

# Selector High Conviction Equity Fund

Monthly report – March 2020

## Market insights

The dramatic events that have taken hold as a result of the novel Coronavirus, known as COVID-19, can only be described as extraordinary. In March alone, the number of confirmed cases in Australia has grown rapidly from 25 to 4,559 while globally the total has jumped from 86,011 to 857,487. Countries, in response, have closed their borders and imposed stringent lockdown laws in an effort to stem the impacts of the virus. As companies grapple with the growing fallout, increased uncertainty has unsettled financial markets with our local All Ordinaries Index closing down 21.5% to 5,111 points.

While containment of the virus is paramount, the draconian measures governments have imposed to limit movement and individual gatherings have seriously impeded business operations. Since reporting season last month, COVID-19 has completely overwhelmed corporate confidence with some 134 listed companies withdrawing their recently announced guidance figures. Of the ASX 100 constituents, 34% have already withdrawn or reduced guidance. While this is to be expected with increased earnings uncertainty, a sustained hit to cashflows will likely see a significant number of companies call on shareholders for emergency capital raisings.

The social repercussions of a sharp business downturn are undeniable. In Australia, unemployment is on the rise with major companies moving quickly to lay off scores of staff. Notably, airline operator Qantas has stood down 20,000 employees, retail group Myer is moving to stand down 10,000 staff, and Flight Centre has stood down 3,800 staff in Australia. This is just the tip of the iceberg, with the Government estimating as many as one million people could be made unemployed.

Centrelink is already overwhelmed with requests for help. The Government has responded with total stimulus commitments of \$214b of which \$130b in wage subsidies is now being established to provide relief to affected individuals. The ramifications are significant and will not truly be understood until sufficient water has passed under the bridge. Governments around the world have responded in kind with the U.S. and U.K. committing to stimulus packages of US\$2.2t and £440b respectively.

Central banks have moved quickly to cut rates and unveil quantitative easing commitments to help stimulate economic activity. In Australia, we experienced two cuts over March reducing interest rates to a historic low of 0.25%. In the U.S., rates have now reached the 0% lower bound.

With rates already so low, the question of “where to from here” must be asked. “We are one recession away from joining Europe and Japan in the monetary black hole of zero rates and no prospect of escape,” said Harvard University economist Larry Summers. The Fed typically cuts short-term interest rates by 5% in a recession, he said, yet that has been made impossible now with rates at their current levels.

We continue to seek businesses with:

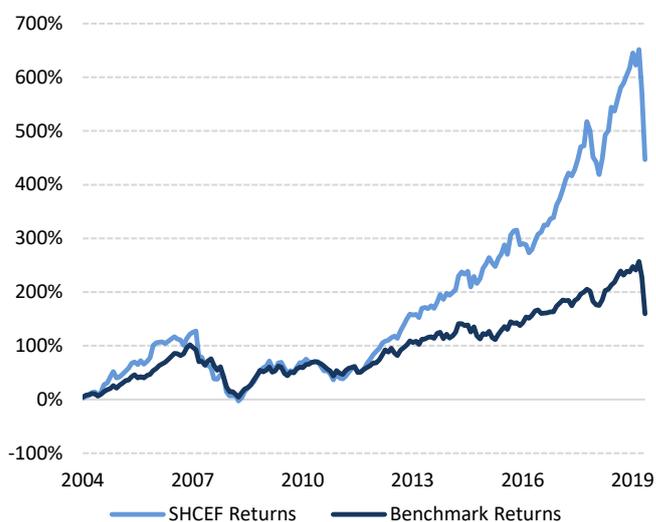
1. Competent management teams
2. Business leadership qualities
3. Strong balance sheets
4. A focus on capital management

## Performance as at 31 March 2020\*

	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	15 Years	Since Inception
Fund (net of fees)	(19.12)	(24.48)	(22.96)	(10.87)	9.38	8.14	10.47	8.98	9.56
Fund (gross of fees)	(18.71)	(24.33)	(22.32)	(8.95)	11.45	10.15	12.53	11.02	11.65
All Ords Accumulation Index	(20.94)	(23.92)	(23.36)	(15.02)	(0.68)	1.49	4.80	5.87	6.38
Difference (gross of fees)	2.23	(0.41)	1.04	6.07	12.13	8.66	7.73	5.15	5.27

