

SGH High Conviction Fund

29 February 2024

Performance ¹	Total Net Return	Distribution Return	Growth Return	S&P/ASX300 Accum. Index
1 month (%)	1.10	0.00	1.10	0.98
3 months (%)	8.74	1.52	7.22	9.46
6 months (%)	7.57	1.50	6.07	7.44
1 year (%)	11.08	5.62	5.46	10.53
3 years (% p.a.)	8.50	9.63	-1.13	9.09
5 years (% p.a.)	7.98	9.02	-1.04	8.61
7 years (% p.a.)	8.77	9.60	-0.83	8.60
10 years (% p.a.)	8.59	10.59	-2.00	7.94
Inception (% p.a.)	9.77	7.38	2.39	8.17

¹ Distribution Return is the return due to distributions paid by the Fund, Growth Return is the return due to changes in initial capital value of the Fund, Total Net Return is the Fund return after the deduction of ongoing fees and expenses and assumes the reinvestment of all distributions.

Past performance is not a reliable indicator of future performance.

- For the month the portfolio returned +1.10% after fees, outperforming the benchmark by 0.18%.
- Reporting season delivered its usual degree of volatility. Key contributors during the month were NextDC, Worley and Treasury Wine Estates, whilst BHP Group and Corporate Travel Management were the main detractors.
- 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 banks to cut rates. 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.
- During the month we reduced the position size in Corporate Travel (ASX:CTD) and added to Beach Petroleum (ASX:BPT) and The Lottery Corporation (ASX:TLC).

Key Facts

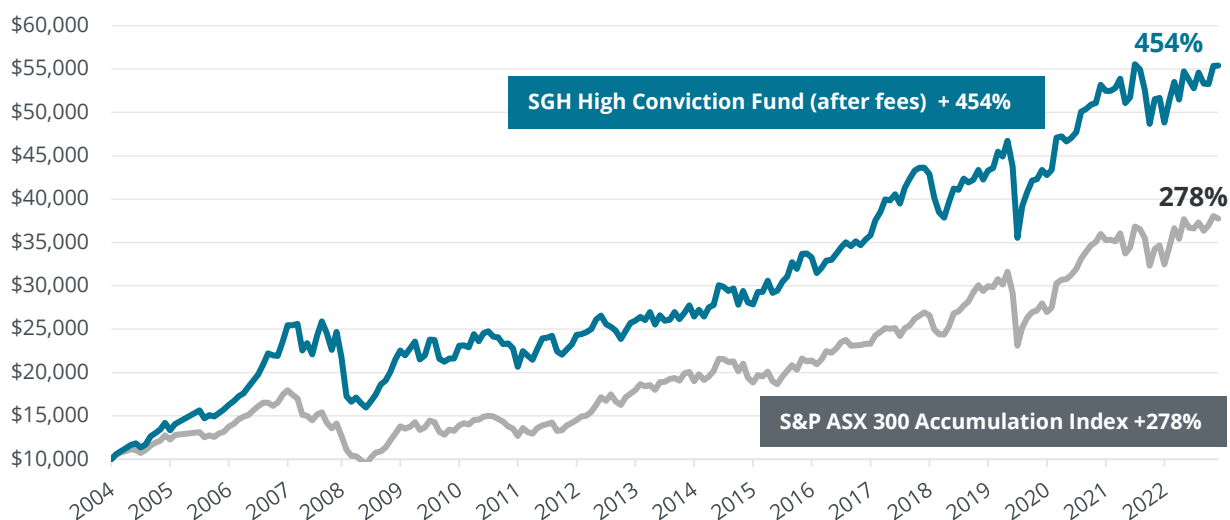
Investment manager	SG Hiscock & Company Ltd.
Launch date	28 Oct 2004
Benchmark	S&P/ASX300 Accumulation Index
Management fees ²	0.90%
Performance fee ³	15.00%
Fund size	\$17.8M
Number of holdings	29
Dividends payable	Biannual
Buy/sell spread	+0.25/ -0.25%
Minimum initial investment	\$20,000
Base currency	AUD
APIR	ETL0042AU
mFund code	SHF01
Domicile	Australia
SIV	Compliant and audited
	Unit price
Application	\$1.5820
Net Asset Value	\$1.5781
Withdrawal	\$1.5742
	Distribution cpu
30-Jun-22	19.8711
31-Dec-22	1.4301
30-Jun-23	5.5247
31-Dec-23	2.1797

Investment objective The Fund invests in a concentrated portfolio of Australian stocks that aims to offer long term returns in excess of the S&P/ASX 300 Accumulation Index (after fees).

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

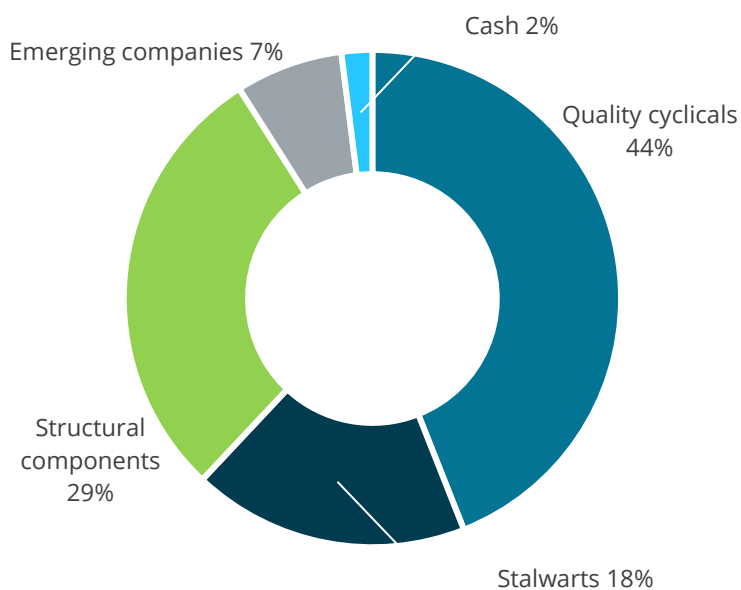
³Effective 1 Dec 2018, a performance fee of 15% (net GST and an estimate of RITC) of any investment return above the fund's benchmark may also be payable as an expense of the fund, subject to a highwater mark.

