

DNR Capital Australian Equities High Conviction Fund

APIR code: PIM0028AU

Performance Report January 2023

Performance

DNR Capital Australian Equities High Conviction Fund increased 5.48% (net of fees) in January, underperforming the S&P/ASX 200 Total Return Index by 0.75%. Over the last 12 months, the Fund increased by 14.39%, outperforming the Index by 2.18% (net of fees).

Net active return as at 31 January 2023

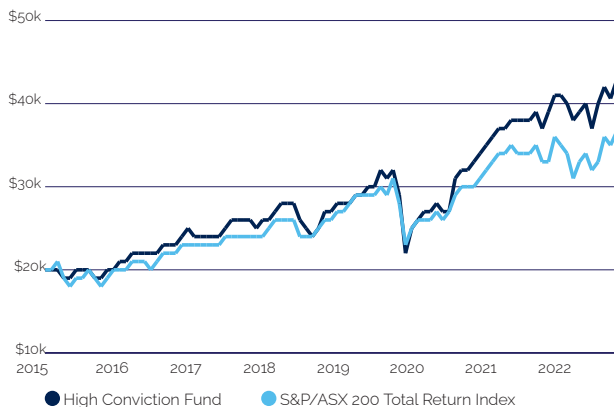
	1mth %	3mth %	6mth %	1yr %	3yr p.a. %	5yr p.a. %	Incep.* p.a. %
High Conviction Fund	5.48	8.44	8.80	14.39	10.36	10.54	10.48
S&P/ASX 200 Total Return Index	6.23	9.59	10.32	12.21	5.96	8.51	8.24
Excess return	-0.75	-1.15	-1.52	2.18	4.40	2.03	2.24

* Inception Date—June 2015.

Source: DNR Capital and Apex Fund Services.

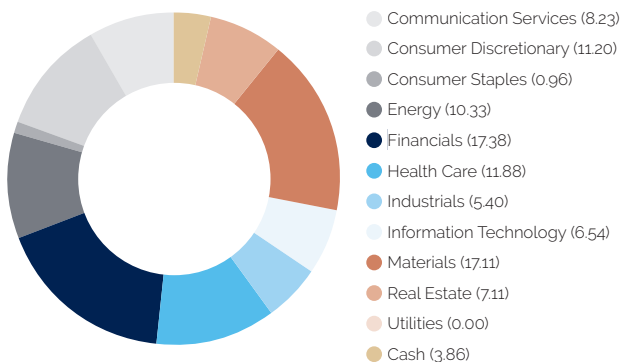
Past performance is not an indication of future performance. Total return shown for the DNR Capital Australian Equities High Conviction Fund has been calculated using exit prices after taking into account all of the product's ongoing fees and assuming reinvestment of distributions. No allowance has been 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)
 CSL (CSL)
 Woodside Energy Group (WDS)
 Scentre Group (SCG)

Source: DNR Capital and Apex Fund Services

Monthly top contributors and detractors

Top 3 contributors

Domino's Pizza Enterprises (DMP)
 Westpac Banking Corporation (WBC)
 SEEK (SEK)

Top 3 detractors

Computershare (CPU)
 Woodside Energy Group (WDS)
 QBE Insurance Group (QBE)

Source: DNR Capital and Apex Fund Services

Experienced portfolio managers



Jamie Nicol
Chief Investment Officer



Scott Bender
Portfolio Manager

Performance attribution

Contributors

- **Domino's Pizza Enterprises (DMP):** outperformed during the month following a successful capital raise to fund the buyout of its German joint venture from its UK counterpart in December. Key commodity inputs continue to decline, providing more comfort on European earnings.
- **Westpac Banking Corporation (WBC, no holding):** underperformed during the month as expectations for a slowing of rate rises impacted the outlook for Net Interest Margin expectations.
- **SEEK (SEK):** duration and cyclical stocks outperformed this month as recession expectations faded, increasing the potential for a soft landing.

Detractors

- **Computershare (CPU) :** underperformed on no company specific news but in line with other interest rate sensitive stocks, as bond yields fell across the curve in January.
- **Woodside Energy Group (WDS):** despite a positive return, a strong rally in the broader market outpaced energy stocks in a month where the oil price finished largely flat. With the Northern Hemisphere passing through the crucial winter period (peak heating and energy requirements), demand has moderated, with the impact of a reopening China yet to be seen.
- **QBE Insurance Group (QBE):** underperformed on no company specific news but in line with other interest rate sensitive stocks, as bond yields fell across the curve in January.

