Stonehouse Core Value Portfolio
Monthly Update - March 2016

stonehouse

March Performance Overview

The Stonehouse Core Value Portfolio (CVP) rose +0.52% in March on the back of a rebound in equity markets and an increase in most commodity prices.

Strong contributions were registered by domestic equity managers such as Allan Gray Australia Equity +5.57%, Vanguard High Yield ETF +5.98% and IML Future Leaders +4.25%. In addition, standout performances were also generated by a number of international investments including our Emerging Markets ETF +12.72% (in USD terms), Barwon Global Private Equity +8.11% and JO Hambro +5.26% (also in USD terms).

Fixed Income holdings also contributed positively to performance with the credit orientated managers doing particularly well; CQS +2.39% and Payden & Rygel +1.52%. Domestic and international listed Property and Infrastructure holdings performed well too with Brookfield +6.80% (in USD terms), Lazard +4.75% and SGH Property Income +3.18%.

Negative performances came primarily from our Alternatives holdings. While several of these investments helped during the quarter, they detracted from performance in a strong equity return environment for the month with 36 South (in which we deliberately took an underweight position leading into the month) returning -13.03% (in USD terms) and AQR Managed Futures -5.76%. More defensive domestic and international long/short equity managers also struggled during the month with Bennelong and Lansdowne recording -6.40% and -5.11% (in EUR terms) respectively.

During the last few quarters we have been focused on capital preservation and managing downside volatility in challenging market conditions. Whilst the Investment Committee remains focused on identifying attractive investments and topping up existing investments to take advantage of opportunities, we are also aware of the growing need for the Portfolio to capture greater upside movements in this 'low yielding' environment and as at time of writing the investment committee is fleshing out strategies to meet this end.

Portfolio Summary

Stonehouse Core Value Portfolio	
Unit price	$1.0465

Asset class ranges & current allocations[1]	Range	Current exposure
Cash & Fixed Int.	15% – 60%	32.2%
Property	0% – 25%	4.4%
Equities	25% – 65%	43.7%
Alternatives	5% – 35%	19.7%

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

[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

The March quarter proved to be a particularly challenging period for global equity markets with the ASX 200 being sold off -9.5% at one stage only to rebound toward the latter part. The reason – central banks once again coming to the rescue with dovish tones from the United States Federal Reserve and the European Central Bank (ECB). Reversing a poor market reception to the ECB's December meeting, equity benchmarks rallied +5% in March responding favourably to Mario Draghi's latest program to defeat deflation and lacklustre Eurozone growth. Many sectors which were hit hard in January-February, including Natural Resources and Financials, led gains and reversed their fortunes from the beginning of the year.

Emerging Markets participated in this recovery with currencies and equities performing best. We are monitoring investment opportunities in Emerging Markets with a view to adjusting our exposures more actively and selectively approach given the various idiosyncratic risks and geopolitical issues that remain.

Central Bank experimentation continues apace with the ECB broadly delivering on market expectations with a further deposit rate cut and an expanded Bond buying program. The immediate impact has been an increase in asset prices across the region with yields being driven lower (which can be expected to support growth through reduced credit costs). In the meanwhile, the fundamental situation in two non-core European economies, Portugal and Greece, are still deteriorating and are headed towards more difficulty in the medium term. The CVP is positioned to take advantage of Europeans opportunities whilst also tactically protecting against the challenges primarily in non-core European countries.

The Bank of Japan is reviewing policy options in light of currency and equity markets reacting unfavourably to the negative interest rate policy introduced early in the quarter. The Yen rallied strongly against major currencies into April calling into question the relationship between negative deposit rates and currency weakness. Given the strong rise in the Yen and poor performance of the Nikkei Index (-15.76% in JPY terms) over the financial year to date, we do anticipate further and more pronounced stimulus by the Bank of Japan and thereby a potential opportunity in the making.

Fixed Income allocations are most impacted by Central Bank policy settings with over $6 trillion of Government Bonds now in negative yield territory. Investors are therefore being forced into higher risk instruments to achieve positive yields let alone their long term target rates of return. Our Fixed Income exposures remain defensively positioned and we continue to regard long duration assets as offering a poor risk-return profile. We remain positive toward shorter duration assets given the more favourable market pricing but cautious about an expected rise in default rates and hence prefer Loans over Bonds as the floating rates protect against future rate rises.

Looking out to the Northern Hemisphere Summer we are anticipating a rise in share market volatility. The recent fall in volatility as measured by the VIX index, has it below 15 at the end of March after having peaked at almost 30 in the middle of February – these market movements provide us with an opportunity to gain some additional protection for the Portfolio. An increase in volatility is also made likely in the short term due to the upcoming US earning season, with most market participants expecting earnings growth to decline by more than 7% from a year ago.

This latest rally continues to reinforce the markets reliance and wavering confidence in Central Bank Policies to support equity markets. We continue to monitor these dynamics carefully and highlight our efforts to regularly assess defensive exposures to ensure the CVP is adequately protected on the downside should the worst occur. We emphasise that valuations on the whole across developed market equities and fixed interest are rather richly valued and the Portfolio is positioned accordingly. Within Equities, Emerging Markets, Europe and Japan are attractive on a relative basis as is the Resources sector. Quality and defensive equities look expensive and susceptible to rotation flows into cheaper sectors.

We believe the Australian Dollar is likely to face downward pressure over this coming quarter, in spite of stronger Resource prices, as a sharper appreciation in the currency will increase the likelihood that the RBA will cut rates (or at least signal this intention) to reduce pressure on Australian economic growth. Should this occur, CVP investors will also stand to benefit through the Portfolio's unhedged international exposures.