\*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. For periods greater than one year, returns are annualised. 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 (%)
ResMed	RMD	6.28
Iress	IRE	5.57
Altium	ALU	5.48
Cochlear	COH	5.45
Domino's Pizza Enterprises	DMP	5.18
CSL	CSL	5.08
Aristocrat Leisure	ALL	4.60
TechnologyOne	TNE	4.58
Nanosonics	NAN	4.36
James Hardie Industries	JHX	4.07

## Unit prices as at 31 March 2020

Entry price	\$2.3676
Mid price	\$2.3617
Exit price	\$2.3558

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## Portfolio commentary

### Cochlear (COH:ASX)

Leading global hearing implant specialist Cochlear has faced two significant headwinds over the past month with a global slowdown in elective surgeries due to COVID-19 and an adverse appeal decision in the long running U.S. patent infringement case.

The U.S. Court of Appeal affirmed an earlier decision by the U.S. District Court to award patent infringement damages of US\$268m against Cochlear. In addition, a prejudgment interest and attorney's fees totaling US\$138m is still pending. The patent at issue has expired and will not disrupt ongoing operations.

Management had initially expected COVID-19 to only impact full year sales in China, with implant surgeries on hold. As the virus has now spread globally, Cochlear have withdrawn their full year guidance, due to a material deferral of elective surgeries, with hospitals focused on combating infected patients and performing more critical procedures.

With the duration and severity of COVID-19 an unknown, forecasting a recovery is difficult, if not impossible. The possibility of an increased debt exposure during this period is not the preferred course. Cochlear decided to initiate a capital raising of up to \$880m to enhance liquidity and to ensure the company emerges from the outbreak in a strong competitive position.

If we take a holistic view of Cochlear, we recognise a business with a strong management team, superior product offerings and significant long-term growth opportunities. For these reasons, we felt it be prudent to fully support this raising and stay the course during this difficult period.

Cochlear has a market capitalisation of \$12b and post this raising will be net cash to the tune of \$700m prior to any patent settlement. The company announced an interim dividend of \$1.60 and have indicated the dividend policy will be suspended until further notice.

### Star Entertainment Group (SGR:ASX)

Since the half year results, the Government has introduced unprecedented changes to close all non-essential services, which includes The Star's casinos. The immediate impact of government directives includes cessation of all gaming activities for an undetermined period, closure of food and beverage, banqueting and conferencing offerings, and reduced capacity for hotel accommodation services.

The Star has since provided a COVID-19 update that will see a significant reduction in operating costs and capital expenditure to reduce losses. The company has chosen to temporarily stand down over 90% of its 9,000-employee workforce, while the board and senior management have chosen to forego a significant percentage of their fees and salaries.

Management has also made the decision to defer payment of its recently announced interim dividend and revoke its dividend payment policy of paying out a minimum of 70% of normalised profit after tax.

The Star Entertainment Group has a current market capitalisation of \$2b and net debt of \$1.3b.

## 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 (%)
Megaport	0.51
NIB Holdings	0.49
Blackmores	0.40
TechnologyOne	0.25
Fisher & Paykel Healthcare Corporation	0.16

Bottom five	Contribution (%)
Flight Centre Travel Group	(2.48)
Aristocrat Leisure	(2.23)
James Hardie Industries	(1.92)
Infomedia	(1.59)
IOOF Holdings	(1.37)

## Industry exposure

Industry group	Weight (%)
Software & Services	25.44
Health Care Equipment & Services	18.36
Consumer Services	15.68
Capital Goods	6.37
Pharmaceuticals, Biotech & Life Sciences	5.08
Materials	5.04
Diversified Financials	4.97
Media & Entertainment	4.52
Commercial & Professional Services	3.76
Household & Personal Products	3.27
Insurance	3.21
Cash & Other	2.23
Automobiles & Components	1.33
Consumer Durables & Apparel	0.76

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