# Pivotal Diversified Fund

Annual Report

**30 June 2023**

AFMG

Pivotal Diversified Fund

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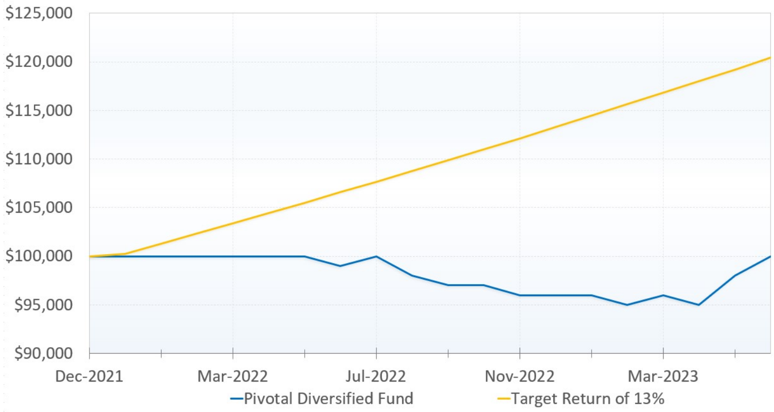
## Annual Report - 30 June 2023

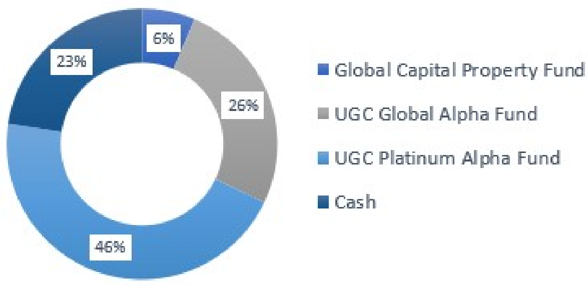
| Fund Returns | 1 Month (%) | 3 Month (%) | 6 Month (%) | 1 Year (%) | Total Return Since Inception (%) |
|---|---|---|---|---|---|
| **Pivotal Diversified Fund** | **2.04%** | **4.17%** | **4.17%** | **1.01%** | **0.00%** |
| Target Return 13% | 1.02% | 3.10% | 6.30% | 13.00% | 13.28% |
| Versus Target Return | 1.02% | 1.06% | -2.13% | -11.99% | -13.28% |

*Fund Inception 22nd December 2021

### Value of $100,000 Invested (AUD)




### Asset Allocation




| Key Information | |
|---|---|
| **Investment Manager** | Australian Funds Management Group Pty Ltd |
| **Fund Inception** | December 2021 |
| **Min. Investment Amount** | $25,000 |
| **Redemptions** | Monthly |
| **Management Fee** | 1.54% per annum |
| **Rec. Investment time** | 5+ Years |

| Strategy Returns | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| **Global Capital Property Fund** | 0.38% | 2.61% | -2.35% | 0.34% |
| **UGC Global Alpha Fund** | 0.07% | 1.73% | 1.23% | -1.70% |
| **UGC Platinum Alpha Fund** | 4.56% | 10.37% | 11.69% | 4.98% |

### Annual Report

The last 12 months have been a story of two halves. The July 2022 through to December 2022 period was characterised by rapidly rising interest rates, eye wateringly high inflation and fears of an impending recession leading to significant negative investor sentiment. Markets had a decent dose of volatility from 1 July 2022 to the end of December 2022 as measured by the CBOE Volatility Index or the VIX, which swung regularly from the highest levels in the mid 30's to lows in the mid teens. For reference when the VIX is trading in the mid 30's you would generally expect the S&P 500 to move by approximately 1.8% - 2% each day (and more for high beta Nasdaq indexes). As the VIX rises it is an indicator of uncertainty, increased risk and high volatility. Since the beginning of 2023, however, the VIX has been on a steady decline, last spiking in March around the time of the regional banking crisis, to end the financial year to be trading around the low to mid teens.

October delivered the lows for most global equity markets correlating with the VIX reaching 35, with broader US indexes bottoming on the 13th October. The S&P 500 and Dow Jones Industrial Average both managed to pick themselves off the canvas and put in some stronger momentum to year end while the technology heavy indexes of the Nasdaq retested October lows as we headed into the end of December 2022. Everything changed on January 6th. The appetite for growth stocks returned early in 2023 as sentiment also turned, initially on the back of falling energy prices and a China re-opening story then followed by signs of an accelerating decline in headline inflation.