Fund and market review

The S&P/ASX 200 Total Return Index was up 6.23% during the period. Consumer Discretionary (+9.8%) was the best performing sector, as strong consumer data and more dovish commentary out of the Federal Reserve encouraged a "soft landing" (WES +8.2%, ALL +11.3%). Materials (+8.8%) also outperformed, benefitting from a reopening China and speculation of increased metals demand (BHP +8.2%, RIO +8.8%). Utilities (-3.0%) and Energy (+1.3%) were the worst performing sectors, as declining gas and coal prices following a mild Northern Hemisphere winter saw producers under pressure (AGL -5.2%, WDS +2.3%).

Following a weak December, January saw a strong bounce back in global markets. Nervousness in December resulted in defensive positioning towards the end of the year, although the outlook appeared to be improving. China re-opened from COVID-19, a warm winter in Europe averting a crisis, and inflation in the US easing encouraged investors to reverse their positioning. The stocks, which sold off last year, rallied throughout January. We examine in this report the sustainability of the rally.

Financial conditions are easing

As a consequence of long-term bonds easing and markets rising, we have seen financial conditions in the US ease substantially in recent months. We see this as somewhat counter to the Federal Reserve's (the Fed) ambitions to rein in inflation.

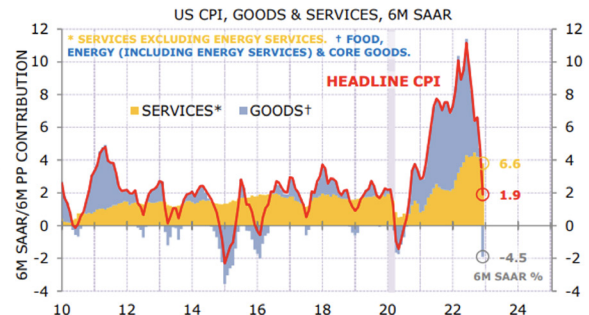
Financial conditions



Source: Bloomberg

Inflation in the US has begun to fall. However, as noted in the chart below, this is primarily driven by falling goods inflation as supply chains normalise and the demand for vehicles and other goods eases. Prices of goods will normalise in time, yet wages are notoriously sticky. Notably, service inflation which reflects wages and rents, remains elevated.

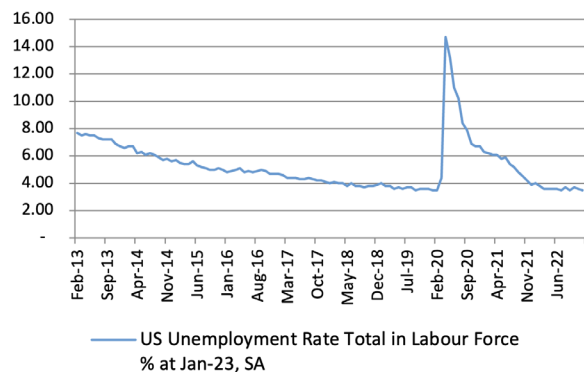
The rise and fall of transitory goods inflation



Source: BLS, NBER; Minack Advisors

The employment market remains tight, with unemployment low. Unemployment tends to be a lagging indicator, but with unemployment tight pressures will remain on wages.

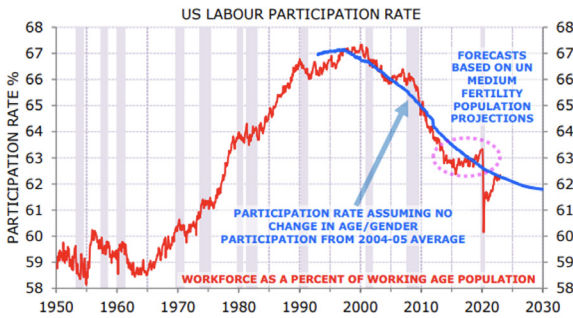
US unemployment rate



Source: FactSet

The labour participation market has remained tight, with an ageing population seeing many employees leave the workforce. How will the Australian market cope with the extra demand from Chinese students and tourists? It is likely to pressure central banks to ensure they do not ease too quickly for fear of further stoking inflation.

