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# Selector High Conviction Equity Fund

## Monthly report – October 2019

## Market insights

In a month marked by growing global unrest, the domestic market retreated. After a turbulent month, the All Ordinaries Index closed down 0.41% to 6,773 points. Interest rates remained a focus domestically while geopolitical relationships have dominated international headlines.

The Reserve Bank (RBA) again cut the official interest rate by 0.25% to a record low of 0.75%. The Treasury acknowledged that bank profits are expected to come under pressure despite Prime Minister Scott Morrison declaring banks were unjustly *"profiteering"* by failing to pass on the full value of the three recent rate cuts. Coupled with over $8b of remediation costs provisioned by the big four banks, the RBA has acknowledged that pressures are building and is exploring options to stimulate the economy. This may include offering discounted loans to banks.

While the U.S. unemployment rate hit a 50-year low, the need for intervention in the short-term money market does not appear to be easing. The Federal Reserve cut interest rates for the third time this year to a range of between 1.50% to 1.75%, while signalling that further reductions are unlikely unless the economy slowed sharply.

In geopolitical news, pro-democratic and anti-government movements have erupted globally. While Hong Kong's separatist protests have continued unabated, this month civilians have taken to the streets of Spain, Lebanon, Chile and Ecuador. While the catalyst differs in each region, the underlying sentiment is consistent. Broad based dissatisfaction with leadership including abuse of civil liberties, financial mismanagement and corruption are at the centre of global unrest. In Australia, the relatively peaceful, Extinction Rebellion climate change protests took place across the country.

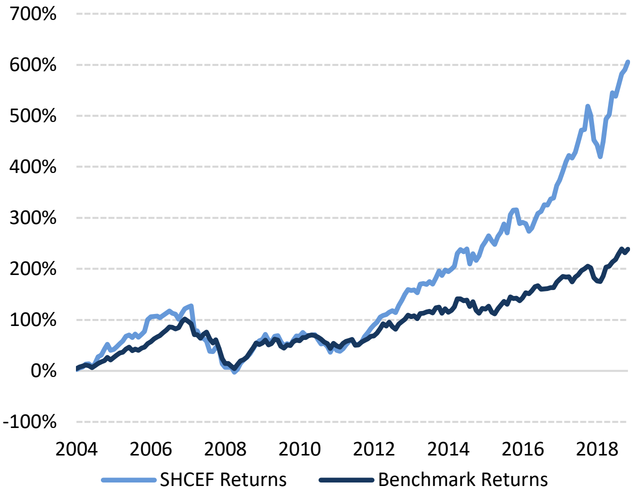
The U.S.- Sino trade dynamic continues to evolve. While the outlines of a partial trade deal were agreed, China accused the U.S. of meddling in *"domestic affairs"* such as the treatment of Uyghur Muslims and Hong Kong. This is in response to sanctions imposed by the U.S. against Chinese officials and a bill which was passed requiring an annual review of Hong Kong's autonomy from Beijing in order for it to retain its special trading status.

Balancing domestic interests and Chinese relations remains a challenge for corporations. The iron fist of the communist party was felt by the National Basketball Association (NBA) after Houston Rockets manager, Daryl Morey, tweeted his support for the Hong Kong protestors. The NBA's unwillingness to discipline Morey, saw China deliver a king hit, as it swiftly moved to sever ties with the NBA, estimated to be worth US$500m per annum. U.S. Vice-President Mike Pence has spoken out against China's intervention in Hong Kong, denouncing companies bowing to their oppressive influence. Pence called out Nike for removing Houston Rockets merchandise from their stores in response to Morey's tweet; *"Nike promotes itself as a so-called social-justice champion, but when it comes to Hong Kong, it prefers checking its social conscience at the door"*.

We continue to seek businesses with:

1. Competent management teams
2. Business leadership qualities
3. Strong balance sheets
4. A focus on capital management

## Cumulative returns since inception




Inception Date: 30/10/2004
Before fees, costs and tax, and assuming reinvestment of distributions

## Top holdings

| Company name | Code | Weight (%) |
|---|---|---|
| Aristocrat Leisure | ALL | 6.06 |
| Jumbo Interactive | JIN | 5.32 |
| Seek | SEK | 5.12 |
| Infomedia | IFM | 4.99 |
| ResMed Inc | RMD | 4.81 |
| James Hardie Industries | JHX | 4.75 |
| Altium | ALU | 4.73 |
| Nanosonics | NAN | 4.71 |
| Cochlear | COH | 4.40 |
| Flight Centre Travel Group | FLT | 4.37 |

## Unit prices as at 31 October 2019

| | |
|---|---|
| Entry price | $3.1132 |
| Mid price | $3.1054 |
| Exit price | $3.0976 |

