

# Portfolio Report April 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.

*First-time readers of this report, please refer to the blue box at the end for added context and history*

### Key Events April

We hope all readers are well and healthy! As we were living through a second month of social distancing or lockdown, stock markets around the world went on a tear, with most markets gaining around 10% or so. A large part of the losses sustained between mid-February and the end of March have been reversed. What is going on?

	April 2020
MSCI World	10.4%
S&P 500	12.8%
DJIA	11.1%
FTSE100	3.9%
DAX	9.3%
Hang Seng	4.4%
ASX200	8.8%

Source: Factset

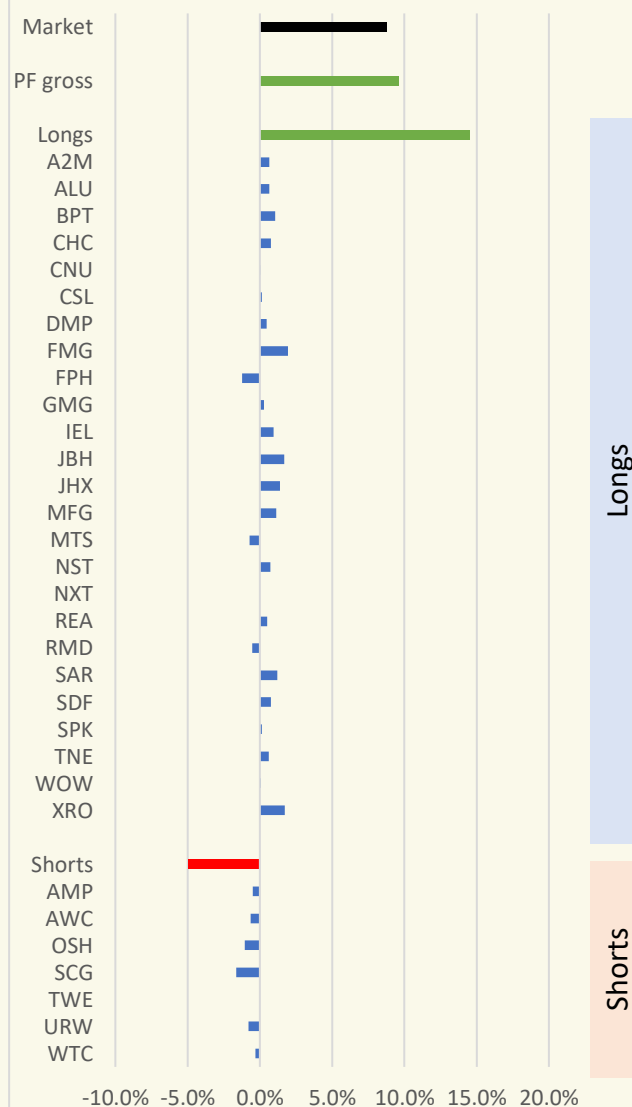
As always, we have been amused by the daily commentary in the press. “The market is up on vaccine hope”. “The market is down on testing shortage”. Didn’t we learn in business school that markets are supposed to look ahead, and discount future cash flows into perpetuity? Are those cash flows changing that much on a day-to-day basis?

The reality of course is that stock markets only look ahead to the future in a general sense and over longer time periods, and they only do this well when the future is fairly predictable. In the short term, and particularly in times of uncertainty, emotions take over, which explains the high volatility we are currently observing.

Having said all that, the broad explanation of the strong markets performance has to be that market participants are factoring in a “V-shaped recovery”<sup>1</sup>, meaning a sharp

<sup>1</sup> This might well become the Oxford Word of the Year 2020, at least among economists. There is a whole alphabet soup of possible recoveries – V, U, L, W. (*The Oxford Word of the Year is a word or*

### April 2020 - Rosevalley 13/3 Contribution to total return



Source: Factset, Rosevalley

recession, but followed by a quick and sharp bounce-back. Here are the broad arguments for and against this belief.

