ROSEVALLEY FUNDS

Portfolio Report July 2022

The Rosevalley Behavioural Finance Funds

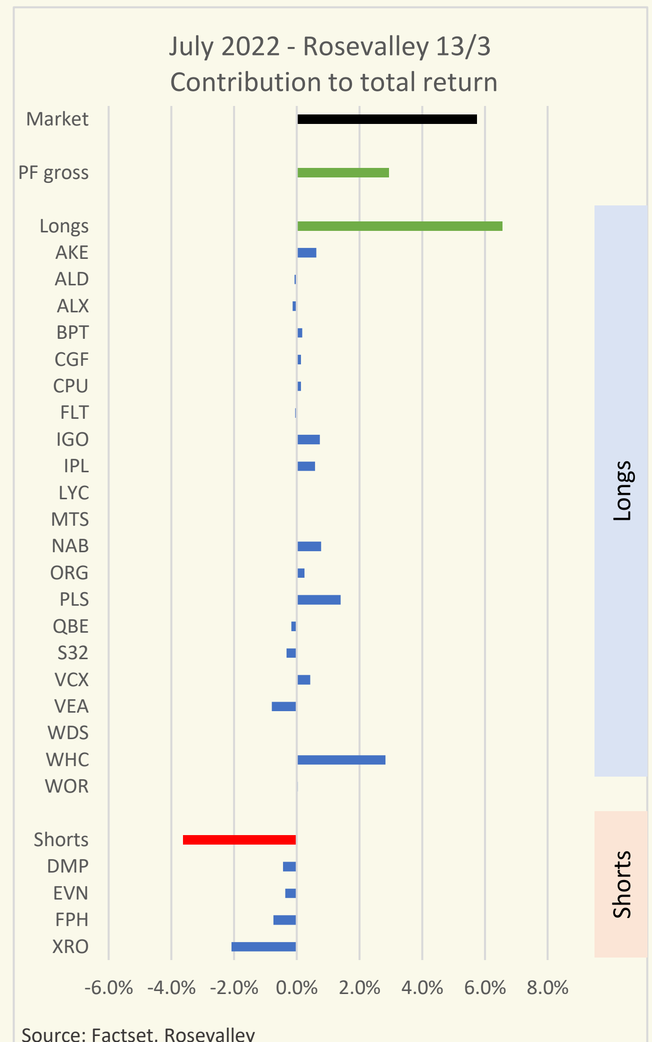
The Rosevalley Behavioural Finance Funds are high-conviction funds that take the theoretical and empirical evidence developed over the past 30 years in Behavioural Finance, and systematically build portfolios from these learnings. The portfolios are constructed on a benchmark-unaware basis, but performance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

The big comeback! That seems an appropriate headline for the month of July. As mentioned in the June report (written in late July), July was a month where interest rate hikes were coming through and expectations for a looming recession were firming up, but stockmarkets did well anyway.

	July 2022
MSCI World	8.0%
S&P 500	9.2%
DJIA	6.7%
FTSE100	3.7%
DAX	5.5%
Hang Seng	-7.3%
ASX-200	5.7%
Rosevalley 13/3	2.9%
Rosevalley 10/0	4.2%



Source: Factset, Rosevalley

Rosevalley was up as well, even though it underperformed the broader Australian market.

Why was the reaction of the market to a continuation of the same type of data so different in July as compared to June? A few things come to mind as possible arguments:

- The second 0.75% interest rate hike by the Fed "proves" how serious they are. Therefore the market anticipates that inflation will be tamed, and equity markets can relax – we'll soon be back to "normal" again, we don't have to worry about ongoing agressive interest rate hikes.
- The bond market has tempered its view on interest rates. In the chart on the right you can see that today's interest rates for government debt with a maturity of 5 year or longer is lower than one month

