ROSEVALLEY FUNDS

Portfolio Report February 2022

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

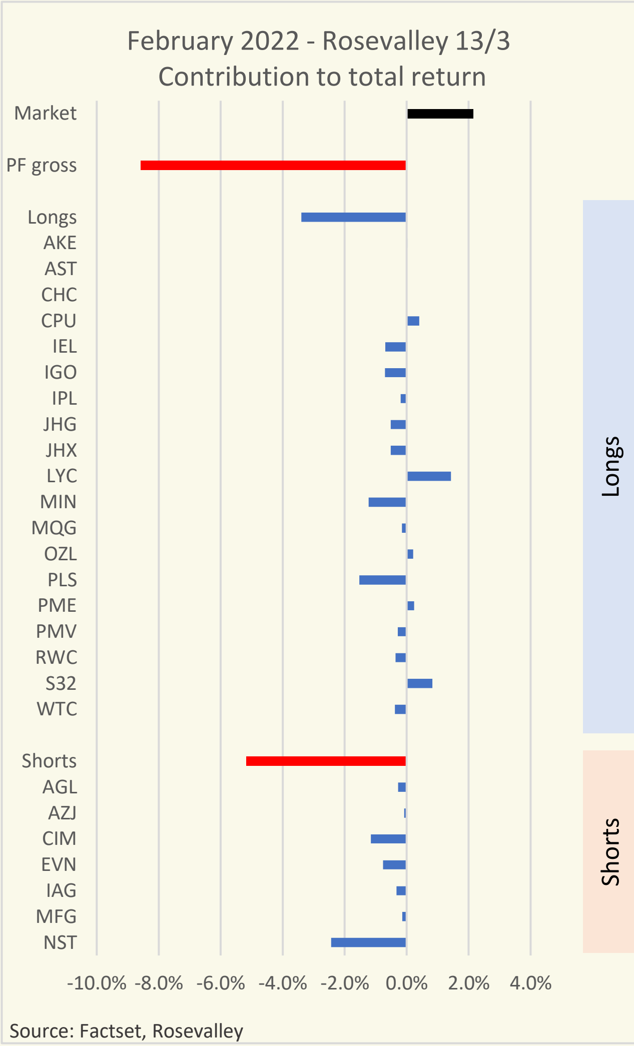
Market commentary

In February, sadly, the world learned that Vladimir Putin does not agree with Edwin Starr and Frankie Goes to Hollywood[1]. At Rosevalley we join the vast majority of the world in condemning in the strongest terms the unprovoked invasion of Ukraine. Our hearts go out to the people of Ukraine, who directly suffer the consequences of war. Our hearts also go out to the people of Russia, who did not choose this war and who will suffer from the consequences of the sanctions imposed on Russia by the rest of the world.

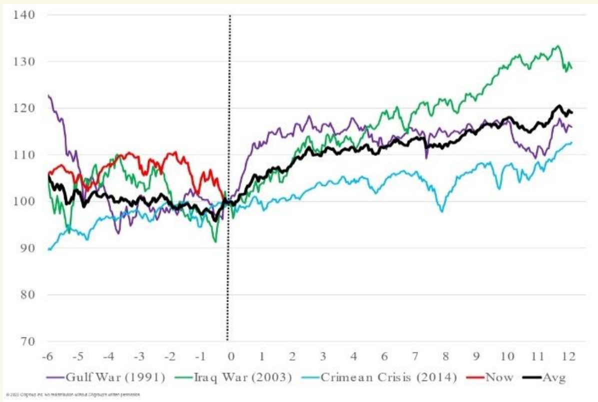
Our moral outrage notwithstanding, we need to ask ourselves how the events in Ukraine impact stock markets. A war is a difficult thing for markets to digest at any time, but perhaps even more so in this case. There are a lot of variables that will ultimately decide the path that markets will follow. Just to mention a few:

- How long will the war last?
- Who will "win" (we actually believe any scenario shows there are only losers here)?
- How far will the West get drawn in?
- How effective and how far will the sanctions on Russia be?
- What is President Putin's ultimate goal or end game?
- How will China view the West's tactics against Russia versus their own ambitions in the South China Sea and Taiwan?

The list goes on. However, these are all questions that neither we nor anybody else has an answer for. Instead let's focus on what we think we can say with some degree of certainty:



Global stock markets performance 6 months before to 12 months after start of war. Source: Citibank

