ROSEVALLEY FUNDS

Portfolio Report April 2021

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

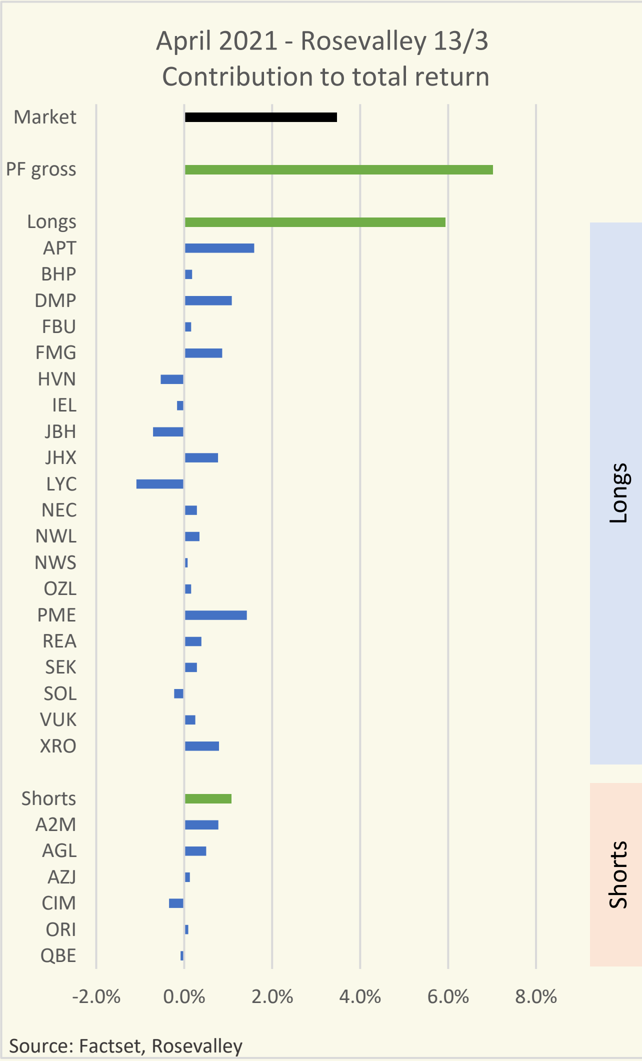
Market commentary

Global markets continued their upwards march in April. Many markets are now at or very near all-time highs. This is an outcome few did or could have foreseen a year ago as the Covid-19 pandemic gathered pace! Having said that, and perhaps because of it, towards the end of the month, and going into May, markets seem to be taking a breather. Tech stocks in particular are being hurt, which points to inflation worries (or worries about inflation worries[1]): the thinking would be that inflation will lead to higher interest rates; higher interest rates have a larger impact on stocks that have their cash flows further into the future, i.e. tech stocks.

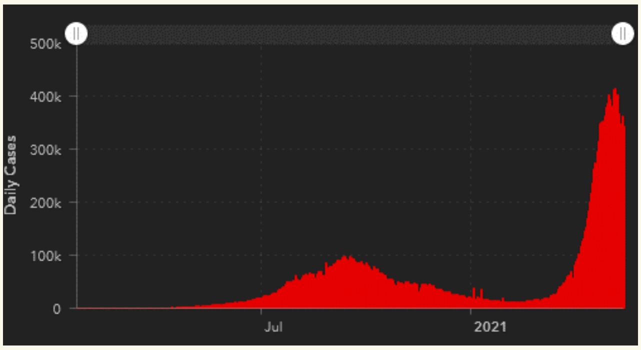
Total return	
	April 2021
MSCI World	3.9%
S&P 500	5.3%
DJIA	2.7%
FTSE100	4.1%
DAX	0.8%
Hang Seng	1.2%
ASX-200	3.5%
Rosevalley 13/3	7.0%

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

During the month, sadly the pandemic saw a severe deterioration in India, where hospitals quickly became overwhelmed. India provides us with a powerful but very costly reminder that this pandemic is far from over. At the same time, the US has gone from COVID-19 basket case to



India daily Covid-19 Cases



Source: Johns Hopkins University Covid-19 Dashboard

[1] Bonus points if you picked up on this oblique reference. The reference is discussed at the end of the newsletter.

