Chester High Conviction Fund

Fund Update

February 2025

APIR OPS7755AU
ARSN OPS7755AU

At 28 February 2025	1 mth %	3 mths %	6 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a	Incep. % p.a. *
Chester High Conviction Fund (after fees)	-2.0	0.7	5.1	13.2	8.8	14.0	12.1
S&P/ASX 300 Accumulation Index	-3.8	-2.6	2.8	9.7	8.9	8.8	8.4
Outperformance (after all fees)	+1.8	+3.3	+2.3	+3.5	-0.1	+5.2	+3.7

* 27 Apr 2017

> **"There is nothing government can give you that it hasn't taken from you in the first place."**
>
> Winston Churchill

Month in review

We found it instructive that new Treasury Secretary Scott Bessent would appear on a Bloomberg interview and explain that Donald Trump will start owning the US economy in the next 6-12 months. With DOGE in full swing, tariffs wars escalating and deportations ramping up, it appears that the incoming administration is engineering a US slowdown, and explaining it to us. They are very focused on re-privatising the US economy, at the expense of government largess, which has been how the US (and Australian) economy has been propped up since the COVID pandemic. The real time indicator of the US economy (Atlanta Fed real 1Q GDP estimate is now -2.5%) is rolling over as Trump prioritises tariffs and spending cuts over pro growth initiatives. Presumably these pro growth initiatives come in 6-12 months with a backdrop of lower interest rates and lower inflation. Sending the economy into a slowdown is one way to achieve lower interest rates.

We have found it interesting that for all the posturing at the end of 2024 that US exceptionalism is here to stay, US stocks accounted for a 70% weight in the world stock market indices, and was widely heralded as the only place to invest. Since then the European market is up 13%, the Hang Seng is up 21% and the Nasdaq is down 6% in 2025 CYTD. We spend a lot of time considering where crowded trades are, as they are often (in our view) the wrong ones.

This reporting season in Australia showed just how positioning matters, with many high quality companies experiencing sell offs on valuation concerns, while various value orientated companies sold off on earnings concerns. It was a genuinely tricky reporting period with record volatility on result days. For the first time in 18 months, the prospect of valuation support became an important driver in share price performance, as opposed to the previously successful style bias of growth and momentum. It appears we may be in the midst of a regime change, where may be, valuation matters.

Portfolio review

During the month the fund returned -2.0% relative to the -3.8% fall in the ASX300. Light & Wonder (LNW) was the best performing stock after three positive pieces of news flow. The first being the positive outcome from the Aristocrat litigation of Dragon Train EGMs in Australia, allowing 10k machines to stay on the floor. Second was the acquisition of Grover Gaming, a high margin, regulation protected business in charitable gaming. This acquisition looks to provide high single digit eps accretion. The third was the 4th quarter results which despite the Dragon Train litigation in the US, showed strong unit sales growth and reaffirmed FY25 guidance, setting up LNW to display earnings momentum at a very reasonable price. Austal (ASB) continued its recent momentum with an upgrade to FY2025 guidance to EBIT not less than AUD80m, from previously ~AUD80m. This comes on the back of a strong period for US sustainment work (including some technology related contracts), a weaker AUD and some green shoots in the Australasian ferry market. Additionally although ASB is yet to finalise the accounting treatment of the previously mentioned USD450m Submarine Expansion contract / grant from General Dynamics it appears likely it will be amortised over 10 years, to potentially add ~AUD70m EBIT per annum resulting in future material upgrades to ASB earnings over the next 10 years.

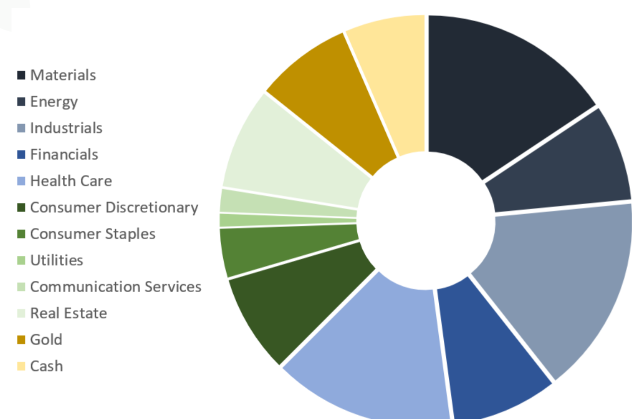
The underperformers for the month were led by Block (XYZ). The dramatic sell off in XYZ (-32%) during the period we believe was somewhat a function of positioning rather than anything fundamentally broken in the model. The market expected a stronger result but it wasn't as soft as the price reaction given operating income guidance for FY25 was reiterated. We acknowledge that the payments space is competitive but XYZ is growing gross payment volumes (GPV) in Square and monetising Cash App at an increasing rate (despite customer growth plateauing). We are optimistic top line growth can accelerate during 2025 with new products (Afterpay being added to Cash App). We continue to see XYZ as attractively priced (FY25 PER of 15.4x) for the growth it is offering. Mineral Resources (MIN) was again weak after a better than expected 1H FY25 result however confessed to needing to spend a further ~AUD300m capex at Onslow to asphalt the haul road and enhance the size of the fleet. While elements of the project are working at or above nameplate capacity this capex increase only gave ammunition to the bear thesis on the project with a haul road that is "95% working". Clearly this is not ideal for a business with a meaningful debt pile. We err on the side of holding MIN (at a lower portfolio weight) given the extreme valuation support we see emerging. On any break up scenario, MIN has significant upside from AUD21.00.

