

DNR Capital Australian Equities High Conviction Fund

APIR code: PIM0028AU

Performance Report April 2023

Performance

DNR Capital Australian Equities High Conviction Fund increased 1.80% (net of fees) in April, underperforming the S&P/ASX 200 Total Return Index by 0.05%. Over the last 12 months, the Fund increased by 3.57%, outperforming the Index by 0.74% (net of fees).

Net active return as at 30 April 2023

	1mth %	3mth %	6mth %	1yr %	3yr p.a. %	5yr p.a. %	Incep.* p.a. %
High Conviction Fund	1.80	-0.84	7.53	3.57	19.83	9.92	10.02
S&P/ASX 200 Total Return Index	1.85	-0.80	8.71	2.83	13.99	8.26	7.87
Excess return	-0.05	-0.04	-1.18	0.74	5.84	1.66	2.15

* Inception Date—June 2015.

Source: DNR Capital and Apex Fund Services.

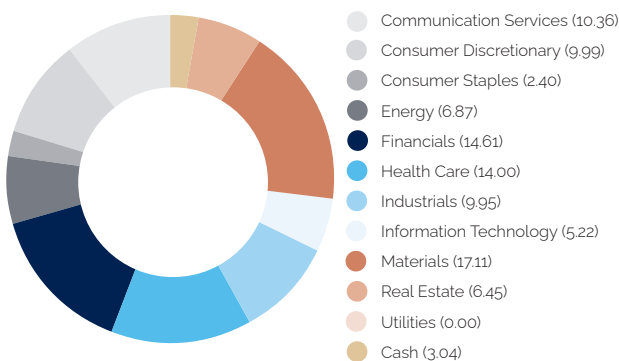
Past performance is not an indication of future performance. Total return shown for the DNR Capital Australian Equities High Conviction Fund has been calculated using exit prices after taking into account all of the product's ongoing fees and assuming reinvestment of distributions. No allowance has been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

Woodside Energy Group (WDS)

CSL (CSL)

The Lottery Corporation (TLC)

Carsales.com (CAR)

National Australia Bank (NAB)

Source: DNR Capital and Apex Fund Services

Monthly top contributors and detractors

Top 3 contributors

Carsales.com (CAR)

Fortescue Metals Group (FMG, no holding)

BHP Group (BHP, underweight)

Top 3 detractors

Rio Tinto (RIO)

Ramsay Health Care (RHC)

ANZ Group Holdings (ANZ, no holding)

Source: DNR Capital and Apex Fund Services

Experienced portfolio managers



Jamie Nicol
Chief Investment Officer



Scott Bender
Portfolio Manager

Performance attribution

Contributors

- **Carsales.com (CAR):** growth stocks rallied during the month due to expectations of lower bond yields. The business continues to benefit from recent price rises and as inventory normalises from lower levels.
- **Fortescue Metals Group (FMG, no holding):** underperformed over the month as iron ore prices slipped on concerns that the China reopening was slower than previously expected.
- **BHP Group (BHP, underweight):** underperformed during the month as a slower than expected pickup in economic activity post reopening in China led to lower iron ore prices.

Detractors

- **Rio Tinto (RIO):** underperformed during the month as a slower than expected pickup in economic activity post reopening in China led to lower iron ore prices.
- **Ramsay Health Care (RHC):** underperformed during the month on concerns around continued cost pressures and the potential for higher funding costs going forward.
- **ANZ Group Holdings (ANZ, no holding):** bounced back following the sell down of banks in March.

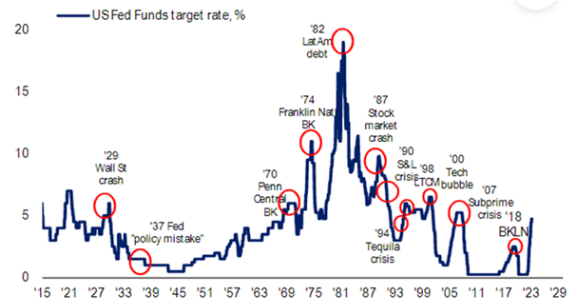
Fund and market review

The S&P/ASX 200 Total Return Index was up 1.85% during the period. A-REITs (+5.3%) were the best performing sector, with bond yields stabilising and the RBA pausing rate hikes. The sector rebounded as the market began pricing a top in interest rates as a more dovish sentiment echoed through central banks (Stockland (SGP) +11.8%, Mirvac (MGR) +15.9%). Information Technology (+4.8%) also outperformed, similarly benefitting from lower terminal rate assumptions. A bias towards established, profitable companies has begun to emerge as interest rates increase from ultra-low levels (WiseTech Global (WTC) +5.3%, Xero (XRO) 4.4%). Materials (-2.6%) underperformed with fears of recession and an underwhelming Chinese recovery hitting iron ore particularly hard (BHP Group (BHP) -6.0%, Rio Tinto (RIO) -6.6%). Utilities (+1.4%) also underperformed, with the under-offer Origin Energy (ORG +0.6%) damping sector returns as it remains tied to its offer price.