Rate hikes remained front of mind for investors and in March the impact of this most recent steepening of hikes was laid out for all to see as we witnessed the collapse of Silicon Valley Bank and Signature Bank with contagion (not the pandemic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kind) ripping through the US regional banking sector. This crisis delivered a windfall for technology, in particular mega cap technology companies, as investors looked for the relative safety of Mega Cap tech balance sheets to shield them from the first and second order effects of a total regional banking collapse.

This resulted in the second best quarter for the Nasdaq Composite index in the past decade, posting a gain of 17.5%, trailing only the remarkable 30% surge in the second quarter of 2020 during the post-Covid rally. Leading the charge was NVIDIA Corp (NVDA), Apple Inc. (AAPL), Microsoft Corporation (MSFT), Meta Platforms (META), and Tesla Inc. (TSLA), all major contributors to the overall performance of both the Nasdaq Composite and Nasdaq 100 Indexes. This was followed up by another stellar June quarter from the technology headliners but also highlighted the narrowness of stock participation in the year to date rally. Earnings supported moves higher in the Mega Caps but the same was not evident initially for the Small and Mid Cap companies, which has lagged much of the index rallies to date.

The last 12 months delivered starkly different environments, October the yearly lows and then a total about face to ring in the new year. The Nasdaq Composite improved by 25.02% with the more concentrated Nasdaq 100 index climbing another 31.95%, all of that over the first 6 months of 2023. The S&P 500, lagged the tech heavy indexes but delivered 17.57% while the Dow Jones lagged the S&P 500 and Nasdaq improving by 11.8%, most of which was generated in the period off the lows in October to early December before trading sideways for most of 2023. Closer to home we saw the S&P ASX 200 track much like the Dow Jones, delivering a solid recovery initially off the October lows only to stall in 2023 with a 12 month return of +9.67%.

## Central Bank Policy

Central bank policy makers have maintained their fiscal tightening stance and continued to hike rates aggressively throughout the year. The US Federal Reserve, which had embarked on the first rate hikes in early 2022, continued with a further 7 hikes taking the Fed Funds rate from 1.5 - 1.75% at the start of the financial year all the way to 5.0% - 5.25%, adding 350bps to the end of May 2023 before taking a breather at its meeting in June. The European Central bank followed the path set by the US with a series of aggressive hikes to take the base rate to 4% while closer to home the RBA initiated 325bps of hikes to take the RBA target cash rate from 0.85 in June 2022 to 4.1% in June 2023. The speed of the interest rate hikes has been a major contributor to asset prices coming under significant selling pressure during much of 2022, in particular longer duration investments such a growth equities. However, the aggressive hiking also hit the relative safety of bonds as the new normal forced significant Mark-to-Market repricing of existing government and corporate debt resulting in many fixed income managers having to take the decision to hold onto the lower yielding debt or accept a haircut and invest into new issued higher yielding bonds.

Initially it appeared as though there was no end in site for the hiking cycle but move forward 12 months and with a hold at the June US Federal Open Market Committee meeting, this now points to the possibility that rates are close to peaking. For this to eventuate, central banks will largely take much of their clues from inflationary data and while headline inflations is falling quickly the stickiness in Housing and Shelter, Wages and an extremely strong jobs market may push the Fed to go a little further than we'd all hope. Locally the much vaunted mortgage cliff has now commenced, that is mortgages settled 2 and 3 years ago when interest rates sat at 0.10bps are now rolling over into new floating rate mortgages. With a target cash rate at 4.1% this now implies that borrowers will have to manage mortgage repayment increases of appropriately 40% to 60% higher than the prior month when they were still on fixed rate repayments.

## Inflation Commentary

High rates of inflation continued to drive much of the narrative over the last 12 months with it being the key driver of interest

### About the Strategy

The Fund aims to generate the Target Return by investing the named Underlying Investments being; Global Capital Property Fund Limited (GCPF), UGC Global Alpha Fund (UGCGAF), UGC Platinum Alpha Fund (UGCPAF), UGC Private Equity Fund (UGCPEF) and third party investments (Other) selected by the Investment Manager. The strategies of each Underlying Investment are described in their respective Product Disclosure Documents (PDS), Prospectus, Information Memorandum or other appropriate offer document. The Fund will provide investors with a spread across these investments according to the Funds allocation rules

### Target Return

The Investment Manager is targeting an annual rate of return to Investors of 13% p.a., pretax and net of all fees and expenses, over a rolling 5-year period. Note, this is a target return only and not a forecast or guaranteed return.

