Chester High Conviction Fund
Quarterly Thoughts
April 2024

In partnership with COPIA

The Chester High Conviction Fund Philosophy

Our Key Principles

High Active Share

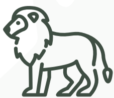
For active managers to outperform over the long term, the fund has to be truly different than the benchmark. This strategy has had an active share above 80% since inception. Don't follow the crowd.

Mid Cap Bias

Broadly speaking, we find more interesting opportunities outside the large cap universe. Exposure to mid and small caps is essential for long term outperformance.

Cash Flow Growth

We seek to invest alongside companies that either generate predictable cash flows in high quality industries, or determine an appropriate margin of safety where valuation support is paramount, which is in more cyclical sectors of the economy.



Back Owners Of Capital

Allocating capital to management teams that think like owners alleviates the principal-agent problem. "Show me the incentive and I'll show you the outcome" Charlie Munger.

Concentration In Few Ideas

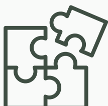
We keep a tight watchlist of stocks that are deemed suitable for investment. Focusing the research effort into fewer ideas provides more opportunity to gain higher conviction views. Too much diversification becomes counter productive.

Focus On Insights

Do we have a different view than the prevailing wisdom of the market? High conviction often comes from a granular understanding of where the market expectations are wrong.

A Contrarian View?

Backing ourselves in unloved, underappreciated or undiscovered stories has been the most consistent source of alpha generation of this strategy.



Keep It Simple

Ultimately, we allocate capital to sectors and companies we understand. The investment thesis needs to be easily articulated for a high conviction idea.

Invest With Humility

All fund managers make mistakes, it's part of the profession. Our tightly knit culture accepts these, tries to learn from them, and keeps making decisions. It is a profession where humility is absolutely essential.

Stay Curious

Fresh ideas or unique insights is critical to ensure the portfolio stays invested with conviction. To consistently generate outperformance we seek to test the investment thesis behind each decision. This requires discipline and a repeatable process in company visitation schedules.

APIR OPS7755AU
ARSN OPS7755AU

At 31 March 2023	1 mth %	3 mths %	6 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a	Incep. % p.a. *
Chester High Conviction Fund (after fees)	5.6	7.6	12.0	14.0	12.0	13.9	12.7
S&P/ASX 300 Accumulation Index	3.3	5.4	14.2	14.4	9.4	9.2	8.6
Outperformance (after all fees)	**+2.3**	**+2.2**	**-2.3**	**-0.4**	**+2.5**	**+4.7**	**+4.1**

* 27 Apr 2017

> *"Resilience matters in success...I don't know how to teach it to you except for 'I hope great suffering happens to you'...greatness comes from character and character is formed out of people who have suffered. I wish you ample doses of pain and suffering" —*
> Jensen Huang, CEO Nvidia

Over Easter a couple of years ago our family was enjoying a pleasant walk along the beach with Paddy, the much loved family groodle. Paddy loves water and chasing birds so it came as no surprise that on this walk he waded into the bay looking to chase the swans paddling in the shallow water. Unfortunately as Paddy got closer to the swans, they simply flapped their wings and flew a further 10m out to avoid capture. This all seemed harmless enough as Paddy, undeterred, started swimming out to the swans. It was only after the first 7 times this occurred that Paddy was suddenly 100m out in the bay, paddling with one sole focus, unaware of the imminent risk of being completely out of his depth. As the family started to panic, it was left to Dad to strip down to his jocks and wade/swim out to rescue Paddy from a precarious position. This would have been far less embarrassing had we not had a bus load of Japanese tourists following the event in real time and capturing multiple photos of Dad in his jocks, much to their amusement. Very little upside, significant downside risk for Paddy, and Dad.

Over the past 12 months the Australian tech sector has risen 54% based on the (real) hype around the onset of Artificial Intelligence (AI) to leave the sector trading at a 110% premium (on a PE basis) to its long term (20 year) average. This enthusiasm for chasing returns (like swans) has been in spite of interest rate expectations changing rapidly over the past 3 months. The very strong equity rally that started in November was predicated on US interest rates being cut 6-7 times in 2024. At the time of writing that has been wound back to 1-2 rate cuts being priced in, which in our view, still feels aggressive given the resilience of inflation data and the underlying strength in the unemployment data. We think in asymmetrical terms, whereby the probability of interest rates on hold or going up, is far higher than interest rates cuts being bought forward. Hence, in our view, the recent strength in the tech sector as interest rate expectations shift, looks to have very little upside, but meaningful downside from this point, notwithstanding the enthusiasm around the long term narrative.

We are at an interesting juncture though, given how influential monetary policy has been in setting asset prices since the GFC. Fed Chair Jerome Powell was the least vigilant around fighting inflation at his most recent press conference (March 22nd), suggesting that the 2% inflation target will be reached "over time". This comment has been interpreted by many to be winding back the rhetoric on inflation and providing wiggle room to cut rates in 2024 in spite of far more resilient inflation data (and economic data) than previously expected. Powell looks to be cornered into making a decision over the next 3-4 months. Does he cut rates to alleviate pressure on households, the Feds own interest expense and recognise the weakening consumer. Or does he err on the side of fighting inflation. If he cuts rates, which is more likely in an election year, the fight against inflation is far from over, but may extend the equity bull market.

Perhaps this is what commodity markets are sniffing out, with gold, oil and copper (and cocoa) all breaking out of technical ranges over the past month. Based on commodity prices, supply chain challenges and wage pressure that remains elevated, it appears to us there may be another wave of inflation occurring through 2024. If we are right with this medium term thesis of structural inflation, we would see a lengthy period of negative real interest rates ahead of us. That is inflation structurally higher than the US 10 year bond rate, allowing for nominal GDP growth to repair the US deficit issue. To us, the US deficit remains the most pressing issue in finance through this decade. With this backdrop we would expect to see higher bond yields, and an ongoing desire for real assets (commodities, infrastructure, property, insurance, agriculture etc) and a focus on fundamental value vs growth investing.

Political volatility

There is a strong likelihood of Donald Trump being re-elected as US President in November. The democrats have tried everything (legally) possible to avoid this outcome. But this means we contemplate what the next 4 years under President Trump would look like. Arguably he would be far less aggressive geopolitically, as he appears concerned with the level of US support of NATO funding while openly is more pro Putin than any Western leader. We understand his leadership would be very focused on raising tariffs once more, as manufacturing jobs in the US (particularly the auto industry) would be a focus of his presidency. Mexico and China would be the trade losers under this framework. Trump has never had any problem with deficit spending, thus this current trajectory is unlikely to change with a change in administration. Undoubtedly there would be a focus on the largess of the US public service sector, with a working paper suggesting the top 5000 bureaucrats could be made redundant under a Trump administration. Trump also fundamentally has a lower taxation mindset, which would most likely be a positive for equity markets, but there may be a lot of political noise between now and then.

For all the rhetoric of geopolitical tensions, ongoing conflicts in Ukraine and the Middle East, the US is actually budgeted to spend a record low 2.7% of GDP on defense in 2024 (above 10% during war time spending historically). This optically suggests the US is not prepared, or preparing for an escalation of global tension. This appears unlikely to change under Trumps leadership, which means it really does suggest we are entering an era of a multi polar world (two major superpowers) as opposed to the US being the world's policeman it has been for the past 70 years. There are many ramifications of this, including the appropriate reserve currency.

So what does this mean for positioning?

The macro landscape is as tricky as ever, which is why we revert back to investing in businesses. We try to insulate the fund as much as possible from macro variables by allocating most of the capital (60-70%) to predictable cash generating companies where there is evidence of sustainable cash flow growth. We are happy to allocate capital to cyclical stocks, but with lower weightings given the cycle of cash flows, while a consistent allocation to gold tends to assist the fund in times of inherent volatility. **Our philosophy with the Chester High Conviction Fund remains to protect and then grow (what we hope to be) generational wealth. Protecting capital means a rigorous focus on asymmetric investing. What is the downside vs what is the upside of an initial investment? This focus on fundamental investment drivers we believe will benefit our fund over the next 2-3 years as we believe the style bias will be firmly in the favour of value investing, which wasn't the case in 2023.**

Portfolio changes this quarter

The portfolio made only modest changes during the quarter outside tweaking several portfolio weights. Atlas Arteria **(ALX)** was added to the fund in the second half of the quarter given our view that most of the bad news has been priced in. ALX owns several toll roads in Europe and the US, while the 31% holding in major French road APRR is the largest asset. In December, the French government imposed a new infrastructure tax on all toll roads (approx 4.6% of revenue) which looks to contravene all preceding contracts in the industry. This impacts ALX distributions to the tune of 4-5c per year, which is well understood. What Australian investors appear to have overlooked is the constitutional challenge the toll roads (3 major French infrastructure companies) will undertake against the new French law over the next 12-18 months. It appears logical to us that a negotiated settlement occurs between the government and the infrastructure players, with the 3 levers to negotiate being the actual tax itself, the length of the concession (with most French roads, including APRR expiring in the mid 2030's) and the level of capital works (maintenance capex) the toll roads commit to every year. Whilst we are simplifying the (mildly complex) argument here, we think the current ALX pricing captures most of the downside (no likelihood of any negotiated outcome) as it has fallen 7% since first being discussed (and subsequently passed), while French listed peer Eiffage (FGR FP) who holds the other significant stake in APRR has ***risen*** 16% (it does have other construction businesses, but concessions are roughly 75% of the NAV of Eiffage). Hence French investors have shrugged of the new French infrastructure tax, while ALX has suffered a derating on the back of it. While we wait, the distribution over the next 12 months will be 40c per security, or at current pricing, a 7.5% yield. We note that IFM investors also hold 23.7% of ALX shares and have been creeping up the register. During the quarter the fund exited Viva Energy **(VEA)**. We recognise the current strength in refining margins and the earnings upgrades associated with the OTR acquisition, which currently provide a strong tailwind. We are somewhat cautious of the execution phase of the OTR acquisition (rolling out the new convenience store format nationwide).

How is the portfolio positioned?

Our investment thesis has been focused on structurally higher inflation during this decade, as opposed to the past 2 decades of deflationary forces. We note the recent strength in the gold price, oil, copper and soft commodities as a sign that hard assets may remain a valuable store of wealth in an inflationary environment. The challenges with energy transition and security, labor scarcity and supply chain security suggests structurally higher cost pressure than markets have been used to, which all else equal, suggests structurally lower valuations (and higher bond yields). We are highly focused on pockets of the economy or individual stocks with either strong valuation support and asset backing, or earnings resilience, and hopefully both. Our focus remains on four key areas of investing, which are listed below and have been consistently applied for the past 4 years.

Gold. We continue to hold a high conviction view that gold equities will perform strongly over the next 2-3 years, given sentiment remains poor, the underlying commodity price has broken out and cash flows will start improving. Gold equities are still trading significantly below the 2011 peak (as per the GDX gold ETF) and as such, we believe as economies slow, and interest rate cuts start being factored in, gold miners will have a very strong period ahead of them. Gold equities currently comprise just over 8% of the portfolio, with we believe a strong earnings momentum cycle about to start.

Real assets. Assets that are very hard to replicate or disrupt indicates a strong starting point. All remain essential services in a modern economy. We would place **AZJ, QUB, EGH, ALX**, **ASK** and **MIN** in this category. We think REITs are interesting when interest rates start falling, while suspect the recent rally in REITs may have jumped the gun on interest rate expectations.

Valuation margin of safety. An asymmetric risk profile. We would place **NUF**, **ASB, QBE, SUN** and **LLC** in this category. A material discount to book value has provided a strong starting point in many cases with catalysts emerging over the next 12-18 months to see the valuation gap close. We are mindful that several of these positions simply haven't worked as yet, with the catalysts for any rerating being pushed to the right. We note the recent conditional bid for Austal (ASB) from South Korean shipbuilder Hanwha at AUD2.825, a 28% premium to the prior close as testament to the value apparent in those assets.

Pricing power, or at a minimum pricing pass through. With cost inflation evident, how likely is a company to be able to at a minimum hold margins, that is, pass through higher costs to their customers without impacting customer engagement? We would place **CSL, TLC**, **LNW** and **NWS** (through it's holding in REA and Move) in this category. We think margin resilience becomes an important driver of equity returns in the post free money era.

