

DNR Capital Australian Equities High Conviction Fund

APIR code: PIM0028AU

Performance Report June 2023

Performance

DNR Capital Australian Equities High Conviction Fund increased 0.69% (net of fees) in June, underperforming the S&P/ASX 200 Total Return Index by -1.07%. Over the last 12 months, the Fund increased by 10.32%, underperforming the Index by -4.46% (net of fees).

Net active return as at 30 June 2023

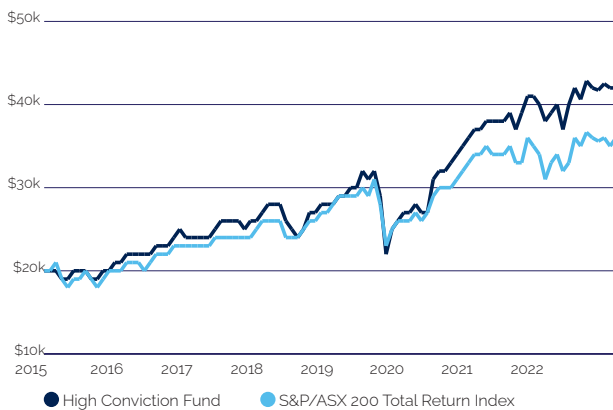
	1mth %	3mth %	6mth %	1yr %	3yr p.a. %	5yr p.a. %	Incep.* p.a. %
High Conviction Fund	0.69	1.02	3.79	10.32	15.77	9.21	9.70
S&P/ASX 200 Total Return Index	1.76	1.01	4.51	14.78	11.12	7.16	7.59
Excess return	-1.07	0.01	-0.72	-4.46	4.65	2.05	2.11

* Inception Date—June 2015.

Source: DNR Capital and Apex Fund Services.

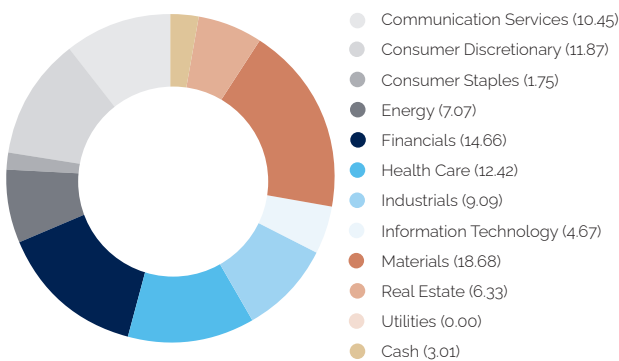
Past performance is not an indication of future performance. Total return shown for the DNR Capital Australian Equities High Conviction Fund has been calculated using exit prices after taking into account all of the product's ongoing fees and assuming reinvestment of distributions. No allowance has been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

The Lottery Corporation (TLC)

SEEK (SEK)

CSL (CSL)

QBE Insurance Group (QBE)

Source: DNR Capital and Apex Fund Services

Monthly top contributors and detractors

Top 3 contributors

QBE Insurance Group (QBE):

Xero (XRO)

Rio Tinto (RIO)

Top 3 detractors

CSL (CSL)

SEEK (SEK)

Fortescue Metals Group (FMG, no holding)

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 this month as general insurance margin outlooks should benefit from higher investment yields.
- **Xero (XRO):** outperformed in June following its strong full year results reported in the previous month, with growing expectations for improved margins through prudent cost control and price increases.
- **Rio Tinto (RIO):** bounced over the month as spot iron ore prices held up in the face of soft Chinese economic data. Chinese policy makers continue to incrementally ease policy, which should support commodity demand.

Detractors

- **CSL (CSL):** provided first-time earnings guidance for growth in FY24, which was below expectations primarily driven by a lower margin expectation. The company reiterated that Behring margins are tracking positively and should return to pre-COVID19 levels in the "medium term", while collection volumes continue to track well.
- **SEEK (SEK):** underperformed given the uncertainty over the near-term volume outlook following heightened economic risk and interest rate rises. However, recent prices in the high single digits give confidence that this will help offset the volume decline into FY24.
- **Fortescue Metals Group (FMG, no holding):** outperformed alongside other iron ore miners in anticipation of further policy easing from the Chinese government in response to the continued sluggish recovery.

