ROSEVALLEY FUNDS

Portfolio Report July 2019

The Rosevalley Behavioural Finance Funds

The Rosevalley Behavioural Finance Funds are high-conviction funds that take the theoretical and empirical evidence developed over the past 30 years in Behavioural Finance, and systematically build portfolios from these learnings. The portfolios are constructed on a benchmark-unaware basis, but performance is compared to the ASX-200 accumulation index.

Key Events July

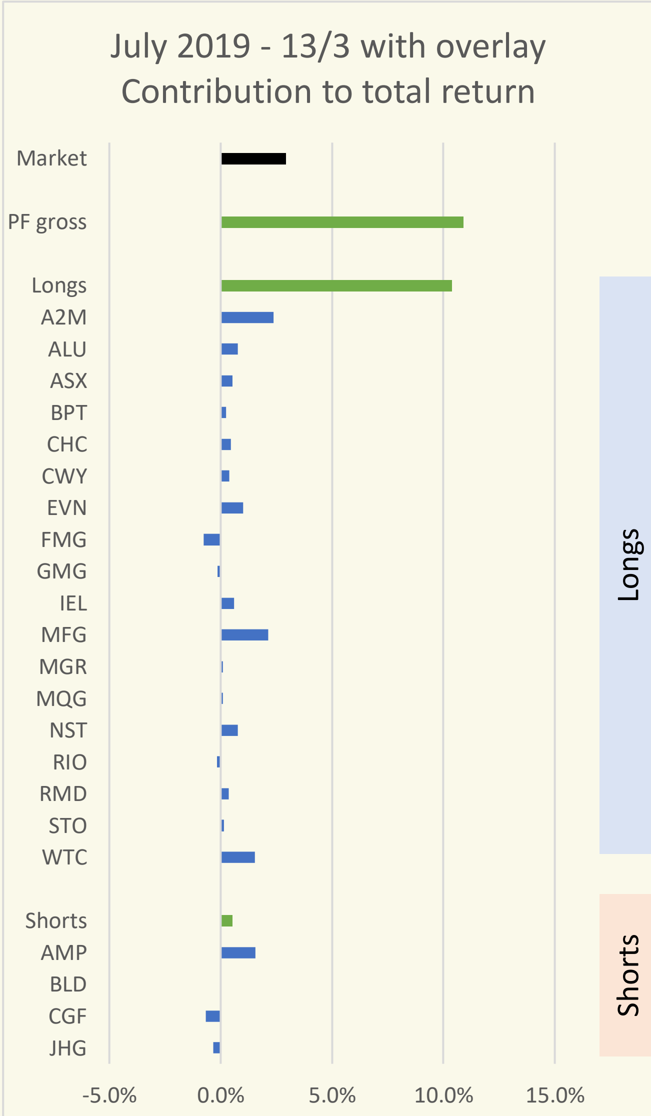
July was another good month for stockmarkets around the world, including Australia, albeit not quite as strong as June:

S&P 500	1.4%
DJIA	1.0%
FTSE100	2.2%
DAX	-1.7%
Hang Seng	-2.7%
ASX200	2.9%

The Rosevalley portfolios however, had their second very strong month in a row, with gross returns around 10-12% for the month.

Interest rates and the trade wars continued to drive stockmarkets. As mentioned last month, the RBA cut rates in June and July. During July markets' expectation of a rate cut by the US Fed intensified, and in early August the rate cut did indeed come, as expected.

In the UK, Boris Johnson became Prime Minister, as expected. The market largely shrugged off this news, or perhaps more accurately, this was such a near certainty that there was no market reaction. As mentioned last month, the uncertainty around Brexit is not resolved, and we believe there is a chance that the Johnson government might not survive, and Brexit will once again be pushed back.