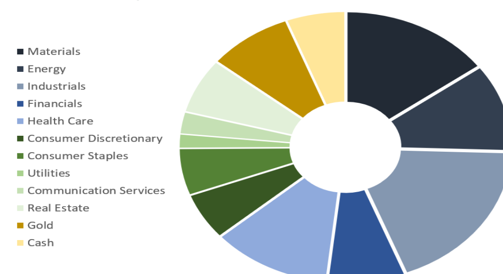
The Portfolio

The CHCF posted a 7.6% rise in the quarter, relative to the 5.4% rise in the ASX300 Accumulation Index. While the fund had many strong contributors over the quarter, Imdex (IMD) led the way with a 25% return. IMD provides hardware and software drilling solutions to the mining industry, which had been oversold on concerns of slowing exploration activity. IMD was able to post a relatively strong February result while it is positively exposed to gold drilling, which should become a tailwind over the coming quarters. Telix (TLX) also performed well, largely on the strength of gaining market share with its imaging product Illucix, while longer term therapy products for prostate and kidney treatment offer significant upside for future earnings should they demonstrate effective progression free survival outcomes, with trial results expected this year. Westgold (WGX) led the outperformers from our gold holdings, while realistically, they were all strong. Underperformers were led by Comet Ridge (COI), retracing some strength from the prior quarter, whereby our conviction in the name remains unwavering. Deep value industrials (AGL and LLC) weighed on performance for various reasons, while they remain deeply unloved.

Top 3 holdings	Portfolio breakdown	
CSL	Industrials	18.7%
Mineral Resources	Materials	14.9%
Austal	Health Care	11.8%

Top 3 portfolio attribution	Bottom 3 portfolio attribution
Imdex	Comet Ridge
Telix	Lend Lease
Westgold Resources	AGL Energy

Fund weights - diverse sector exposure



THE KEY THEMES DRIVING 2024 SENTIMENT AND PORTFOLIO CONSIDERATIONS

THEME	IMPACT	EQUITY CONSIDERATIONS
WHAT IF INTEREST RATES ARE ON HOLD?	The US economy has remained far more resilient than most expected. The forward curve is still pricing in 2 rate cuts in the next 12 months despite stronger data and stickier inflation. Is Powell forced to cut rates this year despite inflation remaining well above trend?	The growth basket has had a very strong 6 months based on the prospect of 6 rate cuts in 2024. We believe this is far too aggressive (for what we know today), hence expect some of this widening dispersion to pull back over the next 6 months as inflation remains stickier and the economy more resilient?
CAN INFLATION MODERATE IF COMMODITIES RALLY?	Gold, Copper and Oil are trading technically very strongly which appears to be an indication that renewed interest is appearing in hard (physical) assets. Whether central banks diversifying away from USD Treasuries or underlying supply/demand imbalances, it isn't deflationary.	Our long term view throughout this decade has been for inflation to remain stickier and a basket of hard assets to be highly desirable as a store of wealth. This trend remains well represented in our portfolio, with a value bias remaining.
CENTRAL BANK DEFICITS	US public debt at USD34.6tn with 5% cash rates and growing by US1.0tn every 100 days. The US interest bill is exploding higher. We ponder how this spending is financed with foreigners stepping away from owning US Treasuries. Eventually, the Fed has to be the buyer of last resort, but it could be volatile in the meantime.	The only solution to us has to be financial repression, meaning inflation is structurally higher than the 10yr bond yield for significant periods. Real assets and gold become highly desirable as stores of wealth under this scenario. We remain firmly of this view, which ties into our portfolio construction framework as per above.
GEOPOLITICS	War is an inflationary event. We don't profess to offer a view of the ongoing tensions in the Middle East, but we do believe the logistical challenges in the Red Sea will drive up supply chain costs and place a higher premium on oil, which is also inflationary. What are the ramifications if Ukraine join NATO?	A rapidly evolving situation which does have implications for portfolio construction. Energy security remains critical, while supply chain "friendshoring" will continue to influence capital investment decisions. Given the cash flow multiples applied to the energy sector, we see significant risk reward in having some exposure.
GOVERNMENT INTERVENTION IN FREE MARKETS	A populist government aiming for the perception of relieving cost of living pressures for consumers. The highly public ACCC focus on grocery margins will be followed by other sectors under scrutiny. Toll roads (TCL) already has a government inquiry into pricing (75% margins).	Insurance (broking), fuel retailing and electricity are other consumer facing sectors that are easy targets. For now, mobile phone charges (TLS mobile margins at 47%) and Bunnings (Australian staple?) remain safe but if it polls well, then we can expect more intervention from Governments.
ENERGY USE IN DATA CENTRES	Data centres represented 2% of US electricity use in 2020 and is expected to account for 7.5% of US electricity by the end of the decade. That equates to adding 270Twh in the space of 10 years, or adding more than 1 Australian energy grid to the market. We think this creates an enormous infrastructure bottleneck in the race for data use.	Perhaps electricity providers become the "picks and shovels" of the AI data wave. As AI is rolled out and the exponential use of data centres accelerates in a very well understood thematic, maybe the best way to gain exposure to this theme is actually the utility providers to ensure the essential service of electricity is part of the solution.
R&D SPEND EXPENSED OR CAPITALISED?	Wisetech (WTC) capitalised 54% of its R&D spend on product development, Telix (TLX) expenses 100% of R&D spend on future products. Technology spend is more likely to be opex, while pharmaceutical development requires risk taking for phase II and III trials. One is conservative, the other one isn't.	We could make the same argument around what is opex or what is capex, particularly for data centre fit outs. Management teams are incentivised to boost eps by all means possible, as in a bull market, no one really cares how the eps momentum is created. In a different market cycle, these accounting shenanigans are looked on very poorly.
M&A CYCLE RAMPING UP	With CSR, Adbri (ABC) and Boral (BLD) receiving bids, the secondary market options for building materials companies has shrunk to James Hardie (JHX) Reliance Worldwide (RWC), Reece (REH) and Maas Group (MGH). The Altium (ALU) bid also highlights the lack of suitable technology exposure in Australia, with Wisetech (WTC), Next DC (NXT) and Xero (XRO) commanding significant premiums on cash flow multiples for the thematic privilege of gaining exposure to the tech sector.	We think M&A will accelerate over the next 6 months as a late cycle play to buy rather than build now interest rates have stabilised. We touch on two stocks inside that have recently had change of control offers that are yet to be fully realised. Given the inherent value on offer in some of our stocks, we would not be surprised to see more M&A activity in our portfolio over the coming months.

Chester High Conviction Fund top 10 holdings

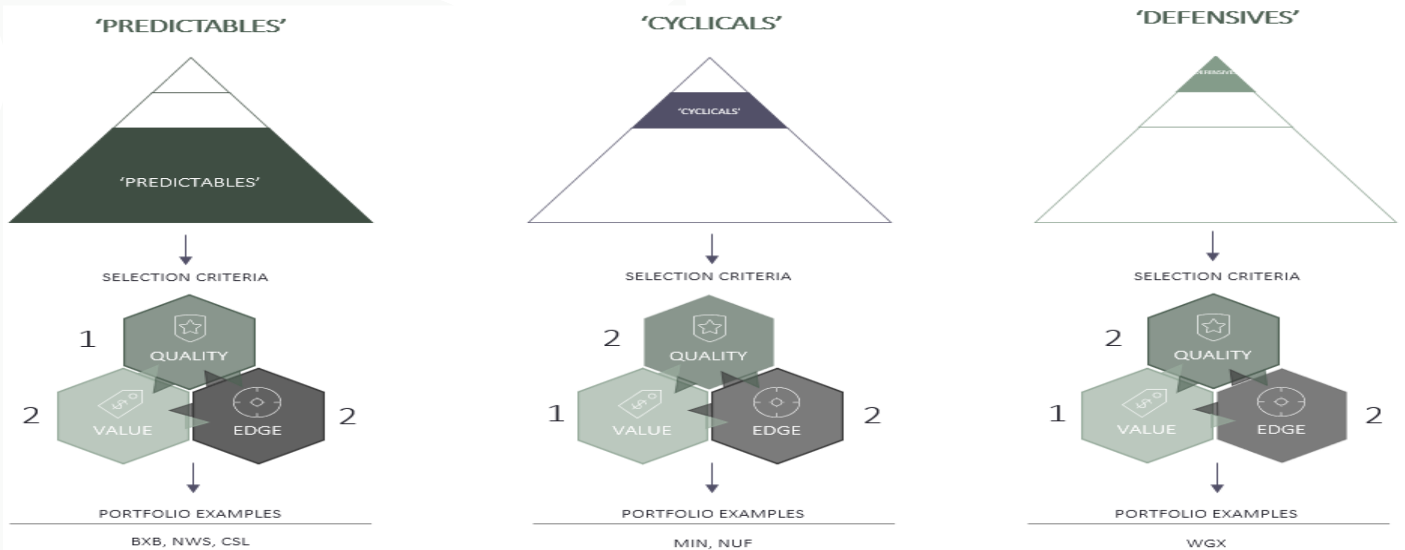
	Cash flow style	FY1 Sales GR	FY2 Sales GR	FY1 Div Yield	FY2 Div Yield	FY1 DPS GR	FY2 DPS GR	FY1 ROE	FY2 ROE	FY1 BOOK VALUE	FY1 EV/EBITDA	FY1 EPS GR	FY2 EPS GR	FY1 PER	FY2 PER
Abacus Storage King	Predictable	nm	10.0%	4.9%	5.0%	nm	2.3%	3.9%	4.0%	0.7	18.5	7.5%	2.1%	20.2	19.9
Atlas Arteria	Predictable	-5.9%	6.5%	7.6%	7.7%	0.0%	0.0%	9.8%	11.0%	1.2	10.5	29.8%	7.3%	12.0	11.2
Aurizon	Predictable	13.7%	4.7%	4.7%	6.0%	21.2%	25.9%	10.7%	11.7%	1.6	7.1	19.0%	12.4%	15.9	14.1
Austal	Predictable	15.2%	19.0%	0.7%	1.8%	-75.7%	152.9%	3.5%	5.4%	0.8	6.3	nm	69.3%	26.9	15.9
Comet Ridge	Cyclical	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm
CSL	Predictable	10.8%	8.4%	1.4%	1.7%	14.1%	17.0%	17.3%	18.0%	4.6	18.7	20.6%	15.7%	30.2	26.1
Light & Wonder	Predictable	8.9%	8.9%	0.0%	0.0%	nm	nm	39.7%	43.8%	9.5	10.3	117.4%	41.4%	27.0	19.1
Mineral Resources	Cyclical	5.7%	16.8%	0.6%	1.6%	-75.6%	165.4%	9.4%	13.4%	3.4	8.6	-53.9%	56.6%	40.3	25.8
Resmed	Predictable	9.7%	6.6%	1.0%	1.1%	10.7%	10.2%	24.2%	27.6%	5.7	17.1	14.3%	11.0%	25.4	22.9
Suncorp	Predictable	21.6%	6.6%	4.5%	5.1%	0.0%	13.9%	10.0%	10.0%	1.5	nm	10.4%	1.0%	15.5	15.4

Source: Chester Asset Management, Bloomberg consensus data

We have listed here our top ten holdings at the 1st of April, 2024. Our fund is actively managed and has no position that is simply there to lower the tracking error against the index. It is truly benchmark unaware investing. We broadly hold positions between 1% and 6% depending on our conviction level on the stock and the size of the company. Our conviction level is dictated by the broad art of combining; 1/ the appropriate valuation of the stock, with; 2/ our assessment of the quality of the assets and management team, overlayed by; 3/ our expectations vs the market (or insight/edge) of the earnings projection. I.e. Do we think the market is mispricing earnings? For our thesis to hold, we require at least 2 of these 3 factors to be validated for the investment case.

To explain that in more detail we have used a slide from our presentation material (chart 2 below). The majority of the stocks currently held in the top ten holdings are classified as "predictables" (industrials, REITs or healthcare, etc) while Mineral Resources (MIN) and Comet Ridge (COI) are classified as "cyclicals". Our gold holdings are classified as "defensives", but they currently sit outside our top ten holdings. When we are allocating capital to those sectors that are more predictable in nature, our primary focus is the quality of the industry position they hold and relative cash flow certainty. We determine this by asking ourselves 7 questions around pricing power, barriers to entry, threat of disruption, etc. We also ask a range of questions around the management incentive structure and track record. Once we decide that a company is well positioned, we then seek at least one other "thesis" to hold true. For predictable companies, we need to be convinced around the quality first, and then valuation or edge. For cyclical or defensive (gold) companies, we need to have a high degree of confidence in the valuation support first (as by definition, we cannot be sure of how predictable the cash flows are). We then seek a degree of conviction around the management team and whether we have a unique insight ("edge") to those particular assets. Thus for the cyclical or gold stocks, it is primarily a valuation driven decision first.

