DNR Capital Australian Equities High Conviction Fund

APIR code: PIM0028AU

Performance Report October 2023

Performance

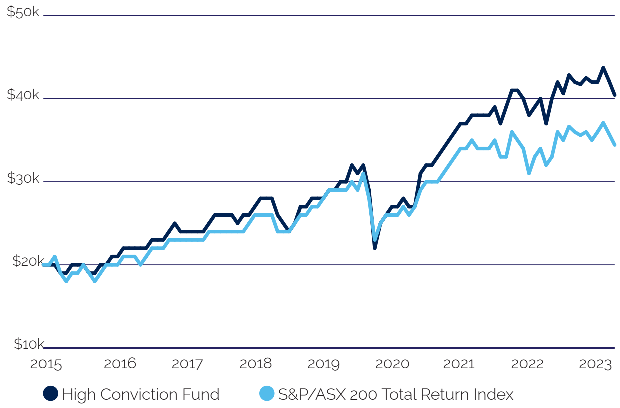
DNR Capital Australian Equities High Conviction Fund decreased -4.09% (net of fees) in October, underperforming the S&P/ASX 200 Total Return Index by -0.31%.

Net active return as at 31 October 2023

	1mth %	3mth %	6mth %	1yr %	3yr % p.a.	5yr % p.a.	7yr % p.a.	Incep.* % p.a.
High Conviction Fund	-4.09	-7.54	-4.82	2.34	13.80	9.30	9.26	8.75
S&P/ASX 200 Total Return Index	-3.78	-7.19	-5.30	2.95	8.88	7.18	7.79	6.69
Excess return	**-0.31**	**-0.35**	**0.48**	**-0.61**	**4.92**	**2.12**	**1.47**	**2.06**

* Inception Date—June 2015.
Source: DNR Capital and Apex Fund Services.
Past performance is not an indication of future performance. Total return shown for the DNR Capital Australian Equities High Conviction Fund has been calculated using exit prices after taking into account all of the product's ongoing fees and assuming reinvestment of distributions. No allowance has been made for entry/exit fees or taxation.

Growth of $20,000 since inception



Source: DNR Capital and Apex Fund Services

Sector weightings %

Source: DNR Capital and Apex Fund Services

Top 5 active holdings

Security details
CSL (CSL)
The Lottery Corporation (TLC)
Aristocrat Leisure (ALL)
SEEK (SEK)
National Australia Bank (NAB)

Source: DNR Capital and Apex Fund Services

Monthly top contributors and detractors

Top 3 contributors
Rio Tinto (RIO)
Liontown Resources (LTR, no holding)
IDP Education (IEL)

Top 3 detractors
Lendlease (LLC)
IGO (IGO)
Fortescue Metals Group (FMG, no holding)

Source: DNR Capital and Apex Fund Services

Experienced portfolio managers

Jamie Nicol
Chief Investment Officer

Scott Bender
Portfolio Manager

Performance attribution

Contributors

- **Rio Tinto (RIO):** bounced over the month as spot iron ore prices held up in the face of soft Chinese economic data. Chinese policy makers continue to incrementally ease policy which should support commodity demand going forward.
- **Liontown Resources (LTR, no holding):** underperformed during the period, following a spoiled takeover attempt. The company's value was being held artificially high due to a strong bid from Albermarle, which was subsequently withdrawn following a large decline in lithium prices and the attempts of Hancock Prospecting to derail the deal through an accumulated ownership stake.
- **IDP Education (IEL):** bounced back following a weak prior month with tensions between Canada and India easing.

Detractors

- **Lendlease (LLC):** was softer along with the whole property sector as the market digested the impact of higher for longer interest rates.
- **IGO (IGO):** underperformed during the period, after a poor quarterly update and continued weakness in lithium prices. While operationally well executed, the business suffered from a declining price for its product out of the Greenbushes Lithium Mine and an issue within the asset joint venture structure which will restrict sales in the coming quarter.
- **Fortescue Metals Group (FMG, no holding):** outperformed alongside other iron ore miners in anticipation of further policy easing from the Chinese government in response to the continued sluggish recovery.

