Portfolio Report October 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.

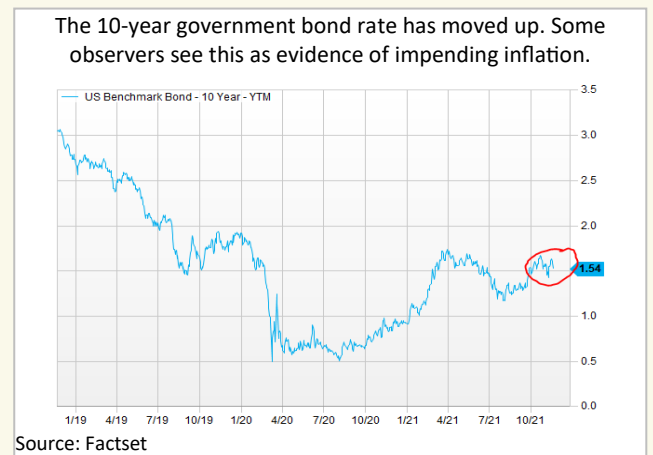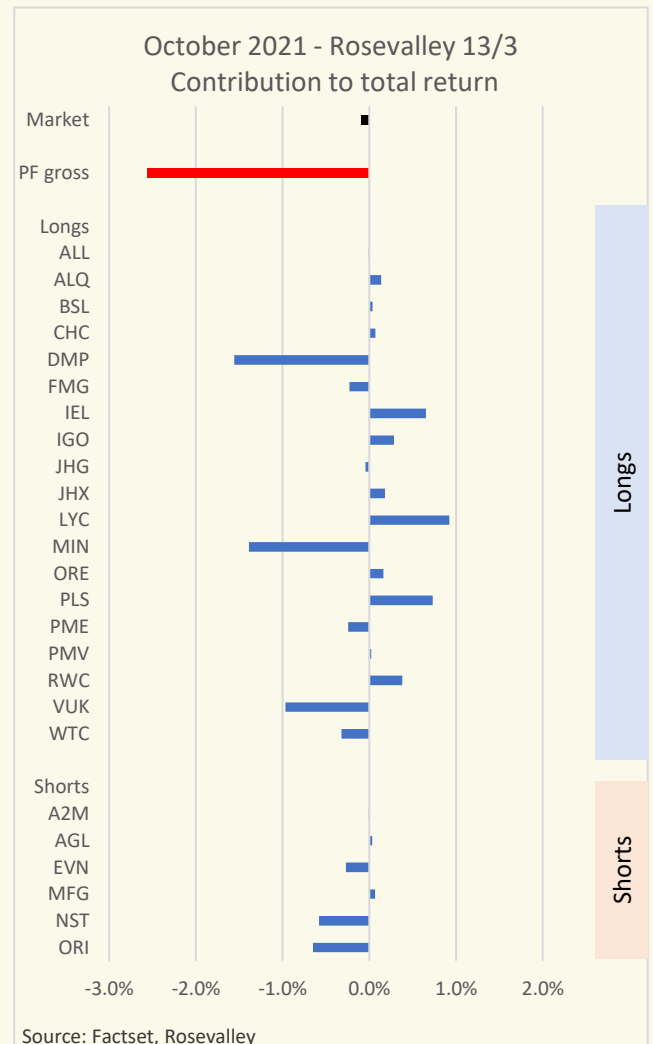*First-time readers of this report, please refer to the blue box at the end for added context and history*

Market commentary

October was a strong month for markets around the world, but Australia was a laggard with a flat outcome for the month. Rosevalley was down a bit, underperforming the broader market by ~150-250 bps.

Total return	
	October 2021
MSCI World	5.5%
S&P 500	7.0%
DJIA	5.8%
FTSE100	2.2%
DAX	2.8%
Hang Seng	3.3%
ASX-200	-0.1%
Rosevalley 13/3	-2.6%
Rosevalley 10/0	-1.4%

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

As in the past few months, the main issue driving markets continues to be the inflation debate. It seems every day brings another couple of datapoints that suggest inflation is heading higher and is here to stay as well as some that suggest that inflation is transitory. Compared to a month ago, it seems that the bond market's expectations about inflation have stabilized (see chart on the right: interest rates have not risen over the past month). This is a likely explanation for the good performance of stock markets around the world. In Australia, however, the Central Bank did seem to indicate it is becoming slightly more worried about inflation, which in turn would explain the lagging performance of the Australian market. As ever, we are slightly uncomfortable writing these sentences: as behavioural investors we are only too aware how investors' minds (including our own) are wired to find

October 2021 - Rosevalley 13/3
Contribution to total return

Source: Factset, Rosevalley

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

Source: Factset

Performance as of October 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	-2.6%	-4.4%	7.4%	11.5%	18.4%		
	Net	-2.8%	-5.9%	5.0%	8.2%	14.9%		
Rosevalley 15/5	Gross	-3.2%	-3.8%	8.9%	11.7%		18.4%	
	Net[1]							
Rosevalley 10/0	Gross	-1.4%	-0.6%	9.0%	25.5%			20.5%
	Net	1.0%	2.0%	9.2%	19.0%			8.8%
ASX-200		-0.1%	1.6%	7.5%	29.4%	9.7%	9.2%	9.2%

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.

causality and explanations in data where in reality there might be nothing more than noise to be found.