Portfolio performance

The flagship portfolio (13/3 with overlay) was up 10.9% (gross), compared to the ASX200 up 2.9%. For this month, the portfolio manager's overlay did not improve performance: the model without overlay was 12.2%. The performance was broad-based, with only the long in Fortescue (FMG) and the short in Challenger (CGF) significant detractors. Still, cumulatively both the longs and the shorts contributed positively.

Similarly, the 15/5 portfolio with overlay was up 10.3%. Here also the performance was broad-based, with Fortescue and Challenger the most significant detractors. However, there were a few more shorts that detracted, such that the cumulative shorts marginally detracted for the month.

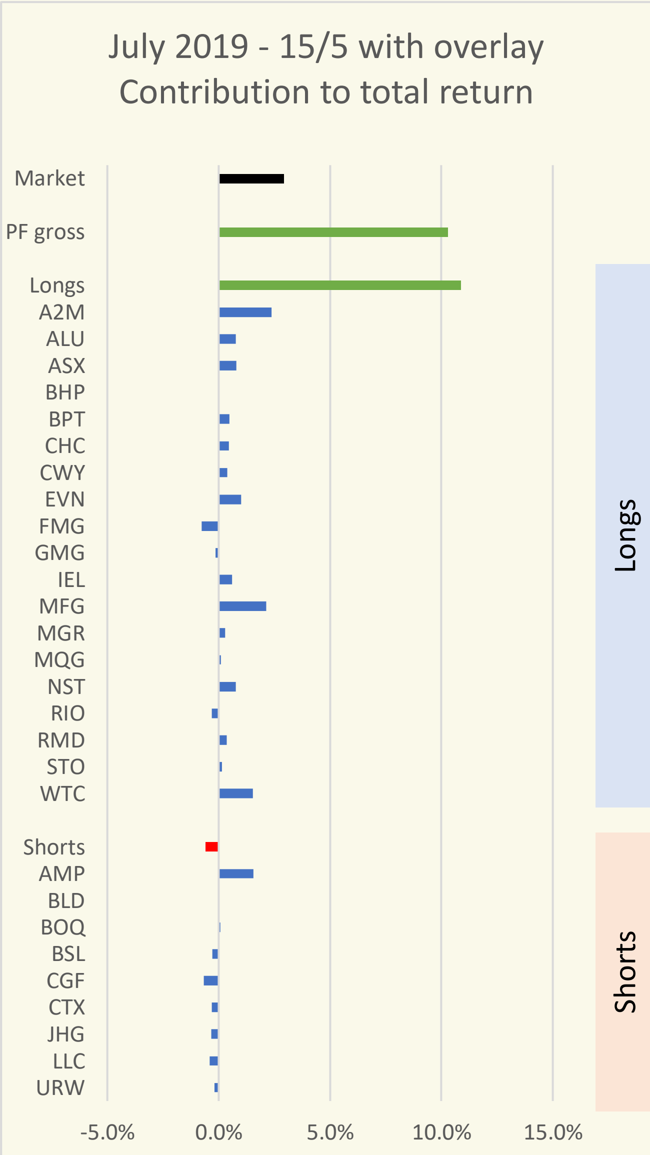
Performance since inception – as of July 2019						
Portfolio	1 month	3 months	6 months	Since inception (1 Oct 2018)	Since inception (14 Aug 2018)	Since inception (1 Aug 2018)
13/3 – with overlay – gross	10.9%	27.7%	43.4%	23.2%		
13/3 – with overlay – net	8.3%	21.1%	31.3%	17.2%		
15/5 – with overlay – gross	10.3%	27.5%	40.5%		27.4%	
15/5 – with overlay – net	10.0%	26.9%	37.1%		21.2%	
Long only – with overlay – gross	9.9%	21.0%	36.0%			33.4%
Long only – with overlay – net	9.3%	17.8%	28.8%			16.3%
ASX-200	2.9%	8.6%	18.7%	13.1%	12.8%	13.3%

Note: Returns are unaudited. Net returns are after borrowing and trading costs, but before fees.

