Chester High Conviction Fund
Fund Update | 28 February 2021

Fund Performance

At 28 February 2021	1 mth %	3 mths %	6 mths %	1 yr %	2 yrs % p.a.	3 yrs % p.a.	Incep. % p.a. (27 Apr 2017)
Chester High Conviction Fund (after fees)	1.9	3.7	18.7	25.4	15.3	8.5	13.0
S&P/ASX 300 Accumulation Index	1.5	3.2	11.7	7.0	7.9	7.5	7.5
Outperformance (after all fees)	**+0.4**	**+0.5**	**+7.0**	**+18.4**	**+7.4**	**+1.0**	**+5.5**

"All truth passes through three stages. First it is ridiculed. Second, it is violently opposed. Third, it is accepted as being self evident"

Arthur Schopenhauer

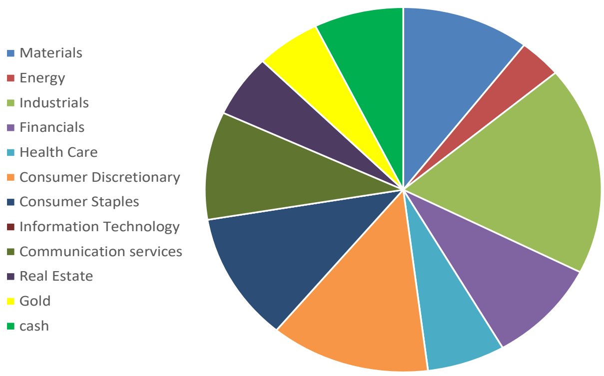
Month in review

When Joe Biden won the election it heralded in a new era of market leadership. Well, most likely it happened to coincide with the news of vaccine success after the election. The ongoing long duration outperformance driven by healthcare and technology and relentlessly lower bond yields is now under threat, or has been for 6 weeks. Reflation is now the overriding dynamic which has seen a strong style rotation back into economic recovery beneficiaries of banks, commodities and energy. These sectors are commonly referred to as short duration sectors as they are more cyclical in nature, but are clearly benefiting from the cycle.

We are at a very interesting juncture for markets. Given the recent move in bond yields (the Australian 10 yr bond yield has risen from 0.97% to 1.86% in 2021 alone), the narrative around lower bond yields forever is under threat. This rise in bond yields globally has the ability to unsettle asset prices if it continues at its current pace, given how all asset prices have been tied to the notion of cheap interest rates forever. It appears the price action in bond markets will see more pressure on central banks (both in Australia and the US) to step in with more asset purchases in an attempt to control interest rates, while if all else fails, we expect the US to embark on Yield Curve Control (YCC), which is what the RBA in Australia has already started. The base premise being, governments are so indebted, they themselves cannot afford materially higher interest rates.

Thus, we think 2021 becomes a tussle between the reflation trade (as the global economy under goes a cyclical recovery), and asset prices fretting over inflationary forces that may end up being too hot. The latter appears inevitable to us, given the amount of money supply growth in 2020, and the pent up spending waiting for the world to reopen. We would make the broad comment though, that it appears market leadership has changed, with more value oriented stocks starting to enjoy renewed interest. In our experience, this is not usually a 3-6 month trend, more like a 2-3 year trend.

Fund sector weights



Portfolio review

For the month of February the fund returned 1.9%, relative to the ASX300 Accumulation Index return of 1.5%. The start of the year has seen a strong start to several of our larger holdings, Westpac, News Corp and Tabcorp. We wrote up News Corp (NWS) in our October quarterly as a stock that remains significantly undervalued as a result of owning 62% of REA Group and Dow Jones (owner of the Wall Street Journal and Barrons). Our sum of the parts still suggests significant upside to the NWS share price based on these assets alone, with the recent 2Q results demonstrating the strength in other NWS properties. The bank sector in Australia has enjoyed a stellar 6 month period as with each passing month, it appears both credit growth and impairment charges are heading in the right direction, meaning higher dividends. While no longer cheap, the tailwind provided by rising bond yields is the first time in years banks have seen earnings upgrades, even if it has been essentially funded by the Australian Government. Tabcorp (TAH) is a stock we have owned previously, and re-entered in January. It does have strong tailwinds behind the lottery business, while there has been much speculation around a sale of their troublesome wagering division.

