Chester High Conviction Fund
Market Commentary

	1 month %	3 months %	1 year %	2 years % p.a.	3 years % p.a.	Inception % p.a.
CHESTER HCF (after MER)	+2.25	na	na	na	na	+2.42
S&P/ASX 300 Accumulation Index	+0.22	na	na	na	na	-2.34
Value added (after MER)	+2.03	na	na	na	na	+4.76

Note Inception date as the 27th of April, 2017. After fees calculations includes both management fees and accrued performance fees for the period.

The NAV as of the 30th of June 2017 was $1.0242. Note the spread between the buy and sell price is 30bpts.

"Continuous effort - not strength or intelligence - is the key to unlocking our potential"

Winston Churchill

The Quarter in Review

The biggest change to consensus thinking over the past 4 weeks appears to be the acceptance of Central Bank policy makers that now is an appropriate time to remove the current accommodative monetary policy, whether in the US (ongoing rate hikes and potentially shrinking the Fed balance sheet) or in Europe (gradual removal of the bond purchase program). This surprises us, given how important inflation (not apparent yet) and US tax reform will be in driving US growth projections over the coming cycle. Without clarity on tax reform, which is due to be tabled during Q3 (August-September), it appears uncertain what the economic projections should look like, which appears at odds with the current Fed speak that remains committed to ongoing hikes, regardless of what happens at the fiscal level (tax reform or new spending initiatives) and how these programs are funded.

We have been of the view that at the macro level, equity markets need two conditions to continue the current expansion. Ongoing accommodative policy; and earnings upgrades, which should be broadly driven by economic expansion. Therefore this rhetoric (removing liquidity from asset markets) suggests we should be less optimistic for the US market to continue higher, without a correction, which to our way of thinking, would be healthy. Domestically, we find little reason to disagree with the consensus view that Australian housing activity looks to be rolling over. The co-ordinated response from major banks to reprice interest only loans should be seen as prudent, but may exacerbate consumption problems with record household debt to income ratios.

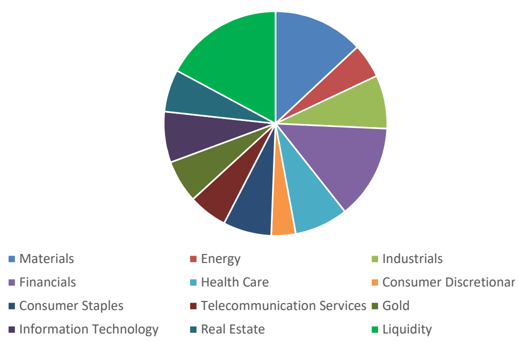
The Portfolio

We focus most of our attention on cash flow generation, i.e. can the companies we invest in continue to provide either highly predictable cash flows, or is the market significantly discounting a company's prospects for future cash flow growth. We believe that we can still find 25-40 companies across the ASX300 and a narrow Asian universe that can generate superior risk adjusted returns in all market conditions through superior diversification.

For the first 2 months since inception, the Chester High Conviction Fund (CHCF) delivered a positive 2.42% return after fees, relative to the 2.34% fall in the ASX300 Accumulation Index.

The stocks that provided positive attribution this quarter were led by Capitol Health (CAJ), Syrah Resources (SYR) and Saracen Minerals (SAR). CAJ is a Diagnostic Imaging provider that started 2017 with a large debt overhang. By June 30th, through a capital raise and asset sale, it now has net cash on the balance sheet and strong profit guidance for FY18. SYR rose on the wave of Electric Vehicle news, as it closes in on producing graphite from the worlds largest graphite deposit. The small position in Banks detracted from performance as did Chinese gas producer, Sino Gas, which is currently trading at a 70% discount to our valuation. As they move closer to full scale production in 2018/19, we expect the discount to valuation to narrow. The weight in Asian stocks is currently 8%.

Chester High Conviction Fund Sector Weights



Top 3 Active Holdings
Lend Lease
Syrah Resources
Synlait Milk

Portfolio Breakdown	
Materials (incl Gold)	19.3%
Financials	13.6%
Information Technology	7.8%

Top 3 Portfolio Attribution
Capitol Health
Syrah Resources
Saracen Minerals

Bottom 3 Portfolio Attribution
ANZ Limited
NAB Limited
Sino Gas & Energy

Past Performance - SGH Australia Plus Fund October 2013 - February 2017

	2013#	2014	2015	2016	2017^	Total Return	Total Return % p.a.
SGH Australia Plus (after MER)	+5.68	+19.38	+22.05	+10.73	+3.25	+76.05	+18.16
S&P/ASX 300 Accumulation Index	+4.75	+5.30	+2.80	+11.79	+1.34	+28.53	+7.62
Value added (after MER)	+0.93	+14.08	+19.25	-1.06	+1.91	+47.52	+10.54

Inception date as the 8th of October, 2013. ^ First 2 months of 2017. After fees calculation includes both management fees and accrued performance fees.

Source, SGH Australia Plus unit price history, Bloomberg

We note this is a statement of fact of the performance achieved by the fund during the time which Rob Tucker was the sole Portfolio Manager making active decisions on the SGH Australia Plus portfolio. We note performance is the record of the firm not the individual however past performance has been constructed from publicly available unit price data. Past performance is not necessarily indicative of future performance and should not be relied upon in making investment decisions.

Past Performance - HSBC Australian Country Fund January 2005 - December 2009

	2005	2006	2007	2008	2009	Total Return	Total return % p.a.
HSBC Australian Country Funds (USD)	+18.44	+31.25	+35.33	-47.17	+78.96	+98.83	+14.74
FTSE AUS+NZ (USD)	+15.42	+30.18	+27.80	-50.76	+73.69	+64.23	+10.43
Value added (after MER)	+3.02	+1.07	+7.53	+3.59	+5.27	+34.60	+4.31

Source: HSBC Asset Management (formerly known as Halbis Capital Management). Performance is a combination of various institutional mandates that has been presented in a GIPS compliant format.

We note this is a statement of fact of the performance achived by the fund during the time which Rob Tucker was the sole Portfolio Manager making active decisions on the HSBC Australian portfolios. Past performance is not necessarily indicative of future performance and should not be relied upon in making investment decisions. The HSBC Australian Funds were run on a benchmark aware basis with a 3% tracking error constraint, hence are not directly comparable to the Chester High Conviction Fund.

What we are thinking about...

1. **Private Equity bids for Public Companies -** The recent Fairfax, Pepper Group and Vocus bids (not that we were involved in any) again brings to light the flawed practice of highly conditional bids being tabled by Private Equity firms to listed companies. We find this practice frustrating as a non binding bid that is conditional on due diligence, is effectively giving a potential bidder access to management accounts and internal forecasts that most (all) secondary market investors are not privy to. This is akin to insider trading whereby if a bid arrives post due diligence, then the bid is using information that is not public for the secondary market to assess on the same merits. We have been watching this practice unfold for too long. Something should change.

2. **US Deficit and Budget Spending** - The US Federal Government is already running a US690bn budget deficit in 2017, which according to the Congressional Budget Office (CBO) is projected to rise to US1.2tn by 2027, or 5.2% of GDP. Running a deficit this high for 10 years without any plans to run a budget surplus over the 10 year forecast, sees the US fiscal position as precarious by 2020. This is before Donald Trump has enacted any meaningful reform (which is becoming less likely by the month). If he were able to pass meaningful tax reform (and not watered down by his own party), then the US budget deficit would rise above and beyond the projections in place. It is highly likely that the US deficit rises from USD600bn in FY16 to over USD1.0Tn in FY18. We discuss the ramifications of this on page 6, and question how the US Government can afford significantly higher interest rates, ever.

3. **Chinese Debt -** Our base case is that China is able to fund its growth targets internally, while creating a larger debt burden in the future. This doesn't necessarily mean that China is on the verge of a systemic crisis, but does suggest for this debt burden to be managed in the future, foreigners will be an important part of funding this growth. The key risk to China being the confidence in lending between banks, which is managed by the overnight Interbank rate. This is crucial to watch for funding stress, and is something we look at more closely on Page 7.

4. **Chinese Consumption** – Having visited China again during May, we returned with a consistently positive view on the outlook for Chinese consumption growth. We find the willingness of Millenials (the beneficiaries of being the only child to 4 grandparents and 2 parents) to consume like Westerners in the internet age as a driving force in the "New China". We find reason to be optimistic looking at the fundamentals of the dominant companies exposed to these powerful demographic trends.

5. **Megatrends** - This is a framework for how we look at the macro world of investment opportunities. We revisit this every 6-12 months to assess where the opportunities are to find companies that have the ability to grow in spite of the challenging macro backdrop. These are often referred to as investing "tailwinds". We refer to these sectors and underlying stock ideas on page 5.

6. **Electric Vehicles -** This is a well known trend, but the thematic is still yet to reach its tipping point. Tesla and BYD are the two market leaders in manufacturing electric vehicles (in the US and China respectively), but every other major car manufacturer is also attempting to put a product into the market in the next 3 years. We look in more detail on page 10, but our conclusion is simple; without access to reliable raw material supply (Graphite, Cobalt, Lithium and Nickel) battery producers will not be able to keep up with the demand pull from car manufacturers and consumers over the next 3-5 years.

7. **Australia -** We do worry that the dual impact of rising interest rates on interest only loans and rising electricity prices are impacting Australian consumers ability and willingness to consume. We have followed with interest the argument put forward by Macquarie Bank that suggests the most levered households in Australia are the households with these interest only loans, that are being so aggressively repriced by banks. We look at the statistics on page 11, with concern that for the most geared sector of the property market, real stress is only just starting to occur.

8. **The Valuation Conundrum -** We started our investing career in 2000, and one of our first tasks was to help prepare asset allocation papers. Equities as a rule, were always valued relative to bonds (using the "Fed model"). But the rule was that the Equity Yield (EY) would trade at a premium to account for the risk an investor undertook for investing in equities, the "Equity Risk Premium" to Bond Yields (or the risk free rate). If the Australian 10 year bond yield (BY) traded on 6% then we would add around 1.5% for equities, which suggested that Australian equities should trade on a 7.5% EY. The inverse of this number is the PE ratio, so effectively we were of the view that Australian equities should trade on a PE ratio of 13.3x forward earnings. Fast forward to 2017, where the Australian 10 year bond is trading at 2.7%. Using the same Equity Risk Premium, the EY should be 4.2%, which equates to a PE ratio for the Australian market of 23.8x forward earnings, all else being equal. Clearly all else is not equal. So is the market fully valued relative to history, or still cheap relative to bonds? We look in more depth on page 13.