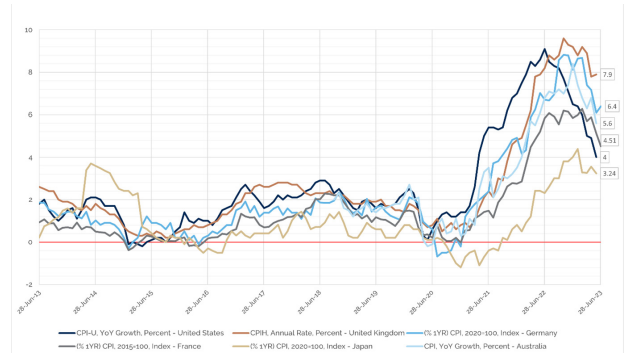
Fund and market review

With June marking the end of Australia's financial year and half time on the calendar year, markets look surprisingly different to most forecasts from six months ago. Dire recession and equity drawdowns predictions have failed to eventuate, with key global indices posting strong gains. The technology heavy NASDAQ index posted its best half yearly return on record, despite the yield on the 10-year US Treasury sitting ~40bps below its post COVID-19 highs. Many economies have remained surprisingly resilient in the face of generationally high interest rates, inflation, and growing pressure on households. Despite inflationary pressures easing, the next phase in normalising consumer prices is crucial. The stickiness of inflation will determine the course of central banks and will be a decisive factor in the outlook for equities over the next financial year. In assessing the current inflationary environment, we also review China's subdued economic rebound from lockdowns and its potential impact on global demand.

Where to for inflation?

Whilst at various stages of slowing, inflation has peaked in key economies, but still eludes the 2-3% band targeted by most central bankers.

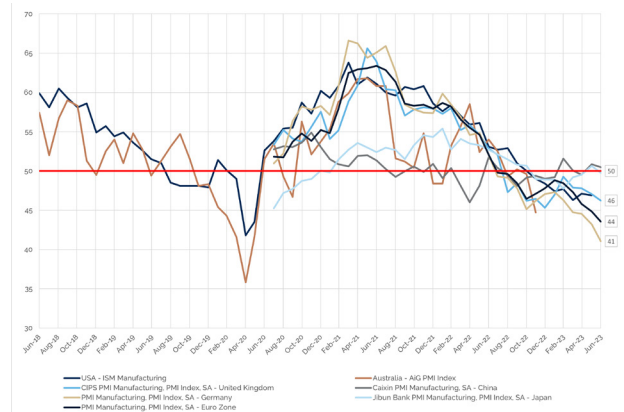
Key Global Inflation Measures



Source: DNR Capital, FactSet

A range of important forward measures of economic activity are exhibiting weakness. Global Purchasing Manager Indices (PMI), measuring the prevailing direction of economic trends in manufacturing, generally sits in contractionary territory, following strong rebounds post COVID-19 lockdowns.

Key Purchasing Manager Indices (PMI)



Source: Factset, DNR Capital

Supply chain capacity also continues to free up, with closely watched freight rates now below levels observed prior to the pandemic, providing further Cost of Goods (COGS) relief to businesses. It could be argued, however, that the "easy lifting" on reducing inflation has been done.

Energy and Commodity Prices (Indexed to 2019)



Source: DNR Capital, FactSet

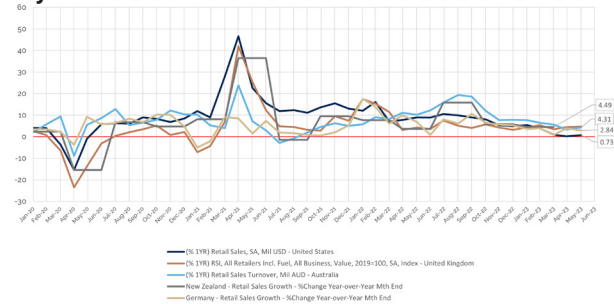
Logistics and energy expenses may have declined from the extreme levels experienced during the pandemic. Still critical commodities remain elevated,

and investment in supply is insufficient to address decarbonisation needs.

Markets continue to lurch in reaction to economic data as investors wait for evidence that inflationary pressures are under control. The next few quarters are crucial in answering the key question: will inflation remain sticky, requiring ongoing and coordinated tightening?

Despite indications of slowing growth, when looking through the volatility, overall retail sales remain surprisingly (and for central bankers frustratingly), resilient. Whilst volumes are subdued, inflation appears to support nominal sales.

