Stonehouse Core Value Portfolio
Monthly Update - January 2018

January Performance Overview

The Stonehouse Core Value Portfolio (CVP) began 2018 on a good note, returning +0.79% in January, in a month that saw strong gains in US equities (+5.6%) contrasted by the Australian market which moved down -0.5%.

In a month of mixed Equity manager performance, the Portfolio stand-outs were JO Hambro (6.1%)[1] and Old Mutual World Equity (5.9%)[1], providing a combined contribution of some 27bps to the months performance. The weakest performers within the Equities sector were IML (-0.8%) and Wingate (-0.7%).

The Portfolio's Fixed Income managers provided modest returns for the month. Ardea (+0.9%), T Rowe (+0.4%) and Kapstream (+0.4%) delivered good returns, however Payden was flat and CQS slightly down (-0.3%).

Within the Alternatives sector, AQR Managed Futures had a very strong month as did JP Morgan Global Macro (4.0%) and Blackrock Absolute Return (2.3%). On the other side of the ledger Arcadian (-2.4%) detracted from the Portfolio's performance but it is expected that not all of these investments will fire at once, hence the Portfolio's carefully selected diversified mix of managers in the sector.

The Property and Infrastructure sector had a poor month as interest rate concerns weighed with Cromwell Phoenix Property Securities (-3.4%), Lazard Global Infrastructure (-2.8%) and Resolution Global Property (-2.6%), although note we still remain relatively underweight in this sector.

During January the CVP topped up its positions in Macquarie Australian Equity True Index and Cromwell Phoenix. In addition, the S&P500 put option was rolled to extend downside protection from June out to September.

Portfolio Summary

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Unit price	$1.1226

Asset class ranges & current allocations[2]	Range	Current exposure
Cash & Fixed Int.	15% – 60%	29.4%
Property	0% – 25%	4.5%
Equities	25% – 65%	44.1%
Alternatives	5% – 35%	18.6%

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).

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Market Performance and Outlook

January was another strong month for equity markets globally with the MSCI World Index delivering +3.3% (in AUD Hedged terms) The Australian dollar (+3.7%) appreciated strongly for a second month in a row. With regards to regional performance, the rest of Asia (MSCI Asia ex Japan) once again delivered the strongest gain (7.5%) during the month; the US was +5.6% (S&P 500 Index), Europe +1.6% (MSCI Europe Index) and Japan +1.5% (Nikkei Index).

As noted above the Australian equity market fell 0.45% (S&P/ASX 200 Accumulation Index). Best performing sectors were Healthcare (+3.1%), Telecoms (+0.7%) and Materials (+0.5%) while Real Estate (-3.3%), Industrials (-2.1%) and Financials (-0.8%) lagged.

Fixed interest markets saw higher yields with the US 10 year bond rate rising from 2.4% to 2.7% while the Australian 10 year bond rose from 2.6% to 2.8%.

January's strong markets have been followed by sharp weakness in early February which has been partly recovered by mid-month. However, it is unclear whether this was a simple correction in an ongoing bull market or tremors before a period of weakness. In any case, the period of extremely low downside market volatility that marked 2017 seems to be over.

We do believe the downside risks are not insignificant, especially with continued high market valuations and increased investor caution suggesting the market "melt up" scenario some were anticipating (and relying on) is now less likely. A key will be whether markets can quickly and confidently recover to recent highs or alternatively we see the rally momentum fade.

Current economic fundamentals are strong across much of the globe, with both developed and developing economies expected to grow solidly in 2018. However, in respect of the outlook for financial markets it is worth highlighting:

1. Major equity market peaks tend to occur when the economy is doing well (and trough when the economy is doing poorly) so caution is needed in automatically linking strong economies currently to future strong equity markets. (Especially when the economic cycle is already quite mature as it is in the US).

2. Strong economies (especially the US) are increasing the prospects of inflation and interest rate rises in the near term which could prove negative for financial markets (and ultimately the economy) especially given high debt levels and excessive reliance on low interest rates over many years. Already there is now growing expectations of 4 rate rises by the Federal Reserve in 2018 with the first expected in late March.

3. Some of the strong economic fundamentals relate to high asset prices and related business and household confidence effects which could at least partly reverse if asset prices were to fall.

While the general consensus is the recent weakness is a "healthy" correction this view downplays these perspectives and risks. The next few months should help to clarify the outlook and a well-diversified approach with a defensive tilt remains appropriate in the meantime.