

SGH High Conviction Fund

31 August 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.

Performance ¹	Total Net Return	Distribution Return	Growth Return	S&P/ASX300 Accum. Index
1 month (%)	0.05	0.00	0.05	-0.76
3 month (%)	3.93	3.86	0.07	3.88
6 month (%)	3.26	3.84	-0.58	2.87
1 year (%)	7.55	5.02	2.53	8.96
3 years (% p.a.)	8.88	9.34	-0.46	10.51
5 years (% p.a.)	5.24	8.88	-3.64	6.99
7 years (% p.a.)	7.62	9.55	-1.93	8.53
10 years (% p.a.)	8.16	10.60	-2.44	7.95
Inception (% p.a.)	9.61	7.47	2.14	7.98

¹ 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.

Past performance is not a reliable indicator of future performance.

- For the month the portfolio returned 0.05% outperforming the benchmark by +0.81%.
- The ASX300 Accumulation returned -0.76% after rallying 3.0% from intra-month lows, outperforming most global indices including the S&P500 which lost 1.5%.
- Reporting season dominated proceeding during the month. The portfolio held up relative well, with a number of stocks that had lagged or done little coming into results rewarded on the back of delivering in-line or better than expected results including Johns Lyng Group, Qube and Treasury Wine Estates.
- In August Johns Lyng Group, Seven Group Holdings and James Hardie Industries contributed strongly, while Chorus, Corporate Travel Management and BHP Group were the major detractors.
- We took the opportunity to initiate a position in Resmed (RMD) during the month, which was sold off 25% on a slightly softer than expected fourth quarter result and concerns around the threat to the long-term growth for CPAP as the leading the treatment for Obstructive Sleep Apnoea (OSA) from the impacts of obesity drugs.

Key Facts

Investment manager	SG Hiscock & Company Ltd.
Launch date	28 Oct 2004
Benchmark	S&P/ASX300 Accumulation Index
Management fees ²	0.90%
Performance fee ³	15.00%
Fund size	\$19M
Number of holdings	27
Dividends payable	Biannual
Buy/sell spread	+0.25/ -0.25%
Minimum initial investment	\$20,000
Base currency	AUD
APIR	ETL0024AU
mFund code	SHF01
Domicile	Australia

Unit price

Application	\$1.4915
Net Asset Value	\$1.4878
Withdrawal	\$1.4841

Distribution cpu

30-Jun-22	19.8711
31-Dec-22	1.4301
30-Jun-23	5.5247

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

³Effective 1 Dec 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.

Portfolio Characteristics and Performance

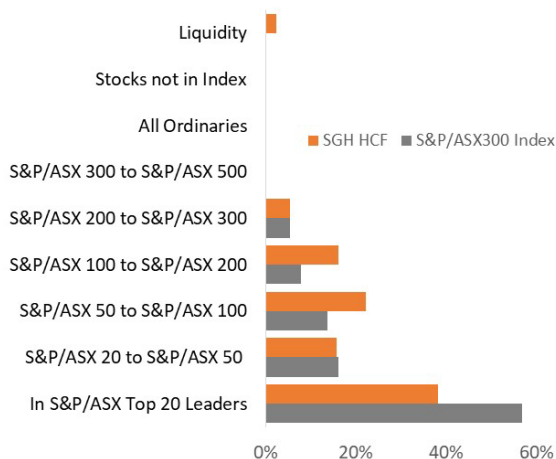
Top 3 Holdings	Portfolio Breakdown	Top 3 Contributors	Top 3 Detractors
Chorus Limited	Financials 23.2%	Johns Lyng Group	Chorus
NextDC	Materials*	Seven Group Holdings	Corporate Travel
Qube	Industrials 15.3%	James Hardie Industries	BHP Group

* Incl. gold

Superior Return on Equity (ROE) to the index with stronger sales growth EPS characteristics

