Stonehouse Core Value Portfolio
Monthly Update - August 2014

stonehouse ASSET MANAGEMENT

Performance overview

Over the month of August the Stonehouse Core Value Portfolio (SCVP) rose +0.45% as markets were buoyed by continued signs of recovery in the US economy, the prospect of further monetary easing in Europe and a moderation in the pace of growth in the UK economy.

Positive performances over the month came from our emerging markets exposures Northcape (+2.51%) and the FTSE Emerging Markets ETF (+3.84%), international equities manager Epoch Global Equity Yield (+2.92%) as well as a recovery in the trend following manager AQR Managed Futures (+3.63%) and international property manager Brookfield (+3.27%).

Detractors to performance over the month came from Platinum International (-0.67%) and Platinum Japan (-1.76%) as well as defensive positions, the Gold Bullion ETF (-0.94%), volatility trader 36 South (-1.80%) and long/short Australian equities manager Bennelong (-1.70%). As we have said in the past, whilst these defensive managers may underperform in rising markets they also help to mitigate losses in falling markets and therefore represent a valuable component of the SCVP.

Leading up to the notoriously volatile October market period we are continuing to incrementally increase our cash reserves while at the same time ensuring that our defensive positions are adequately sized to help minimise losses in the Portfolio should the markets substantively fall. In light of this, we have recently completed due diligence on volatility trading alternatives manager Triple 333 and are looking to move 2% of our cash reserves into this position in early September.

Portfolio Summary[1]

	Stonehouse Core Value Portfolio
Unit price	$1.0299

Asset class ranges & current allocations[1]	Range (min)	Range (max)	Current exposure
Cash & Fixed Int.	15%	60%	32.6%
Property	5%	25%	6.4%
Equities	25%	65%	42.1%
Alternatives	5%	35%	18.2%

0% 20% 40% 60% 80% 100%

[1] The current exposures include the underlying asset allocations of each investment. The total exposure may not sum to 100% due to any direct derivative investments (such as options and futures).

Top 10 investment holdings (ex cash)
1. S&P / ASX 200 Accumulation Index ETF
2. Ardea Australian Inflation Linked Bond Fund
3. Schroders Fixed Income Fund
4. Payden & Rygel Global Income Opportunities Fund
5. Vanguard FTSE Emerging Market ETF
6. Bennelong Long Short Equity Fund
7. Kapstream Absolute Return Fund
8. 36 South Kohinoor Core Fund
9. Platinum International Fund
10. Wingate Global Equity Income Fund

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Market Performance and Outlook

Like July, August remained a relatively upbeat month for markets overall as signs of the global economic recovery became more firmly entrenched. This was especially the case for the US where a variety of economic indicators illustrated a relatively robust expansion. Europe however, was quite the opposite with Italy once more sliding into recession and key economic engines – France and Germany – clearly struggling. Much of this has to do with what we characterise as 'structural rigidities' in the European economy which have been hampering its recovery for some time now. So much so in fact that European Central Bank President Mario Draghi hinted at yet another round of monetary easing and this, somewhat perversely, buoyed European equity markets.

For the UK, markets were encouraged (yet again, somewhat perversely) by a moderation in the economy. The UK's economic growth has been a little too strong of late and this has invoked rampant asset price inflation in the housing sector. This was forcing Bank of England Governor Mark Carney's hand in raising rates - a prospect that UK equity markets took a dim view of. As the UK economy has moderated, so too has the day of reckoning in terms of interest rate rises been pushed out and this perceived delay placed UK equity markets in a more positive light over the month.

Still, as we creep closer to calendar year end we do anticipate that the market's focus will eventually turn toward the inevitable 'normalisation' of monetary policy settings across much of the developed world – particularly for the US. Just as the infamous 'taper tantrum' caused a considerable degree of market dislocation late last year, we anticipate a similar 'hike hysteria' mindset raises the prospect of market upheavals late this year. Volatility has been tracking near all-time lows in many asset classes recently and we anticipate that concerns about interest rate rises has the potential to reinvoke a heighted degree of volatility that has been uncharacteristically absent from markets of late.

In response to this we are incrementally increasing our cash levels – in similar vein to what we did pre the market upheavals late last year when we used cash to take advantage of the market's dislocation in adding to positions where we saw considerable value (at more attractive entry prices) –most particularly in emerging markets. Further, we have been undertaking extensive modelling to ensure our defensive positions are adequately sized in the event of a market fall.

Inclusive of this defensive positioning is our unhedged international equity exposure. Traditionally a spike in volatility which is associated with an equity market fall goes hand in glove with a decline in the $A. The valuation effect associated with this fall in the $A's value will help insulate the size of any losses in the international holdings of the SCVP and therefore assist our defensive stance should equity markets take a decided turn for the worse.