9. **Gold -** We have always invested a portion of our fund in Gold equities as we have been of the view that the expansionary monetary policies over the past 10 years by central banks must end at some point. Gold, we believe, has a strong negative correlation to other asset classes, and hence, we have always been of the view that owning gold is a valuable way of diversifying portfolio risk. We look in more detail on page 12.

Stock Selection - Synlait Milk (SM1 or SML NZ)

Synlait Milk (SM1) is a business to business dairy processing company, in Canterbury (south of Christchurch) NZ. SM1 doesn't own their own brands however they control the supply chain with farmer relationships and processing facilities and will effectively control (CFDA and FDA) processing licenses. SM1 is probably best known for its relationship with A2 Milk (A2M) where it is the exclusive supplier of infant milk formula (IMF) to A2M in Australia, NZ and China and has first right of refusal for any new regions. The relationship was recently extended in August 2016 for a minimum 5 year term. Another interesting relationship is with Munchkin, a private US based baby product company with >USD300m annual sales. Munchkin acquired ~4% of the company in 2014 and has entered into agreements with SM1 to supply a new "Grassfed" IMF product in Australia, USA and China. SM1 has invested materially in the past 10 years with recent additions leaving the company with ample near-term capacity. Last month we met with Management and toured their state of the art facilities which includes: 3 spray dryers, the third completed in September 2015, taking capacity to ~140,000tpa; two wet mix kitchens, the second added in 2017, which increases base IMF capacity to 80,000tpa; and two IMF canning facilities, the second being the acquisition of New Zealand Dairy Company in May, providing them ~60,000tpa of canning capability.

These investments have coincided with a period of considerable growth with sales volumes increasing from 55,000t in FY11 to 116,000t in FY16. During this time however gross profit increased ~5x which underlines the true growth opportunity for SM1 being margin expansion from upscaling from base ingredients (whole milk powder, skim milk powder, etc.) to complete nutritional products (IMF). I.e. Gross margin (GM) per tonne (inc D&A) has increased from <NZD400/t in FY11 to NZD859/t in FY16 on the back of IMF growth. What the math, and discussions with Management suggests, is that canned IMF can generate 10x the GM per tonne of base ingredients. We estimate NZD2,500-NZD3,000/t for finished IMF plus an additional NZD700-1,000/t for canning (at full capacity) which compares to NZD300-NZD400/t for base ingredients. All of this obviously depends on the mix of IMF and base ingredients produced but we calculate NZD3-4m EBITDA for each additional 1kt of canned IMF vs base ingredients. We estimate 5% change in FY18 NPAT on 1kt of canned IMF. This highlights similar earnings leverage in volume growth for SM1 and A2M.

During our recent meeting with Management we discussed progress with CFDA approval for Chinese labeled IMF products which is important given consolidation of >2,000 IMF brands to ~500 has potential to create big winners and losers in the ~1Mtpa China market. Management stated that one of the elements to SM1's strategy for progressing was to register only the most important brand first (A2M platinum). SM1 has a team working in Beijing and Management feels the team are as experienced as anyone trying to seek approval from the CFDA. Furthermore, it appears the Chinese Government has already determined a first batch of (VIP) registrations accepted but have approvals pending. We believe A2M will be one of those brands. We further note that as the 1/1/18 approval deadline approaches management believes China will be pragmatic and won't leave the market short of IMF, we expect an announcement on the first brands by year end, and feel SM1/A2M are well placed for this outcome.

SM1 has an interesting share register. A2M acquired an 8.2% stake in March. Mitsui and Co also owns 8.4% and Bright Dairy owns 39%. Bright Dairy acquired a 51% interest in SM1 in 2010 due to a desire to launch a range of premium IMF and milk powder products in China. Per SM1's FY16 Financials Bright purchased ~NZD10m of milk powder products from them in FY16 (2% of revenue). Although without great insight we suspect consolidation of IMF brands in China may see Bright Dairy's IMF product 'canned' (i.e. a discontinued brand). This would see the significance of their holding reduced further. The optimistic case would suggest that as A2M considers a more aggressive push into Europe they would desire the expertise to process the product in country(s) which SM1 could provide, then A2M could acquire a controlling stake in SM1 (from Bright Dairy?). Note, this is not our base case. Never the less, we see a good valuation margin of safety with SM1. We have good visibility for canned IMF production in FY18. Based on the projection of 28,000t we derive a 2018 P/E of ~13x (the market is at 15x). This compares to our projected multiple for A2M of 23x (market 26x). Beyond FY18 there is more forecasting error, but given our comments about CFDA approval, industry consolidation and continued success of A2M we see a case where SM1 can grow to >50,000tpa of canned IMF in 5 years which provides the basis for our ~AUD7.00/share DCF valuation. From our analysis the current share price justifies ~30,000tpa of canned IMF production into perpetuity, so we believe that the share price doesn't reflect any growth beyond FY18.

Synlait (SM1) Key Metrics

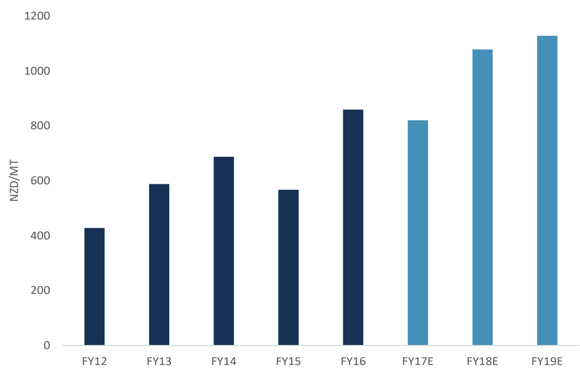
Chart 2

Metric	Measure	2016A	2017E	2018E	2019E	2020E
Dairy Production	(000t)	*116,386*	*137,457*	*141,422*	*145,422*	*152,422*
Revenue	(NZDm)	547	762	823	872	941
EBITDA	(NZDm)	84	93	129	140	167
Underlying NPAT	(NZDm)	33	39	61	64	83
Capex	(NZDm)	50	50	130	125	35
Operating Cash Flow	(NZDm)	104	45	90	99	116
Underlying EPS	(NZD)	0.22	0.22	0.34	0.36	0.46
P/E	(NZD)	18.45	18.73	13.1	12.4	9.6
CPS	(NZD)	0.71	0.25	0.5	0.55	0.65
ROE	(%)	12.70%	10.10%	13.40%	12.40%	13.90%
[Net Debt / (Cash)] / EBITDA	(x)	2.55	1.33	1.27	1.36	0.65

Source: Chester Asset Management estimates

Synlait (SM1) Gross Profit per tonne

Chart 3



Source: Chester Asset Management, Synlait

** This is not a securities recommendation or a solicitation to buy this security. It merely provides historical representation of the consideration the fund undertakes when selecting securities for its portfolio.*

Megatrends

Chart 4

Megatrends	Technology Everywhere	Changing Consumption	Aging Population	Globalisation	Government Debt Levels
Investment Themes	Sharing Economy	The Rise of Services	Health & Wellness	Abundance of Capital	Monetary Policy Exhaustion
	Robotics & 3D Printing	Rising EM Incomes	Biotechnology	Overcapacity	Erosion of Fiat Currencies
	Big Data	Feeding the World	Genome Sequencing	Price Deflation	Cryptocurrencies
	Social Media	Education	Health Care Spending	Urbanisation	Alternative Assets
	Mobile Payments	On-line Retail	Aged Care Services	Immigration	Rising Income Inequality
	Digitisation	Obesity	Wealth Management and Retirement Planning	Climate Change	Increased Regulation & Taxes
	Artificial Intelligence	Electric Vehicles	Welfare Systems	New Breed of EM competitors	Demand for Safety (Yield)
Stock Examples	Seek iSentia Alibaba Tencent Clean Teq Next DC	Treasury Wine C-Trip Samsonite Synlait Milk Huon Aquaculture BYD	CSL Ramsay Healthscope Mayne Pharma Challenger Anta Sports	Lendlease James Hardie Macquarie Bank Boral Sino Gas & Energy Qube Holdings	Sydney Airport Beijing Airport Transurban Spark Infrastructure Saracen Minerals Gold Road Resources

Source: Chester Asset Management, CLSA, BoAML, UBS

We have used this template for several years, simply as a way of formulating a framework for how we start filtering down the investible universe into stocks that we ultimately focus on. There are many varied forces at play globally and assessing them all takes a considered approach, where we have aggregated these broad topics into one of five "megatrends" that then feed into the smaller themes. Of course there is a large amount of overlap between different megatrends, particularly when assessing the population growth of the world and the aging population thematic, and then assessing technological changes and how that affects globalisation and consumption habits.

What we are ultimately trying to do is identify a subset of stocks that have "tailwinds" behind them. We define tailwinds as stronger than GDP growth rates over the foreseeable future. This is not always easy when every asset class is faced with the amount of government and central bank intervention as has been the case over the past 7 years. It has certainly changed the way markets operate, all of which is out of our control. We can control however, the individual investments we allocate capital to in our portfolio.

Whilst far from perfect, this is one of our frameworks we use to identify our watchlist. Our watchlist is a subset of the ASX300 and select Asian consumer names that we then spend more time understanding in greater depth. Our watchlist ends up being around 80-90 stocks (roughly 70-75 Australian names and 10-15 Asian names).

Then, to how we narrow the focus on sectors, let's use an example. i.e. feeding the world appears to be a structural trend that will play out over a number of years, particularly as Asian incomes rise, and the demand for diary products and proteins (salmon and beef) only increases. The obvious sector to focus on is agriculture, which extends from wine, dairy products, beef, cereal producers to fertilisers and crop protection. Using ASX codes to illustrate the universe here; TWE, HUO, TGR, AAC, A2M, BAL, BGA, SM1 and NUF all provide exposure to this theme.