Performance as of April 2021								
Portfolio		1 month	3 months	6 months	1 year	Since inception annualized (1 Oct 2018)	Since inception annualized (14 Aug 2018)	Since inception annualized (1 Aug 2018)
Rosevalley 13/3	Gross	7.0%	7.0%	3.9%	44.3%	19.1%		
	Net	7.0%	5.4%	3.0%	39.6%	15.8%		
Rosevalley 15/5	Gross	8.1%	10.1%	2.5%	45.3%		18.4%	
	Net[1]							
Rosevalley 10/0	Gross	5.8%	2.7%	15.1%	42.2%			20.9%
	Net[2]	4.8%	-0.2%	9.0%	25.3%			7.0%
ASX-200		3.5%	7.5%	20.3%	30.8%	8.6%	8.1%	8.1%

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.

one of the leaders in the race to vaccinate the population. The fact that stock markets have stayed strong in April says something about what investors want to believe: it's much more pleasant to look at the US and think "we're close to the end of this thing", than look at India and think "the worst is yet to come". In Behavioural Finance this is called Optimism Bias, and it is a very powerful driver of human behaviour.

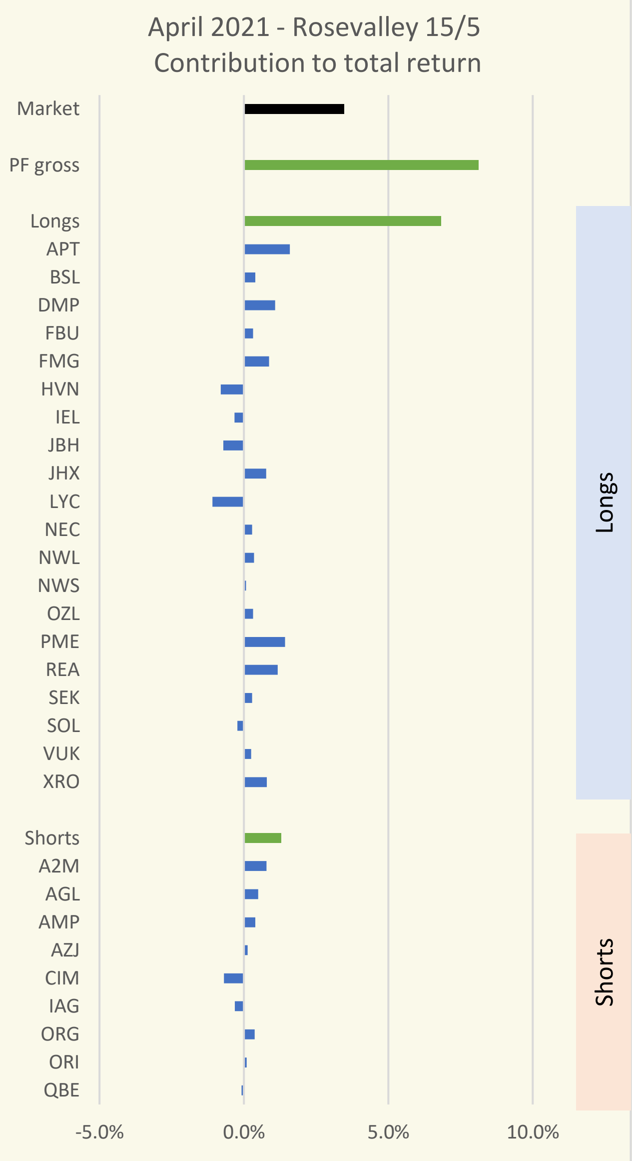
As for the coming few months, the combination of markets being close to their all-time highs, and seeing investors worry about inflation (whether warranted or not), makes us believe the market is in for a period of consolidation[2].

