

DNR Capital Australian Equities High Conviction Fund

Performance Report – April 2021

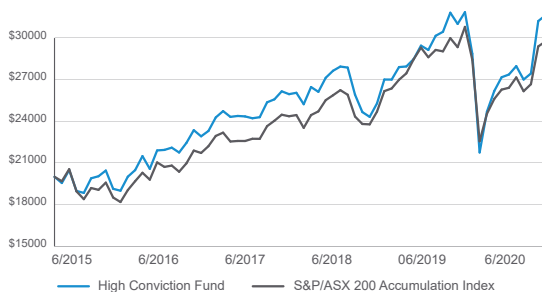
Performance

The S&P/ASX 200 Accumulation Index was up 3.47% during the period.

Information Technology (+9.6%) was the best performing sector. Growth stocks in general performed well with bond rates falling, forcing investors to consider a potential return to a duration-friendly, low-rate environment. Materials (+6.8%) also outperformed. Global commodities prices continued their recovery-led run, with iron ore prices reaching new highs. Energy (-4.9%) was the worst performing sector. Oil prices were lower during the month following an extended period of strength following the vaccine recovery trade. Consumer Staples (-2.6%) also underperformed. The quarterly updates from many retailers disappointed investors, as they cycle earnings from the COVID-19 lockdown activity surge.

The DNR Capital Australian Equities High Conviction Fund outperformed its benchmark for the period. Key stock contributors were Cleanaway Waste Management (CWY), Woolworths Group (WOW, no holding), and ALS (ALQ). Key stock detractors were Computershare (CPU), Woodside Petroleum (WPL) and Lendlease (LLC).

Growth of \$20,000 since inception



Source: Mainstream Fund Services and DNR Capital

Top 10 active holdings

Security details	Active weight %	Actual weight %
Tabcorp Holdings	4.85	5.40
Lendlease	4.08	4.52
National Australia Bank	4.02	8.47
Macquarie Group	3.90	6.66
ALS	3.56	3.81
Aristocrat Leisure	3.46	4.67
BHP Billiton	3.34	10.53
Computershare	3.07	3.48
SEEK	3.01	3.56
Telstra Corporation	2.89	4.93

Source: Mainstream Fund Services and DNR Capital

Fund overview

APIR Code	PIM0028AU
Investment bias	Style neutral with a quality focus
Designed for	Investors seeking a medium-term investment focused on achieving growth, with less focus on generating excess income. The investor is prepared to accept higher volatility in pursuit of higher growth.
Investment objective	To invest in a high conviction portfolio of Australian equities that aims to outperform the Benchmark by 4% p.a. (before fees) over a rolling three-year period. The investment objective is not a forecast of the Fund's performance.
Benchmark	S&P/ASX 200 Accumulation Index
Investable universe	Australian equities and cash
Investment constraints	The Fund will not invest in derivatives.
Investment guidelines	Maximum exposure to an individual security is 15% of Fund NAV Minimum exposure of 80% of the Fund NAV to be invested in the S&P/ASX 200
Asset allocation	Australian Equities – 80-100% Cash – 0-20%
Risk level	High
Number of securities	Min 15 - max 30, typically 25
Minimum suggested investment timeframe	5 years
Buy/sell spread	+0.25% / -0.25%
Management fee	0.90% (inclusive GST and RITC)
Minimum initial application amount	\$20,000
Minimum further application amount	\$5,000
Minimum withdrawal amount	\$5,000
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
Entry/exit fees	Nil

Net active return as at 30 April 2021

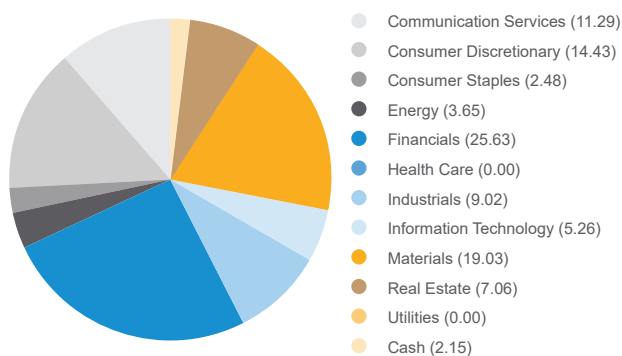
	1mth %	3mth %	6mth %	1yr %	3yr %	5yr %	Incep.* %
High Conviction Fund	3.81	11.38	28.22	42.49	9.96	11.43	10.07
S&P/ASX 200 Accumulation Index	3.47	7.54	20.33	30.76	9.50	10.27	8.36
Excess return	0.34	3.84	7.89	11.73	0.46	1.10	1.71

* Inception Date—June 2015

Source: Mainstream Fund Services and DNR Capital

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 fees or taxation.

