selector

Selector High Conviction Equity Fund

Monthly report – May 2021

Market insights

The V-shaped economic recovery post the COVID-19 shock of 2020 has been mirrored by the share market. The All Ordinaries Index closed out the month at a record high of 7,407, well above its pre-COVID peak of 7,121. Over the month, miners and producers including BHP, Rio Tinto and Fortescue have benefitted from new highs in iron ore prices surging beyond US$200 per tonne.

A significant focus domestically has been on the ugly $161b Federal Budget deficit delivered for 2021. The AFR Chanticleer best summed up the 2021 Budget, *"a deficit of 1 per cent of GDP is forecast to persist until 2031-32. By then, deficits will have lasted for 24 years, barring the one year the Coalition managed to balance the budget."*

We now find ourselves in a predicament as a nation. Debt is now not only acceptable but justified on almost any grounds. Net debt will increase to $617.5b, or 30% of GDP ($2.05t) this year, and peak at $980.6b, or 40.9% of GDP ($2.42t) in June 2025 based on current Budget forecasts. The upside, taking the Government's rhetoric, is that our overall debt position to GDP *"is low by international standards".*

However, the stability of national debt is predicated on interest rates remaining at current rock bottom levels. A level which the Reserve Bank of Australia has publicly endorsed as recently as March 2021, *"our judgment is that we are unlikely to see wages growth consistent with the inflation target before 2024. This is the basis for our assessment that the cash rate is very likely to remain at its current level until at least 2024."*

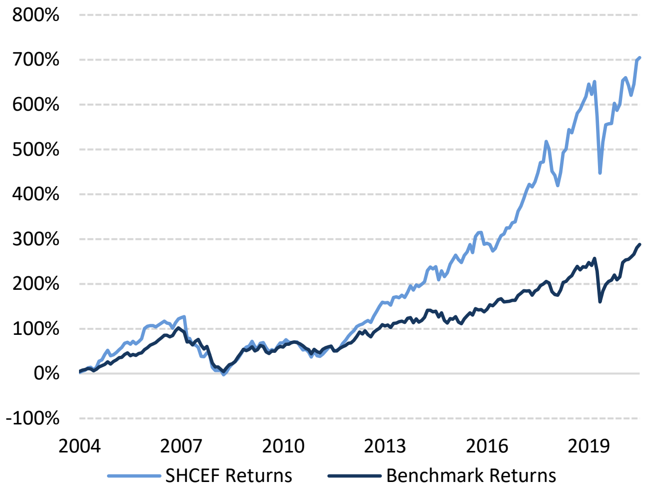
The Budget forecast for the annual interest bill alone is estimated to hit $17.3b per annum. While the promise of rates remaining lower for longer is alluring, we encourage you to consider this number not only at its current level, but also at its potential. If rates were to double from current forecasts, the implied annual interest costs would similarly double to $34b. This is before factoring in the additional circa $350b in national debt the Government is expecting to incur by 2025. The economy no doubt would be hit hard. This also goes to the heart of why we do not see talk of interest rate rises as being sustainable in an era of Budget deficits and soaring debt levels.

The other dilemma we face is the closing of our international borders until mid-2022 as suggested by the Government. This restriction is stopping the flow of offshore skilled workers and students, thereby squeezing businesses at the very time that the Government is pushing through massive stimulus packages. The Government did well to marshal the JobKeeper program during the early days of COVID-19. However, they seem unable to outline a coherent plan to reopen our borders with all the necessary health protocols and quarantine infrastructure in place to allow all quarters of our economy to function more efficiently. The fact that we still do not function as one united country but are dictated by health officials in each State illustrates how non-sensical this approach is. Ultimately, this will come back to bite us and reflects a lack of true leadership.

