

# DNR Capital Australian Equities High Conviction Fund

APIR code: PIM0028AU

Performance Report July 2023

## Performance

DNR Capital Australian Equities High Conviction Fund increased 3.73% (net of fees) in July, outperforming the S&P/ASX 200 Total Return Index by 0.85%. Over the last 12 months, the Fund increased by 11.06%, underperforming the Index by -0.61% (net of fees).

## Net active return as at 31 July 2023

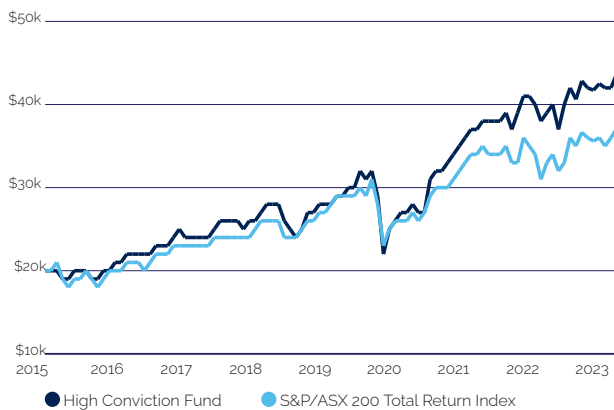
	1mth %	3mth %	6mth %	1yr %	3yr p.a. %	5yr p.a. %	Incep.* p.a. %
High Conviction Fund	3.73	2.94	2.08	11.06	16.91	9.61	10.09
S&P/ASX 200 Total Return Index	2.88	2.04	1.22	11.67	11.99	7.47	7.88
<b>Excess return</b>	<b>0.85</b>	<b>0.90</b>	<b>0.86</b>	<b>-0.61</b>	<b>4.92</b>	<b>2.14</b>	<b>2.21</b>

\* Inception Date—June 2015.

Source: DNR Capital and Apex Fund Services.

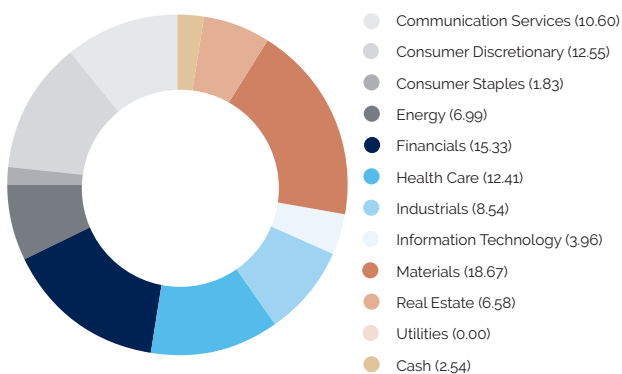
Past performance is not an indication of future performance. Total return shown for the DNR Capital Australian Equities High Conviction Fund has been calculated using exit prices after taking into account all of the product's ongoing fees and assuming reinvestment of distributions. No allowance has been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

SEEK (SEK)  
 Woodside Energy Group (WDS)  
 CSL (CSL)  
 The Lottery Corporation (TLC)  
 James Hardie Industries (JHX)

Source: DNR Capital and Apex Fund Services

## Monthly top contributors and detractors

### Top 3 contributors

SEEK (SEK)  
 Woodside Energy Group (WDS)  
 Lendlease (LLC)

### Top 3 detractors

Commonwealth Bank of Australia (CBA, no holding)  
 CSL (CSL)  
 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

- **SEEK (SEK):** with softer-than-expected inflation prints in the USA and Australia, investors are more hopeful of a soft landing and this supported the outperformance of cyclicals.
- **Woodside Energy Group (WDS):** outperformed during the period as global energy prices rose and the company reported a strong quarter of production, beating estimates. Energy prices have recovered from recent lows as recent OPEC+ cuts begin to bite and Russian over-production slows from historic levels.
- **Lendlease (LLC):** outperformed on no stock specific news. Management continues to make incremental progress towards its stated 2024 return targets with a sharpened focus on executing the existing development backlog of over \$100bn.

### Detractors

- **Commonwealth Bank of Australia (CBA, no holding):** banks bounced in July as the outlook for bad debts improved and some signs of easing competition.
- **CSL (CSL):** underperformed during the month as the market continued to digest weaker than expected earnings guidance for growth in FY24. The stock was also softer following the release of trial results for a competitor's treatment of Chronic Inflammatory Demyelinating Polyneuropathy (CDIP) which could impact demand for CSL's immunoglobulin (IG) portfolio.
- **ANZ Group Holdings (ANZ, no holding):** banks bounced in July as the outlook for bad debts improved and some signs of easing competition.

