

Portfolio Report July 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

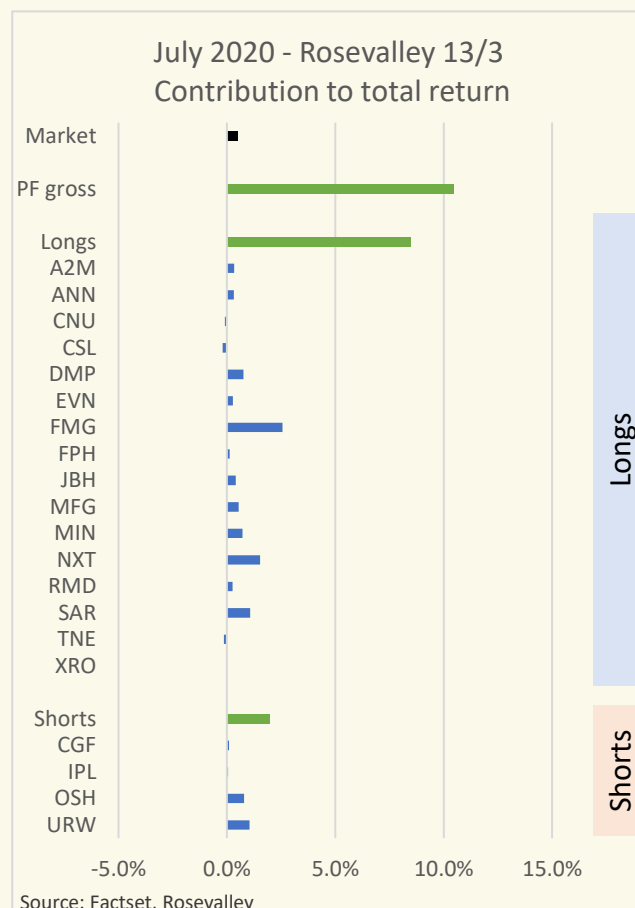
Key Events July

Economies around the world continue to be ravaged by the global pandemic. In Australia, the State of Victoria went into a second lockdown after a flare-up of cases; NSW closed its borders with Victoria, and Queensland closed its borders with NSW. In the US daily new cases continued to grow, while in many developing markets numbers showed a serious acceleration (e.g. Mexico, Brazil, India) even as, due to inadequate testing in many of these countries, the rates of infection are likely to be understated. Several countries are also experiencing emerging second waves. Against this backdrop global markets still managed a positive, albeit lacklustre, performance. The positive news that kept investors going was most likely around the development of a vaccine: during the month there were a few announcements of further trials with encouraging early results; however, any mass production of a vaccine is likely to be a long way off. The US also confirmed that rates will stay lower for much longer than expected.

The Rosevalley Funds did exceedingly well, returning ~10% vs the market 0.5%.

Total return	
	July 2020
MSCI World	3.3%
S&P 500	5.6%
DJIA	2.4%
FTSE100	-4.2%
DAX	0.0%
Hang Seng	0.7%
XJO	0.5%
Rosevalley 13/3	10.5%

Source: Factset, Rosevalley. Note: The Rosevalley figures are unaudited.



Source: Factset, Rosevalley

The Australian government delivered its *Economic and Fiscal Update* during the month. One of the things investors were most looking out for was an update around the “fiscal cliff”: the potential sharp decrease in personal income as the JobKeeper and JobSeeker programmes announced early in the pandemic were scheduled to expire in September. As it happened, the government announced a continuation of the programmes, albeit with some modifications. This also supported the local market during the month.