Sector weightings %



Source: Mainstream Fund Services and DNR Capital

The top stock detractors for the month were:

- Computershare (CPU):** Retreated post a capital raising for a surprise acquisition. While we view the acquisition favourably it has created some indigestion for the share price given buyers demand for new stock was satisfied in the raising.
- Woodside Petroleum (WPL):** Production for the quarter was in line with expectations but they did raise expected capex costs for a new project and sentiment remains soft towards the company with no CEO.
- Lendlease (LLC):** Fell over the month on no incremental news flow. The company continues to make progress towards its \$8b development target and investors' appetite for build-to-rent and commercial products are showing some signs of improvement.

Attribution

The top stock contributors for the month were:

- Cleanaway Waste Management (CWY):** Announced it had agreed to acquire a portfolio of NSW assets from Suez for \$501m. The assets are strategic and complementary to the existing CWY business. The acquisition price looks very attractive and highlights the strong bargaining position CWY took into the negotiations.
- Woolworths Group (WOW, no holding):** Underperformed during the month following the release of a quarterly sales report. A slowing sales trend was noted as the fourth quarter began and shopping trends normalise. WOW is well positioned with a strong balance sheet but currently trades on a stretched valuation, and we maintain a preference for Coles Group (COL) in the supermarkets' industry.
- ALS (ALQ):** After a couple of softer months the stock bounced along with the gold price and expectations for increased mining activity boosting results.

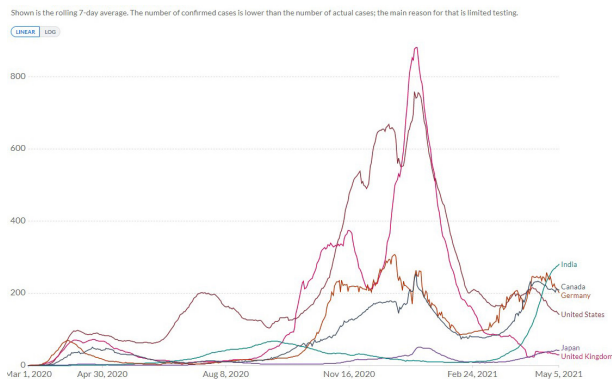
Market review

While the health and societal impacts of the COVID-19 pandemic cascade around the world, the government and central bank responses to the crisis have produced outcomes seemingly implausible a year ago. The consequences of unprecedented fiscal and monetary intervention have evolved as unpredictably as the virus itself, presenting both unforeseen macroeconomic risks, and emerging bottom-up opportunities. This month we take stock of both infection trends and the complications impacting vaccine rollouts and we explore some key economic trends informing our current positioning.

COVID-19 infections and vaccinations

With India as the focal point, infections in emerging markets are accelerating just as many Western economies open up.

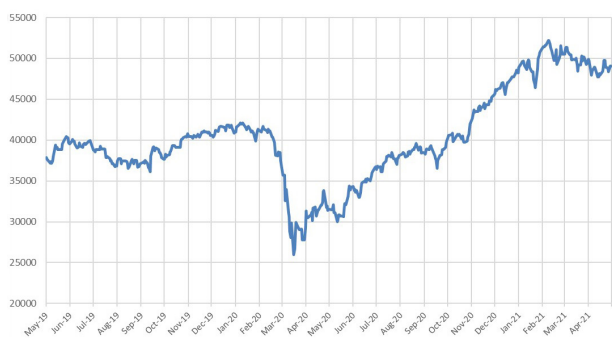
Daily new confirmed COVID-19 cases per million people



Source: Our World in Data

Despite the ebb and flow of the pandemic around the world, markets are touching all time highs, reflecting expectations of generational-high GDP growth. Markets would appear to be looking through surges in infections and mutation risk, with even India's key stock market index (Sensex) showing remarkable resilience.

