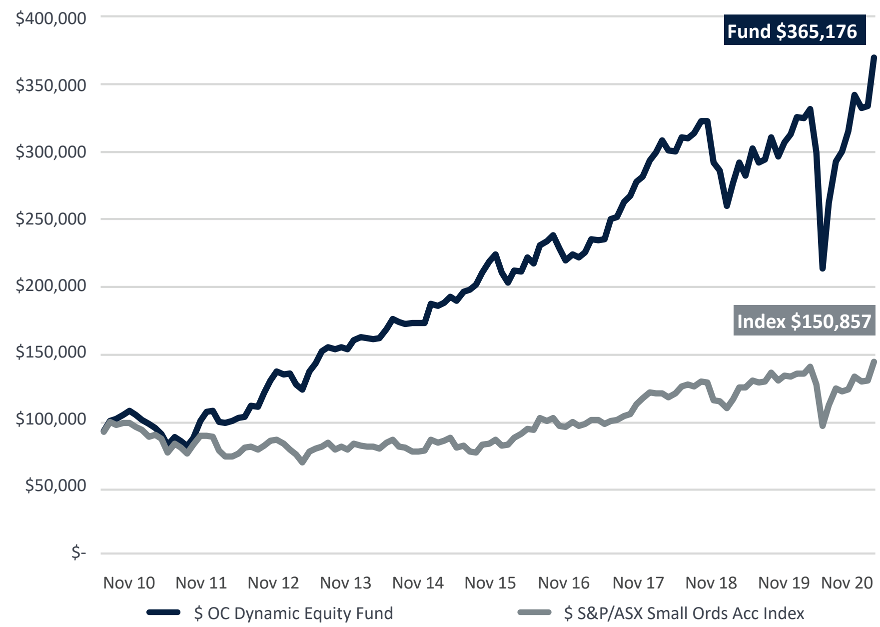
OC Dynamic Equity Fund
Fund Update | 30 November 2020

10.4% Fund up 10.4% for the month

13.9% Returned 13.9% p.a. for the past 10 years

We remain confident the Fund will continue to deliver attractive long-term returns

Performance comparison of $100,000 over 10 years*



Total returns

At 30 November 2020[†]	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	7 yrs % p.a.	10 yrs % p.a.	Incep. % p.a. (Dec 2000)
OC Dynamic	10.4	7.9	13.2	9.2	10.7	12.8	13.9	12.7
S&P/ASX Small Ords Accum	10.3	7.7	6.0	6.7	10.7	8.2	4.2	6.3
Outperformance	**0.1**	**0.2**	**7.3**	**2.5**	**0.0**	**4.5**	**9.7**	**6.3**
S&P/ASX Small Ind Accum	10.1	8.3	3.2	7.3	9.2	8.9	9.0	6.8
Outperformance	**0.3**	**-0.4**	**10.0**	**1.9**	**1.4**	**3.9**	**4.9**	**5.9**

The total return performance figures quoted are historical, calculated using end-of-month hard-close mid-prices and do not allow for the effects of income tax or inflation.

Performance review

The OC Dynamic Equity Fund successfully navigated the overwhelmingly positive vaccine news in early November to post a return of +10.4% for the month, ahead of both the S&P/ASX Small Ordinaries Accumulation Index and the S&P/ASX Small Industrials Accumulation Index which were up 10.3% and 10.1% respectively for the month. Despite the strong headline numbers from indices domestically, it was a challenging month for fund managers given the high volatility in individual stocks as the share prices of perceived ‘opening up’ or ‘vaccine beneficiary’ companies rocketed and conversely the share prices of ‘COVID-19 beneficiary’ companies came falling back to earth.

November was the Fund’s third double digit monthly return since the March lows and the Fund is now well ahead of the broader S&P/ASX Small Ordinaries Accumulation Index over the past 12 months having returned +12.7% (versus +6.0% for the Index). This is particularly pleasing given that the Fund was poorly positioned heading into the COVID-19 pandemic, being overweight travel and global growth stocks at that time.

