

# Selector High Conviction Equity Fund

Monthly report – October 2021

## Market insights

Following an extended period of COVID restrictions, and with vaccination rates hitting targeted safety levels, the NSW Government took the necessary steps to reopen the economy. While financial market indexes were largely unmoved, headlines were dominated by rising inflation concerns, ongoing supply constraints, interest rate expectations and China's slowing growth profile.

In the U.S. consumer prices rose again in September leading to an inflation reading of 5.4%, measured year on year and matching the largest annual shift since 2008. While well above the Central Bank's 2% target, U.S. Federal Reserve Chair Jerome Powell, believes the elevated price pressures relate to supply-chain bottlenecks and other transitory developments tied to the reopening of the economy. The Feds September minutes indicated that half the 18 officials that participated expect U.S. interest rates to be increased by the end of 2022. The bond markets are clearly reflecting a view that rates will rise, with both short and long dated paper lifting during October. At month end, the two year and ten year U.S. bond yields stood at 0.52% and 1.57% respectively.

Domestically, despite the Reserve Bank of Australia (RBA) having pledged to not increase the cash rate before 2024, markets are betting that rising inflation will persuade the Central Bank to raise rates sooner and faster than previously guided. Peers in Norway, Brazil, Mexico, South Korea, and New Zealand are among those to have already raised interest rates. N.Z. cash rates rose 25 basis points and now sit at 0.50%. In Australia, repercussions of any sustained increase in rates will be hard felt in the property market, where 65% of home loans sit above 4x income and 22% at the 6.5x level.

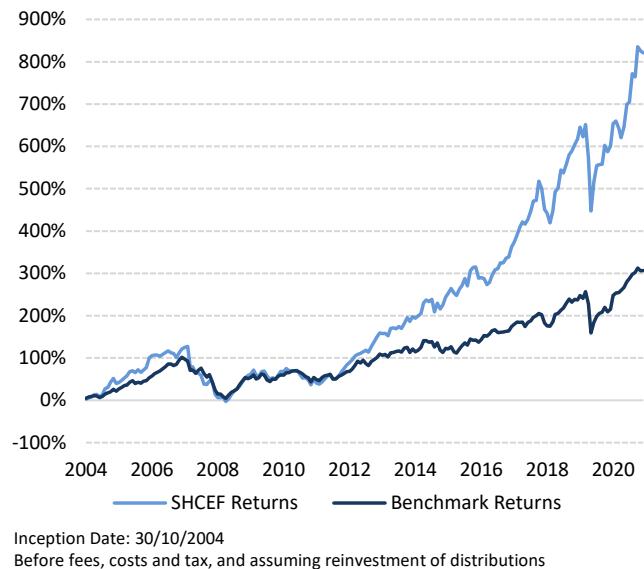
Reports swirled that China tested a nuclear capable hypersonic weapon. This was later confirmed by Mark Milley, The Chairman of America's Joint Chiefs of Staff, who described it as a "significant technological event". Separately, LinkedIn said it would shut the version of its professional-networking site that operates in China, marking the end of the last major American social-media network operating openly in the country.

While a string of property developer defaults saw high yield corporate bonds skyrocket, China's most serious problem is slower growth. China's GDP grew by 4.9% year on year in the third quarter and industrial production expanded by only 3.1% in September. As Yale University faculty member and former chairman of Morgan Stanley Asia Stephen Roach explained, "*the new dual thrust of Chinese policy – redistribution plus re-regulation – strikes at the heart of the market-based "reform and opening up" that have underpinned China's growth miracle since the days of Deng Xiaoping in the 1980s. It will subdue the entrepreneurial activity that has been so important in powering China's dynamic private sector, with lasting consequences for the next, innovations-driven, phase of Chinese economic development. Without animal spirits, the case for indigenous innovation is in tatters.*"

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



## Top holdings

| Company name               | Code | Weight (%) |
|----------------------------|------|------------|
| Domino's Pizza Enterprises | DMP  | 6.47       |
| James Hardie Industries    | JHX  | 5.92       |
| Aristocrat Leisure         | ALL  | 5.85       |
| Altium                     | ALU  | 5.37       |
| carsales.com               | CAR  | 5.09       |
| TechnologyOne              | TNE  | 4.95       |
| ResMed                     | RMD  | 4.78       |
| Reece                      | REH  | 4.45       |
| Cochlear                   | COH  | 4.15       |
| SEEK                       | SEK  | 3.95       |

## Unit prices as at 31 October 2021\*

|             |          |
|-------------|----------|
| Entry price | \$3.8554 |
| Mid price   | \$3.8458 |
| Exit price  | \$3.8362 |

