Chester High Conviction Fund

Fund Update | 31 August 2019

Total returns

At 31 August 2019	1 mth %	3 mths %	6 mths %	1 yr %	2 yrs % p.a.	Incep. % p.a. (27 Apr 2017)	Incep. % (27 Apr 2017)
Chester High Conviction Fund	**-2.14**	**+2.40**	**+3.34**	**-3.50**	**+7.73**	**+9.74**	**+24.29**
S&P/ASX 300 Accumulation Index	-2.27	+4.30	+9.53	+9.14	+12.25	+9.63	+24.00
Outperformance	+0.13	-1.90	-6.18	-12.65	-4.52	+0.11	+0.29

"A man must be big enough to admit his mistakes, smart enough to profit from them, and strong enough to correct them."

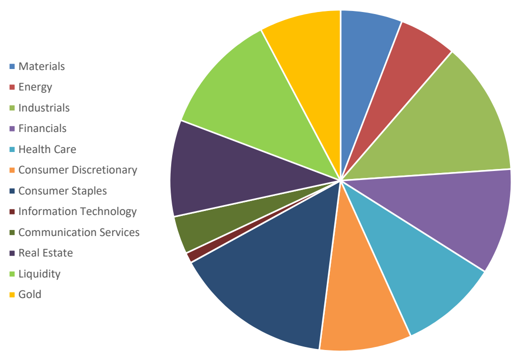
John C Maxwell

Month in review

We do find ourselves in an unusual period, given how dramatic the move in bond yields have been in 2019. We feel like a broken record, but all investors are grappling with the desire to be invested to generate a level of return, while understanding the backdrop of deteriorating economic fundamentals and government debt burdens (and ongoing budget deficits) are the primary reason bond yields are so low. The myriad of challenges from a geopolitical stand point are well documented and hence we are of the view that the strong outperformance of large caps relative to small caps is the low beta, high liquidity way of gaining exposure to equities (and returns), but with strong risk aversion. We would see the resolution of a trade deal and a Federal Reserve rate cut as the catalysts for risk appetite returning to equity markets (and for small caps to start outperforming again), albeit unlikely as we sit here today. We will discuss the framework for how we think about the outlook from here in our next quarterly thoughts, but maintain our view of investing in companies on a fundamental basis, rather than pure low volatility momentum, which has been wonderfully successful this year.

Reporting season has delivered a mixed tone, with downgrades of around 9% on average worse than normal, while only 10% of companies in the ASX200 delivered upgrades. In somewhat unusual fashion, many stocks delivering an in line result, were deemed to be "strong" results in the context of no further deterioration, and hence, were rewarded with outsized relief rallies. Many of the domestic facing companies saw this occur, including the retailers (JB Hi Fi and Super Retail Group) along with auto facing companies (Carsales.com and Smart Group). While many of the high growth businesses delivered results that were expected, and subsequently continued on their way (CSL, Resmed). The Industrials market trades on 20x one year forward PER, which is a 10-15% premium to historical averages, while the consensus eps growth of 4.5% is below the long term earnings trend.

Fund sector weights



Portfolio review

We were pleased with the performance of our companies during the August reporting season, with most companies delivering results in line or ahead of expectations. We added Lend Lease back to the portfolio on the FY19 result after selling it in August 2018. We feel the development pipeline of their partnership with Google in San Fransisco adds strong visibility to their order book and are hopeful that the worst of the Engineering concerns are behind them, with a strong catalyst ahead should they be able to exit this business.

For the month of August, the fund returned -2.14%, relative to the ASX300 Accumulation Index return of -2.27%. The fund remains highly benchmark unaware, and while we have been frustrated with the past 12 months of performance, we feel our focus on absolute returns will once again demonstrate meaningful positive returns again.

The outperforming stocks were led by Electro Optic Systems, an investment we made in Q1, 2018. They have a strong proprietary position in providing Remote Weapons Systems (RWS) for the defence sector. The long term nature of contracts sees a forecast tripling of revenues from 2019 to 2024. While it has enjoyed a strong 2019, we see many positive catalysts to occur over the next 12 months to retain our position. Westgold remains the cheapest way to gain exposure to Australia's gold sector, with a strong resource position and production growth over the next 18 months.