## Performance as at 31 October 2019*

| | FYTD | 1 Month | 3 Months | 6 Months | 1 Year | 3 Years | 5 Years | 10 Years | Since Inception |
|---|---|---|---|---|---|---|---|---|---|
| Fund (net of fees) | 7.49 | 1.40 | 4.14 | 9.98 | 26.84 | 20.26 | 16.99 | 14.09 | 11.87 |
| Fund (gross of fees) | 9.09 | 1.89 | 5.40 | 11.38 | 30.17 | 22.73 | 19.28 | 16.28 | 14.04 |
| All Ords Accumulation Index | 2.44 | (0.37) | (0.50) | 7.72 | 19.39 | 12.42 | 8.76 | 8.34 | 8.44 |
| Difference (gross of fees) | 6.65 | 2.26 | 5.90 | 3.66 | 10.78 | 10.31 | 10.52 | 7.94 | 5.60 |

*Performance figures are historical percentages, calculated using end of month redemption prices, and do not allow for the effects of income tax or inflation. Returns assume the reinvestment of all distributions. Performance can be volatile and future returns can vary from past returns.

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## Portfolio commentary

### ResMed (RMD:ASX)

Global sleep solutions business ResMed delivered a very strong first quarter performance with market share gains across both sleep apnea devices and masks. Management continues to build upon the connected care strategy of out of home care, that is extending beyond the original obstructive sleep apnea (OSA) market to now include chronic obstructive pulmonary disease (COPD). These are early days but the interconnection that is underway between a host of industry service providers and ResMed, servicing patients in the out of hospital setting, is illustrative of the transformative changes underway and the role that digital and cloud technology is delivering.

For the quarter, ResMed lifted global group revenues by 17% to US$681m, while higher gross margins and reduced operating costs led to net profits, adjusted for amortisation, up 22% to US$135.4m compared to US$116.2m in the comparable period. This was underpinned by U.S. device sales growth of 8% and masks up 19%, well above industry growth rates of 5% and mid-single digit rates respectively. In particular, the release of a suite of new masks over the course of the year has the business achieving strong market share gains. This is being supported by a resupply program that automatically restocks patient masks, removing delays and the potential for competitive responses.

The group's Software-as-a-Service (SaaS) offering is continuing to take shape and underpins the longer-term potential of servicing a growing number of out of hospital patients, targeting the respiratory segment. In addition, the SaaS operations allow for recurring levels of revenue, at higher gross margins, which is contributing to higher overall group gross margins. For the quarter, gross margins lifted from 58.3% to 59.5%.

Financially, the company continues to fully expense research and development costs, which continues to run at 7% of group revenues. Operating margins lifted to 28%, a function of disciplined cost management and business scale.

### Flight Centre Travel Group (FLT:ASX)

This month Flight Centre Travel Group released a preliminary trading outlook ahead of the more detailed FY20 profit guidance to be released in November. Despite total transaction value (TTV) increasing solidly during Q1 FY20, the period has proved challenging with underlying profit below the prior corresponding period. CEO Graham Turner commented that stabilisation was expected during Q2 FY20 with underlying profit likely to be heavily weighted towards the second half of FY20.

The softness in net income has primarily been driven by; a comparatively high profit benchmark set in Q1 FY19, continued political unrest and uncertainty caused by Brexit and safety concerns in traveling to the Dominican Republic. In addition, increased costs due to the new wage model introduced in October 2018, reduced interest earnings from lower Australian yields and higher debt funding have contributed to the softer profit guidance.

Despite the challenging trading conditions Flight Centre has faced, the company reported strong growth in online leisure sales in Australia with sales doubling during Q1 FY20.

## Performance contributors

| Top five | Contribution (%) |
|---|---|
| Infomedia | 0.57 |
| IOOF Holdings | 0.49 |
| IRESS | 0.35 |
| Nanosonics | 0.34 |
| Domino's Pizza Enterprises | 0.33 |

| Bottom five | Contribution (%) |
|---|---|
| Flight Centre Travel Group | (0.52) |
| Jumbo Interactive | (0.48) |
| OFX Group | (0.30) |
| Altium | (0.17) |
| Sims Metal Management | (0.16) |

## Industry exposure

| Industry group | Weight (%) |
|---|---|
| Consumer Services | 21.88 |
| Software & Services | 21.60 |
| Health Care Equipment & Services | 16.48 |
| Materials | 6.45 |
| Capital Goods | 6.20 |
| Diversified Financials | 5.77 |
| Commercial & Professional Services | 5.12 |
| Pharmaceuticals, Biotechnology & Life Sciences | 3.67 |
| Insurance | 3.23 |
| Household & Personal Products | 2.99 |
| Energy | 2.94 |
| Media & Entertainment | 2.28 |
| Cash & Other | 0.78 |
| Consumer Durables & Apparel | 0.61 |

## About Selector

Selector Funds Management ("Selector") specialises in high conviction, index agnostic, concentrated portfolio management (AFSL 225316). The investment team have a high level of experience, are owners of the business and invest in the funds alongside clients. Selector has a long-term track record of performance.


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