*expression shown through usage evidence to reflect the ethos, mood, or preoccupations of the passing year, and have lasting potential as a term of cultural significance.)*

Performance as of April 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	9.6%	-14.1%	2.0%	12.9%	8.9%		
	Net	9.3%	-15.5%	-0.0%	9.7%	4.7%		
Rosevalley 15/5	Gross	7.7%	-15.4%	-0.1%	9.3%		9.2%	
	Net <sup>1</sup>							
Rosevalley 10/0	Gross	10.1%	-15.2%	-0.7%	7.5%			18.5%
	Net	7.7%	-17.5%	-5.5%	-2.6%			-3.8%
ASX-200		8.8%	-20.3%	-15.5%	-9.1%	-5.3%	-5.5%	-5.1%

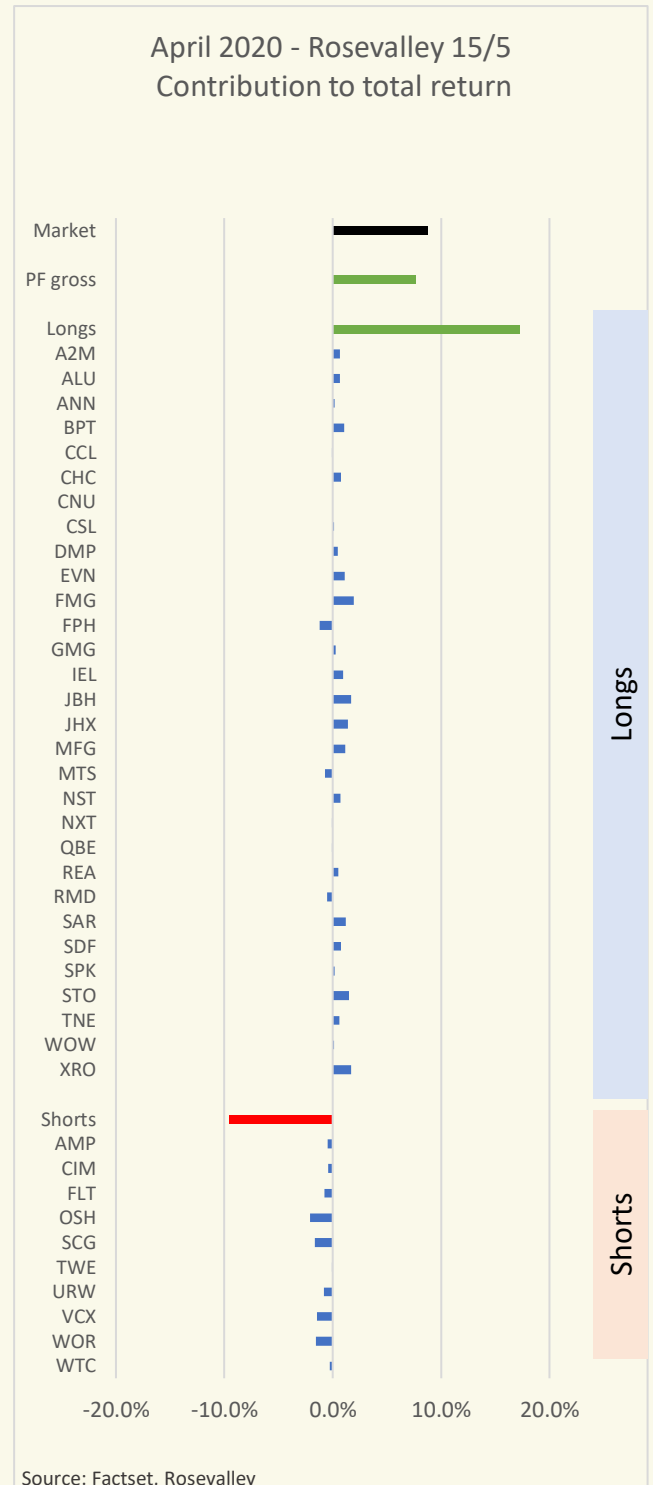
Source: Rosevalley, Factset. Note returns are not audited. <sup>1</sup>Rosevalley 15/5 was not actively traded during the month, so no net numbers are available.

- On the one hand you could argue that as soon as the lockdown is over, things will go back to the way they were, provided companies have not ceased to exist in the interim. Since government actions around the world are designed to make sure that is not happening, this is not an implausible argument to make.
- On the other hand: Are you kidding me? 25 million Americans out of work, over a million Australians. Come September, are we all going to pretend nothing happened? This is too ludicrous to contemplate! It will take a long time for confidence to return to the economy, which means demand will be suppressed for a long time.

