

Portfolio Report June 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 June

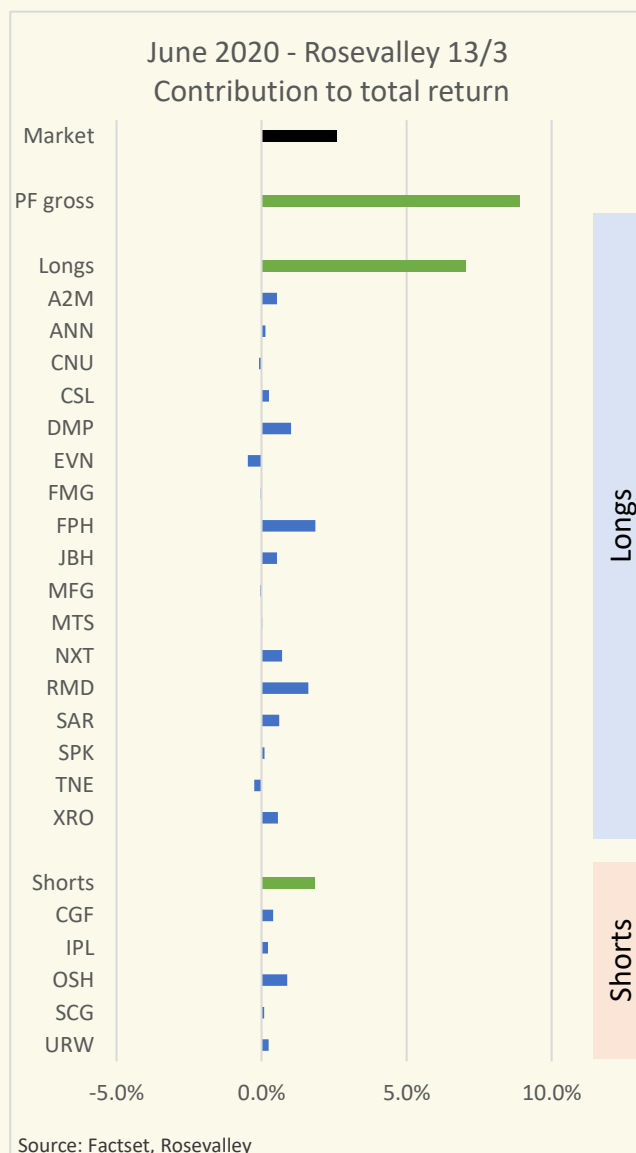
The Australian market ended the financial year with a small gain (like many other markets around the world). However, for the full financial year, the market as measured by the S&P/ASX 200 (XJO) showed a 7.7% loss – the first loss since the euro crisis 7 years ago. It is not surprising that the market lost money in the year of the coronavirus pandemic. What is (or should be) surprising is the strong recovery of the market during the June quarter after the steep fall in the March quarter. Here are the numbers for June, and for the first half and 3rd and 4th quarter of fiscal 2020 for markets around the world, with the results for Rosevalley 13/3 added for comparison:

	June 2020	1HFY20	3QFY20	4QFY20	FY20
MSCI World	2.2%	8.3%	-20.5%	17.9%	1.5%
S&P 500	2.0%	10.9%	-19.6%	20.5%	7.5%
DJIA	1.7%	7.3%	-23.2%	17.8%	-3.0%
FTSE100	1.7%	3.7%	-23.8%	9.1%	-13.8%
DAX	6.2%	6.9%	-25.0%	23.9%	-0.7%
Hang Seng	6.4%	-1.2%	-16.3%	3.5%	-14.4%
XJO	2.6%	3.1%	-23.1%	16.5%	-7.7%
Rosevalley 13/3	8.9%	1.1%	-11.8%	29.9%	16.1%

Source: Factset, Rosevalley. FY20 refers to the year ended 30 June 2020.
 Note: The Rosevalley figures are unaudited total return performance numbers.

So what's going on? A lot of newspaper inches have been filled with trying to come up with explanations for the apparent paradox of economies in recession but stock markets going up. We wrote about these same issues last month, but here are some things that we picked up from the popular and financial press in recent weeks:

- It's all because of the Robinhood generation! This refers to a trading app called Robinhood which offers commission-free stock trading. The app is designed to make buying and selling shares, ETFs



and options frictionless and fun (balloons and confetti when you make a profit on a sale!). The thinking is that lockdowns around the world have restricted access to gambling and betting, and that people have turned to online share trading as an alternative. It is true that Robinhood, as well as competitors like E*Trade, Schwab and others, have seen record new account openings in the past few months.

