



SG HISCOCK & COMPANY

SGH High Conviction Fund

31 December 2022

Investment objective	The Fund invests in a concentrated portfolio of Australian stocks that aims to offer long-term returns in excess of the S&P/ASX 300 Accumulation Index (after fees).		
Investments held	A portfolio of 15 to 30 stocks that are listed on the Australian Securities Exchange.		
Investment Manager	SG Hiscock & Company Limited	APIR	ETL0042AU
Commencement	28 October 2004	mFund Product Code	SHF01
Management costs¹	0.90% p.a.	Buy spread	+0.25%
Performance Fee²	15%	Sell spread	-0.25%
Minimum initial investment	\$20,000	Fund size	\$20.38 million

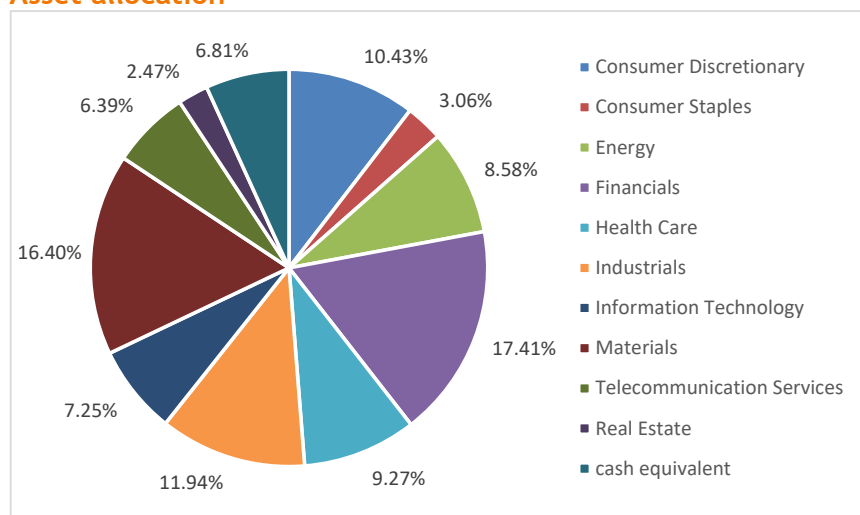
Unit Price	Application	Net Asset Value	Withdrawal
	\$ 1.4509	\$ 1.4473	\$ 1.4437

Performance ³	1 mth %	3 mths %	6 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	Inception % p.a.
Distribution Return	0.95	1.04	1.05	13.01	9.86	10.77	7.53
Growth Return	-4.71	4.46	4.98	-17.09	-4.82	-5.27	2.00
Total Net Return	-3.76	5.50	6.03	-4.08	5.04	5.50	9.53
S&P/ASX300 Accumulation Index	-3.29	9.13	9.62	-1.77	5.51	7.10	7.90
Total Net Return vs. the Index	-0.47	-3.63	-3.59	-2.31	-0.47	-1.60	1.62

Past performance is not a reliable indicator of future performance.

Distribution Period	30-Jun-21	31-Dec-21	30-Jun-22	31-Dec-22
Distribution rate (cents per unit)	10.8854	3.0211	19.8711	1.4301

Asset allocation



Top 5 holdings

BHP Billiton Limited
 CSL Limited
 AUD State Street - Current A/c
 National Australia Bank Limited
 Woodside Energy Group Ltd

Top 5 holdings represent 40.41% of the total Fund.

- Includes estimated GST payable, after taking into account Reduced Input Tax Credits ("RITC").
- Effective 1 December 2018, a performance fee of 15% (net GST and an estimate of RITC) of any investment return above the fund's benchmark may also be payable as an expense of the fund, subject to a highwater mark
- Performance: Distribution Return is the return due to distributions paid by the Fund, Growth Return is the return due to changes in initial capital value of the Fund, Total Net Return is the Fund return after the deduction of ongoing fees and expenses and assumes the reinvestment of all distributions.



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Monthly Observations

December saw somewhat of a reversal of the bear market rally of the last few months. The S&P/ASX300 Accumulation Index closed down -3.3% for the month, after rallying 12.5% in October and November, resulting in the Australian market closing down -1.77% for the year. This was well ahead of the US S&P500 which declined 5.9% in December and closed down 19.5% for the year.

All sectors were negative in the month with Discretionary (-7.0%), Property (-5.6%) and Technology (-5.4%) falling the most, while Resources (-0.9%) Consumer staples (-1.9%) and Utilities (-2.2%) relatively outperformed.

Across the ASX300 Energy (+49%), Utilities (+31%), Materials/Resources (+13%) and Financials (+2%) were the only sectors to post positive returns in the last 12 months, with Technology (-32%), Discretionary retail (-20%) and Property (-19%) the worst performing sectors. Needless to say, it was an extreme year in terms of returns dispersion.

A growing feeling inflation may have peaked combined with growing hope the US may avoid a recession have been the catalysts for the recent bear market rally. However, the hawkish December US Federal Reserve FOMC meeting, and a surprise change to Japanese monetary policy, dampened sentiment and with it weighed on equity markets.

The all-important US 10-year Treasury bond yield ended the month at 3.87%, 46 basis points down from its 2022 peak of 4.34% reached in October, though up 47 basis points from the recent low of 3.40% in early December.