Which of these points of view is right? We are not economists, and have taken both sides of this debate in different discussions over the past 4-6 weeks. We think of ourselves as optimists, and like to believe in the V-shaped recovery. However, as students of Behavioural Economics we know and understand that our brain is good at deceiving us. We spend a lot of time reading the news from around the world. We know that our brain effectively filters out news that disagrees with our pre-conceived point of view, and picks up on stories that confirm it. This is called Confirmation Bias (and interestingly, everybody will fall prey to this, even if they are aware of its presence). So how sure can we really be of our convictions?

Fundamental investors will position their portfolios according to one of the two views above. Ex-post the path that developed will look very obvious (hindsight is 20/20). As a result, those that will turn out to have chosen the right option will look like geniuses, while those that have not will look less smart. In reality, however, we would argue that ex-ante it's not obvious at all, and neither group of investors will be smart or dumb, just lucky or unlucky...

An update on last month's prediction: We said (with the appropriate caveat and low level of conviction) that the market would bottom in April. How are we doing? To date it looks like the market bottomed in March, even earlier



than our bold (optimistic) prediction! We'll get back to this prediction again in coming months.

In the meantime, as always, we are not changing our approach. We still believe that even in the uncertainty of the pandemic, and the associated economic and stock market volatility, people's behavioural biases stay the same, and the Rosevalley portfolios will continue to take advantage of those.

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### *Portfolio performance*

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The Rosevalley portfolios had a mixed performance this month. On a gross basis, Rosevalley 13/3 and 10/0 outperformed (80 and 130 bps respectively), while Rosevalley 15/5 underperformed by 110 bps. Broadly speaking, longs contributed while shorts detracted, showing how broad-based this month's market was.

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### *Longer term performance*

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Both on a gross and a net basis, all three portfolios continue to be significantly ahead of the benchmark on a 3-month, 6-month, 1-year and since-inception basis.

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### *Execution*

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Execution was neutral this month, with the realized gross-net gap a bit larger than modelled, but the biggest discrepancy was in the way the reporting entity treats dividend (we accrue, our provider's monthly report is on a cash basis).

	Model	Realized
Gross performance	9.59%	9.59%
deviation from model portfolio		0.00%
difference between trade price and end-of-previous-month price	0.84%	0.34%
trading costs	-0.25%	-0.17%
borrow costs	-0.12%	-0.00%
prior month dividends		-0.45%
Net performance	10.06%	9.32%

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### *May Portfolio Manager model overrides*

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The portfolios for May have one substitution. The model's list contains four stocks in the materials sector, three of

which are gold miners. We have decided to replace the lowest ranked gold miner with the next stock on the list.

	13/3	15/5
Longs taken out	NST	NST
Replaced by	MFG	ASX
Comments	Sector concentration – for both portfolios the next stock in the list was chosen as substitute.	

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### *Looking ahead*

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The message for the month ahead and beyond is the same as the past two reports: more volatility. From the point of view of an observer of the economy and the stock market the next couple of months are probably the more interesting than the past two months: when the pandemic started, and lockdowns were imposed around the world, it was easy to predict that people would be losing jobs and the economy would be taking a hit. As countries are opening up, however, it's much harder to predict how economies respond. This is especially so given the amount of government and central bank action that we have witnessed since the pandemic began.

"Hope springs eternal" they say. Here's to hoping the PM is right and by July 850,000 lost jobs will have been regained. It's going to be a wild ride!

### **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 that 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, and the full portfolio holdings for the following 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.