Once the sector has been narrowed, we then filter through the individual stocks and focus heavily on the idiosyncratic risk (stock specific risks) of each company. This means assessing the operational risk (industry structure, earnings sensitivity and volatility, working capital concerns), the financial risk (balance sheet risk and debt profile) and the corporate governance risk (board structure, remuneration policy, OH&S issues or reputational risk). This is how we evaluate each company. Combining this assessment with our internal valuation then suggests which (if any) of the stocks we would like to own. In this scenario, it is very much a competition for capital between stocks that offer a compelling risk reward outcome, combined with any particular insights we may have that gives rise to the highest conviction ideas.

Other trends aren't as easy to access from the ASX universe. For example, mobile payments, big data and social media. There are very few ways to gain exposure to this thematic in Australia. XRO, NXT and ISD are probably the three stocks that provide this exposure. We do find the ability for the Chester High Conviction Fund to invest offshore as a way of gaining access to several of these trends and as a strong way to diversify the portfolio away from the traditional Australian influence of property and banks. Changing consumption patterns, particularly in Emerging Markets is a thematic that will identify interesting investment opportunities for a long time to come.

Cash Flow Growth

Whilst we use the megatrend framework to identify the narrow subset of stocks we then spend more time understanding, we ultimately invest capital on a stock by stock, bottom up basis. We focus heavily on cash flow growth as a key metric of how we look to invest money. We also acknowledge the need to appropriately diversify the portfolio holdings from an industry perspective.

We do spend almost all of our time trying to find ideas where companies can generate cash flow growth, regardless of the macro backdrop we are faced with. If a company can generate strong cash flows in different market environments, then we believe the market will recognise the inherent value in a company's ability to generate cash flow growth, and the share price will ultimately reflect that.

The examples we have set out below provides more detail around this idea, with all these companies (operating in a wide variety of industries) demonstrating an ability to at least double cash flow over the next 5 years (using EBITDA as an admittedly imperfect proxy). How a company is selected for the portfolio then is a combination of the predictability of those cash flows, or on our belief the market is significantly discounting a company's ability to generate those cash flows. Just as important in stock selection, is what is the capital (capex) required to generate that cash flow growth? Return of capital employed is a critical metric to assess a company's ability to generate shareholder returns. The companies listed below have a combination of organic growth (CSL and Alibaba) while Synlait and Syrah are spending significant capital to generate the cash flow trajectory. We think the return on capital provides strong incentive for these companies to outlay this capital. Speedcast made an industry transforming acquisition in 2016 which effectively removed one of their largest competitors.

Without spending significant time explaining each company (we do outline a detailed explanation of Synlait on page 4), we touch briefly on the other stocks below.

CSL has the dominant position in the global blood therapeutics industry (circa 35% market share). It is the lowest cost producer of plasma derived therapies that treat a wide range of immune deficient diseases. Our thesis revolves around an industry growing at 6-8% per annum with a major competitor (Shire 25% market share) not growing plasma collections at all. This enables the rest of the industry to grow in the mid double digits over the next 12-18 months, with CSL well placed to enhance margins through this period. We view the cash flows as relatively predictable. We see CSL as fair value at current levels, and expect a period of consolidation ahead given the strong price appreciation over the past 6 months. We will look to accumulate on weakness, given we believe, the unique nature of the CSL industry structure and growth profile.

Syrah (SYR) is 6 weeks away from producing high grade graphite flake from the worlds largest graphite mine at one of the lowest costs globally. The graphite flake can be used for a variety of purposes, but the fastest growth area in graphite use is for flake to be processed into spherical graphite which is then used in the production of battery anodes for Lithium Ion batteries. Our assumptions below reflect a confidence that Syrah will spend significant capital processing their flake into spherical graphite. On our estimates, we believe the share price can double in the next 3 years, while understanding there is significant forecasting error in these numbers due to a range of pricing and production outcomes. We believe the share price though is overly discounting the likelihood of this scenario occurring, thus we see a strong valuation margin of safety.

Alibaba (BABA US) is one of the world's largest companies that dominates online shopping in China. Taobao (consumer to consumer) and Tmall (business to consumer) are the dominant ecommerce sites in China that are backed by Alipay, the dominant online payment system in China. At a recent investor day, BABA upgraded its expectations for FY18 revenue growth from 35% to 45-49%. On a price to growth basis, it remains very compelling value.

Speedcast (SDA) provides satellite telecommunication solutions to remote areas. It provides services to the Energy industry, Cruise ships and Maritime services, Mining sites and Defence force locations. By purchasing Harris Caprock in 2016, it has removed one of its largest competitors in the Energy industry. This is a company transforming acquisition which gives SDA strong diversification across both geographic and sector exposure. We believe the remote communications industry will continue to grow in excess of GDP for the foreseeable future, and SDA is certainly not expensive for the growth it provides.

Chart 5

CSL (Health care)	2016A	2017E	2018E	2019E	2020E	2021E	5 YR CAGR
EBITDA (USD bn)	**1.706**	**2.134**	**2.463**	**2.75**	**3.07**	**3.38**	**June year end**
growth		25.1%	15.4%	11.7%	11.6%	10.1%	**14.7%**
Capex	495	622	640	735	925	940	
PER		34.2	28	24.9	22	20	

Synlait (Consumer Staples)	2016A	2017E	2018E	2019E	2020E	2021E	5 YR CAGR
EBITDA (NZD mn)	**83.7**	**92.8**	**128.9**	**139.5**	**166.6**	**190.1**	**July year end**
growth		10.8%	38.9%	8.3%	19.4%	14.1%	**17.8%**
Capex		50	130	125	35	36	
PER		20.2	13.1	12.4	9.6	7.9	

Syrah (Materials)	2016A	2017E	2018E	2019E	2020E	2021E	5 YR CAGR
EBITDA (AUD mn)	**-14.9**	**-7.1**	**101.2**	**254.7**	**376.7**	**510.8**	**Dec year end**
growth			NA	151.7%	47.9%	35.6%	**NA**
Capex	134.1	196.1	316.3	154.5	21.7	22.2	
PER	NA	NA	14.6	6.2	3.9	2.7	

Alibaba (Technology)	2016A	2017A	2018E	2019E	2020E	2021E	5 YR CAGR
EBITDA (USD bn)	**8.04**	**11.07**	**15.1**	**19.7**	**25.3**	**31.2**	**Mar year end**
growth		37.7%	36.4%	30.5%	28.4%	23.3%	**31.2%**
Capex		2.6	3.3	3.8	4.2	4.3	
PER			32.2	24.57	19.4	16.3	

Speedcast (Telecommunications)	2016A	2017E	2018E	2019E	2020E	2021E	5 YR CAGR
EBITDA (USD mn)	**42**	**127**	**145**	**155**	**166**	**178**	**Dec year end**
growth		204.9%	14.7%	6.8%	7.2%	7.1%	**33.8%**
Capex	531	50	40	40	41	42	
PER		15.8	12.0	10.6	9.1	7.9	

Source: Chester Asset Management estimates, Bloomberg

US Debt

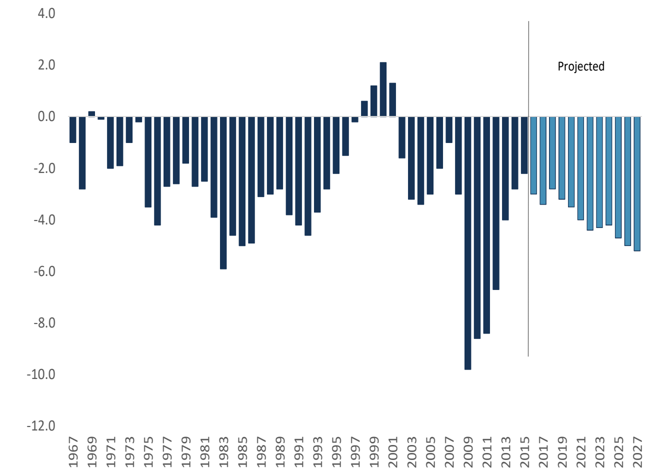
While this is macro in nature, this thinking does underpin our belief that while we expect a cyclical upswing in interest rates, given the current hawkish tone in the commentary from both the Fed and the ECB, we are firmly of the view that the US (we could use Japan as well) has a structural position of too much debt. Hence we remain of the view that while interest rates may rise in the next 12 months, it is effectively necessary to cushion the economy from the next downturn, and interest rates (paraphrasing Ben Bernanke) will never normalise again in (his/our) lifetime.

We have very simplistically analysed the US budget deficit from 2017 using the Congressional Budget Office (CBO) projections. The CBO releases 10 year budget projections every year, so these projections are assumptions made before President Trump has enacted any meaningful reform. Should material tax reform be passed (it may end up being a watered down version), the budget deficit in the US would only increase from these conservative assumptions shown on chart 6. Note this assumes no material drop in revenue over the next 10 years (no recession). It has the US federal deficit rising from US690bn in 2017 to over US1.2Tn by 2027. This in percentage terms has the budget deficit going from 3.5% of GDP to 5.2% of GDP, effectively as the aging population draws more heavily on healthcare and social services. The debt burden only gets worse with the increase in life expectancy. When does it start being repaid? If we were to factor Trump's most optimistic policy changes into these assumptions, corporate taxes cut from 35% to 15% and a US100bn p.a. boost to infrastructure spending (assuming all other proposals are revenue neutral), then the US600bn deficit in 2016 would be closer to US1.0Tn in 2017/2018, massively increasing the debt burden. From the first 6 months of Trump's presidency, it appears less likely that material reform will be legislated. We are of the view that this (Keynesian) approach is the right way to grow the economy, but see more structural issues ahead given the starting point of the debt position.

Chart 8 highlights simplistically that with US public debt (the debt the US government pays interest on - there is another US6.0Tn of intergovernmental debt), at a 2% interest rate, the interest bill is 7% of total revenues (US293bn on US3.3Tn). If we assumed that interest rates rose to 5% then the interest bill would be US733bn on US3.3Tn of revenues, or 22% of total revenues, all else equal. While there are many assumptions here (it is plausible that should GDP growth accelerate, then the US revenue would look better than these projections), we still reach the conclusion that the US debt burden faced by the Government, without the prospect of returning to a fiscal surplus any time soon, sees the US public debt continue to accelerate. Under this scenario, we are firmly of the view that while interest rates can rise in the short term from a cyclical upswing, structurally over the long term, the US Government cannot afford materially higher interest rates. Of course the easiest way to solve a debt crisis is with inflation (as asset values rise well in excess of debt servicing requirements) which is ultimately what is needed, not just in the US, but globally.

