ROSEVALLEY FUNDS

Portfolio Report December 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

Market commentary

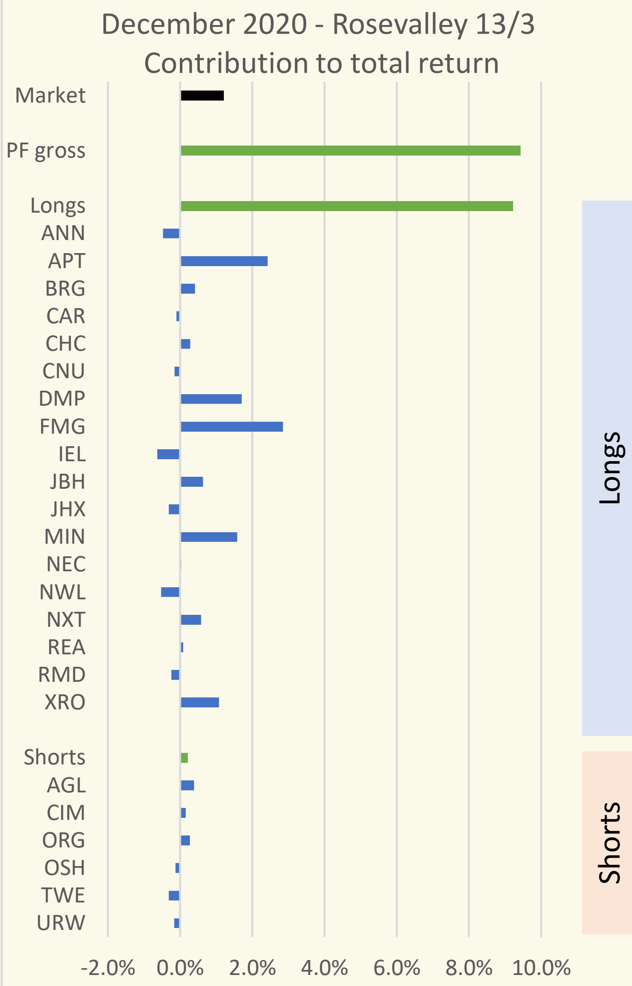
After a terrible November, Rosevalley had a very strong December (outperforming ~800 bps), closing off another very strong year for the funds.

Total return		
	December 2020	**CY 2020**
MSCI World	3.4%	11.7%
S&P 500	3.8%	18.4%
DJIA	3.3%	7.2%
FTSE100	3.3%	-11.5%
DAX	3.2%	3.5%
Hang Seng	3.4%	-3.4%
ASX-200	1.2%	1.4%
Rosevalley 13/3	9.4%	30.4%

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

December was a positive month for most global markets with returns around the 3.5% mark. Australia fell a bit short of this, with a return of 1.2%.

Broadly speaking, the month's trends continued the November themes, albeit not with the same ferocity. The good news on vaccines helped markets, while the political chaos in the US seemed to no longer impact markets much. The market's ability to change its view on events was again in full view: over the past few months we have seen the view that a Democratic clean sweep was best for markets change to a divided government being better, and back to a clean sweep being better[1]. As behavioural practitioners we are not really surprised – this is the Narrative Fallacy at work – but we still find it fascinating how so many people can so quickly collectively change



Source: Factset, Rosevalley

their mind on something that should be rather clear-cut and static.

It's interesting to reflect for a moment on the full-year return numbers in the table above. In a year that gave us COVID, lockdowns, economic standstill, the worst recessions around the world in living memory, and ballooning government and private debt, stock markets gave us positive returns – indeed very strong returns for some. We have commented before that some of these

[1] At the time of writing, the mob attack on the Capital has happened, as has the certification of Joe Biden's election win, and indeed the election of the two Democratic senators in Georgia.

