ROSEVALLEY FUNDS

Portfolio Report January 2020

The Rosevalley Behavioural Finance Funds

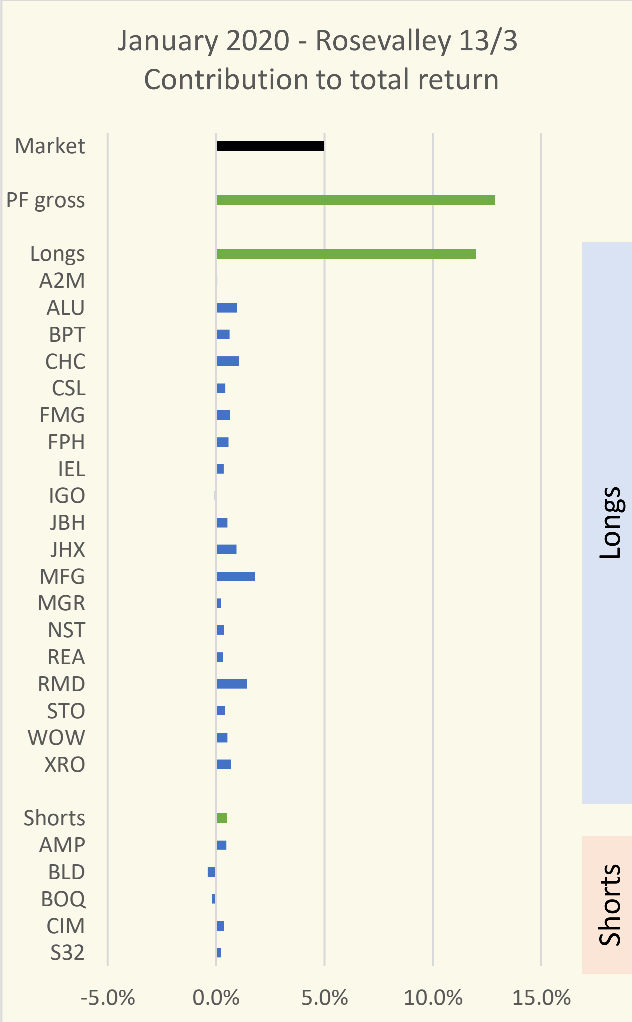
The Rosevalley Behavioural Finance Funds are high-conviction funds that take the theoretical and empirical evidence developed over the past 30 years in Behavioural Finance, and systematically build portfolios from these learnings. The portfolios are constructed on a benchmark-unaware basis, but performance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

Rosevalley is looking for a Sponsor

As most readers are probably aware, the Rosevalley Behavioural Finance Funds are currently run in “Proof of Concept” mode. Of the three portfolios discussed in these monthly newsletters, two (the 15/5 and 10/0) are run with actual money in two different broker accounts, while the third one (the 13/3) is run as a “paper portfolio” with the same broker. The idea is to establish a paper trail that shows the validity of the strategy and can be independently verified.

The monthly newsletters reflect the purpose of the exercise. The comments on gross vs net, execution, trading costs, etc. reflect the goal of establishing credibility both with regard to the strategy itself and the practical implementation of it. The publication of the full portfolio result of the previous month (which no fund manager would normally do) further serves to create the possibility of independent verification.

We are currently looking for a sponsor to enable us to continue to build out our track record. We are keen to meet with potential clients interested to sponsor these strategies and /or invest alongside us.



Source: Factset, Rosevalley. Note returns are not audited

January 2020 should probably become known as “the month that showed Australian investors just don’t care”. In spite of seemingly sky-high valuations (more about that later), massive bush fires, Trump’s impeachment, the outbreak of the Wuhan coronavirus, and lacklustre markets around the world, the Australian market was up 5%. The Rosevalley portfolios had an even better month, with gross returns around 10-13%.