Source: Factset

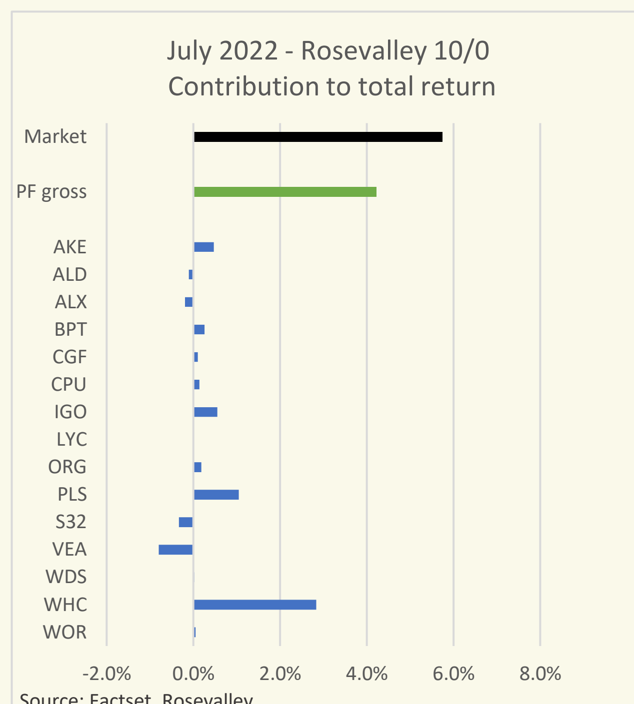
Performance as of July 2022								
Portfolio		1 month	3 months	6 months	1 year	Since inception annualized (1 Oct 2018)	Since inception annualized (14 Aug 2018)	Since inception annualized (1 Aug 2018)
Rosevalley 13/3	Gross	2.9%	-11.7%	-12.7%	-14.9%	11.2%		
	Net	2.7%	-12.4%	-13.9%	-18.0%	7.9%		
Rosevalley 15/5	Gross	1.3%	-11.2%	-16.0%	-18.3%		10.1%	
	Net[1]							
Rosevalley 10/0	Gross	4.2%	-8.5%	-3.5%	-4.9%			15.1%
	Net	4.1%	-8.5%	-4.1%	-3.2%			5.7%
ASX-200		5.7%	-6.0%	1.7%	-2.2%	6.7%	6.4%	6.4%

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.

ago (green line below red line). Interestingly, for 6-month-to-3-year debt, interest rates are now higher than a month ago – this translates into the bond market believing the Fed will continue to raise interest rates for a while longer, but that the end is in sight.

A side note on our favorite pet peeve: the behavioural aspect of the financial press. The chart of interest rates for different maturities as shown on the previous page is called the "Yield Curve". Under normal circumstances, the yield curve slopes upwards: investors demand a higher interest rate for locking up their money for a longer period of time. The picture today shows a hump on the left and a downward slope to the right – this is called an inverted yield curve. Every time this happens the financial press goes bananas and starts writing about a coming recession. The reason for this is the conventional wisdom that "every recession in the past 100 years was preceded by an inverted yield curve", or something similar. Few journalists bother to define "inverted yield curve" properly. The original academic paper (we looked it up – it seems we are the only ones[1]!) correlates an inversion of the yield curve on the 3-month-to-10-year timeframes, that persists for three months or longer, is a useful predictor of a recession 12-18 months later. Note that when comparing today's 3-month rate and 10-year rate, there is no inversion at all. Nor has there been recently. There certainly has not been an inverted yield curve that has lasted 3 months or longer. Why do journalists not pick up on these details? The behavioural answer is: the narrative fallacy, coupled with our brain's habitual lazyness. It is simply too easy and attractive a story to write: "Yesterday the yield curve inverted – recession on the way!"

Does this mean we believe there won't be a recession? Not at all – we think there will be one, we just don't base it on an incorrect reading of the yield curve. No, what has us worried is the coming squeeze in consumer spending. Central banks around the world are raising rates to bring down inflation. Higher interest rates means larger mortgage payments and higher credit card bills, and therefore less money left over to spend.This is occuring at a time when we have widespread price increases for a widespread range of consumer goods and energy prices. Spending comes down, ie. demand is less, which should bring prices down (or at least stop them rising). We (and many other market watchers and economist) are worried that central banks won't be able to fine tune their policies such that demand slows enough to lower inflation but not so much that the economy goes into a recession.



This is not necessarily all bad news. Unemployment is at record lows (in the US and Australia anyway). It would't hurt if it went from 3+% to 4+%, and if the demand and supply of jobs were in better balance (instead of 2-3

[1] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1001228

vacancies for every job seeker as we are currently experiencing).

What about stock markets? Our reading of history is that stock markets usually bottom out around the time recession arrives. On that theory, perhaps counterintuively, we say: Bring it on!!

