Greencape High Conviction Fund

Quarterly report - June 2020

Performance #	Quarter %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Inception % p.a.
Fund return	18.37	1.44	8.33	8.29	9.50	8.99
Growth return	18.37	0.28	1.56	2.02	2.95	2.55
Distribution return	-	1.16	6.78	6.27	6.55	6.44
S&P/ASX 200 Accumulation Index	16.48	-7.68	5.19	5.95	7.80	5.64
Active return^	1.89	9.12	3.15	2.34	1.69	3.35

Past performance is not a reliable indicator of future performance.

Performance figures are calculated after fees have been deducted and assume distributions have been reinvested. No allowance is made for tax when calculating these figures.

^ Numbers may not add due to rounding

Investment objective

The Fund aims to outperform its benchmark over rolling three-year periods.

Responsible entity

Fidante Partners Limited

Investment manager

Greencape Capital Pty Ltd

Investment strategy

Greencape is an active, 'bottom-up' stock picker. Whilst Greencape does not target any specific investment style and will invest in stocks displaying 'value' and 'growth' characteristics, its focus on a company's qualitative attributes will generally lead to 'growth' oriented portfolios. This is an outcome of its bottom-up process. As such, Greencape's investment style may be classified as 'growth at a reasonable price'.

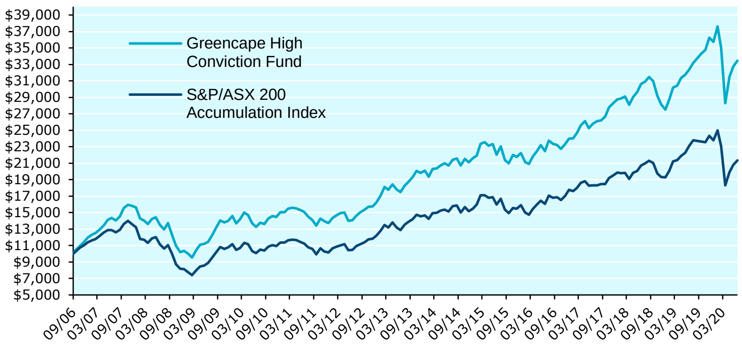
Distribution frequency

Quarterly

Suggested minimum investment timeframe

At least five years

Growth of $10,000 invested since inception (net of fees)



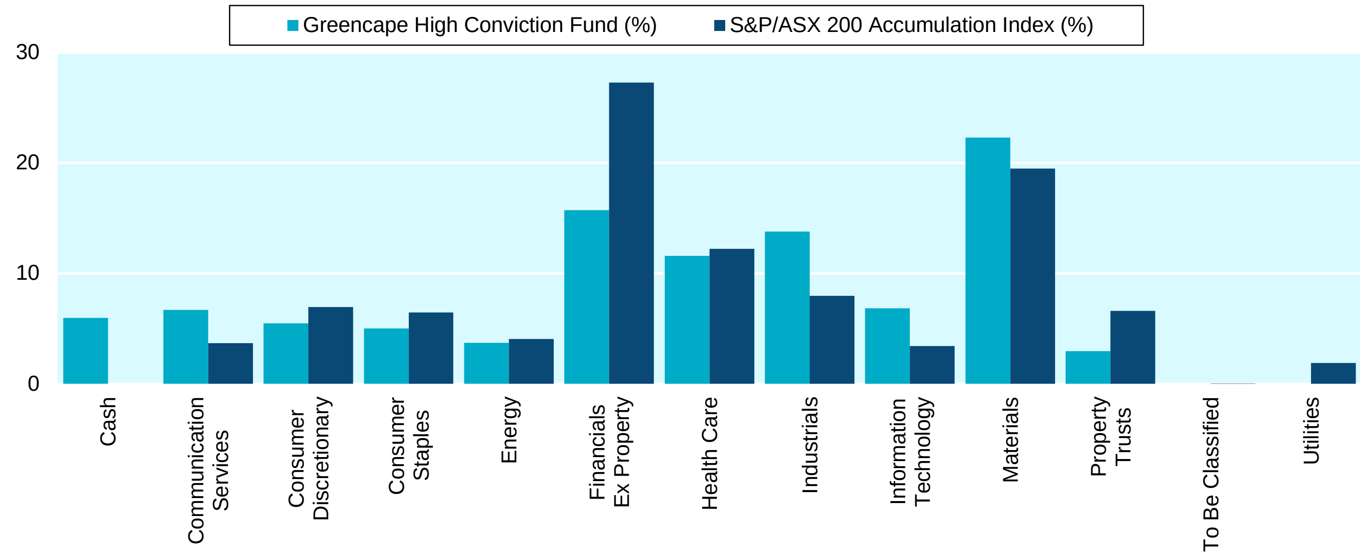
Asset allocation	Actual %	Range %
Security	94.04	85-100
Cash	5.96	0-15

Fund facts	
Inception date	11 September 2006
APIR code	HOW0035AU

Fees	
Entry fee	Nil
2017-2018 ICR	1.59%
Management fee	0.90% p.a.
Performance fee	15% of the Fund's daily return (after fees and expenses and after adding back any distributions paid) above the Fund's Performance Benchmark (the daily return of S&P/ASX 200 Accumulation Index).
Buy/sell spread	+0.20% / -0.20%

Data Source: Fidante Partners Limited, 30 June 2020.

