



SG HISCOCK & COMPANY

SGH High Conviction Fund

31 October 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	\$20.79 million

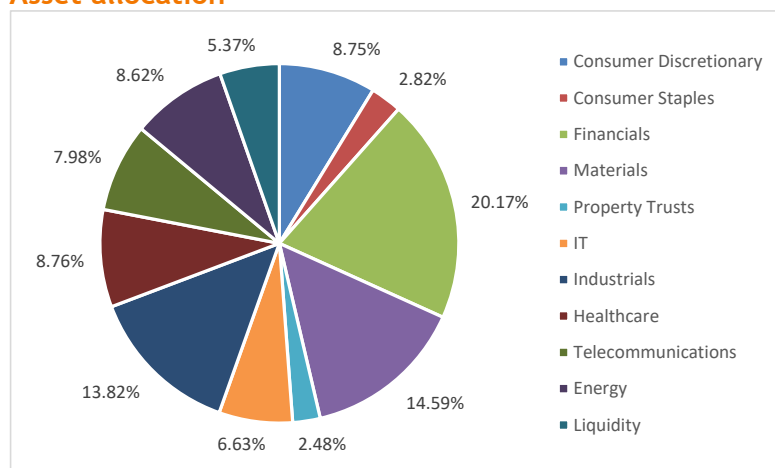
Unit Price	Application	Net Asset Value	Withdrawal
	\$ 1.4443	\$ 1.4407	\$ 1.4371

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	0.00	11.88	13.94	10.12	11.00	7.54
Growth Return	5.02	-0.41	-18.39	-15.84	-4.16	-4.27	2.05
Total Net Return	5.02	-0.41	-6.51	-1.90	5.96	6.73	9.59
S&P/ASX300 Accumulation Index	5.96	0.46	-5.77	-2.61	4.86	7.23	7.80
Total Net Return vs. the Index	-0.94	-0.87	-0.74	0.71	1.10	-0.50	1.79

Past performance is not a reliable indicator of future performance.

Distribution Period	31-Dec-20	30-Jun-21	31-Dec-21	30-Jun-22
Distribution rate (cents per unit)	0.7331	10.8854	3.0211	19.8711

Asset allocation



Top 5 holdings

CSL Limited
National Australia Bank Limited
BHP Billiton Limited
Woodside Energy Group Ltd
Chorus Ltd

Top 5 holdings represent 36.37% 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

Equity markets had a strong month in October. The SAP/ASX300 Accumulation Index closed up 5.96% largely reversing the -6.3% drawdown in September, but lagged the S&P500 which gained 8.1% and Dow Jones Index which surged 13.95%, its best month since 1976!

Financials (+12.2%) and Banks (+14.4%) led the Australian market higher. Energy (+9.5%) and Real Estate (+9.3%) also performed strongly, whilst Consumer Staples (-0.2%) was the largest detractor. The large iron ore producers also underperformed on the back of the iron ore price falling 16% to US\$82/ tonne (having now halved since March). This primarily reflects Chinese property sector weakness and growth concerns. Mid-caps outperformed large and small cap counterparts, whilst Industrial stocks outperformed Resources.

Intra month volatility and sector returns dispersion remains at extreme levels as heightened geopolitics, macro uncertainty and ongoing debate around the size and timing of the rate tightening cycle continues to drive equity market positioning and performance.

Central to this is the debate around how high central banks will have to increase interest rates to rein in inflation, the impact this will have on economic growth and when central banks will then need to temper the pace of rate increases and potentially pause or even reverse course.

In September the market sold off after the US Federal Reserve Chairman reaffirmed the need to fight inflation and prospects bond yields would need to move higher than the market had been assuming. In October sentiment shifted and the market started to price in the potential we are nearing the peak of policy tightening. This has been driven by the fact many key leading economic indicators have deteriorated sharply and emerging commentary from the US reporting season that some companies are starting to cut costs and headcount to manage profitability. As a result, markets rallied on the adage of "bad news is good news" and the current pace of interest rate increases will likely need to slow. The more dovish than expected RBA 25 basis point interest rate hike to 2.60% supported this narrative and helped drive domestic markets higher.

