Chester High Conviction Fund

Fund Update

May 2023

APIR OPS7755AU
ARSN OPS7755AU

At 31 May 2023	1 mth %	3 mths %	6 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a	Incep. % p.a. *
Chester High Conviction Fund (after fees)	0.7	-0.6	-0.7	0.3	17.3	9.2	12.4
S&P/ASX 300 Accumulation Index	-2.5	-1.0	-0.8	2.4	11.3	7.4	7.3
Outperformance (after all fees)	+3.2	+0.4	+0.1	-2.1	+6.0	+1.8	+5.1

* 27 Apr 2017

"Those who are victorious plan effectively and change decisively. They are like a great river that maintains its course but adjusts its flow." **Sun Tzu**

Month in review

The link between the art of war and portfolio management is a tenuous one, but markets are forever changing. The recent "resolution" of the US debt ceiling debate only allows deficit spending to go largely unchecked in the US for another 18 months, while 40% of all government owned US Treasuries in the US mature in the next 2 years. This will have to be re-financed at (current rates) 5.05-5.25% up from 0% 2 years ago. The US governments own interest bill is starting to go parabolic. The US deficit to us is the "great river" that maintains its course, but adjusts its flow. There is an inevitability to it.

We (like many) have been guilty of calling the peak in the interest rate cycle for the past 6-9 months (influenced heavily by the bond market), while admittedly, the economic picture remains clouded. Recent payroll data in the US and minimum wage rises of 8.6% in Australia and housing related strength in both markets suggests that the bond market is pre-mature in pricing in rate cuts. It appears that central banks are prepared for higher rates than most market participants want to factor in, yet the market keeps "fighting the Fed". Maybe that is due to Artificial Intelligence or "AI", or the simple maths that inflation should be starting to decelerate soon.

It appears to us that "peak AI" enthusiasm is near, given the blow off top in Nvidia trading (US chip manufacturer). We may very well be wrong, but the thematic of "AI" investing has been a very powerful one thus far in CY23. We touched on our initial thoughts in our last quarterly, and have been doing much thinking around the permutations of outcomes with such a transformative change to the way many will approach business processing. The winners of this thematic in Australia will be far narrower than the tech heavy US market, while given "AI" is currently an arms race, it is not entirely clear which companies emerge as AI leaders at this point in the lifecycle of such a new technology.

The other influence in the macro landscape remains China, where to this juncture, the "re-opening" narrative has been tepid at best. We have been on the cautious side of Chinese appetite for raw materials for a long time. It would take aggressive stimulus from this point to make us reconsider that stance.

Portfolio review

During the month the fund returned 0.7% relative to the 2.5% fall in the ASX300. The strong performers in April were led by Austal (ASB), which had actually been a frustrating investment thesis since announcing a US3.5bn contract with the US Coast Guard last July. For a variety of reasons ASB retraced all its gains from last September to May, trading on just 0.6x PB. In May ASB announced the award of a design contract for the T-AGOS surveillance ship, which is highly likely to convert to a US3.2bn 7 ship program. This would effectively see ASB have a full order book for the next 10 years at their Alabama facility, while creating more certainty around the sustainment (maintenance) program. Post this contract, ASB will have an order book of around AUD11bn which suggests (to us) the market cap of AUD800m is mispriced. Recent press speculation suggests we are not alone. We added AGL to the portfolio in the first quarter, acknowledging the tailwinds in the electricity market remain highly cash flow positive for AGL, while recognising AGL has to be a key participant in the energy transition in Australia over the next 10 years. Allkem (AKE) is also a recent addition as we watched the lithium price retrace much of its 2022 gains, while remaining believers in the structural EV story. We were attracted to the relative maturity of the AKE assets and the production growth to come over the next 3 years, while being pleasantly surprised by the merger with Livent group. This merger creates a vertically integrated EV player of scale with both geographic resource and product diversification.

The underperformers for the month were led by Aussie Broadband (ABB), which stands to benefit (as do all telcos) from a revised pricing structure with the NBN. The ACCC draft submission effectively delayed the prospect of a pricing tailwind, but this is still likely to eventuate over the next 6-12 months. Those telcos more exposed to higher end plans (ABB) should see the cost of connection to the NBN fall in aggregate (eventually). QBE was also softer in May after a strong 6 months, after guiding to a higher catastrophe claim outlook in CY23 than we (or the market) had hoped. While we believe QBE is doing a far better job of controlling the controllables, unfortunately they have yet to devise a plan to control the weather, which is perhaps why it is trading on an FY24 PE of 8.8x. Imdex (IMD) has been a long term position that we have reduced over the course of 2023, being slightly cautious around exploration spend of their customers over the next 12 months.