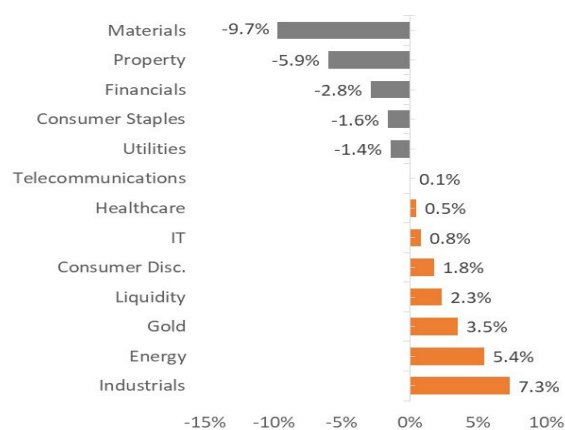
	Sales Growth		EPS Growth		Yield		PER (x)		ROE	
	FY22/FY21	FY23/FY22	FY22/FY21	FY23/FY22	FY22	FY23	FY22	FY23	FY22	FY23
SGH High Conviction	11.8%	6.7%	6.2%	9.0%	2.9%	3.1%	18.9	18.4	13.7%	15.1%
ASX 300 Index	5.6%	1.1%	-0.8%	-1.1%	4.3%	4.1%	17.4	17.2	13.6%	13.6%

Market cap weights relative to ASX300



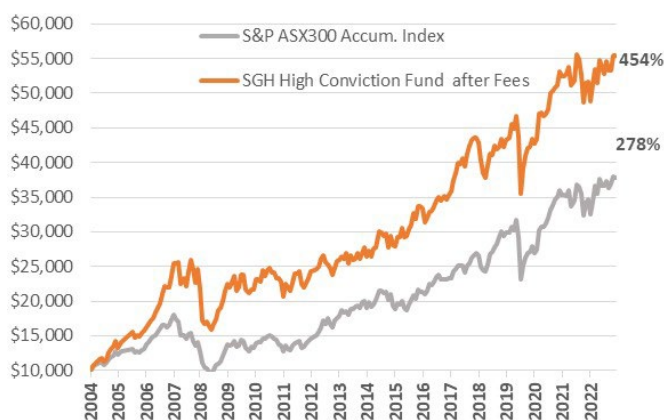
Sector weights relative to ASX300

Our bottom-up stock analysis and structural views is evidenced in our deviation from the index



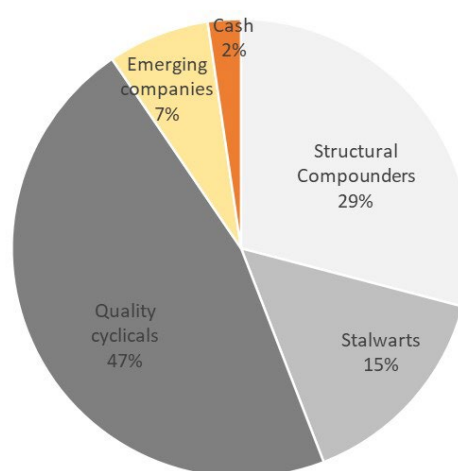
\$10,000 invested since inception

Long track record of adding alpha



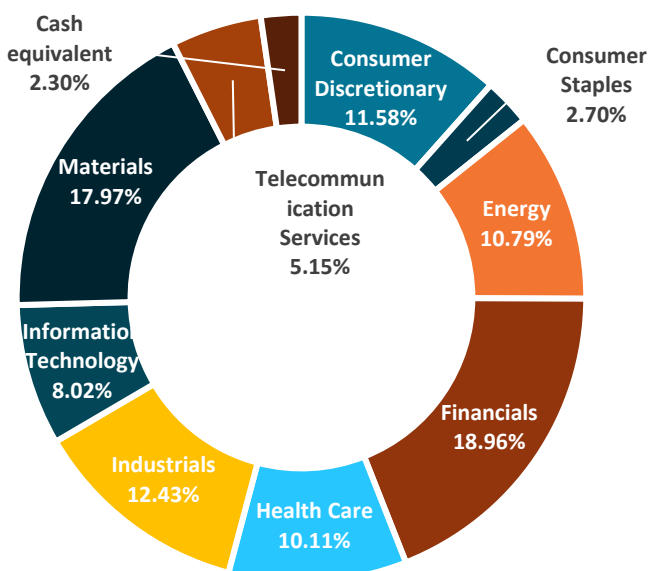
Portfolio lifecycle exposure

Portfolio diversification by lifecycle, sector and size



Asset Allocation

Sector	Fund (%)
Consumer Discretionary	11.58
Consumer Staples	2.70
Energy	10.79
Financials	18.96
Health Care	10.11
Industrials	12.43
Information Technology	8.02
Materials	17.97
Telecommunication Services	5.15
Cash equivalent	2.30
	100.00



Commentary & Outlook

In August the ASX300 Accumulation returned -0.76% after rallying 3.0% from intra-month lows, outperforming most global indices including the S&P500 which lost 1.5%.