Following a soft March, markets rebounded in April as investors anticipated slowing inflation and lower interest rates. We discuss the current economic outlook as well as some opportunities that we see as emerging over the longer term.

As we noted last month, when interest rates rise sharply, things break. We are now seeing problems emerge within the US financial system, specifically amongst regional banks and lenders with significant commercial property exposures.

Federal Reserve rate hikes & significant market events

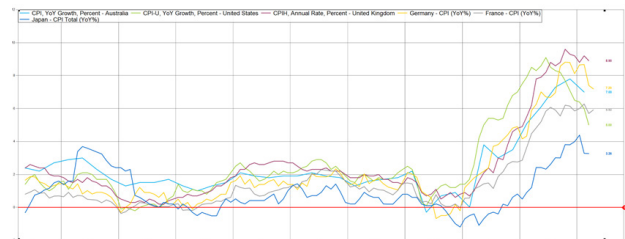


Source: BofA

Inflation in major countries

Inflation may be peaking in a number of countries but remains elevated globally. Markets tend to react to the direction of inflation, so moderating consumer prices are typically favourable for equity valuations. We are witnessing inflation moderating, but the lagged effect of higher pricing expectations on wages remains a key question.

Select global consumer price indices



Source: FactSet

A slowing economy, combined with fractures appearing in US regional banks, leaves the US Federal Reserve and other central banks with less flexibility in dealing with sticky inflation.

Core service inflation and wage growth in the US

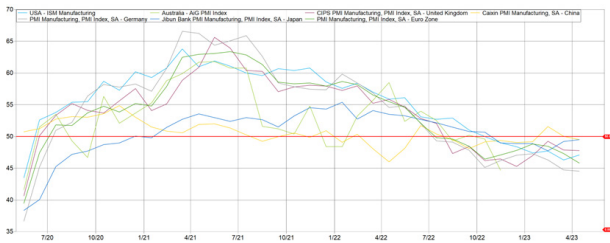


Source: Minnick Advisors

Economic outlook

Economic indicators remain mixed. US business confidence has fallen to a level that suggests a reasonable economic slowdown, and, globally Purchasing Managers' Indexes (PMIs) are at contractionary levels. Combined with tighter lending standards, markets are anticipating further contraction in economic activity.

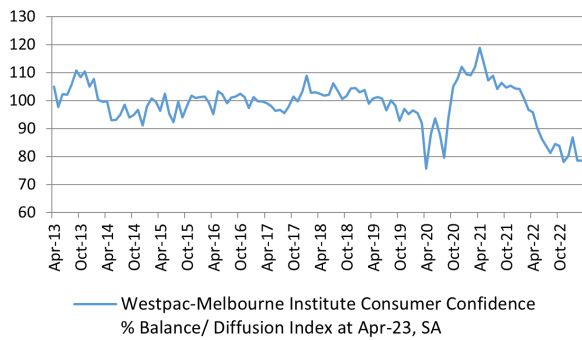
Global manufacturing purchasing manager indices



Source: FactSet

The Australian consumer also continues to feel under pressure.

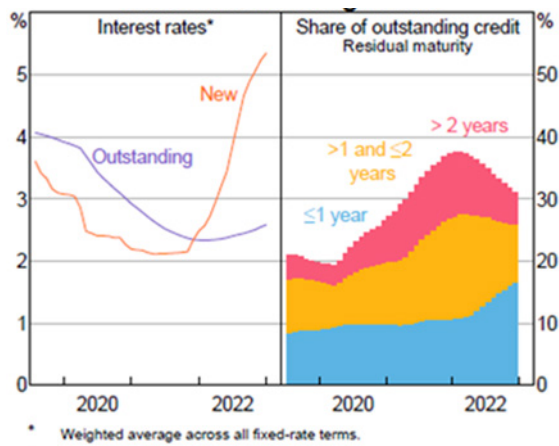
Australian consumer confidence



Source: FactSet, DNR Capital

We note a significant proportion of fixed loans, fixed at historically low rates, have begun to rollover, placing further pressure on households.