Key Events January

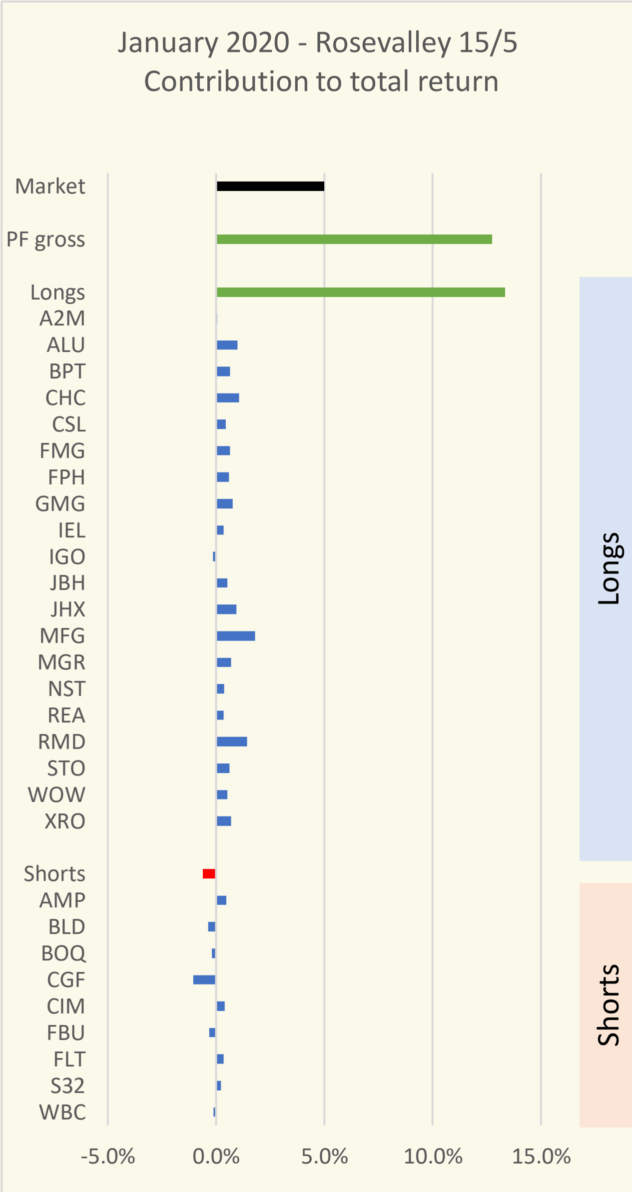
Global markets were lacklustre, with the exception of Australia:

	January 2020
MSCI World	-0.3%
S&P 500	0.0%
DJIA	-1.0%
FTSE100	-3.4%
DAX	-2.0%
Hang Seng	-6.7%
ASX200	5.0%

Source: Factset

Performance as of January 2020								
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	12.5%	18.8%	2.9%	47.6%	26.7%		
	Net	12.5%	18.4%	1.6%	44.2%	23.9%		
Rosevalley 15/5	Gross	12.7%	18.2%	1.4%	42.5%		29.2%	
	Net	12.3%	16.7%	-2.7%	33.5%		18.0%	
Rosevalley 10/0	Gross	9.6%	17.2%	4.8%	42.5%			39.7%
	Net	8.5%	14.6%	0.3%	29.2%			16.6%
ASX-200		5.0%	6.1%	5.1%	24.7%	18.9%	18.6%	19.0%

Source: Rosevalley, Factset. Note returns are not audited



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The most significant event for markets, one might have thought, was the outbreak of the coronavirus epidemic in China. While it did create some volatility, there was an offset in better news from the trade war front, as well as the fact that Chinese markets themselves were closed for the Lunar New Year holiday when the initial news spread. Thus, the Chinese stock market didn't get to react until they reopened in February (with a delay as the Chinese authorities extended the holiday in a bid to slow down the spread of the virus). Markets opened sharply lower when they finally did reopen.

A lot has been written and prognosticated in the past few weeks about the virus and its impact on the global economy. While we have our opinion, we're not sure that we have any particular insight that is more valid than other market participants. For what it's worth, it seems likely to us that the outbreak will continue to get quite a bit worse before it gets better. As countries continue to put measures in place to halt the spread of the virus, it is hard to see that the impact on global economic activity will be as limited as consensus currently seems to believe.

While for the fundamental investor the question of a sharp market correction looms large, for us another question presents itself: if the spread of the virus turns out to be as big an event as some people fear (think a lot worse than SARS, but hopefully not quite the 1918 Spanish flu), will that interrupt people's normal decision making? Remember, the portfolios are built upon the concepts of loss aversion, prospect theory, and mental accounting. Will these broad principles of behaviour still hold in extreme market conditions? The next few months will be very interesting!

A word about broad market valuations, another topic that has received a lot of airtime in recent times. While we believe there is certainly a debate that can be had, we take exception to some comments that we come across. The worst of these is the "market hits all-time high" comment. This is usually presented as proof of some form of exuberance, or some indication that we've reached a risky level. The reality of course is that, in a completely rational market, a new high should be reached <u>every day</u>. If markets discount future cash flows, and the world population is growing, and there is time value of money, the value of all future cash flows will be higher tomorrow than today. Of course the world is messy, and things change, but to see the absolute level as indicating some kind of danger level is plain wrong. It gets even worse when comparisons are made with a long-ago peak level ("the market is now back to the level where it was right before the GFC", or similar comments). Hello! The economy is 30% larger than it was back then! Reaching that peak from 12 years ago now, if it means anything (which it doesn't), says we have another 30% to go before things get dangerous. Ah, the frustrations of reading the popular and the financial press!

Portfolio performance

The Rosevalley portfolios showed significant outperformance, with broad contribution – e.g. the 13/3 portfolio only had 3 detractors out of 24 positions. While the market did 5.0%, the 15/5 and 13/3 did 12.7% and 12.5% respectively, while the 10/0 did 9.6%. The gross-net gap was relatively small this month.

Longer term performance

On a gross basis, all three portfolios are now significantly ahead of the market, both on a 1-year view, and on a since-inception view. On a net basis as well all portfolios are ahead on the 1-year numbers. On a since-inception basis, 13/3 is ahead, 15/5 is even, and 10/0 is below market.

Execution

Execution was in-line with the modelled outcome this month, albeit that there were some offsetting differences between the different components of the gross-net gap.