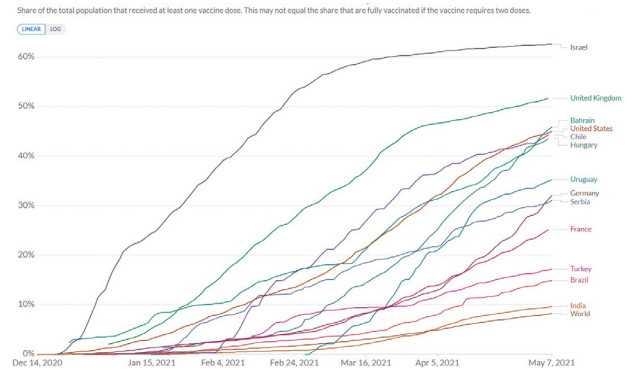
India BSE 30 Sensex



Source: FactSet, DNR Capital

With several vaccines now approved for use, programs around the world are progressing steadily, with over 1.2 billion doses administered, or around 8.4% of the population vaccinated.

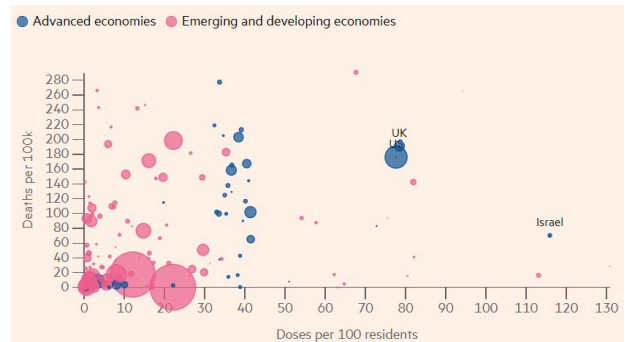
Share of people who received at least one dose of COVID-19 vaccine



Source: Our World in Data

Developing countries lacking access and infrastructure continue to lag developed nations in terms of vaccine rollout.

Progress on vaccinations vs death toll, circle size represents population



Source: FT.com

As side effects from the vaccines surface and logistical issues arise, even wealthy, developed nations are impacted by a range of issues that have stalled, delayed or threatened to compromise the programs.

Reported side effects have produced concern in populations, leading to delays and alterations to vaccination programs in several countries. Common side effects including headaches, muscle pain, chills, fever and nausea have been reported. Of most concern are rare incidences of blood clotting from the AstraZeneca vaccine, leading to several countries, including Australia, amending their programs.

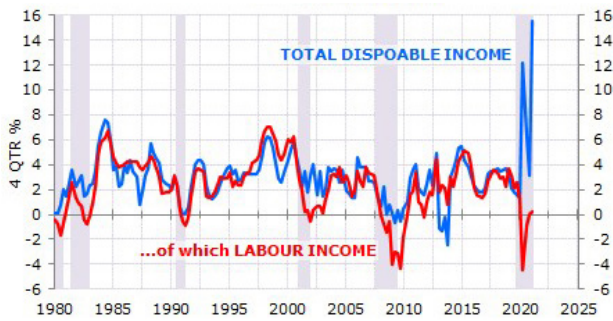
Logistically, the availability of consumables required for administering shots has suffered from bottlenecks in the global supply chain. Sourcing of raw materials and products like tubing and plastic bags, already hamstrung by impacted freight networks, has been exacerbated by political and nationalistic actions.

Variants are a normal part of virus 'progression', and there are likely thousands of variants globally. Several have been deemed "variants of concern", where there is clear evidence indicating a significant impact on transmissibility, severity or immunity. The UK, Brazil and South African variants fall into this category but, notably, the Indian variant does not. An extensive and effective regime of genomic testing tracks mutations around the world to monitor these risks.

Key economic data

With the unprecedented stimulus payments beginning to roll off, economies around the world have been anticipating the 'fiscal cliff'. As household balance sheets have swelled enabling consumption to be funded from savings, this has to date, failed to transpire.

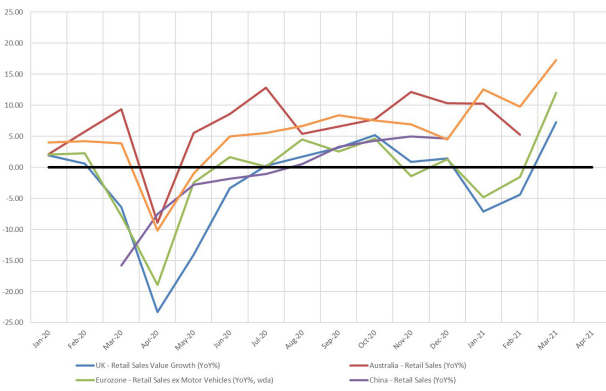
US real household income



Source: Minack Advisors

This has manifested most strikingly in ongoing elevated retail sales.

