SGH Australia Plus Fund

SG HISCOCK & COMPANY

31 August 2019

Fact Sheet

Investment objective	To outperform the S&P/ASX300 Accumulation Index by 5% on a rolling 3 year basis		
Investments held	Generally within the largest 300 companies listed on the ASX, plus companies listed in Asia with a focus on Asian domestic consumption.		
Investment Manager	SG Hiscock & Company		
APIR	ETL0383AU	**Buy spread**	+ 0.25%
Commencement	8 October 2013	**Sell spread**	- 0.25%
Management costs[1]	0.70% p.a.	**Performance Fee**[2]	20% capped at 1.25% in any calendar year, subject to a highwater mark
Minimum initial investment	$20,000	**Fund size**	$8.99 million

Unit Prices as at 31 August 2019	**Purchase**	**Net Asset Value**	**Withdrawal**
	1.4709	1.4672	1.4635

Performance as at 31 August 2019[3]	**1 mth %**	**3 mths %**	**6 mths %**	**1 yr %**	**2 yrs % p.a.**	**3 yrs % p.a.**	**Incept' % p.a.**
Distribution Return	0.00	0.80	0.81	2.34	5.59	5.81	7.94
Growth Return	-2.82	0.51	1.78	-5.84	1.74	3.25	6.73
Total Net Return	-2.82	1.30	2.59	-3.50	7.33	9.07	14.67
S&P/ASX 300 Accumulation Index	-2.27	4.30	9.53	9.14	12.25	11.34	8.96
Total Net Return vs. the Index	-0.54	-2.99	-6.94	-12.64	-4.92	-2.27	5.71

Top 5 holdings as at 31 August 2019
Australia & New Zealand Banking Group Limited
CSL Limited
National Australia Bank Limited
Macquarie Group Limited
James Hardie Industries SE

Top 5 holdings represent 28.66% of the total Fund.

Why Australia Plus?

1. We want access to the best quality companies in Asia, at the right price. It is the choice, but not the obligation to invest in emerging companies with strong local franchises
2. The strong rise in both the sheer number of Asians entering the middle class and the growth in disposable income, suggests that this is a multi year trend that is very hard to access by restricting the investible universe to Australian listed stocks.
3. Investors appropriately diversify their portfolio by enhancing returns with a focus on the domestic demand thematic within Asia.
4. It offers Australian investors a wider opportunity set without the requirement to have money invested in Asia through a pooled vehicle.
5. By focussing purely on the domestic demand thematic in Asia, our investible universe grows by 40-50 stocks outside the ASX300. This is a very narrow subset of Asian stocks that meet our basic quality filters and would consider owning at the right price.

1. Includes estimated GST payable, after taking into account reduced input tax credits (RITC).
2. A performance fee of 20% (net GST and an estimate of RITC) of any investment return above the fund's benchmark may also be payable as expense of the fund, capped at 1.25% in any year, subject to a highwater mark
3. Performance: Total Net Return is the Fund return after the deduction of ongoing fees and expenses assuming the reinvestment of all distributions.

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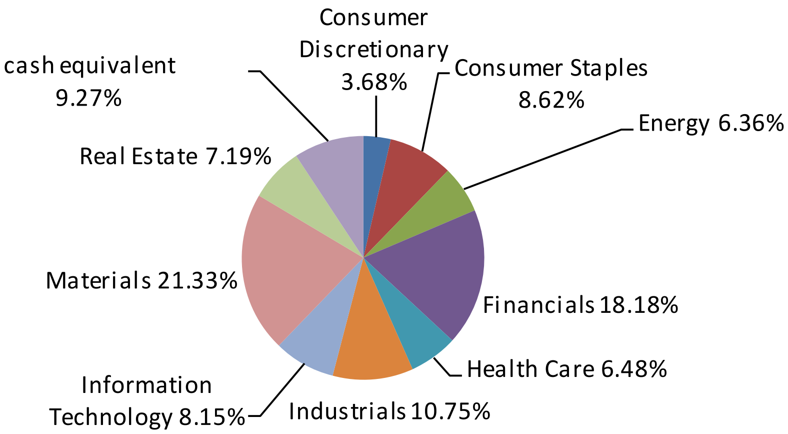
Asset allocation as at 31 August 2019