## Fund and market review

The S&P/ASX 200 Total Return Index was up 2.88% during the period. Energy (+8.8%) was the best performing sector, with continued cuts from OPEC+ supporting oil prices and strong quarterlies from Woodside Energy Group (WDS) +10.3% and Beach Energy (BPT) +19.6%. Financials (+4.9%) also outperformed, with falling inflation and a stout economy presenting a conditionally better macro-outlook for banks (Commonwealth Bank of Australia (CBA) +5.4%, National Australia Bank (NAB) +7.8%). Health Care (-1.5%) was the worst performing sector, led by sector heavyweight CSL (CSL) -3.2% which was negatively impacted by the successful trials of a competing drug. Consumer Staples (-1.1%) also underperformed, as improving economic sentiment saw a shift away from defensive names in favour of more cyclical exposures (Woolworths Group (WOW) -2.8%, Coles Group (COL) -1.3%).

The markets have enjoyed a strong month albeit, subsequently falling, as expectations around interest rates once again rebound. The debate has remained focused on the strength of the economy versus signs of inflation easing. While we risk sounding like a broken record, we review these factors again.

## The economy has surprised to the upside.

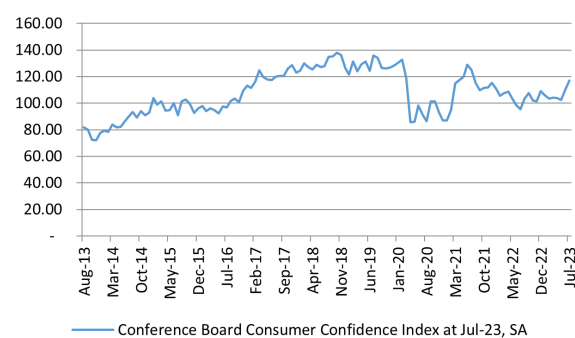
We have been waiting for the economy to stagger in the face of a substantial lift in interest rates however, to date, it has remained surprisingly resilient. Unemployment has remained low, and consumer confidence has begun to rebound in the US raising the possibility of a softer landing for the economy.

### Aus unemployment rate



Source: FactSet

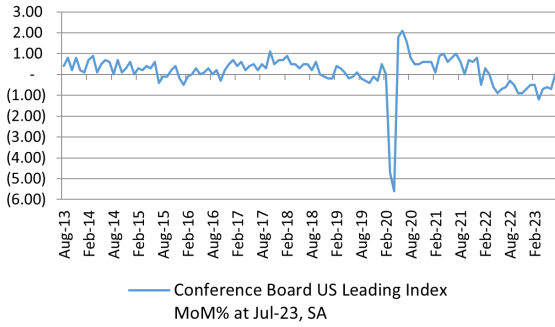
### US Consumer confidence



Source: FactSet

There are a number of possible explanations for this economic resilience. Businesses and consumers used the COVID-19 stimulus to hoard cash, meaning that debt levels for many businesses appear reasonable, and consumers have retained a significant level of cash in the bank, which means they have been able to endure the rise in interest rates better than expected. In addition, fixed rate loans in Australia have delayed the impact and businesses seem reluctant to lay off staff following the difficulties they had employing people a year ago. Furthermore, higher interest rates have been helpful for some consumers, such as retirees, and we are seeing elevated travel spending as a result. With input costs declining, some confidence has re-emerged which is reflected in leading indicators.

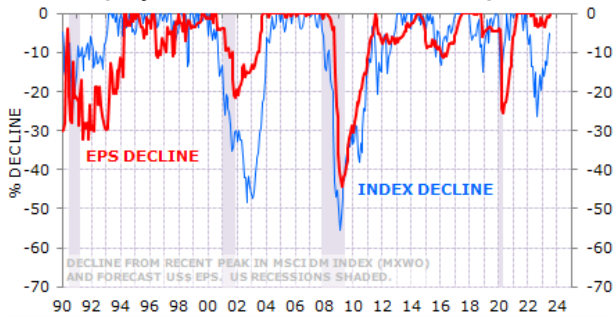
**US leading indicators**



Source: FactSet

The result is that, globally, earnings have held up better than expected and the market has bounced as a result.

**Global Equity Index & EPS drawdown from peak**



Source: FactSet

**Bond rates and inflation expectations**

As a consequence of the economic strength, expectations around inflation and interest rates have risen. The Australian bond yield is now back over 4%. It would appear that central banks need to keep interest rates higher for longer to dampen economic demand.