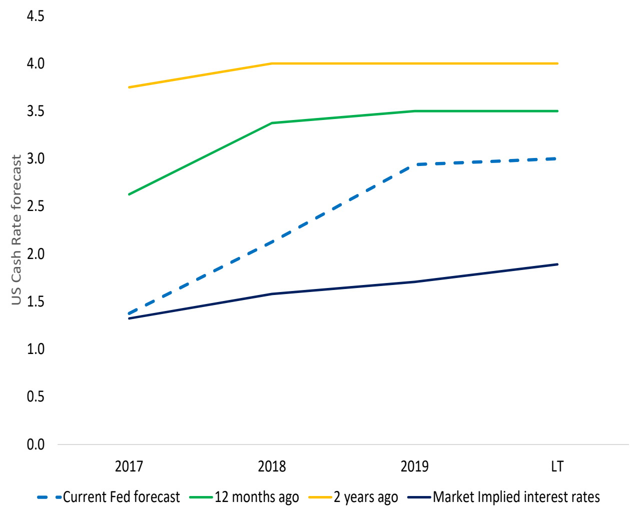
The summary of this is that in our view, we understand that cyclical upswings will occur, (which using current PMI readings, is occurring now), but we remain of the view that interest rates will remain low in a historical sense, for as far as we can forecast.

Chart 6 **US Budget deficit never close to surplus**



Source: Chester Asset Management, CBO

Chart 7 **Interest rate projections over time**



Source: Chester Asset Management, Bloomberg

Chart 8 **Interest Repayments balloon out**

US Public Debt 2017	US Public Debt 2027
14.6 Tn	25.5 Tn
US Revenues	**US Revenues**
3.3 Tn	5.1 Tn
Interest Repayments	**Interest Repayments**
at 2% - 293 bn	at 2% - 510 bn
at 5% - 733 bn	**at 5% - 1.3 Tn**
Interest = 22% of revenue	**Interest = 25% of revenue**

Source: Chester Asset Management, CBO

Chinese Debt

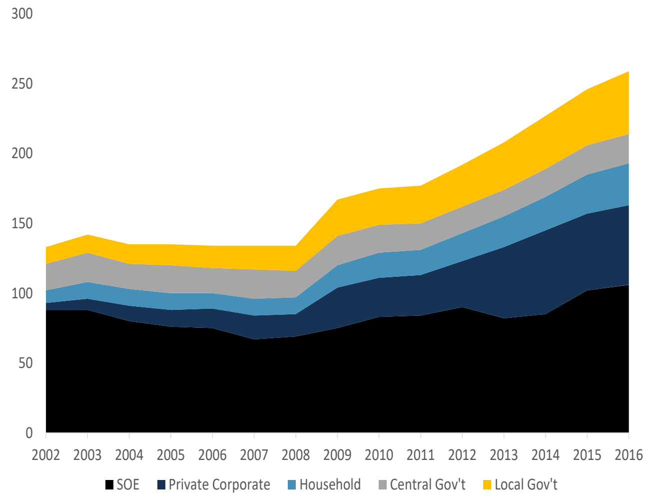
We have captured here some of our thoughts around the issue of Chinese Debt, which is clearly one of the key risks in the investing landscape.

In summary, we think that debt accumulation can continue for the medium term (1-2 years) before it needs to be addressed.
Debt to GDP doesn't actually forecast a financial crisis. Some Emerging Markets (Thailand, Argentina etc) have had worse financial crises, with significantly lower Debt to GDP. In aggregate, China is just catching up to many developed markets where Debt to GDP is around the same level (260%). It is the growth trajectory (doubling in the past 10 years) that gives rise to the trouble ahead.

But the rise in debt by itself doesn't signal a crisis, arguing about debt thresholds is actually meaningless. The true crisis eventuates with the funding of this debt. The liability side of the balance sheet is more critical. China has no foreign funding, which is a positive (all creditors are domestic) but credit growth in China has exploded from 5 major banks into hundreds of NBFIs (non banking financial institutions) which fund their assets with wholesale funding. This is where the risk lies. Chart 10 highlights the growth of NBFI's claims on other institutions, accelerating aggressively through 2014 and 2015, while slowing down in 2017. The longer the debt bubble expands, the smaller drawdown to start a banking crisis. The way to assess this funding issue is the overnight interbank repo rate, i.e. the interest rate required by one lender to lend to another, for which there are various timeframes (7 day, one month, three months etc). Monitoring these interbank rates is the most transparent way to see if the funding in China is behaving smoothly.
What is important to monitor in China is the loan to deposit ratio at financial institutions which has grown from 70% to now around 130%. Historically, there is a strong link between the loan to deposit ratio and the 5 year change in that ratio, that foreshadows severe banking crises. Most of the major banking crises have occurred with loan to deposit ratios above 150%. China is not there yet. But systems that have rapidly growing reliance on outside liabilities show the biggest risk. Chart 10 highlights this. Although more recently (chart 11), credit growth has moderated back towards nominal GDP growth which appears a more sustainable footing, but indicates to us, that just as the credit growth led to GDP acceleration in 2016, the slowing credit growth will lead to a softer 2H 2017 GDP number in China. There does seem to be no clear exit strategy from this reliance on credit growth, which is exacerbating the exchange rate imbalances, the rapid growth of onshore RMB liquidity against the backdrop of domestic liquidity issues.
The only way to achieve true stabilisation is to let growth fall or volatility increase which is extremely unpalatable to Beijing. The exchange rate is the inevitable release valve. China has a semi fixed exchange rate, but a hard peg should rise and fall with Central Bank assets and domestic liquidity. Explaining the FX outcomes here are beyond the pages of this quarterly, and probably beyond our intellectual capacity, but we can summarise like this; 5 years ago China had USD18Tn of RMB liquidity backed by USD4Tn in FX reserves. Today China has USD35Tn in RMB liquidity with USD3Tn of reserves. On current trends, in 3 years this will be USD70Tn in RMB liquidity with USD3Tn of FX reserves.

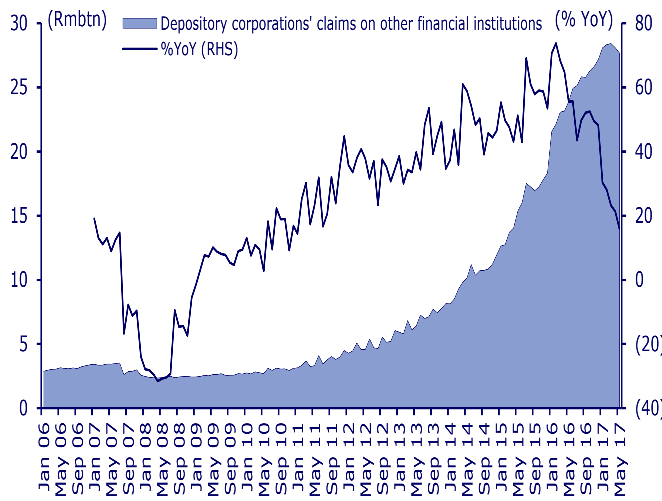
The result of this means the magnitude of capital flow swings has gotten much bigger. This is when the currency management becomes extremely challenging. The two things that can't go up forever are loan to deposit ratios and local liquidity vs FX reserves. So we do understand how a potential debt crisis emerges in China, it is just our view that this is not imminent.

Chart 9 **Chinese Debt largely SOE and Local Gov't**



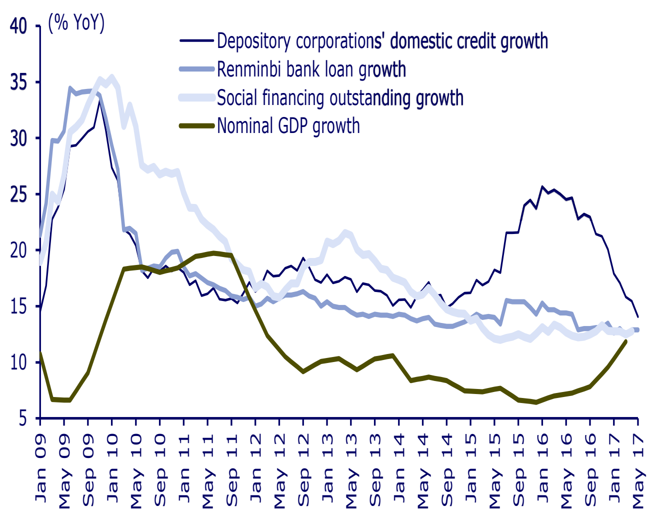
Source: Financial Times

Chart 10 **Claims on other institutions**



Source: CLSA, PBOC, CEIC data

Chart 11 **Credit growth leads GDP growth**



Note: Domestic credit includes loans and other claims on government, other financial institutions and non-financial sectors. Source: PBOC, CEIC Data, CLSA

Source: CLSA

Chinese Consumption

After a trip to China in May we remain optimistic over the medium term for Chinese consumption growth, and all the associated companies that have exposure to this trend. We see reason why consumption, which is now the largest component of Chinese GDP can continue to grow at a low double digit rate for the foreseeable future. Chart 12 highlights the trends with consumption that are being driven predominantly by the upper middle and affluent classes, who account for 75% of all spending. The younger generation is also responsible for much of this growth, where almost 70% of consumption is coming from adults aged under 36. The other trend to note is the penetration of the online channel, where now over 44% of purchases are made online. Interestingly, in China, 85% of online purchases are made using a mobile device, while only 15% of purchases are made using a PC.