Notably Industrials outperformed Resources by 1.5% with Consumer discretionary the best performing sector returning 5.7% over the month. REITs (+2.3%) also outperformed on Goodman Group rallying (+12.9%) after tapping into the artificial intelligence narrative and highlighting its pipeline opportunity for developing data centres.

Consumer Staples (-3.2%) was the worst performing sector driven by a weaker result from Coles Group (-11.2%) on the back of cost pressures and theft, and Endeavour (-8.7%). Materials (-2.1%) also lagged with resource stocks weaker from ongoing concerns around the slowdown in the Chinese economy and lack of policy stimulus.

The July Chinese data was unequivocally weak with negative year on year inflation, another month of declining property prices and the lowest monthly RMB loan growth to the real economy since 2006.

Perhaps more concerning for confidence is the lack of transparency and growing pattern of the Chinese Government suspending or not reporting weak economic data: the youth unemployment series was suspended in July after the 16–24-year-olds rate climbed to 21% in June, land sales have not been published in 2023 after volumes dropped 53% in 2022, and March consumer confidence numbers were released in May and April numbers in August. This is adding to questions about the state of China's economy and whether its weaker than the headlines suggest.

The spark for the rally in Australian equities from intra-month lows was correlated with the more dovish domestic July CPI print at 4.9%, and better than expected retail sales numbers. The inflation data provided further confirmation that tradable/ goods inflation has slowed (from a peak of 9.9% in December to just 1.7% in July).

However, non-tradable/service inflation remained relatively sticky (at 6.5% in July, although down from its cycle high of 7.7%). The 6% increase in electricity prices was the surprise reading in the CPI numbers and coupled with the resurgence in the oil price (23% in the last quarter) has potential to

disrupt the recent downward trend in inflation over coming months, adding to the noise around whether rates have peaked.

The US driving season typically results in an uptick in the oil price at this time of year, but geo-politics appears to also be playing its part, as always. A less publicised, but notable development during the month was the decision at the BRICS countries summit in Johannesburg to invite Saudi Arabia, Iran and the UAE to join the BRICS alliance.

This is potentially a significant development as the BRICs countries will now control 42% of the world's oil exports (up from 14% currently). In addition to this the new group of 11 BRICs countries will account for 68% of coal production, 38% of natural gas production and 46% of the world's population. This has potential to exert more influence on commodity prices, but also has longer-term implications for inflation, shifts in global trade patterns and the US dollar. The full implications are hard to predict.

However, it adds further weight to the argument the international rules-based order is under threat, we are past peak globalisation, and the world is shifting to an era of 'spheres of influence' and alliances built around economic resilience and national security: arguments supporting a higher inflation regime.

Moving from the big picture to more domestic and stock specific news, reporting season dominated proceeding during the month. Overall, beats versus misses were broadly in line with longer term averages, but an improvement on the last few halves. However, the results showed a discernible slowdown in overall sales growth in the last 6 months (8% versus 12% in Jun-Dec-23), operating margins contracted modestly (approximately 2% drag on earnings on average) and aggregate earnings were downgraded by about 6%.

Higher labour and wage costs were a feature of many company results, but the full impact was helped by falling input prices (particularly freight, commodity inputs). The increase in financing costs from higher rates, was unsurprisingly also a feature of reporting season, and we expect will continue to be an earnings headwind as the benefits of those companies that have fixed their debt at lower interest costs continues to roll-off.

The share price movements around results were more volatile than usual. According to Goldman Sachs circa 15% of companies that reported saw share prices move +/-10%, double the long-term average, and valuation multiple expansion explained approximately 85% of the gains for companies that rallied greater than 10%. This speaks to positioning being a bigger driver than fundamentals, consistent with investors being too negative about the economy and consumer discretionary and cyclical stocks tending to do better than the more defensive sector like staples and healthcare names.