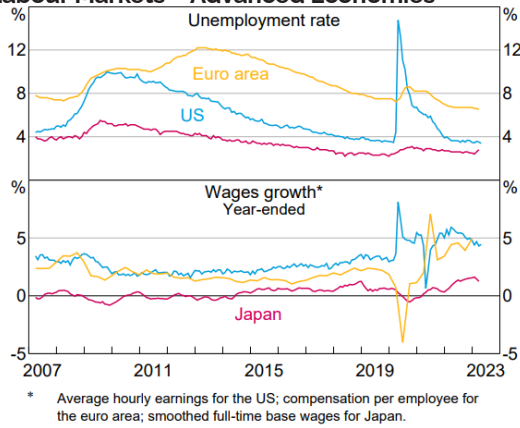
Key Global Retail Sales Growth



Source: DNR Capital, FactSet

Stubbornly low, record unemployment continues to be a feature of most developed world economies.

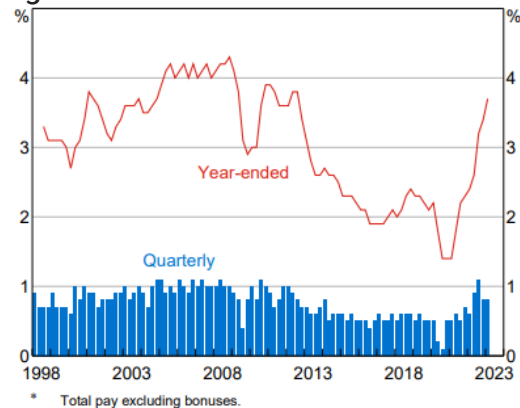
Labour Markets – Advanced Economies



* Average hourly earnings for the US; compensation per employee for the euro area; smoothed full-time base wages for Japan.

Source: RBA June Chart Pack

Wage Price Index Growth



* Total pay excluding bonuses.

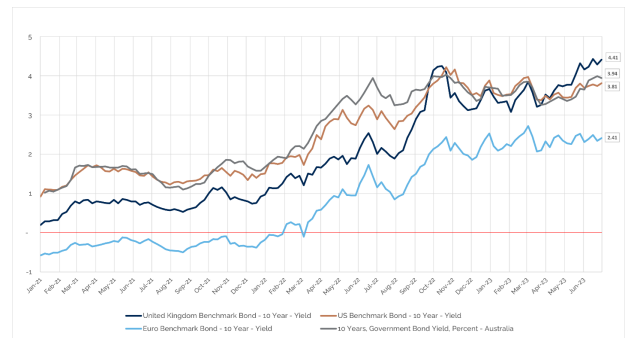
Source: ABS

Without increased slack in the labour market, fighting inflation is exceedingly difficult and risks the circular reference of a wage price spiral. As employees demand higher compensation to offset higher consumer prices the upward pressure on wages ultimately flows back into consumer prices, as companies respond to increased labour expenses, and around it goes.

The impact on interest rates

After peaking in late 2022, benchmark government bond yields declined, coinciding with inflation cresting worldwide. These declines accelerated in March during the US banking “mini-crisis”, starting with Silicon Valley Bank and Credit Suisse failing and ending with JP Morgan acquiring First Republic Bank. These events saw liquidity pumped back into the market, and concerns over systemic financial contagion lowered the chances of further rate rises.

Key Government 10 Year Yields

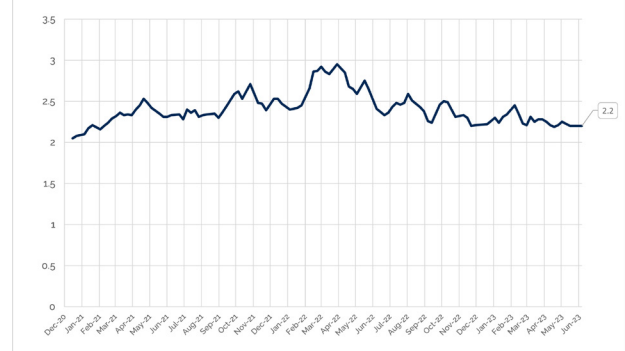


Source: DNR Capital, Factset

Several central banks then paused interest rate hiking cycles to take stock of the lagged impact, with data pointing to cooling global demand and declining inflationary pressure.

