ROSEVALLEY FUNDS

Portfolio Report FY 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.

The year in review

Fiscal 2020 will be a year to remember for stockmarket investors. It saw both the fastest dive from record high to bear market, as well as the fastest turnaround from bear back to bull market since index performance has been recorded– all this happened in the space of five months. And it all had to do with the coronavirus pandemic that is sweeping across the world and still shows no sign of being close to over.

Over the full year ending June 2020, the MSCI World index eked out a small gain, while the S&P 500 showed a solid return of 7.5%. Most other global markets had single to mid-double digit declines, as can be seen in the table below:

	1 Jul 2019- 20 Feb 2020	20 Feb 2020- 23 Mar 2020	23 Mar 2020- 30 Jun 2020	FY2020
MSCI World	13.8%	-32.8%	35.9%	1.5%
S&P 500	16.1%	-33.5%	39.3%	7.5%
DJIA	9.8%	-36.4%	38.8%	-3.0%
FTSE100	2.7%	-32.4%	24.1%	-13.8%
DAX	10.2%	-36.0%	408%	-0.7%
Hang Seng	-1.8%	-21.1%	13.9%	-14.4%
ASX200	10.7%	-35.9%	30.1%	-7.7%

Source: Factset

Note: Percentage figures are accumulation returns.

Rosevalley 13/3 the only fund ranking in the top-10 in Australia for three consecutive surveys

As usual, Mercer tabulated and ranked fund managers' performance for FY20. 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 (long-only and long/short managers). In this group, the best performer returned 29.3%, and the second best 19.0%. Had the Rosevalley funds been part of the survey, Rosevalley 13/3 would have taken 3rd place pre-trading costs, and 7th place post-trading costs (remember that trading costs are elevated due to the small size of the fund). Similarly, Rosevalley 15/5 and 10/0 both would have made it into the top-10.*
- *Using the same methodology for the survey as of June 2019, December 2019, and June 2020,* ***Rosevalley 13/3 is the only fund that features in the top-10 in all three surveys,*** *underscoring the consistency in returns.*

Note: Rosevalley's return are not audited

Portfolio performance

The Rosevalley portfolios ended the year with very strong performance on an absolute basis and when compared to a peer set of investment managers. 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 16.1% gross and 10.7% net, as compared to the ASX 200 return of -7.7%.
- The Rosevalley 15/5 portfolio returned 13.5% gross (we don't have a net number).
- Rosevalley 10/0 returned 7.4% gross, and -4.0% net – the difference due to the high relative trading cost.

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, 50 stocks made it into the portfolio, with an average of 24 positions each month.

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. [1]Rosevalley 15/5 has not been actively traded since January, so no net numbers are available. [2]Rosevalley 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.

- Of these, 27 had a positive contribution, while 23 had a negative contribution.
- However, the positive contributors contributed on average 1.50%, while the negative contributors contributed -0.91%.
- Longs contributed 2/3 of the performance, while shorts contributed 1/3.
- There were 6 stocks that contributed more than 2.5%, while there was 1 stock that detracted more than -2.5%.
- The largest contributors[1] were:

Stock	Contri-bution	Position	Time held (mo.)
Fortescue (FMG)	5.6%	Long	11
Fisher & Paykel Healthcare (FPH)	5.6%	Long	7
Resmed (RMD)	4.2%	Long	11
Xero (XRO)	4.0%	Long	10
AMP (AMP)	3.2%	Short	11
Saracen Mineral Holdings (SAR)	2.8%	Long	4

Source: Rosevalley

  - Fortescue (FMG) is an iron ore miner. Over the year, iron ore prices strengthened considerably, leading to the strong performance of the stock.
  - Fisher & Paykel Healthcare (FPH) is a provider for medical equipment. The global pandemic sparked interest in the stock, making it one of the better performers over the past few months.
  - Resmed (RMD) is a provider of masks for sleep apnoea breathing machines. The interplay with ventilators for COVID-19 patients has pushed the stock higher as the company has expanded its margins with the production of this new line.
  - 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.
  - Saracen Mineral Holdings (SAR) is a gold miner. Generally, in times of great uncertainty, gold stocks tend to outperform. In addition ,there are people who turn to gold when they worry about inflation – currently some investors worry about inflation caused by the unprecedented expansion of the money supply by Central Banks (even though there is no evidence of increasing inflation yet).

