

Selector High Conviction Equity Fund

Monthly report – May 2022

Market insights

With COVID visibly at an endemic stage, investor focus has shifted to inflation, monetary policy decisions and the subsequent threat of an economic slowdown and recession. Sentiment remains bearish with the All-Ordinaries Index falling 3.5% to 7,455, its second consecutive monthly decline.

Inflation has become 2022's new 'COVID' as record readings have forced central banks (CBs) to pull out all stops in achieving containment. The two big monetary levers, aggressive cash interest rate hikes and the shrinking of the government's balance sheet through quantitative tightening (QT), are now underway. The U.S. Federal Reserve has earmarked cash rates to reach 3% by year's end from its current 0.75% level.

As CBs try to 'thread the needle', and achieve maximum employment and price stability, the biggest risk facing investors today is from policy errors. Specifically, CB's striving to attain R-star, referred to as the real interest rate that is neither expansionary nor contractionary when the economy is at full employment. The current aggressive cash rate outlook elevates the risk of overshooting R-star, leading to unintended economic consequences, and exacerbating the inevitable slowdown. New Zealand provides an early read into this, having lifted cash rates to a record beating 2% without curtailing inflation, while economic growth has begun to slow.

Macquarie Strategist Viktor Shvets echoes this, believing central banks will have no choice but to back pedal in due course, *"CBs and fiscal authorities are facing severe limitations on their ability to tighten, and we still expect both monetary and fiscal policies to once again become stimulative into '23-24"*.

In May, the Australian Financial Review (AFR) wrote that sentiment among fund managers was about as low as it goes, with cash weightings up from 4.1% to 6.1%, while positioning in the technology sector swung from 40% overweight to 12% underweight. The article iterates the bearish sentiment in equities, *"JPMorgan strategist Marko Kolanovic calculates U.S. equity markets are pricing in a 70 per cent chance of a U.S. recession in the near term, but that is much higher than the 50 per cent chance ascribed by the investment-grade debt market, the 30 per cent chance priced in by the high-yield debt market, and the 20 per cent chance in rate markets."*

Compounding this negative sentiment was research produced by analysts at Macquarie Bank, Wei Sim and Darren Leung titled, *"Aussie tech – The (potential) downside risk for tech"*. Released as markets were roiling, the piece assesses how current Australian 'tech' companies compare to those in 2000. While fundamentally, the companies today differ vastly from those in the dot com era, the analysis relies on the sole metric of Enterprise value (EV)/sales to draw its conclusions. Unfortunately, in our opinion, this one misses the mark.

While acknowledging the difficult macroeconomic backdrop, our focus is on the individual businesses and their actions. Ultimately, the fundamentals do matter and focusing on what can be controlled and understood, based on facts, is a solid place to be.

We continue to seek businesses with:

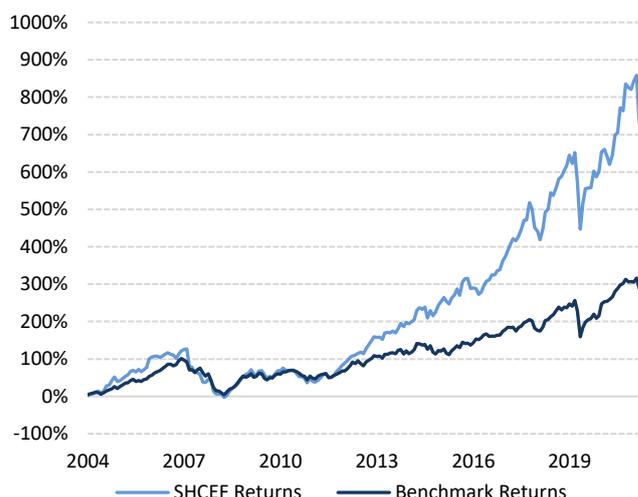
1. Competent management teams
2. Business leadership qualities
3. Strong balance sheets
4. A focus on capital management

Performance as at 31 May 2022*

	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years	15 Years	Since Inception
Fund (Net of fees)	(5.23)	(6.66)	(21.20)	(9.04)	3.37	10.55	15.22	6.60	10.01
Fund (gross of fees)	(5.10)	(6.29)	(21.07)	(7.60)	5.28	12.56	17.31	8.55	12.08
All Ords Accumulation Index	(3.13)	2.72	0.25	4.73	8.48	9.34	10.46	5.36	8.30
Difference (gross of fees)	(1.97)	(9.01)	(21.32)	(12.33)	(3.20)	3.22	6.85	3.19	3.78

*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.

