Greencape High Conviction Fund

Quarterly report - December 2020

Performance #	Quarter %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Inception % p.a.
Fund return	12.39	4.89	8.52	10.58	9.34	9.52
Growth return	12.25	4.20	1.88	4.33	2.91	3.23
Distribution return	0.14	0.69	6.64	6.24	6.44	6.30
S&P/ASX 200 Accumulation Index	13.70	1.40	6.71	8.72	7.84	6.35
Active return^	-1.31	3.49	1.80	1.85	1.50	3.17

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'.

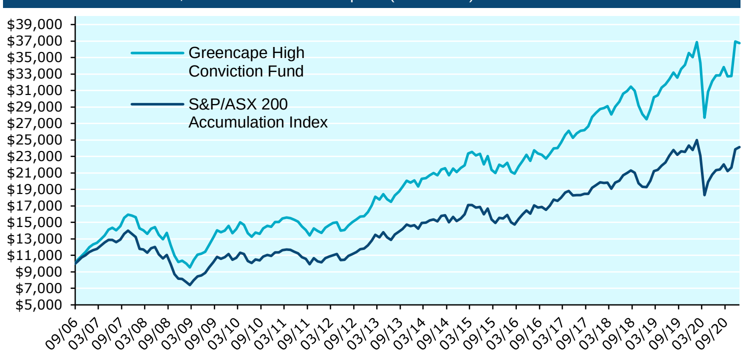
Distribution frequency

Quarterly

Suggested minimum investment timeframe

At least five years

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



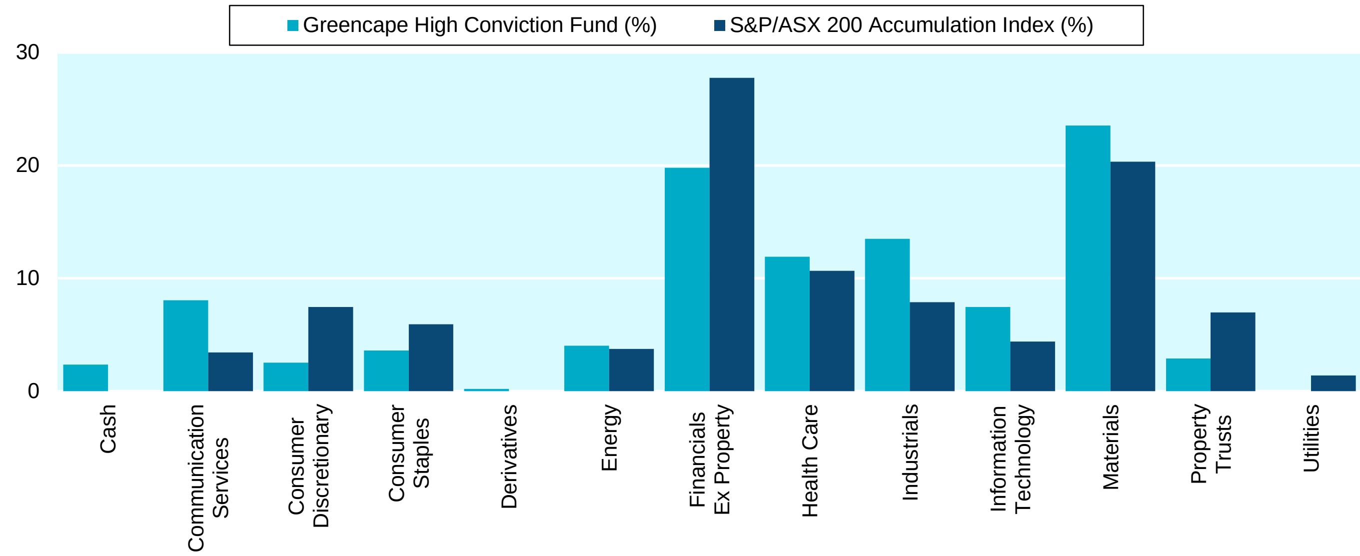
Asset allocation	Actual %	Range %
Security	97.63	85-100
Cash	2.37	0-15

Fund facts	
Inception date	11 September 2006
APIR code	HOW0035AU

Fees	
Entry fee	Nil
2019-2020 ICR	1.52%
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, 31 December 2020.

