DSCAPITAL

DS Capital Growth Fund

September 2022 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.

As at 30 September 2022	Financial Year to Date	3 Years (pa)	5 Years (pa)	Since Inception (pa)
DS Capital Growth Fund (net of all fees)	**-0.6%**	**5.0%**	**7.8%**	**12.2%**
All Ordinaries Accumulation Index	0.8%	3.1%	7.1%	8.2%
Small Ordinaries Accumulation Index	-0.5%	-0.8%	4.1%	4.5%

Notes: (1) Inception date is 1 January 2013. (2) Returns are after all fees and assuming reinvestment of net distributions. (3) Data does not include franking credits distributed to unitholders.

Against a challenging investment backdrop, the Fund was slightly lower for the quarter. Investors grappled with heightened geopolitical risks, continuing supply disruptions, financial system stability and continuing elevated inflation. Stock markets took a step down in September after Federal Reserve Chair, Jerome Powell, confirmed that the Fed "will keep at it until inflation is down to 2%" and various central banks intervened to stabilize credit and currency markets. Domestically, the Reserve Bank appeared similarly committed to fighting inflation with three 50 bp rate increases in the September quarter.

During August, most companies reported full year results. We did not see a meaningful deterioration in the profits of most of the businesses that the Fund owns. The common themes were inflation, labour shortages and labour inflation, the ability to pass through price rises and the lack of quantitative earnings guidance or outlook commentary. Share prices however, derated during the quarter. This was mainly due to the effect that higher interest rates have on valuations (future earnings are worth less in today's dollars at higher rates) and investor fears about the economic environment rather than on weaker than expected reported earnings. In these times, we continue to focus on businesses with a degree of pricing power that should mitigate the effect of inflation.

Strong results were delivered by **Seven Group, REA Group, Breville** and **PSC Insurance**.

The two key divisions of **Seven Group**, WesTrac and Coates, both performed strongly. Notwithstanding inflationary pressures and labour shortages, both businesses grew revenues and margins. This outweighed a softer than expected result from the newly acquired investment in Boral that now appears will take longer than expected to realize value.

Although the broader residential market outlook weighed on the share price of **REA Group**, its flagship asset, realestate.com.au, continued to perform well. A combination of price increases and the growing adoption of premium services allowed REA to report impressive results and guide for continuing strong earnings growth driven by improving revenues and margin gains.

In a difficult consumer environment, **Breville** reported impressive results. Strong performance in the US against a challenging consumer backdrop evidence Breville's more resilient target demographic market. Offsetting this was weaker European performance due to consumer caution relating to the Ukraine war rather than the execution of its European growth strategy.

The full year results of **PSC Insurance** beat expectations. A combination of a continuing strong premium cycle and disciplined cost control saw PSC standout in an inflationary environment. PSC is continuing to pursue acquisitions and has capacity for further investment that could see earnings increase by at least 40% over the next 3 years.

The Fund's cash level finished the quarter at 24%.

Outlook

Further economic strength and consumer resilience will likely mean that inflation remains stubbornly high. Strong economic growth will be perceived as 'negative' until it slows sufficiently to reduce inflation and upward pressure on interest rates. Recent pullbacks in prices for materials, energy and freight rates are encouraging but labour markets remain tight, and credit and equity markets are pricing in further rate increases that will be a headwind for stock markets. Central Bank interventions also warrant monitoring as managing inflation targets with higher rates will need to be balanced against the impact that higher rates have on financial system stability.

Markets that are primarily driven by macro and geopolitical factors will be a headwind for our portfolio. As central banks transition the global economy away from policy settings that were too accommodating and balance inflation, interest rates and financial stability, volatility will persist. This will likely weigh on equities causing our list of opportunities to grow. We currently have 24% cash, part of which is expected to be gradually deployed over the balance of this financial year. We will continue to favour businesses with pricing power because pricing power helps a business grow profits. This helps protect the value of our investments because higher profits, even at a lower multiple, should mean the business is worth more in the future than it is today.

We have been asked many times about whether it is a good time to add to investments now. Although overwhelmingly pessimistic financial news can be unsettling, these times are the most interesting to a long term investor. Many opportunities present and patient investors, like us, should be rewarded for investing in quality businesses when clarity regarding inflation appears.

During these times, we remind our investors that we are available for an update, so please feel free to contact us if you have any questions.

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