- The largest detractors[1] were:
  - Beach Energy (BPT) has been weak due to a collapse in the oil price notwithstanding its FY2020 production ending the year within the company's guidance at 8.8 MMbbl.
  - Challenger (CGF) was strong during the first half of the year, when the portfolio was short. However, the short had been closed prior to March, during which the company issued a profit warning and announced the suspension of its dividend.
  - James Hardie (JHX) supplies building materials. Perceived weakness in home building in Australia and the US has impacted the stock. In the run up to 30 June, the company recovered some of its earlier weakness as the National Association of Realtors

[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.

reported a strong surge in the index of existing home sales to beat market expectations.
  - Santos (STO): An energy stock suffering from a weaker energy price.
  - Charter Hall (CHC) is a REIT with exposure to the office and retail sectors. The negative contribution was heavily concentrated in the month of March, when the pandemic-induced lockdowns raised questions about the future value of office and retail real estate.

Execution

To illustrate the difference between gross and net performance, we show a waterfall chart at the bottom of page 3, 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

What a difference six months can make! Six months ago we acknowledged that some investors worried about a pending recession, but we were not convinced this would actually happen. Today we are in the midst of what will likely turn out to be the worst global recession since the Great Depression!

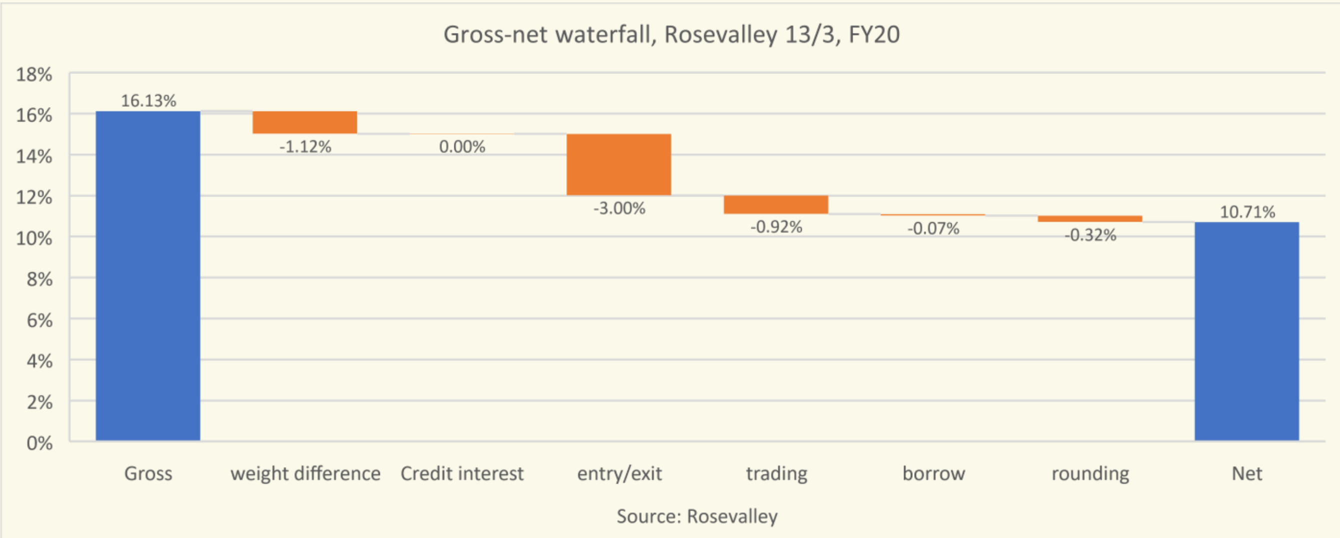
Coronavirus will drive stockmarkets for the foreseeable future, but not the way one might expect. Clearly, the impact of the virus and associated lockdowns is having devastating impacts on economies around the world. But stockmarkets have done well after their initial fall in February-March. Why? Was the fall overdone? Economic data in April, May and June came in better than most people feared – does that justify the stockmarket performance? But isn't that economic performance artificially propped up by government and Central Bank policies, meaning there is a hit yet to come when those programs run out? But wait, if that were to be a risk, wouldn't governments and Central Banks just extend their policies, thus protecting economies and justifying share prices? And what about a vaccine? There are quite a few