## Performance as at 31 October 2021\*

|                             | 1 Month | 3 Months | 6 Months | 1 Year | 3 Years | 5 Years | 10 Years | 15 Years | Since Inception |
|-----------------------------|---------|----------|----------|--------|---------|---------|----------|----------|-----------------|
| Fund (net of fees)          | (0.52)  | 5.89     | 14.07    | 29.40  | 16.36   | 16.65   | 17.73    | 8.69     | 11.81           |
| Fund (gross of fees)        | (0.52)  | 6.59     | 15.27    | 31.45  | 18.65   | 18.86   | 19.93    | 10.70    | 13.94           |
| All Ords Accumulation Index | 0.15    | 1.13     | 6.87     | 28.97  | 12.91   | 11.37   | 10.19    | 6.71     | 8.60            |
| Difference (gross of fees)  | (0.67)  | 5.46     | 8.40     | 2.48   | 5.74    | 7.49    | 9.74     | 3.99     | 5.34            |

\*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

### Aristocrat Leisure (ALL:ASX)

In October, global gaming operator Aristocrat Leisure announced the strategic acquisition of U.K. listed Playtech for \$3.9b, implying an enterprise value of \$5.0b. Playtech is one of the leading online gambling software suppliers with expertise in developing software platforms and content.

Playtech provides scale in Real Money Gaming (RMG) which consists of iGaming products (online slots, live casinos, and poker) and online sports betting. iGaming is a natural adjacency to Aristocrat's existing offering and provides complementary growth channels for gaming content.

To fund the acquisition, Aristocrat expects to raise \$1.3b in new equity capital, with the remainder to be financed through the company's corporate debt facility and \$1.1b of existing cash. Pending approval, the transaction is expected to complete in Q2 CY22. Post synergies, the acquisition is expected to be earnings per share (EPS) accretive in the first full year of ownership (FY23).

Aristocrat has a current market capitalisation of \$31.6b.

### Reliance Worldwide Corporation (RWC:ASX)

Specialist plumbing fittings manufacturer Reliance Worldwide Corporation announced its intention to acquire EZ-FLO, a leading manufacturer and U.S. distributor of plumbing supplies and specialty plumbing products.

The strategic acquisition will accelerate growth in the North American market and immediately positions Reliance as a leader in major appliance installations through EZ-FLO's EASTMAN brand. EZ-FLO is expected to improve Reliance's competitiveness, providing manufacturing and sourcing capabilities in China, alongside a network of seven distribution centres in the U.S.

The US\$325m acquisition will be debt funded with Reliance's pro-forma leverage increasing to 1.78x, compared with 0.62x as of 30 September 2021. Within three years, Reliance is expecting to realise \$10m in annual synergistic cost savings post acquisition. EZ-FLO recorded net sales of US\$169m and adjusted EBITDA of US\$27m in the year to 31 July 2021.

Reliance has a current market capitalisation of \$4.6b.

### ResMed (RMD:ASX)

This month, leading out-of-hospital medical device, mask, and software provider, ResMed reported its 1Q FY22 result. The group delivered ahead of market consensus despite ongoing global supply chain constraints, with revenue increasing 20% to US\$904m and adjusted operating profits up 18% to US\$280.7m.

CEO Farrell described the quarter as an "*unprecedented perfect storm*", involving the re-opening of demand post COVID, supply shortages of critical components and the demand impact of the full product recall of nearest competitor Philips' DreamStation 1 CPAP devices in June. It is estimated that the recall contributed between US\$80m to US\$90m in additional sales over the quarter with the Global Devices segment increasing revenue by 31%. The company noted that not all demand could be met. The Masks and Software as a Service (SaaS) segments also performed well over the period increasing sales by 9% and 6% respectively.

ResMed has a market capitalisation of US\$38.6b and net debt of US\$530m. The company declared a quarterly dividend of US\$0.42 per share.

## 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.

## Performance contributors

| Top five                       | Contribution (%) |
|--------------------------------|------------------|
| TechnologyOne                  | 0.37             |
| Appen                          | 0.35             |
| Reliance Worldwide Corporation | 0.32             |
| SEEK                           | 0.20             |
| Altium                         | 0.19             |
| Bottom five                    | Contribution (%) |
| Domino's Pizza Enterprises     | (1.26)           |
| Infomedia                      | (0.56)           |
| Flight Centre Travel Group     | (0.21)           |
| Nanosonics                     | (0.21)           |
| FINEOS Corporation Holdings    | (0.18)           |

## Industry exposure

| Industry group                           | Weight (%) |
|--|------------|
| Software & Services                      | 24.65      |
| Consumer Services                        | 17.86      |
| Health Care Equipment & Services         | 14.80      |
| Media & Entertainment                    | 10.28      |
| Capital Goods                            | 7.59       |
| Materials                                | 5.92       |
| Diversified Financials                   | 4.37       |
| Pharmaceuticals, Biotech & Life Sciences | 4.35       |
| Insurance                                | 2.33       |
| Automobiles & Components                 | 2.30       |
| Household & Personal Products            | 2.26       |
| Cash & Other                             | 2.10       |
| Consumer Durables & Apparel              | 1.18       |

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