Sector exposure as at 31 December 2020



Data Source: Fidante Partners Limited, 31 December 2020.

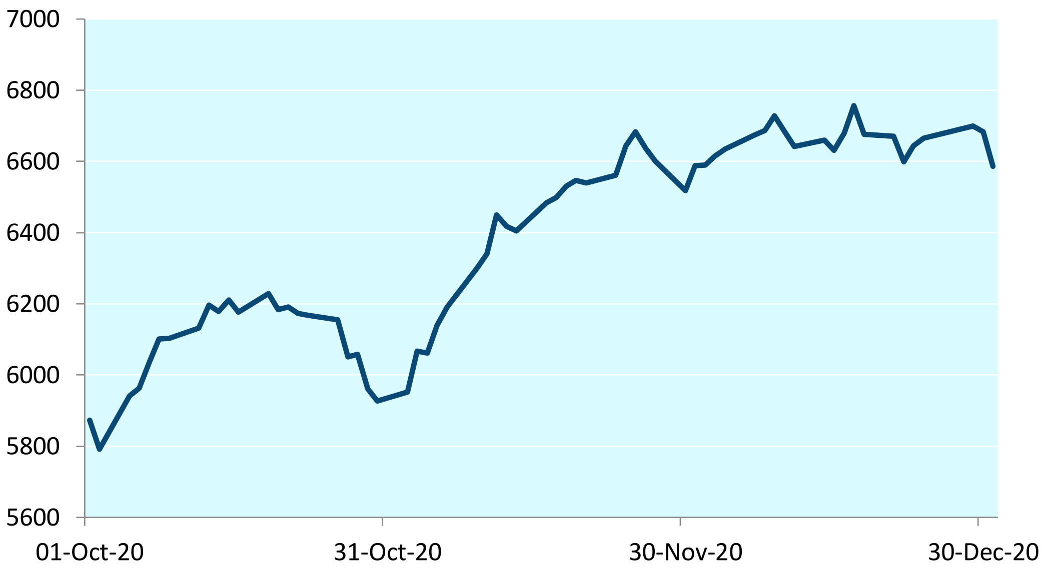
Fund performance summary

The S&P/ASX 200 Accumulation Index returned +13.70% for the quarter. The fund underperformed the market and delivered a +12.39% return over the quarter.

Market overview

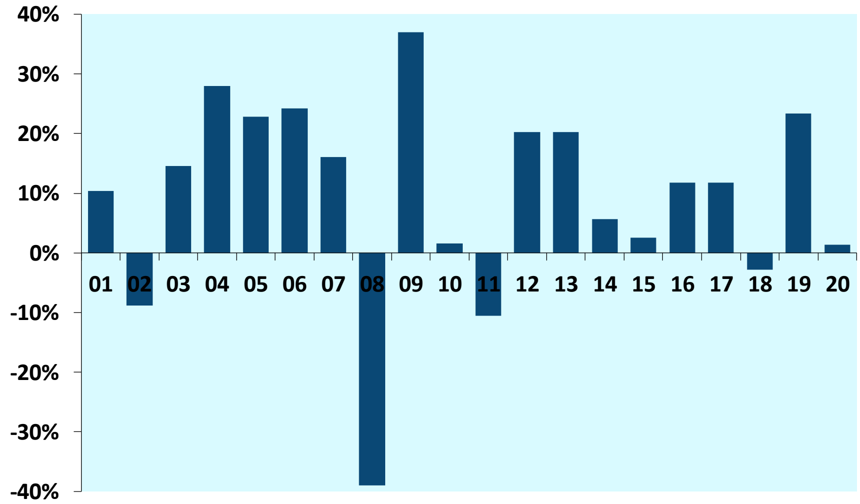
The Australian market rallied throughout the quarter, initially buoyed by a successful effort to suppress the virus relative to the rest of the developed world. The index then got a ‘shot in the arm’ in November as positive data was released for several vaccine candidates. Despite the late recovery, the ASX200 only managed to achieve a slight gain for the calendar year.