Sector exposure as at 30 June 2020



Data Source: Fidante Partners Limited, 30 June 2020.

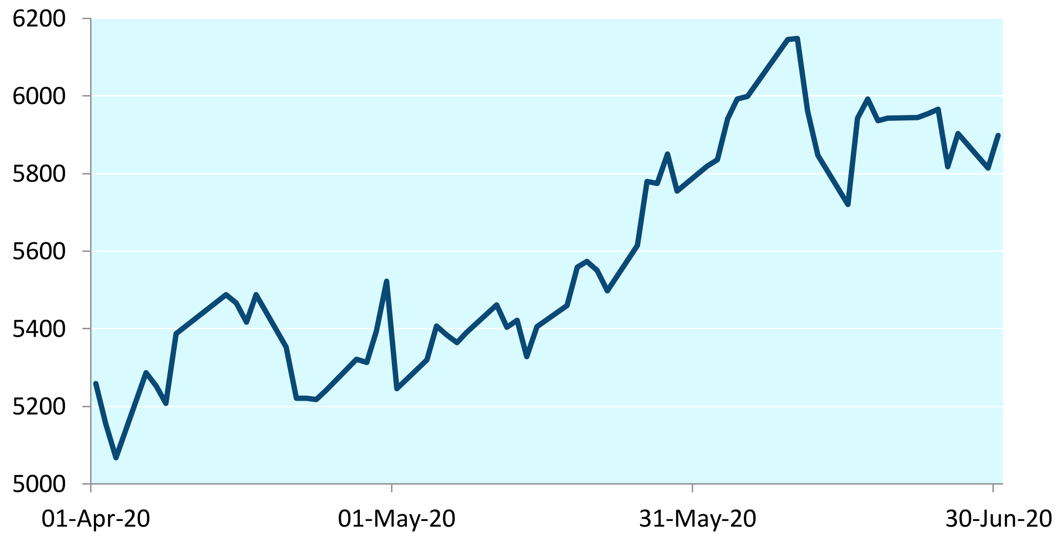
Fund performance summary

The S&P/ASX 200 Accumulation Index returned +16.48% for the quarter. The fund outperformed the market and delivered a +18.37% return over the quarter.

Market overview

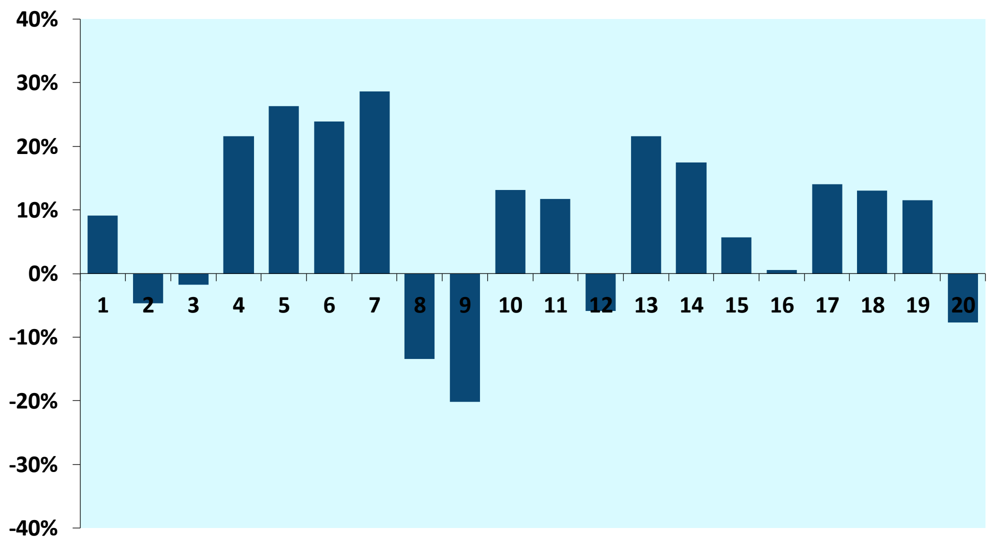
Following the worst quarterly performance since 1987 in the first quarter (Q1) of the year, Q2 saw the largest quarterly gain since 2009 (GFC). The deficit was too large to overcome for the financial year however, with the market posting its worst annual performance since 2009. The Coronavirus crisis overwhelmed all other news during the period, as the market oscillated between optimism on the prospects of a recovery and pessimism on the likelihood of a second wave.

