

# DNR Capital Australian Equities High Conviction Fund

APIR code: PIM0028AU

Performance Report December 2022

## Performance

DNR Capital Australian Equities High Conviction Fund decreased 2.23% (net of fees) in December, outperforming the S&P/ASX 200 Total Return Index by 0.98%. Over the last 12 months, the Fund increased by 3.93%, outperforming the Index by 5.01% (net of fees).

## Net active return as at 31 December 2022

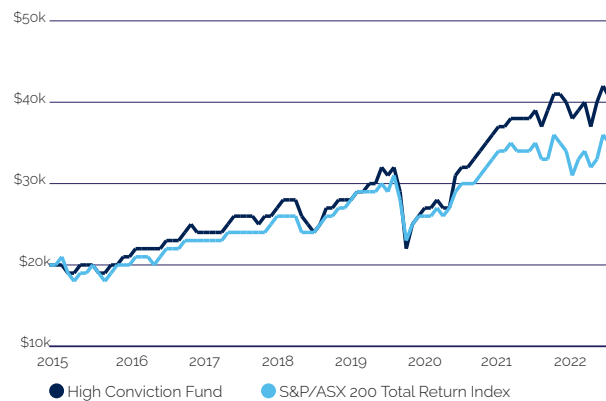
	1mth %	3mth %	6mth %	1yr %	3yr p.a. %	5yr p.a. %	Incep.* p.a. %
High Conviction Fund	-2.23	9.02	6.29	3.93	9.40	9.20	9.83
S&P/ASX 200 Total Return Index	-3.21	9.40	9.82	-1.08	5.55	7.11	7.48
<b>Excess return</b>	<b>0.98</b>	<b>-0.38</b>	<b>-3.53</b>	<b>5.01</b>	<b>3.85</b>	<b>2.09</b>	<b>2.35</b>

\* Inception Date—June 2015.

Source: DNR Capital and Apex Fund Services.

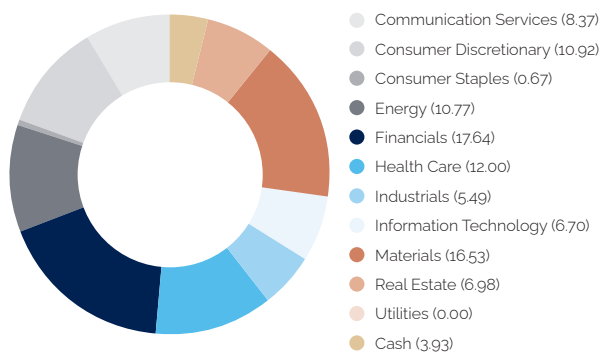
Past performance is not an indication of future performance. Total return shown for the DNR Capital Australian Equities High Conviction Fund has been calculated using exit prices after taking into account all of the product's ongoing fees and assuming reinvestment of distributions. No allowance has been made for entry/exit fees or taxation.

## Growth of \$20,000 since inception



Source: DNR Capital and Apex Fund Services

## Sector weightings %



Source: DNR Capital and Apex Fund Services

## Top 5 active holdings

### Security details

The Lottery Corporation (TLC)

National Australia Bank (NAB)

Woodside Energy Group (WDS)

CSL (CSL)

Scentre (SCG)

Source: DNR Capital and Apex Fund Services

## Monthly top contributors and detractors

### Top 3 contributors

QBE Insurance Group (QBE)

Rio Tinto (RIO)

Lendlease (LLC)

### Top 3 detractors

Aristocrat Leisure (ALL)

Fortescue Metals Group (FMG, no holding)

Carsales.com (CAR)

Source: DNR Capital and Apex Fund Services

## Experienced portfolio managers



**Jamie Nicol**  
Chief Investment Officer



**Scott Bender**  
Portfolio Manager

## Performance attribution

### Contributors

- **QBE Insurance Group (QBE):** outperformed during the month on no stock specific news but remains well positioned with top line growth, improving margin and repaired balance sheet.
- **Rio Tinto (RIO):** outperformed during the month in line with the materials sector and also after receiving shareholder approval to acquire the outstanding shares in the Turquoise Hill joint venture.
- **Lendlease (LLC):** outperformed on no stock specific news but following weakness in the prior month after reporting softer than expected guidance for the first half of FY23.