Mineral Resources (MIN) has frustrated us since our initial entry around AUD15.00. It delivered earnings above market expectations, saw earnings upgrades and re-worked its JV with Abermarle for the sale of the Wodgina Lithium mine, which we saw as a positive outcome given the large reduction in capex MIN is faced with over the next 2 years. While it currently trades on 6.5x PER, with net cash post the Abermarle transaction and a forecast dividend yield >6%, it remains compelling value to us, albeit influenced by both Iron ore and Lithium prices, which will fluctuate.

Top 3 holdings
CSL Limited
Electro Optic Systems
Atlas Arteria

Portfolio breakdown	
Consumer Staples	15.0%
Industrials	12.6%
Financials	10.0%

Top 3 portfolio attribution
Electro Optic Systems
Westgold Resources
James Hardie

Bottom 3 portfolio attribution
Mineral Resources
Oceana Gold
Synlait Milk

Past Performance - SGH Australia Plus Fund October 2013 - February 2017

	2013# %	2014 %	2015 %	2016 %	2017^ %	Total return % p.a.	Total return %
SGH Australia Plus	**5.68**	**19.38**	**22.05**	**10.73**	**3.25**	**18.16**	**76.05**
S&P/ASX 300 Accumulation Index	4.75	5.30	2.80	11.79	1.34	7.62	28.53
Outperformance	0.93	14.08	19.25	-1.06	1.91	10.54	47.52

#Inception date as the 8th of October 2013 ^First 2 months of 2017. After fees calculation includes both management fees and accrued performance fees.

Source: SGH Australia Plus unit price history, Bloomberg

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.

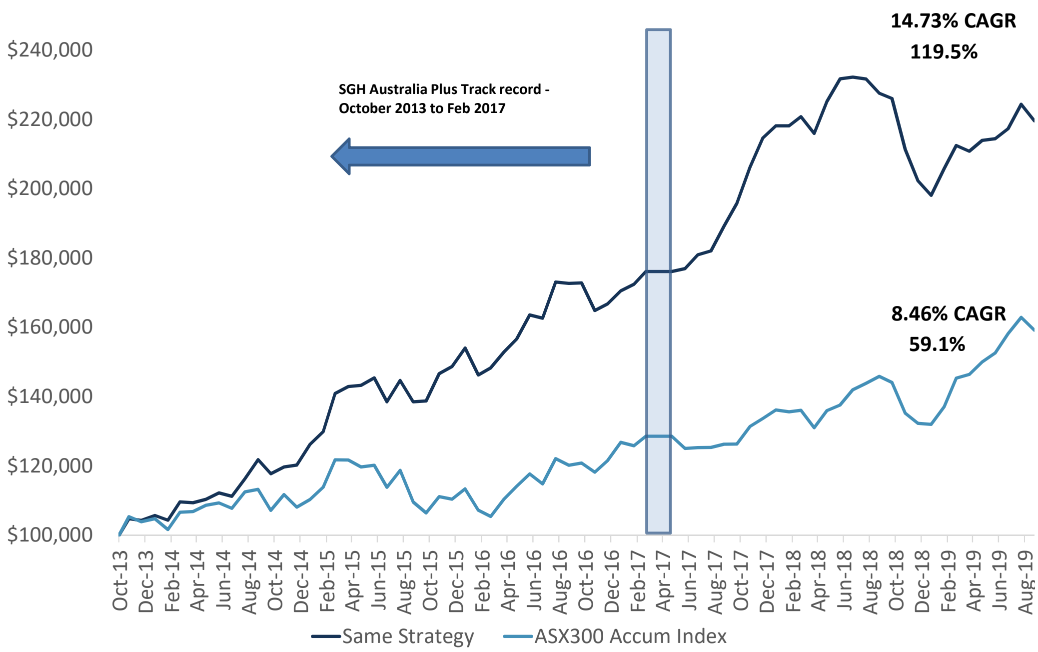
Past Performance - HSBC Australian Country Fund January 2005 - December 2009

	2005 %	2006 %	2007 %	2008 %	2009 %	Total return % p.a.	Total return %
HSBC Australian Country Funds (USD)	**18.44**	**31.25**	**35.33**	**-47.17**	**78.96**	**14.74**	**98.83**
S&P/ASX 300 Accumulation Index	15.42	31.18	27.80	-50.76	73.69	10.43	64.23
Outperformance	3.02	1.07	7.53	3.59	5.27	4.31	34.60

Source: HSBC Asset Management (formerly known as Halbis Capital Management). Performance is a combination of various institutional mandates that has been presented in a GIPS com¬pliant format.