S&P/ASX 200 Index



Source: IRESS

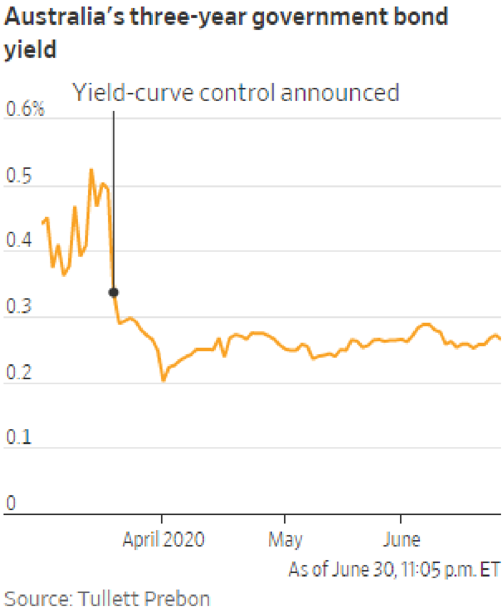
S&P/ASX 200 Accumulation Index Financial Year Returns Since 2001

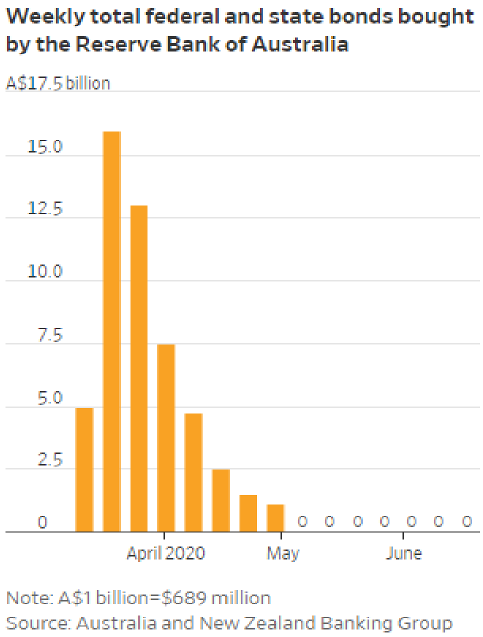


Source: IRESS

After cutting the cash rate twice in Q1, the Reserve Bank of Australia (RBA) left the cash rate at a record low of 0.25%. The central bank also implemented its Quantitative Easing (QE) strategy, targeting a yield of 0.25% on 3-year government bonds which would be achieved through buying in the secondary market.

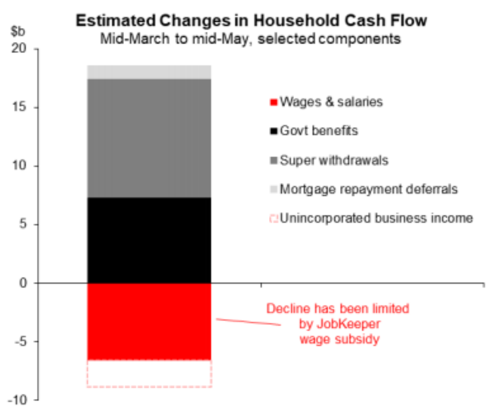
As evidenced below, the RBA has been effective in capping the yield on 3-year government bonds.



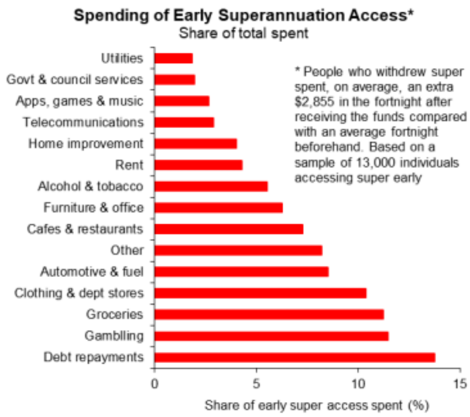


Source: Wall Street Journal

The Federal government also played its part in stimulating the economy with a range of subsidies designed to enable the economy to cross the 'bridge' to the other side of the pandemic. These included but were not limited to a $550 per fortnight Coronavirus Supplement and a $1,500 per fortnight JobKeeper payment for eligible recipients. The government also enabled early access to $20,000 from superannuation over FY20 and FY21. These withdrawals proved popular, with the ATO website reportedly crashing on July 1 as superannuants rushed to access their second $10,000 withdrawal. There were some interesting outcomes (some of which we assume were unintended) which arose from these measures. Aggregate household cashflow actually increased and of those who accessed Super early, 64% of their incremental spending was directed at discretionary items such as gambling and alcohol.