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 (%)
Cochlear	COH	5.15
CSL	CSL	5.10
TechnologyOne	TNE	4.98
carsales.com	CAR	4.98
Altium	ALU	4.85
Aristocrat Leisure	ALL	4.79
James Hardie Industries	JHX	4.68
ResMed	RMD	4.45
Computershare	CPU	4.29
Reece	REH	4.05

Unit prices as at 31 May 2022

Entry price	\$3.0925
Mid price	\$3.0848
Exit price	\$3.0771

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Portfolio commentary

Aristocrat Leisure (ALL:ASX)

Global gaming operator Aristocrat Leisure reported a strong half year 2022 result with group revenue up 23.1% to \$2.7b and EBITDA rising 30.3% to \$970.3m. In Land-based, total gaming revenue rose 38.3% to \$1.4b, driven by market leading game performance. Digital revenue grew 6.4% to US\$953.4m. The company also announced its intention to implement an on-market share buyback program of up to A\$500m funded from existing cash reserves. Aristocrat Leisure has a market capitalisation of \$23.6b and net cash of \$524m.

James Hardie Industries (JHX:ASX)

In May, leading fibre cement producer James Hardie reported its FY22 result with net sales growing 24% to US\$3.6b and adjusted net income (NPAT) excluding asbestos payments up 36% to US\$621m. For FY23, the company reaffirmed strong guidance for NPAT to be within the range of US\$740m-US\$820m, representing a 26% increase at the midpoint relative to FY22. James Hardie has a current market capitalisation of A\$16.8b and net debt of US\$761.4m.

Fisher & Paykel Healthcare Corporation (FPH:ASX)

Leading respiratory care manufacturer Fisher & Paykel Healthcare reported its FY22 result with operating revenues down 15% to NZ\$1.7b while net profits fell 28% to NZ\$376.9m. To provide some perspective, FY19 revenue was NZ\$1b. Looking forward, the company is well positioned, having accelerated the release of new products and applications, grown its sales teams globally, and continued to expand manufacturing and distribution facilities. Fisher & Paykel Healthcare has a market capitalisation of \$10.7b and net cash of \$221.6m.

Infomedia (IFM:ASX)

This month, Infomedia received two indicative proposals for 100% acquisition from TA Associates and Battery Ventures with the latter offering the higher price of \$1.75. Infomedia intends to provide the same limited historical information to the multiple interested parties. Infomedia has a market capitalisation of \$643m.

OFX Group (OFX:ASX)

International payment services provider OFX Group delivered a record FY22 result with revenue up 17.7% to \$158m and underlying EBITDA rising 53.1% to \$44.5m. All regions grew revenue by double digits with Asia Pacific up 12.8% to \$83.7m, North America up 27.8% to \$43.1m and EMEA up 26% to \$28.9m. The record performance was underpinned by investments in people and technology, with the purpose of driving operational efficiencies and business scale. OFX has a market capitalisation of \$590m and net debt of circa \$15.8m following the completion of the Firma acquisition.

TechnologyOne (TNE:ASX)

Global enterprise resource planning (ERP) software provider TechnologyOne reported its half year 2022 result with revenue increasing 19% to \$172.5m and net profit before tax lifting 14% to \$33.2m. Software-as-a-Service (SaaS) annual recurring revenue (ARR), seen as a better indicator of management execution and business quality grew 44% to \$225.1m. Notably, revenue from SaaS and Continuing Business now represents over 97% of total revenue. TechnologyOne has a market capitalisation of \$3.5b and net cash of \$116.4m.

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.

The information presented in this fact sheet is not intended to be advice. It has not been prepared taking into account any particular investor or class of investors investment objectives, financial situation or needs, & should not be used as the basis for making investment, financial or other decisions. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information. SFML does not guarantee the repayment of capital, payment of income or performance.

Performance contributors

Top five	Contribution (%)
Infomedia	0.76
PolyNovo	0.21
nib holdings	0.13
Aristocrat Leisure	0.07
TechnologyOne	0.02
Bottom five	Contribution (%)
Altium	(0.69)
James Hardie Industries	(0.64)
SEEK	(0.55)
ARB Corporation	(0.46)
Computershare	(0.40)

Industry exposure

Industry group	Weight (%)
Software & Services	26.45
Health Care Equipment & Services	14.91
Consumer Services	14.83
Media & Entertainment	9.32
Capital Goods	6.47
Diversified Financials	5.87
Pharmaceuticals, Biotech & Life Sciences	5.52
Materials	4.68
Cash & Other	4.01
Insurance	2.94
Household & Personal Products	1.97
Automobiles & Components	1.84
Consumer Durables & Apparel	1.20

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