Chester High Conviction Fund

Fund Update

October 2022

APIR OPS7755AU
ARSN OPS7755AU

At 31 October 2022	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)	3.8	0.9	-6.1	4.1	15.0	10.8	12.9
S&P/ASX 300 Accumulation Index	6.0	0.5	-5.8	-2.6	4.9	7.2	7.0
Outperformance (after all fees)	-2.2	+0.4	-0.3	+6.7	+10.1	+3.6	+5.9

* 27 Apr 2017

"Successful investing is about managing risk, not avoiding it."

— Benjamin Graham

Month in review

Equity markets remain beholden to "Fed speak". Jay Powell's language at last weeks' FOMC press conference suggests a more hawkish stance than many equity participants were expecting. This quote stood out, ***"Risk management is key here. If we were to over tighten, we could use our tools to support the economy later on, but if we failed to tighten enough, inflation would become entrenched, and that would be a much bigger problem".*** This sounds asymmetrically hawkish to us. Hence the revised view that interest rates stay higher than previously thought. The dual mandate of focusing on inflation and unemployment appears laser focused on inflation. There has never been so much focus on each individual US CPI print as 2022 for signs of peaking, while it does appear that unemployment is heading higher over the next 3-6 months.

China has three distinct challenges ahead of it as an economic growth engine. The first is President Xi consolidating power and being overtly anti-capitalist, the second being how and when China reopens the economy from its zero-COVID policy and the third being just how challenged the growth model is with a demographic issue that isn't going away. The prospect of China "reopening" is more than a simple binary outcome to us, given there are 102 cities with more than 1m people, hence any "reopening" will most likely be gradual and staged.

Probably the most interesting thematic that emerged throughout October was the concept of resource nationalism. While this has been bubbling along since the Russian invasion of Ukraine, the US DOE (Department of Energy) providing up to USD2.8bn in grants, including writing Syrah (SYR) an Australian graphite producer (in Africa) a USD220m cheque to ensure battery grade graphite is produced in Louisiana is testament to the West's focus on security of supply. Canada banning Chinese investments in lithium assets in Canada was also a stark reminder of the growing divisions between China and the West.

Portfolio review

For the month of October the fund returned 3.8%, relative to the ASX300 Accumulation Index return of 6.0%. The strength in the ASX300 was led by the bank sector after a Bank of Queensland result that highlighted the current tailwinds behind the net interest margins of bank earnings. Banks are capturing the benefit of higher interest rates, without yet feeling the impacts of those higher rates on impaired loans. In fact impaired loans at ANZ and WBC are running at 4-5bp of total loans, 25bp below the 35 year average of 30bp. Our view of banks remains consistent in that they are leveraged exposure to the Australian economic cycle. We are less than convinced that banks offer any real downside protection should economic conditions worsen over the next 12 months. We will broadly keep a watch, but note the rising pressure on commercial property pricing, which is worth bearing in mind.

The strong performers for the month were again led by Mineral Resources (MIN), a long term holding that benefited both from the current enthusiasm for anything related to the EV thematic and the actual project pipeline within the MIN portfolio. In our view it actually has a relatively predictable pathway to see EBITDA grow at least 200% over the next 3 years, while there is more chatter around an eventual separation of the lithium assets from the MIN portfolio. Nufarm (NUF) offers interesting value given the crop protection business is still experiencing favorable growing conditions, while the Nuseed business has a visible pathway to create strong value for shareholders over the next 3-5 years. We note a recent transaction at UPL (a NUF competitor) valuing their seeds business at 26x EV/EBITDA. Optically this provides a material uplift to the NUF portfolio.

Our gold allocation hasn't worked in 2022, at all. OceanaGold (OGC) has been our preferred gold name for the past 2 years, based on our conviction in the assets in the ground across four diversified operations. We remain holders on a fundamental basis, while the primary listing has moved to Canada. OGC fell 12% through the month with broad sentiment across the sector after posting better than expected quarterly production numbers. We still see strong value on offer. Aurelia (AMI) delivered a feasibility study into developing Federation, their prized asset. This feasibility study was disappointing from an economic perspective relative to expectations that were far higher than delivered. We exited the position shortly after. Gold remains around 6% of the portfolio which we maintain is prudent from an allocation perspective.

