



# Portfolio Report August 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 August

August saw a small step back after two strong months for stockmarkets around the world.

	Aug 2019	12-mo to Aug
MSCI World	-2.1%	-0.7%
S&P 500	-1.6%	2.9%
DJIA	-1.7%	1.7%
FTSE100	-4.1%	1.4%
DAX	-2.0%	-3.4%
Hang Seng	-7.4%	-7.8%
ASX200	-2.4%	9.0%

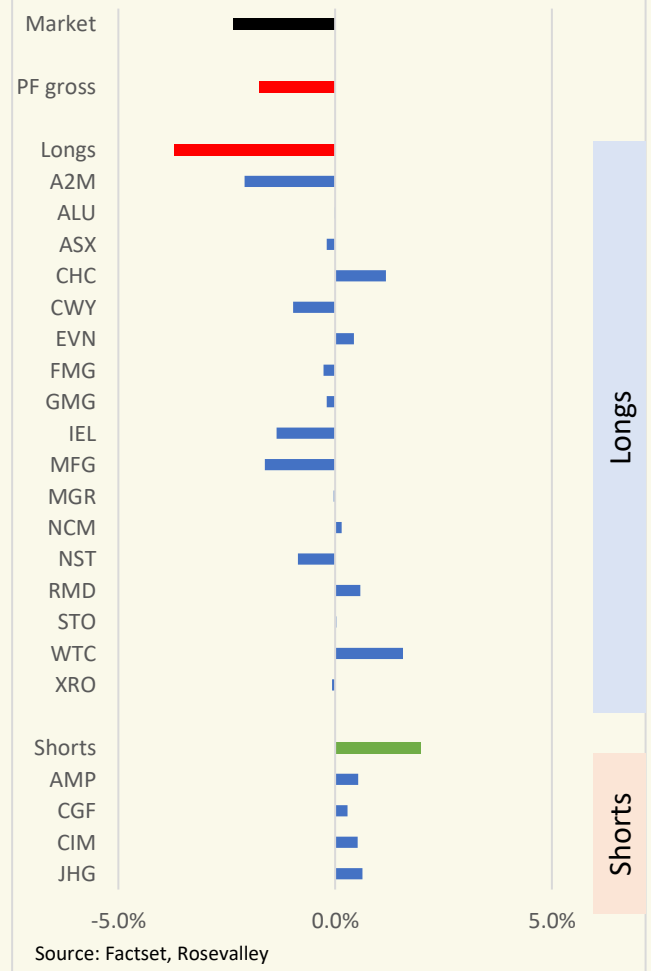
Source: Factset

Globally, the main driver was the trade war, with increasing rhetoric coming out of the White House and China, and with new tariffs being announced. In addition to this thematic, Hong Kong was hit by the unrest in the territory, the UK saw further Brexit turmoil, while in Australia it was reporting season.

**The trade war:** President Trump behaved himself uncharacteristically well at the G7 summit in Biarritz, France. However, on most other days of the month his fingers did find their way to his mobile phone in order to tweet something about China (including a comment about “China called us at the highest level” – a phone call that China said it was not aware of). More and higher tariffs were announced, although towards the end of the month it was announced that China and the US will return to the negotiating table. Our two-cents worth (and please, don’t believe it’s worth much more than that): Trump is misreading the Chinese capacity for patience. Their leadership thinks in decades, whereas Trump has to think about the election campaign next year, and how a slowing economy might affect that. This might not work out as well for the US as Trump is hoping.

**Unrest in Hong Kong** continued with the weekend demonstrations not letting up, and actually getting more strident. There were a couple of days during the month where the Hong Kong airport had to be closed. This is one

### August 2019 - Rosevalley 13/3 Contribution to total return



of the busiest airports in the world, and the closures will have done huge damage to the Hong Kong economy. It is hard to see how the stalemate will be resolved, given the largely incompatible desires on either side of this conflict (autonomy/democracy vs one state with full government control).

