ROSEVALLEY FUNDS

Portfolio Report September 2021

The Rosevalley Behavioural Finance Funds

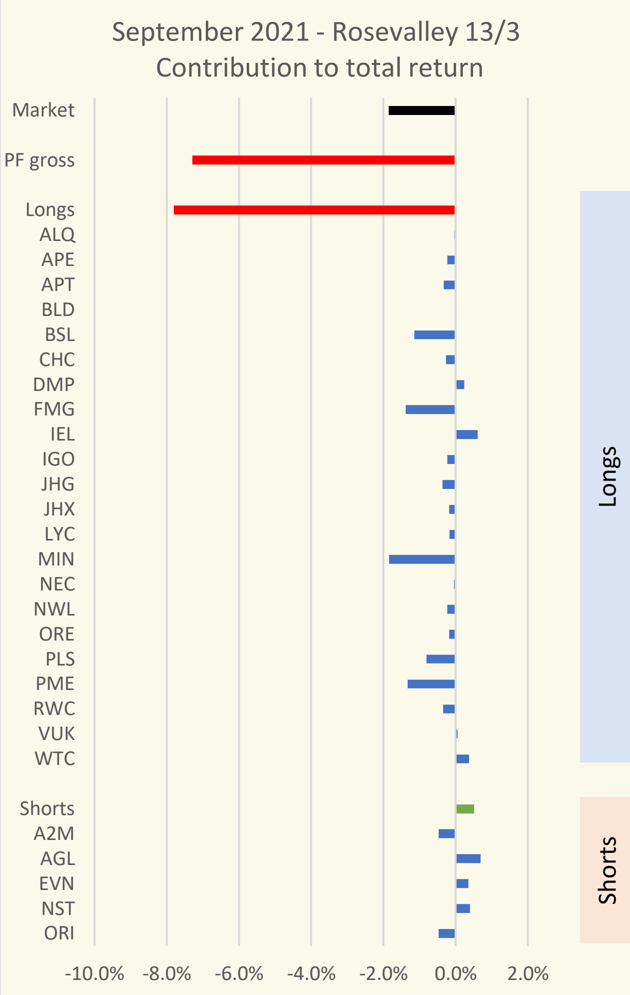
The Rosevalley Behavioural Finance Funds are high-conviction funds that take the theoretical and empirical evidence developed over the past 30 years in Behavioural Finance, and systematically build portfolios from these learnings. The portfolios are constructed on a benchmark-unaware basis, but performance 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

September saw a pullback for markets around the world. Australia was one of the better markets at "only' 1.9% down. Rosevalley had a particularly bad month, underperforming between 400-550 bps.

Total return	
	September 2021
MSCI World	-3.6%
S&P 500	-4.7%
DJIA	-4.3%
FTSE100	-0.2%
DAX	-3.6%
Hang Seng	-4.7%
ASX-200	-1.9%
Rosevalley 13/3	-7.3%
Rosevalley 10/0	-5.8%
Source: Factset, Rosevalley. Note: The Rosevalley figures are unaudited.	



Source: Factset, Rosevalley

The main issue driving markets was the inflation debate. While inflation has been on the radar of the markets for many months now, it appears that many investors are starting to give less credence to Central Banks' assertion that the currently observed inflation is "transitory". If you believe that inflation will persist, your conclusion will be that interest rates will go up faster and further than previously assumed. This in turn, will impact growth. In the market this manifested itself in particular through "growth stocks" (which are more sensitive to interest rates), and commodity stocks (which are highly sensitive to economic activity). Rosevalley's exposure to commodities in particular explains the underperformance for the month.