Fund and market review

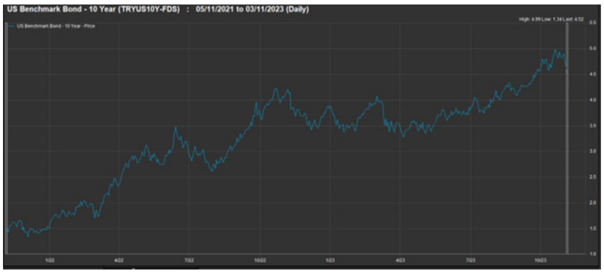
The S&P/ASX 200 Total Return Index was down 3.78% during the period. Utilities (+1.7%) was the best performing sector, with Origin Energy (ORG +4.0%) rejecting a longstanding takeover bid due to undervaluation and peer AGL (AGL +0.2%) benefitting from the comparison. Materials (-0.8%) also outperformed, with the iron ore majors (BHP Group (BHP +0.6%), Rio Tinto (RIO +3.6%)) benefitting from increasing evidence of fiscal stimulus in China. Information Technology (-7.6%) was the worst performing sector, with higher rates forcing a de-rate across longer-duration, growth companies (Wisetech Global (WTC -10.6%), Xero (XRO -5.1%)). Health Care (-7.2%) also underperformed, similarly impacted by the move in bond rates and in continued sympathy with overseas peers (CSL (CSL -7.4%), Cochlear (COH -5.7%)).

The market experienced a decent pullback over October. This was due to higher interest rates creating valuation and economic uncertainty as well as heightened geopolitical risk. Since month's end, bond yields began to fall which caused a bounce in markets. We discuss this impact and current portfolio positioning.

Bond yields

As noted in the chart below bond yields nudged 5% before pulling back towards 4.5%. This pullback has driven a strong bounce in the market. As we explained last month, higher bond yields have been creating uncertainty for markets. From a valuation perspective, having more confidence in the long-term bond yield provides investors with greater confidence in terms of how much to pay for each dollar of earnings. If you are unsure whether interest rates will be 4% or 6%, this creates an unwillingness of buyers to step into the market. At the same time, central banks' efforts to lift rates is expected to have an economic impact and so increasingly higher rates create uncertainty regarding the future level of profitability for the market.

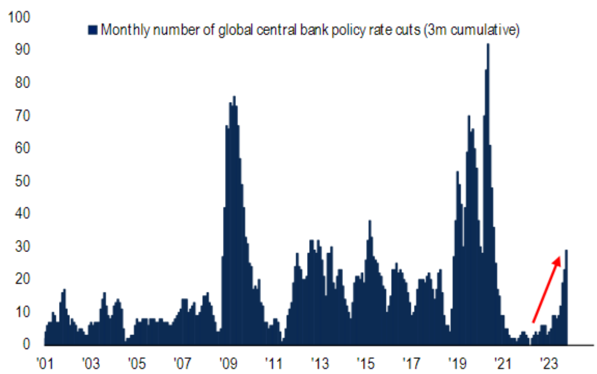
US 10 year bond yield



Source: FactSet

Looking across the globe, it would now appear that we are getting closer to the end of the rate rising cycle with a significant increase in the number of central banks cutting interest rates. To the extent that the rate cycle peaks, then the market will have greater certainty regarding the rate at which to discount future earnings. For example, if interest rates settle at 4.5% then the market will have greater confidence in what prospective return is high enough to compensate for the risk. A sense of interest rates peaking is therefore important in this regard.

