SGH SG HISCOCK & COMPANY

SGH Ex-20 Australian Equities Fund

29 February 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 (%)	1.65	3.40	-1.75
3 months (%)	7.14	10.72	-3.58
6 months (%)	4.25	5.66	-1.41
1 year (%)	9.69	9.63	0.06
3 years (% pa)	5.00	7.46	-2.46
5 years (% pa)	6.78	7.46	-0.68
7 years (% pa)	6.59	8.38	-1.79
10 years (% pa)	8.78	8.98	-0.20
Inception (% pa)	8.76	9.97	-1.21

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.

- In February the portfolio increased by +1.65% (net of fees), underperforming the S&P/ASX300 Accumulation index excl. S&P/ASX20 Leaders Index's +3.40%.
- Equity markets appear to be continuing to favour the 'goldilocks' scenario where growth slows but not too much, corporate earnings remain resilient, and inflation continues to cool allowing central backs to cut rates.
- The February reporting season produced corporate earnings that in aggregate, were ahead of expectations. There was however wide dispersion in performance across sectors. Consumer discretionary was a strong outperformer as resilient sales momentum and clean inventory positions during the period meant that a discounting cycle was avoided and retailers were able to extract better margins as freight costs and other inflationary pressures eased. Outlook statements however, were generally muted and much is dependent on how the ongoing economic slowdown will impact consumer spending over the coming months.
- Other observations include: 1) the significant (and often unjustified) volatility in share price reactions through reporting season. I.e. a number of stocks that delivered outsized outperformance were not a result of large earnings upgrades, and were in fact primarily driven by multiple re-rating, and well as 2) continued heightened M&A activity benefitting selective stocks (e.g. ALU +30.4% despite a material earnings miss, amongst several others) .

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	$43.6M
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
SIV	Compliant and audited
	Unit price
Application	$5.1493
Net Asset Value	$5.1365
Withdrawal	$5.1237
	Distribution cpu
30-Jun-22	2.7819
31-Dec-22	3.7500
30-Jun-23	1.7333
31-Dec-23	3.8551

[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).

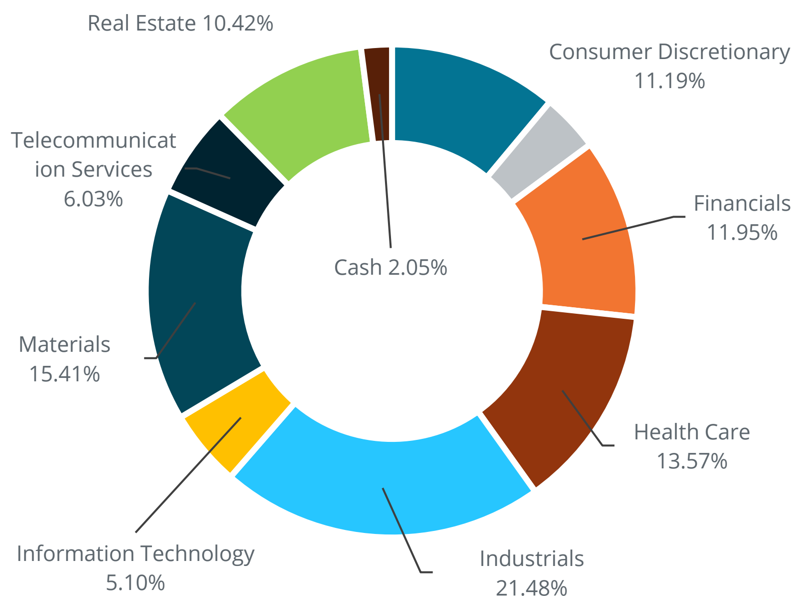
Top 5 Holdings (in alphabetical order)
Chorus Limited
Cochlear Limited
Infratil Ltd
Northern Star Resources Ltd
Resmed Inc.

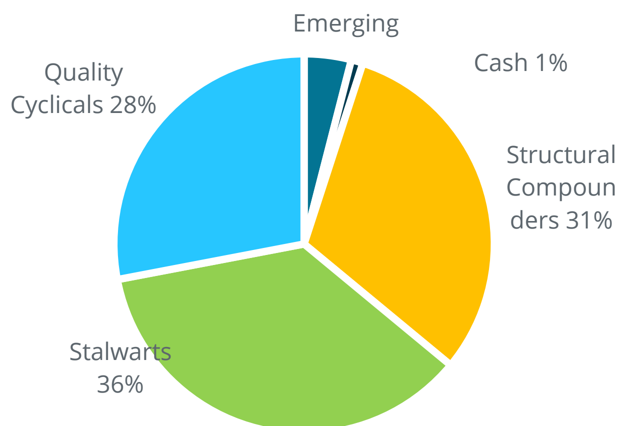
Top 5 holdings represent 21.3% of the total Fund.