Select global retail sales growth (YoY)

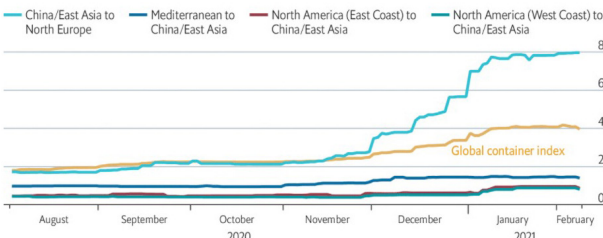


Source: FactSet, DNR Capital

Many companies are reporting difficulties in global supply chains that are straining under increased demand for goods. Container shipping costs, in particular, are spiking in response to increased demand and this was further impacted by the March blockage of the key Suez Canal shipping lane.

Sea change

Container freight costs, \$'000 per 40-foot container
By route

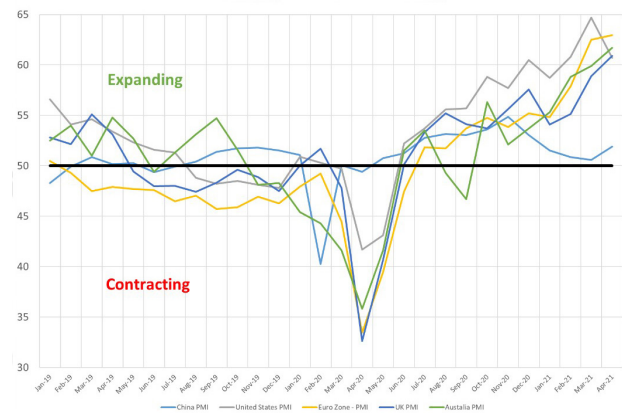


Sources: Freightos Baltic Index; Refinitiv Datastream

Source: The Economist

The closely watched Purchasing Manager Indices (PMI) also points to continued expansion in key global economies, evidencing the pace of global recovery and despite the lingering threats of the virus.

Select global PMI



Source: FactSet, DNR Capital

With the economic data pointing to synchronised global GDP growth, the recovery has exceeded the expectations of economists and the International Monetary Fund (IMF), leading many to question whether the global economy is running too hot.

For richer, for poorer

GDP 2021, % increase on a year earlier
Countries with biggest change in forecast*

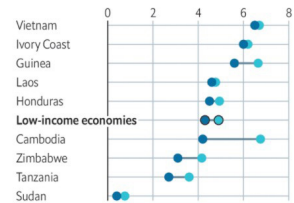
Forecast made in: ● Oct 2020 ● Apr 2021

Advanced economies



Source: IMF

Low-income economies



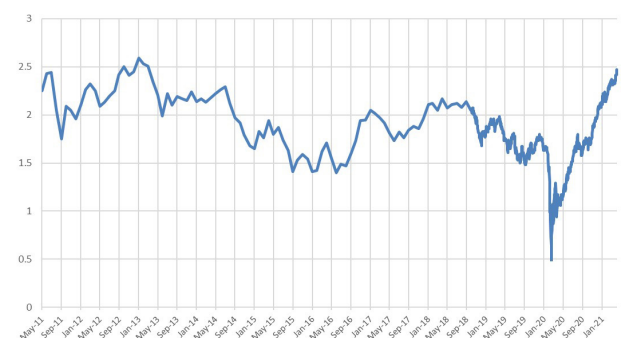
*Excluding Myanmar (-14.6% points)

Source: The Economist

As such, the key debate in financial markets is firmly around inflation. While there is general agreement that we will see increased pricing near term, many central banks view it as transitory and are pushing back strongly on the idea that interest rates need to rise to contain excess pricing pressures.

Our favoured barometer of consumer price expectations is breakeven inflation, which measures the difference between inflation-linked, and non-inflation-linked, government bonds. This indicator is at near decade highs, although for now well within ranges tolerable to central banks.

US 10-year breakeven rate



Source: FactSet, DNR Capital

This dynamic is throwing up a range of opportunities, anchored by our quality criteria. Since positive news of vaccine efficacy late in 2020, the sharp rise in bond yields has seen some sustained derating of higher growth and longer duration stocks. This remains volatile, however, and subject to unpredictable macro factors. With the economic climate and ever-evolving path of the pandemic in mind, several stocks demonstrate particular appeal on a bottom-up basis.