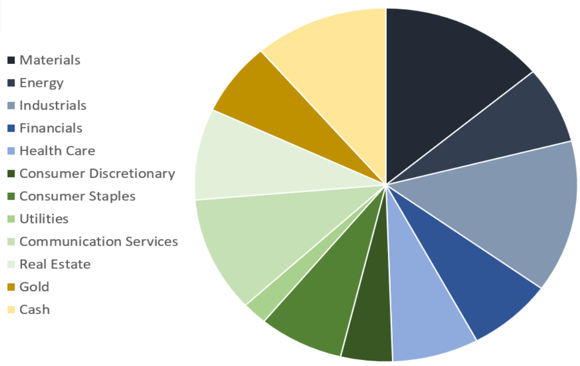
Top 3 holdings
CSL Ltd
QBE Insurance Group
Mineral Resources

Portfolio breakdown	
Industrials	13.9%
Materials	13.9%
Comm Services	10.5%

Top 3 portfolio attribution
Mineral Resources
Nufarm Ltd
News Corp

Bottom 3 portfolio attribution
OceanaGold
Aurelia Metals
Synlait Milk

Fund weights - diverse sector exposure



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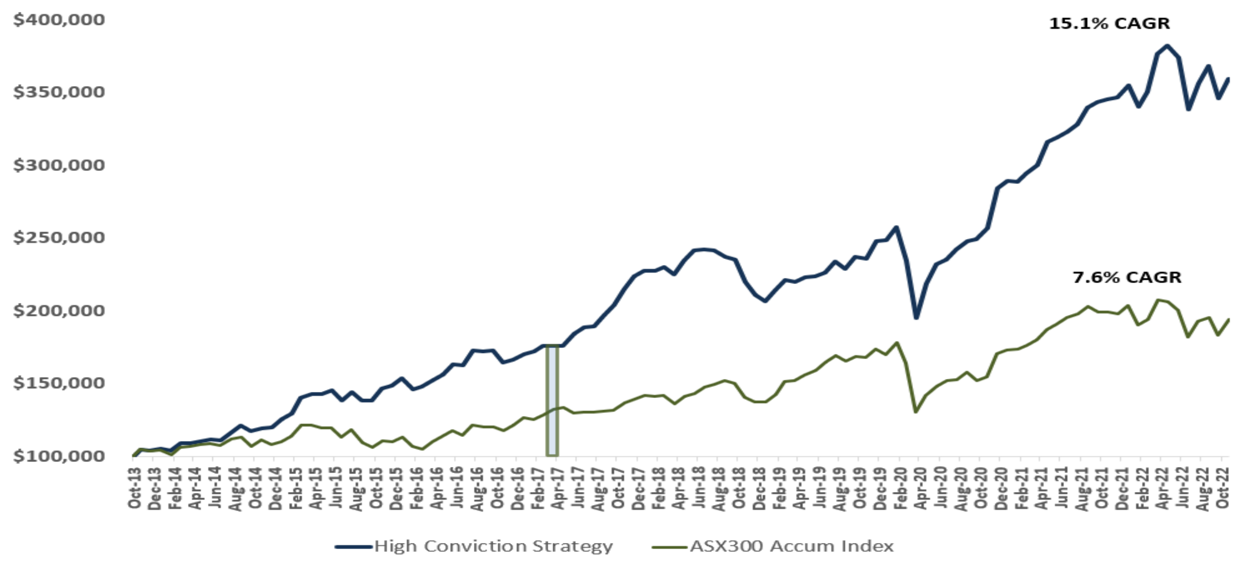
Accumulated Performance by Financial Year - Same Strategy

	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	+6.1	+15.1
S&P/ASX 300 Accum Index	+7.8	+5.6	+0.9	+9.1	+13.2	+11.4	-7.7	+28.5	-6.8	+6.4	+7.6
Value added (after MER)	+3.5	+18.9	+16.4	+2.1	+15.1	-17.8	+11.6	+8.7	+11.6	-0.3	+7.5

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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