OC Dynamic Equity Fund

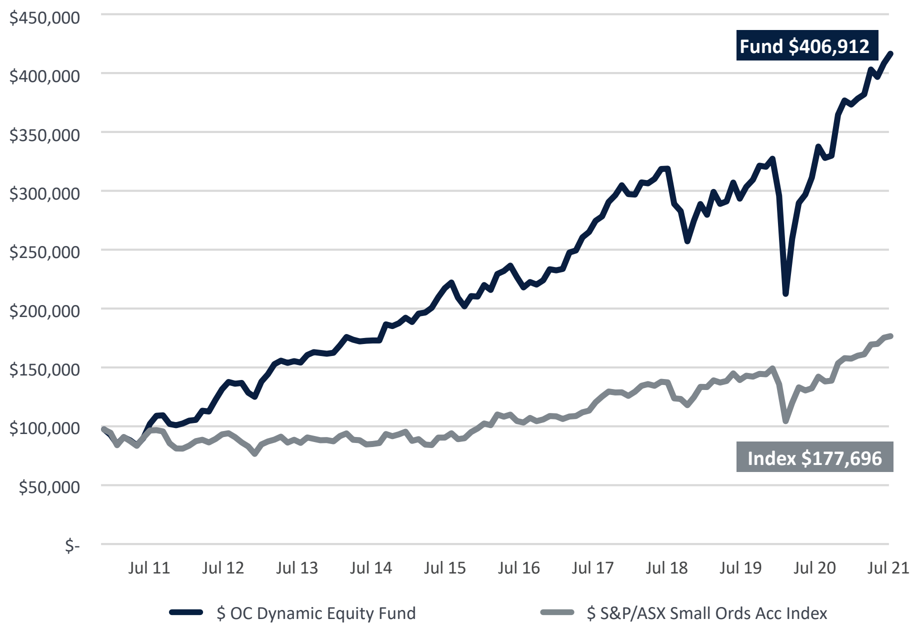
Fund Update | 31 July 2021

2.0% Fund up 2.0% for the month

15.1% Returned 15.1% 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 31 July 2021†	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	2.0	3.3	33.1	10.1	12.4	13.4	15.1	12.9
S&P/ASX Small Ords Accum	0.7	4.1	32.3	9.2	9.6	9.4	5.9	6.8
Outperformance	**1.3**	**-0.8**	**0.8**	**0.9**	**2.8**	**4.0**	**9.2**	**6.1**
S&P/ASX Small Ind Accum	-0.9	2.3	31.9	9.3	8.9	9.8	10.1	7.1
Outperformance	**2.9**	**1.0**	**1.2**	**0.9**	**3.5**	**3.6**	**5.0**	**5.8**

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 new financial year continued the positive recent momentum in Australian listed equities with the S&P/ASX Small Ordinaries Accumulation Index recording its sixth consecutive monthly gain and the S&P/ASX 200 Accumulation Index stretching its winning run to an impressive 10 months. Whilst the month was relatively quiet from a company news flow perspective with many companies in 'black-out' ahead of August results, corporate activity kicked up another gear with several M&A proposals disclosed during the month including bids for Sydney Airport, Spark Infrastructure Group and Iress Limited. News headlines were dominated by the misery caused by the highly infectious Delta variant of COVID-19 which has plunged much of the country back into lockdown and caused significant economic damage at a time when government subsidies and hand-outs have been substantially wound back.

The OC Dynamic Equity Fund started the financial year on a positive note with the Fund returning +2.0% for the month. This was a solid result given that resource stocks were particularly strong in July, led by battery material names, which saw the S&P/ASX Small Resources Accumulation Index (+7.4%) materially outperform the S&P/ASX Small industrials Accumulation Index (-0.9%). Long-term investors will be aware that the OC Dynamic Equity Fund does not hold core positions in resource stocks due to their elevated risk profiles, so the outperformance versus the Index during the month was particularly pleasing.

Select Harvests (SHV; +17.8%), Australia's largest almond grower and marketer, saw a sharp rise in its share price during the month reflecting the rally in the international almond price that has been spurned by the ongoing severe drought in California. The almond price had been depressed by lower demand due to COVID-19 and a record crop in the US for the prior season, but the US Department of Agriculture released an objective estimate of the current almond crop that was significantly lower than its prior subjective estimate. As the US is by far the largest grower of almonds globally, factors such as the downward revision in the forecast, fears about the impact of the ongoing drought on crop yields and increasing production costs have seen the almond price rally hard off its lows. At the same time, SHV released its own crop update with record production reflecting a significant increase on the 2020 crop and recovery in demand leading to strong sales volume growth in key markets such as India, China and Europe. SHV is set to continue to see increased production due to the maturing of younger orchards (both planted and acquired) over recent years. While the almond price has started to move higher, the financial impact from this will be most acutely felt in the 2022 crop because SHV commits to sales in advance. The question left to be answered is whether the movement in the almond price will continue higher, possibly to levels seen in the 2015/16 Californian drought, with rainfall deficits in key catchments already at similar levels. If this is the case, we could continue to see earnings estimates for SHV move higher over the coming 12 months.

