

Selector High Conviction Equity Fund

Monthly report – September 2019

Market insights

The domestic market shrugged off continued global uncertainty and a volatile reporting season to race back towards record territory. Despite the ongoing trade war between the U.S. and China and an attack on Saudi Arabia's oil supply, our local market index finished up 1.53% to 6,800 points. Stealing the headlines this month has been the U.S. Federal Reserve's (Fed) recent attempts to stabilise economic activity by reducing their interest rate target range and intervening in the short-term repurchase agreement (repo) money market.

Continued trade tensions alongside waning global growth has forced governments to intervene as they attempt to stimulate growth and bring stability to financial markets. This has been particularly evident over the month as the Fed cut interest rates for the second time this year from a target range of 2.00-2.25% to a range of 1.75-2.00%. Despite this move, Trump has continued to publicly criticise the Fed for not cutting rates far enough, "Jay Powell and the Federal Reserve Fail Again. No 'guts,' no sense, no vision!".

The Fed's move to stabilise the repo market, where US\$3 trillion of debt is financed daily, with a cash injection was a measure not seen since the Global Financial Crisis. The repo market is essentially the plumbing for the entire global financial system in which banks and financial counterparties lend vast amounts of money to each other to meet funding obligations. Basically, it helps a wide range of transactions go smoothly, including trading in the \$16 trillion US treasury market. In response to an increased demand on cash, partly due to companies paying their corporate tax bills, supply in the overnight market dried up causing the cost of borrowing to skyrocket from around 2% to as high as 9%. In response, the Fed has injected over \$380b into the market by purchasing Treasuries with the view to continue this until demand normalises.

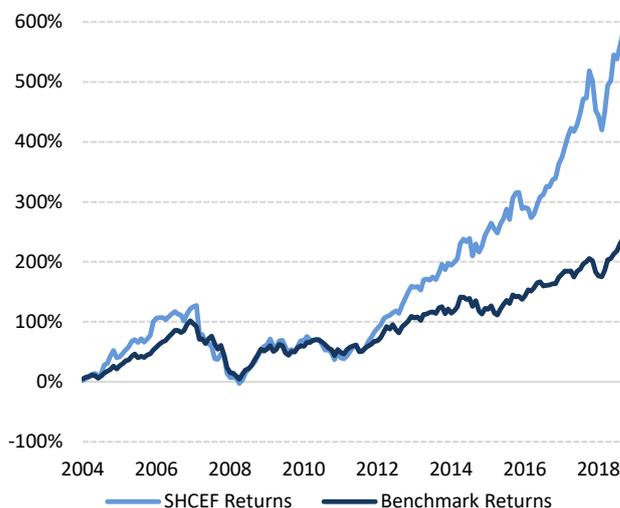
An attack targeting two plants of the Saudi Arabian oil giant Aramco, shook international oil markets this month. 18 drones and 7 missiles were used to cripple 5% of global production in the biggest assault on regional oil facilities since the Gulf war. While Iran immediately denied responsibility, Saudi Arabia, the U.K. and the U.S. continue to view them as the primary suspect. The oil price has since steadied on news that 70% of the lost capacity had already been restored within days of the attack, with full production expected within two to three weeks.

This month, our travels took us north to the U.K. and Ireland, across to Germany and over to the U.S. The opportunity to visit companies and meet with management teams on their home turf provides us with invaluable insights into these businesses. In all, we met with nine companies and subsidiaries of businesses we hold. A detailed summary of the trip has been included in the September 2019 Quarterly Newsletter.

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 (%)
Aristocrat Leisure	ALL	5.97
Jumbo Interactive	JIN	5.90
Altium	ALU	5.00
Flight Centre Travel Group	FLT	4.98
Seek	SEK	4.93
James Hardie Industries	JHX	4.83
ResMed	RMD	4.57
Infomedia	IFM	4.50
Nanosonics	NAN	4.45
Cochlear	COH	4.41

Unit prices as at 30 September 2019

Entry price	\$3.0702
Mid price	\$3.0625
Exit price	\$3.0548

Performance as at 30 September 2019*

	FYTD	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	Since Inception
Fund (net of fees)	6.00	1.99	6.00	15.59	14.66	16.99	17.49	14.36	11.84
Fund (gross of fees)	7.07	2.20	7.07	17.23	17.28	19.28	19.71	16.52	13.99
All Ords Accumulation Index	2.82	2.13	2.82	10.87	12.08	11.73	9.69	8.17	8.52
Difference (gross of fees)	4.25	0.07	4.25	6.36	5.20	7.55	10.02	8.35	5.47

*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 the disqualification of five directors and executives within 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 Venardos' comments at the Annual General Meeting, held less than two weeks earlier.

While Venardos and Managing Director Chris Kelaher stepped aside pending the resolution of these matters with APRA, the company maintained that the allegations raised by APRA were misconceived. As such, they intended to vigorously defend against the proceedings.

The Federal Court of Australia has now validated IOOF's position, holding that the five directors and executives did not contravene the SIS Act. The Court declined to make any disqualification orders and awarded costs in IOOF's favour. This comes as welcome news for management and shareholders alike.

The company ended the year with \$427m in debt, a cash balance of \$97m and a current market capitalization of \$2.2b.

Sims Metal Management (SGM:ASX)

After a challenging FY19, global scrap recycler Sims Metal Management released a disappointing trading update brought on by the recent, significant falls in ferrous and non-ferrous metal prices.

In their FY19 results release, the company explained that challenging trading conditions, created by the volatility in ferrous prices and disruptions from the continuing China-U.S. trade war, has presented significant headwinds over the year. To date, there has been no relief with the trade war remaining unresolved, continuing to reduce demand for steel and aluminium. This lack of demand has led to a reduced requirement for scrap, in turn forcing a steep fall in prices. At current prices, it has become uneconomical for a number of Sims' scrap suppliers to continue operating.

This effect has been compounded by the continued freight cost increases. Alistair Field, CEO and Managing Director, explained that *"under normal market conditions this would be manageable, but in this very low-price environment, with poor liquidity, it is not possible to recover increased freight costs through the buy price."*

While the company acknowledges that it is not possible to predict the duration of low prices and poor liquidity environments, they are confident that the scrap market will mean-revert and recover in the medium term. In the interim, these market pressures will reduce the 1H FY20 earnings materially below the prior corresponding half year.

The company ended the year with debt of \$35m, a cash balance of \$383m, and a current market capitalization of \$2.1b.

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.

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 (%)
IOOF Holdings	0.77
Blackmores	0.48
James Hardie Industries	0.45
Jumbo Interactive	0.44
OFX Group	0.35
Bottom five	Contribution (%)
Infomedia	(0.52)
Altium	(0.49)
Nanosonics	(0.26)
IRESS	(0.23)
Sims Metal Management	(0.20)

Industry exposure

Industry group	Weight (%)
Consumer Services	22.57
Software & Services	20.96
Health Care Equipment & Services	15.63
Materials	6.76
Capital Goods	6.27
Diversified Financials	5.68
Commercial & Professional Services	4.93
Insurance	3.43
Pharmaceuticals, Biotechnology & Life Sciences	3.41
Energy	3.06
Household & Personal Products	3.02
Media & Entertainment	2.28
Cash & Other	1.34
Consumer Durables & Apparel	0.65

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