**In the UK,** Boris Johnson became Prime Minister in late July. During the month initially nothing much actually happened beyond repeated assurances that the UK will leave the EU on October 31, “do or die”. However, as it became clear that MPs were seriously looking at ways to

Performance since inception – as of August 2019

Portfolio		1 month	3 months	6 months	1 year	Since inception (1 Oct 2018)	Since inception (14 Aug 2018)	Since inception (1 Aug 2018)
Rosevalley 13/3	Gross	-1.7%	24.1%	31.6%		21.0%		
	Net	-2.3%	17.2%	22.2%		14.5%		
Rosevalley 15/5	Gross	-0.6%	26.6%	31.8%	19.7%		26.6%	
	Net	-2.3%	23.8%	27.2%	12.2%		18.4%	
Rosevalley 10/0	Gross	-2.9%	16.8%	23.3%	22.5%			29.5%
	Net	-4.0%	13.1%	16.1%	8.0%			11.7%
ASX-200		-2.4%	4.2%	9.3%	9.0%	10.4%	10.2%	10.6%

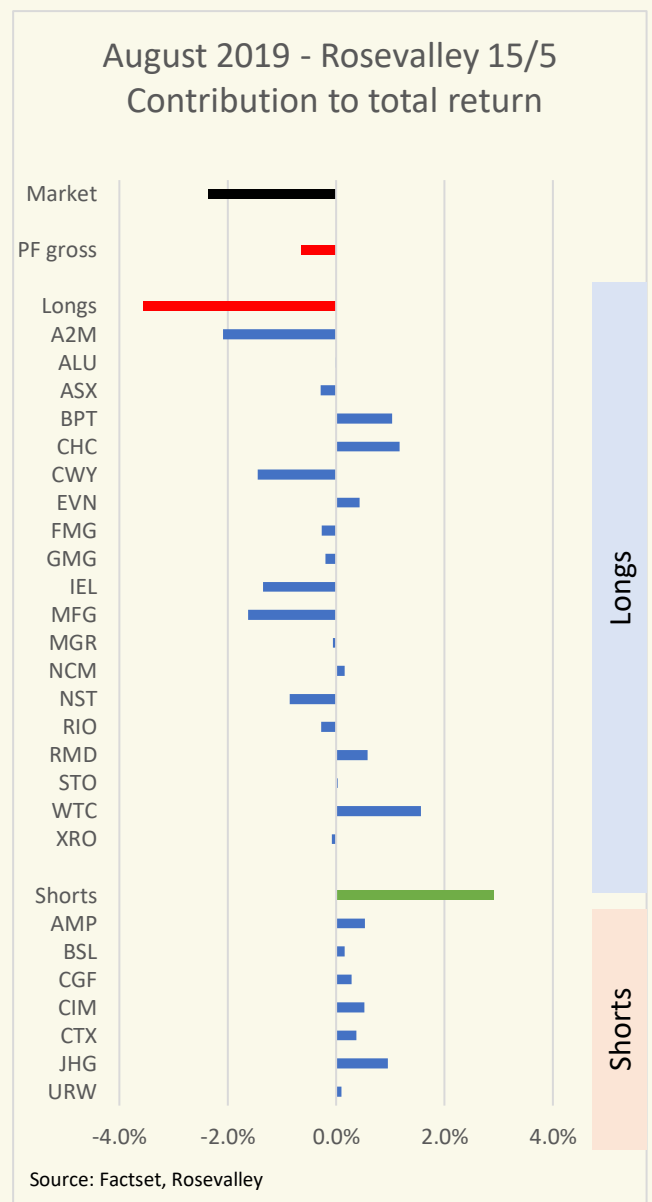
Source: Rosevalley, Factset

force another delay, Johnson announced a suspension of parliament from mid-September to mid-October. All his protestations to the contrary, nobody was fooled into thinking this was anything other than a ploy to reduce the available time for MPs to put such a plan in place. Boris (may I call you Boris, Boris?), however, seems to have misjudged the capacity of the MPs to get their Act together under pressure: at the time of writing, the House of Commons had passed legislation to force him to ask the EU for an extension. Since then he tried and failed to call an election for mid-October. Finally, he then said he'd "rather be dead in a ditch" than ask the EU for a delay. Who said politics is boring?

