heart of a manager's portfolio turnover.

PEXA, the government sponsored e-conveyancing company, scotched a bid to list on the ASX following muted investor support. Although the business model is attractive, the anticipated valuation of \$1.88b - \$2.18b was ultimately too high. PEXA will now need to look elsewhere.

We continue to seek businesses with:

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

## Performance as at 31 October 2018\*

	FYTD	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	Since Inception Annualised
Fund (gross of fees)	(3.46)	(8.21)	(3.70)	4.28	18.90	16.65	16.05	16.98	12.93
All Ords Accumulation Index	(4.73)	(6.47)	(5.88)	(0.55)	3.07	8.26	6.19	8.61	7.67
Difference (gross of fees)	1.27	(1.74)	2.18	4.83	15.83	8.39	9.86	8.37	5.26
Fund (net of fees)	(3.93)	(8.33)	(4.05)	3.54	17.22	14.99	14.25	14.98	10.87

\*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.

## 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 (%)
Aristocrat Leisure	ALL	6.65
Reliance Worldwide Corporation	RWC	5.20
ResMed	RMD	5.19
Altium	ALU	5.08
Jumbo Interactive	JIN	5.00
Oil Search	OSH	4.94
CSL	CSL	4.18
Flight Centre Travel Group	FLT	4.18
Reece	REH	3.96
Domino's Pizza Enterprises	DMP	3.87

## Unit prices as at 31 October 2018

Entry price	\$2.6053
Mid price	\$2.5988
Exit price	\$2.5923

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## Portfolio commentary

### Domino's Pizza Enterprises (DMP:ASX)

We attended the company's investor day held at their Brisbane headquarters during the month. CEO Don Meij provided a business overview which focused on the group's current service offering and key competitive advantages. ANZ CEO Nick Knight, Chief Marketing Officer Allan Collins and Chief Digital & Technology Officer Michael Gillespie all presented on their respective areas of expertise.

A key message from the presentations was the efficiency gains that technology is driving within the Domino's business. Delivering high quality food to customers, quickly, is key to generating repeat sales and a consistent investment in technology is helping achieve this. Moreover, technology transfer is now a two-way street. The introduction of an inventory control app, for store managers, transforms an end of night practice key to operational efficiency - unit cost savings. This app was developed and built by DPZ in the USA.

Technology will only cut delivery times so far and getting physically closer to customers is critical. To this end, an important leg of the company's strategy is splitting store territories. Questions have been asked of this approach, suggesting the strategy might lead to cannibalisation of store sales. Domino's findings to date have been the opposite. Split store territories not only experience increased demand due to shorter delivery times, but the stores become more profitable as the labour and transportation costs per order fall substantially. Time will tell whether this is experienced consistently across the network, but the success so far has management confident they can execute.

### ResMed (RMD:ASX)

Global sleep apnoea specialist ResMed reported strong first quarter results for 2019. The group is delivering solid top line growth and operating leverage is magnifying the impact at the bottom line. For the quarter, group revenue rose 12% to US\$588m, while adjusted profit after tax rose 23% to US\$116.3m, equivalent to EPS of US\$0.81.

Selling into more than 120 countries, ResMed recorded an increase in quarterly device growth of 13% to US\$324m, masks sales growth of 9% to US\$217m and revenue from digital services of US\$47.5m. Margins have risen from 20.6% to 23.6%, an illustration of the operating leverage of the business.

The group continues to target sufferers of sleep apnoea, of which there are estimated to be 936m as well as the Chronic Obstructive Pulmonary Disease (COPD) patient cohort of circa 400m. A key enabler has been the company's significant commitment to research and development expenditure that has resulted in market leading products and the rollout of digital health technologies. This has enabled patients and physicians to be better informed on the daily health outcomes of those affected, leading to higher levels of patient compliance and better treatment outcomes.

## 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.

The information presented in this fact sheet is not intended to be advice. It has not been prepared taking into account any particular investor or class of investors investment objectives, financial situation or needs, & should not be used as the basis for making investment, financial or other decisions. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information. SFML does not guarantee the repayment of capital, payment of income or performance.

## Performance contributors

Top five	Contribution (%)
MYOB Group	0.38
Navitas	0.29
Domino's Pizza Enterprises	0.06
Computershare	(0.02)
Breville Group	(0.05)
Bottom five	Contribution (%)
Altium	(1.22)
Oil Search	(0.65)
Seek	(0.58)
Infomedia	(0.54)
Aristocrat Leisure	(0.47)

## Industry exposure

Industry group	Weight (%)
Consumer Services	24.73
Software & Services	20.28
Health Care Equipment & Services	12.60
Capital Goods	9.15
Diversified Financials	5.14
Materials	4.99
Energy	4.94
Commercial & Professional Services	4.81
Pharmaceuticals, Biotechnology & Life Sciences	4.18
Household & Personal Products	3.31
Insurance	2.46
Media & Entertainment	2.17
Retailing	0.76
Cash & Other	0.47

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