- The stock market is not the economy. Listed companies by definition are large (compared to the average small/medium-sized company). They

Performance as of June 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	8.9%	29.9%	14.5%	16.1%	29.0%		
	Net	8.5%	27.4%	10.7%	10.7%	21.9%		
Rosevalley 15/5	Gross	9.0%	29.2%	14.4%	13.5%		31.1%	
	Net ¹							
Rosevalley 10/0	Gross	4.5%	21.2%	2.3%	7.4%			30.4%
	Net ²	3.2%	14.3%	-5.0%	-4.0%			2.1%
ASX-200		2.6%	16.5%	-10.4%	-7.7%	1.4%	1.2%	1.6%

Source: Rosevalley, Factset. Note returns are not audited. ¹Rosevalley 15/5 was not actively traded during the month, so no net numbers are available. ²Rosevalley 10/0 is traded on a demonstration basis – as a result of its small size commissions are a large proportion of assets, which explains the large gap between gross and net returns.

are more likely to have access to capital than smaller companies. In the current economic downturn most of the pain is being borne by smaller unlisted companies, so listed companies do not and are not expected to show a similar pattern to the broader economy.

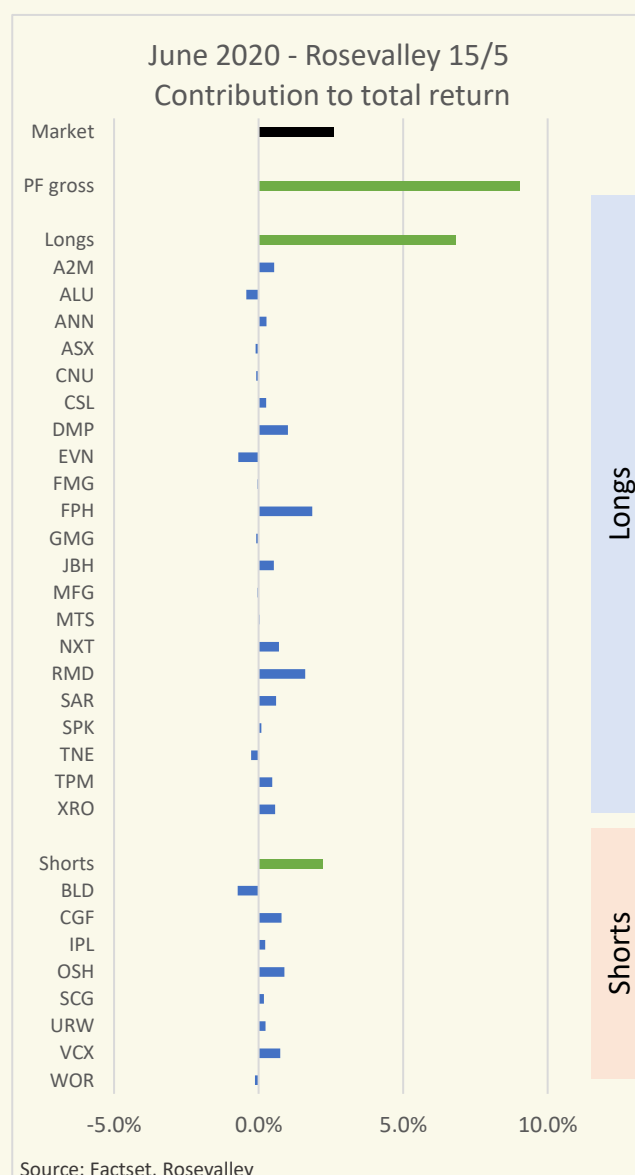
- The stock market recovery is a bit misleading, in that it is driven by a few stocks in a few sectors – most notably tech companies that stand to benefit from an accelerated move to an online world during the pandemic uncertainty. In the United States the companies benefiting from the surge in online business such as Apple, Amazon, Google, Netflix, have had strong performance, and their share in the index is substantial, so their share price gains drag the broader index up. If you were to take some of these stellar performers out, the rest of the market would indicate a much more mundane recovery. As an example, in the table below are the market-cap weighted returns of the 220 largest stocks on the ASX, and separated in two groups according to their returns in the March-June 2020 timeframe:

	1 Jan to 23 Mar	23 Mar to 30 Jun
All 220	-28%	40%
Top 10 for Mar-Jun	-69%	481%
Bottom 210 for Mar-Jun	-27%	34%

Source: Factset

Our view is that all of these play a role, along with investors' expectations of continued fiscal and monetary support for as long as economies need it (most likely out past 2021). Add in a bit of FOMO (fear of missing out), and a lack of returns available from most other asset classes, and you have the makings of a strong stock market.

Of course, many professional investors, if they participate at all in this rally, do so with some feeling of trepidation. Is this a bubble? If so, when will it pop? Will I be able to get out in time?



