ROSEVALLEY FUNDS

Portfolio Report CY 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.

The year in review

Calendar 2019 has turned out to be a very good year for stockmarkets around the world. It wasn't clear that this was going to be the case at the beginning of the year: markets had just gone through their worst quarterly performance for many, many years, and the world was staring at a variety of issues: US-China trade war, Brexit, North Korea, to name just a few. But the driving factor turned out to be interest rates: The proximate cause of the downturn in 4QCY18 was the raising of interest rates by the Federal Reserve. Then, in late December 2018, the Fed indicated that it had changed its mind, and was not going to raise rates any further. This was followed up with successive messages of continued restraint, and a developing bias toward lowering rates (which they finally did in late July). Many stockmarkets had their best 6-month period in many years during January-June. The second half of the year was more subdued, but still very positive in the context of long-term averages.

	Jan-Jun	Jul-Dec	CY2019
MSCI World	15.3%	8.3%	24.9%
S&P 500	18.5%	10.9%	31.5%
DJIA	14.0%	7.3%	22.3%
FTSE100	13.1%	3.7%	17.3%
DAX	17.4%	6.9%	25.5%
Hang Seng	10.4%	-1.2%	9.1%
ASX200	19.7%	3.1%	23.4%

Source: Factset

Rosevalley Funds in top-10 in Australia

As usual, Mercer tabulated and ranked fund managers' performance for CY19. We don't have access to the full list, but from various newspaper reports we can surmise the following information:

- *The closest peer group is Australian large cap funds. In this group, the best performer returned 39.2%, and the second best 38.2%. Had the Rosevalley funds been part of the survey, Rosevalley 13/3 would have taken 2nd place.*
- *As traded, Rosevalley 15/5 would have been in the top quartile. If we make an estimated adjustment for the outsized trading costs related to the small size of the portfolio, the portfolio would have been in 9th place.*
- *Similarly, as traded Rosevalley 10/0 came in around the median, but corrected for size would likely have been in the top-10.*

Note: Rosevalley's return are not audited

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 serve 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.

Performance as of December 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	1.1%	1.5%	1.4%	41.5%	12.6%		
	Net	1.0%	1.3%	0.0%	38.6%	10.2%		
Rosevalley 15/5	Gross	1.4%	-0.1%	-0.8%	36.8%		14.6%	
	Net	0.9%	-1.9%	-4.6%	28.6%		5.1%	
Rosevalley 10/0	Gross	1.5%	2.5%	5.1%	37.0%			27.5%
	Net	0.8%	1.1%	1.0%	23.9%			7.5%
ASX-200		-2.2%	0.7%	3.1%	23.4%	13.2%	12.9%	13.4%

Source: Rosevalley, Factset. Note returns are not audited

For the full year Australia was one of the best-performing markets in the world (measured in local currency).

Portfolio performance

The Rosevalley portfolios ended the year with very strong performance. On a gross basis, all portfolios showed significant absolute performance, as well as outperformance relative to the index. On a net basis, while still strong, performance was negatively impacted by the small size of the portfolios, which drove up average trading costs.

- The flagship portfolio (Rosevalley 13/3) returned 41.5% gross and 38.6% net.
- The Rosevalley 15/5 portfolio returned 36.8% gross and 28.6% net. We estimate that, if the size had been similar to the 13/3, the net performance would have been 33.9%.
- The Rosevalley 10/0 portfolio returned 37.0% gross and 23.9% net. This portfolio is the smallest of the three – we estimate net return would have been around 34% if the size had been larger.

For a discussion on a stock-specific level, we refer to the Rosevalley 13/3 portfolio (see chart on page 4).

- Over the course of the year, 46 stocks made it into the portfolio, with an average of 23 positions each month.
- Of these, 31 had a positive contribution, while 15 detracted from portfolio performance.
- However, the positive contributors contributed on average +1.4%, while the detractors contributed -0.4%.
- There were 6 stocks that contributed more than 2.5%, while there were no stocks that detracted more than -2.5%.
- The largest contributors[1] were:

Stock	**Contri-bution**	**Position**	**Time held (mo.)**
Wisetech (WTC)	5.3%	Long	12
Magellan (MFG)	4.9%	Long	10
Charter Hall (CHC)	4.6%	Long	12
Fortescue (FMG)	3.3%	Long/Short	9/1
Goodman (GMG)	3.2%	Long	12
Xero (XRO)	2.5%	Long	5
AMP (AMP)	3.8%	Short	12