Performance as of December 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	9.4%	1.4%	13.9%	30.4%	46.9%		
	Net	9.5%	2.1%	14.3%	26.5%	39.4%		
Rosevalley 15/5	Gross	9.2%	-0.9%	10.6%	26.5%		44.4%	
	Net[1]							
Rosevalley 10/0	Gross	8.4%	19.7%	26.0%	28.8%			64.3%
	Net[2]	7.5%	16.7%	19.7%	13.8%			22.3%
ASX-200		1.2%	13.7%	13.2%	1.4%	14.8%	14.5%	15.0%

Source: Rosevalley, Factset. Note returns are not audited. [1]Rosevalley 15/5 was not actively traded during the month, 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.

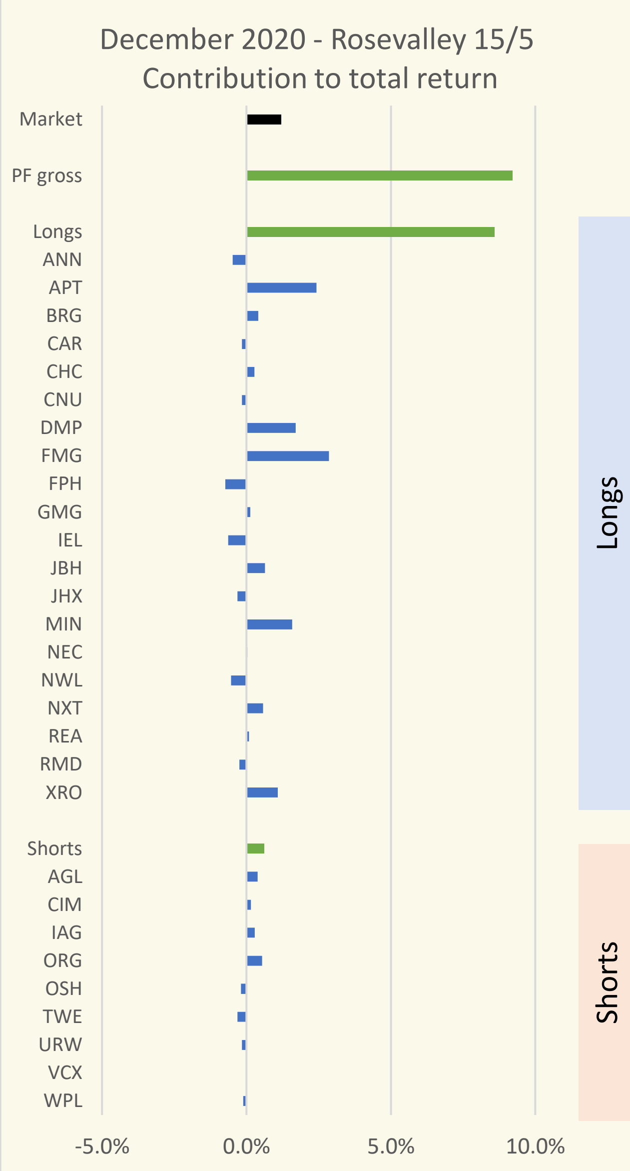
numbers are skewed by the fact that a small number of companies did extremely well, even if most companies did not. This is particularly evident in the 18.4% return of the S&P 500, and this same effect carries over into the MSCI World. The Australian market, with fewer listed tech companies, suffers (or benefits) less from this effect, so is probably more representative of the broader economy. On that basis the stock market seems to be telling us: *"Ok, we had COVID, it wasn't good, but the long-term effects are not that severe – we can just pick up from here where we stopped a year ago."*

Does that sound plausible? Actually, to us it does. We would contend that, while COVID is a real and severe shock to the world economy, it does not fundamentally alter the future. With a number of vaccines now available, the light at the end of the tunnel is visible. It doesn't really matter for valuations whether we 'go back to pre-COVID levels' in 2021 or 2022 – for most stocks the profits/cash flow in the first year of the forecast amounts to only a very small portion of the total value.