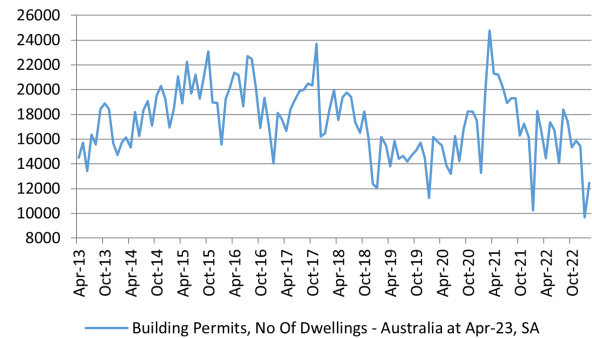
Fixed-rate housing loans in Australia



Source: APRA; RBA

Housing in Australia and the US is trying to bounce off a low point but remains sensitive to further interest rate rises.

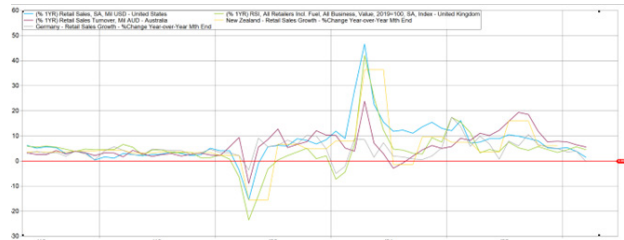
Australian building approvals dwellings



Source: FactSet, DNR Capital

Buffered by high savings, low unemployment, and wages growth, consumers around the world are defiantly resilient in the face of cost of living pressures, and weak sentiment.

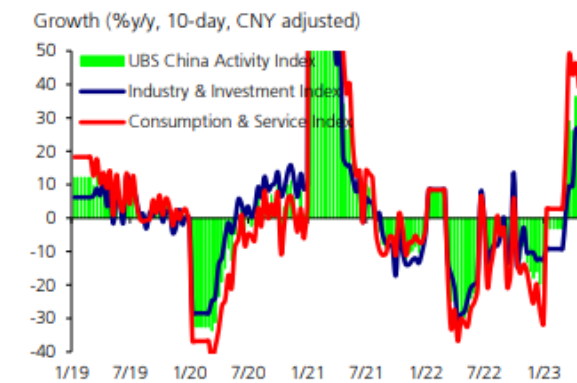
Select global retail sales growth



Source: FactSet, DNR Capital

China's reopening has been the source of much excitement and focus but, in some respects, has disappointed with its pace of economic recovery. Given the delayed rollback of its COVID-19 restrictions, the economic outlook remains on a different trajectory to the developed world.

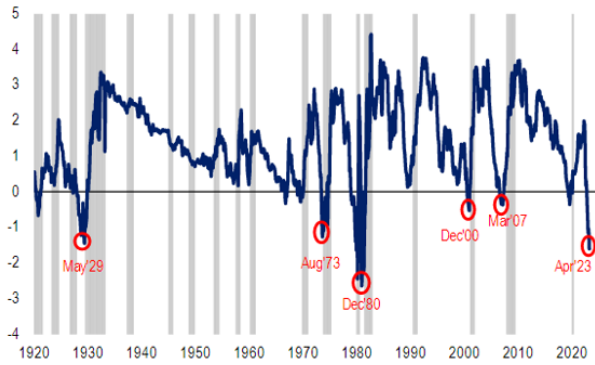
China activity, investment & consumption indices



Source: CEIC, Wind, G7, China Port Association, UBS estimates

Lead indicators remain consistent with a recession in the US and Europe, with yield curves supporting this. Historically, when the 10-year bond rates are lower than short term interest rates, the bond markets herald an economic slowdown.

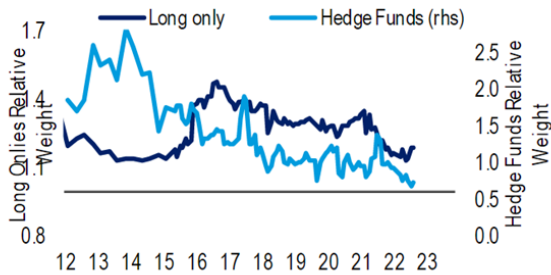
US 3s10s yield curve



Source: BofA

With this in mind, it is somewhat surprising that markets have not been weaker. Sentiment is reasonably subdued, and volatility is low. Unlike many previous slowdowns, this potential recession has been widely anticipated, and investors have been positioned accordingly. The chart below highlights that US investors hold the lowest level of cyclical relative to defensive exposures in over a decade.