In Australia, August was **reporting season**. While it is always hard to summarize earnings across 300+ companies in just a few words, here is an attempt:

- On the whole there were slightly more misses than beats for the FY19 financial year just finished; however, guidance for the coming year was clearly more bearish than the market was expecting.
- Share price reactions to both positive and negative surprises were frequently quite extreme compared to the size of the surprise.
- Some examples of the latter include:
  - Boral -20%, Speedcast -32%, Inghams -17%, Appen -11%, A2Milk -21%, Cleanaway -14%, IDP Education -13%, Magellan -16%, CIMIC -16%, Caltex -11%
  - JBHifi +16%, Super Retail Group +8%, Kathmandu +20%, Beach Energy +15%, Wisetech +16%
- There seems to be general agreement that large movements downward happened for stocks that were "priced for perfection". Large upward movements are a bit more puzzling, since they seemed to be somewhat concentrated in cyclical stocks – which doesn't really gel with the overall bearish economic outlook.

Whatever the underlying cause of the individual stock price moves, the market as a whole did -2.4%, which we would describe as a relatively good outcome in the face of global uncertainty, the strong performance in the past



few months, and the (perceived) high valuations the market is already trading at.

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### Portfolio performance

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Some of the large price swings referred to above did impact the Rosevalley portfolios. However, while all portfolios went backward over the month, the long/short strategies outperformed the broader market, with the long-only strategy only slightly underperforming. See the table above for all the numbers.

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### Longer term performance

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All portfolios have outperformed since inception on both gross and net basis. Two portfolios have now passed the 1-year mark – both outperformed the benchmark by over 1000 bps on a gross basis. The larger portfolio also outperformed on a net basis; the smaller portfolio didn't, due to the large cost of trading in relation to the size of the portfolio.

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### Execution

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Execution was a bit weaker this month: the prices at which the rebalancing was done were quite unfavourable relative to the month-end prices that are used to calculate the gross performance. As an example, below is the reconciliation for Rosevalley 15/5 (the other portfolios showed a similar trend). While disappointing, the cause was simply bad luck: a few stocks that underwent rebalancing on 1 August happened to open trading that day with quite a big movement – e.g. Janus Henderson opened more than 12% down after they announced their earnings the previous day after market close. Our backtest shows that these events do occur from time to time but can go in both directions. Over the long term they cancel each other out.

	Model	Realized
Gross performance	-0.65%	-0.65%
deviation from model portfolio		0.01%
difference between trade price and end-of-previous-month price	0.78%	-1.41%
trading costs	-0.21%	-0.14%
borrow costs	-0.21%	-0.15%
rounding		-0.01%
Net performance	-0.29%	-2.34%

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### September portfolio

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The portfolio for September sees one long and one short idea replaced for both the 13/3 and 15/5 portfolios:

	13/3	15/5
Longs taken out	NST	NST
Replaced by	ASX	CSL
Comments	NST 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	JHG
Comments	There were no available shorts in CYB. For both portfolios the next stock in the list was chosen as replacement.	

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### Looking ahead

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At the risk of becoming repetitive, we think stockmarkets will continue to be driven by the trio of Brexit, Interest Rates, Trade War (we propose a new acronym: the BIT Market Volatility – if it catches on, remember you read it here first, folks!). For Australia there is likely a bit more volatility just from reporting season, as analysts and portfolio managers have their meetings with management, and digest earnings and outlooks. As always, we trust that they will continue to behave according to their hard-wired biases, thus allowing the Rosevalley portfolios to continue to outperform.

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### Investors in the traded 15/5 fund

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

**Rosevalley 13/3  
Since inception  
Growth of \$10,000**



**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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