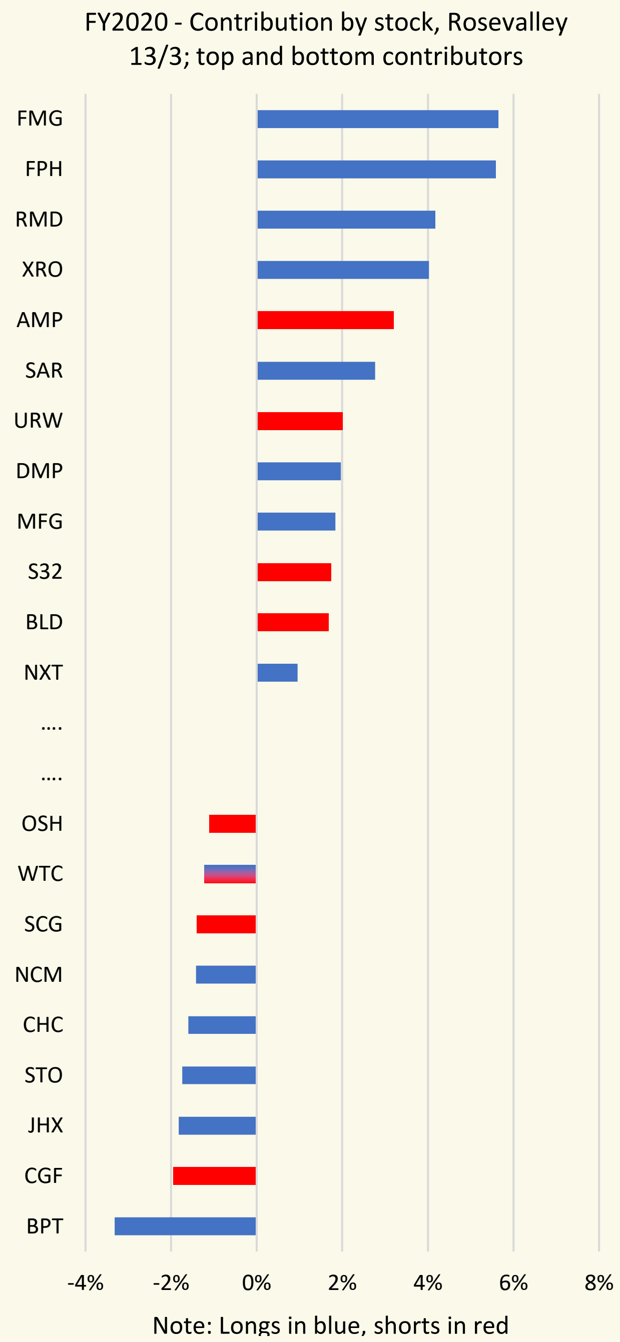
Rosevalley is looking for a Sponsor

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, one (the 10/0) is run with actual money, while one other (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.