Some examples include:

Qube Holdings (QUB)

QUB is a logistics company that is benefiting from increased activity across Australia. Increased consumer demand is fuelling imports of container volumes and QUB is also enjoying the increased movement of commodities from grain to iron ore. QUB has strong strategic assets, strong management and a strong balance sheet which provides it with strategic flexibility. QUB has reached a non-binding agreement with LOGOS for the sale of 100% of its interest in the warehousing and property components of Moorebank, at a price of \$1.65b (pre tax), with LOGOS expected to fund and develop the remaining 500 km² of warehousing. QUB will retain the logistics division of Moorebank. Following the Moorebank sale, we estimate QUB will have franking balances that would allow it to pay a special distribution of >15cps (fully franked). QUB's strong balance sheet should allow accretive corporate activity and we believe the market is currently underestimating the likelihood of more contract wins, investment opportunities and acquisitions.

ALS (ALQ)

ALQ is a global leader in minerals and life science testing. Demand for commodities to support the growth in renewables and infrastructure products is supporting growth in minerals testing. In addition its environmental testing business should be supported by efforts of governments around the world to expand infrastructure. We note under US President Biden we expect the Environment Protection Agency (EPA) to have more teeth which increases compliance. As a global leader ALQ enjoys strong margins and returns and future growth will be supported by incremental acquisitions.

Cleanaway Waste Management (CWY)

CWY has strategic assets within the Australian waste industry. Australia is seeking to create a circular economy for waste product following China's decision to limit the waste it is receiving. This has increased the strategic importance of CWY's assets such as landfill, recycling stations etc. Further growth in infrastructure and the economy should support further demand for waste disposal and CWY has sought to enhance its position by acquiring the NSW assets from SUEZ for \$501m. These assets are highly strategic and complementary to the existing CWY business. The acquisition price look very attractive and highlights the strong bargaining position that CWY took into the negotiation.

Fund positioning

Our current positioning is:

1. **Reopening beneficiaries:** SKYCITY Entertainment Group (SKC).
2. **Beneficiaries of infrastructure/green new deal spending:** ALS (ALQ), QUB Holdings (QUB).
3. **Improving quality:** Computershare (CPU).
4. **Strong franchise companies:** James Hardie Industries (JHX), SEEK (SEK), Aristocrat Leisure (ALL).
5. **Resilient/defensive companies:** Tabcorp Holdings (TAH).

Key risks

Key risks to the Fund include:

- **COVID-19 disruption.** The longer and deeper the disruption from the COVID-19 pandemic, the greater the negative impact on equity markets. Any disruption to the roll out of the vaccines would be negative, as would the development of vaccine-resistant COVID-19 variants.
- **Interest rates.** Low interest rates are the prime driver of markets at present. Any change to the inflation outlook would have a significant impact on valuations.
- **Political environment.** Further geopolitical uncertainty, like civic destabilisation in the US following the election, could create negative implications for stocks and portfolios.

Portfolio moves

No major changes to the Portfolio during April.

Investment philosophy

DNR Capital believes a focus on quality businesses will enhance returns when it is combined with a thorough valuation overlay. We seek to identify quality businesses that are mispriced by overlaying a quality filter, referred to as the 'quality web', with a strong valuation discipline. The portfolio is high conviction and invests for the medium term.

Investment strategy

The DNR Capital Australian Equities High Conviction Fund has an investment style best described as 'style neutral'. The security selection process has a strong bottom-up discipline and focuses on buying quality businesses at reasonable prices. We define quality businesses as being those with the following five attributes:

- earnings strength (particularly improving return)
- superior industry position
- a sound balance sheet
- strong management
- low environmental, social and governance (ESG) risk.

Where we are satisfied that a company possesses quality characteristics, then it is eligible for inclusion in the Fund. However, it must also represent value and sit comfortably within our portfolio construction requirements.

A range of valuation methodologies are used depending on the nature of the company being assessed to identify mispriced opportunities.

The portfolio construction process is influenced by a macroeconomic appraisal and also considers the risk characteristics of the portfolio, such as stock and sector correlations.

Platform access

- Asgard & BT Wrap
- BT Panorama
- Colonial First State FirstWrap
- HUB24
- Macquarie Wrap
- My North & North
- Netwealth

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