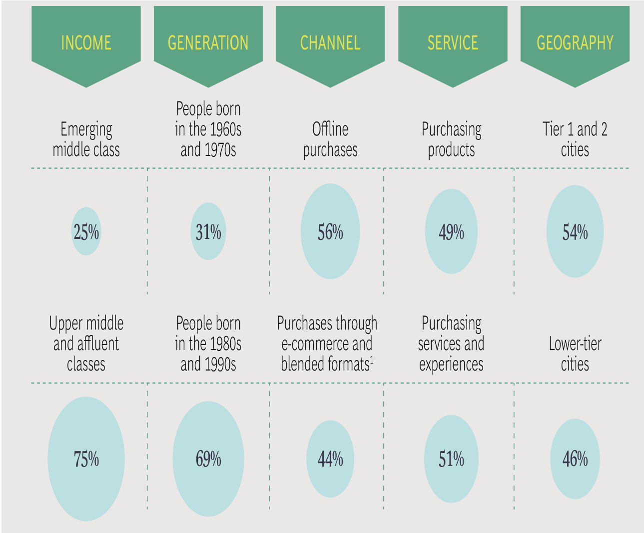
In summary, China's consumption is being driven by young, mobile affluent consumers that live predominantly in Tier 1 and Tier 2 cities. In many ways, this is simply mirroring the trends we see in developed markets, and in fact, in some trends (O2O - which means offline to online, i.e. enter a physical store select the item you want to buy, then pay for it online and have it delivered to your home) China is actually setting them (the trends).

One reason for the strength in consumption has been Government Policy. We have found while looking at and investing in China for over 13 years that it's best to invest along policy lines in China. Policy does change, thus it bears careful monitoring as to how this plays out. The recent regulatory changes in the infant formula space come to mind as how we need to be vigilant when investing in the sectors providing exposure to Chinese consumption. Chinese Policy has been determined to bring much of the outbound shopping from Chinese tourists back to China. This has meant a raft of tariff reductions for imported goods to be sold into China as the Government realised it was losing sales because of prohibitive taxes on foreign goods. This has seen a clear trend to the re-shoring of consumption (buying local, rather than buying cosmetics in Korea because the goods are 30% cheaper).

One other primary reason for this trend in consumption is simply the family set up, the one child policy has meant there is a large cohort (estimated at over 200m Chinese) that are between the ages of 15-29 that are the only children. Four grandparents, doting on two children (both single children) who are working parents of one incredibly spoilt young adult. The parents and grandparents have certainly helped with support for this cohort to enter the property market, or buy cars, etc. This demographic (as outlined on chart 14) will be the biggest contributor to urban consumption growth over the next 5 years.

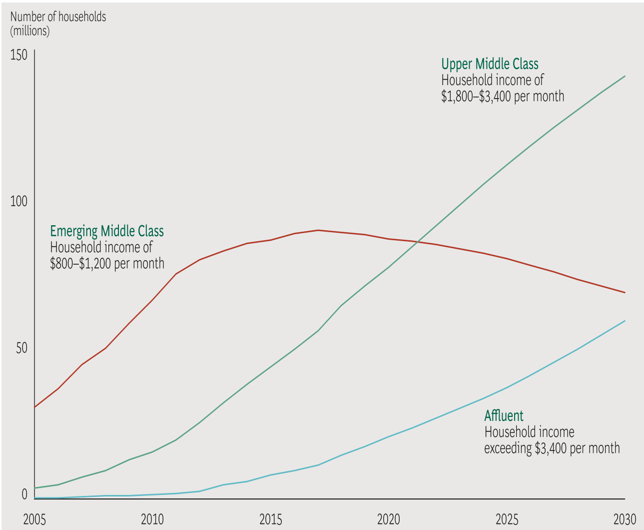
The other supporting factor for the trend is the household balance sheet. We know (chart 9 on page 8) that household debt to GDP (at 35%) is still significantly lower than most OECD countries (Australia at 130% springs to mind), but the average household only has liabilities of 6% of total assets (source CLSA and SWUFE) and net assets have grown by 58% over the past 5 years given the strength in Chinese property prices. Over the next 5, we see reason to believe that the savings rate at the household level can decline significantly, a combination of increased household wealth (property prices) and a ramp up of social security spending by the Central Government. A lack of social security has often been cited as the reason for the high household savings rate.
In combination, we are of the view that Chinese consumption is a strong thematic that will grow at well in excess of GDP over the medium term.

Chart 12 **Factors driving Chinese consumption**



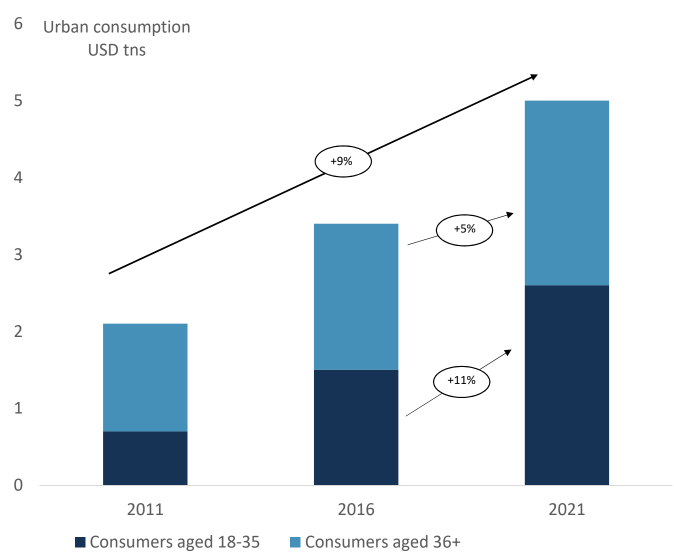
Source: BCG

Chart 13 **Affluent Households growing**



Source: BCG

Chart 14 **Young consumers spending more**



Source: BCG

Australian Household Debt

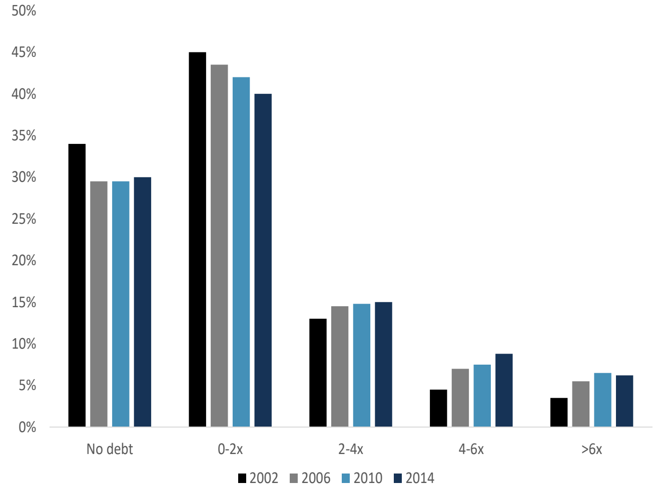
The Australian household debt level has generated many headlines over the past few years, which at 130% of GDP, is the highest household debt level in any country. This is alarming in its own right, but it is necessary to narrow this down further to see where the stress may lie.

Macquarie Research provided some insightful analysis on where the household debt level lay, by breaking down debt levels to household income. Chart 15 highlights that in 2014, households with no debt accounted for around 30% of all households, so no risk there. Households with debt to income ratios of 0-2 times account for around 40% of households, so there seems little risk there. It is the households with debt to income levels above 4 times where servicing that debt can become problematic if interest rates were to rise. That means 15% of households with debt levels above 4 times their household income levels are potentially vulnerable. For many years lending standards suggested that banks would not lend anyone more than 4 times their household income, but in the past decade, these standards have changed.

What this means in practice is the current trend towards clamping down on interest only mortgages, which is prudent, will actually impact those households that are the most geared. Chart 16 highlights that households with debt to income ratios above 6x, actually own 33% of all household debt. 6% of houses, own 33% of all household debt. If interest rates rise by 1%, which they effectively have in the past 12 months for interest only loans, then chart 17 highlights the amount of interest that is paid out of household income. That is, the most geared households will pay 60% of their income towards interest expenses. So while most households in Australia are relatively disciplined, it is the most geared sections of the market (6% of households) that will be under severe stress should interest rates rise significantly. This helps form our view that the RBA is acutely aware of the balancing act needed to cool down the property market, while not causing a wave of forced selling from this over geared section of the market.

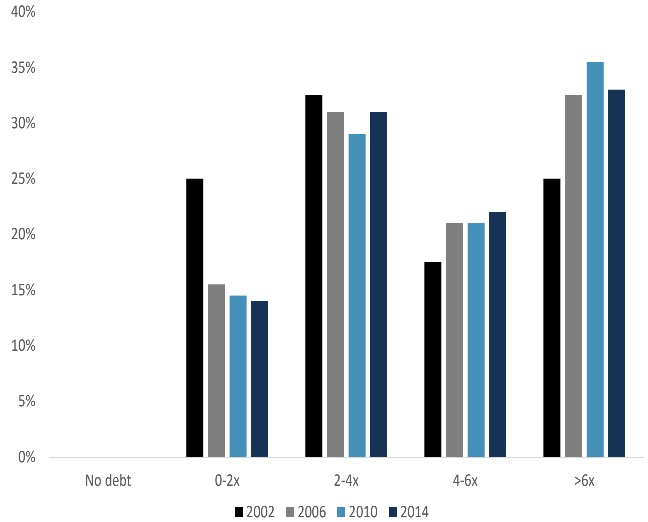
As always, we refer to chart 18 below and the Bad and Doubtful debt charges of the banking sector. We have lived through a very benign period for impairments, with record low rates, we are of the view that should we see significantly higher interest rates, then this chart mean reverts towards the long run average of 31 bpts (from the current 18bpts across the sector). The bank sector earnings risk is clearly to the downside in this scenario.