Portfolio performance

The Rosevalley portfolios had a decent month, even if they slightly underperformed the market. Rosevalley 13/3 was up 2.7% and Rosevalley 10/0 was up 4.1%.

The performance was broad-based, with most longs contributing and all shorts detracting. The standouts to mention were Whitehaven (WHC), a coal company that benefited from higher coal prices, and Pilbara Minerals (PLS), a lithium miner.

Longer term performance

Since-inception performance numbers now look weaker than before, albeit the portfolios are still returning about twice the market returns.

Execution

This month the usual sources of gross-net difference were favourable for the portfolio: the gross-net gap was -24 bps (vs. an expected -34 bps).

Rosevalley 13/3 Execution

	Model	Realized
Gross performance	2.94%	2.94%
deviation from model portfolio		-0.01%
difference between trade price and end-of-previous-month price	-0.02%	0.00%
trading costs	-0.19%	-0.07%
borrow costs	-0.12%	-0.14%
Reported net performance	2.60%	2.70%

August Portfolio Manager model overrides

The portfolios for August have no stock substitutions.

See the appendices for full detail on the list for August.

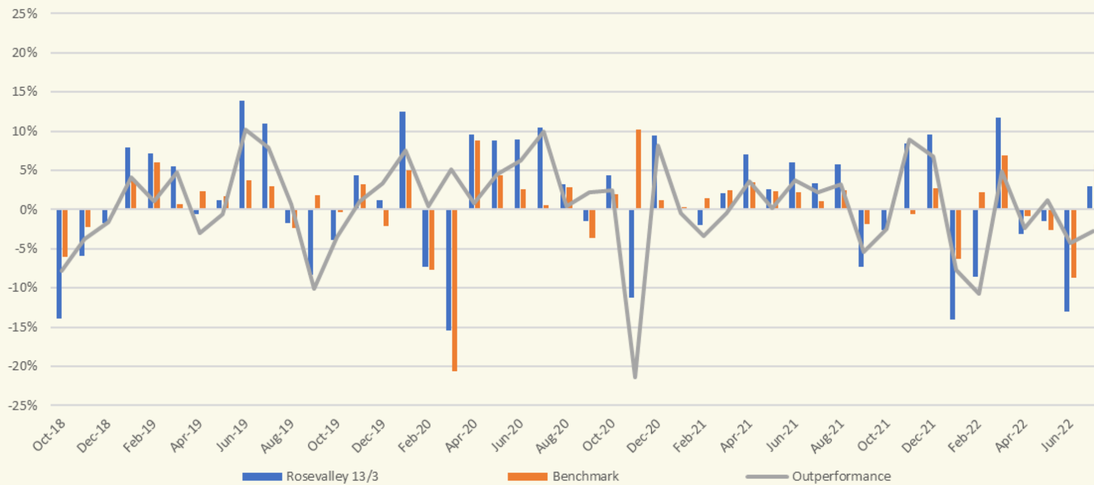
Some context for readers who are less familiar with Rosevalley Funds:

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 August-August 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 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.

The material contained in this communication (and all its attachments) is general information only and has been prepared by Rosevalley Advisory Pty Ltd ("Rosevalley"). It is not intended to take the place of professional advice and you should not act on any recommendation (if any) made in this communication without first consulting your investment advisor in order to ascertain whether the recommendation (if any) is appropriate, having regard to your investment objectives, financial situation and particular needs. Nothing in this communication shall be construed as a solicitation to buy or sell a security or to engage in or refrain from engaging in any transaction. Rosevalley believes that the information and advice (if any) contained herein is correct at the time of compilation. However, Rosevalley provides no representation or warranty that it is accurate, complete, reliable or up to date, nor does Rosevalley accept any obligation to correct or update the opinions (if any) in it. The opinions (if any) expressed are subject to change without notice. Rosevalley does not accept any liability whatsoever for any direct, indirect, consequential or other loss arising from any use of the material contained in this communication. This communication August refer to the past performance of a person, entity or financial product. Past performance is not a reliable indicator of future performance. Investors should obtain the relevant product disclosure statement and consider it before making any decision to invest.

ROSEVALLEY FUNDS

Behavioural Finance Funds

info@rosevalleyfunds.com
+61-457-807-914
www.rosevalleyfunds.com