Stonehouse Core Value Portfolio
Monthly Update - February 2016

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February Performance Overview

The Stonehouse Core Value Portfolio (CVP) fell a modest -0.24% in February as markets continued their difficult start to the calendar year. In contrast, the ASX 200 fell by a more significant -1.76% over the month and at various stages was down substantially more as fears of a global economic slowdown took hold.

As at time of writing, market sentiment in March seems to have become more positive and our long equity positions are poised to respond accordingly.

During February, positive performances came from our deep value manager Allan Gray +6.77% and commodities focused manager Henderson Global Resources +8.05%. Encouragingly, trend following managers AQR Managed Futures +3.40% and Cantab +2.68% also performed well. These managers can also generate sizable returns if markets take a decisive turn for the worst and are therefore a valuable component of the Portfolio.

Negative performances over the month came from Australian equities long/short manager Blackrock Absolute Return -3.35%, domestic small caps managers IML Future Leaders -0.98% and SG Hiscock ICE -3.49% as well as international property manager Brookfield -2.63%.

Market Performance and Outlook

It seems everyone decided to become depressed all at once. The rationale? China devaluing the yuan (albeit marginally) and some softer than expected economic indicators out of the United States. Aside from that, not much has changed. As previously mentioned, presently the negativity in terms of market sentiment has once more turned to euphoria and markets seem again to be seeing the world as a ‘glass half full’ phenomenon rather than being a ‘glass half empty’.

Portfolio Summary

Stonehouse Core Value Portfolio	
Unit price	$1.0411

Asset class ranges & current allocations[1]	Range	Current exposure
Cash & Fixed Int.	15% – 60%	31.5%
Property	0% – 25%	4.4%
Equities	25% – 65%	42.4%
Alternatives	5% – 35%	21.7%

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

[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).

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Market Performance and Outlook (continued)

Such schizophrenic behaviour on behalf of markets is not uncommon at the mature stages of the investment cycle. Our thesis has always been that once the US Federal Reserve started withdrawing monetary accommodation from the markets and then began raising rates, the entry into the mature stage of the investment / credit cycle had begun.

Hand-in-glove with this assessment was an expectation of greater market volatility and commensurately we tailored our positions within the CVP to cater for the heightened volatility environment. The significantly smaller monthly movements in the CVP relative to broad equity market indices such as the ASX 200 bear testament to our endeavours to preserve capital during this tumultuous market phase.

What to expect going forward? Unfortunately it will likely be more of the same. While markets are at present in a more ebullient mood, we know that such sentiment can be short-lived and that pessimism can just as easily take hold (without any real fundamental rationale) once again. Subsequently, we retain heightened cash reserves within the CVP to both preserve capital and to opportunistically buy markets that have become demonstrably oversold in response to such negative sentiment.

To be sure, we are continuing to maintain our defensive positions within the portfolio and are even looking to add to these holdings as the investment /credit cycle further matures and we approach the next phase of market weakness. Interestingly, the best analogy for the present market environment has more to do with earthquakes rather than pure market fundamentals. As investment cycles mature they are typified by a series of 'shocks' that are both increasing in frequency and amplitude. Our first such shock for the present (mature) investment cycle was in August last year. This has been followed up by another seismic shock of increasing amplitude in January / February this year and unfortunately expect more of these over the course of the year ahead.

It is for this reason that we are focusing first and foremost on volatility management - with an ever present eye toward preserving capital during this tumultuous time. As we approach the ultimate end of the present investment cycle we will without doubt be reining back our market exposure even further and – as mentioned above – bolstering our defences even more. For the time being however, it appears as though the markets have once more decided to undertake a more positive outlook and as a consequence some degree of market exposure is warranted.

It is maintaining this fine balance of generating returns while times are good but at the same time accommodating for the significant downside end game that occupies most of our time at this stage of the investment cycle. No doubt we will continue to remain vigilant as markets work through this difficult period.