We have long told our investors that when the facts change, we are willing to change our investment views and we undertook a significant portfolio rotation again during the month as soon as the stunning Pfizer/BioNTech and Moderna vaccine results were released. In previous monthly reviews, we had talked of our “cautious optimism” around the likelihood of positive near-term vaccine news. As a result, the Fund had entered the month with a comfortable level of ‘vaccine insurance’ in the form of companies that were well capitalised and would benefit from positive vaccine news, including companies such as **Sydney Airports**. Concurrently, we had been reducing our exposure to perceived COVID-19 beneficiaries such as **Kogan** and **NextDC** which had served us well in the preceding six months, but were likely to face near term headwinds in the event of the rotation toward more cyclical stocks which would likely come from successful vaccine trials. Whilst both of these companies have long term structural tailwinds that we expect will to continue to drive growth in the coming years, we sought to get ahead of the herd who were likely to follow suit using perceived

'COVID-19 beneficiaries' as a funding mechanism for more cyclical or value-style companies.

Pleasingly, we navigated the major shift in market sentiment relatively smoothly by employing sensible risk management strategies and by further rapidly repositioning the portfolio as soon as the investment landscape changed.

Two of our better performing stocks during the month were not surprisingly travel exposed stocks, namely **Helloworld Travel (HLO; +77.8%)** and **Flight Centre Travel (FLT; +51.9%)**, which were obvious beneficiaries of positive vaccine news. International borders have been largely shuttered to tourists since March and even domestic tourism and travel has been limited with state borders largely closed in the absence of protracted quarantining. FLT and HLO have each conducted material capital raisings since the onset of COVID-19 to ensure they have an adequate liquidity runway to survive the pandemic and both have materially reduced their cost bases. Although 'normal' travel conditions are still some way off, both companies are quality operators who will eventually bounce back, whilst many of their less well capitalised competitors will either go out of business or move forward with significantly scaled back operations. In the case of HLO, we have reduced our position into the recent share price strength. The journey for both HLO and FLT back to solid profitability is still a long way off and somewhat uncertain with the structure of the travel industry likely to change materially in the coming years. We will therefore continue to keep a close eye on the valuation of both stocks and trim or exit them should their share prices get ahead of our assessed value.

Worley (WOR; +37.1%) was another position we added to as part of this portfolio rotation on vaccine news. The company's share price has remained depressed on lower oil prices caused by lower demand from airlines and reduced mobility, however, beyond the potential for some recovery in the oil price, we see WOR's exposure to 'energy transition spend' as the key growth driver in the future. The shift from fossil fuels to sustainable energy is a key area for investment for governments looking to spend on infrastructure to boost their economies as well as to put the globe on a more sustainable environmental path. Goldman Sachs estimate directly addressable spend in this area of US$498 billion by 2030, which will have the dual benefit to WOR of increased growth (with energy transition spend more than offsetting only partial recovery of traditional oil spend) as well as reduced cyclicality from the new project mix. WOR already has significant experience relevant to sustainable energy projects, with complex engineering for offshore wind farms and carbon capture and storage as well as chemical and petrochemical experience, all likely required for alternate fuel projects further into the future. WOR remains a key thematic exposure in the portfolio.

Mining services provider, **Mineral Resources (MIN; +29.5%)**, one of our portfolios long standing positions, performed strongly during the month as a bullish AGM strategy update combined with ongoing strength in iron ore prices to propel its share price to all time highs. At its core, MIN is a service provider to Australia's iron ore majors and the ongoing demand for product from the Asian steel producers, and some recent supply disruptions out of Brazil, is undeniably positive for sentiment toward MIN's business. However, under the outstanding leadership of one of Australia's foremost entrepreneurs, Chris Ellison, MIN continues to pursue an iron ore growth strategy in its own right and the market is rightly excited by this. Under its growth strategy, outlined at the November AGM, MIN will develop two iron ore hubs in the West Pilbara and at South West Creek in Port Headland (along with associated infrastructure) and will also develop two new iron ore berth facilities at Ashburton (25Mtpa) and South West Creek (40Mtpa). These new projects have the potential to more than treble MIN's current iron ore operations to approximately 90Mtpa in the next 3-5 years and would place MIN as the fourth largest iron ore producer in Australia next to Fortescue Metals Group. Whilst there is some way to go for these projects in terms of approvals, financing and CAPEX/construction, they will leverage MIN's existing "pit to port" capabilities and will also increase the growth rate of MIN's underlying mining services business. We are willing to back MIN in its growth ambitions and the stock remains one of our top 5 holdings.