S&P/ASX 200 Index



Source: IRESS

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

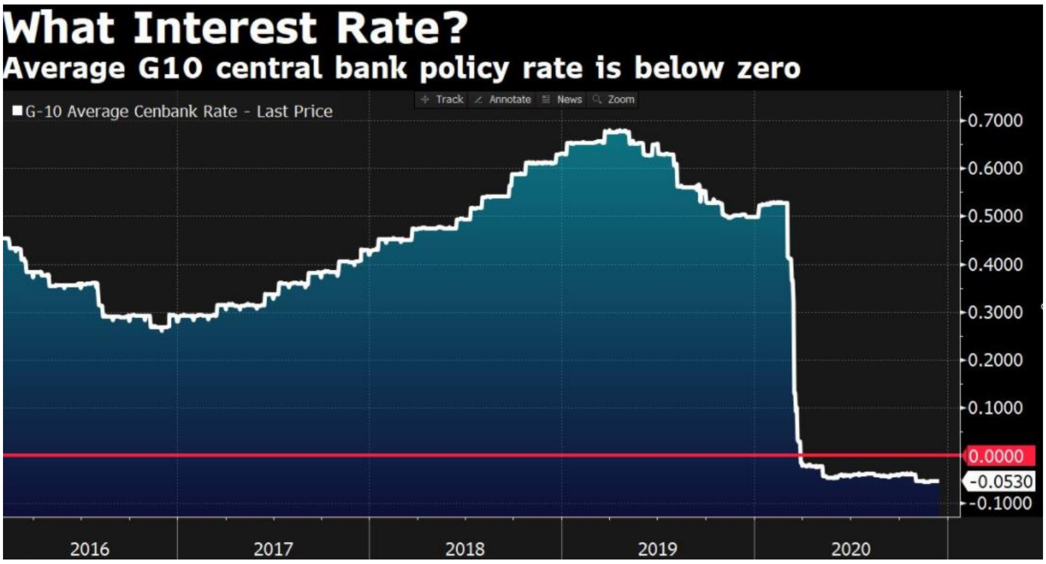


Source: IRESS

The Reserve Bank of Australia (RBA) fired its final Cash Target Rate bullet in November, cutting the rate from 0.25% to 0.10% in November. Philip Lowe (RBA Governor) also revealed the central bank does not expect to raise the benchmark rate “for at least three years”. Given the lack of room to maneuver on the cash rate, the RBA indicated they would continue to pursue further unconventional mechanisms, including buying $100bn in government bonds over the next six months.

“As the economy opens up, though, it is reasonable to expect that further monetary easing would get more traction than was the case earlier.” Philip Lowe, RBA Governor, 15/10/2020

Incredibly, the average G10 central policy rate went negative in December. This suggests that monetary policy will continue to be more unconventional going forward, and fiscal policy will be likely be forced to carry more of the stimulus burden.