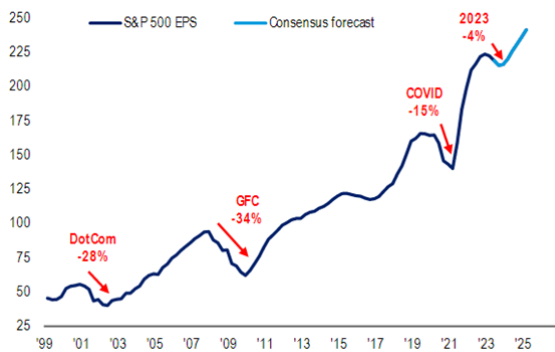
Cyclicals v defensive positioning



Source: BofA US Equity & Quant Strategy, FactSet Ownership

This widely anticipated recession is taking longer to unfold. High levels of residual savings among consumers, and the flow on effects of fiscal stimulus, have driven surprisingly resilient earnings. Consequently, we have not seen the pullback in earnings generally observed in a recession (perhaps this remains in front of us).

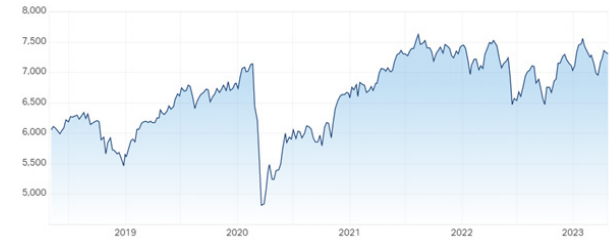
Historical versus forecast S&P 500 earnings per share drawdowns



Source: BofA Global Investment Strategy, Bloomberg

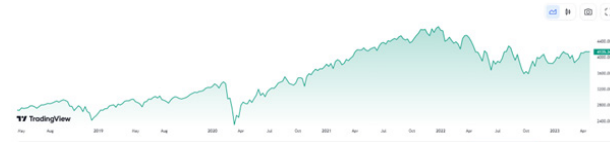
Markets have therefore shown reasonable strength, particularly in Australia, where the proximity to China has supported resources and energy valuations. The longer markets stay resilient; the more inclined investors are to deploy cash into the market.

ASX 200



Source: Tradingview.com

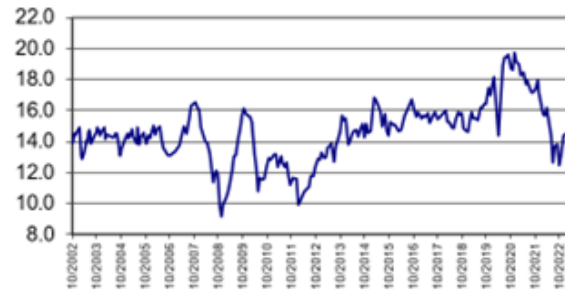
S&P 500



Source: Tradingview.com

The Australian economic outlook remains uncertain, but this has at least partially been anticipated by the market. Valuations are trading near long-term averages, notwithstanding downside risk to earnings should the global economy begin to slow.

Australian market PE



Source: FactSet, DNR Capital

If inflation remains sticky, forcing further interest rate tightening into the face of a slowdown, globally, we're likely to experience a negative surprise. We believe that resource demand combined with elevated population growth, positions Australia as more resilient than many other markets.

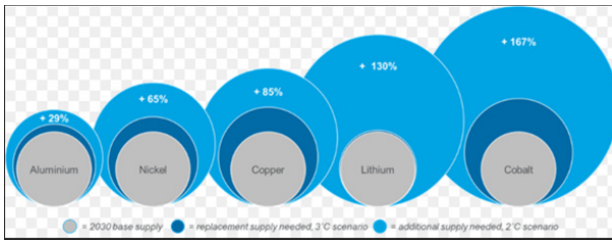
Bottom-up opportunities

With the top-down view of the world more uncertain, we consider a range of thematics more likely to offer opportunities for growth over the next decade.

1. Energy transition

Long term plans to electrify the grid and adopt lower carbon intensity will drive demand for domestic commodities and infrastructure over the next decade. Australia's fortunate position as a primary producer will benefit a range of exposed companies and the broader Australian economy.