Portfolio performance

The Rosevalley portfolios had another stellar month: on a gross basis they returned 7-10.5%, delivering outperformance of ~650-1000 bps. Pleasingly, both the

Performance as of July 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	10.5%	30.9%	12.4%	15.7%	42.5%		
	Net	10.0%	28.1%	8.2%	9.9%	34.1%		
Rosevalley 15/5	Gross	11.4%	33.6%	13.0%	14.6%		46.0%	
	Net ¹							
Rosevalley 10/0	Gross	7.0%	17.8%	-0.1%	4.6%			39.5%
	Net ²	5.7%	12.2%	-7.4%	-7.1%			8.0%
ASX-200		0.5%	7.6%	-14.2%	-9.9%	1.9%	1.7%	2.1%

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.

long side and the short side contributed positively to performance. Positive contributors included:

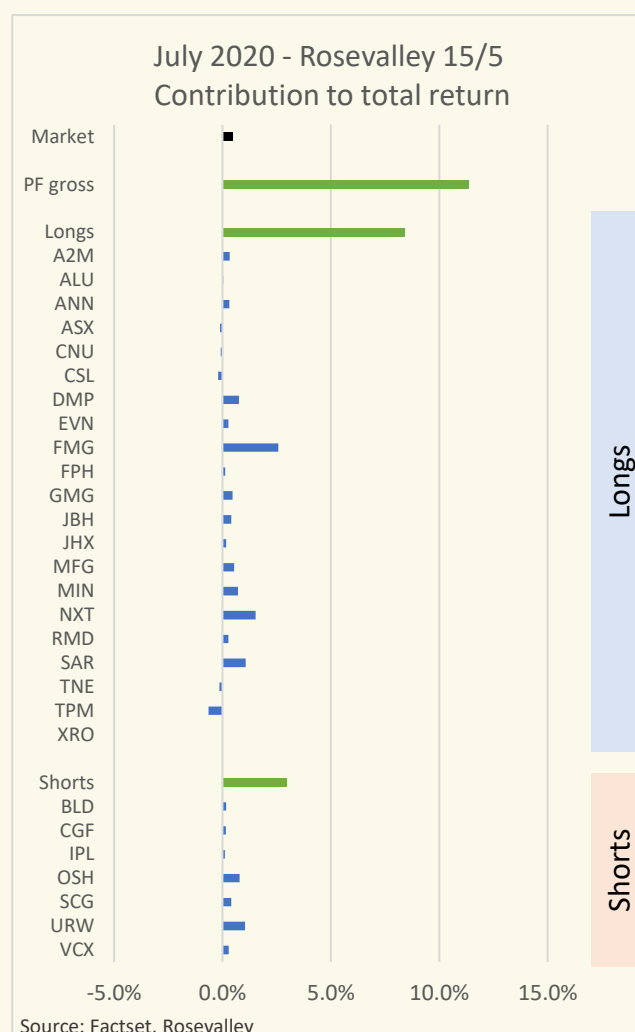
- The long position in iron ore miner Fortescue (FMG). The iron ore price continued to climb during the month (to perhaps an unsustainable level?), as the pandemic restricted supply coming out of Brazil at the same time that China's rebound increased demand.
- The short position in real estate manager URW, which is under pressure from the economic costs of the pandemic and declining asset prices, primarily through its European holdings.

There were no negative contributors of note.

A word on statistics

Rosevalley 13/3 now has shown 9 consecutive months of outperformance, while Rosevalley 15/5 has outperformed 7 out of the past 9 months. Obviously, we are both pleased and proud with this performance. However, we feel it would be wise to make the following points:

- The 25-year backtest shows that the portfolios outperform about 2/3rd of all months. Therefore, a streak of 9, or 7 out of 9, is unusual¹.
- This does not mean we're "due for an underperforming month" – that's not how statistics works.
- It does mean, however, that we should be careful not to extrapolate this streak into the future. Our promise to investors remains the same: expect outperformance in 2/3rd of months over the long term, with an approximate 10%



p.a. outperformance relative to the ASX200 over the longer term.

¹ In fact, given the observed distribution of the backtest, the probability of having 9 consecutive outperforming months, or 7-or-more

outperforming months in a 9-month period, are approximately 1% and 24% respectively.

Longer term performance

Not surprisingly after a streak of outperformance of many months, long-term performance looks very strong across all time periods, with realized outperformance running closely in line with the expected 21% gross and 16% net outperformance.

Execution

The rebalancing trades at the start of the month were done in line with expectation, but there was a slight discrepancy between the model and the actual portfolio, which negatively impacted net returns. However, this was offset by lower than modelled trading and borrow costs, thus bringing the gross-net gap in line with the modelled value.