Source: ABA, ABS, APRA, DSS, Treasury, Macquarie Macro Strategy



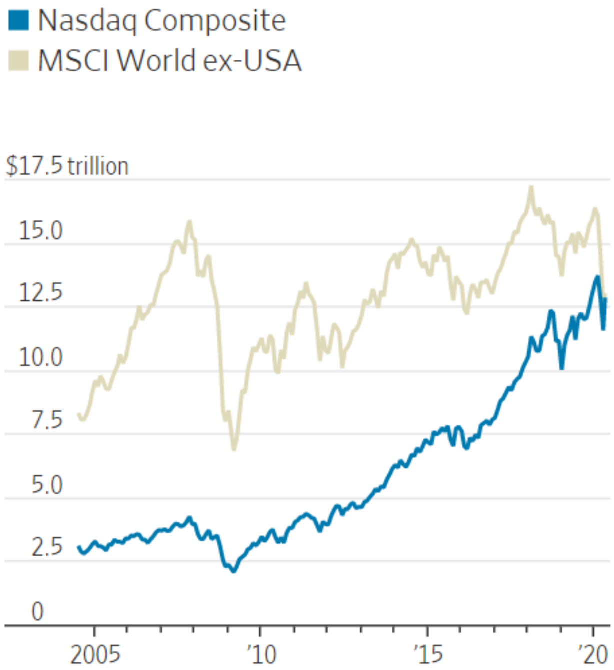
Source: illion/AlphaBeta, Macquarie Macro Strategy

Source: Macquarie

"I think we should all be worried about what happens post-September." Rob Scott, CEO of Wesfarmers, 25/06/2020

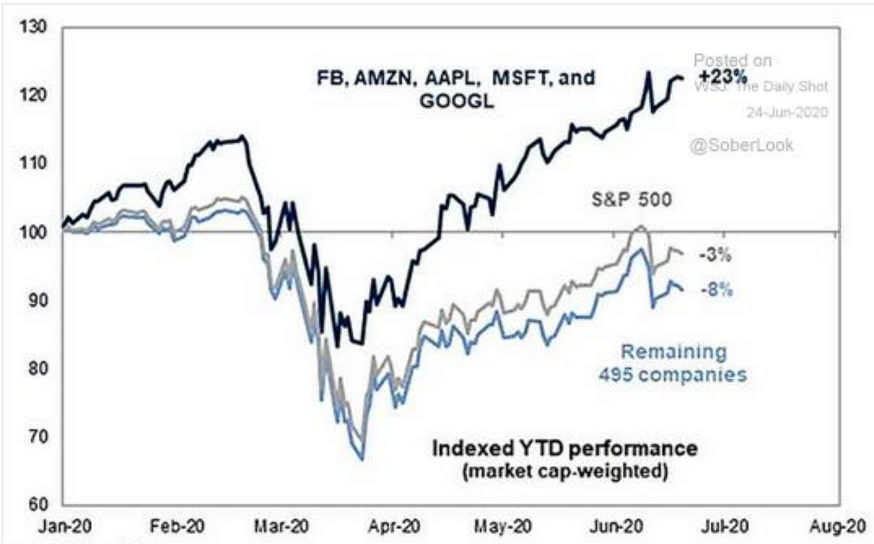
"We are facing a cliff and we'd prefer a slope." Paul Zahra, Australian Retailers Association, 25/06/2020

Whilst the recovery of the Australian market was admirable, it was modest relative to the staggering rally seen in the US market. In April, the NASDAQ even surpassed the rest of the world in terms of market capitalisation.



Source: Wall Street Journal

The gains were not broad based however, with the S&P500 rally index driven by a select number of mega cap Technology stocks.