### Fund Structure

Diversified Fund of Funds

### Asset Allocation

Cash: 2 - 25%
GCPF: 10 - 35%
UGCGAF: 10 - 35%
UGCPAF: 10 - 50%
UGCPEF: 0 - 35%
Third Party Investments: 0 - 40%

rate policy by central banks the world over. Key regions such as the US, Australia and parts of Europe saw inflation rates begin to peak in late 2022 while emerging economies saw astonishing rates of inflation which in some instances have yet to be controlled, including countries such as Turkey and Argentina.

In the US the rate of inflation peaked in July 2022 when US CPI for June was reported at 9.1%, the highest level in over 40 years, however over the following months we saw the headline CPI begin to cool as many of the commodities that had seen sharp spikes in price after the Russian invasion of Ukraine began to moderate and eventually fall. Many input commodities across the energy sector such as oil, gasoline and heating oil experienced double digit declines with other commodities also cooling in what became a significant sell off across several commodities in particular metals such as silver, copper, steel and iron ore and the agricultural segment, such as lumber, wheat, soybeans, canola and corn.

The falls across commodity inputs is only part of the story and while the inflation rate in the US has declined significantly and last reported at 3% there are still several areas where inflation remains sticky. This stickiness remains concerning for the Federal Reserve, while much work has been done to alleviate many of the rising cost pressures there remains risks that inflation could accelerate again if areas such as unemployment remains, putting upward pressure on wages. The US has set the trend on inflation and the rest of the world is expected to follow the cooling trend in due course, especially if central bank policy remains co-ordinated and tight for a sufficient period of time.

Back home in Australia our rates of inflation have lagged the US as we saw a peak in the quarterly rate of inflation at 7.8% in December 2022 while the monthly rate saw a peak at 8.4% in December 2022 (Note that in Australia the quarterly rate of inflation is still viewed as a better indicator than the monthly CPI). Rates of inflation have seen a cooling in Australia also with monthly CPI coming it at 5.6% in May. With similar concerns to the FED, Australia's RBA is keeping a close eye on strong employment figures, increasing wages and rising housing costs that continue to weigh on the inflation numbers. Nevertheless, Australia's reliance on China and the emerging economic troubles related to real estate in that country is proving to be somewhat of a counterweight recently with expectations increasing that the slow down in China could mean that the peak in Australia's interest rate raising cycle may be close, albeit rates will likely remain higher for longer.

## Recession Risk

Looking closer to home the risk Australia falls into recession continued to increase over the last 12 months. Australia's inflation rates and subsequent policy adjustments lagged that of the US and European economies. For instance, Australia's inflation rate peaked in December last year, a significant lag to that of the US which peaked some 5 months earlier. The big risk for the Australian economy is that significantly higher interest rates bite economically more than expected and economic activity slows so much that we enter into a recession.

Real household disposable income is falling and more falls are expected as large volumes of fixed rate mortgages roll into much higher variable rate mortgages through the back half of 2023 and early 2024. How this affects Australian economic activity will become clearer over the next 6 - 12 months, however, as households begin to face higher rates of mortgage stress the probabilities of the RBA navigating the pathway to a so called "soft landing" is now becoming more difficult.

In the US with inflation showing clear signs of cooling we are now entering a new phase of interest rate policy. The question being asked is if this new phase will be higher for longer or will we see cuts in the short term? For now the US consumer is showing remarkable resilience and broader economic activity still remains somewhat robust despite the dire forecasts by many economists. GDP growth remains positive all be it lower than previous years and the employment backdrop is just about as good as it gets. While Americans still have jobs the economy will hum along, and this can remain the state of play until all of a sudden it isn't. A couple of months of unemployment surprising to the upside could be the sign of problems ahead, it's at this point the much vaunted soft landing probabilities will be thrown out the window, but for now this is not the case. The unemployment rates in both countries continue to show resilience with the US unemployment rate currently tracking at 3.6% and the Australian unemployment rate sitting at 3.7% at the time of writing.