Top 3 holdings
CSL
Light & Wonder
Austal

Portfolio breakdown	
Industrials	15.9%
Materials ex Gold	15.6%
Healthcare	14.6%

Top 3 portfolio attribution	Bottom 3 portfolio attribution
Light & Wonder	Block
Austal	Mineral Resources
Develop Global	Maas Group

Fund weights - diverse sector exposure



BROAD THOUGHTS FROM FEBRUARY

THEME	IMPACT
VALUATIONS VS EARNINGS EXPECTATIONS	Growth and momentum saw a sharp reversal in February from the persistent trend through 2024, where it appeared valuations didn't matter. While earnings expectations (beats and misses) are important, with interest rate settings expected to be higher in 2025, valuations actually do matter.
US ENGINEERING A SLOWDOWN	New treasury secretary Scott Bessent has been very clear in his messaging that the Trump administration wants to reprivatise the US economy, at the expense of government spending. With DOGE, deportations and tariffs, there appears to be a slowdown underway, making us cautious on US cyclicals.
TRUMP'S TARIFF UNCERTAINTY	In conjunction with the above, ongoing headlines around universal tariffs and 25% tariffs from Canada and Mexico are unhelpful for export companies and strategic planning. The market dislikes uncertainty, which is what tariffs provide, unless a negotiated outcome can be reached. Whilst most economic history says tariffs are inflationary, if demand destruction is large enough, they could be deflationary?
BANK IMPAIRMENTS	While the Banks saw slight margin compression (ex CBA), the ongoing benign impairment charges for the sector has augured well for the upgrades over the past 12 months. Historic lows in impairments are unlikely to be sustained in our view. Rate cuts happen for a reason.
IS WELLNESS A NEW MEGATREND?	Consumption of alcohol remains weak, with commercial wine and beer consumption remaining in contraction. The challenge of investing in high quality assets (ORA, TWE, EDV) with a structural headwind of a younger generation placing a premium on wellbeing is something we are pondering.
AI MOVING SLOWLY IN THE REAL WORLD, RAPIDLY FROM A TECH PERSPECTIVE	We have been concerned about AI since it was launched and the disruptive influence on software businesses over the next 5-7 years. Deepseek and Grok launches illustrate how quickly the pace of change is occurring. The structural pressure on Saas businesses is not discounted in current valuations.
THE HEALTH CARE SYSTEM	The health care system is structurally challenged with health insurers remaining profitable (albeit claims have accelerated/normalised in the past 12 months) at the expense of hospitals which are suffering negative jaws from lower utilisation and higher costs. It becomes a delicate balance for the industry/government in terms of affordability and commercial viability.
HIGH STAFFING COSTS - RELIEF ON THE HORIZON?	The biggest challenge for companies over the past 3 years from a cost perspective has been wage growth and full employment. Given many industries are mandating return to work policies, we just may be on the cusp of seeing wage relief on the horizon. Office occupancy appears to be normalising
GLOBAL MARITIME INDUSTRY	China produces around 50% of commercial ships globally, with South Korea around 28%. The US recognises the threat to US trade from this imbalance, as the US does no commercial shipbuilding. Scott Bessent called out shipbuilding as one industry that the US should focus on bringing back onshore. The sentiment augurs well for Austal (ASB) albeit ASB builds Naval vessels only in the US.
CHINA LOOKING TO ENTREPRENEURS?	We have always believed that in China you should invest alongside government policy. For the first time in his tenure, President Xi is opening his arms to the tech entrepreneurs to assist in stabilizing the Chinese economy. It has to shift towards domestic consumption, with policy support coming.
NZ ECONOMY DARKEST BEFORE DAWN?	New Zealand is at an interesting juncture, given how weak the economy has been for the past 3 years, but interest rate relief has emerged, cutting interest rates by 1.75% in 6 months, which has us considering the possibility of a cyclical recovery over the next 12-18 months.
M&A CYCLE	M&A activity is often a feature of late cycle bull markets. We do see significant value in many unloved assets, and as shown by competing PE bids for Insignia Financial, the CoStar bid for Domain and a bidding war emerging in Pointsbet.

