Stonehouse Core Value Portfolio
Monthly Update - December 2016

December Performance Overview

The Stonehouse Core Value Portfolio (CVP) had a solid month in December with a return of +1.21%.

Equity holdings delivered predominantly positive returns. Strong performers included Allan Gray +6.1%, Lazard Global Small Caps +3.8%, Macquarie Australia True Index +3.3%, the new entrant Old Mutual World Equity* +3.2% and Wingate +3.2%. The Australian Long/Short manager LHC was the only detractor in the Equity component.

Property and Infrastructure holdings had a strong month with Cromwell Phoenix +5.2% and Lazard Global Infrastructure +5.1%. Fixed Income holdings contributed positively to returns in what was a challenging environment for the sector with Ardea +1.2%, CQS +1.1%, Payden & Rygel +0.5% and T Rowe +0.7%.

Alternative holdings were mixed with positive performances coming from 36 South Kohinoor*+2.9%, Invesco +2.0% and JP Morgan Global Macro +1.9%, while detractors included Bennelong Long/Short -3.2% and Acadian Diversified Alpha -1.5%.

The Investment Committee noted a marked improvement in sentiment over December with markets factoring in a smooth implementation of US President Elect Donald Trump's fiscal policies. The Investment Committee is cautiously optimistic about prospects of increased earnings growth globally, however we do note the increased uncertainty related to the policies of an incoming US Administration as well as the prospect of substantial shifts in the geopolitical status quo. At the time of writing the Prime Minister of the UK, Theresa May has indicated they will likely to go down the path of a hard "Brexit" which when combined with a number of key elections to be held in an increasingly fragmented Europe this year, is likely to increase volatility. As such our expectation is for this year to present increased opportunities as a by-product of a reflationary shift due to higher fiscal spending, regulatory changes and increased market dispersion, however we do note the path is likely to involve greater volatility.

Portfolio Summary

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Unit price	$1.0545

Asset class ranges & current allocations[2]	Range	Current exposure
Cash & Fixed Int.	15% – 60%	30.7%
Property	0% – 25%	2.7%
Equities	25% – 65%	46.6%
Alternatives	5% – 35%	18.5%

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

AFSL: 292 469

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Market Performance and Outlook

As we reflect on the year that was 2016, the emergence of political populism stands out as a key secular shift which is likely to have significant impact on the global economy over the next few years. Equity markets have experienced a strong rally since the initial shock of a Trump win. In January, the Trump rally has started to fade but it has driven sentiment strongly upward with Trump rhetoric perceived to be favourable for the asset class.

The victory of Donald Trump has put fiscal policy firmly on the agenda and questioned the consensus “lower for longer” narrative. The prospect of corporate tax cuts and repatriation of overseas cash are likely to provide a substantial boost to corporate earnings. However, earnings could be challenged by a stronger USD and higher interest rates along with the squeeze on profit margins from the pick-up in wages. Our overall Equity market outlook is cautiously positive with our upside case based on constructive policy measures of a Trump presidency and the prospect of real fiscal expansion. This should take further pressure off the Federal Reserve and allow for higher interest rates and/or divesting the multi-trillion dollar balance sheet accumulated through the US quantitative easing programs.

Elsewhere a positive growth impulse from the US is being mirrored across the globe with Europe, China and Japan expecting to show better growth and inflation in 2017. Indeed China factory gate prices recorded a 5% jump in December as a 2-3 year deflation trend ends sharply. Downside risks do remain however with political risks within Europe on the rise, Chinese capital outflows continuing and the high likelihood of a hard Brexit for the UK. Forthcoming elections in France, the Netherlands and Germany pose a threat to Eurozone stability—but have been well-flagged to investors.

We expect to see a continuation of investor flows which favour Cyclicals away from Defensives and Bond-like substitutes such as REITS and Infrastructure. In particular, we favour Japan given strong corporate governance reforms as well as Japan being a beneficiary of a stronger US Dollar. Emerging Markets are suffering from a continued outflow and currency weakness as stress re-appears in core markets like Turkey. We are maintaining our position in Emerging Markets however favour active strategies which factor in macroeconomic and geopolitical risks.

In Australia, imbalances remain with Resources and Housing continuing to dominate growth and trade figures though the overall competitiveness of Australia has improved with the currency adjustment and the economy has performed remarkably well in the global context. The Australian Dollar (AUD/USD) weakened to 72c during the month but finished roughly flat with January (75c) seeing more strength as economic and trade data have improved. The issue for AUD/USD bulls is that the short term interest rate differential with the US is closing faster than expected; we would need to see a more hawkish RBA stance than in recent months to turn this primary factor more favour of the AUD. Other factors may however drive the AUD/USD higher including continuing Commodity reflation and/or another (all too common) pause from the US Fed.

*In local currency terms.