Demographics are reducing labour participation

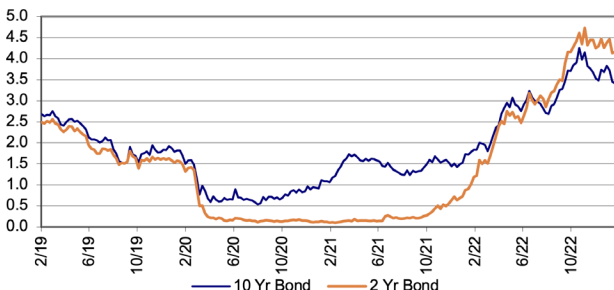


Source: BLS, UN, NBER; Minack Advisors

Inverted yield curve

The chart below highlights that the US 10 year vs. 2 year bond yield has inverted. Since 1970, the 10-2 year spread inverted nine times, not including the latest episode. During this long period, there were eight recessions. By and large, the inversion of a yield curve happens whenever monetary policy is tighter than what is required by underlying economic conditions. This is because the Fed controls the short end of the curve, and thus the levels of short rates reflect policymakers' views on where interest rates should be. However, the long end of the curve is driven by the collective assessment among bond investors on the appropriate cost of long-term borrowing. When the curve is inverted, it simply says that short rates are higher than the bond market deems necessary over time. Historically, whenever the divergence occurs, the Fed is always the one who, in hindsight, has misjudged the situation. In other words, whenever the curve is inverted, the implication is that the Fed has either mistakenly lifted rates too high or is purposely doing so to slow the economy.

US 10 v 2 year bond yield

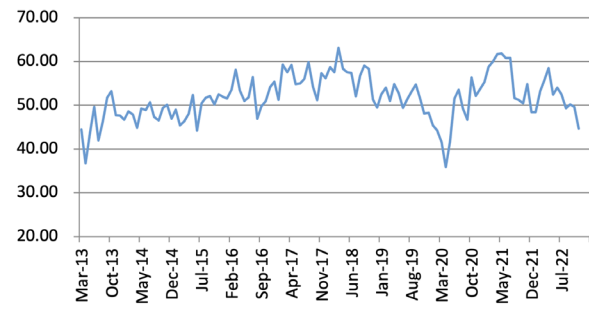


Source: FactSet, DNR Capital

Economic indicators

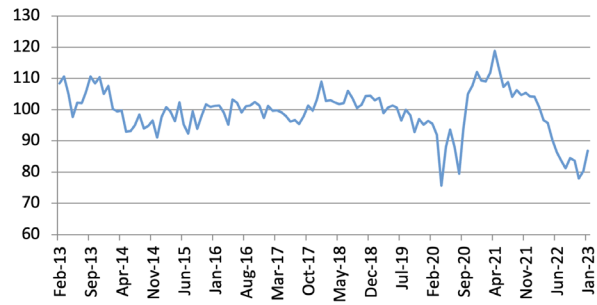
So while the yield curve suggests some reason to be cautious, the outcome will depend on the central bank's willingness to keep rates high while conditions are easing. Lagging indicators such as employment remain strong, while lead indicators such as business and consumer confidence appear to be easing.

Australian business confidence (PMI)



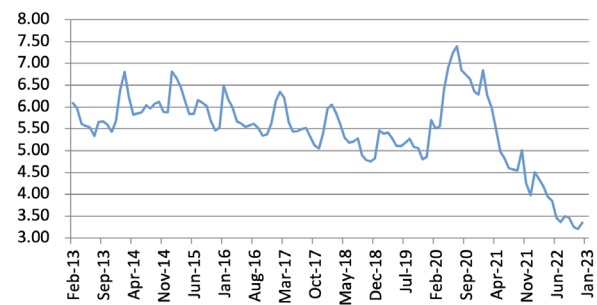
Source: FactSet

Australian consumer confidence



Source: FactSet

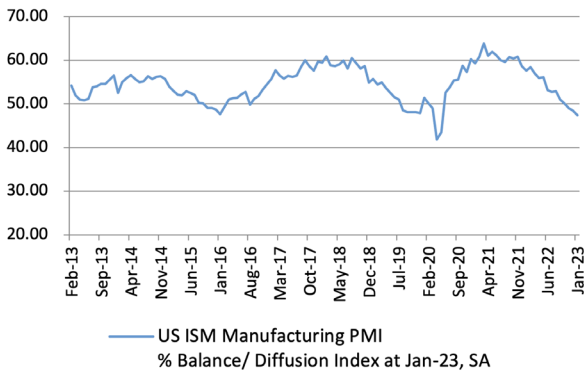
Australian unemployment rate



Source: FactSet

The same is true in the US, where business confidence is below 50, suggesting slowing activity.