Source: Rosevalley

- Wisetech (WTC) is one of the high-flying tech stocks on the ASX, member of the so-called WAAAX[2] group. However, contrary to the other members in this group, WTC is not a young company. It has been around for 25 years. WTC is a global provider of logistics software, claiming to service 19 of the top 20 logistics companies globally. WTC makes money by charging its customers on a 'per use' basis rather than as a subscription model. This means WTC directly benefits as its customers grow their businesses. While it's trading at a very high multiple, earnings have grown at a CAGR of 54% over the past six years.
- Magellan (MFG) is the most successful listed funds manager in Australia and is mostly focused on international equities. The company has delivered strong investment returns for its clients, but it has also outperformed peers in the area of distribution: it has one of the largest sales forces of any funds manager in the country. It is trading at a very high multiple, but it does tend to outperform in rising markets.
- Charter Hall (CHC) is a REIT. Like many REITs in the market, CHC benefited from the decline in interest rates during the year. In times of low interest rates, yield stocks tend to do well.

[1] To clarify: these are contribution numbers, not stock returns, i.e. they are the stock return multiplied by the weight in the portfolio for the duration they were held.

[2] Wisetech, Appen, Altium, Afterpay, Xero

- Fortescue (FMG) is an iron ore miner. It has performed well during 2019, mostly on the back of increases in iron ore prices after the breaking of the tailings dam in Brazil stopped production by Vale for a large part of the year. The portfolios were long for 9 months and short for 1 month.
- Goodman (GMG) is another REIT. Like CHC, it benefited from the decline in interest rates and the resulting search for yield. It also benefits from the expansion in online retail and service providers.
- Xero (XRO) is a provider of accounting software for small- and medium-sized businesses. Its rapid growth has translated in significant share price appreciation over the year.
- AMP (AMP) was once the pre-eminent and dominant asset manager and superannuation provider in the country. However, the company was hit hard when the Royal Commission into the financial industry uncovered many inappropriate (and some fraudulent) practices in the industry in general and in AMP in particular. The company lost its CEO and Chairman in April/May 2018 and has been in crisis mode ever since. The new CEO started in December 2018. We expect it will be a multi-year journey to recover. The portfolio made money through a short position.

Execution

To illustrate the difference between gross and net performance, we show a waterfall chart, using the Rosevalley 13/3 portfolio as an example. The sources of difference between gross and net are:

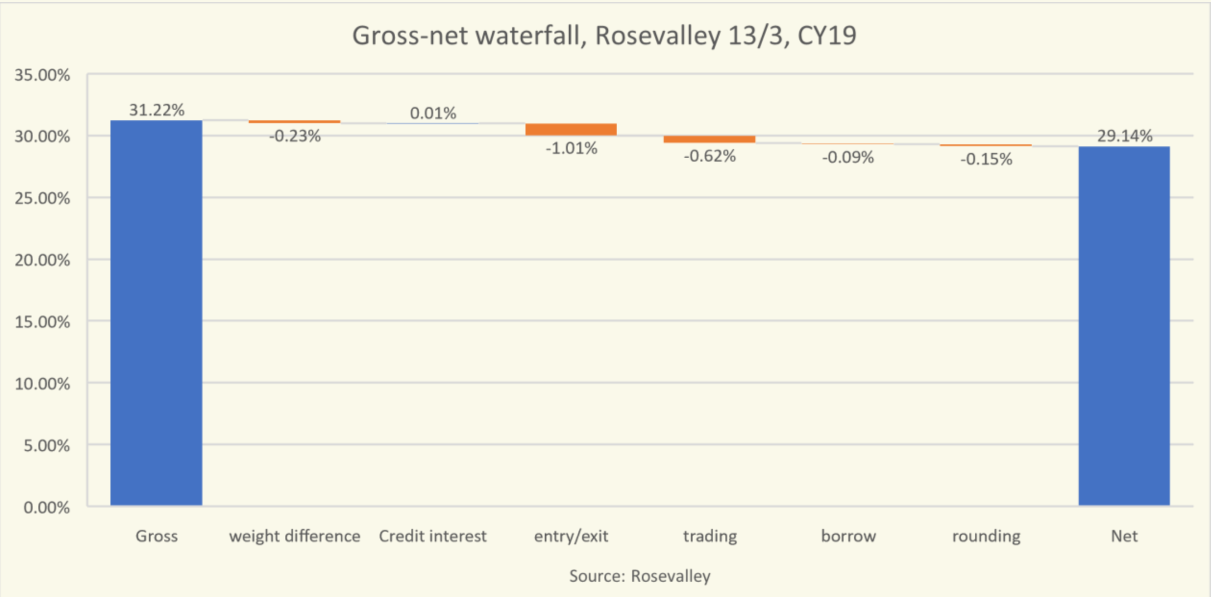
- Weight difference: due to small position size, sometimes the achieved weight differs marginally from the model weight
- Entry/exit price: the difference between achieved trade price and the end-of-the-month that the model uses as the basis for its gross performance calculation
- Trading: brokerage commissions
- Stock borrow cost: the borrow fee and interest costs on the short positions
- Rounding: the residual difference as a result of geometric compounding over time for the above-mentioned differences