Top 5 Contributors	**Top 5 Detractors**
NEXTDC Limited	Resmed Inc.
Pilbara Minerals Limited	Deterra Royalties Limited
ARB Corporation Limited	Lifestyle Comunities Limited
Worley Limited	Johns Lyng Group
Cochlear Limited	Beach Energy Limited

Asset Allocation: The Fund

	Fund (%)
Consumer Discretionary	11.19
Energy	3.83
Financials	11.95
Health Care	13.57
Industrials	21.48
Information Technology	5.10
Materials	15.41
Telecommunication Services	6.03
Real Estate	10.42
Cash equivalent	1.01





Monthly Observations and Outlook

The ASX 300 Accumulation Index provided a modest return of 1.0% underperforming global peers, with the US S&P500 the standout market up 5.3%, while Japanese equities were up 4.9%.

Technology continued to provide a major driver both here and abroad with NVIDIA rising 29%, adding to its 225% annual gain. The performance of the "magnificent seven' US tech stocks has become more nuanced based on their perceived leverage to the AI theme. Apple (-2%) and Alphabet's (-1.4%) performance was more subdued. Domestically, technology (+19.7%) and consumer discretionary (+9.7%) were the best performers while materials (-4.8%) and energy (-5.9%) lagged.

For markets hoping to see a continued easing in inflation pressures leading to a near term US central bank rate cut, the latest Consumer Price Index (CPI) report in the US was disappointing. [1]

For January, the report showed the monthly pace of inflation accelerated from prior months on both a "headline" and "core" (excluding food and energy) basis. While January data can sometimes produce aberrant results (often caused by volatility in weather conditions), it caused bond markets to wind back their expectations of US interest rate cuts starting in March.

However, equity markets appear to be continuing to favour the 'goldilocks' scenario where growth slows but not too much, corporate earnings remain resilient, and inflation continues to cool allowing central backs to cut rates. This "soft-landing" scenario has increasingly become the prevailing consensus view. If this was to change or the data no longer supported this narrative, there is a growing risk of a market pullback given the strength of the recent run.

In Australia, the latest inflation report was more supportive of markets with the Australian Bureau of Statistics (ABS) reporting the Australian CPI rose 3.4% in the 12 months to January 2024, steady with the rate recorded in December, and at the lowest annual rate since November 2021.

In contrast the RBA's preferred wage measure – the Wage Price Index - rose by 0.9% in the December quarter taking the annual rate of wage growth to 4.2%, the highest increase since March 2009.

Because much of the inflation pressures present in Australia are "home-grown" and emanating from the services sector, for which wages are a very significant proportion of overall costs, the RBA is acutely focussed on trends in wage rates. In isolation it is hard to see how the latest report gives the RBA any reason to bring forward their rate cutting cycle.

The key risk for investors who have been hoping for central bank rate cuts sooner rather than later is that the persistence of inflationary pressures is pushing out the prospects of interest rate relief, with monetary officials assessing that the risks from cutting too early are less than the risks of cutting too late.

The domestic reporting season delivered its usual degree of volatility with some patchy performances late in the month offsetting early strength in domestic cyclicals. Overall:

- Top line growth again proved resilient as did margins helped with companies still looking to pass on costs, and where this is becoming more challenging there was greater evidence on cost control.

[1] US Bureau of Labor Statistics

- Consumer discretionary and industrial cyclicals surprised versus expectations as did many technology stocks as the market gave the greenlight on those companies achieving cashflow breakeven and increasing confidence they will be self-funding and won't need to come back to the capital well for more.
  - Caution around slower growth also played second fiddle to the hope of lower rates and tax cuts with share prices outpacing earnings upgrades in many instances.
  - The metal and mining sector, particularly within the larger caps, underperformed as higher capex, write-downs and lower commodity prices weighed on earnings and share prices.
  - There was evidence borrowing costs are still rising as interest rates reset, but the number of companies missing versus consensus was lower than in August.

The M&A theme continued to gain traction with $21billion in takeovers announced in February, comprising 7 deals. Interestingly, 4 were offshore buyers, suggesting perhaps in a relative sense Australian companies continue to look attractive from a valuation and geopolitical perspective given the uncertainty that prevails globally.[2]

Portfolio positioning & performance

For the month of February, the portfolio rose by +1.65%, underperforming our benchmark index by 175 basis points.