International student placement business **IDP Education (IEL; +15.0%)** has agreed to acquire the India IELTS business from British Council (BC) for A$238m, with the deal being funded through existing cash and debt arrangements. The International English Language Testing System, or IELTS, is an international standardized test of English language proficiency for non-native English language speakers and India is the biggest market for IELTS testing globally. Currently IEL and BC both administer IELTS testing in India operating parallel pan-Indian distribution networks, but IEL will become the sole distributor of IELTS in India following the completion of the transaction. There ought to be material benefits from combining and simplifying the operations with estimated run-rate synergies of $6m-$8m expected to be delivered within 24 months of completion of the acquisition. The Indian IELTS market was growing at +20% from CY10 through to CY19 (prior to the onset of COVID-19) and the structural drivers for high growth remain once the pandemic passes given the relatively young demographic, a high propensity to study abroad and good levels of demand for migration to English speaking countries. The transaction appears to be financially compelling being ~13% EPS accretive (pre synergies) on a pro forma CY19 basis (reflecting the 12 months prior to the impact of COVID-19) and as much as 25% accretive should the expected synergies be realised. No doubt the IEL business has faced its share of challenges brought about by COVID-19, but the business has a very strong strategic position, a well regarded management team and a balance sheet well positioned to sustain strong medium term growth once the world normalises post the COVID-19 pandemic.

Domestic pathology player **Australian Clinical Labs (ACL; +14.1%)** rallied during the month as COVID-19 testing levels in Australia surpassed all prior records. ACL listed in unspectacular style in May this year but with the current outbreaks of the Delta strain of COVID-19 sending long lists of exposed individuals off to be tested across the country, the share price has finally started heading in the right direction. Given that current testing volumes are well above Prospectus assumptions and will likely remain so for the foreseeable future, we expect material earnings upgrades to wash through in the coming month. While the market is reluctant to attribute any level of recurrence to COVID-19 testing earnings, it does appear that, even as vaccination rates climb, the focus will remain on testing symptomatic individuals to avoid unnecessary exposure to the general population and monitoring the effectiveness of the government's vaccination program. Regular testing for elective surgeries and other illnesses that has declined during COVID-19 related lockdowns, should return to growth once these lockdowns are behind us. Despite the recent rally in the share price, we remain happy holders of the stock and expect positive outlook commentary to be provided by the company at its August result release.

At the end of July, **Life360 Inc. (360; +19.3%)** delivered a blockbuster quarterly (beating market expectations at almost every line) which nicely bookended the bullish update it delivered to the market just four weeks earlier. In the market update, 360 announced its acquisition of wearables business Jiobit was tracking toward completion but also reiterated that it was continuing to evaluate both strategic and financial opportunities which could result in a dual listing of the company on a US based stock exchange. We see this outcome as highly desirable given the multiple re-rate we could expect for the company should the opportunity to invest in 360 be available to the broader US investor universe. The company also announced the creation of a Family Advisory Council which will help create and expand 360 app features that will further facilitate trust between parents and their children. Stacked with US based celebrities and influencers, the council is a coup for the company which is also expected to see these sports stars and media personalities personally invest in the company (to the tune of US$2.1m).

OC has been invested in 360 since its ASX listing in mid-2019 and whilst our initial investment experience had been somewhat disappointing, with the stock trading below its IPO issue price for some time, more recent developments give us confidence that 360 is on the right track for success. We believe 360 is well positioned to capitalise on its market leading position in North America and, with an expanded product offering and new geographies to move into, we see excellent growth and cash flow generation potential for the 360 business as it matures.

Outlook

Readers will be painfully aware that the Australian economy is again being impacted by yet another broad-based lockdown this time brought about by the highly infectious delta variant of COVID-19 with around 16 million Australians across threes state directly impacted. Despite the emergence of the COVID-19 vaccines, there seems to be no easy pathway through this pandemic, as policy makers are once again having to balance competing priorities, being an appropriate health policy approach, which will necessitate physical distancing and other short-term measures which will undoubtedly harm economic activity, against the reality of a market-based economy, which requires highly interconnected trade and cross border commerce in order to function in an orderly manner.