Commentary

Having regained its pre-GFC highs in July, the momentum did not last long, with the ASX300 Index down 2.3% in August. A mostly disappointing results season together with a weak month for Energy (-5.6%) and Materials (-7.6%) sectors combined to pull the market back. Healthcare and REITS were the only sectors to eke out positive returns at 3.5% and 0.7% respectively. A key negative in the month was the 28.5% fall in iron ore prices, which was a negative delta for the earnings of iron ore companies, and for Australian household income in general. On the plus side, Australia's housing recovery appears to be gathering momentum, with house prices rising again post the recent rate cuts. However, it looks like physical construction activity will still contract in FY20.

Global equity markets declined in August, with the MSCI Global Equity Index (ex Aust hedged $A) down 2.1%, reducing the gain for the year to date to 15.3% while almost erasing the gain for 12 months. Across the regions performance was broadly negative.

The tone for August was set at the beginning of the month with US President Trump's announcement of a 10% tariff on the remaining US$300bn of Chinese exports to the US, citing frustration with the lack of progress on trade talks. When the Chinese yuan dropped through the key 7 level, markets became increasingly concerned over a serious escalation in the trade war. The US Treasury's declaration on August 6 that China was a currency manipulator added to the risk-off dynamic.

Growing trade and geo-political concerns saw the US 10-year yield dropping -52bp in the month. This decline markedly outpaced the compression at the front end of the curve (2Y: -37bp), which resulted in the US 10Y/2Y curve ending the month inverted, prompting further fears of a sharp slowdown in economic activity. While much has been said of inverted yield curves and their historical links, there is a school of thought, however, that "this time is different", that the term premium has disappeared and that central bank purchases have distorted the yield curve signal. In any case, the escalation and broadening of the conflict in the trade, IT and currency spheres saw markets fall around 5% within the first few days of August. Weaker manufacturing data in the US, Europe and China (production growth weakest in 17 years) only added to concerns over the growth outlook during the month.

The August reporting season provided a welcome distraction from the ongoing geopolitical circus, and brought its normal bout of volatility, and was generally subdued from an earnings perspective. Only 25% of companies managed to report ahead of expectations and close on 70% of companies experienced earnings downgrades, with every sector seeing downgrades to consensus earnings per share. The ratio of consensus eps downgrades to upgrades hit the highest level since the GFC and the average eps revisions of -9% was higher than recent periods of -6.5%. The ASX200 recent trends of boosting shareholder returns at the expense of re-investment continued with dividends per share increasing by 13% versus eps growth of 3% and 41% of Free Cash Flow was directed to capital returns above this decade average of 31%.

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Adding to soft earnings, there was a deterioration in the key metrics around earnings quality. One-offs were around 24% of underlying profit, while earnings were boosted by the lowest effective tax rate since 2009.

The main bright spots were sectors exposed to an improving trend in discretionary spending thanks to RBA easing, tax cuts and tentative signs property prices are recovering (discretionary retailers, gaming, on-line real-estate). On the negative side there was a longer list of disappointments with Housing Construction (weaker outlooks), Packaging (weak demand, cost inflation), Miners (higher costs), China Consumer Exposures (regulatory impacts, softer consumer), Financials (rising costs, impacts of lower rates), Telcos (NBN headwinds).

Share price performance was driven more by multiple expansion, with the resurgence of the traditional high- P/E cohort (ie. valuations are more stretched!) to the resurrection of some, but not all, domestic cyclicals. The travails of those exposed to the Sinking construction cycle were laid bare through disappointing results from the likes of Adelaide Brighton and Boral. Costs remained under the microscope both relative to inflation and in an absolute sense currently in a net cash position and trading on ~15x FY21 earnings.

