Stonehouse Core Value Portfolio
Monthly Update - August 2016

August Performance Overview

The Stonehouse Core Value Portfolio (CVP) returned -0.17% in August during a difficult month for the local Equity market with the ASX 200 Index returning -2.33%. The CVP is still now up +1.62% since the start of this financial year.

Equity managers were mixed with Allan Gray +1.28%, JO Hambro[1] +4.05%, Platinum International +3.17%, MSCI Japan High Dividend ETF[1] +2.07% and Lansdowne Europe[1] +0.43% delivering solid returns. Macquarie Australian True Index -1.56%, Epoch Global Equity Hedged -1.55%, Henderson Global Resources -1.91% and SGH ICE -1.90% detracted for the month.

After a very strong July Listed Property holdings retracted in August with SG Hiscock -1.44% and Cromwell -0.88%, whilst global Listed Infrastructure manager Lazard was flat at +0.03%.

Alternatives managers generally had a difficult month with AQR Managed Futures -4.28%, Bennelong Long Short -5.90%, JP Morgan Global Macro -2.96% and 36 South Kohinoor[1] -0.31% whilst Invesco contributed positively +0.71%.

Fixed Income holdings, Ardea +0.34%, CQS +1.14%, Kapstream +0.59%, Payden +0.28% and T Rowe +0.26% all contributed to performance, with the rally in fixed income markets continuing through August.

The Investment Committee has anticipated recent volatility in equity markets with specific insurance purchased in the form of a Put Option to bolster the existing alternatives holdings.

In light of attractive relative valuations, the Investment Committee is gradually increasing Australian equities relative to International equities. This was achieved through deploying capital to a long/short Australian Equities manager, who we believe are well positioned to capture current market opportunities in both up and down markets.

Portfolio Summary

	Stonehouse Core Value Portfolio
Unit price	$1.0622

Asset class ranges & current allocations[2]		Current exposure
Cash & Fixed Int.	15% – 60%	32.0%
Property	0% – 25%	4.2%
Equities	25% – 65%	39.6%
Alternatives	5% – 35%	18.9%

Top 10 investment holdings (ex cash)
1. Northcape Emerging Markets
2. Macquarie True Index Aus Shares Fund
3. AQR Managed Futures
4. Platinum International Class A
5. Wingate Global Equity Income
6. T Rowe Dynamic Global Bond Fund
7. Payden and Rygel Global Income Opportunities
8. J O Hambro Asia ex Japan
9. Kapstream Absolute Return
10. Invesco GTR

[1] In local currency terms.
[2] 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).

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Market Performance and Outlook

August was a generally constructive month for global equities as investors were largely absent and volumes well down on the previous quarter. Within this however, the local share market (ASX200, -1.55%) reversed a prior outperformance as banks and resource stocks continued to weigh on the broader market.

While writing this report, markets are seeing a marked increase in volatility after several months of abnormally low volatility levels. The big story is unfolding in Bonds as we have seen a backup in longer term Bond yields from record lows in August.

As we migrate into September serious questions are being asked about the efficacy of Negative Interest Rates and the effects of a flat Yield Curve. The absence of term premium has been a ball and chain on the banking sector which has been burdened by competing commands to simultaneously raise capital buffers and lend more to the economy. The solution appears simple – let long term rates rise and keep the cash rate low for longer which will give banks more interest spread on lending. Achieving this steepness is one way central banks can keep cash rates low or negative without hurting the Banks; indeed, the BoJ and the ECB are both considering an explicit change to their Bond purchase programs.

With the US election in November and the Italian constitutional referendum on the horizon, political events are likely to add further to uncertainty and increase volatility over the next few months.

These developments reinforce our underweight position in Fixed Income and preference for both Equities and Alternatives in the expected market environment. Whilst Equities may suffer from a re-pricing of the bond rate over the short term, as we see a pickup in inflation coming through this quarter. We believe investors will lean into Equities away from Bonds as the latter has become far less attractive.

The Core Value Portfolio remains well positioned for a more difficult environment with modest Equity weightings, appropriate Alternatives exposure and some specific Equity hedges.