During the month, we exited our position in portfolio stalwart, **Appen (APX, -2.4%)**, on concerns that its calendar year 2020 earnings guidance might be a stretch given the COVID-19 induced slow-down in advertising revenue earned by some of its large tech clients, who may temporarily slow critical programs of work for APX. Additionally, the weakness in the US dollar creates an additional earnings headwind for the company given it frames its guidance based on set USD/AUD assumptions. We view APX as a quality stock with a strong long term growth outlook, however, the share price has continued to fall post our exit and could continue to do so should the company have to re-base its guidance. We will reassess APX as an investment proposition once we get greater clarity on the outlook for earnings, which will likely be in the near term.

The fund participated in the in the IPO of **Nuix (NXL)**, a provider of investigative software. NXL helps customers in the advisory, government, corporate and legal sectors globally with the Asia Pacific region contributing only 20% of revenue. The Nuix software platform enables indexing, searching, analysing, and extracting knowledge from unstructured data sets and documents. It has applications that include digital investigation, cybersecurity, e-discovery, information governance, and email migration and privacy. This technology has been developed over the last 15 years since the original core algorithm was developed by ANU for a government department. NXL has since assisted customers to solve complex document and data challenges such as investigations related to the Panama Papers and the Hayne Royal Commission. We were attracted to the ongoing growth in the industry due to the proliferation of data, in addition to the track record of the product and the multiple avenues of growth for the product from new and existing customers. The market also took a similarly positive view with the stock closing 51% higher on the first day of trade in a strong debut.

Outlook

Investors have continued to take a 'glass half full' approach in recent months casting aside record daily COVID-19 cases in the US and parts of Europe, as well as poor economic data across the globe, with a confluence of individually significant events arousing the 'animal spirits' of investors creating a risk-on investment environment for equities which bodes well for continuing solid near-term investment returns. Some of these events include:

- record low interest rates domestically and the adoption of a quantitative easing strategy by the RBA;
- an election outcome in the US which ought to be supportive of equity markets; and
- stunning early successes on the COVID-19 vaccine front (in the West) with preliminary Phase 3 efficacy data from both Pfizer/BioNTech and Moderna and later Oxford/AstraZeneca extremely promising.

Following the gravitational pull of other central bank moves offshore, the RBA again dropped the official cash rate in early November to just 0.10% and announced that it would commence buying A$100 billion of bonds in the coming six months. This so called 'quantitative easing' is designed to make the structure of interest rates in Australia lower, to make it cheaper for businesses, households and governments to borrow and invest, and to keep the AUD lower to support economic growth and jobs recovery. Significantly, the RBA laid out a medium-term forecast: "*[T]he Board will not increase the cash rate until actual inflation is sustainably within the 2 to 3 per cent target range. For this to occur, wages growth will have to be materially higher than it is currently… require[ing] significant gains in employment and a return to a tight labour market. Given the outlook, the Board is not expecting to increase the cash rate for at least three years*." We are in a 'lower for longer' interest rate environment and RBA governor Dr Philip Lowe has urged households and businesses to guard against becoming too risk averse and "seize the opportunities" offered by low rates to invest and grow. Dr Lowe conceded that it is certainly possible that the domestic economy could rebound quicker than the RBA's own upgraded growth forecasts from earlier in the month.

Investors have also been emboldened by the outcome of the US election with a gridlocked Congress close to the ideal scenario for many investors. A Biden presidency is highly likely to be more predictable than an ongoing Trump regime, but none of the Democrats' more progressive policies such as tax hikes, large public spending and widespread regulatory reform are likely to pass into legislation. The Republicans don't yet have a decisive majority in the Senate, with the remaining two seats to be decided when Georgia's run-off election races are held in early January. But the Democrats gaining control of the Senate seems like an unlikely tail-risk given Georgia is typically Republican leaning.