More recently, surprising strength in consumer prices in the UK stood out from stubborn yet moderating prints in Europe, Australia and the US, reminding markets that the battle against economically corrosive inflation is ongoing and can flare up unexpectedly. Whilst bond yields have begun rising again in recent weeks, the closely watched US “breakeven rate”, which infers market expectations for inflation, peaked in early CY22 and continues to decline.

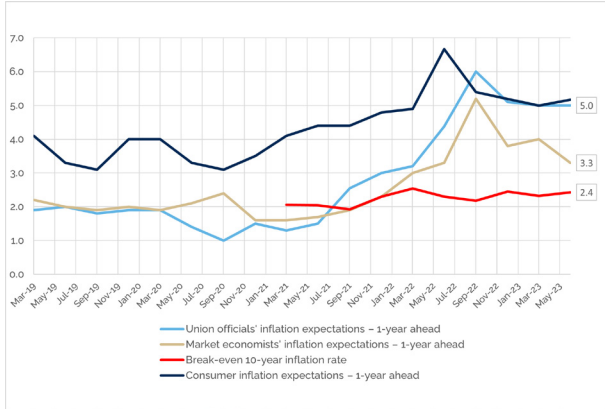
US 10-year Breakeven Rate



Source: DNR Capital, FactSet

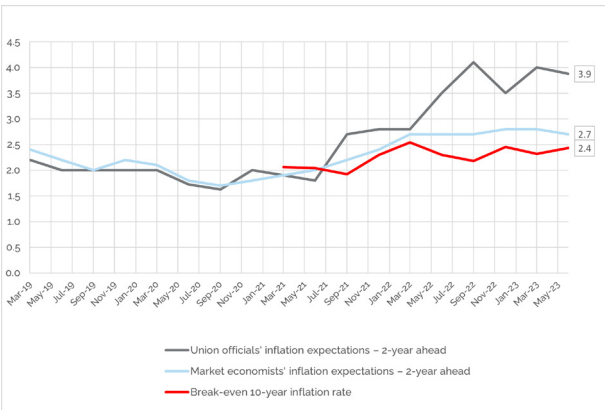
Similarly, breakeven measures of inflation in Australia remain within the Reserve Bank of Australia (RBA) target band. Surveyed expectations released by the RBA show differing expectations near term. Economists see inflation nearly at target within one year, whilst consumers and union official surveys see inflation sustained for longer.

RBA G3 Inflation Expectations - 1 Year Forward



Source: RBA

RBA G3 Inflation Expectations - 2 Years Forward



Source: RBA

Markets have rallied strongly since inflation expectations peaked. Notable is the marked outperformance of higher growth and technology stocks, which have greater sensitivity to interest rates, given the timing of their cashflows. We believe there is a live risk that inflation remains stickier than market expectations, putting at risk the now stretched valuation of many growth exposures.

China update

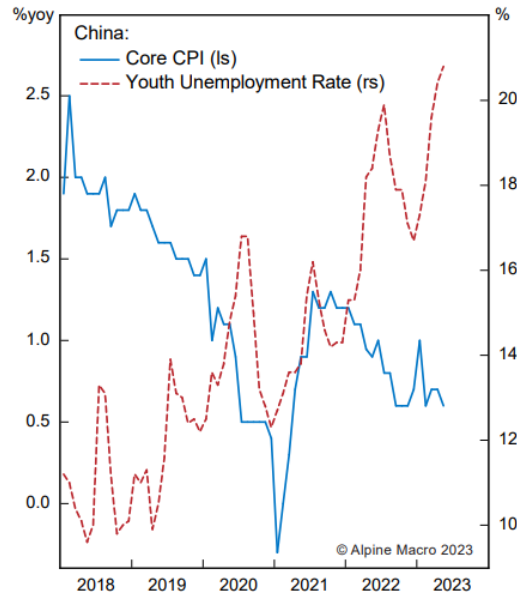
Despite a faster than expected return to everyday life, China's economy has disappointed as it emerged from lockdown. Weak economic growth has belied optimistic forecasts, based on other countries' reopening experience. China's Purchasing Manager Index (PMI) remains below 50 and firmly in contractionary territory. Retail sales are sluggish, and for an economy highly dependent on construction, property starts are worryingly low. In contrast to challenges facing most of the world, China's inflation is anaemic, and policy makers are concerned about youth unemployment.

