# Selector Australian Equities Fund

## Monthly report – August 2019

## Market insights

World politics played out on Twitter, alongside fluid global monetary policies, combined to deliver a volatile backdrop to corporate Australia's annual reporting season. By month's end our local market index finished down 2.88% to 6,698 points. No prizes for guessing that the headlines continue to land on two separate but interconnecting macroeconomic developments. The first surrounds the trade war while the second incorporates the flow on effects of a global economic slowdown and the subsequent actions taken by government authorities endeavoring to stimulate growth.

On the first, the likely outcome is anyone's guess, suffice to note that business is getting on with what needs to be done. This is having an impact with executives commenting on the frustration and difficulty of navigating current conditions throughout reporting season. CEO of push-to-connect plumbing group Reliance Worldwide Corporation, Heath Sharp offered perhaps the most honest assessment of its impact, *"Frankly, we have no idea what tariffs we will face next week…let alone by the end of the year. [But] we think it will actually be a competitive advantage given a high proportion of our products are made in our own factories…whereas the majority of our competitors are procuring finished goods from China."*

While Reliance may be better positioned than others, disruptions to manufacturing supply chains and the necessity to forward plan in an environment of unpredictability should be sufficient grounds for investors to give management some latitude. Pre-empting President Trump's next move is certainly playing on the minds of the world's central bankers, who have collectively taken action to cut cash rates. In the U.S., the Federal Reserve took action to cut rates for the first time since 2008, followed in quick succession by others, including the New Zealand Reserve Bank that promptly cut rates by 0.50% with the promise of more to follow.

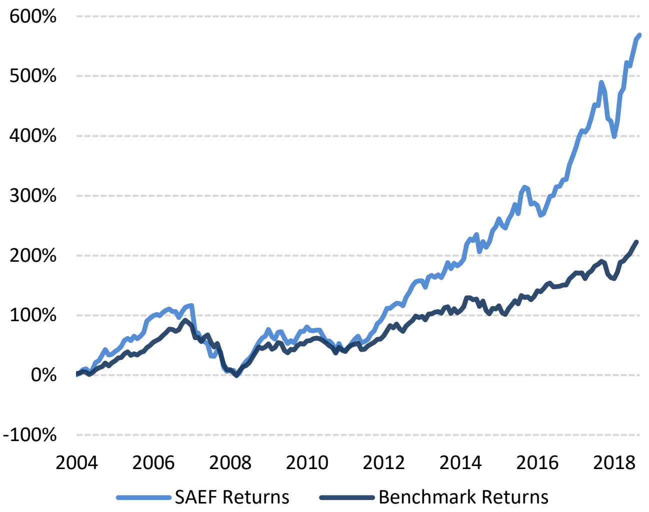
Furthermore, the U.S. two-year Treasury securities traded above the 10-year note yield for the first time since 2007, with market commentators pointing to the "*inverted yield*" as an indicator of an impending recession. The implications of these yield moves have some merit, but investors should be cautioned into thinking that a recessionary outcome is a given. What seems very apparent, is the failure of monetary policy in having the same stimulatory impact on activity as in previous eras. Ultimately, this will force the hand of governments to consider other stimulatory fiscal measures.

With that as a backdrop we were delighted with the performance of the majority of our large investment holdings during the month. Reporting season, twice a year, provides the best avenue for genuine investors to measure the ongoing financial health and progress of businesses and hear from management teams. To that end, there were many positives that emerged despite the current political and economic backdrop.

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: 07/12/2004
Before fees, costs and tax, and assuming reinvestment of distributions

## Top holdings

| Company name | Code | Weight (%) |
|---|---|---|
| Aristocrat Leisure | ALL | 4.61 |
| Altium | ALU | 4.59 |
| Jumbo Interactive | JIN | 4.20 |
| Flight Centre Travel Group | FLT | 4.20 |
| ResMed | RMD | 4.19 |
| Seek | SEK | 4.17 |
| Infomedia | IFM | 3.80 |
| James Hardie Industries | JHX | 3.78 |
| Cochlear | COH | 3.77 |
| IRESS | IRE | 3.77 |

## Unit prices as at 31 August 2019

| | |
|---|---|
| Entry price | $2.3048 |
| Mid price | $2.2991 |
| Exit price | $2.2934 |

