SGH SG HISCOCK & COMPANY

SGH Ex-20 Australian Equities Fund

31 January 2024

Performance[1]	Total Net Return	S&P/ASX300 Accumulation Index excl. S&P/ASX20 Leaders Index	Total Net Return vs. the Index
1 month (%)	0.98	0.45	0.53
3 months (%)	11.16	12.98	-1.82
6 months (%)	2.29	0.73	1.56
1 year (%)	6.35	4.33	2.02
3 years (% pa)	3.19	6.30	-3.11
5 years (% pa)	7.22	7.85	-0.63
7 years (% pa)	6.61	8.14	-1.53
10 years (% pa)	9.12	9.15	-0.03
Inception (% pa)	8.73	9.88	-1.15

Past performance is not a reliable indicator of future performance.

[1] Total Net Return is the Fund return after the deduction of ongoing fees and expenses and assumes the reinvestment of all distributions.

- For January the portfolio increased by +0.98% (net of fees), outperforming the S&P/ASX300 Accumulation index excl. S&P/ASX20 Leaders Index's +0.45%.
- The traditional pre-earnings 'confession' season appeared to be more muted, with negative trading updates seemingly isolated to a handful of company specific issues rather than broader signs of a weakening demand environment. There wasn't a discernable theme with negative trading updates from Domino's Pizza, medical device company Nanosonics, employment services provider APM, and data services business Appen (all unheld).
- We expect the upcoming Februrary reporting season to produce results that are broadly inline or perhaps even slightly ahead of expectations given consumer demand at the end of 2023 have been fairly resilient. However, cost pressures will likely be the recurrent theme, so it will be important in providing confirmation around earnings trends and their sustainability, but also in determining whether capital continues to flow more the mid and smaller cap names and we continue to see markets grind higher.
- Looking out over the course of the next 12 months we believe that there is prospects of a better balance between inflation and growth.

Key Facts

Investment manager	SG Hiscock & Company Ltd.
Launch date	31 December 1992
Benchmark	S&P/ASX 300 Accumulation Index excluding S&P/ASX 20 Leaders Index
Management fees[2]	0.95%
Performance fee	Nil
Fund size	$46.02M
Dividends payable	Semiannual
Buy/sell spread	+0.25/ -0.25%
Minimum initial investment	$20,000
Base currency	AUD
APIR	CRS0003AU
mFund code	SFZ19
Domicile	Australia
	Unit price
Application	$5.0655
Net Asset Value	$5.0529
Withdrawal	$5.0403
	Distribution cpu
30-Jun-22	2.7819
31-Dec-22	3.7500
30-Jun-23	1.7333
31-Dec-23	3.8552

[2] Includes estimated GST payable, after taking into account Reduced Input Tax Credits ("RITC").

Fund Strategy

Our focus is to identify businesses with 'quality sustainable growth' that are mispriced. The portfolio composition is determined by our confidence and conviction in the underlying quality of the business and margin of safety to valuation.

Investment Objective

To outperform the benchmark, the S&P/ASX 300 Accumulation Index excluding S&P/ASX 20 Leaders Index, after fees, over rolling three-year periods.

Investment Held

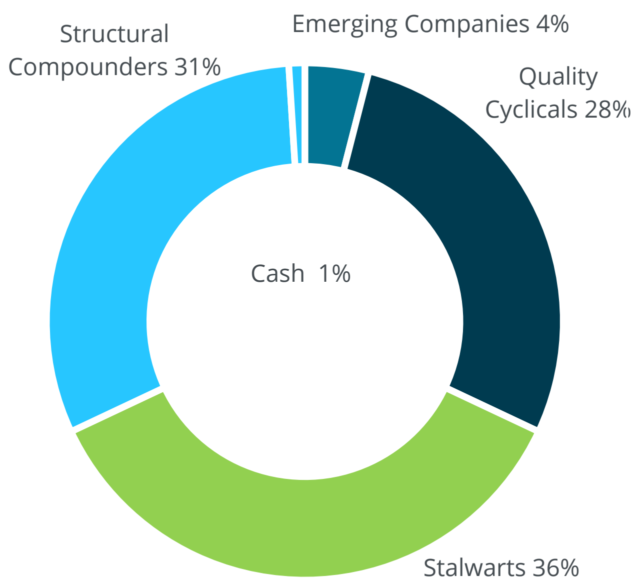
A portfolio of 20 to 60 stocks that are listed on the Australian Securities Exchange, excluding the largest 20 securities in the S&P/ASX 300 Accumulation Index (as determined by their market capitalisation).