One interesting thing to note is that the pandemic seems to be largely ignored by investors. Even though there is clearly another wave of infections occurring across the globe, and several countries have announced new lockdowns and tighter restrictions, stock markets seem largely to be ignoring this (so far, anyway).
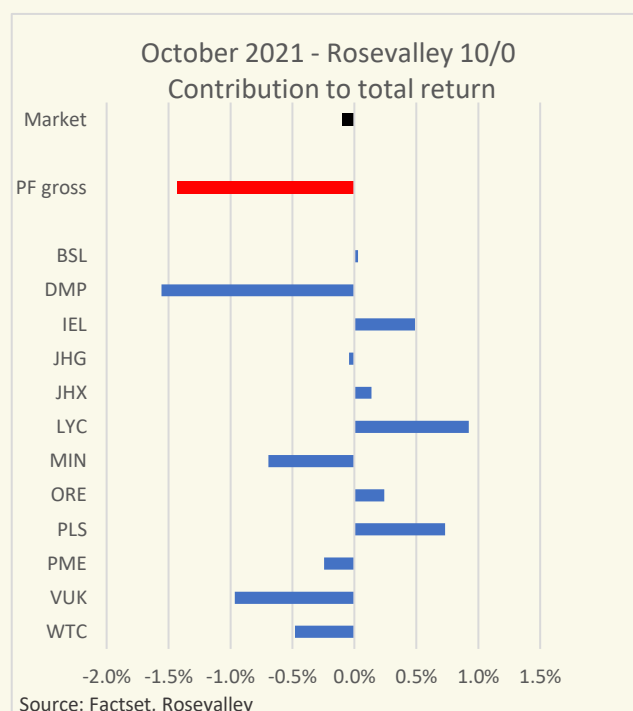
Portfolio performance

All three Rosevalley portfolios underperformed, down 1.5-2.5, vs. the ASX200 flat. The underperformance was driven both by long and short positions, but there were three positions in particular that hurt the portfolios: fast-food restaurant Dominos (DMP), iron ore and lithium miner Mineral Resources (MIN), and UK bank Virgin Money (VUK) – these stocks were down an average of 13% for the month, each for their own idiosyncratic reasons.

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.

Execution

This month the usual sources of gross-net difference were very close to the modelled expectation: the gross-net gap was -28 bps (vs. an expected -29 bps).

October 2021 - Rosevalley 10/0
Contribution to total return

Source: Factset, Rosevalley

Rosevalley 13/3 Execution		
	Model	Realized
Gross performance	-2.57%	-2.57%
deviation from model portfolio		0.01%
difference between trade price and end-of-previous-month price	0.02%	-0.13%
trading costs	-0.16%	-0.07%
borrow costs	-0.12%	-0.09%
Reported net performance	-2.86%	-2.85%

November Portfolio Manager model overrides

The portfolios for November 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 Aristocrat (ASX:ALL), a manufacturer of casino equipment, in Rosevalley 13/3 and Charter Hall (ASX:CHC), a real estate investment trust (REIT), in Rosevalley 15/5.

	13/3	15/5
Longs taken out	APT	APT
Replaced by	ALL	CHC
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 November-November 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

$16,860

$13,316

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

Rosevalley 13/3 — ASX200

Rosevalley 13/3 - monthly performance

Rosevalley 13/3 - monthly performance   Benchmark   Outperformance
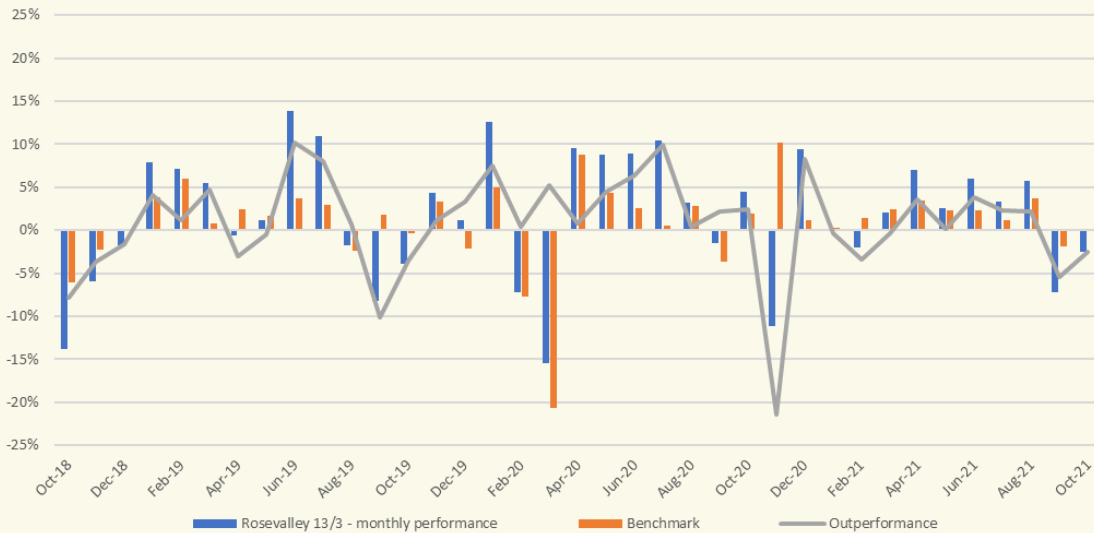
Source: Factset, Rosevalley

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.

ROSEVALLEY FUNDS   Behavioural Finance Funds

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