Chart 2



Source: Chester Asset Management

CHCF portfolio construction framework

We have always broken down our portfolio construction into three categories as outlined in chart 3. We think of most sectors in the predictables bucket: healthcare, consumer staples, defence, infrastructure, etc. as, in general, able to offer relatively predictable cash flow profiles from the industry structure they operate in. We are the first to admit this is a relatively primitive exercise given that many stocks have very different cash flow characteristics that may be categorised in several ways. For example, gaming or more specifically casinos have historically been relatively predictable cash flow generators, but COVID derailed many of these formerly "predictable" sectors. We focus heavily on the industry structure and competitive advantages of each company when assessing the investment thesis for "predictable" stocks.

We use the word "relatively" predictable, as sectors that are genuinely cyclical in nature (energy, commodities, retail, etc) there is always less certainty over the longevity of a cash flow cycle and sustainability of margins, hence given the uncertainty, we tend to desire much greater valuation support in cyclical sectors.

The "defensive" sleeve is comprised of positions that are historically uncorrelated to the ASX300. We classify gold equities with this lens, as a historical study of large equity market drawdowns highlights how well gold holds up in extremely volatile markets. Cash is often a residual position that we simply state as the option to buy something cheaper in the future.

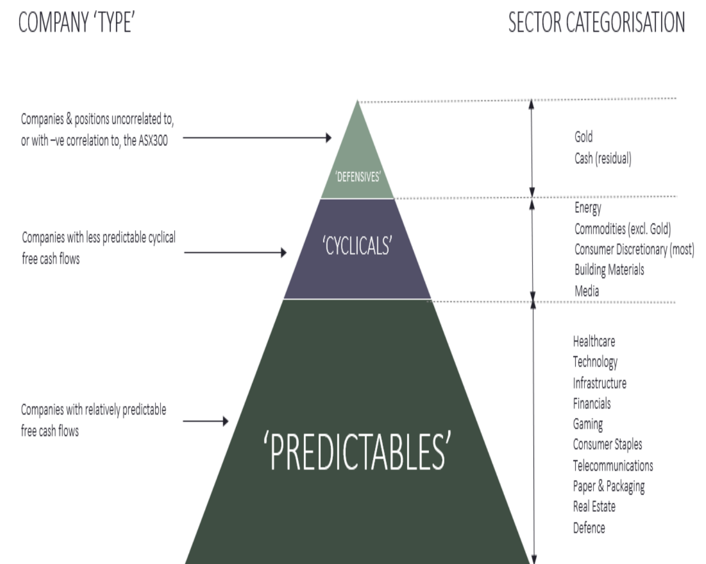
Chart 4 illustrates how these "buckets" have looked over the past 9 years. On average, the allocation to predictables has been 60-70%, while cyclicals have averaged around 18% (10-25%) and defensives have ranged from 10-25% (averaging around 15% of the fund). We have tended to hold an increased cyclical position over the past 6 months, which is predominantly in energy, uranium and select idiosyncratic ideas. The history of the strategy has been successful in delivering alpha, outside FY19, in which the fund was (in hindsight) too cyclical leading into the end of 2018, and then far too defensive during the first part of 2019. We are aware that cyclicals by their nature are higher beta, which means they often appear as the best, or worst performers. Hence the exposure to this part of the market is managed accordingly.

Chart 5 highlights the portfolio characteristics of the CHCF vs the ASX300. We historically find these metrics relatively fluid given the portfolio changes that reflect new weights and new decisions. While these characteristics provide a snapshot of the fund at a point in time, in aggregate, we don't find them particularly insightful.

What this data highlights is that the fund has a value bias, which is assisted by stocks such as Westgold (WGX), which is trading on 8.0x PER and has 486% eps growth in FY24. These types of idiosyncratic decisions can influence the overall shape of the portfolio. But at an aggregate level, the fund has a lower yield than the ASX300, which is primarily a result of no exposure to BHP, RIO or the major banks, which is where the bulk of the ASX300 yield is generated. The fund also shows far superior eps growth relative to the ASX300, with better valuation support and a similar ROE to the market. Bearing in mind, this strategy is designed to be different from the ASX300. The ambition of our strategy is provide a very different product than the ASX300, as without thinking differently, we would never have achieved the track record over the past 10 years, with lower volatility than the market.

How do we allocate capital?

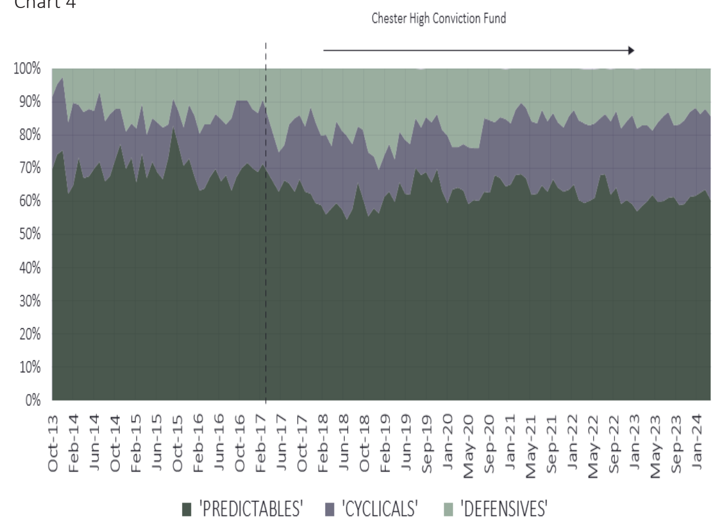
Chart 3



Source: Chester Asset Management

Which has been done consistently over time

Chart 4



Source: Chester Asset Management

Chester High Conviction Fund portfolio characteristics

Chart 5

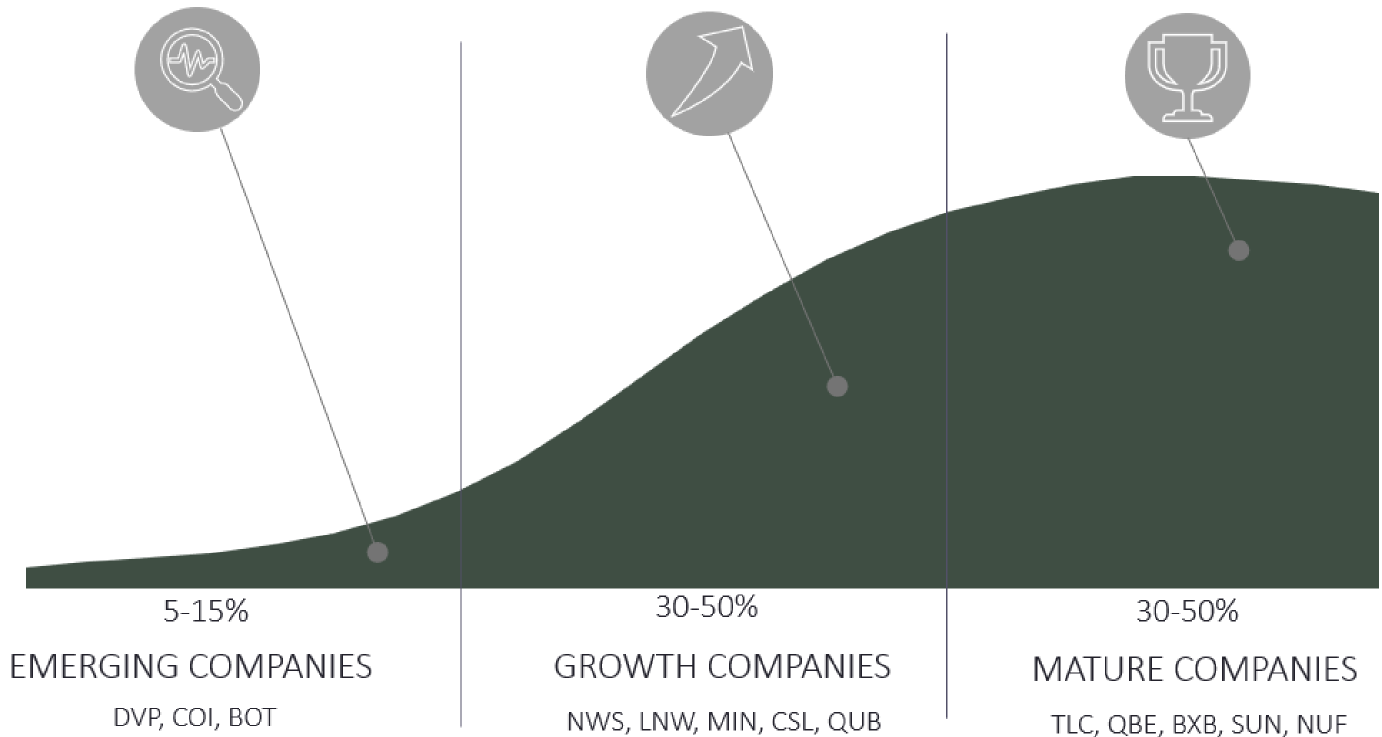
	CHCF	ASX300 Index
PER FY24	16.3	16.6
PER FY25	14.4	16.1
FY1 EPS growth	31.3%	-2.6%
FY2 EPS growth	23.9%	2.7%
ROE	13.6	13
Beta	0.89	1.00
FY24 Yield	2.1	3.9
FY1 DPS growth	12.5%	-5.3%

note Chester data excludes non revenue generating companies

Source: Chester Asset Management, Bloomberg, Macquarie research

The Lifecycle Approach

Chart 6



Source: Chester Asset Management

Our aspiration is to compound returns between 12-15% p.a over a 7-10 year time frame. That is aspirational, while past performance is not a reliable indicator of future performance. Clearly market forces dictate the outcome on a short term basis. To do this you need to think differently than the ASX300. Index returns over the past 10 years have been 8% p.a, which is right in line with the 30 year and even 100 year average.

With that pre-amble, the above graph has been extracted from our presentation material. We do separate the portfolio construction 2 ways. The first is the type of cash flow the stock generates (cyclical, predictable, defensive), the second way is allocating capital across emerging companies, growth companies and mature companies. The fund has consistently allocated capital to emerging companies, but has always been constrained to less than 20% of the fund given the volatility in this part of the market. It is certainly far higher beta than large caps. These ideas can be a source of significant deviation from the overall index.

Many of our best ideas have been sourced from this part of the market. Our first investment in Aussie Broadband (ABB) was as a AUD100m company, while exiting it with a market cap >AUD1.0bn. In this part of the market, we do tend to play the market cap game. Asking ourselves the question, what is the potential upside if things go right? As always, it is attempting to identify the risk/reward trade off, as we know the risk in small caps is higher given liquidity concerns in bear markets. It has been a very challenging environment for small/micro caps over the past 12-18 months. At some point in the next 12 months (as interest rates peak), we expect these headwinds to become tailwinds. Hence we try to remain consistent in our approach of identifying stocks that can be a source of significant upside, while being firmly focused on right sizing the portfolio weight. We make the flippant remark that we never have a big enough weight in successful stocks, while we always have too much exposure to poor performers. Portfolio weighting plays a very important role in managing both the risk, and the opportunity in this part of the market.

If we take our exposure to Comet Ridge (COI) as an example of the market cap game, it is currently a AUD220m market cap as an undeveloped gas resource in the Bowen Basin. If we assumed that COI traded on the same EV/Resource multiples as Warrego (WGO) when it was acquired by Hancock Prospecting in March 2023, then COI would have an AUD800m market cap. We are not saying that is going to happen by any means, but we do think the assets in the ground, given the shortage of east coast gas, are materially undervalued. We have held COI for over 4 years, and it has been a slow (painful at times) journey. We raise it now, as we are of the view that over the next 12-18 months these assets will be a highly desirable part of the east coast gas solution. Can COI become a AUD500m market cap company? Absolutely it can, with various milestones being checked off along the way. To paraphrase Rachel Hunter, we are confident “it won’t happen overnight, but it will happen”.