Chart 15 **Share of households by debt-income**



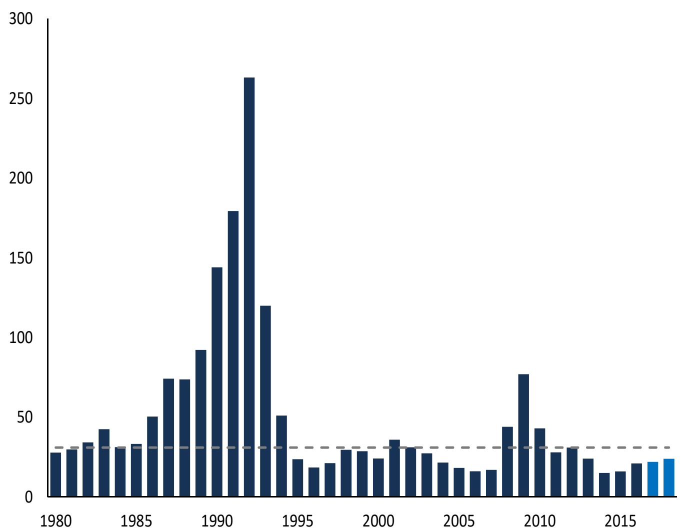
Source: Macquarie Research

Chart 16 **Share of h'hold debt by debt to income**



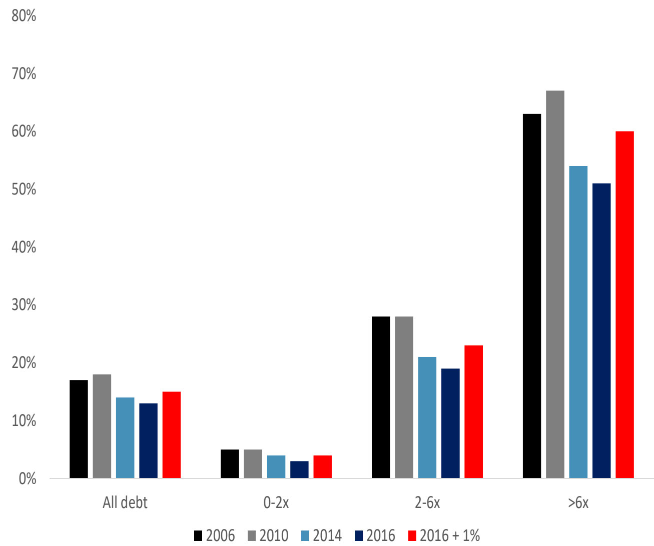
Source: Macquarie Research

Chart 18 **Bank Bad and Doubtful Debt charges**



Source: UBS, Chester Asset Management

Chart 17 **Interest burden by level of indebtedness**



Source: Macquarie Research

Electric Vehicles

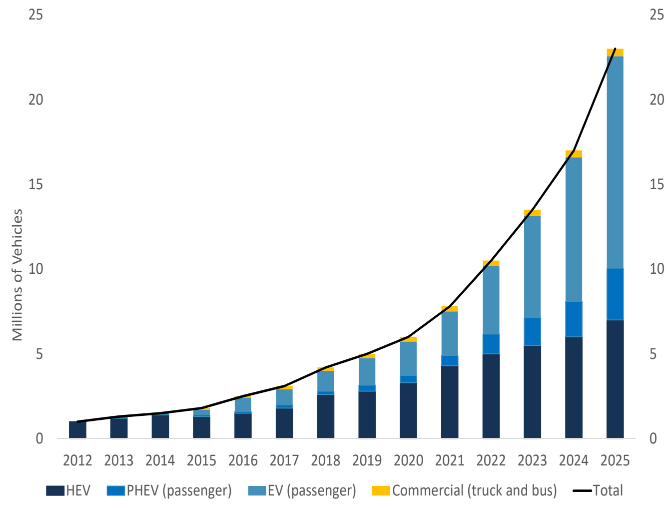
Demand for Electric Vehicles (EVs) continues to be driven by global climate change policies specifically in China. Last year there were fears the removal of subsidies in China might impact EV demand but 12 months on we have only seen their government increase supportive regulations, including a car maker cap-and-trade credit system. This credit system dictates that 8% of the cars manufactured in China are required to be electric by 2018 and 12% by 2020. In response, we have just witnessed Chinese EV and Lithium-ion mega factory announcements from several manufacturers including most recently (in June) by Tesla, GM and GAC. Estimates peg China's Gigafactory capacity at anywhere from 120GWh to 175GWh by 2020, or in car units around 1.8-3.0m EV's per annum. In comparison Tesla's Nevada Gigafactory stage 1 is planned to have 35GWh capacity, or 500k cars per annum, enough to meet the demand for the Tesla Model 3.

But it's not just China that is fueling demand for EVs and Lithium Ion Batteries. Volvo recently announced that every new Volvo will be a hybrid or electric car after 2019 while Porsche plans 50% of its production to be electric within 6 years. So, although stark the projected estimates of Lithium Ion Battery demand of ~800GWh by 2030, 10x 2016 capacity, representing a 20% CAGR, does not seem unreasonable to us.

We further note that in June Tesla announced Q2 sales. The announcement of 22,000 cars and SUVs (mainly Model S and Model X vehicles) compared to 25,051 in Q1 placing it in the lower end of its guidance. "The major factor affecting Tesla's Q2 deliveries was a severe production shortfall of 100 kWh battery packs". Tesla further commented that the number of vehicles shipped was about 40% below demand. We see this as a bullish near-term signal for battery demand. It could be argued that Elon's 2018 target of 500k vehicle deliveries looks unrealistic however this forecast is mainly based on the Model 3 for which Tesla has seen pre-orders of 600k vehicles. The battery shortage is less likely to impact Model 3 deliveries given it is expected to have a battery pack smaller than 60kWh for which the Gigafactory is being ramped up to produce. Elon Musk reiterated that Tesla could produce 20,000 Model 3s per month by December end.

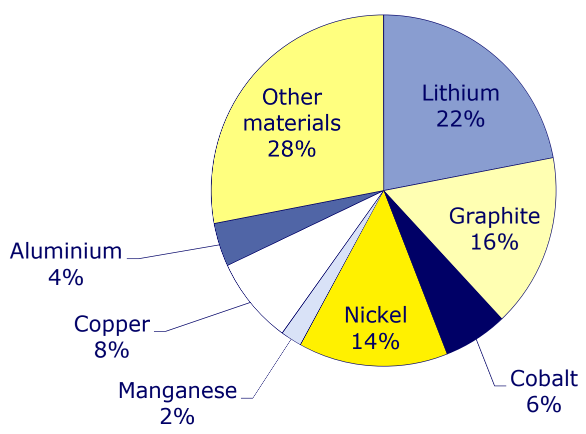
With exponential growth in EVs and hence lithium-Ion batteries we continue to see opportunities in the battery materials space. Potential cobalt shortages continue to garner headlines as China switches towards Cobalt-rich NCM (Nickel, Cobalt and Manganese) batteries from traditional (non-cobalt) LFP (Lithium, Iron, Phosphate) batteries. We also note with interest developments in Tanzania regarding the country's mining laws which could materially impact the funding and economic aspirations of Graphite companies such as Magnis, Black Rock and Kibaran.
So, we continue to be attracted to world class projects that sit at the lower end of the cost curve to feed this exponential growth. At a time when aspirants will no doubt struggle for funding, producers, or financed projects have a big headstart.

Chart 19 **Electric Vehicles reaching a tipping point**



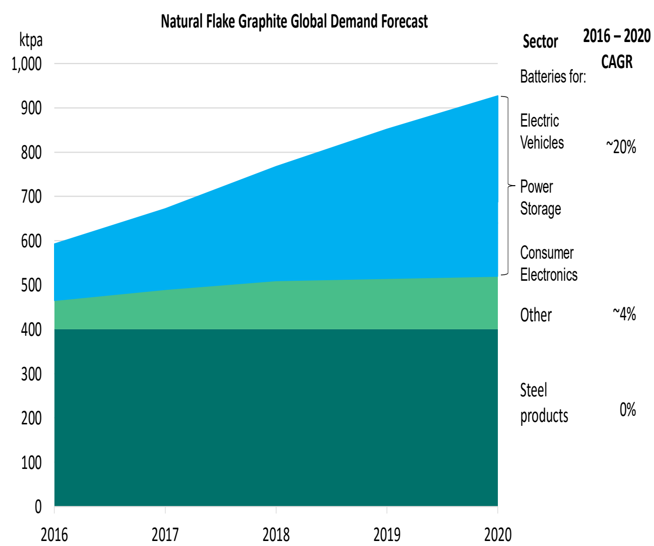
Source: UBS

Chart 20 **Share of cell cost by material**



Source: CLSA

Chart 21 **Graphite demand growth**



Source: Syrah Resources

Gold

We are of the view there are two types of investors. Those who believe gold has no meaningful value and delivers no return (the Warren Buffett argument), and those that believe gold offers an alternate store of wealth relative to all other asset classes. We fall into the later camp, where we see a non correlated asset relative to other sectors of the economy. In fact gold often has an inverse correlation to every other sector (depending on what time frame the correlation is run over). So we have always used gold as a hedge of sorts, when other sectors are falling, gold tends to do well, and vice versa. From our perspective, we are talking about investing in gold mining equities, where the focus is heavily on the assets in the ground, the cost of extracting those assets and the capability and strategy of the management team running those assets.

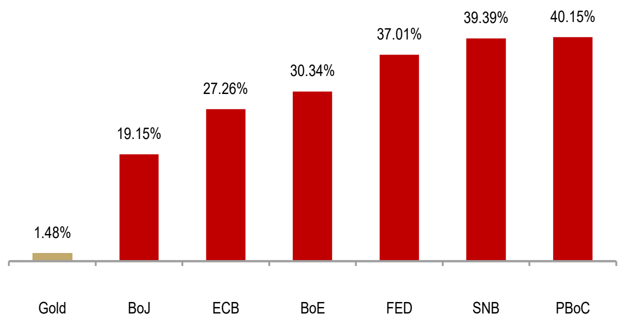
The reason we see gold as an alternative asset class stems from the historical context of being a store of wealth and a globally accepted form of exchange. To us, it is no coincidence that the start of the generational trend of credit expansion started effectively when Richard Nixon took the USD off the gold standard in 1971. This meant the USD no longer needed to be backed by physical gold, and since then the ability for central banks to create new supply of fiat currencies has become widely accepted. Chart 22 represents this idea well, where Central Banks globally have printed enormous amounts of money to prop up their respective economies, whereby the supply of paper money has grown at 20-40% per annum; yes, per annum for the past 14 years. This compares to gold which has limited production growth and mining depletion rates have seen very small (1.5% CAGR) increases in gold reserves over the same time.
What puzzles us, from a very simplistic view, is the breakdown in the correlation between the gold price and the central bank balance sheet expansion. While central banks have created 300% growth in their balance sheets, gold has barely moved over the past 10 years, in a relative sense. All else being equal, we can create a scenario whereby gold should be trading significantly higher.