The scorecard for reporting season saw the portfolio hold up relatively well, outperforming its benchmark by 0.81%. Pleasingly several companies that had lagged or done little coming into results were rewarded on the back of delivering in-line or better than expected results including:

- **Johns Lyng Group (JLG):** which highlighted good ongoing momentum in its Australian insurance building and restoration services business and progress on US expansion resulting in first time FY24 earning guidance in excess of 20%.
- **Qube (QUB):** which continued to show the diversification of the business and defensive characteristics continue to prove resilient in the face of macro-economic uncertainty. Management also disclosed for the first time an external valuation of its Patrick business with an

enterprise value of \$6 billion, around 40% above our valuation, reinforcing the high-quality infrastructure-like nature of the asset.

- **Treasury Wine Estates (TWE):** which highlighted a very strong result from its Penfolds business and operational changes to leverage its position should the China tariffs be removed.

The biggest detractors during the month were Chorus (CNU) and BHP and Corporate Travel Management (CTD).

Chorus (ASX: CNU) delivered an in-line result and continued to show evidence it is growing new fibre subscribers and penetration. There was nothing in the result to change our investment thesis and the sell-off in the share price seemed a reflection of disappointment in a lack of upgrade to dividend guidance, providing an opportunity to add to our position.

Corporate Travel (ASX: CTD) highlighted it continues to execute well in a tougher market environment that has been subdued and slower to recover than expected following Covid. The Asian and UK businesses performed at or above expectations in the last half, but the North American, Australia and New Zealand businesses continue to be slow to recover. We continue to see Corporate Travel as a different business to pre-covid and with two major acquisitions now fully integrated. Benefits should start to be realised in FY24.

We took the opportunity to initiate a position in **Resmed** (ASX: RMD) during the month, which was sold off sharply on a slightly softer than expected fourth quarter result and concerns around the threat to the long-term growth for CPAP as the leading the treatment for Obstructive Sleep Apnoea (OSA) from the impacts of obesity drugs like Glucagon-like peptide-1 (GLP-1) receptor agonists being used for chronic weight management. Clinical trials for Novo Nordisk's Saxenda and Wegovy GLP-1 RA drugs have raised concerns they will displace a large percentage of the addressable market for CPAP treatment for Resmed. Whilst we see a degree of uncertainty in relation to GLP-1 uptake and implications for OSA which could reduce the long-term growth rate for CPAP we view the potential impacts implied by the 25% decline the share price as overstated.

SGH High Conviction Fund - Overview

What makes us different?

- High conviction benchmark unaware portfolio holding 15 – 30 stocks.
- Focus on quality businesses that are sustainably growing free cash flow and improving returns.
- Focus on capital preservation and absolute returns for shareholders.
- Disciplined repeatable process to stock selection and portfolio construction.

Investment Philosophy

The core premise of our philosophy is to invest in companies that deliver absolute returns for investors, with a strong focus on capital preservation. In our view this is best achieved by investing in quality businesses that can deliver sustainable value creation over the medium term, rather than simply investing in companies because they are a significant part of an index.

We allocate capital only to high quality ideas where we have conviction, believing only a few quality ideas are required to build a good portfolio. We do this through investing in quality companies which are sustainably growing free cash flow and returns and are mispriced. We believe price is what you pay, and value is what you get, and valuation discipline is fundamental to investing and creating longer term shareholder value.

Investment Strategy & Process

SGH High Conviction is a concentrated portfolio holding 15 – 30 stocks. Our focus is on identifying businesses with 'quality sustainable growth' that are mispriced. We do this through a disciplined and repeatable process that seeks to identify companies which are:

- Sustainably growing free cash flow and returns.
- Well-positioned in attractive end markets with a source of competitive advantage.
- Appropriately structured and have a sound balance.
- Lead by engaged, focused and innovative management Where we are satisfied companies meet these criteria, they are eligible for portfolio consideration subject to valuation. A range of valuation methodologies are used depending on the nature of the business.

As part of our process, we undertake an extensive company visitation program which is important in providing 'insight' in developing and testing our thinking, understanding and investment thesis. We seek to know as much about our companies as possible, with a view to mitigating permanent capital loss.

The portfolio construction process is determined by our confidence and conviction in the underlying quality of the business and margin of safety to valuation. It is also influenced by top-down economic considerations and industry and company life cycle risk characteristics.

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The Fund's Target Market Determination is available on the [SGH website here](#). A Target Market Determination is a document which is required to be made available from 5 October 2021. It describes who this financial product is likely to be appropriate for (i.e. the target market), and any conditions around how the product can be distributed to investors. It also describes the events or circumstances where the Target Market Determination for this financial product may need to be reviewed.

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