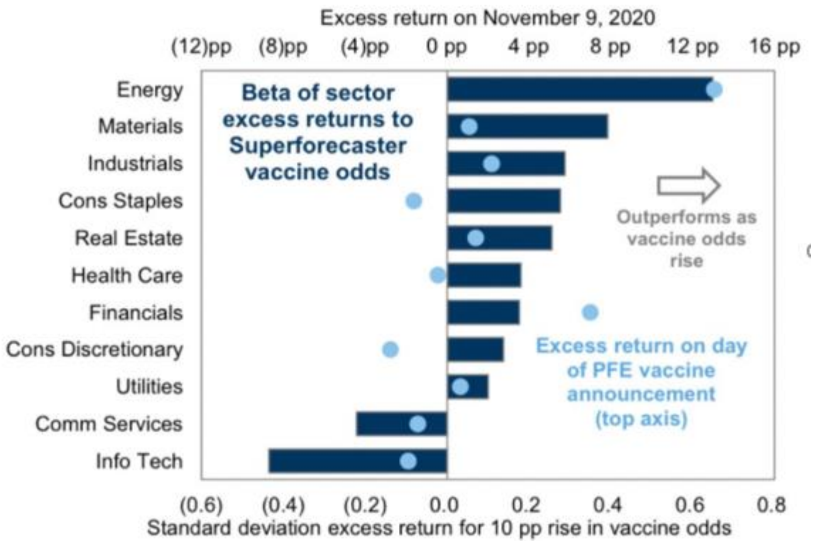
Source: Bloomberg

Elsewhere, much of the focus was on the US Election which ran in November. As has become custom, the result was much closer than the polls suggested in the lead up to the vote. The likely outcome in the aftermath of the election, whereby Biden takes the White House but the Republicans retain control of the senate, was viewed as a 'goldilocks' outcome for global markets. Under this scenario, Biden likely didn't have a path to implementing his administration's proposed tax reform, however he was still in theory able to implement immediate stimulus. This scenario was forced to be reconsidered post period end following the Senate run-off elections which were both won by the Democrats.

"They'll spread these vaccines over the world so fast, it'll make your head spin." Charlie Munger, Vice Chairman of Berkshire Hathaway, 15/12/2020

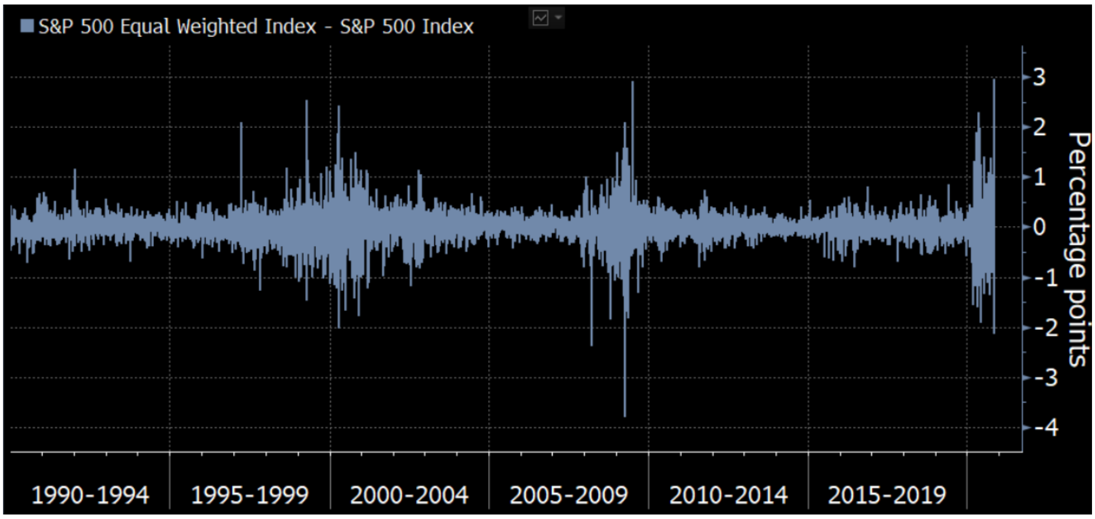
The market reaction to the election was relatively muted compared to the announcement a week later that the Pfizer vaccine was indicated to be over 90% effective in preventing COVID-19. Value and Cyclical stocks which had been hit by the pandemic rallied strongly, whilst COVID-19 'winners' were sold off harshly.

This saw investors trade out of sectors such as Technology and E-Commerce into Travel and Energy, the latter whose recovery profile became a lot more visible due to the encouraging vaccine data.