SGH High Conviction Fund Cumulative Total Return Since Inception



Asset allocation

Sector	Fund (%)
Consumer Discretionary	11.61
Consumer Staples	3.07
Energy	6.31
Financials	20.07
Health Care	10.67
Industrials	16.55
Information Technology	7.69
Materials	16.02
Telecommunication Services	5.08
Cash equivalent	2.94
	100.00



Commentary 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, [latest Consumer Price Index \(CPI\) report in the US](#) was disappointing.

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 banks 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.
- 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 \$21 billion 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.

Portfolio positioning & performance

The lead contributor to performance 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 20-30% 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 engineering services contractor **Worley Ltd (ASX: WOR, +12.8%)** also contributed strongly, 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 and its backlog continues to grow with the skew continuing to 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 continues to skew in their favour as a result. Management also addressed 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.

Treasury Wine Estates (ASX: TWE: +14.7%) posted a solid result that was better than market expectations driven by a strong result in its Penfolds business and improving outlook into the second half of the financial year with higher profit growth driven by a full half contribution from the recent Daou acquisition. Whilst not factored into company guidance, there is also the potential for benefits from the removal of Australian wine tariffs in China. Treasury management indicated they are well prepared and placed to commence re-establishing shipping Australian country of origin wine to China should the tariffs be removed. Treasury still has 120 people in China and been selling non-Australian sourced wine. Management believe China remains a good long term growth opportunity irrespective of whether tariffs on Australian wine are removed in the short term. We currently don't include anything for the removal of China in our earnings assumptions, but by way of sensitivity, should Treasury regain half the 600k cases of luxury and icon wines it shipped prior to the tariffs being imposed it would add around 10% to Group earnings over the next 3-years.

BHP Group (BHP, -7.0%) and **Corporate Travel Management (ASX: CTD, -22.5%)** were the two largest detractors from performance during the month. Corporate Travel posted a disappointing first half result with the UK bridging contract materially underperforming versus expectations and US and Australia and New Zealand businesses also experiencing some softness. It appears the December quarter saw a slowdown in corporate travel spending, particularly in the US and corporate budgets expired earlier. The Asia was the standout region in the result and is expected to grow faster than other regions. Overall, Corporate Travel management believe the industry has recovered to around 75% of pre-Covid levels and are assuming this is the new 'fully recovered level'. As a result, they downgraded FY24 guidance and are now assuming no growth in the UK bridging contract from current levels. Management also outlined for the first time a 5-year growth strategy to double its FY24 profit. We continue see the longer term growth opportunity, but have reduced our position size given the increased uncertainty around the near term outlook.

Global sleep therapy leader **Resmed CDI (ASX: RMD, -8.7%)** was also a drag on performance during the month. There was no fundamental news flow for the stock, 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.

SGH High Conviction Fund - Overview

What makes us different?

- High conviction benchmark unaware portfolio holding 15 – 30 stocks.
- Focus on quality businesses that are sustainably growing free cash flow and improving returns.
- Focus on capital preservation and absolute returns for shareholders.
- Disciplined repeatable process to stock selection and portfolio construction.

Investment Philosophy

The core premise of our philosophy is to invest in companies that deliver absolute returns for investors, with a strong focus on capital preservation. In our view this is best achieved by investing in quality businesses that can deliver sustainable value creation over the medium term, rather than simply investing in companies because they are a significant part of an index.

We allocate capital only to high quality ideas where we have conviction, believing only a few quality ideas are required to build a good portfolio. We do this through investing in quality companies which are sustainably growing free cash flow and returns and are mispriced. We believe price is what you pay, and value is what you get, and valuation discipline is fundamental to investing and creating longer term shareholder value.

Investment Strategy & Process

SGH High Conviction is a concentrated portfolio holding 15-30 stocks. Our focus is on identifying businesses with 'quality sustainable growth' that are mispriced. We do this through a disciplined and repeatable process that seeks to identify companies which are:

- Sustainably growing free cash flow and returns.
- Well-positioned in attractive end markets with a source of competitive advantage.
- Appropriately structured and have a sound balance.
- Lead by engaged, focused and innovative management Where we are satisfied companies meet these criteria, they are eligible for portfolio consideration subject to valuation. A range of valuation methodologies are used depending on the nature of the business.

As part of our process, we undertake an extensive company visitation program which is important in providing 'insight' in developing and testing our thinking, understanding and investment thesis. We seek to know as much about our companies as possible, with a view to mitigating permanent capital loss.

The portfolio construction process is determined by our confidence and conviction in the underlying quality of the business and margin of safety to valuation. It is also influenced by top-down economic considerations and industry and company life cycle risk characteristics.

Distribution team



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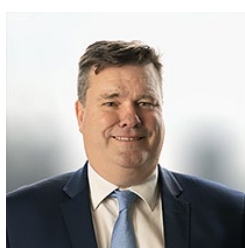


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The Fund's Target Market Determination is available on the [SGH website here](#). A Target Market Determination is a document which is required to be made available from 5 October 2021. It describes who this financial product is likely to be appropriate for (i.e. the target market), and any conditions around how the product can be distributed to investors. It also describes the events or circumstances where the Target Market Determination for this financial product may need to be reviewed.

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