The most obvious response to this argument is the traditional protection that gold provides in times of inflation, given we have seen little real inflation (outside asset prices, which are driven by increases in financial liquidity, as per chart 9), the motivation to own gold as an inflation hedge has been limited, up to this point. We view chart 24 as conceptually very interesting though, because financial assets (bonds and equities) have performed so well during this expansionary phase, real assets, which in our view, is anything you can touch (gold, commodities, jewellery, art, etc), have in a relative sense, been significantly left behind.

So while this has oversimplified many of the reasons why gold forms part of our investment thesis, if we are entering a period where central banks decide to remove some of the liquidity that has driven the bond and equity markets, then we find the spread between real assets and financial assets should narrow. Maybe that is from a correction in financial markets, but in any case, we find the reasons to own "real assets" as compelling as ever.

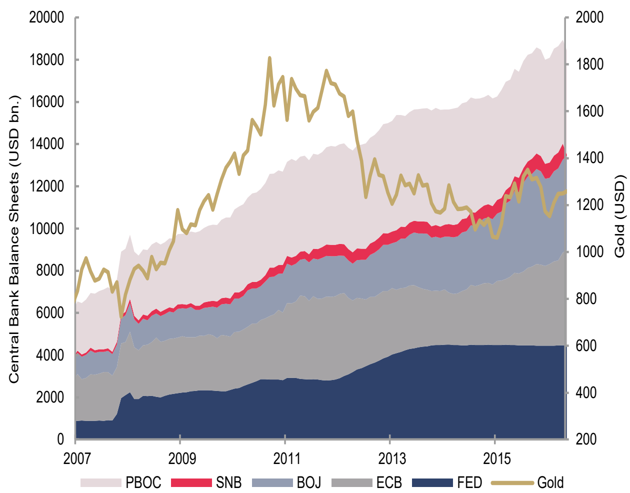
Chart 22 **Fiat Money supply vs Gold supply**

Annualised rate of change of central bank balance sheets vs. annual change of gold reserves (2003-2017)



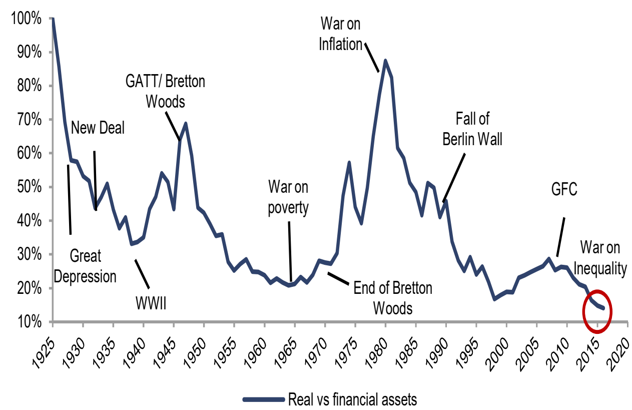
Source: Incrementum

Chart 23 **Central Banks vs Gold Price**



Source: BoAML

Chart 24 **Real assets vs Financial Assets**



Source: BoAML

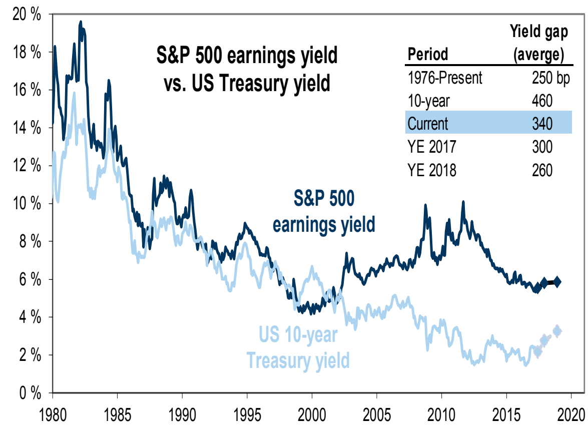
The Valuation Conundrum

We were always of the view that the earnings yield (EY) should trade at risk adjusted premium to the bond yield (BY). Simplistically, this was how asset allocations were determined historically (are equities cheap relative to bonds or vice versa). This thought process is adopting the "Fed model", which compares the EY to the BY and seeks to explain the premium for owning equities. As we can see from chart 25, this model had a strong correlation until the mid 2000's, when it broke down as Alan Greenspan and then Ben Bernanke kept reducing interest rates to historical lows. So the narrative that equities remain "cheap" relative to bonds and the most attractive asset class is based on this argument. Following the Fed model today, would see the US BY of 2.3% currently, and adopting the historical yield gap to the EY, should see the EY at 4.8%. The inverse of this is the forward PE of the market, which would theoretically be 20.8x, or 20% higher than it is today.

This is the bullish case for equities, although one can argue using the Schiller cyclically adjusted price earnings ratio (CAPE), that the S&P500 is at close to record highs. This metric uses a 10 year earnings cycle rather than forward earnings expectations. There are a myriad of reasons why this valuation conundrum exists, and most of it is caused by future interest rate expectations, which is extrapolated using future inflation expectations. We can see from chart 26 that the US 10 year bond yield, for all the talk about increasing interest rates, is yet to break higher, which from our simplistic assessment, is purely based on chart 27, where inflation is yet to show meaningful improvement. This chart (27), to us, is the most powerful in setting interest rate expectations, so simplistically, we are not yet in the camp of believing interest rates are moving materially higher. Equities are also priced on expected earnings growth, which at an aggregate level (both in the US and Australia) we need to see improving economic data that should signal accelerating earnings.

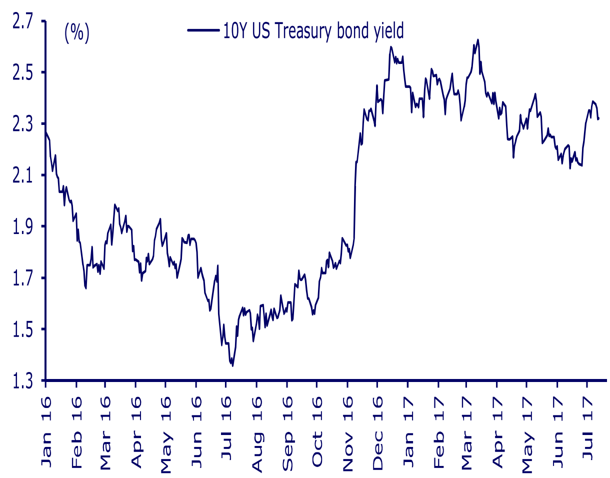
From a fund perspective, this is why we run a high conviction strategy (refer page 6) whereby we select companies that offer cash flow growth in all economic climates. We also note (chart 28) that the market has been willing to pay up for high quality stocks, by definition, those stocks with predictable earnings and strong industry positions, often called "long duration" stocks because of the visibility of earnings. From a valuation perspective this is rational given the discount rate (the 10 year bond) is structurally lower now than at any point in history (low discount rate = higher valuations). While inflation shows no signs of picking up, we expect this valuation framework to persist, that is, quality stocks to remain expensive relative to history. But we are very selective in how we gain exposure to these high PE stocks.

Chart 25 **The US EY to BY gap still high**



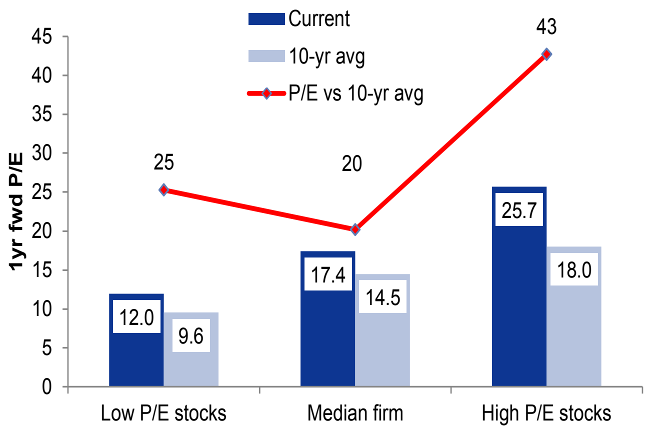
Source: Goldman Sachs research

Chart 26 **US 10 year bond yield**



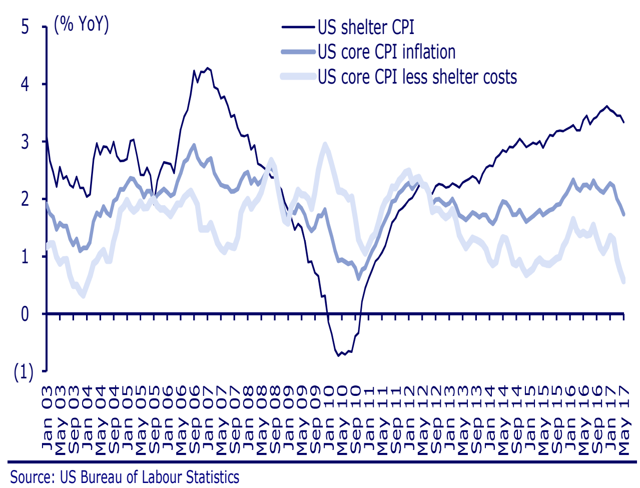
Source: Bloomberg, CLSA

Chart 28 **Quality stocks trading at large premiums**



Source: Goldman Sachs

Chart 27 **US CPI showing no signs of accelerating**



Source: CLSA

Charlie Munger's Investment Principles

1. Risk—All investment evaluations should begin by measuring risk, especially reputational
Incorporate an appropriate margin of safety
Avoid dealing with people of questionable character
Insist upon proper compensation for risk assumed
Always beware of inflation and interest rate exposures
Avoid big mistakes; shun permanent capital loss

2. Independence—"Only in fairy tales are emperors told they are naked"
Objectivity and rationality require independence of thought
Remember that just because other people agree or disagree with you doesn't make you right or wrong—the only thing that matters is the correctness of your analysis and judgment
Mimicking the herd invites regression to the mean (merely average performance)

3. Preparation—"The only way to win is to work, work, work, work, and hope to have a few insights"
Develop into a lifelong self-learner through voracious reading; cultivate curiosity and strive to become a little wiser every day
More important than the will to win is the will to prepare
Develop fluency in mental models from the major academic disciplines
If you want to get smart, the question you have to keep asking is "why, why, why?"