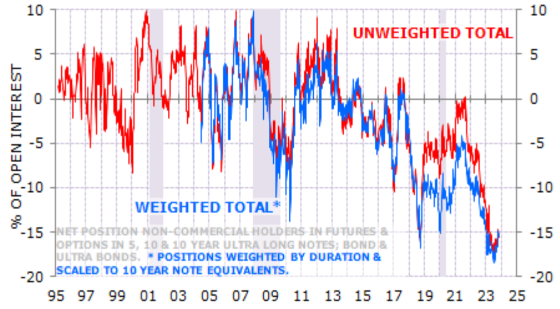
Global central bank interest rate cuts



Source: BofA Global Investment Strategy, Bloomberg

The move in bond rates has been triggered by some softer economic data as well as extreme positioning by the market. Investors have become increasingly underweight to the bond market after two horrendous years for bond market investors.

Speculative position in US Treasury notes & bonds



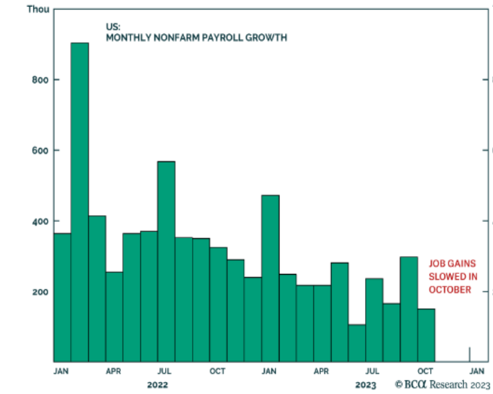
Source: Minack Advisers

Bad news is good news

While bad news regarding the economy provides the bond market with greater certainty that we are close to the end of the interest rate cycle, it is a mixed blessing for equities given it potentially signals a peak in the economy.

Jobs created in the US are beginning to slow. US non-farm payrolls came in well below expectations, rising by only 150,000 in October, with material downward revisions to prior months' data. The unemployment rate ticked higher to 3.9% from 3.8%.

US: monthly nonfarm payroll growth



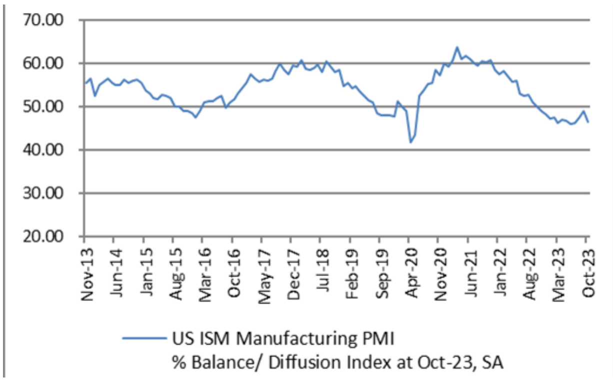
Source: BCA Research

This slowdown in job creation is likely a reflection of the slowdown in both consumer and business confidence (see below). The extent to which this precedes a more significant economic decline is uncertain with corporates being cashed up and there being some evidence that a restocking cycle is looming.

US consumer confidence

Source: DNR Capital, FactSet

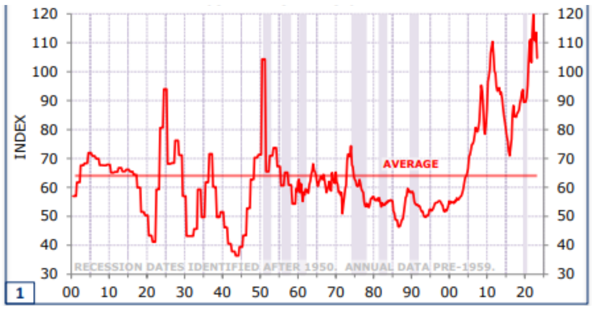
US business confidence (PMI)



Source: DNR Capital, FactSet

Australia is also at a slightly different point in the cycle. Australia has greater sensitivity to higher interest rates due to the percentage of borrowers with variable mortgages but is also seeing an economic boost from strong terms of trade and immigration.