	Model	Realized
Gross performance	10.46%	10.46%
deviation from model portfolio		-0.24%
difference between trade price and end-of-previous-month price	-0.27%	-0.26%
trading costs	-0.12%	-0.05%
borrow costs	-0.12%	-0.01%
prior month dividends		0.05%
Net performance	9.95%	9.95%

August Portfolio Manager model overrides

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

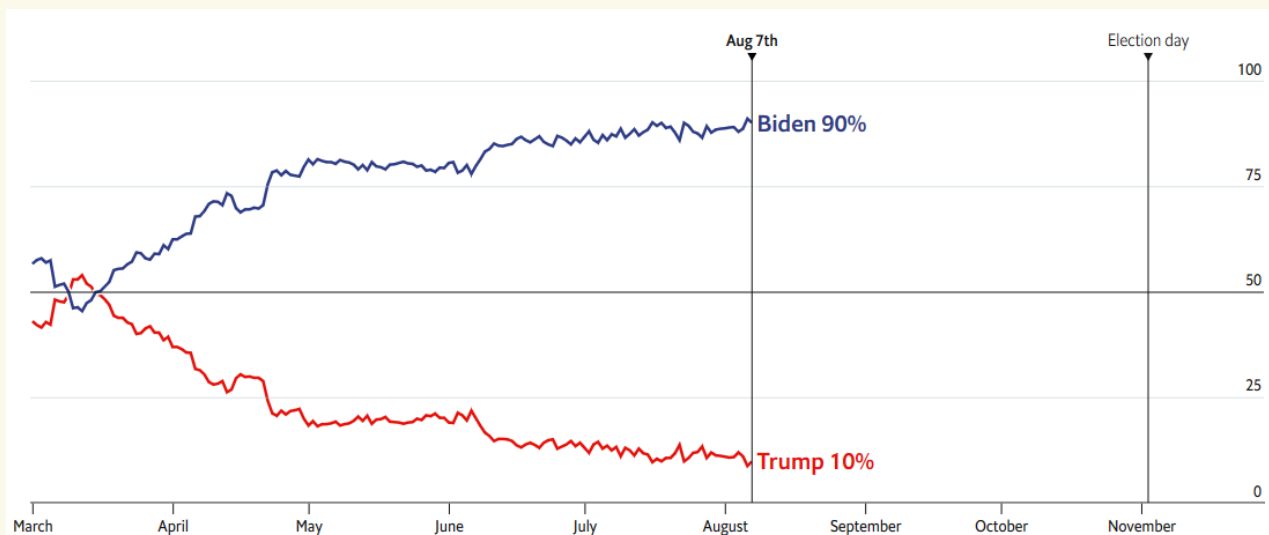
	13/3	15/5
Longs taken out	JBH, OZL	JBH, OZL
Replaced by	A2M, MFG	MFG, GMG
Comments	Sector concentration – in both portfolios the next stock in the list that did not repeat the sector concentration was picked.	

Looking ahead

The message is the same as last month (and likely the next few months – do you remember the good old days

when we worried about Brexit, trade wars, and other now-trivial issues?): Coronavirus will continue to dominate the headlines. We don't see many changes from what we wrote last month. For Australia in particular, the question for the next few weeks is likely whether or not Victoria will get its second wave under control (we think it will), and whether NSW can avoid a second wave (we think it can, but note we are not experts in the relevant fields of healthcare to provide an informed opinion; we do expect some stricter rules on social distancing, and possibly mask-wearing).

On the next page we show the updated version of The Economist's chart showing the probabilities of victory of the two candidates in the US presidential election. Joe Biden's probability of winning has increased further over the past month. As we wrote last month, however, a lot can happen between now and November...