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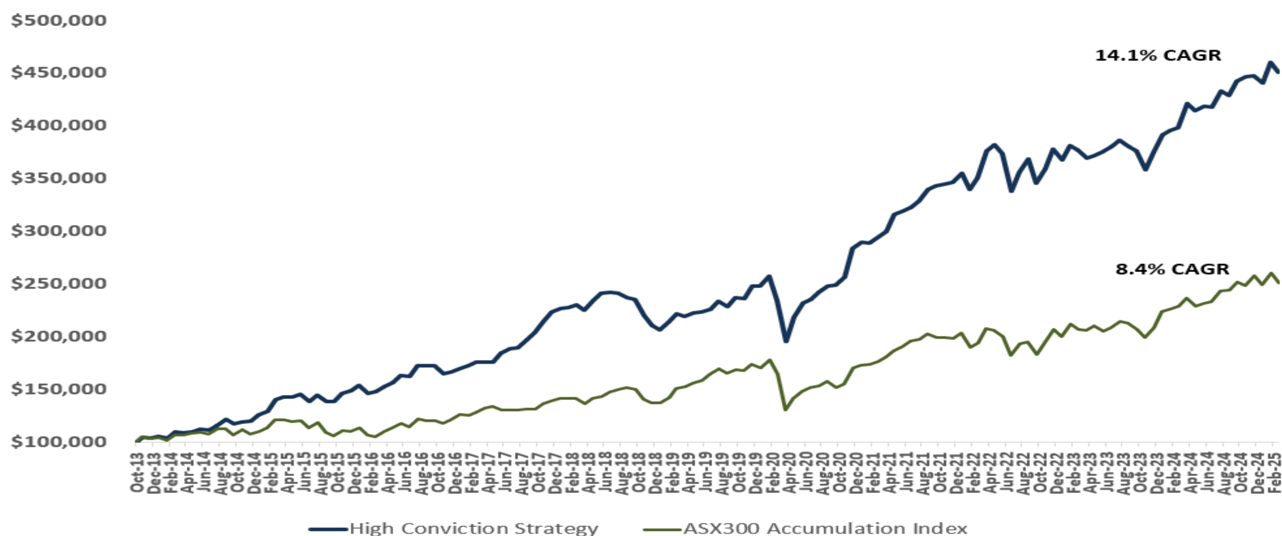
Accumulated Performance by Financial Year - Same Strategy

	FY14 (%)#	FY15 (%)	FY16 (%)	FY17 (%)*	FY18 (%)	FY19 (%)	FY20 (%)	FY21 (%)	FY22 (%)	FY23 (%)	FY24 (%)	FY25 (%)	Inc (%)
Same Strategy (after MER)	+11.2	+24.5	+17.4	+11.2	+28.3	-6.4	+3.9	+37.2	+4.8	+12.5	+9.7	+8.1	+14.1
S&P/ASX 300 Accum Index	+7.8	+5.6	+0.9	+9.1	+13.2	+11.4	-7.7	+28.5	-6.8	+14.4	+11.9	+7.5	+8.4
Value added (after MER)	+3.5	+18.9	+16.4	+2.1	+15.1	-17.8	+11.6	+8.7	+11.6	-1.9	-2.2	+0.6	+5.7

Per Annum. The inception date of SGH Australia Plus was the 8th of October, 2013, where Rob Tucker was the sole Portfolio Manager, until his departure on February 28th, 2017.
* The inception date of the Chester High Conviction Fund was April 26th, 2017, hence FY17 reflects 8 months of SGH Australia Plus and 2 months of the CHCF.
We note this is a statement of fact of the performance achieved by the fund during the time which Rob Tucker was the sole Portfolio Manager making active decisions on the SGH Australia Plus portfolio. We note performance is the record of the firm not the individual however past performance has been constructed from publicly available unit price data. Past performance is not necessarily indicative of future performance and should not be relied upon in making investment decisions.

High Conviction Strategy - accumulated performance



Note this graph is representative only of the combination of the same Portfolio Manager running the same strategy, and would only represent actual returns for unit holders that invested money at inception of SGH Australia Plus, withdrew those funds at the end of February 2017 and then invested all those initial funds again at inception of the Chester High Conviction Fund in April 2017. Note, this depicts returns after fees.

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