Source: The Daily Shot

"Actually, I had a mask on. I sort of liked the way I looked, OK? I thought it was OK… It was a dark, black mask, and I thought it looked OK. Looked like the Lone Ranger." Donald Trump, President of the United States of America, 02/07/2020

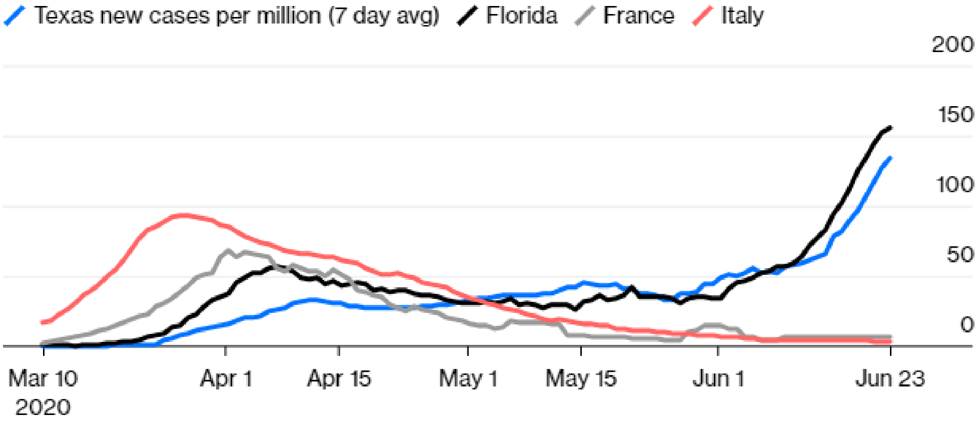
"THE LONE WARRIOR!" Donald Trump, President of the United States of America, 30/06/2020

"LAW & ORDER!" Donald Trump, President of the United States of America, 07/06/2020

Regardless, the rally in the US equity market has continued unabated despite alarming increases in case numbers. Florida and Texas (which cumulatively contribute 14% of US gross domestic product) are currently in the midst of a second wave where daily new case numbers are dwarfing the initial daily numbers in March.

Some of These Curves Are Not Like The Others

Given opportunities, the virus will spread



Source: Bloomberg

Whilst some restrictive measures have been reintroduced, the mid-teens positive test rate in Florida and Texas suggests these efforts may be futile.

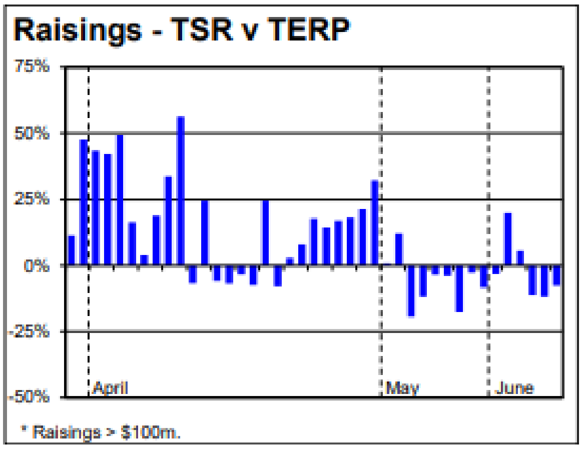
European countries with similar peak average cases were able to flatten the curve effectively after relaxing lockdown restrictions. This has not been the experience in the US hotspot states.

	Peak cases per million (7 day avg)	At reopen	1 month later	Most recent
France	67.7	16.6	7.4	6.8
Germany	67.4	13.7	5.2	7.4
Italy	93.5	30.9	6.4	3.7
Spain	168.3	23.2	8.4	7.3
The Netherlands	64.4	17.0	11.2	5.0
Arizona	53.6	52.4	177.2	374.5
Florida	55.9	31.7	45.9	155.6
California	47.0	47.6	71.0	106.7
Texas	32.7	30.3	38.6	133.8

Source: Bloomberg

Locally, 'Deal Mania' gripped the market as the balance sheet re-capitalisation cycle kicked into overdrive. Companies took full advantage of the ASX lifting share placement capacity from 15% to 25% to shore up balance sheets, ensuring they had sufficient liquidity to ride out the pandemic. The quantum of capital raised was nothing short of astonishing, with over $23bn raised since late March. Investor appetite proved ravenous for placements, with most books well covered soon after launch. Importantly these deals were also well supported in secondary market trading, with stocks on average trading at a 25% premium to their placement price as at the end of June.

A great deal of the positive share price performance post raising was front loaded however, with most companies who hesitated to pull the trigger early on raising capital seeing subsequent lacklustre share performance. The increase in the placement cap expires 31 July, and we imagine the performance of recent raisings is an active discussion point at the board level and amongst equity underwriters for companies looking to beat the 'deadline'.