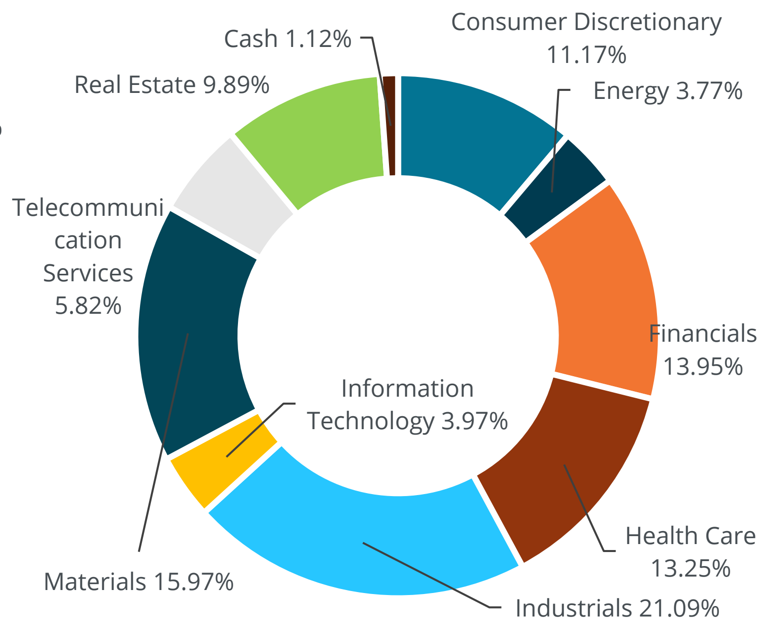
Top 5 Holdings (in alphabetical order)
Beach Energy Ltd
Chorus Limited
Infratil Ltd
Northern Star Resources Ltd
Resmed Inc.

Top 5 holdings represent 21.2% of the total Fund.

Top 5 Contributors	**Top 5 Detractors**
Resmed Inc.	Gold Road Resources
AUB Group	Worley Limited
Judo Capital Holdings	Pilbara Minerals Limited
Infratil Limited	Mondadelphous Group Limited
Johns Lyng Group	Charter Hall Social Infrastructure REIT

Asset Allocation: The Fund





Monthly Observations and Outlook

After a brief pause in early January when markets gathered their collective breath, equities were able to shrug off a slow start and finish the month in positive territory assisted by further evidence that inflation was cooling and data supporting resilient economic growth.

The US S&P 500 was up 1.6% while the local market closed up 1.1%. The Healthcare, Financials and Energy sector led the gains, increasing 4.3%, 5.0% and 5.2% respectively while the Utilities and Materials sectors fared the worst, down 1.5% and 4.8% respectively.

Bonds yields reversed some of their recent rally as investors digested the new round of economic data and the level of optimism priced into rate cut expectations, particularly in the US.

There were a couple of interesting economic data points that caught our eye during the month. Right at the month end, the Australian Consumer Price Index (CPI) came in slightly lower than expected at 4.1% annual rate.[1] While signalling no more rate hikes the print was also supportive of future domestic rate cuts in line with global peers. However, market expectations for the first cut remain in the second half of the year.

The European Central Bank (ECB) kept interest rates unchanged[2] and made sure that investors understand that rate cuts are “not immediately on the table”. In general, central banks are keen to be seen as prudent, and not getting ahead of themselves in calling victory on inflation. One should expect that messages coming out of the RBA, ECB, Bank of England and the Federal Reserve will be cautious with regards to the timing of rate cuts.

For the 2023 December quarter, US GDP growth came out stronger than expected and both the US Manufacturing and the Services Indices showed signs of improvement.

The People’s Bank of China, conscious of the stresses in the system, cut the Reserve Ratio Requirements (RRR) for banks by 50 basis points from February 5.[3] This is in part a recognition of the stresses that property companies are facing, as evidenced by the order by a Hong Kong Court, to one of China's biggest property developers, Evergrande Group, to liquidate after it was unable to reach a restructuring deal with creditors who are owed hundreds of billions of dollars. While this is not a surprise, it has the potential to further weigh on business and consumer confidence and add to concerns of Chinese stagflation.

Not a data point as such, but the likelihood of Mr Trump becoming the next US President, has increased with early primary voting results for the Republican nomination. This is despite court cases, damages, and a multitude of negative headlines. One is unsure how equity markets will greet this news but it raises a number of questions around US domestic and foreign policy and potential for unpredictable pivots and shifts and market volatility.

Looking out over the course of the next 12 months we continue to believe that there is prospects of a better balance of inflation and growth. When and how quickly central banks may cut rates will be influenced by how this places out, which in turn is likely to be heavily influenced by employment conditions.

[1] Consumer Price Index, Australia, December Quarter 2023 | Australian Bureau of Statistics (abs.gov.au)
[2] Press conference (europa.eu)
[3] China cuts bank reserves to defend markets, spur growth | Reuters

This will also be important in determining whether the rally we have seen over recent months continues to broaden out. Performance has mainly been driven by multiple and valuation expansion on lower rate expectations, not earnings. This has been most evident in large cap stocks where capital has flowed first. The February reporting season will be important in providing confirmation around earnings trends and their sustainability, but also in determining whether capital continues to flow more the mid and smaller cap names and we continue to see markets grind higher.