### Detractors

- **Aristocrat Leisure (ALL):** underperformed, which was driven by a strengthening AUD, regulatory concerns in Australia and uncertain growth in online gaming.
- **Fortescue Metals Group (FMG, no holding):** outperformed alongside other iron ore miners as commodity prices rebounded in anticipation of a Chinese reopening.
- **Carsales.com (CAR):** underperformed in line with other online classifieds stocks as concerns over digital property listing spilled into other verticals.

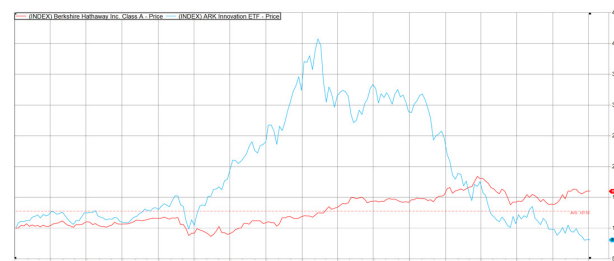
## Fund and market review

The S&P/ASX 200 Total Return Index was down 3.21% during the period. Materials (-0.91%) was the best performing sector, with the majors (BHP +0.24%, FMG +5.83%, RIO +6.19%) continuing their run on the back of a higher iron ore price in anticipation of Chinese reopening. Consumer Staples (-1.87%) also outperformed with Coles Group (COL -1.36%) and Woolworths Group (WOW -2.64%) benefitting from resilient supermarket sales and normalising industry market shares. Consumer Discretionary (-7.04%) was the worst performing sector, with Aristocrat Leisure (ALL -12.87%) selling off following a strengthening AUD and regulatory concerns in Australia. A-REITS (-5.61%) also underperformed, with climbing bond rates over the month negatively affecting REIT valuations.

2022 was the year a decade long secular stagnation receded. Zero interest rate policies quickly unravelled as the inflation that had eluded central banks for so many years swamped unprepared policy makers. Coordinated global rate rises placed heavier discounts on earnings further in the future and punished undisciplined loss-making enterprises. Capital markets whipsawed from There Is No Alternative (TINA) to There Are Now Alternatives (TANA). As the cost of capital reasserted itself on asset prices, many darlings of the COVID-19 era met the brutal reality of normalising activity, liquidity and market demand for sustainable cashflows. In assessing the equities landscape for investment opportunities in 2023, we review recent economic data in the context of slowdown narratives and weigh earnings expectations baked into stocks.

Impactful changes occurring in Japanese bond markets may set the scene for markets in 2023, which continues to digest the astonishing events of the past few years.

## Old world versus new world – Warren Buffet's Berkshire Hathaway versus Cathie Woods Ark Innovation Fund

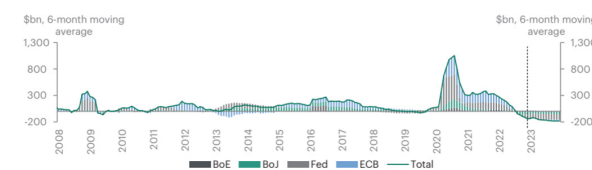


Source: FactSet, DNR Capital

## Early but mixed signs of a slowdown

Coordinated global rate hikes and withdrawal of liquidity have been underway for several months now, with central banks very deliberately architecting an economic slowdown to tame the wrath of inflation.

