SG HISCOCK & COMPANY

SGH High Conviction Fund

28 February 2023

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 costs[1]	0.90% p.a.	**Buy spread**	+0.25%
Performance Fee[2]	15%	**Sell spread**	-0.25%
Minimum initial investment	$20,000	**Fund size**	$20.30 million

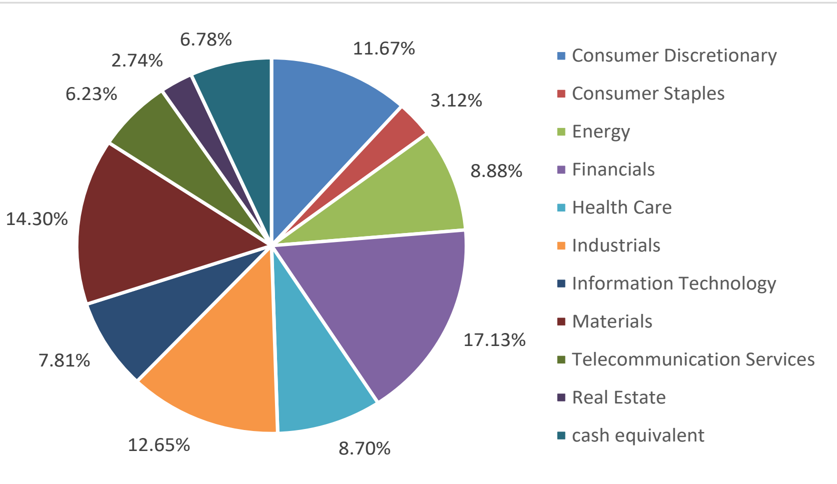
Unit Price	Application	Net Asset Value	Withdrawal
	$ 1.5001	$ 1.4964	$ 1.4927

Performance[3]	1 mth %	3 mths %	6 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	Inception % p.a.
Distribution Return	0.00	1.00	1.03	14.14	10.09	10.83	7.47
Growth Return	-1.80	-0.49	3.12	-9.94	-2.64	-4.72	2.23
Total Net Return	-1.80	0.51	4.15	4.20	7.45	6.11	9.70
S&P/ASX300 Accumulation Index	-2.55	0.17	5.92	6.54	7.94	7.87	8.04
Total Net Return vs. the Index	0.75	0.34	-1.77	-2.34	-0.49	-1.76	1.66

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

CSL Limited

BHP Billiton Limited

National Australia Bank Limited

Chorus Ltd

Woodside Energy Group Ltd

Top 5 holdings represent 35.70% of the total Fund.

1. Includes estimated GST payable, after taking into account Reduced Input Tax Credits ("RITC").
2. 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
3. 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

The S&P/ASX300 Accumulation Index fell -2.55% over February with Materials being the largest laggard closing down -6.9% and Financials down -3.1%. Growth stocks were the beneficiaries with Technology stocks leading the way, rising +4.8% and Healthcare +4.3%.

Interest rates remain the key driver for markets. The RBA and the Federal Reserve both hiked by 25bps during the month. Moreover, the RBA February minutes were demonstrably hawkish and suggested the RBA would have hiked by 50bps had it not been for heightened uncertainty and the option of monthly meetings.

Despite this, economic data released during the month highlighted the tightening in financial conditions appear to be starting to take effect. In Q4 2022 Household savings fell (-3% QoQ) and household interest payable rose to 5.4% of disposable income. January retail trade data also reflected a weakening household, as nominal discretionary retail turnover and broader retail volumes were weak. The January job market data also alluded to a loosening of labour market conditions, with unemployment rising for the second straight month to 3.7% and weaker-than-expected private sector wages growth driving a muted WPI print (+0.8% QoQ, 3.3% YoY).

This will no doubt provide food for thought for the RBA as it seeks to maintain its inflation fighting credentials whilst navigating the narrow path of not overtightening and tipping the economy into recession.

The RBA's position is complicated by the imprecise nature of monetary policy and fact increasing rates disproportionately hurts mortgagees and low-income households over savers and higher income households. It is also the case the politics and scrutiny around increasing rates is very different to when rates are falling. Layered with the fact the RBA was slow to recognise the inflation problem and is now trying to re-establish its reputation following some well documented missteps around forward guidance, and a review of the RBA's mandate, it adds to the uncertainty around the path of future rate increases.