Our lead outperformer this reporting season was data centre developer and operator **Nextdc Ltd (ASX: NXT, +25.8%)**, delivering a +10% EBITDA beat versus consensus primarily driven by strong Enterprise demand growth. Management remains bullish across Enterprise, hyperscale and AI demand and is calling it the 4th industrial revolution, which together with comments that pricing from hyperscalers have improved over the past 12 months, was sufficient to give market increased conviction that earnings growth could accelerate in outer years. We continue to believe management is executing well and that the company remains well placed to capture the current insatiable demand for compute.

Global 4x4 accessories maker, **ARB Corporation (ASX: ARB, +22.2%)** was another strong contributor to performance this month. The company reported a strong 1H24 result that was ahead of market expectations driven largely by improved gross profit margins as freight costs and other inflationary pressures eased. Importantly, the company indicated confidence in maintaining these improved margins over the coming periods and highlighted that constraints with availability of fitment labour have also improved over the past few months. Positively, the company is making good progress with its large supply contracts with both Ford and Toyota for the launch of upcoming north American vehicles models.

Global engineering services contractor **Worley Ltd (ASX: WOR, +12.8%)** was an outperformer, having recovered a large portion of its losses from the prior month. Whilst the half year result was slightly soft on key P&L metrics, cash conversion was strong whilst its backlog continues to grow with the skew continuing its shift towards sustainability related work. Management remains committed to their full year guidance, and importantly counter to recent market concerns, management was adamant that the level of sustainability related work globally is not slowing. and furthermore, continued margin improvement remains achievable noting both contract pricing and terms

[2] Australian Financial Review

continues to skew in their favour as a result. Finally, WOR brushed off concerns regarding potential delays to Venture Global's CP2 project (whom WOR has won), noting procurement and engineering works continues to be run full steam ahead in the background.

Global sleep therapy leader **Resmed CDI (ASX: RMD, -8.7%)** was our key underperformer for the month. There was no fundamental news flow for the stock, with the underperformance for the fund only enhanced owing to our relatively large position (note it was a key outperformer last month when they released their quarterly results), with the only potential explanation being that the stock may have reacted negatively to the news from US pharmaceutical company Viking Therapeutics whom reported positive results for their own GLP-1 weight loss drug as part of a Phase 2 trial. We believe Resmed should be launching new mask products into the market soon which should assist with incremental share gains, and overall remain confident that the long-term growth of this business remains both sustainable and undervalued.

Retirement living operator, **Lifestyle Communities (ASX: LIC, -14.0%)** suffered a soft month of performance. The company announced results that missed expectations largely driven by delayed settlements across its retirement villages in Victoria. These delays appear to be due to the extension in the time to sell a property, as well as an increasing consumer aversion to purchasing uncompleted homes in the aftermath of widespread builder collapses recently observed in Victoria. In addition to this softer than expected update, the market also reacted negatively to the company announcing a surprise equity capital raise, where funds will be predominantly used to purchase new land parcels in order to accelerate the future growth of the business and take advantage of some distressed opportunities currently available in the market. Our conclusion is that LIC's underlying capital recycling model remains sound and therefore whilst we acknowledge this was a set of disappointing results, the accompanying capital raise now sets the company up well to continually create value for shareholders over the long run.

Finally, our position in insurance restoration provider, **Johns Lyng Group (ASX: JLG, -7.0%)** contributed negatively to performance this month. While underlying 1H24 results were largely in line with market consensus, there were larger than expected non-recurring losses from the to be discontinued commercial construction business, which led to some market disappointment. Furthermore, growth in the US business appears to have stalled as a result of significant hurricane damage in Fort Myer, Florida, one of the company's key operating areas. Such events tend to lead to ongoing work for homeowner associations being put on hold in the short term, although the medium term implications are more positive, with the scope and volume of work to be caught up likely to increase over time as a result of the damage endured. The company also upgraded 2H24 underlying earnings guidance as a result of higher contracted catastrophe activity on the eastern seaboard of Australia (and related restoration work) that have been secured.

Distribution team

Igor Kolevski
Senior Business Development Manager
ikolevski@sghiscock.com.au
0406 683 537

Daniel Shelest
Research & Consultants Manager
dshelest@sghiscock.com.au
0432 474 254

Serena Govender
Business Development Manager
sgovender@sghiscock.com.au
0435 509 863

SG Hiscock & Company

ABN 51 097 263 628
AFSL 240679

Level 23, 360 Collins Street
Melbourne 3000

Level 4, 95 Pitt Street
Australia Square Plaza
Sydney 2000

1300 555 511
www.sghiscock.com.au

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