## Central bank asset purchases

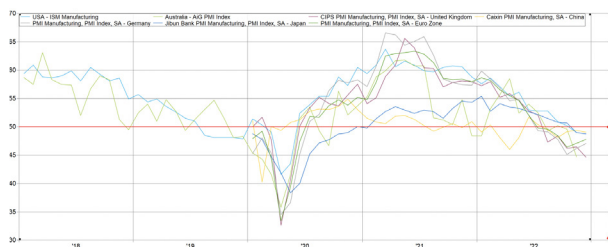


Source: JPMorgan Asset Management

Several sectors are showing clear signs of slowing, whilst others remain resilient in the face of higher rates and stubborn inflationary pressures. Housing and construction in North America have experienced significant downward revisions, whilst energy and materials sectors continue to benefit from elevated pricing.

Global Purchasing Managers Indices (PMI) is a broad measure of economic activity through manufacturing (<50 is contracting, >50 is expanding). Following the peak in mid-2021, major global indices are firmly in contractionary territory.

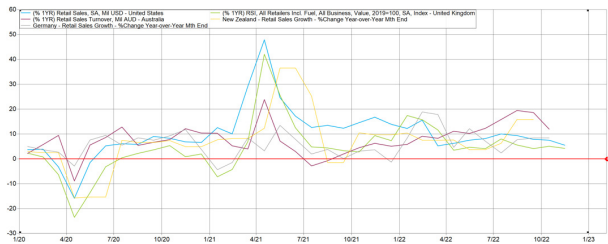
## Select global PMI's



Source: FactSet, DNR Capital

Consumers remain remarkably resilient despite many headwinds from cost inflation to rising mortgage rates.

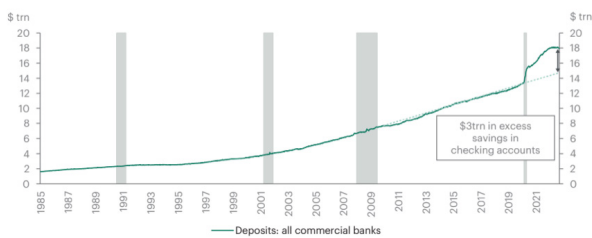
### Select global retail sales growth



Source: FactSet, DNR Capital

The relentless pressure from central banks to stomp inflation and curtail demand has yet been unable to counterbalance generationally low unemployment and historically high household savings.

### US excess savings



Source: Federal Reserve Board (FRB), Haver Analytics, Apollo Chief Economist

Earnings expectations do not appear to reflect a meaningful slowdown, which central bank tightening necessarily architects by design. In general, markets run ahead of earnings and bottom before the end of recessions. With a slowdown all but guaranteed, the question for investors is how much is now priced in?

### Earnings per share bottom later than markets



Source: Haver, as of 30 Nov 2022

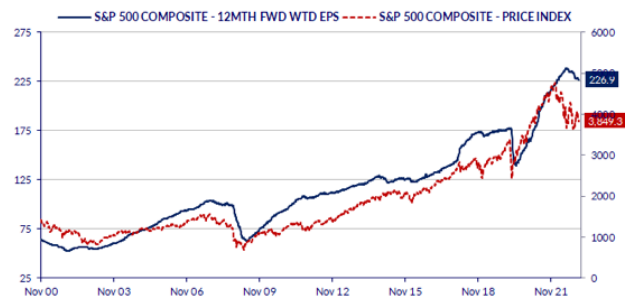
It could be argued that stock markets have already run ahead of earnings revisions with recent pullbacks, but this doesn't preclude further deterioration.

### ASX200 EPS vs Index performance



Source: CLSA

### S&P 500 EPS vs Index performance



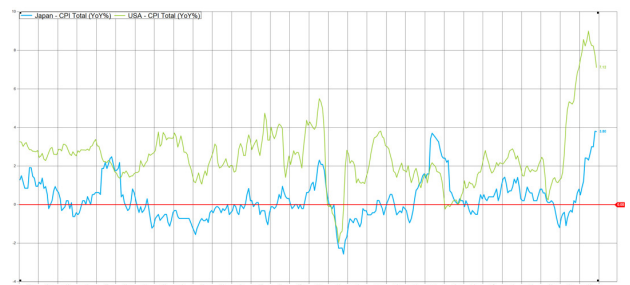
Source: CLSA

A global recession is not guaranteed but based on consensus estimates, more than likely in the developed world. The resolve of central bankers to bring inflation back to target as conditions deteriorate remains unknown, however, and the efficacy of their current monetary policy is unclear.