Hitting a wall (again)



Source: The Economist

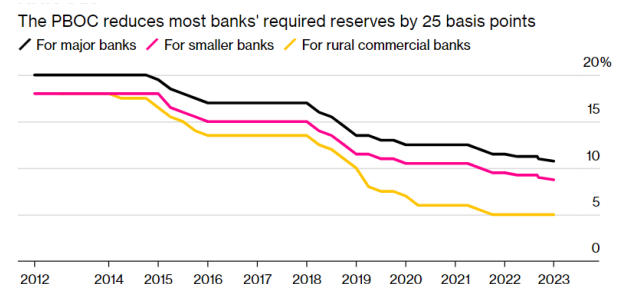
Falling Inflation, Rising Jobless Rate



Source: Alpine Macro

China's central bank, the People's Bank of China (PBoC), has responded via its favoured policy lever by cutting the reserve ratios required by banks to encourage lending and stimulate activity in the property market.

Reserve Requirement Ratio (RRR) Cut

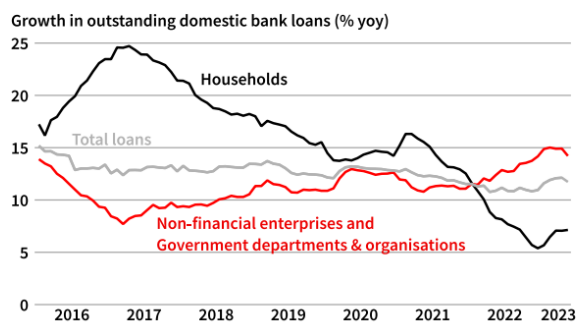


Source: Bloomberg

Lending growth remains a concern for the country's central planners, with households reluctant to step into the void and take on new mortgages, despite the looser lending requirements.

Bank Lending

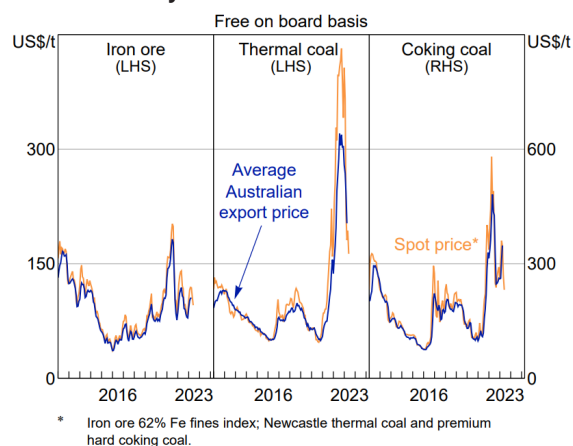
Rebound in lending to households may have run out of momentum



Source: NAB Economic

Despite these concerns, steel intensity, iron ore consumption and metallurgical coal prices have remained relatively strong.

Bulk Commodity Prices



Source: RBA June Chart Pack

For Australia, in particular, investors and policy makers are keenly aware of the risks posed by further deterioration in the Chinese property market. Markets remain focused on the future response, or lack thereof, from the Chinese policy makers and whether the old playbook of fiscal stimulus is pushed out.

Despite the Australian market's strong run and pockets of stretched valuations, we see value in select names left behind in the post-Christmas 2022 rally. SEEK (SEK) has underperformed, mired by valid concerns over macro headwinds from rising interest rates. Following a strong year for job ads, declining listings are apparent, impacting revenues. Looking through the cycle, however, we see compelling value at its current valuation, which discounts its ability to grow earnings through its monopolistic-like position and tremendous pricing power. We continue to take advantage of macro driven volatility to selectively increase high conviction positions and look to add names to the portfolio, where quality franchises are trading at attractive valuations.

Positioning

In light of these contradictions above, we have sought strong quality franchises that we are happy to own through the cycle. A downturn often allows stronger companies to become stronger as they acquire the weak or invest through the cycle.

Some examples that we have been adding to include SEEK (SEK) and Macquarie Group (MQG). While these investments have an element of cyclical, earnings expectations and valuations reflect this cyclical and present the opportunity.

We are finding some opportunities in oversold businesses with reasonably resilient characteristics, such as DMP and look forward to further volatility to present opportunities in other quality businesses.

We continue to avoid banks which is a leveraged play on the consumer, and mortgages which we see as a risk.

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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