Source: Rosevalley, Factset

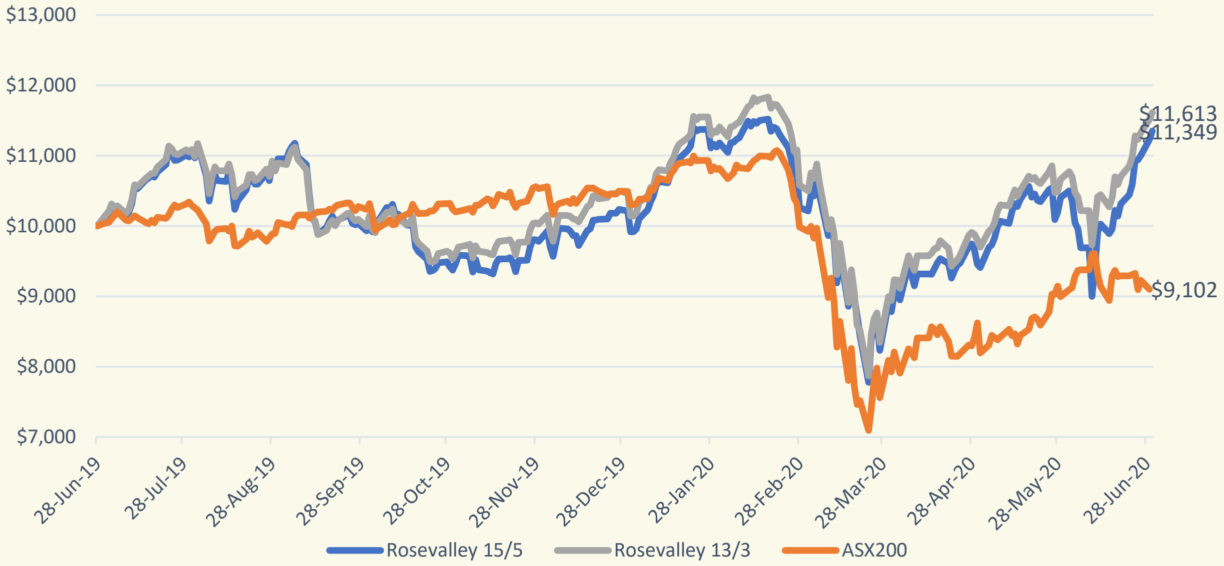
already in Phase-3 trials, and we may have a viable candidate available before the end of the year – does that justify stockprices? On current polls Biden will be the next president of the United States – is that good or bad for stockmarkets? But if a vaccine becomes available sooner rather than later, Trump's election chances may improve. Would that be better or worse for stockmarkets?

The list of questions goes on, and investors' heads are spinning. Investors are busy placing bets on how they think this will all play out, while also trying to hedge their positions in case they are wrong.

For what it's worth, we believe the economic damage is currently being underestimated, and we are therefore in the camp that believes stockmarkets are trading too expensively.

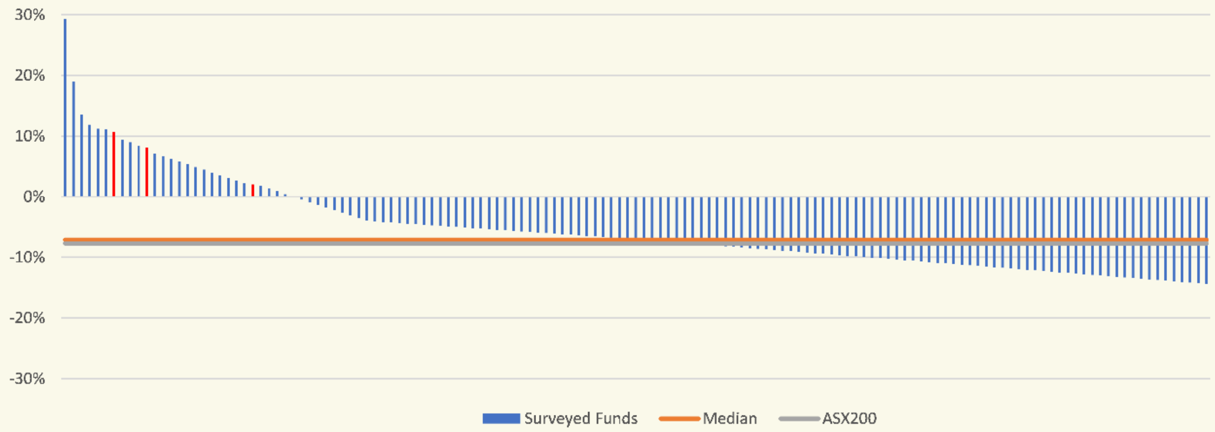
However, the Rosevalley portfolios do not depend on this view: among all the uncertainty in the world, we believe one thing remains unchanged: people's behaviour. Since the Rosevalley portfolios are built to take advantage of how people behave, we are confident that the portfolios will continue to perform well in the coming years.

Rosevalley 15/5 and 13/3
FY20
Growth of $10,000



Source: Factset, Rosevalley

Mercer survey of funds performance - FY20
(Rosevalley Funds in Red)



Source: AFR, Rosevalley. Top 10 funds are identified, the rest of the distribution is interpolated based on the published quartile and median

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.