Stonehouse Core Value Portfolio
Monthly Update - June 2016

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June Performance Overview

The Stonehouse Core Value Portfolio (CVP) fell -0.20% in June, but not enough to sour what was a good final quarter of the 2015/16 financial year with the CVP returning +2.36% for the period. Confidence that was broadly building in global equity markets saw an abrupt pullback after the surprise UK Referendum decision to leave the European Union (popularly known as the "Brexit").

Strong performers for the month included Epoch Global Equity Yield +2.69% and JO Hambro Asia ex-Japan +2.06%. Listed Property holdings were also positive with Cromwell Phoenix +2.75% and SG Hiscock Property Income +3.75%. Our Fixed Income manager T Rowe delivered a solid return of +1.11% and one of our key Alternative exposures AQR Managed Futures delivered an outstanding +9.45%.

The iShares Global 100 was the major detractor at -5.69% followed by Lansdowne European which was directly impacted by the Brexit decision delivering -4.98%. Bennelong Long Short and Invesco were also down registering returns of -1.06% and -2.20% respectively. Infrastructure and credit orientated holdings were also slightly off for the month.

As part of the ongoing monitoring of Portfolio holdings the Investment Committee reduced allocations to assets which we viewed as vulnerable to the Brexit vote and profitably exited a position in US Volatility Futures which we had purchased as protection prior to the UK referendum.

We also used an excessive market sell-off in Japanese Equities post-Brexit vote to initiate our position into what we view as an attractive market on both valuation and macroeconomic conditions. At time of writing this buy has been well rewarded.

Portfolio Summary

	Stonehouse Core Value Portfolio
Unit price	$1.0712

Asset class ranges & current allocations[1]	Range	Current exposure
Cash & Fixed Int.	15% – 60%	38.5%
Property	0% – 25%	4.6%
Equities	25% – 65%	39.4%
Alternatives	5% – 35%	17.6%

Top 10 investment holdings (ex cash)
1. Statestreet S&P/ASX 200 ETF
2. Northcape Emerging Markets
3. AQR Managed Futures
4. T Rowe Dynamic Global Bond Fund
5. Wingate Global Equity Income
6. Platinum International Class A
7. Payden and Rygel Global Income Opportunities
8. Kapstream Absolute Return
9. Invesco GTR
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

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Market Performance and Outlook

June saw Equity markets hit a roadblock with the UK's Brexit surprise. European and Japanese shares were hit hard as the Japanese Yen and Bonds rallied as investors repatriated capital and crowded further into safe-havens. The Australian market finished behind being dragged down predominantly by the banks. The response after Brexit was however far more constructive than most anticipated with Equities rising and the S&P 500 hitting new record highs.

We remain cautious on Equities as we believe the recent rally primarily reflects a rebound from the severe weakness of early 2016 and return chasing by investors starved of yield in a low rate environment rather than an optimistic assessment of current/expected earnings and economic fundamentals. Valuations continue to be more attractive outside of the dominant US market which is now trading over 18.3x 2016e earnings (PEs) – as regular readers will note the US market has been more expensive on only 3 other occasions, each of which have preceded significant market sell-offs.

Japanese Equities also offer value in light of attractive valuations and Prime Minister Abe's party winning a majority in the recent Upper House elections and affirming commitment to further economic stimulus. Resources and European Financials more recently are also starting to show value after trading at levels not seen since the GFC. Emerging Markets which have broadly underperformed US and developed markets more broadly are expected to benefit from a combination of a lower rate environment and stronger economic growth.

As we look beyond the immediate impact of the UK's trigger to exit the EU with newly elected Theresa May expected to provide greater transparency on the UK's plan of action. There are still plenty of catalysts for concern near term as Europe faces a number of referendum and/or election tests with far right parties continuing their rise fuelled by poor economic growth and terror attacks. We should not underestimate the longer term risks to growth from such events however market impact has also been more constructive because central banks are perceived to provide support for them.

Negative Interest Rates continue to challenge fixed income assets with a flood of capital hunting for higher yields driving up demand for Australian Government Bonds and hence seeing their yields lower. Governments can now finance at or below 0% which makes debt interest affordability much better and may also allow for an increase in spending to help lift growth and inflation. Yields broadly are already at record lows in absolute terms and investment grade debt is particularly challenging.

A combination of macro headwinds and accommodative policy is creating more trading opportunities with some of our Active managers doing well to sell into corrections and buy back into the recovering market – we continue to see such an environment persisting and we seem destined to expect a series of volatility spikes only to have central banks come to the rescue and settle them back down. We are long Volatility as a strategy and see potential for expansion from very low levels (11, VIX) but will be quicker to harvest profits as we see volatility contained in severity and duration by central banks.

The Australian Dollar has continued to build and consolidate on a higher level bouncing to 76c but fading from an earlier move in April/May. The market anticipates at least one cut from the RBA this year and many analysts think that at least 2 will be necessary to keep growth and the AUD at a comfortable level. As a result we think Australian Equities and Bonds are well supported but this will likely see the Australian Dollar driven lower.