Looking ahead

Similar to our outlook at the end the fiscal year six month ago, the main thing we foresee for the next twelve months is continued volatility. While some of the market factors we mentioned six months ago have now played out or been pushed to the background (Brexit, Kashmir, North Korea, Venezuela), the outbreak of the Wuhan coronavirus will certainly dominate markets, at least for the next few months. But we'll repeat what we mentioned six months ago: we believe the biggest determinant of market performance over the medium term is interest rates and economic growth.

We continue to be of the opinion that over the next year real economic performance will take over from interest rates as the fundamental driver of sharemarkets. However, in a way this just moves the question one step further: will central banks' policy of lowering interest rates succeed in staving off a potential recession? Six months ago we wrote that we were not as convinced as many commentators that a recession was inevitable. While on balance we still are in that camp, certainly the odds of a recession have shortened with the coronavirus outbreak: the measures taken to stem the spread have real economic consequences.

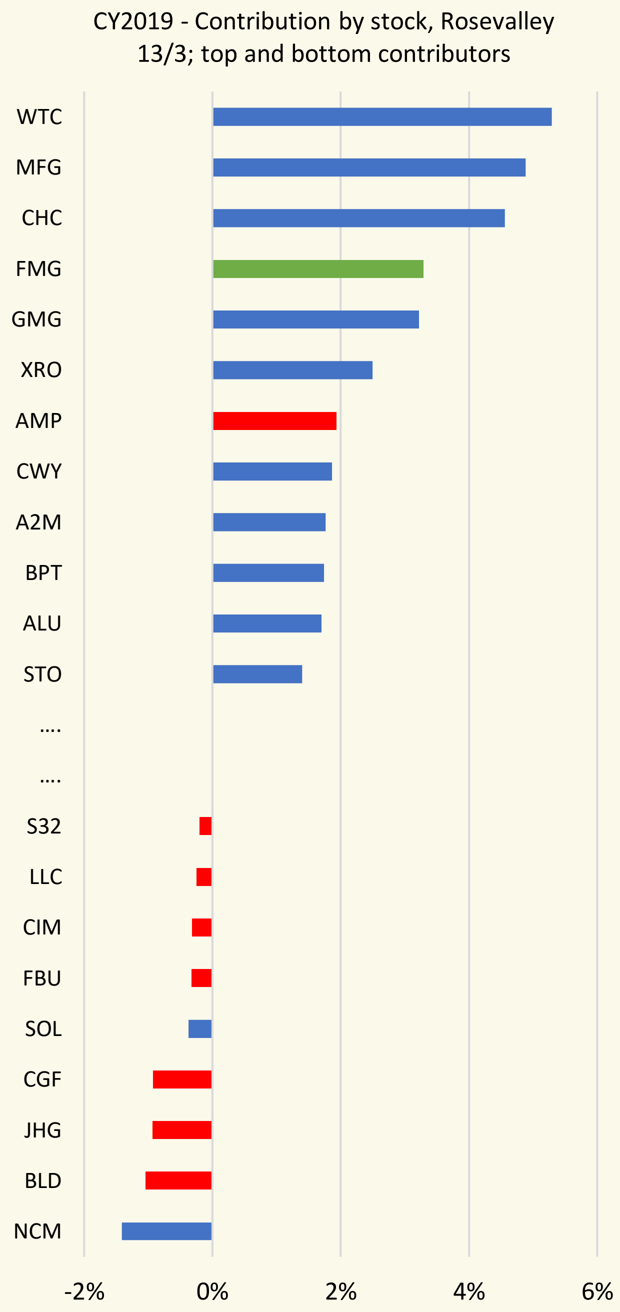
In addition, locally in Australia we have had a couple of extreme weather events that are likely to impact near term GDP: The dramatic fires which destroyed more than 18 million hectares of bushland, caused the loss of 33 lives, destroyed more than 2,500 houses and killed millions if not billions of animals; The extreme February