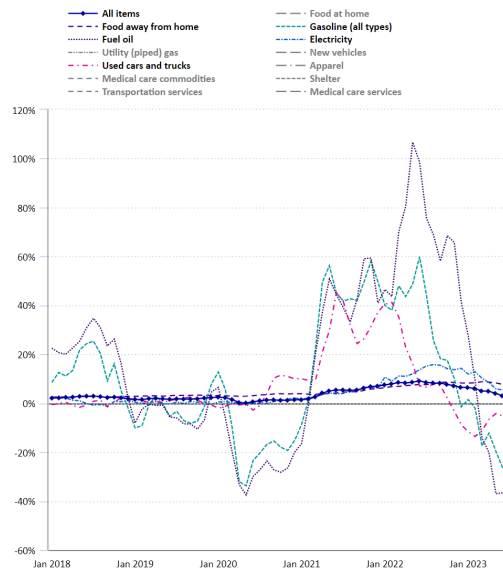
**Australian 10 year bond yield**



Source: FactSet

However, despite the economic strength, inflation has been trending down. The overall inflation rate for urban consumers is back to 3% in the US, encouraging the market to believe in the soft landing scenario. We note however when looking at components of the inflation figure, goods such as cars and oil are deeply negative relative to a year ago and this is impacting the inflation rate. Later this year the component goods' inflation will begin to rise again, which could cause investors to examine the long-term inflation rate and what this means for valuations.

**12-month change CPI for All Urban Consumers, by expenditure category, January 2018 – June 2023, not seasonally adjusted**



Source: U.S Bureau of Labor Statistics

We continue to see a range of drivers of inflation:

- Ageing population should cause softening demand in spending over time.
- Technology innovation such as artificial intelligence (AI) should improve productivity.
- The trend for onshoring is driving greater construction in the US and other friendly countries (see manufacturing chart below).
- The ongoing spend as we transition to a net zero carbon economy will prove to be inflationary given it is prioritising the environment over efficiency.

**Increase in US Manufacturing Construction**



Source: Bloomberg, Barrenjoey Research

**Market strength**

Despite bond yields rising, the Nasdaq in particular has displayed strength in response to excitement regarding AI as well as improvement in profitability for many businesses as technology stocks improve productivity and drive efficiency.

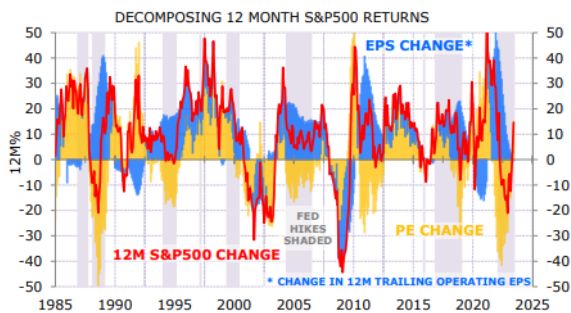
**Nasdaq vs US 10Yr (Inverted) ... decoupled?**



Source: Bloomberg Finance L.P.

While economic growth has surprised this year, particularly in the US, forward profit expectations for global equities (MSCI ACWI) and US equities (S&P 500), haven't risen all year, albeit they have held up better than expected. The entirety of the global and US equity rallies has been about higher valuations, and to an unusual degree. Over the last 25 years, only twice have we seen more year-to-date multiple expansions – in 2009 and 2020. Both of those years saw deep recessions met by enormous easing, supporting the case that valuations should expand ahead of an (eventual) longer-run rebound.

**Unusual re-rating late in Fed tightening cycle**



Source: Standard & Poor's, Federal Reserve; Minack Advisors

In particular, the direction of inflation has been particularly important for the multiple the market is prepared to pay for stocks and this remains a key focus. If later this year the market begins to see inflation remaining stickier, then it is likely to impact valuations particularly of growth stocks.

Speaking to investors, we note that there is still a large level of cautiousness which likely goes to positioning however the run in stocks suggests that there has been some deployment of cash into the rally.

Ultimately, the 6-12 month outlook will depend on whether the US avoids a recession. A recession is not priced but nor is a soft landing: if the US Federal Reserve (Fed) can get inflation back to target without a recession, then there is likely to be substantial equity upside. The current uncertainty in the market is throwing up some interesting opportunities to buy some quality businesses that have de-rated and we continue to have some balance across the portfolio given the broader uncertain climate.

**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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