

# Selector High Conviction Equity Fund

Monthly report – January 2020

## Market insights

Markets rallied to record territory during January with investors navigating growing international uncertainty. For the month, the All Ordinaries Index closed up 4.69% to 7121.2 points. Dominating headlines has been the assassination of an Iranian General, partial resolution of the U.S.-Sino trade war, and the rapid spread of a new coronavirus throughout China.

A U.S. ordered airstrike killing Iran's most powerful General, Qasem Soleimani, increased hostilities between the already feuding countries. The counter-offensive from Iran, targeting a largely empty military base, simmered the possibility of further escalation. Regrettably, at the height of the tension, Iran mistakenly shot down a civil plane killing all 176 people on board.

The first notable sign of progress in the U.S.-Sino trade war has materialised through a signed phase-one agreement. Focused on reducing the trade imbalance with the U.S., China has committed to purchasing US\$200b of goods including agricultural products and energy exports. The agreement also binds China to improve the enforcement of intellectual property rights alongside limiting Beijing from engaging in currency manipulation. In exchange, the U.S. will reduce some of the existing tariffs already imposed, while retaining those relating to US\$360b in Chinese goods.

While the actual impacts from this first round of negotiations are hard to gauge due to scant specifics, especially in relation to how China will allocate its promised spending, the deal is an initial first step in resolving the protracted dispute. Putting the agreement into perspective, overall tariffs on average, have increased from 3% prior to President Donald Trump taking office to 21%. The implementation of phase one of the deal will see them reduce to 19.3%.

Wuhan, the Chinese city at the centre of a deadly coronavirus has been placed in lockdown as officials rush to stem the potential for further propagation. With more than 7,700 confirmed cases including 170 deaths, the virus has been declared a global state of emergency by the World Health Organisation (WHO). In explaining this decision, WHO chief Tedros Adhanom Ghebreyesus commented, "The main reason for this declaration is not what is happening in China but what is happening in other countries", especially those with weaker healthcare systems as there are now confirmed cases of the virus in 19 nations.

The U.S. Federal Reserve decided against a rate move this month, affirming their commitment to higher inflation. The unanimous decision reflected strength in the U.S. labour market and moderate economic growth.

As bushfires impacted the local economy, the question of climate change and its impact continues to gain traction. Politically, pressure is mounting for longer term solutions. With Australia coming in as the 14<sup>th</sup> largest global carbon emitter per capita, there's no hiding from the fact that there needs to be greater accountability across all avenues. This is a topic that we explore in more detail in our upcoming quarterly.

We continue to seek businesses with:

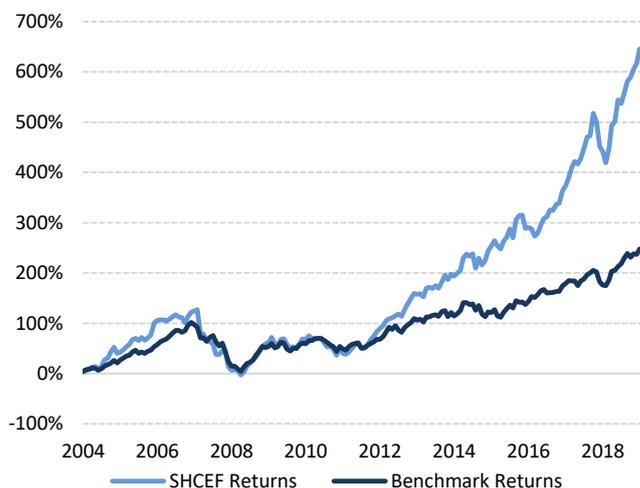
1. Competent management teams
2. Business leadership qualities
3. Strong balance sheets
4. A focus on capital management

## Performance as at 31 January 2020\*

|                             | 1 Month | 3 Months | 6 Months | 1 Year | 3 Years | 5 Years | 10 Years | 15 Years | Since Inception |
|-----------------------------|---------|----------|----------|--------|---------|---------|----------|----------|-----------------|
| Fund (net of fees)          | 3.97    | 4.56     | 8.94     | 34.05  | 23.90   | 17.56   | 14.61    | 11.72    | 11.99           |
| Fund (gross of fees)        | 3.99    | 4.77     | 10.42    | 37.07  | 26.28   | 19.76   | 16.77    | 13.83    | 14.13           |
| All Ords Accumulation Index | 4.69    | 5.86     | 5.33     | 24.88  | 12.40   | 9.64    | 9.01     | 8.22     | 8.70            |
| Difference (gross of fees)  | (0.70)  | (1.09)   | 5.09     | 12.19  | 13.88   | 10.12   | 7.76     | 5.61     | 5.43            |