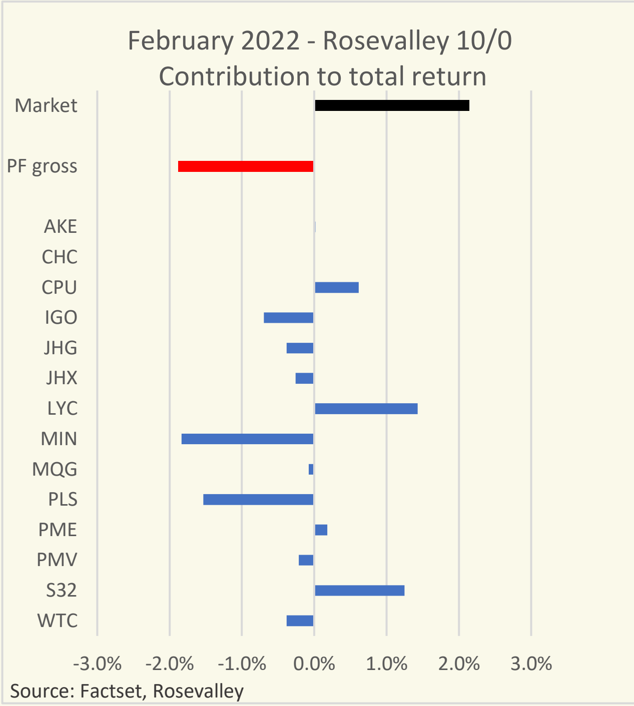


[1] Both recorded a song called "War" -of which the opening lines are: *War, uh! What is good for? Absolutely Nothing.*

Performance as of February 2022								
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	-8.6%	-13.9%	-15.8%	9.3%	14.2%		
	Net	-8.7%	-14.4%	-16.6%	5.2%	10.8%		
Rosevalley 15/5	Gross	-14.4%	-20.7%	-22.1%	5.9%		11.9%	
	Net[1]							
Rosevalley 10/0	Gross	-1.9%	-9.5%	-9.7%	12.0%			17.6%
	Net	-1.9%	-9.6%	-6.7%	9.4%			7.0%
ASX-200		2.1%	-1.7%	-4.2%	10.2%	7.7%	7.3%	7.3%

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.

- While Russia and Ukraine's economies are relatively small when compared to the global powerhouses, there are some products where they have a large share of international trade. Russia is best known for oil and gas, but also plays a large role in markets for metals such as copper, nickel, cobalt, palladium, as well as wheat and other grains. Similarly, Ukraine is a major exporter of iron ore, wheat and other cereals. The disappearance of these products from international markets means prices for commodities will rise, adding to already high global inflation.
- The job of central banks around the world has just gotten a lot harder. Most central banks either already started or were planning to start raising interest rates in order to fight inflation. Certainly, the yield curve across major markets has begun to shift upwards in anticipation of higher inflation and central bank rate hikes. The need to fight inflation has just become more acute – but at the same time growth is set to slow, which would normally point to interest rates going in the opposite direction. For what it's worth, our expectation would be that central banks are not reversing their plans to hike rates; however, the degree of rate increases has just become that much more uncertain.
- While higher commodity prices are bad for global growth and for individual consumers, they are good for commodity producers. Since Australia has a lot of these, the Australian stock market, and indeed the economy at large, may do better than most other markets due to the global demand for our commodities.
- History shows that wars tend to have a short-lived impact on stock markets: markets will go down when tension rise before war actually breaks out, but tend to recover relatively quickly afterwards ("quickly" in this context means a number of months – see the chart on the bottom of page 1).



So what should markets make of this? Daily market moves since the start of the invasion on 24 February show investors are confused – one day worrying about inflation, the next taking comfort from historical trading patterns, etc.

As always we try to look at all this through a behavioural science lens:

- As discussed in previous reports, one of the stronger behavioural heuristics in investing is the narrative fallacy: the tendency to fit a narrative to a set of observations, and then being convinced the narrative must be true because it fits the facts so well. This leads to statements like "Markets rose because investors were relieved that the announced sanctions weren't as severe as first thought", followed a few days later by "Markets rose because investors were pleased to see the West is serious about stopping Putin through far stricter sanctions".

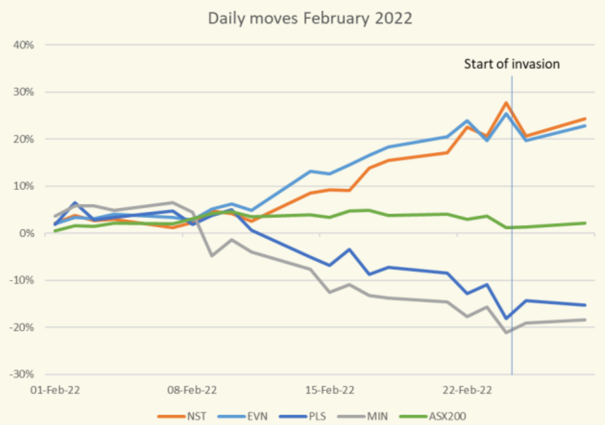
- Rosevalley's portfolio construction is based on human behavioural traits (notably Loss Aversion and Mental Accounting). While we can't say for certain, we can postulate that in a time of upheaval such as the current period, investors experience pressures that lead them to trade a bit differently than they would under normal circumstances. An example would be the performance of gold (a traditional "safe haven asset"), and thus listed gold mining companies: the portfolio was short gold stocks Evolution Mining (EVN) and Northern Star Resources (NST), both of which shot up almost 25% over the month, thus hurting the portfolio (see chart at bottom).