Execution

Below is the breakdown of the gap between gross and net performance for the 15/5 with overlay portfolio. The realized weights differed slightly from the model, leading to an unfavourable 6 bps variance. On the other hand, the realized prices were slightly more favourable than the model assumed, while borrow costs were slightly lower than anticipated. Overall, there was a positive 8 bps variance relative to the expected net performance.

	Model	Realized
Gross performance	10.29%	10.29%
deviation from model portfolio		-0.06%
difference between trade price and end-of-previous-month price	0.00%	0.08%
trading costs	-0.14%	-0.14%
borrow costs	-0.21%	-0.17%
rounding		0.01%
Net performance	9.94%	10.02%



Longer term performance

One of the three portfolios now has a one-year track record, and shows a gross 20% outperformance. The other two portfolios have a gross outperformance since inception of 10% and 15% respectively (see table above). During the month, Mercer published its survey of funds managers for the year to June 2019 (FY19). We did some extrapolations from the inception-to-June 2019 performance and are pleased to report that the funds would have stacked up very well in this survey (see additional material on page 4).

August portfolio

The overlay for the August stand-alone portfolio sees one long and one short idea replaced for both the 13/3 and 15/5 portfolios:

	13/3	15/5
Longs taken out	FMG	FMG
Replaced by	ASX	BPT
Comments	FMG was taken out for sector concentration reasons. For both portfolios the next stock in the list was chosen as replacement.	
Shorts taken out	CYB	CYB
Replaced by	CIM	URW
Comments	There were no available shorts in CYB. For both portfolios the next stock in the list was chosen as replacement.	

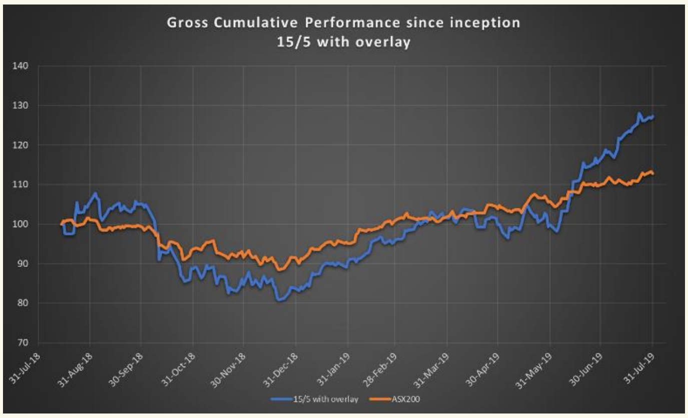
See the appendices for full detail on the list and substitutes.

Looking ahead

Like last month, it seems pretty clear that globally, interest rates will again continue to drive share markets. While the markets expected the Fed to cut, and they did so indeed, the commentary was less dovish than expected or hoped: where some had been looking for indications of a planned series of rate cuts, instead the Fed did not commit to any further cuts. As one might have expected, this angered president Trump, as in his mind more rate cuts would drive the US dollar down and so help the US economy (a debatable line of reasoning at best, but then again, sound economic reasoning doesn't seem to be a feature of the president's tweets). Added to this was the president's decision to increase tariffs on Chinese imports (even while talks were ongoing), and August sharemarkets got off to a rocky start.

In the US, the June quarterly earnings started to come in during the last week of July. The broad theme seems to be that the June earnings were as good as or slightly better than expected, but outlook statements from companies were slightly more bearish.

In Australia, the June (full-year) earnings season will start to get underway this month. This might (will) lead to some surprises and therefore August is likely to be a volatile month. We expect few surprises for the actual results but will be very interested in what the companies have to say about the outlook. We feel there is a tug-of-war going on between the gradual economic slowdown that has been



occurring over the past 12-18 months, and the shot in the arm that the economy received in May, from three factors:

- The Coalition winning the election, which took away the threat of ending negative gearing and cash refunds of franking credits;
- The RBA starting an easing cycle of interest rates;
- APRA loosening mortgage credit standards.