On this basis we are optimistic on the outlook for sharemarkets for the coming year. We see the end of the Trump administration as a positive, and believe the Biden administration's economic policies will be broadly supportive (note that the two do not necessarily go hand in hand). In particular, we expect major investments in infrastructure and in green energy, which will give a boost to the world economy. At the same time, we don't believe interest rates are about to rise any time soon, thus continuing to support valuations.

Portfolio performance

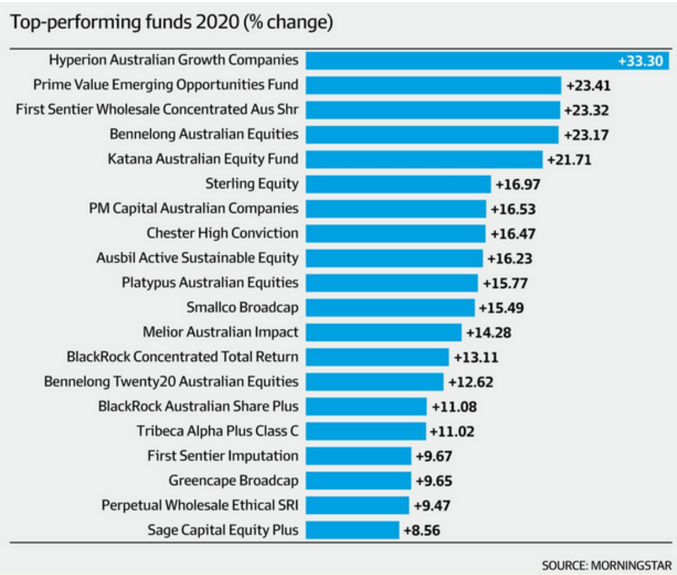
As mentioned above, the portfolios did very well in December. Most of the performance came from the long positions, but the shorts did deliver a small positive contribution too. The largest contributor was Fortescue (FMG), an iron ore miner that benefited from strong iron ore prices (helped by the delay in resumption of production at its largest global competitor, Vale from Brazil). Other strong contributors were Afterpay (APT), Dominos (DMP), and Mineral Resources (MIN).



Source: Factset, Rosevalley

Longer term performance

For the full year 2020 Rosevalley 13/3 returned 26.5% after expenses. This constitutes an outperformance of 24%, a result we can certainly be proud off! We will write a further full analysis of the calendar year later in the month, but for now would like to draw attention to this chart in the Australian Financial Review on 6 January that lists the top performing funds in Australia for 2020[2]. Rosevalley 13/3 would be number 2 if included, and



Rosevalley 15/5 and 10/0 would be number 3 and 4. Rosevalley has now been in the top-10 ranked funds for every 6- and 12-month period since inception.

Execution

This month the rebalancing trades at the start of the month were very favourable. Countering this, there was a deviation from the model portfolio (due to difficulty in finding enough shorts) that hurt performance. Borrow costs and trading costs were less than modelled. Taken together, the net return was 9 bps better than the gross return.

Rosevalley 13/3 Execution

	Model	Realized
Gross performance	9.44%	9.44%
deviation from model portfolio		-0.39%
difference between trade price and end-of-previous-month price	-0.01%	0.59%
trading costs	-0.28%	-0.08%
borrow costs	-0.12%	-0.02%
accrued vs paid dividends		0.00%
Reported net performance	9.02%	9.53%

January Portfolio Manager model overrides

The portfolios for January have one and two long stock substitutions for the 13/3 and 15/5 portfolios respectively, driven by sector concentration concerns – a very similar outcome to the previous month. Both portfolios also have one short substitution, driven by lack of available shorts.

	13/3	15/5
Longs taken out	OZL	OZL, BSL
Replaced by	NEC	SOL, SVW
Comments	Sector concentration – in both portfolios the next stocks in the list that did not repeat the sector concentration were picked.	
Shorts taken out	AGL	AGL
Replaced by	ORG	AZJ
Comments	Lack of shorts availability – in both portfolios the next stock in the list was picked.	