With the reflation trade in full flight, perceived safe havens have underperformed, with our Gold positions down almost 50% over the past 6 months. That's non correlated. Synlait Milk remains friendless due to the slowdown in infant formula sales by A2 into China, with the share price seemingly pricing in no hope of a recovery. It is now trading at 80% of asset backing, which looks very compelling to us. Atlas Arteria has fallen in line with other interest rate sensitive stocks, while still suffering lower traffic volumes from ongoing French lockdowns.

Top 3 holdings
Westpac
Tabcorp Holdings
Qube Holdings

Portfolio breakdown	
Industrials	19.6%
Consumer Staples	13.4%
Consumer Disc	10.1%

Top 3 portfolio attribution
News Corp Ltd
Westpac
Tabcorp Holdings

Bottom 3 portfolio attribution
OceanaGold
Synlait Milk
Atlas Arteria

Reporting Season Trends

REFLATION	Clearly the trend in the forefront of investors' minds. A very strong commodity price backdrop for resources and a strengthening yield curve with lower BDDs has been a significant tailwind for banks. With the two biggest sectors on the ASX facing eps upgrades with a value bias, the backdrop for the ASX300 remains favorable. **WBC, BHP, MIN, MQG**
REGIME CHANGE?	Has stock market leadership changed from high growth industrials that have had both AUD and bond yield compression as tailwinds? Profound implications as this unwinds. Stock specific rationale obviously but what does this mean for: **CSL, COH, RMD, SEK, APT, XRO, ALU, etc.**
SUPPLY CONSTRAINTS	One of the key call outs during reporting season was supply constraints across various industries. Rising freight costs, access to inventory and slower turn around times (laboratory testing) was very prevalent. Whether it be auto dealers, commodity explorers, housing products, the ability to access inventory was (and remains) a key issue. Many retailers calling out better inventory management as a reason for better working capital outcomes and less promotional activity. Clear trend of larger, well capitalised businesses being better able to manage these issues. **WOW, ALQ, ADH, SUL, PMV, BRG, BKL, BSL**
LOCALISATION OF SUPPLY CHAINS	A mistrust in accessing inventory or raw materials in a timely manner is driving structural changes in supply chain management. Whether it be rare earths, or coal, defense or even agricultural products, we think this trend plays into longer term embedded costs of doing business. **LYC, ASB, TWE, ORA, TSI**
DE-CARBONISATION	The Biden administration has been very vocal in tackling climate change with supporting clean energy initiatives. This has accelerated the EV trend with the upstream (commodity) companies experiencing significant inflows. **LYC, MIN, SYR, PLL, INR**
SURPLUS LIQUIDITY	In a world of excess money supply and currency debasement, with cheap rates, private equity is highly incentivized to put money to work. We think this heralds the start of a strong M&A cycle. Balance sheets in the listed space are also strong relative to history and looking to either grow or embark on capital management initiatives, **TAH, HUO, BIN, AHY, AZJ, ANN, WOW, MTS, QUB**
COMMUNITY VS CBD/URBAN	Perhaps a hangover from 2020, but the pull of localisation plays into community hubs while the large CBD property plays still languish. Does it continue? **LIC, EGH, INA, MTS, MGR, LLC**
AGRICULTURE TRENDS	Mostly a function of a very strong cropping season, but the recent headwinds for the ag supply chain has turned into a tailwind. **ELD, CGC, SHV, BGA, GNC, NUF, QUB**
THE END OF THE NARRATIVE?	Low bond yields have given rise to various pockets of speculation in equity markets where stock prices have detached from the reality of cash flows, simply due to the rise of new investors being captivated by the hype of industry domination. Very rarely does this end well. Eventually companies must produce cash flows.