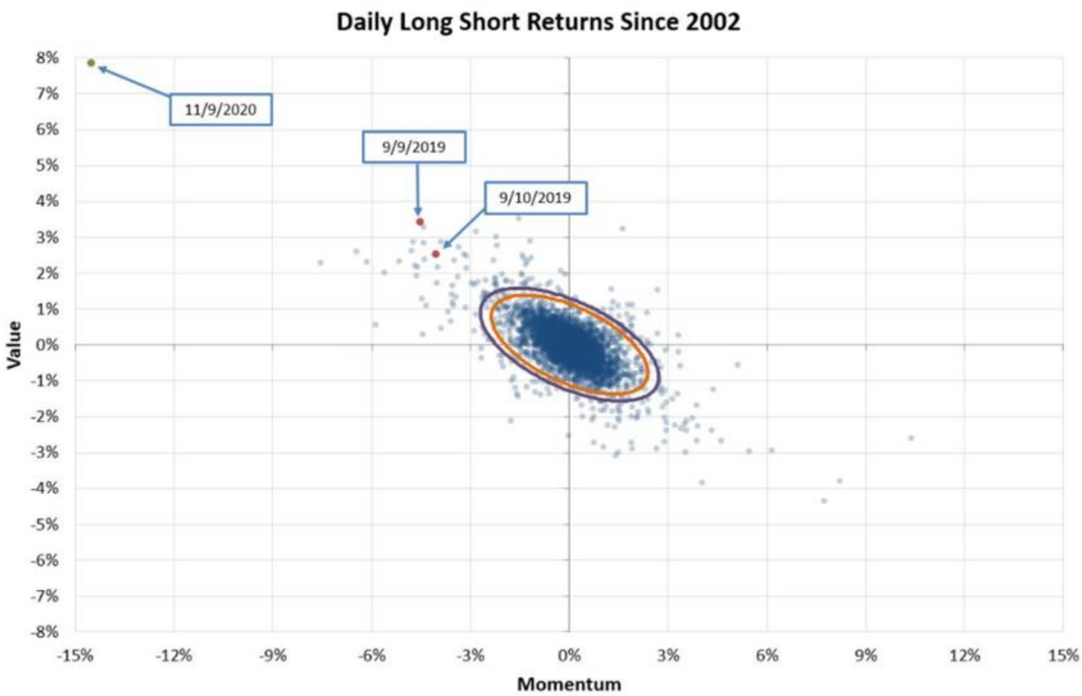
Source: Goldman Sachs

Following the release of the Pfizer data, the Equal Weight S&P 500 Index had its largest outperformance day on record relative to the (market weight) S&P 500.



Source: Bloomberg

The outperformance of Value over Momentum was also historic.



Source: Twitter @wjruss84

The local experience was in tune with offshore, with the Energy sector topping the performance table for the quarter. However, despite the sector's remarkable rally in Q4, it was still by far the worst returning sector for the calendar year. Financial stocks (namely the banks) also benefitted from the flight to 'Value'.

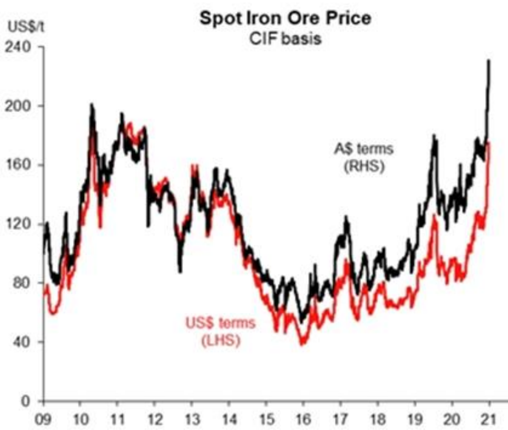
	QUARTER	YEAR
ASX200 Accumulation Index	13.7%	1.4%
Best Performing Sectors		
Energy	26.3%	-27.6%
Information Technology	24.8%	57.8%
Fin Ex-Property Trust	22.8%	-6.3%
Worst Performing Sectors		
Utilities	-5.4%	-16.7%
Healthcare	-1.1%	4.1%
Industrials	4.9%	-12.3%

Source: IRESS

"Much of the improvement today is a function of the reopening of state economies and also the higher-than-expected iron ore prices in the budget." Jim Chalmers, Shadow Treasurer of Australia, 17/12/2020

The listed iron ore names fared notably well during the quarter, aided by the significant tailwind of a strong commodity price. Whilst demand for the metal was strong out of China, the price strength was exacerbated by Vale SA announcing it would miss its production targets.

Whilst in USD terms the iron ore price didn't reach the highs from 10 years ago, in AUD it well surpassed previous highs. It's a profitable time to be an Aussie iron ore miner!