In a stunning turn of events, each of Pfizer/BioNTech, Moderna and Oxford/AstraZeneca have released interim data on Phase 3 human trials which suggests that an effective COVID-19 vaccine is within reach. Significantly, these vaccines are reporting far greater efficacy than had been anticipated and they are immediately applying for emergency use in several countries, including the US. Pfizer/BioNTech and Moderna are reporting approximately 95% efficacy, well above the >50% minimum threshold hurdle set by the FDA for regulatory approval. There are still some unknowns around the vaccines, including the duration of the immunity provided which will not be determined until the trials are concluded and peer reviewed.

Both Pfizer/BioNTech and Moderna will have doses ready for emergency use in the US by year end and the Pfizer/BioNTech vaccine has already received emergency approval in the UK. Australia has secured 10 million doses of the Pfizer vaccine, which still has some logistical challenges to overcome for use domestically, and the Oxford/AstraZeneca vaccine has commenced mass production by pharmaceutical manufacturer CSL at their facility in Melbourne in early November. All three vaccine companies have applied for fast track regulatory approval with key regulatory bodies world-wide. Whilst a vaccine will not be an immediate panacea to the economic damage caused by the pandemic, the prospects for the global economy and markets are vastly improved in the medium term. This will likely encourage more risk taking in equity markets, particularly in COVID-19 'recovery trades' as regulatory approvals are granted.

Domestic markets have once again brushed aside the worsening relationship with China, our largest trading partner, which plumbed new lows during the month as debilitating tariffs were slapped on wine exports and the Chinese foreign ministry mocked the Australian army's alleged human rights transgressions in Afghanistan.

Instead investors are focussing on the steep economic recovery out of recession, recently confirmed in last week's national accounts which showed a 3.3% jump in September quarter GDP, clawing back close to half the 7% collapse in the June quarter. The Treasurer Josh Frydenberg immediately declared the "recession is over", although he cautioned that the "recovery is not". Almost everyone, OC Funds included, has underestimated the resilience of the Australian economy and the strong economic rebound looks set to continue into the new year underpinned by Victoria's reopening and government stimulus measures.

Usually we would be sounding a cautionary note around all the bullish indicators at this time given the risk of the market overshooting while the COVID-19 induced economic damage is still very real, infection rates remain elevated in many countries and the timing around a full vaccine roll-out remains uncertain. But we expect that the domestic small-cap market may continue to grind higher in the coming months with the wave of positive investor sentiment continuing to support risk appetite and as the Australian economy enters 2021 with a recovery tailwind.

The Fund has trimmed several holdings in recent weeks on valuation grounds, including Mineral Resources and Helloworld Travel, although we remain relatively fully invested with our cash holding around 5%.

With the festive season approaching we would like to wish our investors and their families and safe and prosperous holiday season and New Year. We thank you sincerely for your support through what has been one of the more volatile and challenging years in our 20-year journey as fund managers. For those of you who may have endured hardship as a result of the COVID-19 pandemic, we are hopeful that better times lay ahead for you in 2021 and beyond.

Top 5 holdings#

Company	ASX code
Bapcor Limited	BAP
Eagers Automotive	APE
Mineral Resources.	MIN
Redbubble Limited	RBL
Worley Limited	WOR

The top 5 portfolio holdings are in alphabetical order and may not be representative of current or future investments.

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[†]The total return performance figures quoted are historical, calculated using hard-close end-of-month mid-prices and do not allow for the effects of income tax or inflation. Total returns assume the reinvestment of all distributions. The performance is quoted net of all fees and expenses. The index does not incur these costs. This information is provided for general comparative purposes.
[*]The performance comparison of $100,000 over 10 years is for illustrative purposes only. All returns shown are based on Australian dollar figures. Past performance is not a reliable indicator of future performance. The total returns shown are prepared on an ongoing basis (i.e. they include all ongoing fees and expenses and assume reinvestment of all distributions). They do not take personal taxation into account. The comparison with the S&P/ASX Small Ordinaries Accumulation Index is for comparative purposes only. Index returns do not allow for transactional, management, operational or tax costs. An index is not managed and investors cannot invest directly in an index.