	Model	Realized
Gross performance	12.74%	12.74%
deviation from model portfolio		-0.08%
difference between trade price and end-of-previous-month price	-0.13%	-0.02%
trading costs	-0.08%	-0.14%
borrow costs	-0.21%	-0.16%
rounding		-0.00%
Net performance	12.31%	12.32%

February portfolio

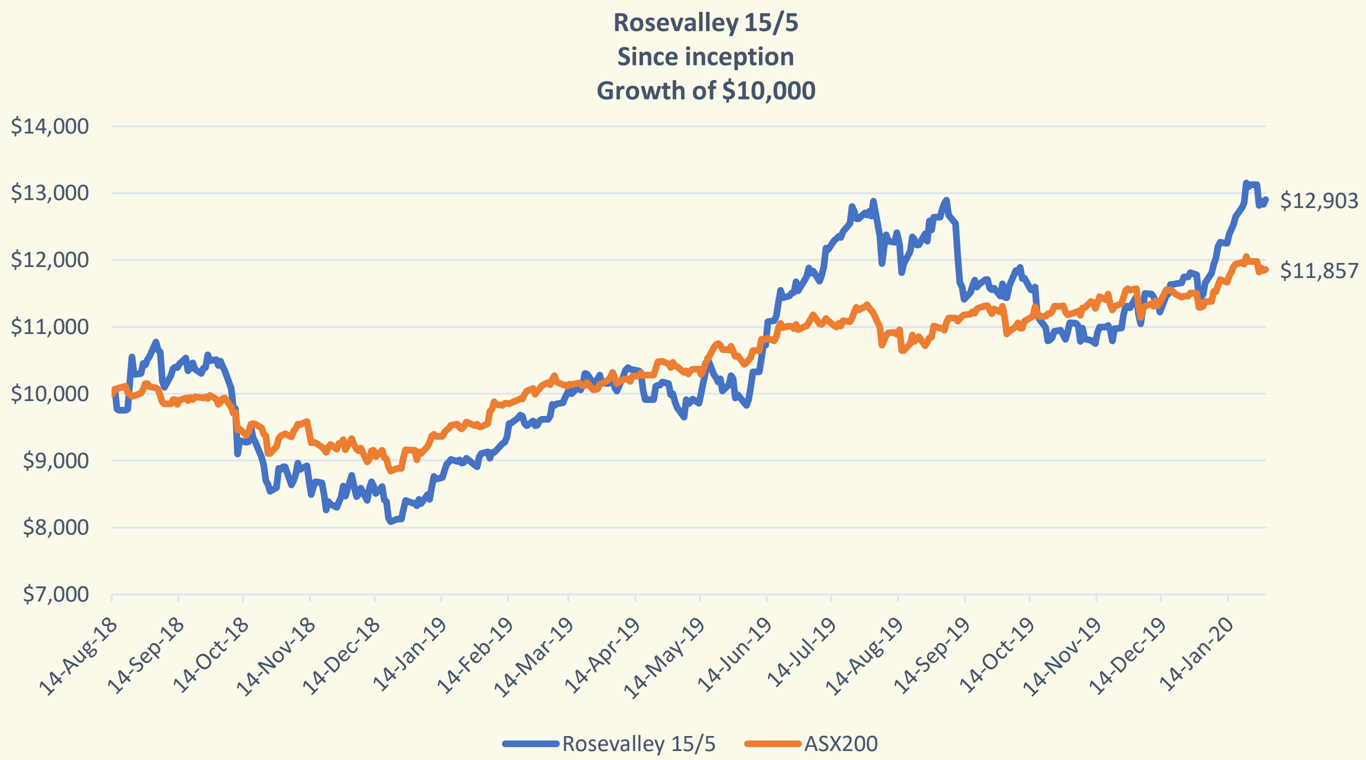
The portfolio for February sees one long and one short idea replaced for both the 13/3 and the 15/5 portfolio:

	13/3	**15/5**
Longs taken out	CSL	CSL
Replaced by	REA	STO
Comments	CSL was taken out to avoid an unacceptable concentration in the Health Care sector. For 13/3, the manager skipped WOW for sector concentration reason, and put in the next stock in the list, REA. For 15/5 the next stock in the list, STO, was put in as a replacement.	
Shorts taken out	S32	S32
Replaced by	FLT	URW
Comments	For both portfolios S32 was eliminated due to the lack of shorts. In both portfolios the next in the list was put in, being FLT and URW.	

Looking ahead

At the time of writing over 30,000 cases of 2019-nCov (the official name) had been confirmed, with close to 600 deaths. We expect the progression of the virus will be the dominant theme driving stock markets and share prices for the next several months.

Companies most impacted are likely to be either tourism-related, or with China exposure (including commodities), closely followed by companies that have supply networks in China (e.g. some car factories in South Korea have shut down due to lack of parts that normally come from China). Australia is likely to be more impacted than, say, the US, due to its proportional higher share of the economy being linked with China. Expect volatility!



Source: Factset, Rosevalley. Note returns are not audited

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.