Nicholas Nasem Taleb (author of the Black Swan) once described his concept of the barbell approach. We should have 80-90% of assets in sleep at night investments, while a smaller portion should be invested in “moonshots” whereby the payoff could be 100x your initial investment. We are slightly more cautious than that, but we think to deliver returns well in excess of the benchmark over a 7-10 year journey, the ability to find investments that can generate 200-500% returns is an important part of that framework. We have several that fit that bill, but with appropriate position sizing.

Stock selection - Austal (ASB)

Description

We have been writing about Austal (ASB ASX) for the past 2 years believing it to be materially underappreciated and unloved. Given the portfolio weight, and the current news flow, we thought it worth updating our thesis. ASB is the largest provider of aluminium ships in the world and has developed a long term successful partnership with the US Navy in providing Littoral Combat Ships (LCS) and Expeditionary Fast Transport Vessels (EPFs) over the past decade from its base in Mobile, Alabama. It also builds commercial vessels as well as defence force vessels out of its locations in Perth, Vietnam and the Philippines. In the past 18 months ASB has announced 3 material contracts being the OPC (Offshore Patrol Cutters) for the US Coast Guard and in May 2023 the award for the T-AGOS program (Tactical Auxiliary General Ocean Surveillance vessels) and recently the award for 3 medical EPF vessels, which are an extension of the existing EPF program. This takes the current order book to in excess of AUD12.7bn with a strong pipeline to come from the AUKUS relationship. ASB forms part of the critical industrial base that is an essential cog in the US Navy's ambitions to renew their naval fleet over the next decade. ASB has also been successful in winning multi year contracts with the Australian Defence Force (ADF) which while, openly discussed in ADF white papers, have yet to be formalised into contracts, but have the potential to add between AUD12-15bn to the order book over the next 12-18 months. This will secure Henderson in WA as an asset of national importance over the coming decade.

Quality

ASB is well entrenched as a reliable supplier of shipbuilding services to national governments. The recent contract wins are testament to the close relationship ASB has with both the US Navy and the Australian Defence Force. On top of this, ASB has developed a global network of support services to maintain the current fleet of LCSs and EPFs that they have already built. To this end, the US Navy has recently awarded ASB support contracts on both the East Coast and West Coast of the US which provides ASB predictable long term maintenance revenues. While contracting can be lumpy, the level of predictable revenue growth over the next 7-10 years should enable ASB to deliver strong cash flow over this period, while thematically, the increasing geopolitical tensions and defence spending remains as relevant as ever.

Valuation

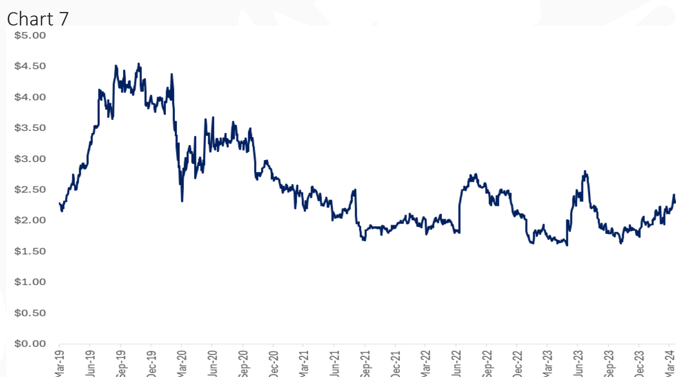
Our assessed value for ASB is currently AUD4.20 per share. Book value is AUD2.62/share, so is currently trading at 0.8x P/B. ASB as per below, now has strong visibility into the revenue trajectory of their recent contract wins, with strong visibility out to 2034.

Insight

There has been much public speculation over the past 12 months as to an M&A transaction with ASB. Given the discount to our assessed valuation and the strategic importance of the ASB asset base this comes as no surprise to us. ASB is somewhat of an orphan stock on the ASX as it has no listed peers and falls outside most fund manager indices, hence many benchmark aware managers place it in the too hard basket. South Korean conglomerate Hanwha (who we have met with) have been vocal in their desire to be able to conduct due diligence on the ASB order book and asset base, in order to firm up a conditional bid for ASB received in January 2024 of AUD2.825 per share. ASB is currently trading at AUD2.30 per share, based on the fact that the market perception is that Hanwha will not receive the requisite FIRB support. It is hard to paint a scenario where this may arise. This however ignores the ongoing US private equity interest in the assets. The AFR is suggesting there are multiple interested parties in these assets. While we are not in a position to speculate as to an eventual outcome (Andrew Forrest does own 19.9%, so will be influential in any case), to us, the asymmetry of this investment remains compelling.

ASB remains an orphan stock listed on the ASX

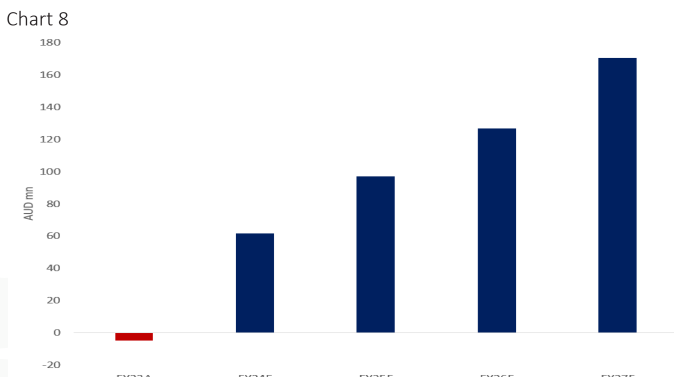
Chart 7



Source: Chester Asset Management

ASB EBIT forecast growth over the next 4 years - a strong recovery story

Chart 8



Source: Chester Asset Management, Bloomberg

The ASB order book with confirmation of Aust contracts

Chart 10

Source: ASB results presentation Feb 2024 and Chester assumptions

ASB trades at a material discount to US defence contractors

Chart 9

Company	Price as % of 52 Wk. High [1]	Enterprise Value [2] ($m)	EV / EBITDA (x)		EV / FCF [3] (x)	
			CY 2024E	CY 2025E	CY 2024E	CY 2025E
RTX Corporation	86.0%	243,410	12.4	11.5	15.4	14.2
Lockheed Martin	86.0%	182,746	12.3	12.1	15.0	14.8
General Dynamics	100.0%	127,363	14.0	13.0	16.9	15.2
Northrop Grumman	94.0%	122,184	14.0	12.9	20.4	17.5
L3Harris	100.0%	81,469	13.6	12.7	15.2	14.1
Huntington Ingalls	100.0%	20,460	12.4	11.5	25.6	21.5
		Mean	13.1	12.3	17.7	16.0
		Median	13.0	12.4	16.2	15.0
Austal Limited	67.0%	676	5.0	4.1	15.4	7.7

Source: Bank of America
(1) As of February 23, 2024.
(2) Enterprise Value calculated as Equity Value + Debt + Finance Leases + Minority Interest – Cash and Cash Equivalents – Long-term Investments.
(3) FCF calculated as (EBITDA – Capex).

Source: ASB Euroz Hartleys presentation March 2024

Stock selection - Eureka Group (EGH)

Description

Eureka Group (EGH) is an AUD160mn ASX listed real estate company that provides affordable rental accommodation for seniors. Largely these seniors can not afford their own housing (<95% of revenue is pension based), thus EGH provide a critical solution for residential affordable housing which is akin to social infrastructure. EGH currently has 2882 units under management across 52 villages in a combination of owned units and managed units. There is a growing demand for the EGH model, which provides community style living and shared facilities for retirees seeking an independent, safe and secure lifestyle. The strategy is supported by a strong pipeline of future opportunities and developments that can double the amount of residential units under management or ownership over the next 5 years. Chester has been an investor in EGH since 2017.

EGH has recently been the subject of an opportunistic script takeover offer from Aspen Group (APZ) valuing EGH at AUD0.439c per share, as opposed to the AUD0.535 at last closing price. We are of the view that the APZ takeover offer and asset base is inferior to the long term growth opportunities (both organic and inorganic) in front of EGH. As such we will not accept the APZ bid.

Quality

The EGH business model is one of beautiful simplicity. Provide low cost affordable housing to independent seniors. Given that 95% of revenue is generated via the pension, this revenue stream is essentially government backed, with operating cashflow occurring every fortnight. It is a highly cash generative business in a sector that is chronically under supplied. The demand from over 65's is only accelerating as baby boomers reach retirement age. Occupancy stands regularly at 98% such is the pent up demand for this type of living arrangement. As such given the CPI linked cash flows (the pension), EGH has very steady operating margins, that suggests an organic growth profile from adding new units and villages with only incremental addition of fixed costs, suggesting a sustainable EBITDA growth rate of 8-10% p.a. into the foreseeable future. Any incremental acquisitions would only accelerate this growth rate. EGH is one of the highest quality businesses in our portfolio.

Valuation

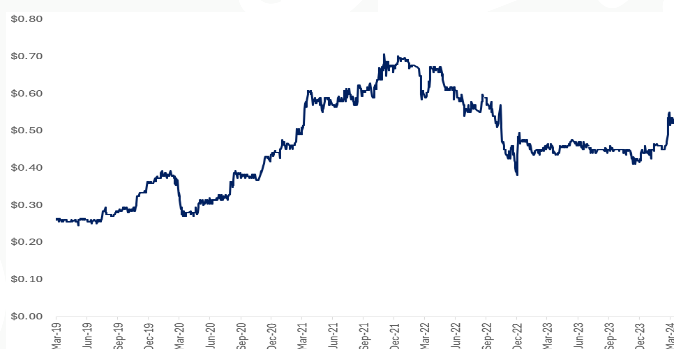
Our last updated valuation for EGH was 57c/share. However, this doesn't take into account the potential complimentary asset injection from what is now EGH's second largest shareholder Filetron Pty Ltd. Filetron is run by a successful private investor Ben Cuttle, who has also indicated he will reject the Aspen takeover offer, with, in our view, a far more interesting growth plan. It also doesn't take into consideration the recent EGH upgrade to FY24 earnings (by 7%) due to stronger occupancy and ongoing bolt on acquisitions.

Insight

We want exposure to 100% of the cash flows in this growing sector, while APZ would add complexity to the asset base and dilute the quality of these long term cash flows. Around 20% of the APZ earnings base is from booking development profits. We are confident that EGH will have access to capital to deploy into the long term growth of the low income retirement sector. With currently 52 villages owned or managed, given the growth in this sector, EGH has identified another 50 (minimum) villages that could be suitable for one of greenfield development (vacant land), brownfield development (expanding existing villages not owned by EGH), infill opportunities (expanding sites within existing EGH owned land holdings) or adjacent land developments (next to existing EGH sites). We are optimistic, with the right management team and execution, EGH can double its existing footprint in the next 5 years. The recent acquisition of 20% of EGH by Filetron Pty Ltd has only increased our confidence of this being achieved. We see a clear pathway for EGH to double again over the next 5 years and as such remain committed shareholders.

EGH has been a steady performer over the past 5 years

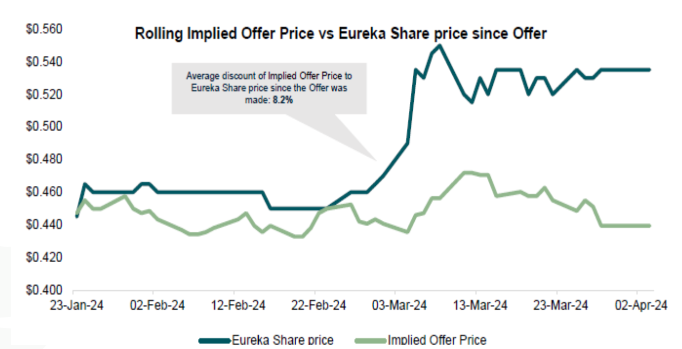
Chart 11



Source: Chester Asset Management, Bloomberg

Aspen offer materially undervalues the optionality of EGH

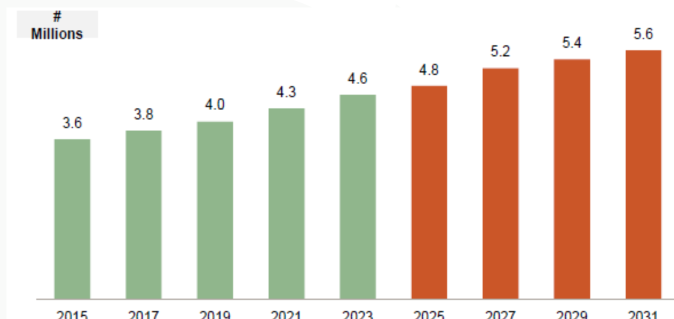
Chart 12



Source: EGH target statement

The number of Australians over age 65 is increasing by 1m

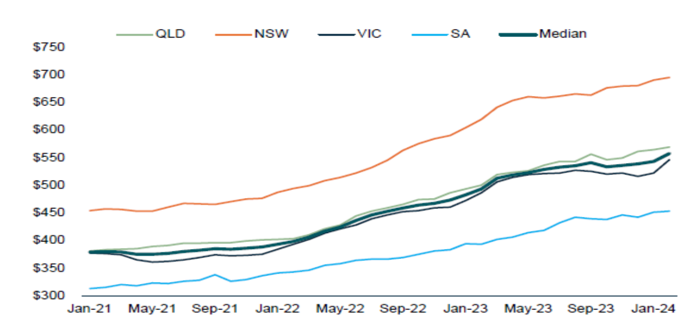
Chart 14



Source: EGH target statement

Rental market increasingly unaffordable for pensioners

Chart 13



Source: EGH target statement

Debt Monetisation

At risk of becoming predictable, we continue to highlight this issue, as we think it is the most challenging aspect to investing over the next decade.