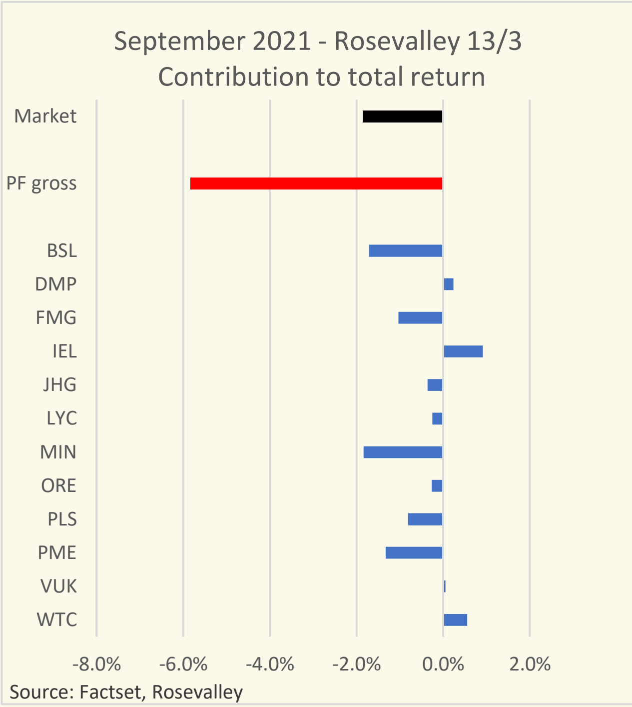
The 10-year government bond rate has moved up. Some observers see this as evidence of impending inflation.

Source: Factset

Those who worry about inflation point to the increases in interest rates over the past month or two (refer chart of

Performance as of September 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	-7.3%	1.4%	17.9%	19.5%	20.0%		
	Net	-7.1%	-0.3%	15.7%	15.7%	16.4%		
Rosevalley 15/5	Gross	-7.0%	2.8%	21.7%	22.1%		20.2%	
	Net[1]							
Rosevalley 10/0	Gross	-5.8%	4.5%	17.0%	35.7%			21.7%
	Net	-4.7%	3.8%	13.3%	24.3%			8.7%
ASX-200		-1.9%	2.8%	11.4%	32.0%	10.0%	9.5%	9.5%

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.



the 10 Yr Government bond), coupled with the language coming from Central Banks about reducing monetary stimulus – even if they generally continue to portray inflation as transitory and signal that official interest rate rises are still quite far into the future, and will be modest when they finally come.

“No matter,” say the inflation warriors (worriers?), “we know better what you are going to do next year than you do, and you will be raising rates faster and further than you say today!”

Ok, the previous paragraph is a bit of a caricature. It is not unreasonable to argue that inflation could be higher than Central Banks expect, and that as a result they will be forced to raise rates faster and further than they expect. However, it should be remembered that generally Central Banks have some of the best and most expansive economic data available to them, so their opinion should certainly have some influence!

What interests us is the way that investors have seemed to have changed their mind over the past month. What triggered this? Was it just the length of time that we now have observed higher inflation (making the argument that it is transitory increasingly more circumspect)? Or did perhaps the (now averted) threat of a government shutdown in the US lead to higher rates, which in turn were misinterpreted as proof of inflation?

We don’t really know, which makes it very hard to predict what will come next. We would perhaps say one thing: looking at the chart on the first page, it seems to us that the current level of interest rates holds no information about the future at all. In fact, we are right where we were in April, and from there rates went down, not up!

Portfolio performance

All three Rosevalley portfolios underperformed, down 6-7%, vs. the ASX200 down 2%. The underperformance was driven by the long positions, in particular by the commodity and commodity-related companies: Steel company Bluescope Steel (BSL), iron-ore miner Fortescue (FMG), iron ore and lithium miner Mineral Resources (MIN), lithium miners Orocobre (ORE) and Pilbara Minerals (PLS), and rare-earth miner Lynas (LYC) – these stocks were down an average of 13% for the month. The shorts contributed a bit, but not nearly enough to offset the decline in the longs.

Longer term performance

For the since-inception timeframes, all Rosevalley portfolios continue to perform strongly, still close to an annualized ~10% ahead of market since inception. For the past 12-months, the portfolios are below the broader market.