Portfolio performance

The Rosevalley portfolios had another stellar month: on a gross basis they returned 4.5-9%, delivering

outperformance of ~200-650 bps. Pleasingly, both longs and shorts contributed. Positive contributors included:

- The long positions in healthcare companies Fisher & Paykal (FPH), and ResMed (RMD) (up 18.5% and 16.1% respectively) – aided by anticipated strong demand for their products due to the pandemic.
- The short position in oil company Oil Search (OSH), which fell 8.9%, giving back some of the strong gains of the previous month.

The only negative contributor of note was:

- The long position in gold miner Evolution Mining (EVN), which fell 7%, giving back part of the strong gains of the previous month.

Longer term performance

This month marks the end of the financial year for 2020. We are happy to note that Rosevalley's performance was extremely strong for the second year running. This was particularly pleasing given the unprecedented volatility in the markets over the past year.

In a year where the broader market returned -7.7%, Rosevalley's portfolios returned 7.5%-16.1% (gross), outperforming by ~1500-2400 bps.

Execution

The rebalancing trades at the start of the month were done at unfavourable prices, leading to a wider gross-net gap than modelled. This was slightly offset by lower trading and borrowing costs than modelled.

	Model	Realized
Gross performance	8.90%	8.90%
deviation from model portfolio		0.00%
difference between trade price and end-of-previous-month price	0.08%	-0.28%
trading costs	-0.21%	-0.08%
borrow costs	-0.12%	-0.01%
prior month dividends		0.00%
Net performance	8.65%	8.54%

July Portfolio Manager model overrides

The portfolios for July have two substitutions on the long side, a consumer stock and a gold miner, both for sector concentration reasons.

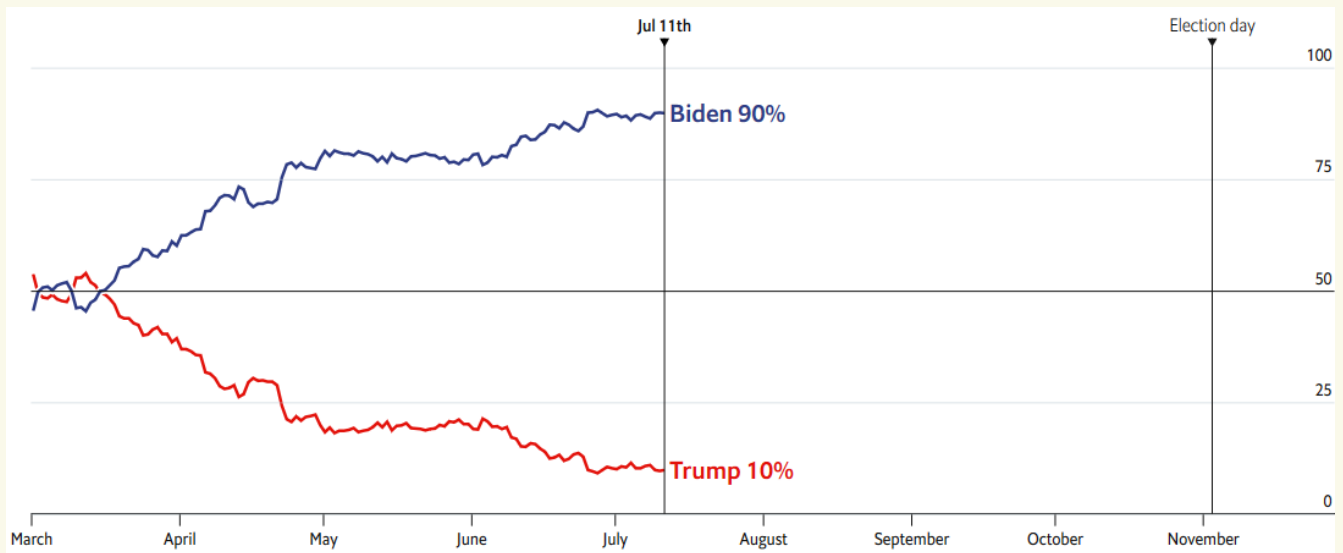
	13/3	15/5
Longs taken out	BRG, EVN	BRG, EVN
Replaced by	MFG, CNU	CNU, TPM
Comments	Sector concentration – in both portfolios the next stock in the list that did not repeat the sector concentration was picked.	

Looking ahead

Coronavirus will continue to dominate the headlines. Two things are different from when we wrote our report a month ago:

- In spite of Donald Trump's tweets and speeches asserting the US government is doing a fantastic job battling the epidemic, the reality is that the US has lost control of the spread of the disease. It is anybody's guess if/when they will get on top of this. A rebound in the US economy is vital to pull Australia and the global economy out of this downturn.
- In Australia, a month ago it looked like the outbreak had been vanquished, with just a handful of cases remaining. However, in the past week a second wave has developed in Victoria, necessitating a second lockdown, and a closing of its borders. While the country will likely get the second wave under control, the cost to the economy is now higher than expected a month ago. Later this month (July), the Federal Treasurer will provide an update on the economic and fiscal outlook for the Australian economy, which is likely to be a little sombre.