We thought we would revisit this given the logic provided by Jared Dillian in a recent thread on X, which articulated the thesis for deficit spending and ultimately gold in a far more succinct manner than we ever could. The italics are from his post.

Gold has been called lots of things, like an inflation hedge. It is an imperfect inflation hedge, at best.
It has been called a store of value, a disaster hedge--it has been called all sorts of things. What it really is, is protection against debt monetization

Debt monetization is when the government runs out-of-control deficits, interest rates skyrocket, and the central bank is asked to cap interest rates in response. Rates are capped by the CB being willing to buy all available bonds at a given price.
With printed money, of course. The money supply explodes, inflation skyrockets, and investors flock to hard assets, like gold, but also pretty much all commodities.
A government bond is a claim. It is a claim on some asset, and that asset is the productive abilities of all the citizens in the country. When the supply of claims exceeds the supply of assets, the result is inflation. This is the main reason gold is rallying right now--interest expense is spiraling out of control, and if interest rates tick up 1 or 2% higher, we will be in fiscal checkmate. The only path forward will be debt monetization So anything that increases the probability that we will monetize makes gold go up, and anything that decreases the probability that we will monetize makes gold go down.

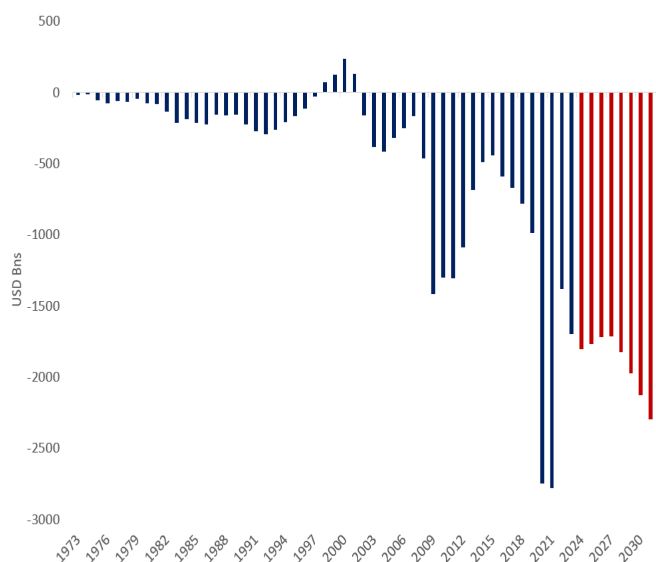
You're probably noticed that rates and gold are now positively correlated. Why? Because when interest rates go higher, it actually increases the probability of monetization. In a normal environment, high rates are bad for gold because gold yields nothing in comparison. Now, high rates are actually good for gold. Gold responds to a number of different economic variables, but the one that it has the highest correlation to is budget deficits. When deficits are large (like 2009-2011), gold goes up. When deficits are small (like 2011-2016), gold goes down.
The one thing we know about the 2024 election is that no matter who gets elected, the deficit is likely to get even larger. Outside of some big disinflationary impulse, we are likely to get much higher rates. There is historical precedent for that, too. The Fed pegged the yield curve during WWII, and after it lifted the peg, inflation went to high double digits. Gold was not freely floating at the time. I have always thought debt monetization was possible since we started QE in 2008. And it's worth talking about QE. How is QE different from monetization?

With QE, you set aside a finite amount of money to buy bonds. With monetization, you set aside an infinite amount. We've been inching closer to this for the last 16 years. Things always take longer than you think in finance, but I wouldn't be surprised if we're doing full-blown monetization in 2024-2028. That is the endgame.

In this scenario, the fed reserve will most likely be the buyer of last resort, or be forced to enact YCC (yield curve control) like the Japanese. Both of which will be bullish for equities, but more so gold and hard assets. We believe this thesis has been the most influential factor in the gold, copper and oil price action over the past 4 weeks.

US deficit spending accelerates over the next decade

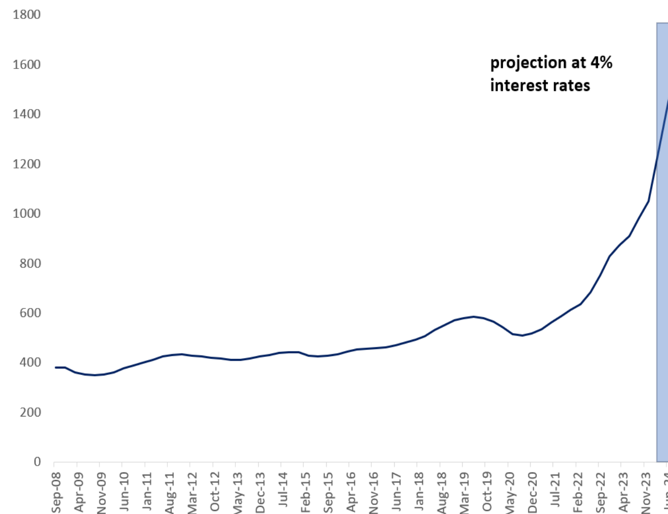
Chart 15



Source: Chester Asset Management, CBO

Meaning the US interest expense is exploding

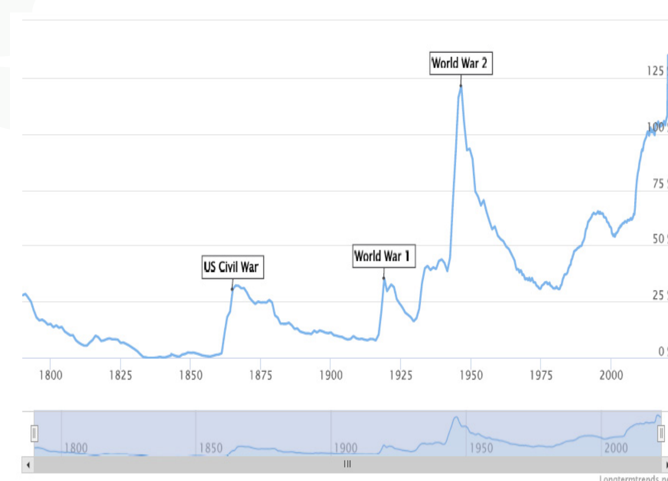
Chart 16



Source: Bloomberg, Chester Asset Management

US Debt to GDP over 200 years - at record highs

Chart 17



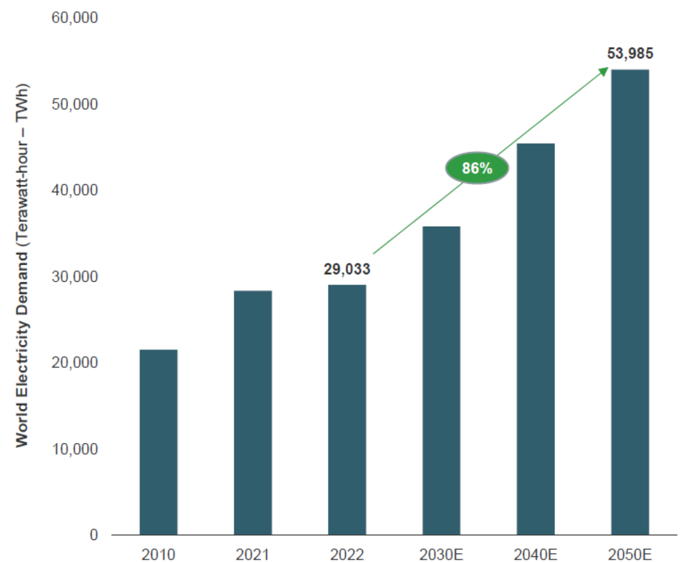
Source: longtermtrends.net

How does the world source electricity for the new age?

It became apparent to us that amongst the AI narrative, which is well understood now, that data usage will rise exponentially over the next decade. Data centres have been well and truly bid up on the prospect of ongoing demand for hyper-scale customers (Microsoft, Amazon, Google, Meta). What, we believe has been left behind in this narrative, is how this all this incremental data gets powered? We're not getting any AI without electricity, and as per chart 18, we are going to need a lot more of it.
The ongoing requirement of the western world for energy transition sees a raft of electricity solutions having capital invested in them, while the obvious (to us) requirement is actually the electricity providers themselves. In Australia that is AGL, Origin Energy and Alinta. We think the focus of the market on the short term forward curve dynamics (driving near term upgrades and downgrades) has possibly overlooked the structural growth drivers needed to power the AI revolution. Chart 20 highlights that the US needs an incremental 270TWh to power the new data centres. Australia for reference requires around 200 TWh to power our national grid, which arguably should grow as well with data centre requirements. Outside electricity providers, the next derivative of this becomes the raw materials needed to power the increased consumption. Chart 22 highlights just how undersupplied the global copper market is. It has to be a structural winner.