Portfolio Performance & positioning

During the month we added Cleanaway Waste Management (CWY) and Phoslock Environmental Technologies (PET) to the portfolio.

We have been following CWY closely for some time and saw recent share price weakness around the result as an opportunity. CWY owns post collections assets (i.e. landfill, transfer stations etc.) and provides collections services to councils, commercial and small to medium enterprises (SME) across a broad range of industries. The post collection assets are high margin and returning assets as they have high barriers to entry given the EPA licences required (with lengthy approval times) and locations while the collection service is lower margin and more capital intensive business similar to a logistics business.

CWY revenue growth is relatively stable benefitting from combination of CPI increases, population growth and economic activity. It has a dominant position in the collections and post collections markets with 40-50% market share and is well positioned with the inevitable structural changes coming since the introduction of China National Sword Policy (banning importation of contaminated recycling waste into China) and the lack of domestic waste management infrastructure. CWY is set to benefit from industry consolidation as many business models are no longer viable (which were reliant on selling waste to China), as in the case of SKM in Victoria, rising landfill fees, building necessary waste management infrastructure, increased waste stream separation and usage of recycling plastics in many industries seeing CWY waste inventory increasing in value overtime.

PET is an emerging company specialising in water treatment products and engineering solutions to remediate water ways, including rivers, canals and drinking water reservoirs using a CSIRO developed product called Phoslock. This environmentally friendly product removes` excess phosphate and other contaminates without damaging the marine life. Currently, the only other available solutions are sub-par and contain damaging chemicals – this is Phoslock's key competitive advantage.

The potential growth for PET is extremely large – the Chinese government alone has allocated over US$1tn in the last five years to address water, air and soil population. Further, there are growing opportunities in North and Latin America. Gross profit margins are high (given the IP product) and the cost of expansion is relatively low, allowing PET to deploy incrementally more capital at high returns on capital. PET is

Fact Sheet

During the month Saracen Minerals continued to perform strongly, with the flight to gold around global geo-political concerns and lower rate expectations. The company also released its 4Q19 production guidance which showed a solid finish to FY19, first time FY20 guidance and reiteration of its commitment to grow production to 400kozpa by 2021.

Treasury Wine Estates also contributed strongly in the month on the back of industry sales data showing increased momentum in the premiumisation of its US portfolio and a solid FY19 result, which showed good cash conversion, an issue which has been overhanging the stock. The result also provided evidence management appear to be continuing to invest in the business and manage brands for the longer term with a more than doubling in the China sales team during the year, and not producing the highly profitable Bin 707 label with the V17 Penfolds release because quality hurdles were not met.

Carsales.com and James Hardie also reported good results and provided positive outlook commentary during the reporting season. We continue to remain attracted to the longer term growth potential of Carsales.Com, which we see as a dominant company in its industry with scalable platform and international growth options, particularly in Korea. James Hardie delivered a strong 1Q20 result driven by solid growth in its core US exteriors fibre cement business. This provided the first credible signs of an improvement in the business under new CEO Jack Trong, and that the new execution plan is starting to gain traction.

Lendlease, which has more recently been plagued with problems around its domestic Australian Civil Engineering business, was also a key contributor in the month. The decision to classify the Engineering business as non-core and sell it has seen the market start to focus back on the underlying core business which has a strong track record and we believe is undervalued. The recent US$15bn partnership announcement with Google to build three mini-communities in Silicon Valley over the next 15 years is a good example of the type of long term urban regeneration project that should help drive future earnings growth and a further re-rating in the company.
Orora was the major disappointment during reporting season, with its US business reporting a weak result on the back of cyclical slowdown in its Orora Product Services (OPS) business, and first time FY20 guidance implying little profit growth.

We have reduced our expose to the banking sector in ANZ and NAB as the RBA continues to flag potentially lower interest rates and remaining low for longer. At these very low interest rates it becomes increasingly difficult for bank to generate sufficient interest rate spreads between deposits and loans potentially eroding banking profitability further.