Portfolio performance

The Rosevalley portfolios performed strongly over the month, returning 6-8%, vs. the ASX200 at 3.5%. The strong performance was broad-based, with both longs and shorts delivering a positive contribution.

Longer term performance

For the 12-month and since-inception timeframes, all Rosevalley portfolios continue to perform very strongly. Note that the one-year performance of 44% may seem extraordinary, but of course is measured against the low level of the market a year ago.



Source: Factset, Rosevalley

[2] Oh, dear! – the euphemisms writers of financial articles use! Don't be fooled: "consolidation" simply means the market will go down for a while!

Execution

This month the usual sources of gross-net difference were small and, on the whole, cancelled each other out, such that the gross-net gap was just 2 bps (vs. an expected 38 bps).

Rosevalley 13/3 Execution

	Model	Realized
Gross performance	7.02%	7.02%
deviation from model portfolio		0.06%
difference between trade price and end-of-previous-month price	-0.08%	0.05%
trading costs	-0.17%	-0.13%
borrow costs	-0.12%	0.00%
accrued vs paid dividends		0.00%
Reported net performance	6.64%	7.00%

May Portfolio Manager model overrides

The portfolios for May have two and three long stock substitutions for the 13/3 and 15/5 portfolios respectively, driven by sector concentration concerns.

	13/3	15/5
Longs taken out	LYC, JHX	LYC, FBU, BLD
Replaced by	XRO, REA	XRO, REA, PMV
Comments	Sector concentration – in both portfolios the next stocks in the list that did not repeat the sector concentration were picked.	

What was that reference in the beginning all about?

John Maynard Keynes (yes, that one, of Keynesian economics) wrote in his famous book *The General Theory of Employment, Interest and Money* (1936) something about price fluctuations in equity markets. He argued that investors are not, as you might assume, trying to figure out what a company is really worth. Rather, they are trying to surmise what other investors might believe the company will be worth in the near future. This leads to an interesting spiral of thought: if everybody is aware of this, what you should really do is figuring out what other investors think that other investors think the company will be worth. But wait, if everybody does that…. etc., etc. Keynes likened this process to a newspaper beauty contest, where judges are rewarded for picking the *most popular* face among all judges (rather than the face they may personally find most attractive). See this Wikipedia entry (I know, I know, lazy reference):

https://en.wikipedia.org/wiki/Keynesian_beauty_contest

Richard Thaler wrote an interesting article in which he takes this idea and puts it in the context of the debate of Efficient Markets vs. Behavioural Finance (our favourite topic!). He also describes how he performed a version of the Keynesian beauty contest, as well as what Game Theory and the Nash equilibrium (more of our favourite topics!) have to say about this. And for the cherry on top, there is a reference to *The Hitchhiker's Guide to the Galaxy*. We can hardly contain our excitement:

https://www.ft.com/content/6149527a-25b8-11e5-bd83-71cb60e8f08c.

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.