Global electricity expected to almost double in 25 years

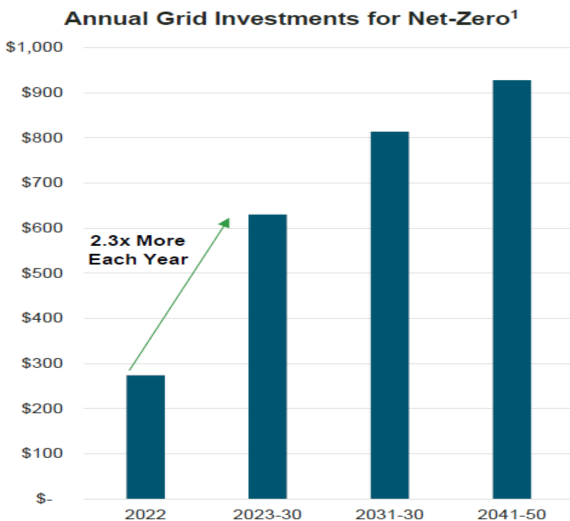
Chart 18



Source: Sprott webcast Uranium and Copper, March 2024

Capex spend on electricity grids is a sustainable theme

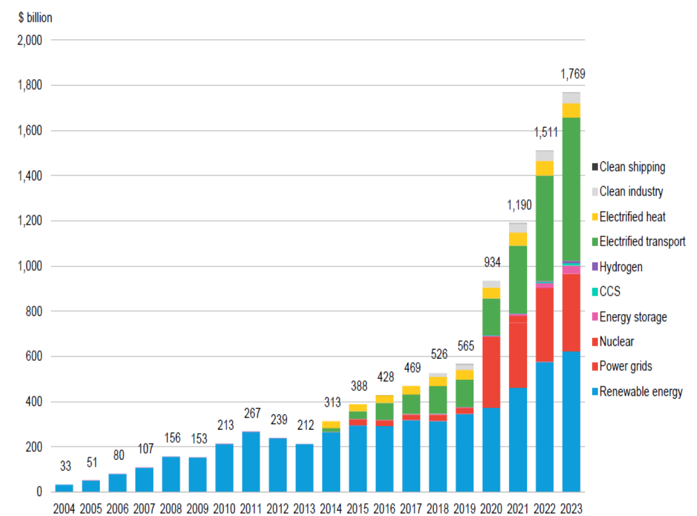
Chart 21



Source: Sprott webcast Uranium and Copper, March 2024

US1.8Tn of capital invested in energy transition in 2023

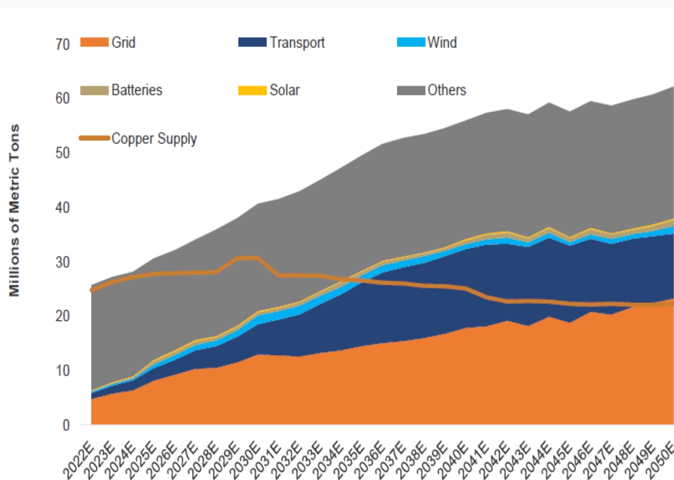
Chart 19



Source: Sprott webcast Uranium and Copper, March 2024

Copper remains chronically undersupplied

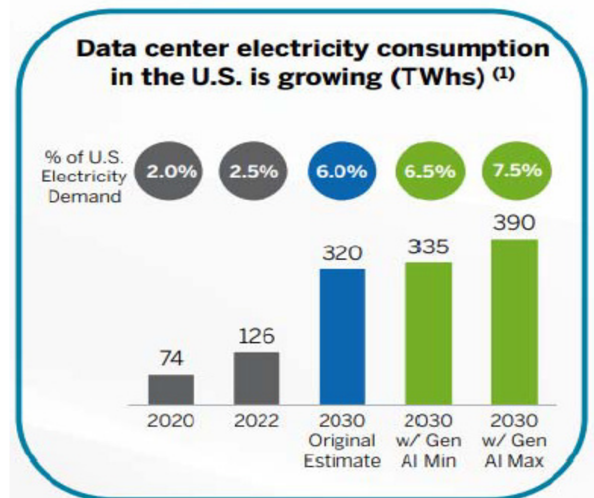
Chart 22



Source: Sprott webcast Uranium and Copper, March 2024

US data centre requirements is adding another Australia

Chart 20



Source: Sprott webcast Uranium and Copper, March 2024

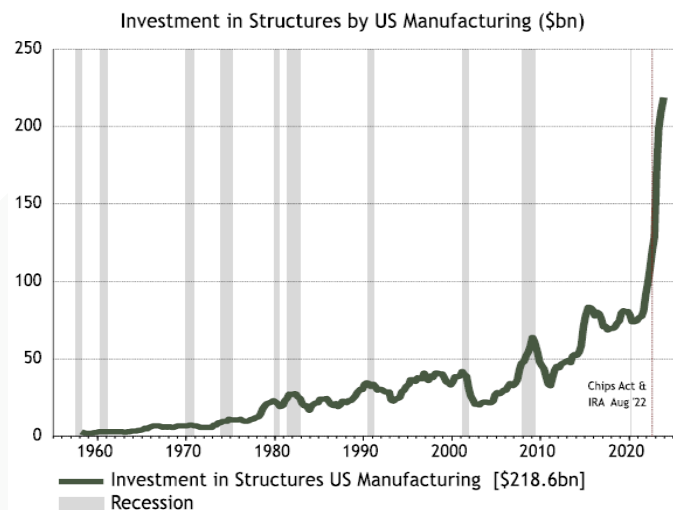
USA

While inflation and interest rates dominate the short term outlook, we do consider the longer term trends around structural shifts to globalisation and the labor market. These are key reasons why we have formed the view that cost pressure (inflation) will be far higher in this decade than the preceding 20 years. Chart 26 highlights the recent uptick in investment in US manufacturing on US soil. The "reshoring" impact is just starting and will continue throughout this decade. A Trump administration will only accelerate these trends. Whether it be semi conductors, battery manufacturing, raw material sourcing, the electricity grid or simply infrastructure renewal to enable easier freight and transport routes, we think the capital investment in the US over the coming decade will be a primary driver of GDP growth and increasing blue collar employment opportunities.

Labor force as a % non farm business output has fallen to historical lows, for various reasons (including automation), but largely as a hollowing out of the US industrial base, which we believe becomes a national priority. Hence with an ageing workforce, the rising minimum wages and tightness in the labor market suggest chart 25 sees elevated wage growth for a significant period of time, which arguably, is long overdue.

Rebuilding US manufacturing is a key issue

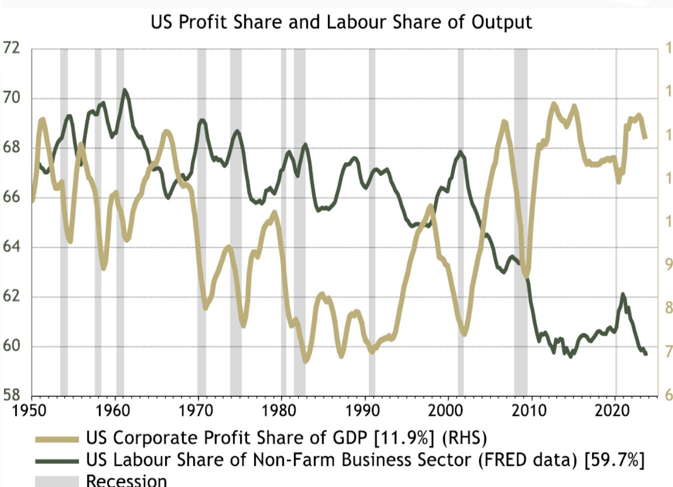
Chart 26



Source: ASR research

Hard to fight wage pressure issues when labor share is so low

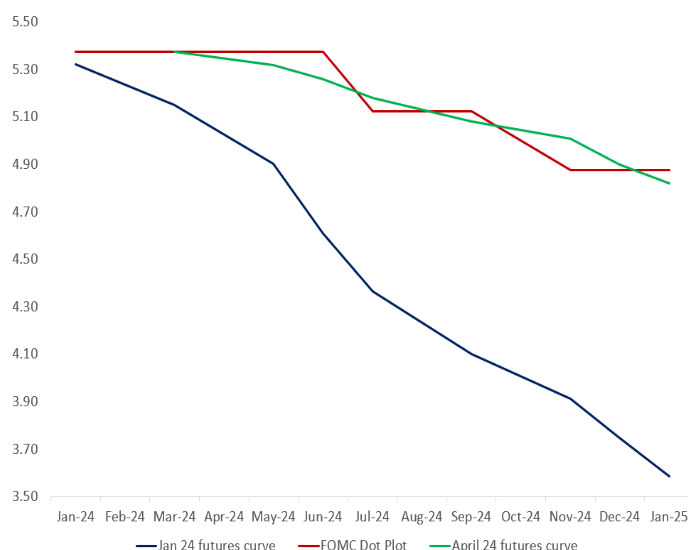
Chart 27



Source: ASR research

Market expecting 1-2 cuts now similar to Fed dots

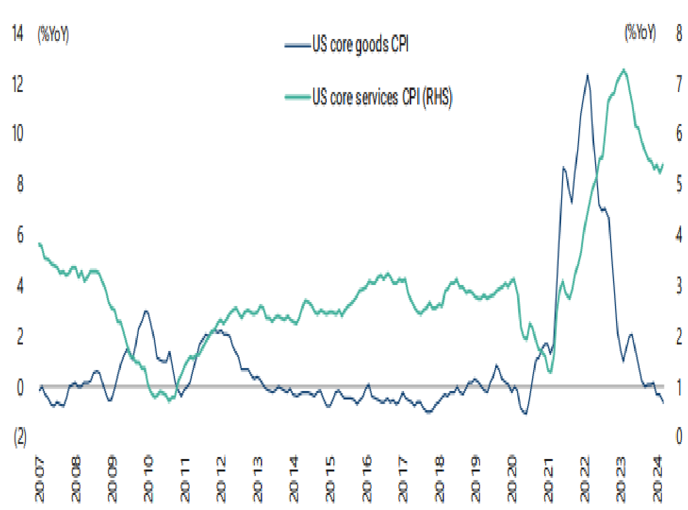
Chart 23



Source: Chester Asset Management, Bloomberg

Service inflation far more worrying than goods deflation

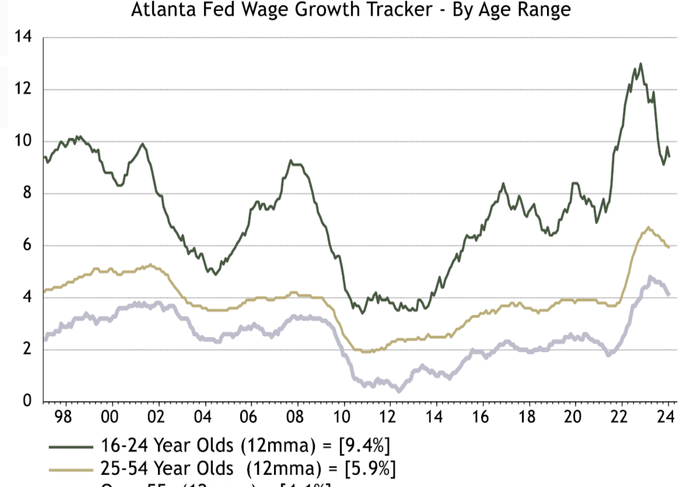
Chart 24



Source: Jefferies research

Wage pressure remains for the gig economy and young workers

Chart 25



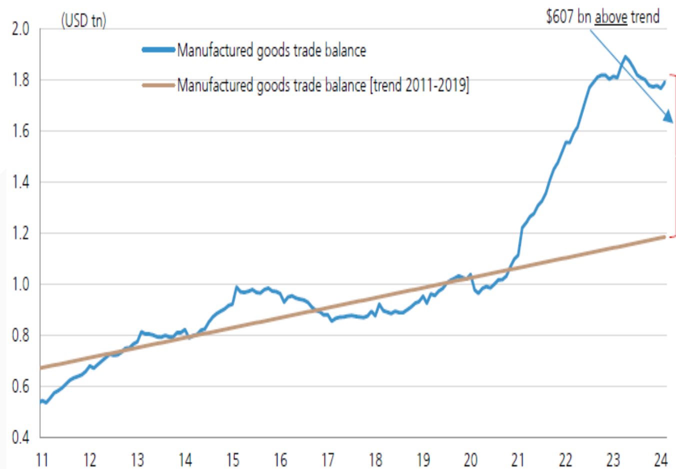
Source: ASR research

China

There has been a significant amount of focus in 2024 on China as an exporter. Chart 31 below highlights just how many excess goods China has produced since COVID. It's not just electric cars. Solar panels, lithium batteries, wind turbines, integrated circuits etc. Chart 32 illustrates how reliant the rest of the world is on China for the energy transition investment. This is something the US is very focused on changing, starting with semi conductors. Refer to the US comments around increasing the onshore manufacturing footprint. Of course given how poorly the domestic market has been performing (chart 29) led by the property market, China has had no option but to provide goods for the rest of the world. The biggest domestic problem in China (unlike Australia or the US) is the household savings rate in 45% of income (in Australia it is 3%). So for China to re-accelerate the economy, it has to be led by domestic consumption, which is an argument we have been using for 5 years, and it hasn't changed yet. The biggest threat from China over the next few months is if they devalue the RMB, to ensure their manufacturing sector remains a world leader from a cost perspective (the Japanese Yen has depreciated by 15% against the USD). We're sure this would not be received well by any OECD country, but wonder why China has been the most aggressive buyer of gold in the past 2 years. We watch with interest.