## Portfolio Update

For much of the past 12 months the fund, through its direct cash holdings and large cash balances held by its sub-fund investments in UGC Global Alpha Fund, UGC Platinum Alpha Fund and Global Capital Property Fund, has held a primarily defensive posture, particularly during the second half of 2022 when equity markets experienced significant bouts of volatility before ultimately bottoming in October. Uncertain economic and earnings outlooks as a result of steep interest rate hikes and inflation hitting 40 year highs provided us with sufficient reason to take a cautious approach to commencing our investment program. This positioning enabled the fund to protect investment capital in readiness to deploy as broader market and economic indicators improved.

While the fund had made investments across the various sub-funds, those same sub-funds also had significant weightings towards cash as they too held out for improving market conditions and less bad economic data. The equity based investment funds (UGC Global Alpha Fund and UGC Platinum Alpha Fund) spent much of the last 6 months of 2022 hedged out or carrying high levels of cash. The aim was to reduce exposure to extreme levels of volatility being experienced in global equity markets in order to preserve investor capital. However, while the fund manager of both funds was focused on capital preservation for much of last year they did have periods where they tested the markets and deployed some capital only to be yet again forced back into a significantly defensive posture as market conditions yet again worsened. Over the last 6 months of 2022 patience was paramount.

The new year brought about a renewed level of optimism, in particular in growth equities, which had been for much of 2022 a tricky asset class to be invested as the rapid rise in borrowing costs delivered significant haircuts to longer duration securities. Since January 2023 there has been a significant change in investor sentiment towards these same growth equities, but primarily in just the Mega Cap Technology names, such as Apple, Amazon, Alphabet (Google), Nvidia, Tesla, Meta and Microsoft. With this improvement the investment managers of the sub-funds began deploying some of their cash hoards while we began deploying new capital held within the Pivotal Diversified Fund into a number of new 3rd party investment funds.

In May of 2023, we commenced the process of initiating investments into five new sub-funds with the aim of providing further diversification into well managed investment funds with good long term track records that offer something different to what was already held within the fund. These funds are the Auscap Long Short Australian Equities Fund (Australian equities focused value manager), Hyperion Australian Growth Fund (Australian equities focused growth manager), Lazard Global Equity Franchise Fund (International equities focused value manager), Munro Partners Global Growth Fund (International equities focused growth manager) and PIMCO Trends Managed Futures Strategy Fund (Global financial markets trend following managed futures strategy).

In addition to these new investments the UGC Platinum Alpha Fund increased its overall net market exposure to both existing stocks and initiated six new positions in the lead in to the end of the financial year as stock price action appeared far more constructive than at any point over the last 2 years. The UGC Global Alpha Fund increased its trade position size and more than doubled trade count as conditions improved and the number of profitable trades increased, as evidence pointed to an improving trading environment. The fund began the June quarter with just one position in the swing trading strategy carrying over from the March quarter, Wisetech, and finished the June quarter with 16 open positions.

Global Capital Property Fund remains a small allocation within the portfolio. Its diversified portfolio of real estate development projects spans Queensland, New South Wales, Victoria, South Australia and Western Australia. Over the last 18 months project performance has been patchy with many projects having to navigate many of the same forces that have seen some of Australia's most prominent builders and developers fall into administration and even bankruptcy. Rising construction costs, increasing cost of funds, supply delays and labour shortages as a hangover from Covid combined to create many challenges for the company's developers and this has meant that its share price performance has stagnated over the past 12 months. However, with many of these issues having now been recognised in the share price the share price has now stabilised around $1.1497 as at 30 June 2023. The investment managers continue discussions with several developers within the portfolio that are considering exiting GCPF early from their projects via refinancings. Importantly, one of GCPF's largest investments, a land sub-division in MacKay, QLD, entered into a sale contract to sell off a major stake in the project. Settlement of this project is expected in late February 2024. With approximately 1/3 of the company's portfolio to be returned to it in full with interest, this sale goes a long way to de-risking the GCPF portfolio and setting it up for opportunistic purchases over the coming 12 months, with the aim to take advantage of the next real estate development cycle when it commences.

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Some numerical figures in this publication have been subject to rounding adjustments.