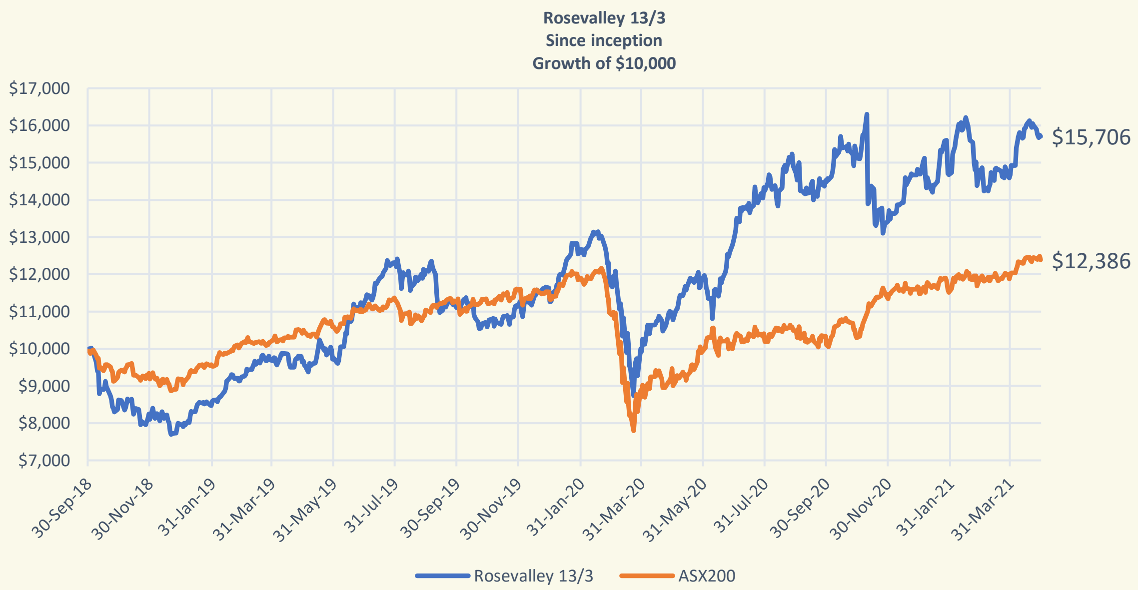
Some context for readers who are less familiar with Rosevalley Funds:

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).

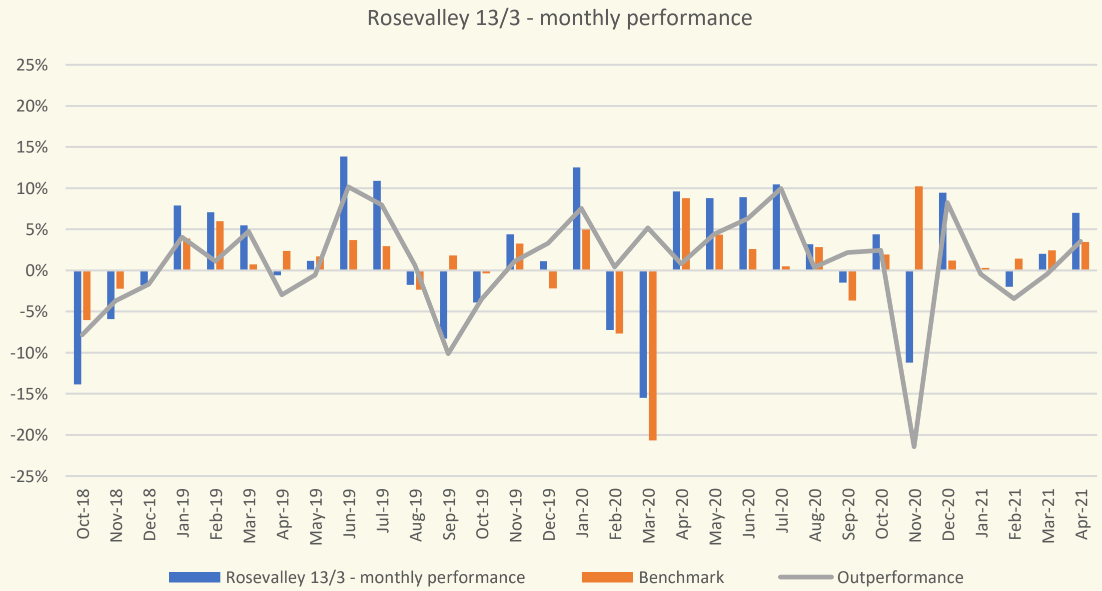
Rosevalley's portfolio construction algorithms are based on these insights. The model yields a ranking of stocks in order of greatest to smallest upside. Portfolio construction then follows by going long the stocks at the top and short the stocks at the bottom. The flagship product is Rosevalley 13/3, 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 May-May 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.



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



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.