An observation on performance numbers

Every month, at the top of page 2 we show performance numbers for the past 1 month, 3 months, 6 months, one year, and since inception. This is standard in the industry and is little questioned. As you would expect, if the monthly number is good, we focus on that one. If the monthly number is bad, we point to the 3-month, or annual number. The problem with all this is of course just that: we can highlight those numbers that put us in the best light. *(Our industry is of course not alone in this – any advertisement from any industry will mention the good things about their products, and be silent about the bad).* To further illustrate the issue, consider our current 1-year number: ~13% below market. However, if October and November are close to flat, by the end of November we will be ahead of market by 6% on an annual view – solely because the bad month of November 2020 falls out of the comparison period. Our more analytical selves do acknowledge this issue, and it's why we believe the only relevant number is the since-inception number (which, as mentioned, is firmly where we are predicting it will be over the long term). For the same reason we remain very confident in our approach and its long-term returns.

Execution

This month the usual sources of gross-net difference worked in favour – in particular the lack of available shorts in A2M - such that the gross-net gap was +18 bps (vs. an expected -20 bps).

Rosevalley 13/3 Execution

	Model	Realized
Gross performance	-7.28%	-7.28%
deviation from model portfolio		0.63%
difference between trade price and end-of-previous-month price	0.18%	-0.29%
trading costs	-0.26%	-0.07%
borrow costs	-0.12%	-0.08%
Reported net performance	-7.48%	-7.10%

October Portfolio Manager model overrides

The portfolios for October have one long stock substitution for the 13/3 and 15/5 portfolios – like last month this is Afterpay (ASX:APT), which is under takeover offer from the US listed company Square (NYSE:SQ). The substitutes are Premier (ASX:PMV), a discretionary retailer, in Rosevalley 13/3 and Washington H. Soul Pattinson (ASX:SOL) in Rosevalley 15/5.

	13/3	15/5
Longs taken out	APT	APT
Replaced by	PMV	SOL
Comments	APT is under takeover offer – consequently the price signal does not reflect the behavioural signals that the model would ordinarily pick up.	

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

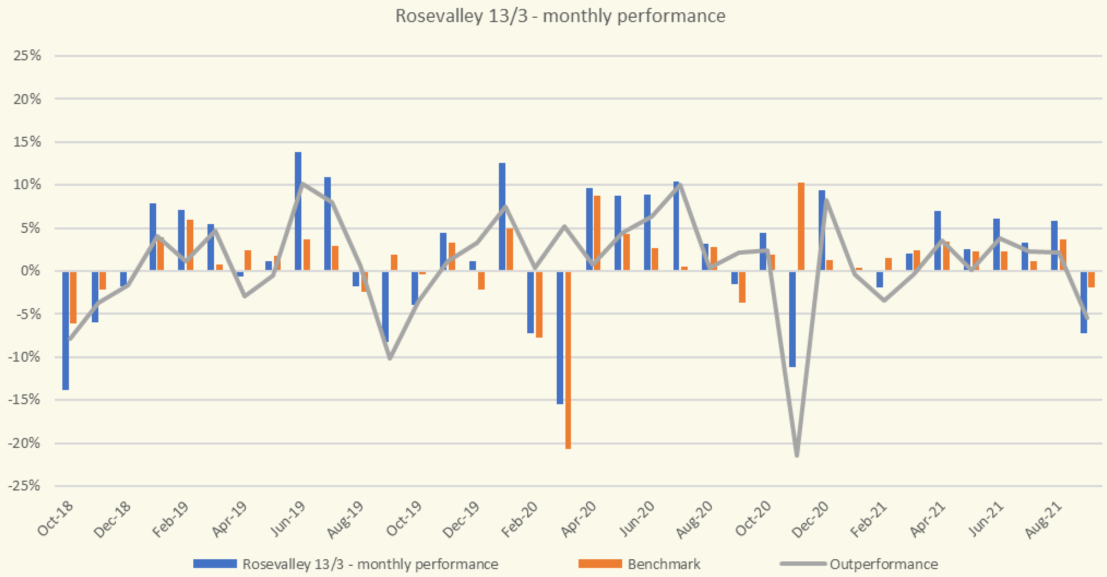
Rosevalley is a boutique funds manager with a unique approach to portfolio construction. Rosevalley Funds are constructed using the principles of Behavioural Finance (BF). Behavioural Economics and Behavioural Finance were developed over the past 30 years or so through the work of economists like Tversky,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

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.