Portfolio positioning & performance

For the month of January, the portfolio rose by +0.98%, outperforming our benchmark index by 53 basis points.

Global sleep therapy leader **Resmed CDI (RMD, +14%)** was our key outperformer for the month. The company released a solid quarterly result showing continued top line growth coupled with good cost management resulted in gross margin finally seeing a recovery. Just as importantly, with the stock decimated mid-2023 due to the concerns that the rising popularity of GLP-1 was going to materially reduce the addressable market of obstructive sleep apnea patients, management used this set of results to present a number of counteracting statistical evidence, which helped give the market comfort. Resmed continues to be a large position in the fund, particularly as we believe the management team is one that is agile and has risen to numerous challenges over the years, whilst overall sector market conditions also remains favourable to them, noting its key rival Philips's consent decree with the FDA will likely hold them back from coming back into the market in any meaningful way for quite some time. Rising freight cost as a result of the shipping disruptions in the red sea as well as the volatile changing sentiment towards GLP-1s remain as near-term risks, however we remain confident that the long-term growth of this business remains sustainable and undervalued.

SME lender, **Judo Capital (JDO, +18.0%)** was a strong contributor to performance this month. The company provided a positive trading update indicating that front book lending margins have improved and together with lower than expected credit losses, profits for FY24 will meaningfully exceed market's expectations. Furthermore, Judo reassured investors that the company's net interest margins will trough in 2H24 as the business cycles through the refinancing of the low cost, pandemic era Term Funding Facility (TFF).

Insurance building services business, **Johns Lyng Group (JLG, +11.2%)** also performed strongly in January 2024. Cyclone activity in Queensland combined with flooding in parts of Victoria is likely to boost the future pipeline of restoration work for Johns Lyng. A large number of insurance claims have been lodged as a result of these catastrophe events and with Johns Lyng having a leading national presence, we expect there to be material make safe and restoration work to be awarded to the company over the coming months. Subsequent to the month end, the company also announced its first major national insurance panel win in the USA, which we anticipate will accelerate the company's US growth strategy.

Our poorest performer for the month was western Australian miner, **Gold Road Resources (GOR, -22.7%).** The company announced quarterly results and forward guidance which disappointed investors due to lower than targeted production volumes and higher operating costs. The main challenge the company is currently facing is a tight labour environment in Western Australia, with its mining contractor unable to attract sufficient labour to ramp up production at the company's Gruyere mine. While this is likely to remain a near term headwind, there are positive signs that labour availability is improving in that region due to the shutdown of neighbouring facilities. This should see an improvement in production over the coming quarters which will ultimately help to reduce per unit operating costs and lift the miner's cash margins. We continue to view the underlying

asset at Gruyere as one of the highest quality gold assets available domestically, with a long mine life and low on the cost curve.

Global engineering services contractor **Worley Ltd (WOR,-15%)** was also an underperformer for us this month. There were primarily two pieces of bad news that contributed to the underperformance. First was in relation to Worley losing an arbitration dispute regarding $59m in unpaid trade receivables for a contract in Ecuador awarded back in 2011, with the international tribunal apparently ruling Worley's claims as inadmissible owing to these contract wins being tainted by illegality and bad faith. The company subsequent ASX release advised that the said subcontractors (employed by Worley at the time) once found to be corrupt by the local courts had their employment terminated, and that various internal processes for the engagement of business partners/subcontractors as well as approval and recording of entertainment expenses have since improved. We don't believe this piece of news was particularly material as it relates to historic contracts and that it bears no impact to future earnings of the company. The second negative piece of news was out of the US, whereby the Biden administration has decided to seek additional environmental evaluation across several LNG projects, one of which includes the Venture Global CP2 LNG project which Worley was awarded for last year. Market estimates a delay could impact ~5% to earnings, with a full cancellation being closer to 10%. Whilst this was indeed disappointing, we believe the market's reaction is starting to appear a little overdone, noting the growing demand for resources to deliver sustainability related work continues to grow, with Worley very well placed to assist other companies in achieving their respective goals.

Tier 1 lithium producer **Pilbara Minerals Ltd (PLS, -10%)** became a detractor again this month, which perhaps is not all that surprising as we previously predicted that lithium prices will continue to remain volatile in the short term. With spot prices at these low levels, we continue to see small higher cost miners being put under immerse pressure, which longer term would only mean that supply will simply struggle to keep up with demand. To reiterate, notwithstanding our constructive structural demand outlook for this sector, we continue to believe Pilbara Minerals as a low cost established miner, with a strong balance sheet and as such its ability to support future growth remains well placed

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