BHP investor presentation

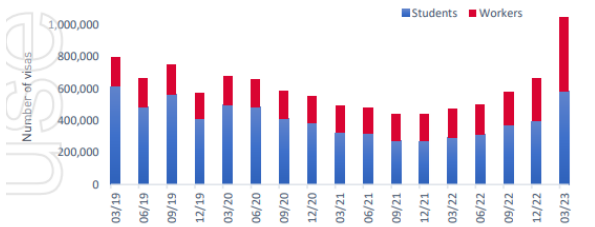


Source: BHP Group

2. Immigration

Australia should also enjoy the benefit of a rise in immigration, which potentially alleviates some inflation pressure and will provide a direct benefit for a range of companies selling to a larger population.

Primary visa holder data¹ shows a recovery in international students and workers coming to Australia



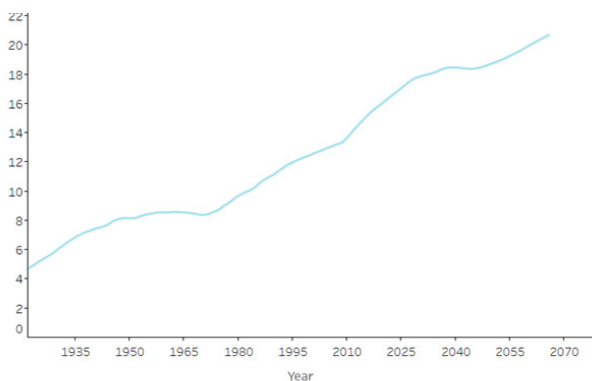
¹ Workers segment includes key contestable visa categories eligible for Medibank's Overseas Workers Health Covers. Bridging visa holders in Australia excluded from all segments. Source Data.gov.au, accessed May 2023

Source: Data.gov.au

3. Ageing population

Australia's average population continues to age, providing opportunities for healthcare providers and hospital groups servicing this age cohort.

Percentage of the Australian population aged 65 and over, at 30 June, over time



Notes
 1. Data for 1921 to 1970 are population estimates. Data from 1971 onwards are estimates of the resident population (ERP).
 2. Population data from 1992 to 2011 are recast estimates following the re-basing of the 2011 Census. For more information, see the ABS explanatory notes.

Source: ABS 2018, 2019

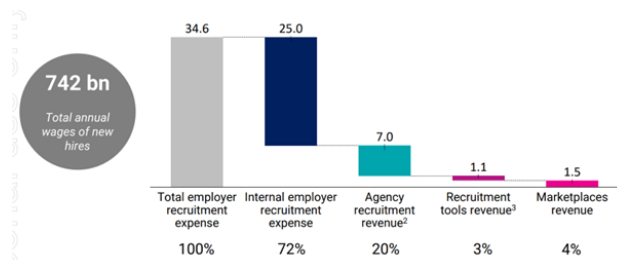
4. Efficiency / disruption

Over the past few months, excitement has grown around Chat GPT and other generative artificial intelligence (AI) products. AI may provide substantial opportunities for companies to improve efficiency. To what extent productivity gains are retained or competed away depends on the competitive environment in which they operate. We are attracted to companies able to drive sustainable operational efficiency for themselves or their customers. We believe Iress (IRE) is well positioned to benefit from this dynamic.

5. Pricing power

If inflation remains elevated, companies with pricing power and the ability to enter new markets can grow and take market share. SEEK (SEK) illustrated these advantages succinctly at its recent investor day. An innovative and dynamic pricing architecture maximises yield while still delivering value and improved efficiency for clients. Product investment and platform unification over the past few years are now enabling the expansion of its market opportunity over time.

Estimated recruitment expense value pool in existing SEEK footprint



Source: SEEK strategy day ASX release

6. Self improvement

Beyond this, self-improvement from good management teams can release value. By the end of FY24, Computershare (CPU) will have \$3b of cash to deploy into acquisitions, potentially adding 25% to earnings. Exiting the lower quality segments of its business will enhance returns and also drive a better market rating.

CPU 1H23 divisional earnings

1H23 Actuals (\$m)	Core	Manage	Group
Management revenue	1,142.2	422.0	1,564.2
Growth	54%	-1%	34%
Revenue excl MI	847.0	365.1	1,212.1
Growth	20%	-9%	9%
EBIT	441.8	6.0	447.8
EBIT margin	39%	1%	29%
EBIT excl MI	146.6	(50.9)	95.7
EBIT excl MI margin	17%	-14%	8%

Source: Macquarie Investor Conference ASX release

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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