Source: Diogenes Research

	QUARTER	YEAR
ASX200 Accumulation Index	16.5%	-7.7%
Best Performing Sectors		
Information Technology	48.7%	19.4%
Consumer Discretionary	30.1%	2.8%
Energy	28.2%	-28.7%
Worst Performing Sectors		
Healthcare	2.3%	27.4%
Utilities	5.5%	-1.9%
Consumer Staples	7.2%	12.7%

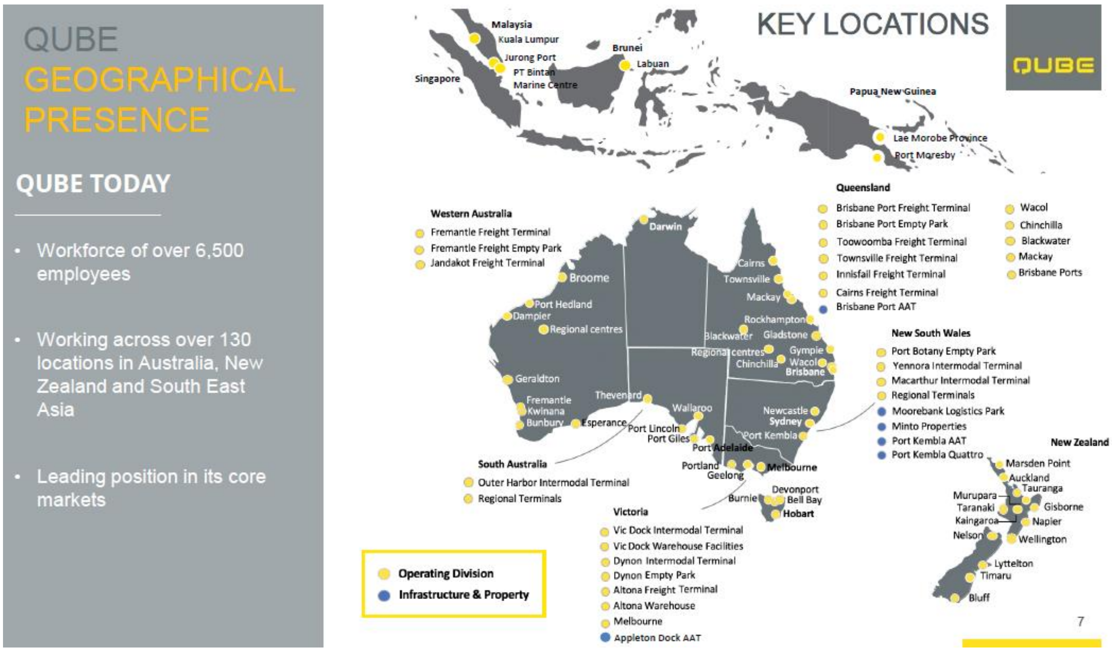
Source: IRESS

At a sector level, similar to the US experience the Technology sector led the market recovery. After reaching a low of $8 in March, Afterpay staged a remarkable rally to close the quarter over $60. At the time of writing, the company's market capitalisation now stands at over $18bn, surpassing the likes of Brambles and Aristocrat. Consumer Discretionary and Energy, two of the biggest detractors in Q1 also bounced back strongly. Again, like we have seen in the US, these sectors were strongly influenced by retail investor behaviour, with broker share data indicating that Commsec and other retail stockbrokers dominated trading activity in names such as Flight Centre, Webjet and Zip Money.

The three best performing sectors in Q1 found themselves in the exact opposite position on the performance tables in Q2. Whilst investors rushed into Healthcare and Staples for their relative defensiveness during the market downturn, investors used these sectors as funding sources in Q2 to buy higher beta names.

