DS Capital Growth Fund

December 2018 Half Yearly Update

The DS Capital Growth Fund ('the Fund') seeks to deliver superior returns through a process designed to minimise the risk of a permanent loss of capital. The Fund comprises a concentrated portfolio of well researched listed businesses. The focus is on companies where we have a deep understanding of their business model and the industries in which they operate. The investment process combines traditional quantitative financial analysis with qualitative tools.

	Financial Year to Date	5 Years (pa)	Since Inception (pa)	Since Inception
DS Capital Growth Fund	**-6.2%**	**13.1%**	**16.3%**	**147.4%**
All Ordinaries Accumulation Index	-7.3%	5.7%	7.9%	58.0%
Small Ordinaries Accumulation Index	-12.7%	5.6%	4.5%	30.5%

Notes: (1) Data is after management fees and before performance fees. (2) Inception date is 1 January 2013. (3) Return since inception after all fees averaged 14% pa and totals 116% assuming reinvestment of net distributions.

The recent half was particularly challenging. Global stock markets ended the half sharply lower. Although we were not spared, we fared better than many assisted by the defensive components of the portfolio. Investors and followers of our updates would be aware that our portfolio predominantly comprises small and mid-capitalisation Australian listed businesses but also contains a few larger Australian businesses and some UK and US listed businesses. In this context, it is worth considering the performance over the recent half of some of the key indices of the various markets, which our portfolio is exposed to.

Index	Change Financial YTD
ASX All Ordinaries Accumulation Index	-7.3%
ASX Small Ordinaries Accumulation Index	-12.7%
UK FTSE Index	-11.9%
US S&P 500 Index	-7.8%
US Nasdaq Index	-11.6%
DS Capital Growth Fund	**-6.2%**

Triggering the selloff in October was the rapid increase in US 10 Year Bond yields that peaked at around 3.25% leading investors to worry that official interest rates were rising faster than the economy could bear. Adding to concerns was the lingering China/US trade war together with some signs of a slowdown in economic growth. This saw further equity market weakness as the initial fears of high interest rates made way for fears of an economic slowdown over the next 12-24 months.

Collins Foods delivered solid first half results. The core Australian business performed well and investors were encouraged by the early success of the new Taco Bell format that opened in Brisbane in 2017. Collins announced a target of 50 new Taco Bell restaurants by 2021 that could meaningfully add to its earnings.

NEXTDC announced new contracts for its second Sydney data centre, S2, that will open in the first half of 2019 and is already about 50% committed. Additionally, given good demand for space, NEXTDC will accelerate the expansion of this centre. NEXTDC are on track for strong earnings growth next year.

Investors in **Challenger** had to digest delays to new government requirements for super funds to offer retirement products (a tailwind for Challenger) and news that Challenger veteran, Richard Howes, will take over from long term CEO, Brian Benari. Encouragingly, the company also confirmed earnings guidance (8-12%

growth) and announced that its partner for Japanese annuities, increased its shareholding in Challenger to its target of circa 10% from the 6% stake it initially took in August 2017.

The takeover for **MYOB** progressed albeit on renegotiated terms. KKR took advantage of weaker stock market conditions and reduced its bid price. MYOB has agreed to accept the revised bid if it cannot solicit a higher bid before 22 February 2019.

During the half a Senate Inquiry was announced to consider credit and financial services businesses such as payday lenders, consumer lease providers, 'buy now, pay later' services and debt management firms. Less significant and more common than a Royal Commission, a Senate Inquiry can still cast a shadow over a sector. For the businesses that we own, we consider the impact will be limited given that **Money3** has already announced the wind down of its very small short term lending business and **Credit Corp's** consumer product is not within the current regulations.

Lifestyle Communities announced the acquisition of a new site in Victoria that will potentially add about 260 homes in 2021 to its existing portfolio of about 3,100 homes.

The lack of progress and missteps that has characterised the recent developments on Brexit impacted our UK investments. We visited London in November and surmised that although in most cases the underlying businesses are operating well, a growing level of uncertainty is hampering confidence.

Outlook

We remind our investors of our philosophy that short term share prices can be influenced more by 'noise' and emotional behaviour whereas long term share price performance will be influenced more by the underlying fundamentals. In periods such as these it is not uncommon to see bouts of indiscriminate selling as some shorter term investors aggressively simply cut exposure to the stock market, as an asset class, rather than to individual businesses. Such behaviour tends to affect the prices of both good and bad businesses. Whilst unpleasant in the short term, the current environment is offering opportunities to those with a longer term investment horizon who are able to 'look beyond the noise'.

We expect stock markets will remain volatile while a heightened level of uncertainty continues in relation to US tariff policy, Brexit and interest rates. Closer to home, we will also have to contend with the economic policy outcomes of the Federal election in the first half of 2019.

Against a backdrop of benign economic conditions, all of these issues result in good businesses being available for investment at prices, in some cases, significantly lower than just a few months ago. To that end, our portfolio has 24% cash and we expect to be increasing our exposure over the next six months given that we now have significantly more opportunities than we previously had. This includes several opportunities flowing from the uncertainty in the UK once Brexit is resolved.

As always, feel free to contact us if we can be of any assistance or if you would like more information about your investment with us.

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