\*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  | 6.26       |
| James Hardie Industries | JHX  | 5.48       |
| Altium                  | ALU  | 5.29       |
| ResMed                  | RMD  | 5.12       |
| Seek                    | SEK  | 4.62       |
| Cochlear                | COH  | 4.53       |
| Nanosonics              | NAN  | 4.34       |
| CSL                     | CSL  | 4.04       |
| Infomedia               | IFM  | 4.03       |
| IOOF Holdings           | IFL  | 3.96       |

## Unit prices as at 31 January 2020

|             |          |
|-------------|----------|
| Entry price | \$3.2595 |
| Mid price   | \$3.2514 |
| Exit price  | \$3.2433 |

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## Portfolio commentary

### NIB Holdings (NHF:ASX)

Private health insurer NIB Holdings, downgraded their earnings guidance for the 2020 financial year with group underlying operating profit (UOP) likely to be at least \$170m, down from the \$200m guided at the 2019 full year result, and statutory operating profit expected to be at least \$150m, down from the guided \$180m. The \$30m adjustment can be broken down into three equal components being the reduced earnings of the Australian Residents Health Insurance (ARHI) business, the reduced earnings of the adjacent businesses, and investment initiatives.

The group explained that the recent claims environments in Australia and New Zealand were starting to place pressure on forecasted earnings. Managing Director Mark Fitzgibbon noted, *"We've definitely seen a tick up in claims and while we did anticipate some level of claims inflation across the Group in FY20, recent experience is that it's been more widespread across a number of business lines than we previously anticipated."* Despite this trend, the company has confirmed that they still expect the ARHI business to deliver a net profit margin of circa 6% this year.

Notwithstanding the recent earnings pressure Fitzgibbon remains confident about the company's outlook, *"The underlying commercial performance across our businesses is very good with attractive returns on invested capital and ongoing growth prospects. And while our nib Travel business will require a longer time horizon, we're still very confident of its outlook and earnings potential. We've also a pipeline of significant initiatives that will further propel long term growth such as our personalisation strategy and joint venture with Cigna, our joint venture in China and investment in Maori population health in New Zealand."*

### Nearmap (NEA:ASX)

Aerial imagery leader Nearmap, provided a market update and revised guidance which fell short of their previous projections. While Annualised Contract Value (ACV) for the 1H20 grew by 23% to \$96.6m against the prior corresponding period (pcp), the ACV guidance for the full year has been reduced to a range of \$102m-\$110m down from \$116m-\$120m.

The main driver behind the reduced guidance was the churn and downgrade events experienced in three enterprise customers within the North American business. The first churn event followed a court-imposed injunction against a partner with the other two resulting from the slowdown in mapping for the autonomous vehicle industry. While these large customers weighed on the results, the ACV of the core business in North America increased 41% on the pcp to \$24.9m.

Commenting on the first half performance, CEO and Managing Director, Dr Rob Newman noted *"The fundamentals of our business model remain firmly intact and we are confident on the outlook for the medium to long-term, notwithstanding that performance in 1H20 showed that at our current scale, our performance can be impacted by a small number of large customers. The potential for a small number of customers to impact our results will become less as we grow, continue to diversify our customer base and leverage opportunities to grow into new markets."*

## 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.

## Performance contributors

| Top five                     | Contribution (%) |
|------------------------------|------------------|
| Altium                       | 0.71             |
| James Hardie Industries      | 0.70             |
| ResMed                       | 0.67             |
| PolyNovo                     | 0.54             |
| CSL                          | 0.49             |
| Bottom five                  | Contribution (%) |
| Nearmap                      | (0.62)           |
| Flight Centre Travel Group   | (0.46)           |
| NIB Holdings                 | (0.37)           |
| Jumbo Interactive            | (0.33)           |
| The Star Entertainment Group | (0.21)           |

## Industry exposure

| Industry group                           | Weight (%) |
|--|------------|
| Software & Services                      | 20.68      |
| Consumer Services                        | 18.78      |
| Health Care Equipment & Services         | 16.74      |
| Materials                                | 7.25       |
| Diversified Financials                   | 6.07       |
| Capital Goods                            | 5.99       |
| Commercial & Professional Services       | 4.62       |
| Pharmaceuticals, Biotech & Life Sciences | 4.04       |
| Cash & Other                             | 3.98       |
| Household & Personal Products            | 2.79       |
| Energy                                   | 2.68       |
| Media & Entertainment                    | 2.28       |
| Insurance                                | 2.25       |
| Automobiles & Components                 | 1.16       |
| Consumer Durables & Apparel              | 0.67       |

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