[2] https://www.afr.com/chanticleer/top-australian-fundies-keep-delivering-the-goods-20210106-p56s4w

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:

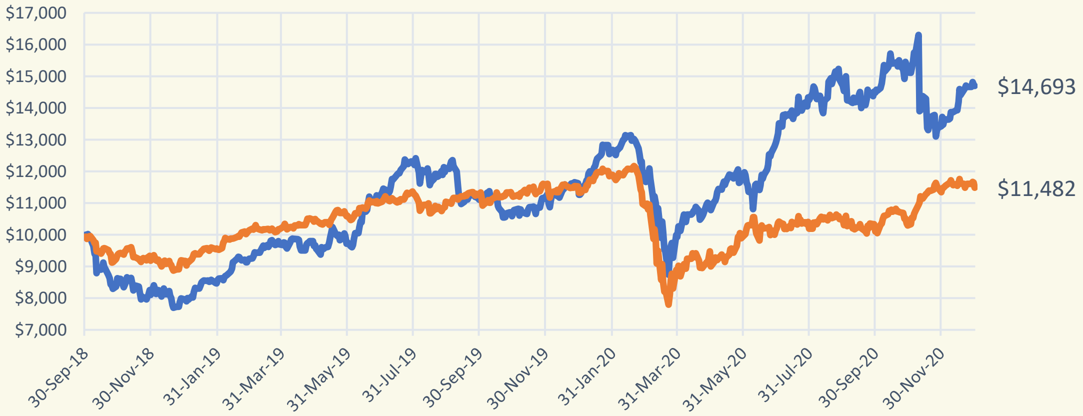
Rosevalley is a boutique funds manager with a unique approach to portfolio construction. Rosevalley Funds are constructed using the principles of Behavioural Finance (BF). Behavioural Economics and Behavioural Finance were developed over the past 30 years or so through the work of economists like Tversky, 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 January-January 2018.

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

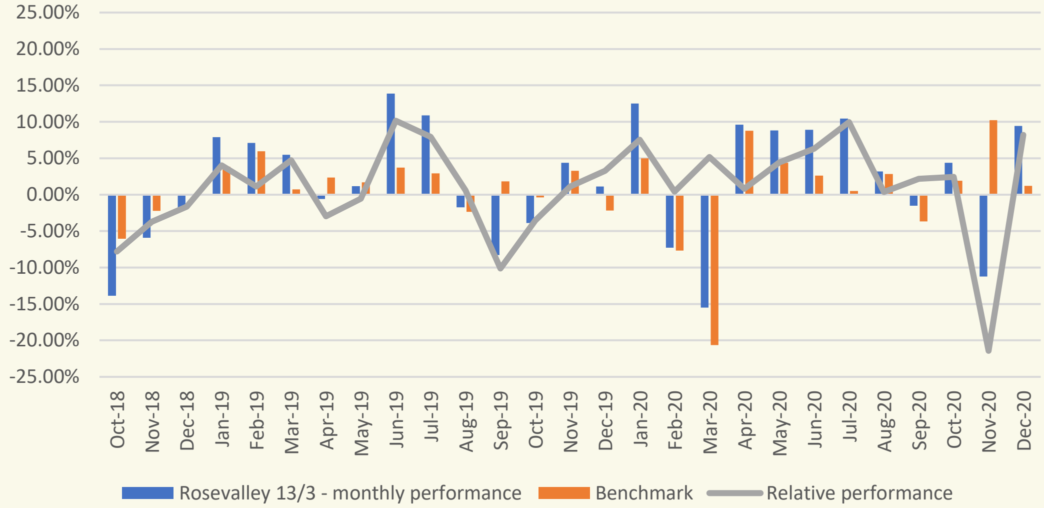
The monthly report discusses current events, portfolio performance, trade execution, gross-net differences, next month's portfolio, and broader market and macro expectations.

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



Source: Factset, Rosevalley. Note Rosevalley numbers are not audited

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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