With all the context above we can understand why markets did what they did (yes, Narrative Fallacy at work, we know – please bear with us!). Overall, markets fell, with Germany the worst (large dependence on Russian gas for its power plants). The execption was Australia, with its larger share of resource companies on the local stock exchange.

	February 2022
MSCI World	-2.6%
S&P 500	-3.0%
DJIA	-3.5%
FTSE100	0.3%
DAX	-6.5%
Hang Seng	-4.6%
ASX-200	2.1%
Rosevalley 13/3	-8.6%
Rosevalley 10/0	-1.9%

Portfolio performance

As mentioned above, the Rosevalley portfolios had a bad month, underperforming the broader market by between 4-10%. Rosevalley 13/3 long-short did poorly: down 8.6% versus the market up 2.1%; the long-only faired much better: down 1.9% versus the market up 2.1%. The poor performance of the month is perhaps not surprising, if it is true that the usual behavioural traits were overcome by extreme tension driving unusual trading behaviour.



The shorts in the gold miners hurt, but paradoxically the longs in lithium miners Pilbara (PLS) and Mineral Resources (MIN) hurt as well (see chart at bottom). We can speculate that investors are speculating that the risk to energy markets world wide will lead to less focus on decarbonization – making lithium miners less valuable (at least for the time being).

Longer term performance

Since-inception numbers still look strong, albeit a bit below where we expect them to be over the long term. The 12-month number is currently slightly below market, even if it's still showing a respectable absolute number.

Execution

This month the usual sources of gross-net difference were favourable relative to the modelled expectation: the gross-net gap was -8 bps (vs. an expected -47 bps).

Rosevalley 13/3 Execution		
	Model	Realized
Gross performance	-8.58%	-8.58%
deviation from model portfolio		0.00%
difference between trade price and end-of-previous-month price	0.02%	0.11%
trading costs	-0.37%	-0.07%
borrow costs	-0.12%	-0.11%
Reported net performance	-9.05%	-8.66%

March Portfolio Manager model overrides

The portfolios for March have one long stock substitution for the 13/3 and 15/5 portfolios driven by concentration concerns: miners Iluka. The substitutes are Tabcorp in Rosevalley 13/3 and Incitec-Pivot in Rosevalley 15/5.

	13/3	15/5
Longs taken out	ILU	ILU
Replaced by	TAH	IPL
Comments	All changes driven by sector concentration considerations.	

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

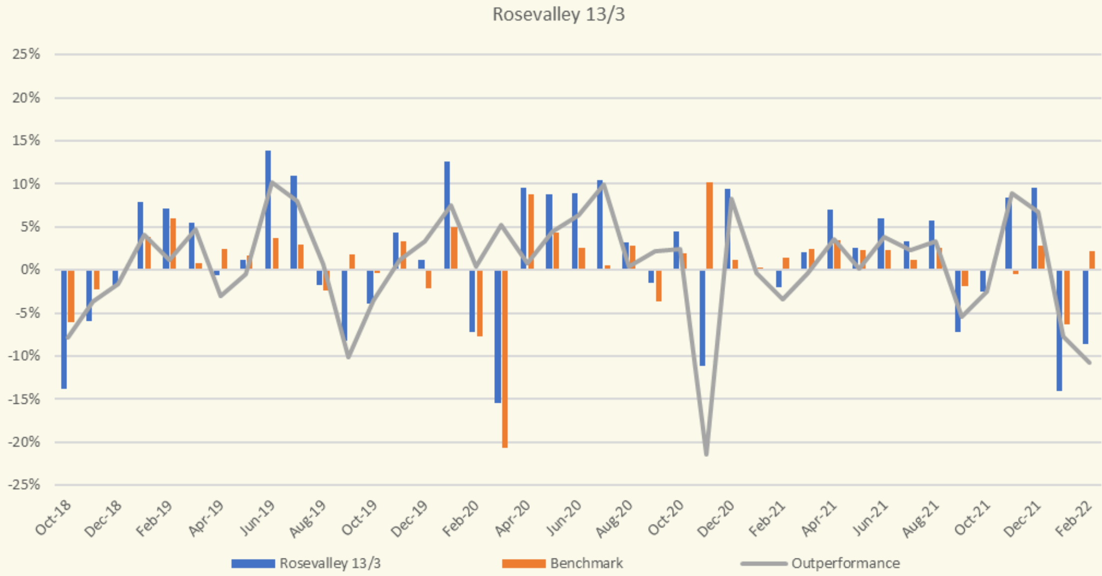
Rosevalley is a boutique funds manager with a unique approach to portfolio construction. Rosevalley Funds are constructed using the principles of Behavioural Finance (BF). Behavioural Economics and Behavioural Finance were developed over the past 30 years or so through the work of economists like Tversky,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

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