

Selector High Conviction Equity Fund

Monthly report – August 2020

Market insights

August, the first reporting period post the onset of COVID-19, saw the pandemic feature heavily across management commentary. While the financial repercussions of the health crisis surprised positively in some areas, predominantly in retail and online, it was equally damaging across tourism, property and the banking sector. Despite these uneven outcomes, the All Ordinaries Index performed strongly, advancing 3.1% to 6245.9.

Reflecting on the financial damage inflicted by COVID-19, the payment of dividends was a necessary casualty. In total, 55% of companies cut their dividend payments, with overall distributions to shareholders falling to \$63.3b, compared to the \$87.7b paid out in 2019.

With COVID-19 and reporting season dominating investor attention, the release of a major policy development went largely unnoticed. In the U.S. the Federal Reserve approved a major shift in how it sets interest rates. At the Jackson Hole economic symposium, Fed Chair Jerome Powell outlined that the long standing practice of pre-emptively lifting interest rates to head off higher inflation, one that was formally approved as a goal in 2012, was now being dropped. As Powell noted the, “reality of a quite difficult macroeconomic context of low interest rates, low inflation, relatively low productivity, slow growth and those kind of things,” has pushed the role of employment targets to the fore. “We’ve really got to work to find every scrap of leverage in helping stabilise the economy.” This new direction, “reflects our view that a robust job market can be sustained without causing an outbreak of inflation.” While lacking specifics on how high or long they would allow inflation to rise above 2%, the agreement from all 17 rate-setting officials sets in train the potential for a longer era of low interest rates. Dropping the inflation target will avert the short sharp moves that saw the Fed raise rates four times during 2018, in anticipation of higher inflation, only to fully reverse it in early 2019 as the economy slowed. Today, the Federal Fund rate sits at its lowest range of 0%-0.25%. Investors should take note that under this setting, a focus on what makes a great business rather than market timing will prove a more successful long-term strategy.

In a significant development for the hearing impaired, a group of 31 international hearing experts from more than 13 countries have authored the industry’s first consensus paper, published in JAMA Otolaryngology. The paper lays the groundwork of establishing a minimum global standard of care for cochlear implantation for adults with severe to profound hearing loss. With an estimated one in eight people in the U.S. suffering hearing loss and current access to cochlear implants sitting at just 5%, this important consensus document will help create clinical best practice guidelines. Listed manufacturer Cochlear is the global leader for the hearing impaired and a company that is very well placed to lead the industry’s awareness among the hearing impaired and government bodies.

We continue to seek businesses with:

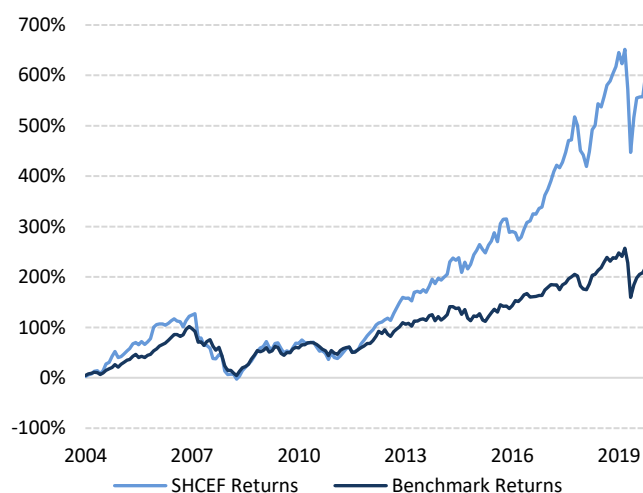
1. Competent management teams
2. Business leadership qualities
3. Strong balance sheets
4. A focus on capital management

Performance as at 31 August 2020*

	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	15 Years	Since Inception
Fund (net of fees)	6.47	6.91	2.76	(0.09)	14.92	15.11	14.49	9.18	10.96
Fund (gross of fees)	6.82	7.24	4.39	1.95	17.21	17.32	16.66	11.22	13.09
All Ords Accumulation Index	3.71	7.14	(2.54)	(3.51)	6.71	7.94	7.90	6.73	7.61
Difference (gross of fees)	3.11	0.10	6.93	5.46	10.50	9.38	8.76	4.49	5.48