### The Japanese band ease

Since the end of the Japanese Economic Miracle of the 80's and 90's, Japan has been mired by anaemic growth and indefatigable deflation. A declining population, a rapidly aging workforce combined with an antiquated corporate culture has stagnated the economy for several decades. Having long embraced ultralow interest rates to stimulate growth, the Bank of Japan (BoJ) introduced Yield Curve Control (YCC) in 2016, effectively pinning the 10-year bond at 0.25%. Whilst manifesting later, the inflation permeating global markets has reached Japan, breaking out from decades of recurring deflation.

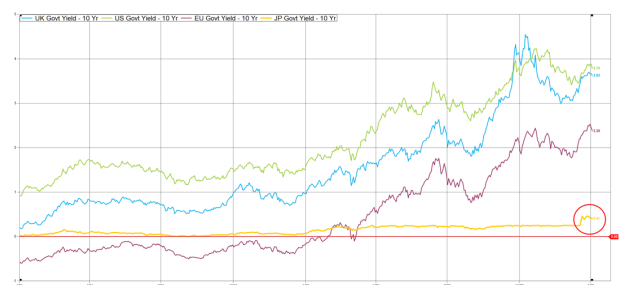
### Japan vs US Consumer Price Index



Source: FactSet, DNR Capital

The BoJ has maintained its yield curve control, even as other central banks stepped back from similar measures. Officials refused to tighten monetary policy, cratering the Yen and threatening to inflict uncontrolled inflationary forces.

### Major economy bond yields



Source: FactSet, DNR Capital

On 20 December 2022, the BoJ unexpectedly widened the tradeable range imposed on the benchmark from 25bps to 50bps, despite maintaining a 0% target and negative short-term rates. The shift was not entirely unanticipated, but many observers expected action post the retirement of BoJ governor Haruhiko Kuroda in April 2023. The BoJ denies this is a shift in monetary policy but it is viewed by many as enabling the next governor to further tighten and move into line with global markets.

This development has several implications for global markets. Negative interest rates have driven trillions of Yen offshore in search of real positive income. Japanese institutions maintain the largest foreign ownership of US Treasuries. As a relatively high dividend paying jurisdiction, the ASX has been a favourite of Mr & Mrs Watanabe (Japanese retail investors). Property trusts, banks, infrastructure and utilities have likely benefited from Japanese retail and institutional ownership. The possibility of more reasonable income opportunities in their domestic market may remove a sizeable buyer of Australia's favoured income sectors.

### Fund facts

**Inception date:** June 2015

**Minimum initial investment:** \$20,000

**Risk level:** High

**Management fee:** 0.90% ( inclusive GST and RITC)

**Performance fee:** Nil

**Entry/exit fees:** Nil

**Buy/sell spread:** +0.20%/-0.20%

**Valuation and unit pricing frequency:**

Each business day

**Distribution frequency:** Semi-Annual

**Responsible Entity:** The Trust Company (RE Services) Limited as part of the Perpetual Limited group of companies.

### About DNR Capital and the Fund

**Concentrated:** Investing in 15-30 highest conviction, quality large cap Australian listed equities.

**Style neutral and quality focussed:** A disciplined approach to quality and valuation. Concentrated portfolios of quality companies maximise the opportunity for outperformance.

**Experienced and aligned team:** The portfolio managers have more than 50 years of combined investment experience and are invested alongside our clients.

**Proven process:** DNR Capital was established in 2001 and a consistent firm-wide investment process has delivered more than 19 years of investment outperformance.

### Disclaimer

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