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 on this website, 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 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:

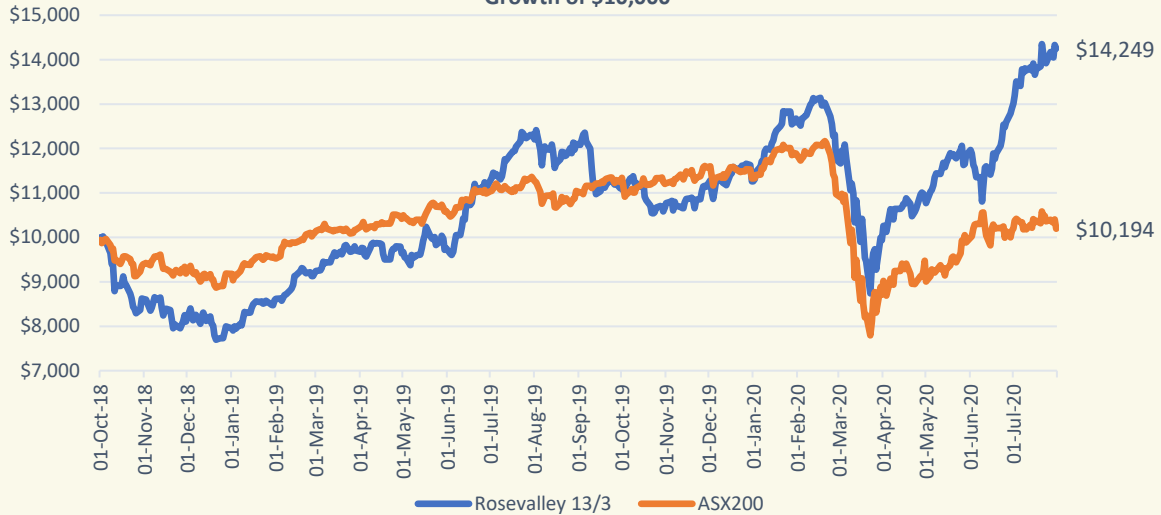
Rosevalley is a boutique funds manager with a unique approach to portfolio construction. Rosevalley Funds are constructed using the principles of Behavioural Finance (BF). Behavioural Economics and Behavioural Finance were developed over the past 30 years or so through the work of economists like Tversky,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

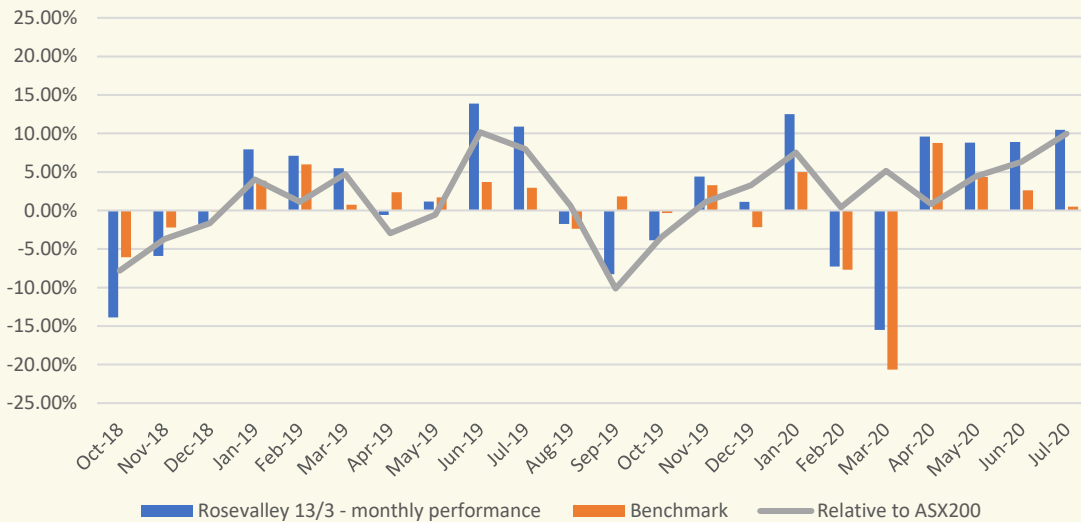
The monthly report discusses current events, portfolio performance, trade execution, gross-net differences, next month’s portfolio, and broader market and macro expectations.

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



Source: Factset, Rosevalley. Note: The Rosevalley returns are unaudited

Rosevalley 13/3 - monthly performance



Source: Factset, Rosevalley. Note: The Rosevalley returns are unaudited

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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