Chinese exports have to find a home somewhere

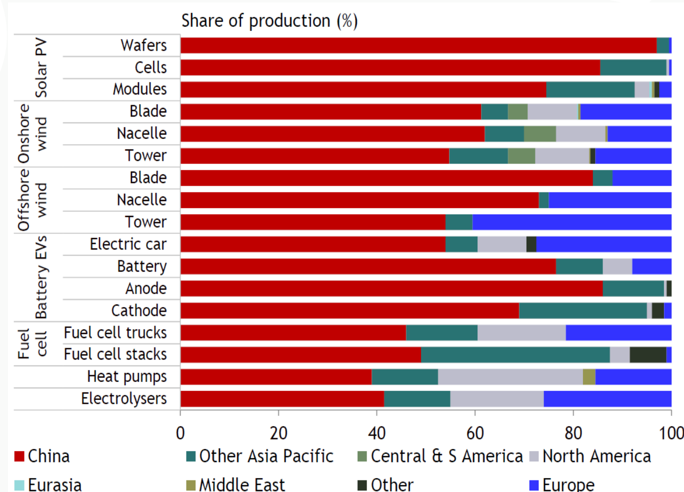
Chart 31



Source: UBS

China remains the worlds manufacturer in many cases

Chart 32



Source: ASR research

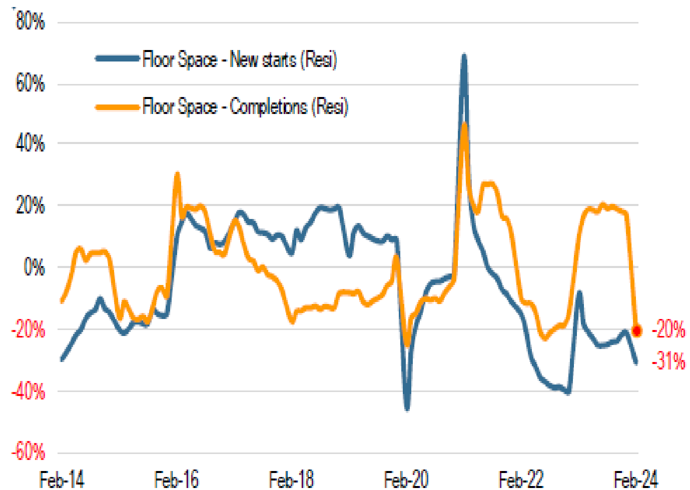
This is the cause of much trade angst

Chart 28

Source: Brad Setser

Chinese residential property is a massive issue

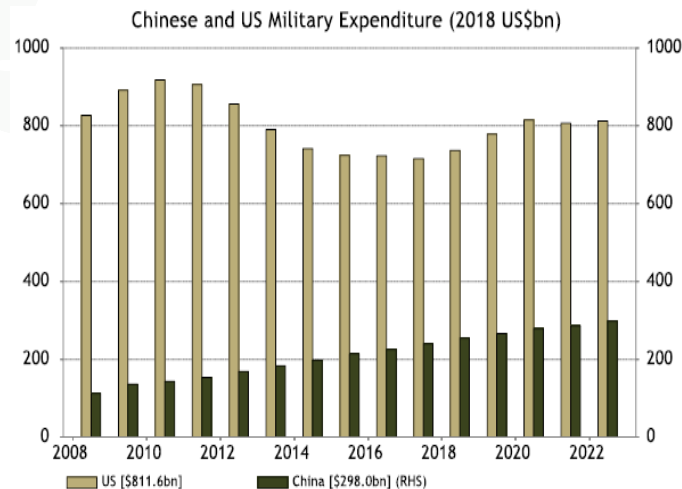
Chart 29



Source: JP Morgan

Productivity of defense spending - China catching up

Chart 30



Source: ASR research

Australia

We have been surprised at the level of resilience in the economy given how quickly interest rates rose through 2022. The recent consumer discretionary reporting season saw strong share price reactions largely as a result of profits being "less bad" than feared. The immigration rate and inflation actually provided tailwinds for this outcome given a higher population and stronger nominal GDP. This may be the case going forward, which doesn't augur well for any interest rate cuts in 2024. We would need to see unemployment rise considerably (above 4%) and wage growth fall below 3% (in our humble opinion) to ensure a change in monetary policy, albeit Australia will be influenced by the US rate cycle as well.

Households have certainly been depleting their savings as interest rates have risen to ensure their lifestyle hasn't materially changed as cost of living pressures have risen. We did see the savings rate go negative in the mid 2000's when house prices really started taking off. But we also had far lower household debt 20 years ago.

For the foreseeable future, while households remain fully employed, house prices are at record highs and the equity market is at record highs, both ensuring the wealth effect on disposable incomes remains strong there seems little pressure on interest rates, which as we sit here today, suggests Australia is stuck in the "no landing" camp.

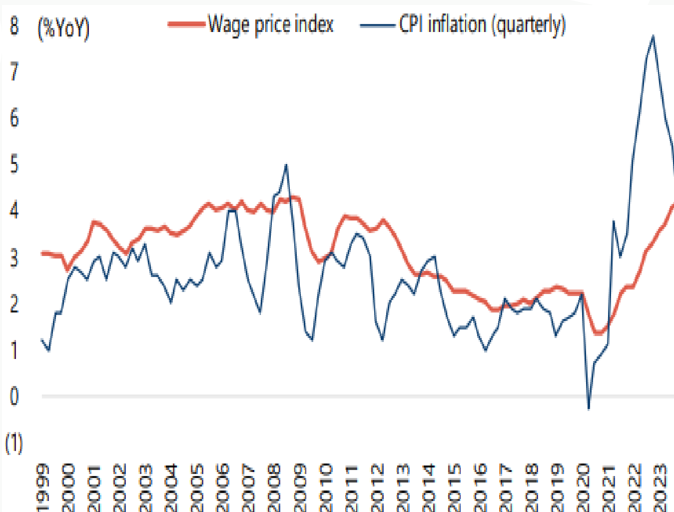
Unemployment stuck near generational lows

Chart 36

Source: Macquarie research

Wages will be the sticking point in the rate cycle

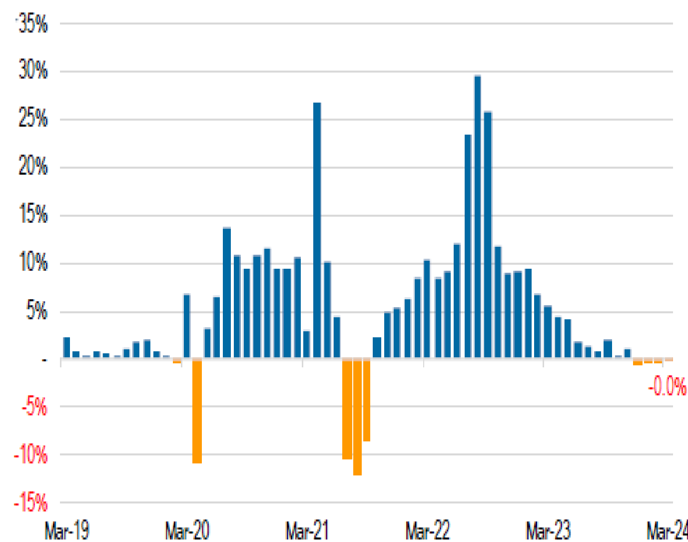
Chart 37



Source: Macquarie research

Retail sales softened, but from elevated levels

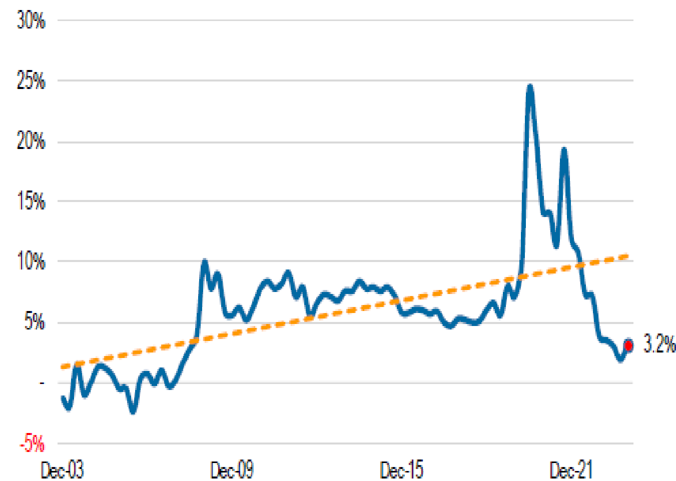
Chart 33



Source: JP Morgan

Savings rate depleted, but can go lower

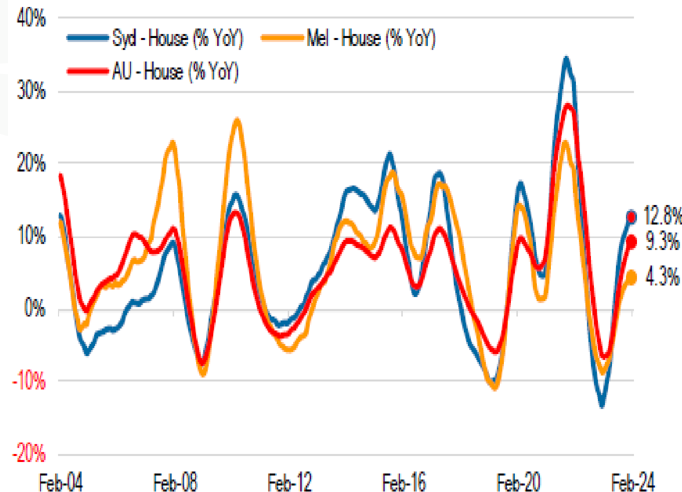
Chart 34



Source: JP Morgan

Lack of supply has assisted in house prices at record highs

Chart 35



Source: JP Morgan

Charts that make you go hmmm...

We often simply post some charts in the quarterly as we tend to think that sometimes, a picture is worth 1000 words. We find the simplest ideas are often the correct course of action, whereby simply, we were surprised at the strength in long duration equities in 2023, given the back up in bond yields. We are still very much in the camp that value as a style should outperform growth over the coming decade, based on the simple premise that interest rates, while cyclical, will be structurally higher than the previous 20 year deflationary period. There is a generation of investors that believe quality and momentum are the only ways to manage money. Chart 41 we find interesting, as purely through the weight of money, CBA has risen to the most expensive valuation it has EVER had! We find this both amusing and concerning, given that we haven't yet had a proper credit cycle in Australia since the GFC, and we will. The asymmetry of owning CBA here is extremely poor.

Chart 39 highlights that tech and other long duration assets (online classifieds and REITs) have been very strong performers over the past 12 months. Given how resilient economic data has been (including inflation) we think these sectors are priced poorly for an outcome that suggests rates should be on hold. The premium the market is paying for these sectors (chart 40) again, seems asymmetric to us.

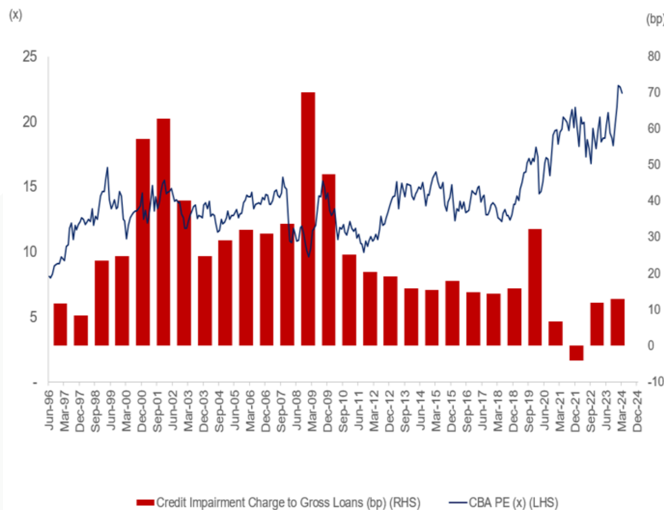
Does growth as a style continue to outperform?