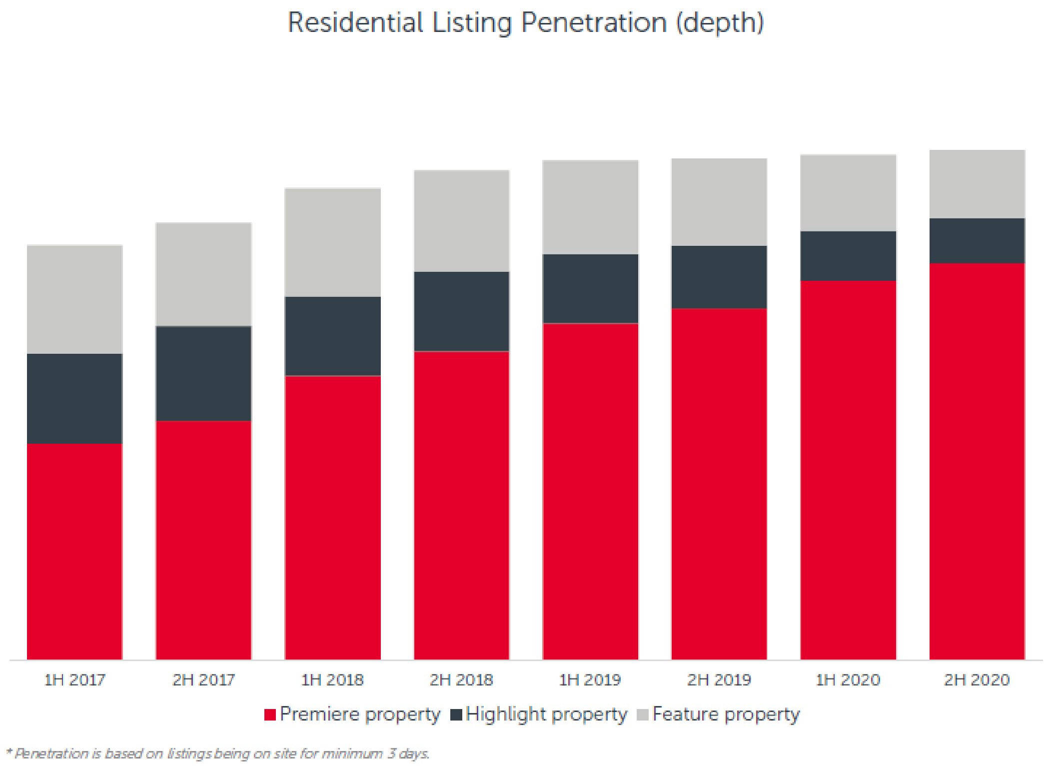


Source: Macquarie

REA Group

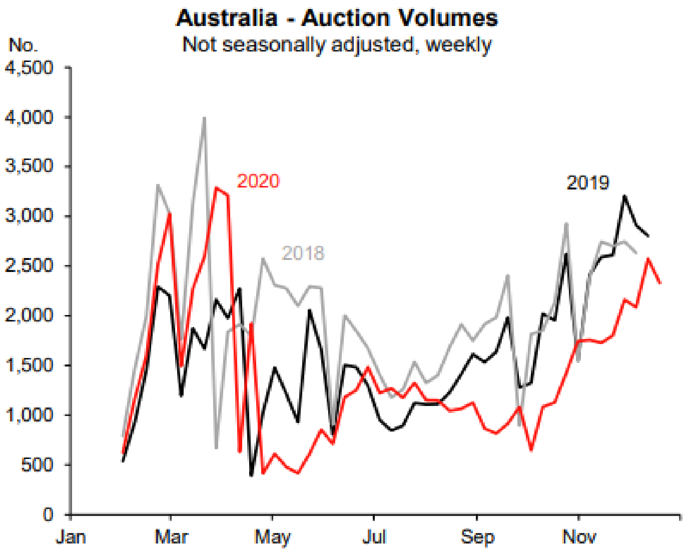
We last talked about REA in our December 2018 report, when the stock was trading around $72. Quite a bit has happened since then notwithstanding the share price trading close to $150. This share price performance has been driven by both earnings' growth and a substantial re-rating in the business by the market.

