Stonehouse Core Value Portfolio
Monthly Update - December 2017

December Performance Overview

The Stonehouse Core Value Portfolio (CVP) ended 2017 strongly, returning +0.52% in December and delivering +9.0% for the calendar year. Equities ended the year well with the Australian market returning +1.8% and the MSCI World Index +1.1% (in AUD Hedged terms). The Australian dollar (+3.2%) appreciated strongly in December but Australian bonds were weak (-0.5%).

The majority of CVP Equity investments delivered a solid return in December. Allan Gray (+4.6%) had a spectacular month outperforming the market by 3%. The other strong performers were the regional exposures through iShares MSCI Japan High Dividend ETF (+3.3%)[1], Northcape Emerging Markets (+3.0%) and J O Hambro Asia ex Japan (+1.4%)[1]. Old Mutual (+1.6%)[1] and SGH ICE (+2.0%) also continued to provide steady positive returns. Main detractors in the equity sector were Wingate Global Equity Income (-2.0%), Lazard Global Small Caps (-0.7%) and Platinum International (-0.3%).

The performance within all other sectors was mixed. Within Fixed Interest, CQS (+0.3%), Payden & Rygel (+0.2%) produced reasonable returns, whilst both Ardea (+0.1%) and T Rowe (-0.1%) were relatively flat for the month.

In the Property and Infrastructure sector Cromwell Phoenix Property Securities (+1.0%) delivered a positive return, however Lazard Global Infrastructure (-1.5%) and Resolution Global Property (-0.9%) detracted from the Portfolio, with both funds impacted by the solid rise in the Australian Dollar.

For the Portfolio's Alternative holdings, Bennelong Long Short (+2.9%) was the standout performer. AQR Managed Futures and Acadian were up +1.2% and +0.9% respectively and JP Morgan Global Macro (0.4%) was also positive for the month. Blackrock Absolute Return (-1.8%) and Invesco GTR (-0.6%) detracted from the Portfolio's performance.

Considering the continued strong run in equities in 2017 the Investment Committee felt it was prudent to take some profits toward the end of the year. Holdings in Platinum International, Old Mutual, Allan Gray and Wingate were trimmed and rotated into various Fixed Interest investments. It is anticipated that 2018 may prove to be volatile year and the Portfolio holds sufficient cash to take advantage of opportunities as they arise.

Portfolio Summary

Stonehouse Core Value Portfolio	
Unit price	$1.1138

Asset class ranges & current allocations[2]	Range	Current exposure
Cash & Fixed Int.	15% – 60%	29.7%
Property	0% – 25%	4.3%
Equities	25% – 65%	46.1%
Alternatives	5% – 35%	18.5%

Top 10 investment holdings (ex cash)
1. Macquarie True Index Aus Shares
2. Old Mutual World Equity
3. Northcape Emerging Markets
4. Invesco GTR
5. Platinum International Class A
6. Wingate Global Equity Income
7. T Rowe Dynamic Global Bond
8. iShares MSCI Japan High Dividend ETF
9. SGH ICE
10. IML Equity Income

[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

1300 778 663 | www.stonehousegroup.com.au | info@stonehousegroup.com.au

Market Performance and Outlook

Equity markets maintained their upward trend in December with the MSCI World Index up +1.14% (in AUD hedged terms). Continued signs of improving economic conditions and the passing of tax reform in the US encouraged investors to add to their 'risk on' exposures.

With regards to regional performance, the rest of Asia (MSCI Asia ex Japan) delivered the strongest gain (+2.5%) during the month; the US was +1.1% (S&P 500 Index), Europe +0.7% (MSCI Europe Index) and Japan +0.2% (Nikkei Index).

The Australian equity market rose +1.8% (S&P/ASX 200 Index) and has now rallied +8.4% in the last six months to December 2017 following a rise of just 1% in the first half of calendar 2017. The sectors recorded mixed returns, with Utilities materially underperforming (-4.5%), while Energy (+6.4%), Materials (+6.2%) and Telecoms (+5.5%) all saw substantial gains.

The Australian dollar (+3.2%) bounced back strongly against the USD in December, after falling for four consecutive months. Gains in commodity prices (Iron Ore is up more than 20% since 31st October), some broad weakness in the USD and strong Australian employment data were the major factors behind the rise.

As expected, the Fed raised interest rates in December and flagged another three rate hikes in calendar 2018. The foreshadowed rate increases would bring the Fed Funds rate to a range of 2.0% to 2.25% with further increases forecast over 2019 and 2020.

With the Fed leading the way, monetary policy normalisation is expected to start in other major economies with the European Central Bank (ECB) expected to begin reducing purchases of bonds in the second half of the year. By purchasing a huge amount of sovereign bonds through quantitative easing (QE), central banks have suppressed bond yields over the past decade. With the Fed now reducing the size of their balance sheet and the ECB scaling back bond purchases this dynamic is going to change significantly. Essentially, there will be a shift from a large net demand for bonds in 2017 to a sizeable net supply in 2018. This swing in the supply/demand balance plus the strong economic activity and employment growth will put pressure on bond yields. Until recently, low bond yields have been generally trending within a narrow band and have underpinned high valuations of the equity market.

Notwithstanding a solid outlook for earnings growth, the likely rise in bond yields combined with already stretched valuations look set to increase market volatility and lead to a less attractive risk return pay-off from equities. While we recommend maintaining a reasonable exposure to equities within a diversified portfolio, we would emphasise the need for a highly selective approach (Emerging Markets, Japan and Europe are still offering a solid risk/return proposition relative to other markets) combined with a sizeable exposure to investments that are not correlated to equity and fixed income markets.