For now, the market has taken the view rates are likely to have to move higher on the back of the latest FOMC and RBA comments and ongoing tightness in labour markets. Terminal rate expectations have moved higher over the last month and suggest at least one to two further rate hikes. However, the situation remains fluid and economic data dependent.

The bottom line is predicting the path of inflation remains very challenging. The risk is as inflation peaks, central banks continue to tighten, and real rates may still need to move higher before they move lower.

Portfolio positioning and performance

From a portfolio perspective it remains important to focus on what we can control and stock fundamentals. The February reporting season provided an opportunity to get a report card on portfolio holdings and insight in the general health of corporate Australia.

Overall, the results season showed corporate earnings have proved relatively resilient in the face of rising inflation and tightening monetary policy, at least to now. There were few signs of any significant slowdown in sales with greater than 80% of companies meeting or beating revenue expectations. Price rises have helped maintain top line growth, even where there has been some softening in demand starting to creep in. However, at the earnings line there was growing evidence of margin pressure with nearly 50% of companies missing expectations (versus ~30% long run). That said, many companies suggested that input costs have peaked and are starting to ease given falls in commodity prices and supply chains easing. Labour costs were generally the exception with labour markets remaining tight (particularly in mining and construction) and little discussion of laying off staff (as distinct from the recent US quarterly reports). Given how hard it has been to attract staff, there seems a general willingness to still hoard labour at this point.

Sector wise, banks underperformed on concerns that net interest margins (NIMs) are approaching peak levels for the cycle. Margins peaking as credit growth slows and bad debt rise suggest further rate increases have arguably become a headwind rather than a tailwind for the sector. We took the opportunity to further reduce our underweight bank position during the month.

Miners also underperformed, in part due to moderate earnings misses from the major iron ore producers, but mainly due a fading impact of the Chinese re-opening trade thematic. Amid weakness in resources, banks and rate-sensitive cyclicals, defensives outperformed.

CSL reported a good 1H23 result. Whilst the headline was largely in line with consensus, importantly plasma collections continue to show good signs of recovery and were up +36% HoH and now 10% above pre COVID and are at record levels. Behring plasma margins look like they bottomed in the September quarter and are now improving sequentially whish should provide good earnings momentum over the next few years. Coupled with the full integration of the recently acquired Vifor renal business and ongoing strength in the Sequirus flu business we see CSL as well positioned to grow irrespective of economic cycle.

Seven Group also reported a strong result with its main operating divisions (Westrac – Caterpillar services and dealership, and Coates – equipment hire) performing strongly and buoyed by improved performance from its investments in Beach Energy and Boral. We continue to believe the current portfolio mix has Seven leveraged to three attractive cyclical sectors in: 1) Mining services 2) infrastructure construction 3) Energy/ East coast gas market, with a management that is returns focused and shown an aptitude to actively manage the portfolio of businesses.

During the month we added Worley. Over the last 5-6 years the company has undertaken quite a transformation following the acquisition of Jacobs Energy, Chemicals and Resources business and restructuring and repositioning to be more leveraged to the renewable energy space. At its heart Worley is a global engineering, advisory and project management services company with a key focus on hydrocarbons, chemical, mining and infrastructure sectors. It employs over 56,000 people who provide engineering services across the entire project life cycle from planning and design to decommissioning.

We see the company as being a beneficiary of the energy transition and drive for decarbonisation and sustainability, whilst also benefiting from the substantial forecast increase in legacy hydrocarbon customers capital expenditure as they seek to realign their businesses to changing geopolitics, supply chains and lower carbon world. Government driven initiatives like the US Inflation Reduction Act are also providing significant incentives and impetus for energy infrastructure reinvestment and tailwinds in many of Worley's key end markets. Over the next three years Worley also investing $100m to support growth in the higher margin sustainability markets. The benefits should in time yield increased volume of higher margin sustainability work. It is still early days, but the recent result showed the benefits are already starting to flow in the form of a 50% increase in sustainability work in hand and lead indicators in terms of pipeline work and staffing are suggesting earnings momentum is building.