## Performance as at 31 August 2019*

| | FYTD | 1 Month | 3 Months | 6 Months | 1 Year | 3 Years | 5 Years | 10 Years | Since Inception Annualised |
|---|---|---|---|---|---|---|---|---|---|
| Fund (net of fees) | 4.34 | 0.94 | 7.98 | 16.36 | 11.69 | 14.90 | 15.48 | 12.77 | 10.58 |
| Fund (gross of fees) | 4.56 | 1.05 | 8.40 | 17.22 | 13.41 | 17.31 | 18.32 | 16.47 | 13.76 |
| All Ords Accumulation Index | 0.68 | (2.22) | 4.13 | 9.32 | 8.58 | 11.10 | 8.05 | 8.58 | 8.11 |
| Difference (gross of fees) | 3.88 | 3.27 | 4.27 | 7.90 | 4.83 | 6.21 | 10.27 | 7.89 | 5.65 |

*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

### Nanosonics (NAN:ASX)

Global leader in infection control solutions Nanosonics unveiled a strong financial report card for 2019. Led by CEO Michael Kavanagh, Nanosonics is continuing to lay the foundations of a long duration business, underpinned by its focus on the infection control solutions market. Currently, the business is underpinned by the global rollout of Trophon2, an automated high-level disinfection (HLD) unit for ultrasound probes. Since its market release, the Trophon technology has become the standard of care for HLD in the healthcare environment, with over 20,000 units installed globally. This compares to a market opportunity estimated to number 120,000 units. The largest region is the U.S. market, where Nanosonics already commands a 46% market share, with over 18,500 units installed in over 5,000 hospitals. The business strategy is to go *"wide and deep",* referring to extending the market footprint while penetrating deeper into each hospital setting. Management continues to point to the Australian market, where it currently enjoys a 75% share, as a handy longer-term reference point for the U.S. market.

During 2019, the company's global presence extended to 21 countries, with new European agreements established with GE Healthcare for distribution in Denmark, Finland, Spain and Portugal. Regulatory approval was also received in Japan, with GE Healthcare also joining as a key distributor. For 2020, management are guiding investors to expect growth in the installed base in the U.S. to continue at similar rates to those experienced in 2019, with adoption in Europe and Rest of World to continue. With substantial investment to come, profitability for 2020 is expected to be weighted to the second half. The company ended the year with no debt and a cash balance of $72m, with a current market capitalization of $1.9b.

### Blackmores (BKL:ASX)

The Blackmores Group delivered a full year underlying net profit result at the lower end of investor expectations, down 24% to $55m. To be clear, a slower market has contributed to this with management taking prudent action to correct imbalances within the business. While group net sales rose 1% to $610m, it was a figure much less than management were expecting.

The introduction of regulatory changes to China's e-commerce laws in January hit sales, which fell 15% to $122m in country. These laws essentially require all customers that undertake trade to be registered by the Chinese Government for tax paying purposes. Looking through this China result however, where the group's products are sold via online e-commerce sites including Tmall and Alihealth, sales continue to grow strongly, up 22%. The real highlight overlooked by many, was the progress made in the Other Asia region. Comprising a host of countries, including Malaysia, Singapore, Thailand, Korea, Hong Kong and Indonesia, this collective group of countries delivered 30% revenue growth to $107m and a more than tripling of operating profits from $2.3m to $7.4m.

While investors have reacted negatively to the result, when consideration is given to the external challenges presented by the Chinese regulatory changes offset by the significant and positive internal actions currently underway, we would suggest a more prudent approach is to stay the course. Blackmores has a market capitalisation of $1.2b with net debt of $94m.

## Performance contributors

| Top five | Contribution (%) |
|---|---|
| Jumbo Interactive | 0.61 |
| Nanosonics | 0.55 |
| Infomedia | 0.37 |
| PolyNovo | 0.34 |
| James Hardie Industries | 0.27 |
| **Bottom five** | **Contribution (%)** |
| Nearmap | (0.47) |
| IRESS | (0.36) |
| Blackmores | (0.35) |
| IOOF Holdings | (0.28) |
| NIB Holdings | (0.17) |

## Industry exposure

| Industry group | Weight (%) |
|---|---|
| Cash & Other | 20.98 |
| Software & Services | 17.44 |
| Consumer Services | 17.16 |
| Health Care Equipment & Services | 14.89 |
| Materials | 4.81 |
| Capital Goods | 4.63 |
| Commercial & Professional Services | 4.17 |
| Insurance | 3.37 |
| Diversified Financials | 3.26 |
| Pharmaceuticals, Biotechnology & Life Sciences | 2.53 |
| Media & Entertainment | 2.51 |
| Household & Personal Products | 2.11 |
| Automobiles & Components | 1.12 |
| Energy | 0.66 |
| Consumer Durables & Apparel | 0.36 |

## 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.

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