*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 (%)
Domino's Pizza Enterprises	DMP	6.20
Altium	ALU	5.33
James Hardie Industries	JHX	5.30
Carsales.com	CAR	5.09
Aristocrat Leisure	ALL	4.75
Iress	IRE	4.71
Cochlear	COH	4.70
ResMed	RMD	4.69
Reece	REH	4.50
Seek	SEK	3.95

Unit prices as at 31 August 2020

Entry price	\$2.9989
Mid price	\$2.9914
Exit price	\$2.9839

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Portfolio commentary

IOOF Holdings (IFL:ASX)

IOOF has entered into an agreement to acquire NAB's wealth management business MLC, subject to regulatory approval. If the transaction is completed as expected, IOOF will become Australia's leading advice-led wealth manager, with circa \$510b of funds under management, advice and administration (FUMA) and 1,884 advisers. We expect these numbers to change before settlement in 2021.

The agreed purchase price of MLC was \$1.44b, requiring an equity raise of \$1.04b with the remainder to be funded through debt and existing cash reserves. Post completion, the company will retain a net debt to EBITDA ratio of less than 1.0x.

Chief Executive Officer Renato Mota commented *"MLC is a natural fit with IOOF and presents a unique opportunity to create value from synergies for the benefit of clients, members and shareholders. This is a once in a generation opportunity to create the leading wealth manager of the future."*

This is a large transaction, and while the timing is not perfect, we think Mota can deliver given time. The Australian financial services industry is currently out of favour and asset prices reflect this sentiment.

IOOF has a market capitalisation of \$2.3b, including funds raised of \$1.04b.

ResMed (RMD:ASX)

The full year 2020 financial result was never going to be a straightforward exercise. The economic fallout from COVID-19 has severely punished some businesses but equally rewarded others. In this camp, global respiratory leader ResMed delivered a very strong fourth quarter and full year result.

In terms of financials, group revenues rose 13% to US\$2,957m, with underlying operating profits rising 24% to US\$891m and underlying net profits up 32% to US\$693m. Benefiting from a global wide surge in ventilator demand, ResMed delivered in excess of 150,000 invasive and non-invasive units during the second half of the financial year, an increase of over three and half times normal production levels. While operations are continuing to run at full capacity, management is forecasting a significant drop in demand, when compared to fourth quarter levels, as health authorities begin to reopen services.

ResMed has a market capitalisation of US\$25.8b and cash of over US\$147m.

Reliance Worldwide Corporation (RWC:ASX)

Reliance described the FY20 result as *"resilient at the core"*, referring to the U.S. and Australian markets, with *"a strong operating performance"*, reflecting the uplift in cashflow and the reduction of net debt by \$124m. At the headline, sales increased 5% to \$1.2b, with net profit after tax of \$130.3m, a decline of 18%.

While earnings and margin were impacted by reduced overhead recoveries from lower manufacturing, work and school from home placed extra pressure on plumbing systems driving demand across the U.S. In contrast, sales cratered in the UK and Europe as governments mandated business closures.

Despite a good start in the first two months of the year, with a continuation of strong sales in the U.S. and a recovery of sales in EMEA, no outlook was provided. Management are cautious about extrapolating these early results which could reflect both a pull forward of sales and pent up demand.

Reliance has a market capitalisation of \$3.1b and cash of over US\$82m.

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 (%)
Reliance Worldwide Corporation	0.95
Reece	0.85
Jumbo Interactive	0.70
Carsales.com	0.62
Domino's Pizza Enterprises	0.60
Bottom five	Contribution (%)
ResMed	(0.78)
Infomedia	(0.31)
Blackmores	(0.25)
Seek	(0.21)
TechnologyOne	(0.16)

Industry exposure

Industry group	Weight (%)
Software & Services	26.38
Consumer Services	18.19
Health Care Equipment & Services	15.30
Media & Entertainment	9.86
Capital Goods	7.62
Materials	5.30
Diversified Financials	4.23
Pharmaceuticals, Biotech & Life Sciences	3.72
Household & Personal Products	2.28
Insurance	2.18
Automobiles & Components	1.86
Consumer Durables & Apparel	1.65
Cash & Other	1.43

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