US business confidence (PMI)



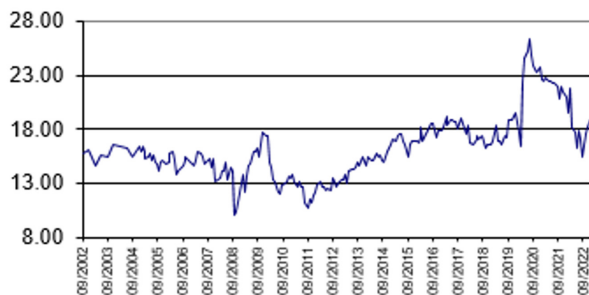
Source: FactSet

One region at odds with this is China, where business confidence has bounced off lows. We see this as broadly positive for the Australian economy, albeit it likely further tightens capacity and raises the risk of higher rates, causing a softer property market.

Valuations

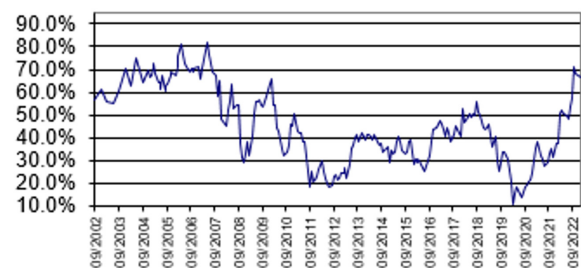
The bounce has resulted in the US market looking moderately expensive compared to 20 year history. The market appears to be pricing in a soft landing for the economy, and there is a risk that market earnings will deteriorate further as it usually does as the economy slows. We favour companies with earnings resilience and quality characteristics from a positioning perspective.

US market – rolling forward per trend



Source: FactSet

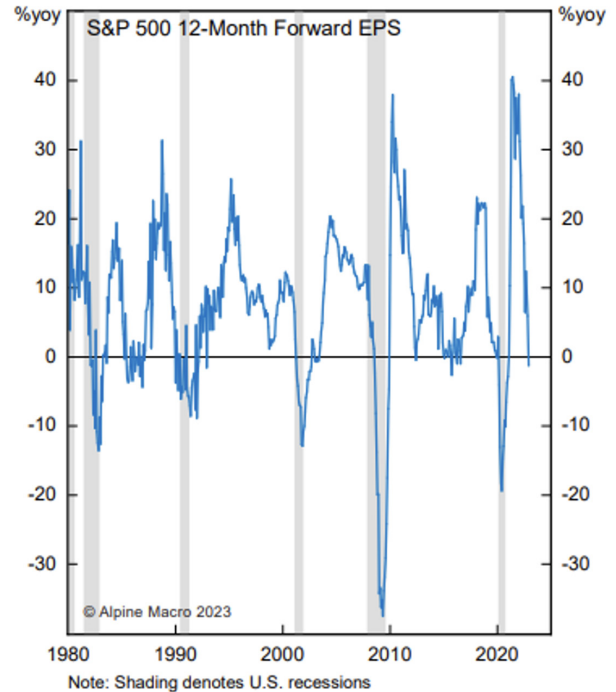
US market – bond yield on earnings yield



Source: FactSet

Historically, an economic slowdown would mean a bear market in equity prices and a 10-15% decline in EPS. There has already been some softening in earnings, but a further adjustment could be expected.

S&P 500 12-month forward EPS



Source: Alpine Macro

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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Office address
Level 23
307 Queen Street
Brisbane QLD 4000

Postal address
GPO Box 3263
Brisbane QLD 4001

Telephone
07 3229 5531

Email
info@dnrcapital.com.au

Website
dnrcapital.com.au