The Federal Reserve's most recent summary of economic projections (the Fed dot plot) suggests the cash rate will peak at 5.1% in 2023, up 50 basis points from September. This suggests despite signs inflation is starting to decline more evidence is required to give confidence inflation is on a sustained path lower, which points to interest rates still having to move higher into the new year.

The key issue is how aggressively the Federal Reserve and RBA will continue to raise rates to fight inflation versus start to slow the pace of increases, or pause, on growing recessionary concerns.

It is fair to say central banks are still feeling their way as headline inflation peaks, and for the time being labour markets remain too strong and core inflation is yet to definitively turn.

Over the first half of 2023 the reported inflation numbers both in the US and domestically will benefit from the positive year-on-year base effect from declining goods, supply chain and oil price inflation. However, returning inflation to sustainable levels requires a slackening in labour markets to dampen wage growth.

There is a risk if wage growth does not ease inflation proves stickier as real wages increase, and consumer spending remains resilient. In the post pandemic era there is also a risk inflation remains more persistent due to the geopolitical and structural forces at play, which we discussed in our October webinar "*Australian equities positioning in a changing world*" and have written about previously at some length.

Despite this, financial markets have become increasingly focused on the potential for inflation to decelerate faster. The catalyst for this was the US November CPI number which rose by 0.1% month-on-month. If this is repeated for the next six months it would imply the US CPI could be 3% year-on-year in May 2023, down from a peak of 9.1% in June 2022 and 6.5% in November. This would still be above the 2% official inflation target but could potentially see an end to the current monetary tightening cycle.

From an investment perspective the issues become determining whether:

1. Inflation proves more persistent and requires tighter for longer monetary policy than markets currently have priced; or
2. Tighter financial conditions start to bite and inflation slows into a slowing economy/ recession hitting corporate earnings.

It is too early to know if the US and Australia will experience a hard or soft-landing and avoid recession, but we expect it to be bumpy. History suggests soft landings are rare and it needs to be remembered raising rates to tame inflation is explicitly intended to destroy demand: and this has been one of the fastest tightening cycles in history (albeit off record lows).

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We also know raising rates works with a lag. We have been a little surprised that the effects of the tightening cycle so far have not already started to bite more, but we believe it is enviable and will be hard to avoid. We still expect the economy to slow in ways not yet observable in 2023.

The reality is equity markets have only discounted valuations on higher interest rates and not earnings downgrades that could come as growth slows. The US third quarter reporting season which kicks off in January, and Australian February reporting season, will be important in providing the next read of corporate earnings and outlook.

If the negative for equities is the mounting prospect of slowing inflation into slowing growth or a recession and deterioration in corporate earnings, the positive is China's U-turn on its COVID suppression policy. Coupled with the relaxation in the property developer financing policy restrictions announced in October and November, this sets China up for a reopening trade in 2023 once the virus has been allowed to run its course.

It is fair to say, the exit from the zero-COVID policy has been much faster than expected with a policy of "rushing to herd immunity" rather than "flattening the curve". Such a dramatic U-turn increases the risk of a deeper economic contraction initially, but also a faster reopening in 2023.

With limited ways to directly play the China thematic through the ASX, it is unsurprising to see the pivot to resources. The iron price after bottoming at US\$82/tonne in late November was up 43% at the of December and the major iron producers have rallied 20-30%. Base metals and gold have also rallied strongly on the China reopening and a US Dollar, which has seen strong performance in portfolio holding Northern Star.

We expect China's reopening to also be positive for oil demand, although concerns around slowing global growth seem to be crowding this out for now.

The largest tailwind for the Chinese economy is expected to be in the recovery in consumption where pent up demand should see a recovery in international and overseas student travel. This should be supportive for portfolio holdings in Corporate Travel, IDP Education and Treasury Wine Estates.

During the month we initiated a position in Genesis Minerals Limited (GMD) which is fast emerging as significant mid-cap Western Australian gold mining company. Genesis is operated by Raleigh Finlayson who we know well from investing in Saracen Minerals and Northern Star over the years.

Raleigh and a number of the ex-senior management from Saracen took over the management of GMD in March 2022 and are looking to the develop and take into production the 1.6moz open pit and underground Ulysses Gold Project located 30km south of Leonora. They have a grander plan to consolidate the Leonora district through optimising ore sources and processing capacity from multiple mines under an owner operator model, similar to the strategy developed at Saracen.

In July GMD made an off-market takeover bid for Dacian which owns the Mt Morgan mine. Whilst this has 150koz p.a production base it also has a large scale mill which GMD plan to utilise, saving the need for them to develop their own mill and \$150-160m in capital expenditure.

In December GMD announced the second step in its plans to consolidate the Leonora precinct through an agreement to merge with St Barbara via scheme of arrangement and rename the merged entity Hoover House Limited. St Barbara owns the Gwalia mine and some smaller assets in Canada and Papua New Guinea through its investment in Atlantic and Simberi that are planned to be demerged under the deal.

St Barbara's board has unanimously recommended the deal, and assuming it is approved by shareholders and completes by May 2023, Hoover House will have around 300koz p.a in production with approximately 205koz coming from Gwalia and the remaining 95koz coming from Mt Morgan's mill and the GMD and Dacian assets.

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