*Some context for readers who are less familiar with Rosevalley Funds:*

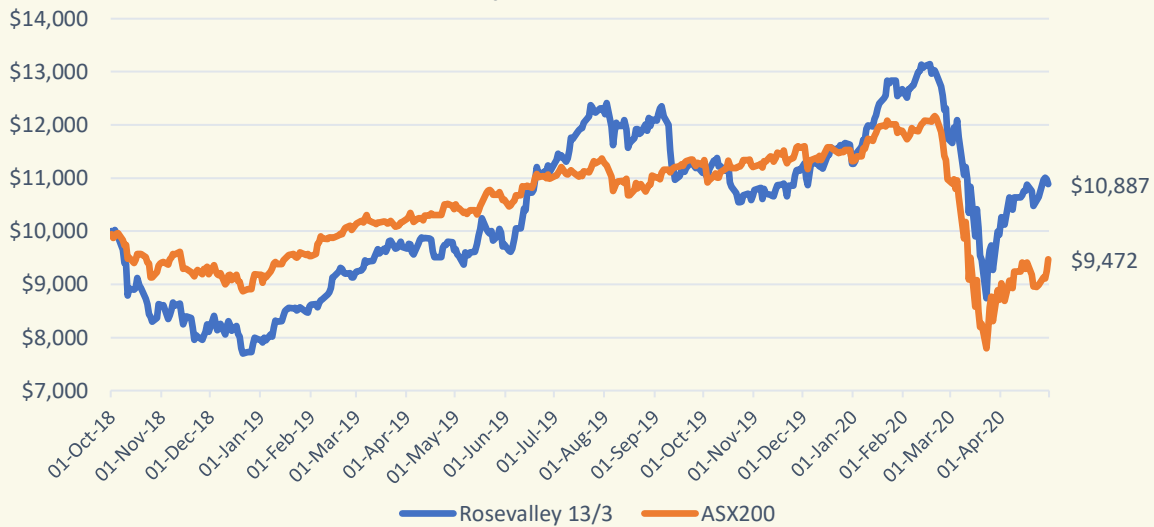
*Rosevalley is a boutique funds manager with a unique approach to portfolio construction. Rosevalley Funds are constructed using the principles of Behavioural Finance (BF). Behavioural Economics and Behavioural Finance were developed over the past 30 years or so through the work of economists like Tversky, Kahnemann, Thaler, Shefrin. The idea behind BF (and the Rosevalley portfolios) is to study human behaviour as it is, not as classical economic theory says it should be (i.e. BF does not believe humans are always rationally maximizing their utility).*

*Rosevalley's portfolio construction algorithms are based on these insights. The model yields a ranking of stocks in order of greatest to smallest upside. Portfolio construction then follows by going long the stocks at the top and short the stocks at the bottom. The flagship product is Rosevalley 13/3, which is a 130/30 fund. We also run a 150/50 (Rosevalley 15/5), and a long-only fund (Rosevalley 10/0). Inception for the three portfolios was during August-October 2018.*

*The portfolios are rebalanced monthly. The Rosevalley team has discretion to make some substitutions, albeit that the bar for those is set high.*

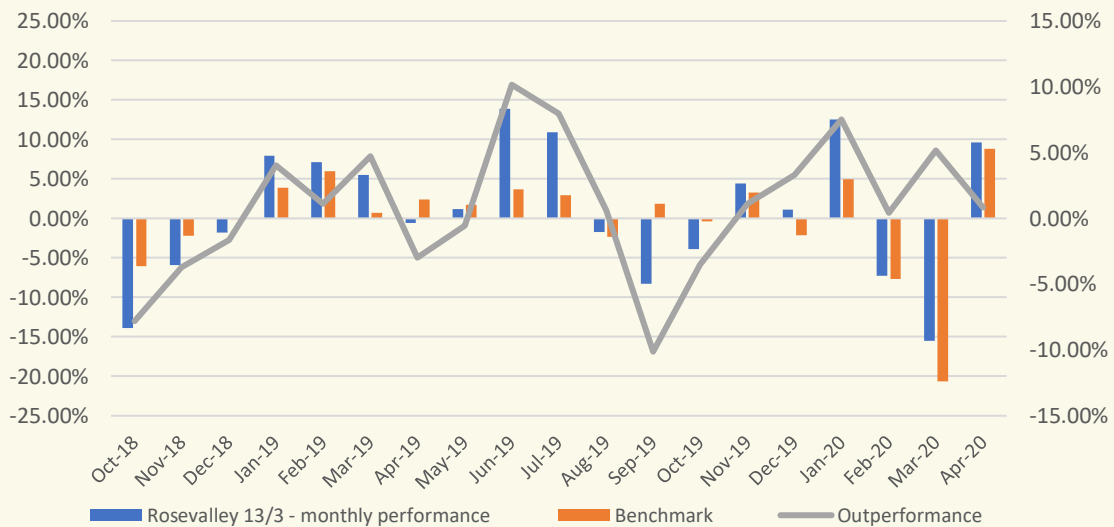
*The monthly report discusses current events, portfolio performance, trade execution, gross-net differences, next month's portfolio, and broader market and macro expectations.*

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



Source: Factset, Rosevalley

### Rosevalley 13/3 - monthly performance



Source: Factset, Rosevalley

### 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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