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 HSBC Austra¬lian portfolios. Past performance is not necessarily indicative of future performance and should not be relied upon in making investment decisions. The HSBC Australian Funds were run on a benchmark aware basis with a 3% tracking error constraint, hence are not directly comparable to the Chester High Conviction Fund.

Same 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.

Fund at a glance

Inception date	April 2017
Objective	To outperform the S&P/ASX300 Accumulation Index by 5% on a rolling 3-year time frame.
Fee	95bp base fee plus a 15% performance fee based on outperformance, after fees, of the benchmark. The performance fee is subject to a highwater mark
Style	Tilt towards quality and growth, but with an emphasis on a valuation margin of safety
Investment strategy	Invests in a concentrated portfolio of companies offering outstanding long term potential. A company's weighting is mainly determined by the likelihood of a company achieving superior returns over 5 years. The fund has a predominant bottom up stock picking style overlayed with portfolio diversification and risk controls.
Active share	This is the % of the portfolio that is different from the S&P/ASX 300 Index. This will range between 70-90%
Benchmark	9S&P/ASX 300 Accumulation Index
Number of holdings	Will range between 25-40 stocks with up to 20% invested in Asia
Investment universe	Generally within the largest 300 companies listed on the ASX, plus companies listed in Asia with a focus on Asian domestic consumption. This increases the investment universe by 40-50 investible stocks
Typical company characteristics	We look to invest in companies that display sustainable earnings growth which is characterised by free cash flow growth. We look for a valuation margin of safety as capital preservation is a key focus for the fund.
Risk guidelines	• Maximum stock weight: ◦ Large Cap = 8% soft, 10% hard ◦ Mid/Small Cap = 4% soft, 5% hard ◦ Asian Stocks = 2% soft, 3% hard • No less than 25 stocks, no more than 40 • Maximum active sector position = +20% GICS tier 2. That is no more than 20% over weight one industry sector. • Up to 100% invested in ASX300 stocks • Between 0% - 20% invested in Asian stocks • Between 0% - 20% invested in Cash • Expected Tracking Error 5% – 10% (but not limited) • Derivative overlay can be taken as portfolio protection

The Chester High Conviction Fund Competitive Advantage

1. Portfolio Managers with significant experience in Asia
2. Portfolio Managers with a proven long-term track record in stock selection and a small FUM starting base
3. Absolute alignment of interest between the portfolio managers and the clients as we invest alongside our unitholders

What is the Chester High Conviction Fund?

- It is a predominantly Australian equities portfolio with the right to invest up to 20% of its assets in Asia. It will hold between 25-40 stocks
- A Concentrated, high-conviction portfolio
- Highly Index unaware, with better sector diversification than the ASX300 universe
- Focus on risk adjusted returns and capital preservation
- Portfolio managed for after-tax returns

The Chester High Conviction Fund is a differentiated Australian equity fund in that it has the right, but not the obligation to invest in the highest quality companies listed in Asia, without necessarily taking full emerging market risk. We believe our experience in Asia, having visited China over 40 times in the past 13 years, gives us a unique insight into the most influential driver of the Australian equity and property markets. The approach is long-term, applying a high conviction methodology that seeks to optimise after-tax returns to investors.

The Chester High Conviction Fund is not bound by external indices, allowing the Fund to invest only in those companies that meet its strict investment criteria. While the fund will look very different to the benchmark ASX300 index, we believe it will offer greater sector diversification and therefore, over the long term, offer more appropriate returns for the level of risk investors are exposed to.

The Chester High Conviction Fund is run by Chester Asset Management as the Investment Manager, using Copia Investment Partners as the Responsible Entity and Trustee. NAB is the custodian of the assets.

A strong focus on capital preservation

The Chester High Conviction Fund will focus heavily on stock specific risk and assesses the operational, financial and corporate governance risks of each investment on its own merits.

Why include the Asian stocks?

1. We want access to the best quality companies in Asia, at the right price. It is the choice, but not the obligation to invest in emerging companies with strong local franchises.
2. The strong rise in the sheer number of Asians entering the middle class and the growth in disposable income suggests that this is a multiyear trend that is very hard to access by restricting the investible universe to Australian listed stocks.
3. Investors appropriately diversify their portfolio by enhancing returns with a focus on the domestic demand thematic within Asia.
4. It offers Australian investors a wider opportunity set without the requirement to have money invested in Asia through a pooled vehicle.

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