Chart 38

Source: Chester Asset Management

CBA trades at a record high with benign BDDs

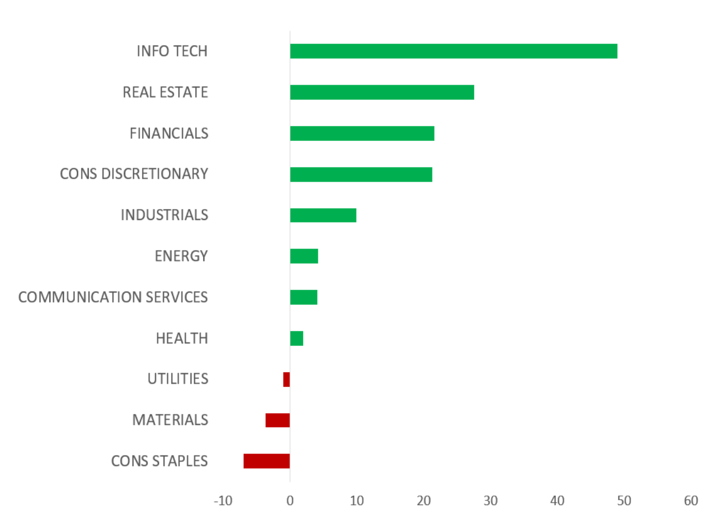
Chart 41



Source: Barrenjoey

ASX300 returns over the past 12 months

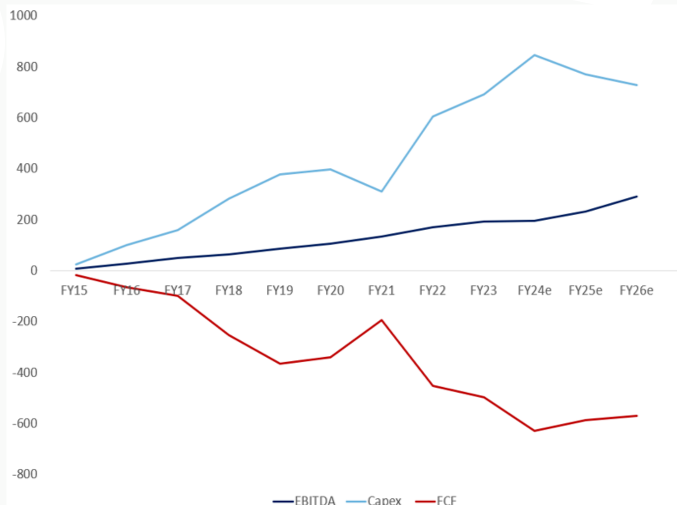
Chart 39



Source: Chester Asset Management, Bloomberg

Next DC free cash flow negative and trading on 4x book value

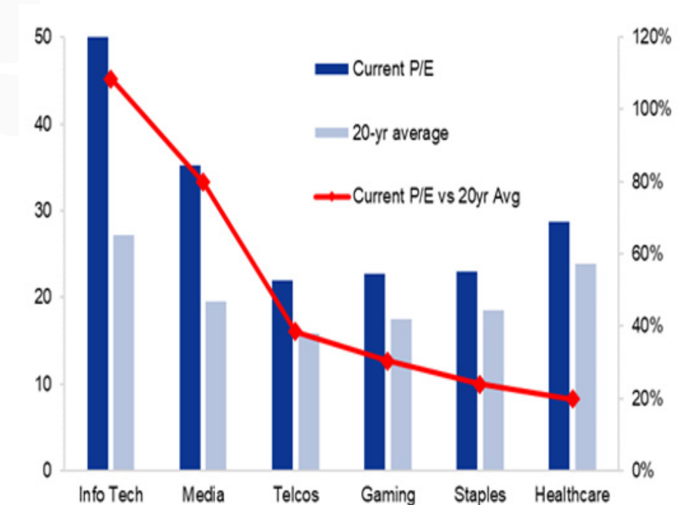
Chart 42



Source: UBS

Technology and online classifieds at elevated premiums

Chart 40



Source: Goldman Sachs, March 2024

Executive summary

Equities

We have been surprised at the strength in long duration returns (technology, REITs and online classifieds) in the face of changing interest rate expectations and stickier inflation over the past 3 months. Economic resilience has been propped up by the decline in the savings rate, both in Australia and the US, while Australia has used immigration as a form of fiscal policy to keep demand for housing very strong amid ongoing shortages. The US has used fiscal policy extremely loosely, as public debt has risen USD3.0Tn in 10 months, which is at odds with monetary policy which is pretending to try to tighten financial conditions. While CPI data has come off highs, it remains well above the 2% target range, which should mean a far more hawkish monetary policy stance than is being communicated. It does appear that Jay Powell has walked back from purely focusing on inflation, which may be the reason for the recent strength in gold, copper and oil, signaling structurally higher inflation ahead. In our view, it will take an acceleration in unemployment to both ease wage pressures and signal a change in policy is near. The obvious wildcard in this decision matrix is geopolitical tension, which given the current tension in the middle east, will create uncertainty for both policy makers and government planning. Wars tend to be inflationary given commodity pressure, supply chain logistics and security planning. China remains a swing factor, as to exactly how stimulatory their monetary policies will be this year to reignite the economic growth engine. We approach China with caution given the banking system leverage, high property prices and an ageing demographic, while still being heavily reliant on export markets (their manufacturing base) to generate GDP growth, aggressive stimulus may well be needed if the current deflationary forces in China continue. We look to any currency devaluation as a sign of economic stress in China.

Our view remains that real assets (property, infrastructure, agriculture, commodities, gold) will outperform capital light or long duration assets over the coming period, where we still see a wide valuation dispersion that needs to unwind. We believe inflation moderates over the next 12 months, but remains somewhat embedded due to localisation of supply chains, decarbonisation, capital investment and a reversal of cheap labour arbitrage from emerging markets over the past 20 years. We are also mindful of the relentless deficit spending in the US, which is accelerating, and needs to be funded, somehow. Our thesis leads itself to see continued pressure on the USD, combined with strong energy transition tailwinds and an underfunded energy sector, which we believe, sets this decade up for an outperformance of commodities relative to financial assets, which again ties into the notion of real assets providing strong returns.

From a strategic perspective, we see far more reason to be allocating capital to essential services than discretionary sectors over the next 12 months, as eps pressure on discretionary spending we think will intensify. We are also of the view that PE re-ratings are a thing of the past, hence earnings will be the only driver of stock prices going forward, meaning a far more fundamental investment process will provide superior returns over the next 2-3 years. We believe Australia is well placed to benefit from this trend over the coming decade, with an enviable lifestyle and strong (if somewhat flawed) democracy. As a primary producer of agriculture and commodities, we are well set up to continue to prosper as a nation, which should all else being equal, attract global capital and labour via both skilled and unskilled migration. Whilst this may appear contradictory (relative to our positive stance on Australia), we remain cautious on China. Hence our commodity exposures are energy, base metals and agriculture over iron ore. At a sector level, we see merit in the idea that insurance is looking attractive from a valuation perspective, energy and healthcare should see earnings resilience in this environment while gold equities look fascinating from a sentiment perspective. Bull markets historically follow bear markets and in that context, small caps tend to perform better as risk appetite increases. Perhaps this is too early, but we do try to prepare for outcomes, rather than predict outcomes (as this is heavily reliant on monetary policy settings).

By and large, our stock selection framework continues to focus on:
Real assets- **AZJ, MIN, QUB, AGL, BXB, STO**
Valuation margin of safety- **QBE, SUN, LLC, ASB, NUF**
Pricing power- **CSL, RMD, NWS, TLC**
Gold- **WGX, OGC, GMD**
As we have demonstrated over the past 10 years with this strategy, the returns we generate do deviate significantly from the benchmark, where we are proud of the track record of the strategy, delivered with lower volatility than the ASX300.

Government spending and bond yields

Interest rates are under enormous strain with the amount of debt issuance by central banks, and we still wonder how ongoing US deficit spending is financed outside the fed reserve embarking on QE. With this backdrop, the only way the debt burden to society gets repaid, is through asset reflation, or in some cases, debt forgiveness. Central banks (led by Japan) have had no other playbook since the GFC, and will continue to issue new bonds to finance the deficit spending of governments and the debt burden, which becomes debt monetisation. Since Alan Greenspan, Fed governors have always issued a "put" on the stock market with new easing policies, which in the next sharp downturn, eventually becomes yield curve control, and ultimately direct equity purchases, if needed. Jay Powell may well have "blinked" in December with his relatively dovish language, despite the fact that inflation remains well above trend. We speculate this was possibly for two reasons. The first being the mathematical reality of how the US government ever finances its own debt burden without lower rates and secondly, the prospect that Trump would be a far more demanding president than Biden, so a more dovish stance in 2024 could theoretically help the incumbent. Just a theory.

Chester High Conviction Fund

Quarterly Thoughts

April 2024

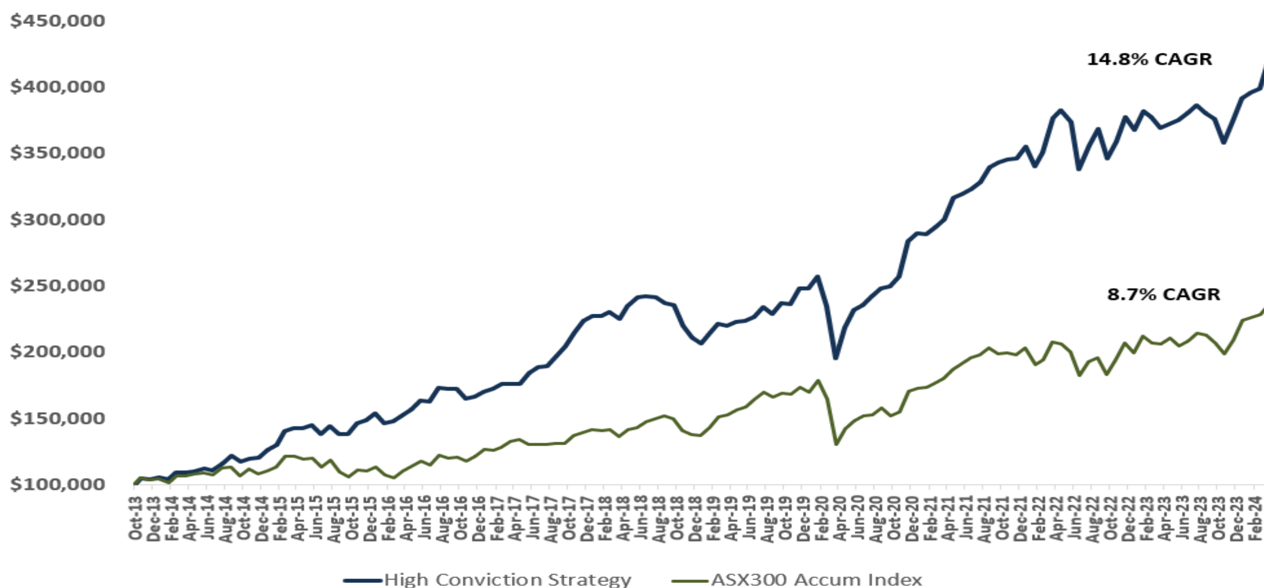
APIR OPS7755AU
ARSN OPS7755AU

Accumulated Performance by Financial Year - Same Strategy

	FY14 (%)#	FY15 (%)	FY16 (%)	FY17 (%)*	FY18 (%)	FY19 (%)	FY20 (%)	FY21 (%)	FY22 (%)	FY23 (%)	FY24 (%)	Since Incep (%)
Same Strategy (after MER)	+11.2	+24.5	+17.4	+11.2	+28.3	-6.4	+3.9	+37.2	+4.8	+12.5	+10.6	+14.8
S&P/ASX 300 Accum Index	+7.8	+5.6	+0.9	+9.1	+13.2	+11.4	-7.7	+28.5	-6.8	+14.4	+13.2	+8.7
Value added (after MER)	+3.5	+18.9	+16.4	+2.1	+15.1	-17.8	+11.6	+8.7	+11.6	-1.9	-2.6	+6.1

Per Annum. The inception date of SGH Australia Plus was the 8th of October, 2013, where Rob Tucker was the sole Portfolio Manager, until his departure on February 28th, 2017.
* The inception date of the Chester High Conviction Fund was April 26th, 2017, hence FY17 reflects 8 months of SGH Australia Plus and 2 months of the CHCF.
We note this is a statement of fact of the performance achieved by the fund during the time which Rob Tucker was the sole Portfolio Manager making active decisions on the SGH Australia Plus portfolio. We note performance is the record of the firm not the individual however past performance has been constructed from publicly available unit price data. Past performance is not necessarily indicative of future performance and should not be relied upon in making investment decisions.

High Conviction Strategy - accumulated performance



Note this graph is representative only of the combination of the same Portfolio Manager running the same strategy, and would only represent actual returns for unit holders that invested money at inception of SGH Australia Plus, withdrew those funds at the end of February 2017 and then invested all those initial funds again at inception of the Chester High Conviction Fund in April 2017. Note, this depicts returns after fees.

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