In addition, the US election is steadily coming closer. At the time of writing, Joe Biden is leading in the polls. On the next page are the probabilities of victory of the two candidates according to the forecasting model of The Economist. However, a lot can happen over the next four months...



Source: The Economist

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 a track record 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 comments on the 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:

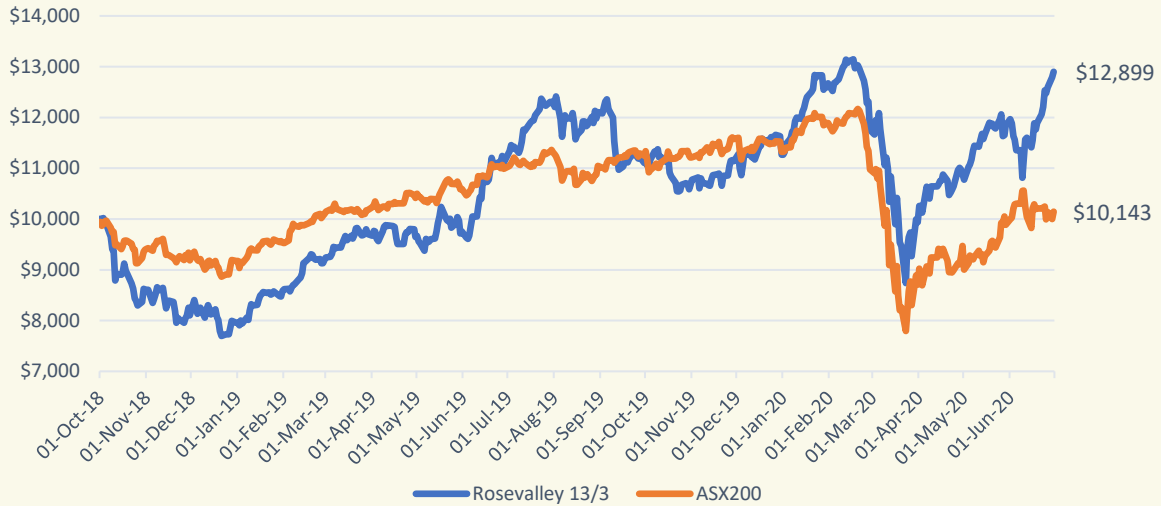
Rosevalley is a boutique funds manager with a unique approach to portfolio construction. Rosevalley Funds are constructed using the principles of Behavioural Finance (BF). Behavioural Economics and Behavioural Finance were developed over the past 30 years or so through the work of economists like Tversky, 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.

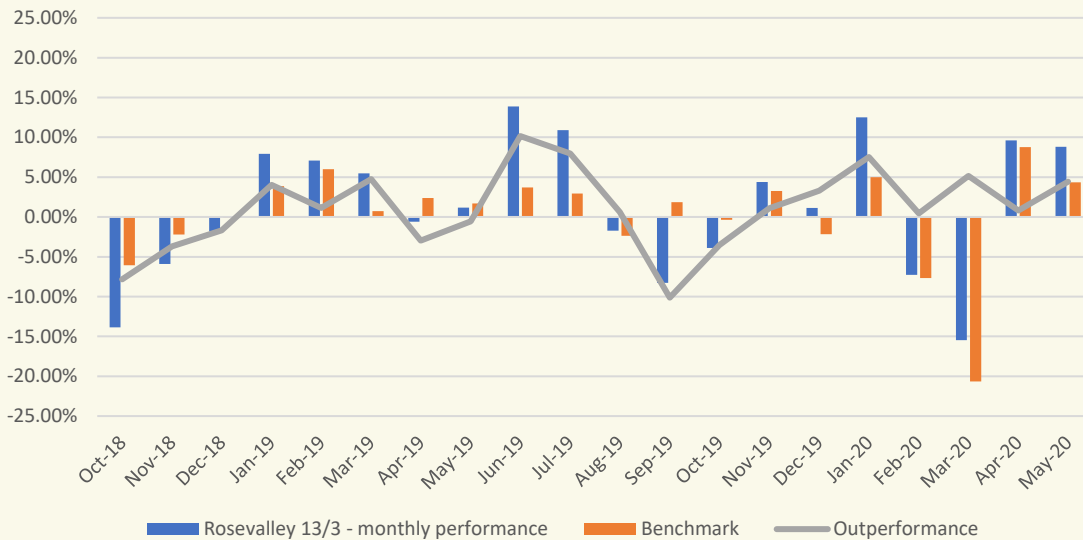
The monthly report discusses current events, portfolio performance, trade execution, gross-net differences, next month’s portfolio, and broader market and macro expectations.

**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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