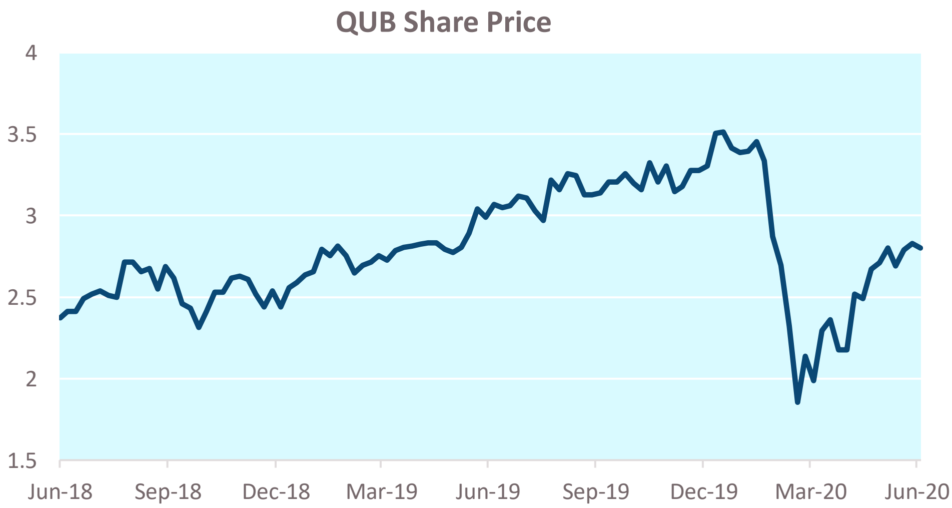
Qube Holdings

During the quarter we meaningfully added to a small position in Qube Holdings Limited (QUB) that we initiated in March 2020. QUB is Australia's largest integrated import and export logistics services provider, operating in over 130 locations across Australia, New Zealand and South-East Asia. It owns and operates numerous ports (including 50% of Australia's largest container port operator, Patricks) and provides integrated logistics services for containers and bulk materials (including road, rail, intermodal terminals and warehousing). In addition, QUB owns strategic logistics infrastructure assets including the large Moorebank intermodal terminal and warehousing precinct in south-west Sydney.



Source: Company reports

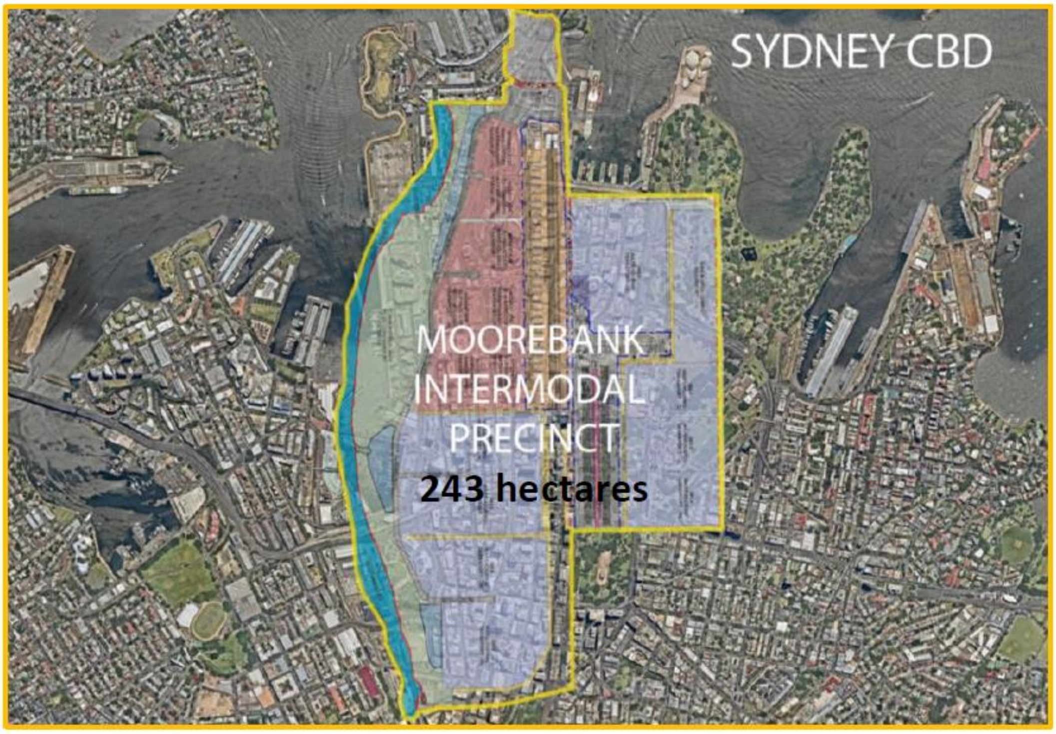
We have long admired the QUB business and management but have struggled to find an attractive entry point given the premium valuation that the stock has historically traded at. In recent years we also have harboured some concern about the high level of leverage in the business. With the market sell-off in March we were able to purchase a small position in QUB in the low $2's per share where we saw good value. In April, QUB raised $500m in new equity at $1.95 per share to provide balance sheet flexibility. With the new equity allaying our balance sheet concerns, we used the raising and days following to meaningfully increase our holding in the stock in the mid $2's per share range, a level at which we see reasonable risk-adjusted value.

