DS Capital Growth Fund

March 2019 Quarterly 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	12 Months	5 Years (pa)	Since Inception (pa)	Since Inception
DS Capital Growth Fund	**0.8%**	**6.8%**	**14.0%**	**16.9%**	**166.0%**
All Ordinaries Accumulation Index	3.0%	11.2%	7.5%	9.4%	75.5%
Small Ordinaries Accumulation Index	-1.8%	5.8%	8.0%	6.3%	46.9%

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 14.4% pa and totals 132% assuming reinvestment of net distributions.

Equities performed strongly in the March quarter with the resources and technology sectors particularly strong. This reversed some of the sharp falls of the previous quarter. Assisting the rally was the renewed possibility of interest rate cuts due to weakening global economic growth as well as low expectations ahead of the important February reporting season. The February market rally masked a disappointing earnings season characterised by noticeably cautious management outlook guidance.

Our portfolio performed reasonably well with several strong results including those from **Breville** and **Lifestyle Communities**. Softer than expected results came from **McMillan Shakespeare**, **Experience Co** and **Challenger**.

The half year result of **Breville Group** reported good growth across its major territories of the US, Europe and Australia. In Europe, the move to a direct distribution model is proving successful giving management confidence to continue this strategy across further European territories and accelerate its European expansion.

The half year update by **Lifestyle Communities** showed continuing demand for Lifestyle's housing solution for 'downsizers' with a total portfolio of almost 3,364 homes and home sites providing a growing base of rental income. House prices in the company's key catchments remain buoyant providing a good environment for continuing strong home sales and settlements. Lifestyle also announced the purchase of another tract of land that will add 185 new homes.

Niche consumer lender **Money3,** announced the sale of its Small Account Credit Contract business. Although cash generative, this division attracted negative sentiment and limited interest from investors and wholesale funders. The divestment should now broaden the appeal of Money3 and allow it to access lower cost funding. Money3 also announced a small acquisition in New Zealand and a strong half year result.

After a challenging 18 months, adventure tourism group **Experience Co,** announced a change of leadership. The CEO resigned and the founder moved to a non-executive director role. The founder is well regarded, still owns about 32% of the business and will focus more on strategy. These moves come after the recent appointment of tourism expert Bob East (ex Mantra) as Chairman and Owen Kemp as CFO. We feel comfortable that the team can improve and reinvigorate this business that, notwithstanding many challenges, has still managed to grow its profits.

In January, **Challenger** downgraded its full year earnings outlook due to lower than expected distributions and performance fees on investment portfolios affected by the volatile December quarter. In March, Challenger had positive news, announcing an expansion of its relationship with its Japanese partner (MS & AD Insurance) to sell US dollar denominated annuities. MS & AD also increased its shareholding in Challenger from 10.4% to almost 15%.

Late in the quarter **McMillan Shakespeare** announced that it would not complete the merger with Eclipx that was proposed in November 2018. We view this favourably given that, following the initial proposal, Eclipx revealed a sharp and continuing deterioration in earnings.

Outlook

Softer global economic growth will maintain pressure on global interest rates that have fallen from the multi-year highs of October 2018 deferring a return to higher rates that seemed likely just six months ago. While lower interest rates are theoretically favourable for equity markets, weaker economic conditions can make it more difficult for businesses to grow earnings. This was evident in the recent reporting season which, together with a recent lift in share prices, gives us cause for caution. Equity markets however do appear to be in a sweet spot with stock markets seemingly comfortable with the slower growth, low interest rate environment combined with optimism toward a favourable US-China trade deal.

As usual, from our post reporting season company meetings, we have compiled a shopping list of businesses that we would like to own or add to our current holding. We are seeing new opportunities and the Portfolio has 20% cash. We will take these opportunities sparingly.

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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