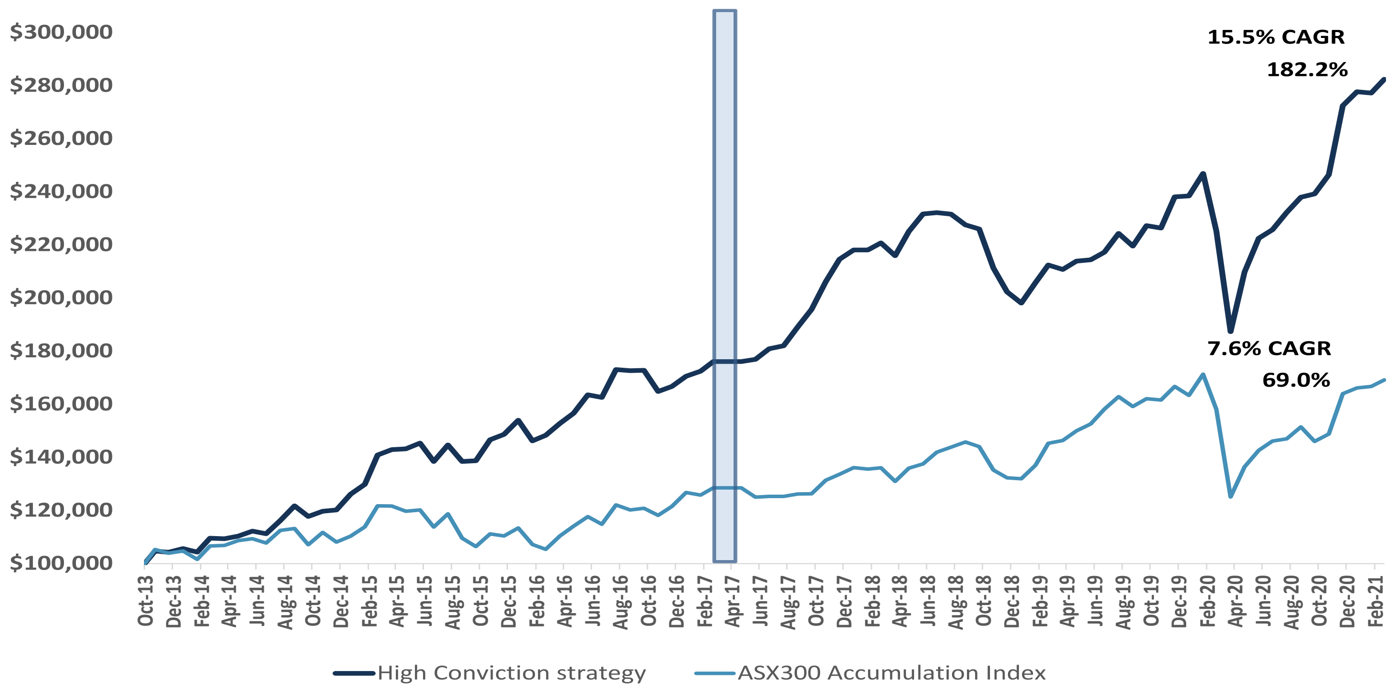
Accumulated Performance by Financial Year - Same Strategy

	FY14 (%)#	FY15 (%)	FY16 (%)	FY17 (%)*	FY18 (%)	FY19 (%)	FY20 (%)	FY21 (%)	Since Inception (%) p.a.
Same Strategy (after MER)	+11.2	+24.5	+17.4	+11.2	+28.3	-6.4	+3.9	+25.0	+15.5
S&P/ASX 300 Accumulation Index	+7.8	+5.6	+0.9	+9.1	+13.2	+11.4	-7.7	+15.8	+7.6
Value added (after MER)	**+3.5**	**+18.9**	**+16.4**	**+2.1**	**+15.1**	**-17.8**	**+11.6**	**+9.2**	**+7.9**

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.

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.

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