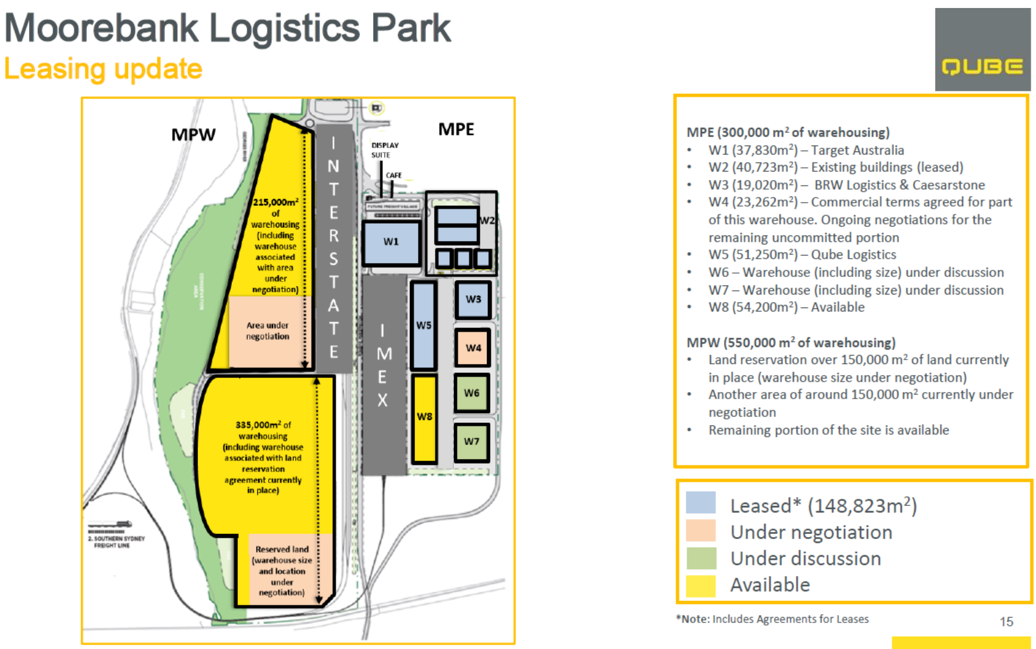


Source: IRESS

The main reason we struggled to see sufficient value in QUB historically is that we believed the market was prepared to ascribe a value to Moorebank (which is approximately 1/3rd of QUB's value) that we believe was too high ahead of the asset being meaningfully de-risked. In June a major key de-risking event occurred with the contracting of Woolworths as a major long-term warehousing tenant to establish new regional and national distribution centres at Moorebank. Not only was the rental revenue from the contract ahead of market expectations (highlighting the strategic value of Moorebank) but we believe this contracting of Woolworths will likely see key Woolworths suppliers also look to set up warehousing at Moorebank given the potential supply chain efficiencies, further de-risking Moorebank. In our view the Woolworths contract will help to de-risk the monetisation process that QUB is undertaking to introduce a capital partner into Moorebank and further highlight the value potential of Moorebank in QUB's share price.

"And then critically importantly, finding the right size for the future and which has not been a trivial exercise in Sydney, the sake a lot of patience and a lot of time to work through to find and say what, I think, what we think is possibly the best logistics sites in Australia." Brad Banducci, CEO of Woolworths, 23/06/2020





Source: Company reports

Aside from Moorebank, we see the 'operating' logistics businesses within QUB as having competitively advantaged positions and a strong growth outlook, both organic and through acquisitions, and we expect QUB's management to make use of its recent increase in balance sheet flexibility to emerge from the COVID-19 slowdown in a much stronger position than its competitors.

Outlook

The market strength and positive sentiment throughout the quarter came as a genuine surprise to us. The momentum in the market appeared at odds with the apparent uncertainty regarding medium term consumer demand and clear caution demonstrated by corporates with respect to capital management. As always, the benefit of hindsight provided commentators with the ability to explain the apparent drivers. The most commonly parroted explanations for market strength included unlimited liquidity injections from central banks, retail day traders punting their stimulus payments, negligible bank deposit rates and re-opening news flow (including hopes for a vaccine). We believe that most of these drivers should in time prove temporary. With this in mind, Greencape has become more cautious. This results in a preference for greater liquidity in positions and higher than typical cash weights.

We believe the scarcity of sustainable dividends will be front of mind for investors during forthcoming reporting seasons. We therefore expect there to be some rotation towards those companies who are able to pay out an attractive distribution without risking the balance sheet.

As always, Greencape will continue to favour our higher scoring shareholder stewardship companies. We believe effective management teams become more valuable in such uncertain times, given the abundance of cheap funding sources magnifies capital allocation outcomes in both positive and negative directions.

"The outlook, including the nature and speed of the expected recovery, remains highly uncertain and the pandemic is likely to have long-lasting effects on the economy. In the period immediately ahead, much will depend on the confidence that people and businesses have about the health situation and their own finances." Philip Lowe, RBA Governor, 02/06/2020

More information

To find out more about investing with Greencape, please contact:

Fidante Partners Investor Services team on: **13 51 53**

Visit the Greencape website: **www.greencapecapital.com.au**

Email Greencape at: **bdm@greencapecapital.com.au**

Financial advisers

For more information, please contact:

Fidante Partners Adviser Services

Phone: **+61 1800 195 853**

Email: **bdm@fidante.com.au**

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