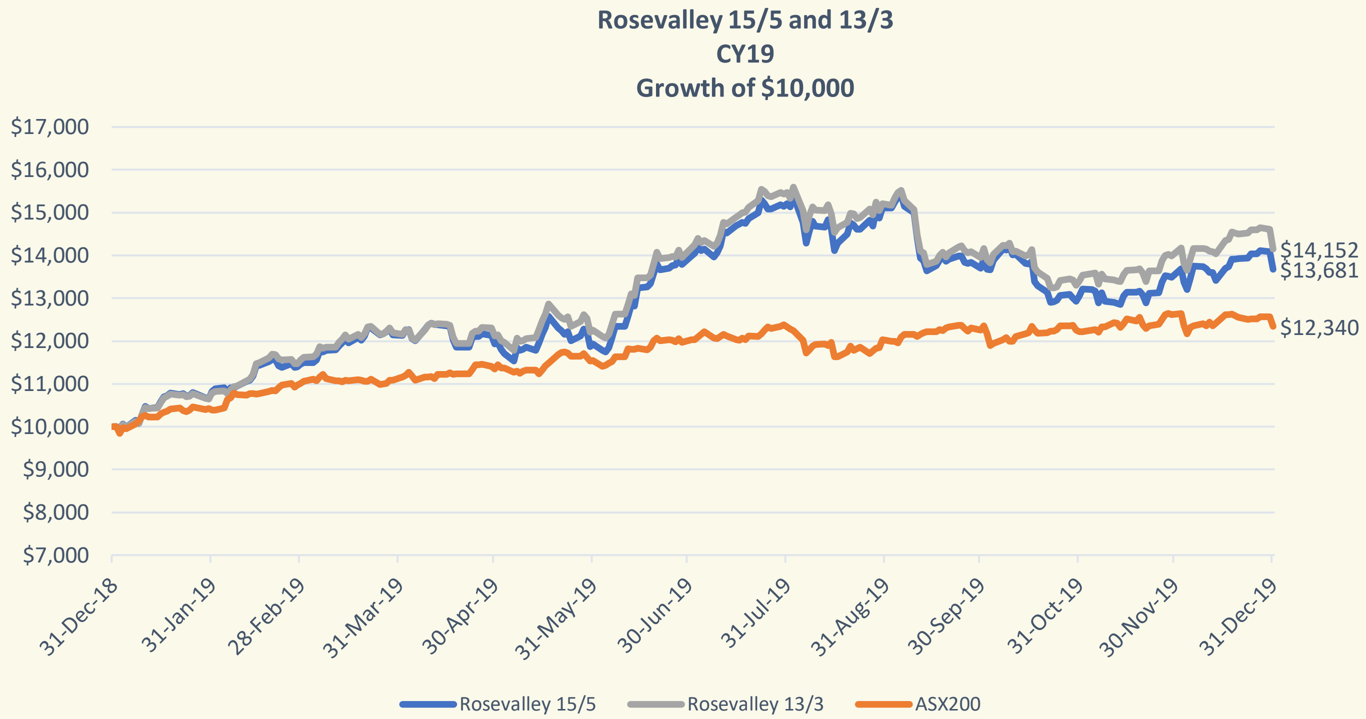
rainfalls in Sydney (which according to the Bureau of Meteorology have been the city's heaviest since 1990) and across NSW which, although they have put out many of the recent fires, have destroyed homes, caused flash flooding and severe erosion.

Of course, there are many who would disagree with us, some of whom are more expert and/or experienced than we are. However, many years of investment experience have taught us that economic forecasting is a very inexact science, and that even the best experts get it wrong frequently. More importantly, there is a great deal of the echo chamber effect going around. All of which means that consensus gets things wrong all the time!

Among all the uncertainty in the world, we believe one thing remains unchanged: people's behaviour. Since the Rosevalley portfolios are built to take advantage of how people behave, we are confident that the portfolios will continue to perform well in the coming years.



Note: shorts in red; green = both long and short over the year
Source: Rosevalley



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 hearttake advantage of the way human beings behave in the real world.

info@rosevalleyfunds.com
+61-457-807-914
www.rosevalleyfunds.com