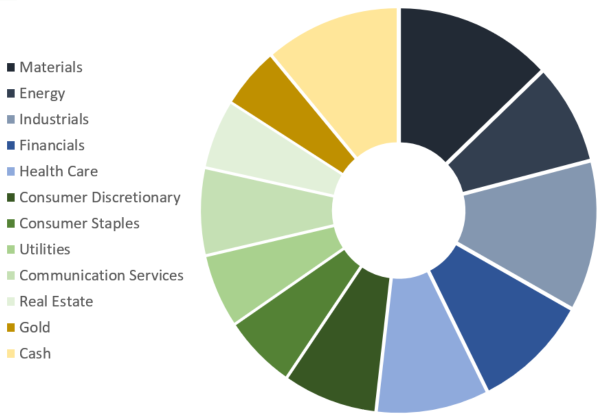
Top 3 holdings
CSL Ltd
Austal Limited
Suncorp Limited

Portfolio breakdown	
Materials	12.8%
Industrials	11.8%
Financials	9.7%

Top 3 portfolio attribution
Austal Limited
AGL Energy
Allkem Limited

Bottom 3 portfolio attribution
Aussie Broadband
QBE Insurance
Imdex Ltd

Fund weights - diverse sector exposure



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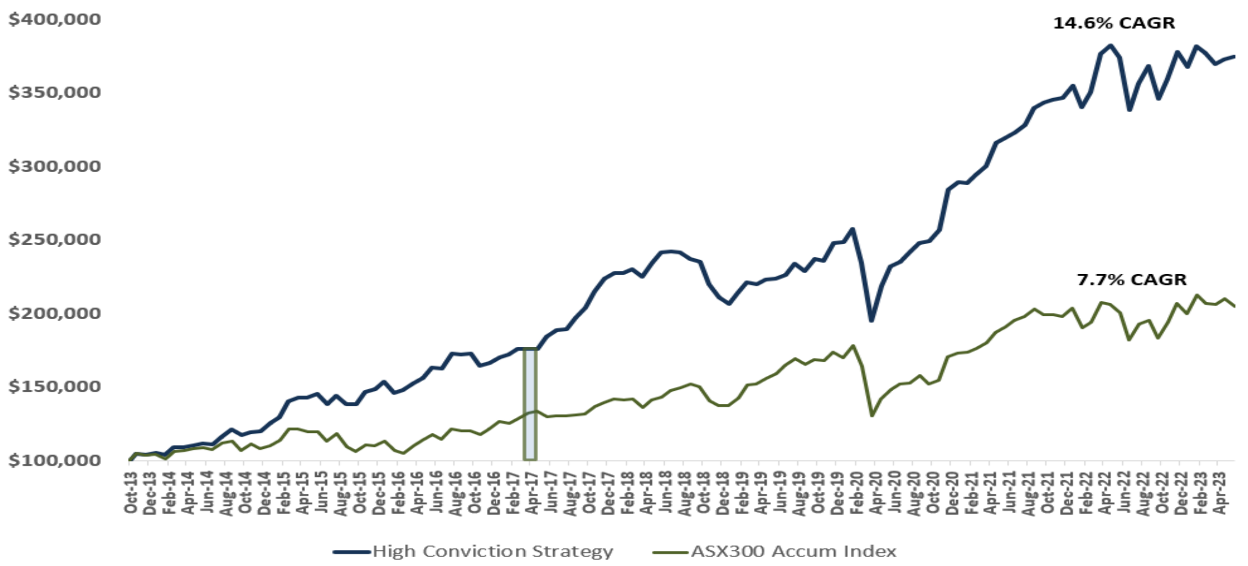
Accumulated Performance by Financial Year - Same Strategy

	FY14 (%)#	FY15 (%)	FY16 (%)	FY17 (%)*	FY18 (%)	FY19 (%)	FY20 (%)	FY21 (%)	FY22 (%)	FY23 (%)	Since Inc (%)
Same Strategy (after MER)	+11.2	+24.5	+17.4	+11.2	+28.3	-6.4	+3.9	+37.2	+4.8	+11.0	+14.6
S&P/ASX 300 Accum Index	+7.8	+5.6	+0.9	+9.1	+13.2	+11.4	-7.7	+28.5	-6.8	+12.5	+7.7
Value added (after MER)	+3.5	+18.9	+16.4	+2.1	+15.1	-17.8	+11.6	+8.7	+11.6	-1.5	+6.9

Per Annum. The inception date of SGH Australia Plus was the 8th of October, 2013, where Rob Tucker was the sole Portfolio Manager, until his departure on February 28th, 2017.
* The inception date of the Chester High Conviction Fund was April 26th, 2017, hence FY17 reflects 8 months of SGH Australia Plus and 2 months of the CHCF.
We note this is a statement of fact of the performance achieved by the fund during the time which Rob Tucker was the sole Portfolio Manager making active decisions on the SGH Australia Plus portfolio. We note performance is the record of the firm not the individual however past performance has been constructed from publicly available unit price data. Past performance is not necessarily indicative of future performance and should not be relied upon in making investment decisions.

High Conviction Strategy - accumulated performance



Note this graph is representative only of the combination of the same Portfolio Manager running the same strategy, and would only represent actual returns for unit holders that invested money at inception of SGH Australia Plus, withdrew those funds at the end of February 2017 and then invested all those initial funds again at inception of the Chester High Conviction Fund in April 2017. Note, this depicts returns after fees.

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