Clearly the health response to delta variant taken by our leaders and those in many other countries suffering similar outbreaks will again materially weaken the global economy. Once again industries which have endured great hardship will again bear the brunt of it including hospitality, entertainment and travel with many of the businesses in these sectors again greatly restricted. Fortunately, the Fund has relatively limited exposure to these sectors. Absent this time (at this stage at least) is the government safety net in terms of JobKeeper and rent relief and other material government subsidies which have now been wound back or have ended. Notwithstanding this, the horrible foreboding about an economic Armageddon that was felt last year is also absent this time around given that the vaccines program is making progress and people overall remain generally optimistic that better times are ahead. Perhaps this helps to partially explain the strange dichotomy that has emerged between the financial markets which are at record highs and the overall near-term economic picture with the prospect of a short sharp recession in this country a real possibility if the lockdown is extended for much longer.

Perversely, the extent to which the delta strain has tempered the global growth outlook over the past month and led to a lessening of inflationary expectations may have served to preserve the longevity of the current bull market in equities. Inflationary concerns have been front of mind for almost all market participants in CY21, OC Funds included, with the rapid escalation in long bond yields potentially seen as a harbinger of an overheating global economy which may eventually require central bank intervention in the form of interest rate rises to quell the threat of inflation. However, the past two months have seen the 10-year bond yield in both Australia and the US fall considerably on the back of a more subdued economic outlook thanks to the delta variant which has alleviated the prospect of near-term interest rate rises that would have almost certainly been detrimental to company valuations and equity returns had they proven necessary.

As August reporting season kicks off there is a strong sense of déjà vu amongst the OC Funds investment team as we find ourselves once again in midst of a COVID-19 induced lockdown and the medium for communication for our post reporting company meetings is once again digital, namely Zoom, Microsoft Teams and Webex. Whilst these meetings are no doubt an efficient medium of communication, we still have a preference for face-to-face meetings when given the choice. The nuances that can be gleaned from management's demeanour, body language and levels of general enthusiasm from an in-person audience cannot be underestimated, and these subtleties are much harder to discern from a digital meeting. Nevertheless, we must play the hand we are dealt, and we have a busy month coming up with well over a hundred company meetings already locked in. Given the uncertainty brought about by the ongoing lockdowns we expect that many companies will be reluctant to provide forward earnings guidance when reporting, particularly those exposed to the overall economy given the impossibility of predicting what may unfold in the coming months. The delta variant has thrown a significant curve ball at the market, but we have not materially changed our portfolio positioning in recent weeks given that our portfolio holdings have solid balance sheets to trade through near-term challenges, and the market is forward looking and therefore focused on the earnings recovery that ought to play out once the population is largely vaccinated.

We reiterate what we said last month: "In such an environment it can be difficult to position a stock portfolio with 'lockdown' and 'reopening' beneficiaries whipping around at the whim of the national and global COVID-19 tally. As investment managers, we look through the 'noise' of the media and near-termism and structure the portfolio with quality stocks that we believe will perform strongly over the next 12 to 24 months". We live in a time of great uncertainty. It is difficult to predict whether other strains of the virus will emerge and derail the vaccination efforts or conversely whether the worst is already past us and the pathway to economic recovery will be smooth from here.

The August reporting season has already kicked off with Fund holdings Pinnacle Investment Management and Genworth Mortgage Insurance Australia already releasing strong results in the first week. That said, the bulk of small and micro-cap companies tend to release their results in the back half of the month following sign off from their auditors. We look forward to reporting back to our investors in early September on our thoughts and observations following financial-year-end reporting in August. During this time, we will be meeting with most of our core portfolio holdings, as well as many of their competitors and other potential investment opportunities. We believe the Fund is well positioned going into the results period and we remain confident in our ability to generate strong long-term investment outcomes for investors.

Top 5 holdings#

Company	ASX code
Eagers Automotive	APE
Mineral Resources	MIN
Sealink Travel Group	SLK
Steadfast Group Ltd	SDF
Uniti Group Ltd	UWL

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.

Past performance is not a reliable indicator of future performance. Positive returns, which the OC Dynamic Equity Fund (the Fund) is designed to provide, are different regarding risk and investment profile to index returns. Total returns are calculated after taking into account performance fees. Where OC Funds Management generates a return on the OC Dynamic Equity Fund over and above the performance hurdle of 15% in any financial year, a performance fee of 20.5% of all profits above this level is charged to the Fund directly. This document is for general information purposes only and does not take into account the specific investment objectives, financial situation or particular needs of any specific reader. As such, before acting on any information contained in this article, readers should consider the appropriateness of the information to their needs. This may involve seeking advice from a qualified financial adviser. Copia Investment Partners Ltd (AFSL 229316, ABN 22 092 872 056) (Copia) is the issuer of the OC Dynamic Equity Fund (ARSN 098 644 681). A current PDS is available from Copia located at Level 25, 360 Collins Street, Melbourne Vic 3000, by visiting ocfunds.copiapartners. com.au or by calling 1800 442 129 (free call). A person should consider the PDS before deciding whether to acquire or continue to hold an interest in the Fund. Any opinions or recommendation contained in this document are subject to change without notice and Copia is under no obligation to update or keep any information contained in this document current.