We believe we are in the 'twilight zone' where the impact of higher rates is yet to fully be reflected broadly in slower growth and earnings. It needs to be remembered that ultimately the intention of raising rates is to tame demand and thereby inflation. It is to be expected there will be a lag. Historically it has averaged around 12 months, but each cycle has its nuance. The fact this has been a very aggressive and sharp tightening cycle so far has led some to believe the impact will be less delayed. However, the fact we are coming off effective zero rates, and the unprecedented nature of the increase in money supply and household savings on the back of the pandemic, may mean there is a greater economic buffer and tightening financial conditions will take longer to take effect.

As we saw in the domestic August reporting season, the third quarter US reporting season has showed some signs inflation cost pressures are starting to bite and volumes slow, but little signs of a material broad based weakening in demand. On the whole sales and top line revenue growth is holding, or even continuing to grow as companies increase prices to pass on costs, and consumers have accepted the increases.

The risk in a rising inflationary environment is investors are lulled into a false sense of confidence as sales in nominal terms continue to meet or beat expectations. If demand softens and volumes start to fall, it will be harder for companies to pass on prices and margins will come under pressure. Forecasting this has been made even more difficult by the pandemic which has led to extreme distortions in historical sales and margin trends. Determining what is the 'new normal' in this environment, and where monetary policy and financial conditions are also radically changing is challenging.

Things can turn quickly, and the risk is margins can gap down sharply particularly if the distortions and benefits of the last couple of years prove unsustainable or temporary. Too often, we have learnt over the years from experience and disappointment, that a surge

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in sales is in hindsight shown to be a pull forward in demand and not a more permanent structural shift. In this respect, we are consciously avoiding more consumer discretionary businesses and those companies that were COVID beneficiaries where we have reservations about the sustainability of demand and benefits accrued.

Portfolio positioning and performance

For the month the portfolio returned 5.02% underperforming the S&P/ASX300 Accumulation Index by -0.94%. BHP, National Australia Bank, Chorus and Woodside Petroleum were the best performers for the month, whilst Cooper Energy, BHP and Megaport were the largest detractors.

We put some cash to work during the month adding to our gold position through Northern Star Resources (NST) and to Johns Lyng Group (JLG), TPG Telecom (TPG) and Megaport (MP1). Cash held at the end on month decreased to 4.5%.

Megaport's 1Q23 result during the month saw the stock sell off on concerns around port consolidation and higher capital expenditure which raised concerns around the need for capital. After speaking to management and clarifying these issues we view the price weakness as opportunity to add to our exiting position, and the emerging companies lifecycle sleeve of the portfolio. We continue to see Megaport as having a highly strategic competitive position in the software defined networking space through its over 423 installed and 787 enabled data centres in 25 countries. With only limited exceptions we continue to see Megaport as having leadership in many areas in the early stage and growing segment it serves. The company is also highly leveraged to the USD with more than half of its revenues derived in US dollars.

During the month we exited our position in Ebos Group (EBO). Whilst the first quarter result was relatively strong demonstrating continued momentum in the underlying businesses we have growing concerns around the sustainability of the COVID-related pharmacy sales being maintained and risk around the renewal of the Chemist Warehouse contract.

In positioning the portfolio, we continue to maintain exposure to:

- Inflation beneficiaries and in particular:
 - Commodities and energy stocks benefiting from higher prices and fundamental changes resulting from policy and geopolitical realignment including BHP, Woodside Petroleum (BHP) and Cooper Energy (COE).
 - Financials benefiting from higher rates and near-term interest margin tailwinds including National Australia Bank (NAB), ANZ Bank (ANZ) and Computershare (CPU).
- COVID recovery beneficiaries including CSL, Corporate Travel (CTD) and IDP Education (IEL).
- Essential infrastructure and services plays which are more defensive but by their nature are benefiting from their unique market position and structural tailwinds such as Cleanaway (CWY), Qube (QUB), Next DC (NXT), and Chorus (CNU).
- Gold given the risk of inflation being more entrenched and sticker and recent strength in the US dollar being at or close to peaking.

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