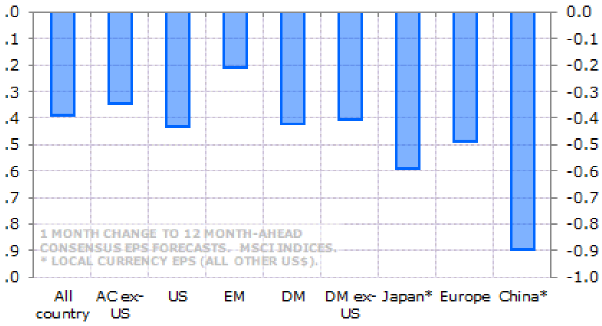
Australia's terms of trade



Source: Minack Advisors

Nonetheless, across most markets the signs of a slowdown are being reflected in declining earnings per share.

Revisions to consensus EPS forecasts

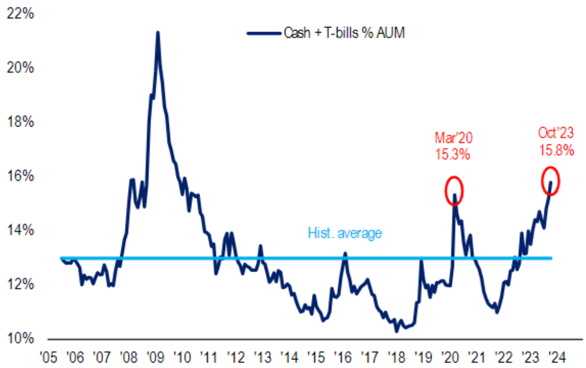


Source: Minack Advisors

Positioning

Not surprisingly given the geopolitical tensions the level of cash holdings in the market is at an elevated level. This means the market can potentially rally harder than expected, despite the economic uncertainty.

Weighting to cash and treasury bills



Source: BofA Global Investment Strategy

Outlook

Last month we highlighted the difficulties for equities and these remain, albeit the appropriate valuation becomes a little clearer as bond yields settle.

- Investors have alternatives in cash or bonds.
- The appropriate earnings ratio is also a little unclear given the potential for higher rates to squeeze the economy.
- The appropriate valuation multiple to pay will become clearer as interest rates peak.

However, amongst the uncertainty opportunities arise.

- With the capitulation of markets around the idea of 'higher for longer' we can begin to think about the other side of the trade. Some companies have moved quicker than others to price in higher bond yields.
- Some defensive companies, where we are confident about earnings, have derated and therefore we can buy with greater confidence.
- Some quality early cyclicals are already forecasting or pricing in a cycle and these companies are likely to do better when interest rates peak. Obviously, timing can be difficult here but for investors willing to take a longer-term view, opportunities arise.
- Resources and energy will potentially be less correlated to yields and more to the outlook for China.

Fund facts

Inception date: June 2015

Minimum initial investment: $20,000

Risk level: High

Management fee: 0.90% (inclusive GST and RITC)

Performance fee: Nil

Entry/exit fees: Nil

Buy/sell spread: +0.20%/-0.20%

Valuation and unit pricing frequency: Each business day

Distribution frequency: Semi-Annual

Responsible Entity: The Trust Company (RE Services) Limited as part of the Perpetual Limited group of companies.

Target Market: The DNR Capital Australian Equities High Conviction Fund is an actively managed fund that offers investors exposure to a concentrated portfolio of high quality, large cap Australian listed equities. This product is likely to be appropriate for a consumer seeking capital growth to be used within an investment portfolio where the consumer has a medium or long investment timeframe, high or very high risk/return profile and needs daily access to capital.

About DNR Capital and the Fund

Concentrated: Investing in 15-30 highest conviction, quality large cap Australian listed equities.

Style neutral and quality focussed: A disciplined approach to quality and valuation. Concentrated portfolios of quality companies maximise the opportunity for outperformance.

Experienced and aligned team: The portfolio managers have more than 50 years of combined investment experience and are invested alongside our clients.

Proven process: DNR Capital was established in 2001 and a consistent firm-wide investment process has delivered more than 19 years of investment outperformance.

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DNRHCF. 3.08.2310