On balance we expect that the economy will continue where it has been tracking for the past year or so: a relatively steady, slow-paced growth, but no recession.

Investors in the traded 15/5 fund

The closing value of the portfolio was $134,292. The current participation is:

Investor 1	4.55%
Investor 2	90.27%
Investor 3	5.17%

*And now, a bit of bragging: **

During July, Mercer published its ranking of Australian share funds for FY19. The press only carried the top-10, but did report that:

- The median manager returned 9%, failing to beat the market
- The list included 134 strategies, of which 85 were long-only
- The worst long-only strategy lost 18.8%

How would the Rosevalley funds have performed?

As explained before, we have 3 strategies that are actually trading. Inception for these strategies was 1 August 2018, 15 August 2018, and 1 October 2018 – therefore we have no actual numbers for the strategies for the full financial year. However, here we are taking the liberty to engage in some simple extrapolation to get an idea of how the funds performed relative to their potential competitors.

The assumptions are simple: take the average net-gross gap for the traded period and apply it to the model gross performance for the 1-3 months the funds weren't trading yet, to arrive at an estimated net performance for the full financial year. A further adjustment goes to the effect of small fund size on trading costs (i.e. the percentage trading commission is higher if the trade size is so small that the minimum dollar commission is triggered). For this adjustment we assume that the trading costs for the largest fund is representative, and we adjust the performance of the two smaller funds for the difference. Note that this is still a conservative adjustment, as even in the largest of the three funds most trades attract the minimum dollar commission.

On this basis we get the following result:

	Gross	Estimated Net	Adjusted Net	Rank (out of 137)
13/3 with overlay	22.4%	21.5%	21.5%	1
10/0 with overlay	21.7%	5.4%	17.6%	3
15/5 with overlay	16.6%	10.5%	12.0%	22

Of course, these are estimates and therefore should be read with that caveat in mind. Still, the numbers are intriguing, and the gross and net numbers for the strategies on an inception-to-EOFY are real.

Best performing Australian share funds, year ending June 2019

Manager/fund	1 year		3-year		5-year	
	%	Rank	%	Rank	%	Rank
Martin Currie Australia Real Income	18.8	**1**	11.0	**99**	15.5	**5**
BlackRock Equitised Long Short	17.5	**2**	15.5	**11**	9.1	**61**
AMP Capital Sustainable Share Fund	17.1	**3**	13.4	**50**	9.1	**63**
Regal Australian Long Short Equity Fund	16.9	**4**	15.1	**14**	12.8	**12**
ECP AM All Cap	16.6	**5**	14.5	**26**	–	–
Selector High Conviction Equity Fund	15.1	**6**	20.8	**3**	19.2	**1**
Alphinity Sustainable Share	15.0	**7**	17.3	**5**	11.6	**17**
Aberdeen Australian Equity	14.5	**8**	–	–	–	–
BlackRock Specialist Australian Equity	14.1	**9**	14.0	**34**	9.1	**62**
Panther Trust Australian Shares	13.6	**10**	21.5	**1**	–	–

SOURCE: MERCER

*We published a more detailed report on the inception-to-June-2019 performance, including some statistical analysis – available on request.

Rosevalley Funds: The Behavioural Finance Approach

Over the past 30 years Behavioural Finance has emerged as a serious alternative to the Efficient Market Hypothesis. Whereas the Efficient Market Hypothesis starts with the assumption that people (investors) are rational and profit-maximizing, Behavioural Finance builds upon empirical observations of how people actually behave, and goes on to explain securities prices from this principle. Along the development of Behavioural Finance, it has been able to explain many peculiarities that had remained puzzles under the Efficient Market Hypothesis.

Rosevalley Funds portfolios are built around the theoretical and empirical underpinnings of Behavioural Finance, and at heart take advantage of the way human beings behave in the real world.

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