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 (%)
Domino's Pizza Enterprises	DMP	6.90
James Hardie Industries	JHX	6.19
Aristocrat Leisure	ALL	5.94
Reece	REH	5.72
carsales.com	CAR	4.85
TechnologyOne	TNE	4.56
Cochlear	COH	4.49
SEEK	SEK	4.44
CSL	CSL	4.26
ResMed	RMD	4.21

Unit prices as at 31 May 2021

Entry price	$3.4000
Mid price	$3.3915
Exit price	$3.3830

Performance as at 31 May 2021*

	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	15 Years	Since Inception
Fund (net of fees)	0.60	11.23	5.92	21.21	11.56	13.61	15.30	9.13	11.28
Fund (gross of fees)	0.73	11.67	6.77	22.86	13.70	15.72	17.45	11.13	13.39
All Ords Accumulation Index	1.96	7.90	11.70	29.96	10.44	10.47	8.86	7.04	8.52
Difference (gross of fees)	(1.23)	3.77	(4.93)	(7.10)	3.26	5.25	8.59	4.09	4.87

*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. For periods greater than one year, returns are annualised. Performance can be volatile and future returns can vary from past returns.

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Portfolio commentary

James Hardie Industries (JHX:ASX)

Leading fibre cement producer James Hardie delivered a strong fourth quarter and full year 2021 performance, marking eight consecutive quarters of consistent, profitable growth. At a group level, total sales lifted 12% to US$2.9b, while adjusted net income (NOPAT), excluding asbestos payments increased 30% to US$458m. Operating margins improved to 21.6% from 18.7% last year.

The business transformation that has occurred since CEO Jack Truong took over the reins in early 2019 is undeniable. James Hardie has embraced world class manufacturing standards via LEAN, enhanced global supply chain operations, rolled out a globally integrated management system, and furthered relationships with customers via a push/pull demand creation strategy. Into FY22, the company is seeking to take this push/pull strategy further through direct engagement with the ultimate decision maker, the homeowner. With this new piece in place, the company is guiding towards FY22 NOPAT of between US$520-US$570m.

James Hardie has a current market capitalisation of $19.4b.

Fisher & Paykel Healthcare Corporation (FPH:ASX)

Leading respiratory care group Fisher & Paykel Healthcare reported exceptional growth over FY21, albeit a modest miss to market expectations. The primary driver of this result was the Hospital segment which grew 87% as nasal high flow oxygen therapy devices became widely adopted for treating patients with COVID-19. As a result, group revenue increased 56% to NZ$1.97b with net profits after tax rising 82% to NZ$524m.

The operational feat of driving this level of growth over a year despite supply chain disruptions and physical distancing requirements should not be overlooked. For some hospital products, Fisher & Paykel lifted production sixfold with output of hospital consumables doubling. This required recruitment and training of 1,800 new staff over a tumultuous period.

The company has increased its dividend to NZ$0.22, bringing the total annual dividend to NZ$0.38, an increase of 38%. Due to ongoing uncertainty, the company has refrained from providing guidance for next year.

Fisher & Paykel has a current market capitalisation of $16.2b.

Nearmap (NEA:ASX)

Eagle View Technologies and Pictometry International have filed a complaint against Nearmap's U.S. subsidiary. The complaint alleges patent infringement relating to roof-estimation technology. Importantly, this does not affect the core business of capturing imagery or the delivery of premium content to users.

CEO and Managing Director, Dr Rob Newman commented, *"Nearmap has always taken the subject of intellectual property rights and patent protections seriously and believes the allegations are without merit. We will vigorously defend against the complaint. The business remains unaffected by the complaint."*

Nearmap has a current market capitalisation of $870m.

Performance contributors

Top five	Contribution (%)
Aristocrat Leisure	0.62
CSL	0.29
IOOF Holdings	0.26
OFX Group	0.25
Computershare	0.25

Bottom five	Contribution (%)
Fisher & Paykel Healthcare Corporation	(0.44)
Infomedia	(0.41)
Flight Centre Travel Group	(0.24)
Nanosonics	(0.23)
Nearmap	(0.18)

Industry exposure

Industry group	Weight (%)
Software & Services	22.34
Consumer Services	18.22
Health Care Equipment & Services	14.98
Media & Entertainment	10.77
Capital Goods	9.13
Materials	6.19
Diversified Financials	4.91
Pharmaceuticals, Biotech & Life Sciences	4.76
Automobiles & Components	2.44
Insurance	2.39
Household & Personal Products	2.06
Consumer Durables & Apparel	1.35
Cash & Other	0.48

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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