Our original thesis was that increasing 'depth' penetration of 'Premiere' property listings would continue to provide strong revenue growth. We were also expecting annual price rises given the franchise has strong pricing power due to the its position in the market and specifically, the relationship and reliance on REA by agents and vendors alike. Understanding the impact that 'vendor paid advertising' has in key depth markets was important in gaining conviction around these price increases. By and large, this has been playing out as expected and importantly from here, we continue to think that 'depth' as well price increases can continue to play a material role in driving group revenues higher.



Source: Company reports

What has become more pronounced now however will be potential impact of property transaction volumes. Since 2018, the Australian residential property market has endured a Federal Government election, a Royal Commission into banking (which had seen banks tighten lending standards), and more recently; material uncertainty in the form of Covid-19, which has meant that there have been months on end where the property market was effectively shut. The result has been a continued year on year material percentage reduction in property transaction volumes as homeowners think twice about selling (and buying). We expect transaction volumes to increase from current artificially low levels over the medium term. Call it normalisation if you will, but this growth in transactions volumes in conjunction with both expected price increases and a higher level of depth we believe sets REA up nicely for accelerated revenue growth going forward.



Source: Macquarie

"In October, we received another record month in visits to realestate.com.au, a staggering 125 million, up 36% year-on-year… This strong buyer demand is fuelled by low interest rates and healthy bank liquidity. The announcements by the RBA this week with even lower interest rates and increased liquidity measures will only underpin this." Owen Wilson, CEO of REA Group, 05/11/2020

In 2018, we also spoke about 'earnings certainty' from REA and the company's ability to control costs given we believed that there were a number of levers available to management. This ability to manage costs and therefore earnings was never more evident than this year, where during the worst of the pandemic, REA's management team actively realigned its expense base and in Q4, they were able to reduce costs by 21%. This helped insulate against the unprecedented decline in listing conditions which was down 12% nationally in FY20. We were pleased that our thesis around relative earnings certainty played out, and with this evidence in mind, through the recent COVID-19 period the market appears to have also become more accepting of the defensive earnings quality of the REA franchise.

We are confident REA has the potential to accelerate its revenue growth from its core business, and we have confidence in its ability to manage costs. Taken together, we expect that as the market normalises, strong cost control will continue, and operating leverage will therefore become more apparent. Augmenting this is our belief that REA management have continued to invest in the business through this period, which means there are a number of growth options which are yet to play out materially whether it be vendor leads or agent matching for example. We're happy to back a quality management team going forward to execute on these growth options, whilst the core business is in excellent shape to deliver strong returns. Taken on balance, we think that this helps justify its re-rate and therefore REA remains a core portfolio holding for Greencape.

Outlook

Optimism remains evident in the equities market fuelled by supportive high frequency economic data, expedited vaccine roll out expectations, reduced geopolitical uncertainty (post Trump) and further fiscal stimulus. This is in addition to persistently low interest rates and lack of attractive investment alternatives. Mitigants to the upside from here include already embedded optimism in asset prices, Democrat Senate control (higher US corporate taxes & inflationary expectations) and rising energy prices.

Rotation from Growth to Value names has been evident, although the biggest influence on index returns has been strength in major bank stocks given the large weight they carry, as well as resources names on the back of strong commodity prices and weak USD. This has helped the index claw back some underperformance relative to other global indices, however we still remain some distance away from our previous highs.

The market's focus now shifts firmly to the forthcoming February results season. We expect vague guidance statements as input prices, FX and patchy consumer demand (with various COVID driven shutdowns) act to make forecasting more difficult. We observe that many companies are turning to their dividends as a key confidence signalling tool, and for others, potential acquisitions. Given the wide range of potential outcomes, capital allocation decision making by management and boards is all the more critical. Greencape's focus on Shareholder Stewardship remains key to our stock picking, as are our Market Milestone assessments. We remain confident that the combination of cheap money plus effective management will deliver attractive long term returns.

"If you buy something with a 10% free cash flow yield and hold it for 3 years, management is going to be responsible for allocating a third of the value of the company over that time. You have to really care about that." Adam Weiss, Founder of Scout Capital

More information

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

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