Stonehouse Core Value Portfolio
Monthly Update - December 2015

December Performance Overview

The Stonehouse Core Value Portfolio (CVP) recorded positive performance over the month of December – rising by +0.05% which was a good result helped by a 'Santa Clause' rally in equities late in the month following a turbulent start during which time our defensive positions had much work to do. For the quarter (Oct – Dec 2015), the CVP posted 1.85%, as we continued to strive for a stable pattern of returns for CVP investors.

For the month, positive performances came from our domestic small caps managers IML Future Leaders (+3.62%) and SG Hiscock ICE (+2.75%). Domestic property managers Phoenix Property Securities (+3.37%) and SGH Property Income (+5.15%) also posted impressive monthly results.

Negative performances over the month came from certain defensive elements 36 South (-4.17%) and AQR Managed Futures (-1.76%) as well as resources focused 90 West (-4.00%).

We anticipate the negative performances of our defensive line up will soon turn around given the poor start to equity markets in 2016.

We continue to put cash reserves to work in areas that we see representing value – effectively buying small amounts or 'averaging in' as markets drop in value – a move we feel should place us in good stead (due to our lower buying price for the assets) when volatility abates and markets recover.

The Stonehouse Investment Committee understands some investors find such periods of market instability and severe short term weakness disheartening or even frightening. However, we need to stay focused during these volatile short term market moves because such periods often produce the most compelling longer term opportunities and it is therefore important investors don't become overly focused on short term movements. Instead, the aim should be to keep an eye on longer term return targets and investment goals.

Portfolio Summary

	Stonehouse Core Value Portfolio
Unit price	$1.0597

Asset class ranges & current allocations[1]	Range	Current exposure
Cash & Fixed Int.	15% – 60%	29.0%
Property	0% – 25%	4.3%
Equities	25% – 65%	44.9%
Alternatives	5% – 35%	21.8%

Top 10 investment holdings (ex cash)
1. Statestreet S&P/ASX 200 ETF
2. Bennelong Long Short Equity
3. Northcape Emerging Markets
4. Payden and Rygel Global Income Opportunities
5. 36 South Kohinoor Core Fund
6. Kapstream Absolute Return
7. Ardea Inflation Plus
8. Platinum International Class A
9. Wingate Global Equity Income
10. J O Hambro Asia ex Japan

[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).

AFSL: 292 469

Market Performance and Outlook

To reiterate comments we made last week (posted on the Stonehouse website), presently global markets are undergoing yet another challenging period. Some equity markets have recorded their worst start to a calendar year ever. And this comes on the back of calendar 2015 performances which in price terms were negative for most major equity market indices.

What is the reason for all the carnage? That age old enigma – China (and the associated effect that this is having on the resource sector slide). Has this taken us by surprise? In June last year, as part of our Investment Committee operations, we wrote a discussion paper titled 'The Next Asia Crisis'. It detailed the deteriorating balance sheet situation in China and the ramifications that this would have for a (then) skyrocketing Chinese equity market and fragile Chinese economy. Indeed, our investment thesis has increasingly been that we are now in the mature stage of the investment / credit cycle. Mature stage investment cycles are typified by volatility shocks that are both more frequent and increasing in amplitude. The August / September 2015 market upheaval in response to China concerns represented the first seismic shock for global financial markets. It appears January 2016 is lining up to be a quite a nasty aftershock.

So what does this mean for the CVP? Well, this is where our defensive players have their chance to shine. The August / September 2015 volatility shock represented a good test run for our defensive line up. We made some subtle changes in response – removing volatility manager Triple 333 from the portfolio - even though overall our defensives did a very good job in preserving capital over the downturn (our losses were less than a quarter of those experienced by the ASX 200). Right now, it appears our defensives are again being called into play.

Our base case scenario is that we will ride out the present shock in similar fashion to our August / September 2015 experience but are ever conscious of the potential for a greater level of severity.

We take comfort from the fact that we perennially maintain an array of defensives within the CVP whose aim is to make money even in bear markets. No doubt if we are wrong (and the present market turmoil represents the start of a more significant event) we will make asset allocation changes to bring even more resources into our defensive line up. But the 'sleep at night' insurance is that we already have some of these defensive positions firmly in place within the CVP.