Stonehouse Core Value Portfolio

Monthly Update – August 2018

August Performance Overview

The Stonehouse Core Value Portfolio (CVP) returned a solid +1.23% in August. The month saw the Australian and global markets (as represented by the unhedged MSCI World Index), post gains of +1.4% and +4.1% respectively, but a large dispersion of returns between sectors was evident. Bond markets were volatile and the Australian dollar depreciated further against the major currencies.

The domestic component of the Portfolio's equity investments contributed positively to overall performance with the smaller cap exposure SGH ICE (+2.50%) the strongest performer. This was followed by the beta exposure held in Macquarie Australia Shares True Index (+1.4%), Allan Gray Australia Equity (+0.8%) and IML Equity Income (+0.2%).

Performance of the global component of the Portfolio's equity investments was mixed. The top performing strategy was Northcape Emerging Markets (+4.2%) who posted a strong return despite emerging market equities being flat in August. Other strong contributors to performance were Wingate Global Equity (+3.6%), closely followed by the European exposure held in Lansdowne European Equity* (+3.5%), the smaller cap manager Lazard Global Small Caps (+3.2%) and Old Mutual World Equity* (+2.9%). After a strong July, the portfolio's Asian specific exposures posted negative returns, led by Blackrock iShares Japan High Dividend Yield ETF* (-3.7%) and J O Hambro Asia Ex Japan* (-2.6%).

Within Alternatives the top performing strategy Bennelong Long Short Equity Fund (+10.6%) had a stellar month, rebounding from the disappointing July return and receiving some significant triumphs through reporting season. The other exposure to deliver a positive return was JP Morgan Global Macro (+0.3%) whilst Invesco Global Targeted Returns (-1.3%) detracted from returns.

The Property and Infrastructure sector posted mix results with the top performing strategy being the Resolution Global Property (+3.7%) followed by Cromwell Phoenix Property Securities (+1.8%). The Lazard Global Infrastructure (-2.3%) was the only exposure that detracted from returns in August.

Volatility returned in bond markets, providing a challenging environment for both domestic and global fixed income managers. The top performer was the Portfolio's credit exposure in CQS (+0.5%) followed by YBR Smarter Money Active (+0.3%) and Payden & Rygel Global Income Opportunities (+0.3%). The top detractor from returns was the T Rowe Dynamic Global Bond Fund (-1.1%) followed by Ardea Real Outcome (-0.1%).

A rotation of some Alternatives managers is underway to enhance the bias to market neutral strategies whilst we are faced with a difficult global market environment. During the month new positions were initiated in the Watermark Market Neutral Trust and Ellerston Australian Market Neutral Fund and full redemptions were placed for Acadian and BlackRock. The Investment Committee is focused on ensuring an appropriate mix of defensiveness and alpha generation for the Portfolio.

*In local currency terms.

Stonehouse Core Value Portfolio

Monthly Update – August 2018

stone|house

Market Performance and Outlook

August saw some significant developments for global financial markets. On the one hand, the US economy continued to post some good figures, including corporate earnings, and the equity market rose to new highs. The Australian economy also looked to be in fair shape and the Australian equity market outperformed quite a few global markets.

However, cracks have been emerging elsewhere in the system. There were more out-of-cycle interest rate increases from banks in Australia and reports of further weakness in house prices. At the same time, a number of emerging market economies saw their equity markets and currencies come under renewed pressure. These are both results of the same broad underlying cause: the gradual tightening of global liquidity as the US Federal Reserve moves its monetary policy settings back to "normal" levels. At this stage, the normalisation process looks like it has some way to go, which heightens the odds of more volatility in global markets.

The Australian dollar fell further in August, driven partly by concerns about a "trade war" between the US and China. The Reserve Bank again left the cash rate at 1.5% and reiterated this is likely to persist until there are meaningful signs of higher wage inflation. However, the Bank expects this will take some time to happen.

Global liquidity conditions will continue to tighten as we move into 2019. Not only will the US Federal Reserve continue its program of normalising monetary policy, but the ECB has flagged that it will start its quantitative tightening program by next year as well. The ongoing strength of the US economy has been more than we have been expecting, but it adds to the capacity pressures in the US and increases the likelihood that our forecasts of higher inflation will be realised. That in turn increases the risk of the Fed tightening more than the markets currently expect, which would push bond yields and the US dollar up, leading to further pressure on the emerging market economies which are struggling at the moment. At some point the odds are that all this spills over into a more significant correction in global equities across the board, a scenario the Investment Committee has been preparing for, even if the timing of such is unknown.

Portfolio Summary

Stonehouse
Core Value Portfolio

Unit Price at 31 August 2018 $1.1116

Asset Class Ranges & Current Allocations[1]		Current Exposure
Cash & Fixed Interest	15% - 60%	28.7%
Property	0% - 25%	4.6%
Equities	25% - 65%	46.6%
Alternatives	5% - 35%	20.0%

[1] 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. Old Mutual World Equity
2. Macquarie Australian Shares True Index
3. Northcape Emerging Markets
4. T.Rowe Price Dynamic Global Bond
5. Invesco Global Targeted Returns
6. Platinum International
7. Payden & Rygel Global Income Opportunities
8. Ardea Real Outcome
9. Bennelong Long Short Equity
10. SGH ICE