4. Intellectual humility—Acknowledging what you don't know is the dawning of wisdom
Stay within a well-defined circle of competence
Identify and reconcile disconfirming evidence
Resist the craving for false precision, false certainties, etc.
Above all, never fool yourself, and remember that you are the easiest person to fool

5. Analytic rigor—Use of the scientific method and effective checklists minimizes errors and omissions
Determine value apart from price; progress apart from activity; wealth apart from size
It is better to remember the obvious than to grasp the esoteric
Be a business analyst, not a market, macroeconomic, or security analyst
Consider totality of risk and effect; look always at potential second order and higher level impacts
Think forwards and backwards—Invert, always invert

6. Allocation—Proper allocation of capital is an investor's number one job
Remember that highest and best use is always measured by the next best use (opportunity cost)
Good ideas are rare—when the odds are greatly in your favor, bet (allocate) heavily
Don't "fall in love" with an investment—be situation-dependent and opportunity-driven

7. Patience—Resist the natural human bias to act
"Compound interest is the eighth wonder of the world" (Einstein); never interrupt it unnecessarily
Avoid unnecessary transactional taxes and frictional costs; never take action for its own sake
Be alert for the arrival of luck
Enjoy the process along with the proceeds, because the process is where you live

8. Decisiveness—When proper circumstances present themselves, act with decisiveness and conviction
Be fearful when others are greedy, and greedy when others are fearful
Opportunity doesn't come often, so seize it when it does
Opportunity meeting the prepared mind: that's the game

9. Change—Live with change and accept un-removable complexity
Recognize and adapt to the true nature of the world around you; don't expect it to adapt to you
Continually challenge and willingly amend your "best-loved ideas"
Recognize reality even when you don't like it—especially when you don't like it

10. Focus—Keep things simple and remember what you set out to do
Remember that reputation and integrity are your most valuable assets—and can be lost in a heartbeat
Guard against the effects of hubris and boredom
Don't overlook the obvious by drowning in minutiae

Chester High Conviction Fund
Fact Sheet

Fund at a glance

Inception date	April 2017
Objective	To outperform the ASX300 Accumulation Index by 5% on a rolling 3 year basis
Fee	95bp base fee plus a 15% performance fee based on outperformance, after fees, of the benchmark. The performance fee is subject to a highwater mark
Style	Tilt towards quality and growth, but with an emphasis on a valuation margin of safety
Investment strategy	Invests in a concentrated portfolio of companies offering outstanding long-term potential. A company's weighting is mainly determined by the likelihood of a company achieving superior returns over 5 years. The fund has a predominant bottom up stock picking style overlayed with portfolio diversification and risk controls.
Active Share	This is the % of the portfolio that is different from the S&P/ASX 300 index. This will range between 70-90%
Benchmark	S&P/ASX 300 Accumulation Index
Number of Holdings	Will range between 25-40 stocks with up to 20% invested in Asia
Investment universe	Generally within the largest 300 companies listed on the ASX, plus companies listed in Asia with a focus on Asian domestic consumption. This increases the investment universe by 40-50 investable stocks
Typical company characteristics	We look to invest in companies that display sustainable earnings growth which is characterised by free cash flow growth. We look for a valuation margin of safety as capital preservation is a key focus for the fund.
Risk Guidelines	• Maximum stock weight ◦ Large Cap = 8% soft, 10% hard ◦ Mid/Small Cap = 4% soft, 5% hard ◦ Asian Stocks = 2% soft, 3% hard • No less than 25 stocks, no more than 40 • Maximum active sector position = +20% GICS tier 2. That is no more than 20% over weight one industry sector. • Up to 100% invested in ASX300 stocks • Between 0% - 20% invested in Asian stocks • Between 0% - 20% invested in Cash • Expected Tracking Error 5% – 10% (but not limited) • Derivative overlay can be taken as portfolio protection

What is the Chester High Conviction Fund?

- It is a predominantly Australian equities portfolio with the right to invest up to 20% of its assets in Asia. It will hold between 25-40 stocks
- A Concentrated, high-conviction portfolio
- Highly Index unaware, with better sector diversification than the ASX300 universe
- Focus on risk adjusted returns and capital preservation
- Portfolio managed for after-tax returns

The Chester High Conviction Fund is a differentiated Australian equity fund in that it has the right, but not the obligation to invest in the highest quality companies listed in Asia, without necessarily taking full emerging market risk. We believe our experience in Asia, having visited China over 40 times in the past 13 years, gives us a unique insight into the most influential driver of the Australian equity and property markets. The approach is long-term, applying a high conviction methodology that seeks to optimise after-tax returns to investors.

The Chester High Conviction Fund is not bound by external indices, allowing the Fund to invest only in those companies that meet its strict investment criteria. While the fund will look very different to the benchmark ASX300 index, we believe it will offer greater sector diversification and therefore, over the long term, offer more appropriate returns for the level of risk investors are exposed to.

The Chester High Conviction Fund is run by Chester Asset Management as the Investment Manager, using Copia Investment Partners as the Responsible Entity and Trustee. NAB is the custodian of the assets.

The Investment Managers

Rob Tucker and Anthony Kavanagh have worked together for over 7 years, most recently running the SGH Australia Plus strategy. Rob was the portfolio manager of SGH Australia Plus from October 2013 to February 2017. SGH Australia Plus generated a 18.2% per annum return, after fees during this period. Relative to the 7.7% return the ASX300 Accumulation index delivered this equates to a 10.5% outperformance per annum over more than 3 years.* The Chester High Conviction Fund is run using the same strategy as SGH Australia Plus.

A strong focus on capital preservation

The Chester High Conviction Fund will focus heavily on stock specific risk and assesses the operational, financial and corporate governance risks of each investment on its own merits.

Chester High Conviction Fund
Fact Sheet

Why include the Asian stocks?

1. We want access to the best quality companies in Asia, at the right price. It is the choice, but not the obligation to invest in emerging companies with strong local franchises.
2. The strong rise in the sheer number of Asians entering the middle class (chart 1) and the growth in disposable income suggests that this is a multi year trend that is very hard to access by restricting the investible universe to Australian listed stocks.
3. Investors appropriately diversify their portfolio by enhancing returns with a focus on the domestic demand thematic within Asia.
4. It offers Australian investors a wider opportunity set without the requirement to have money invested in Asia through a pooled vehicle.
5. Chart 2 highlights that just 15% of the MSCI Asia Pacific Index is exposed to domestic demand drivers, while 50% of the market is exposed to global economic forces. We very selectively seek ideas purely from the 15% of the universe exposed to domestic consumption. Through quantitative and qualitative screening, this extends our investible universe to 40-50 stocks outside the ASX300.

The Chester High Conviction Fund Competitive Advantage

1. Portfolio Managers with significant experience in the domestic and Asian equity markets.
2. Portfolio Managers with a proven long term track record in stock selection.
3. Absolute alignment of interest between the portfolio managers and the clients as we invest along side our unitholders.
4. A small FUM starting base which provides a much easier platform to outperform in the initial stages given no liquidity constraints and trading flexibility.

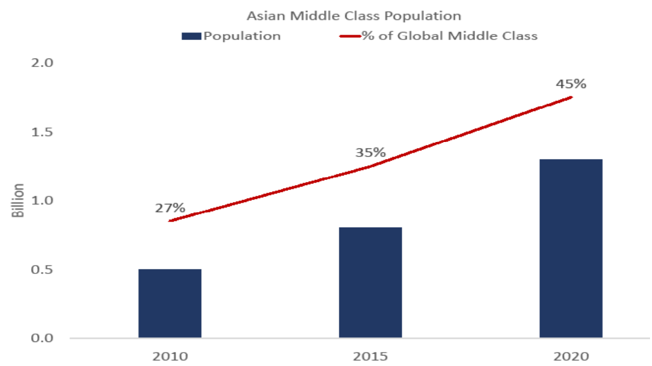
Chester Asset Management

Chester Asset Management was founded in 2017 by Rob Tucker and Anthony Kavanagh. It is 100% owned by the staff and as such has absolute alignment of interests with the unitholders. Chester Asset Management operates under the Copia Investment Partners AFSL (Australian Financial Services License) and will use Copia as the Responsible Entity of the fund as well as compliance and back offices services.

Contact us

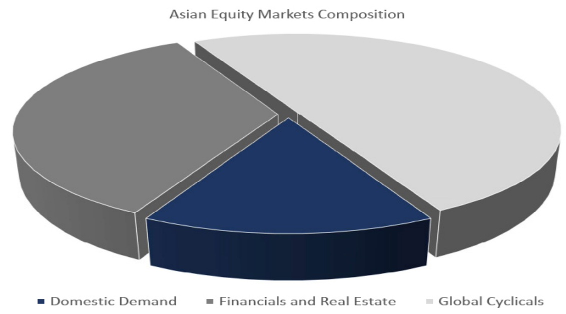
For further information about the Chester High Conviction Fund, or to obtain a copy of the Information Memorandum (IM), please visit our website www.chesteram.com.au or contact us directly. Rob Tucker can be contacted at rtucker@chesteram.com.au and Anthony Kavanagh can be contacted on akavanagh@chesteram.com.au.

Chart 1



Source: Macquarie Research

Chart 2



Source: DSG Asia

About the Fund Managers

Rob Tucker

Rob Tucker has over 18 years experience in investment management.

He founded Chester Asset Management in April 2017 after working at SG Hiscock for 7 years and before that HSBC Asset Management for 9 years. He spent 5 years in Hong Kong managing money for HSBC where he delivered strong returns for his institutional clients. Prior to this Rob started his finance career at Merrill Lynch

Anthony Kavanagh

Anthony Kavanagh has over 8 years experience in investment management.

He co-founded Chester Asset Management in April 2017 after working with SG Hiscock for 4 years from Core Energy where he advised institutional clients on energy investments including SG Hiscock. Prior to this Anthony was an Assistant Manager at KPMG.