Stonehouse Core Value Portfolio

Monthly Update – May 2019

May Performance Overview

The Stonehouse Core Value Portfolio (CVP) generated a small negative return (-0.81%) in the month of May. This was against a backdrop of disappointing returns in global equity markets, with the MSCI World Ex Australia Index posting a loss of -4.2%.

Within the domestic equity component of the Portfolio, the best performing strategy was the index exposure held through Macquarie Australian Share True Index (+1.7%). This was followed by Allan Gray Australian Equity (+0.9%) and SGH ICE (+0.0%). IML Equity Income (-0.5%) posted a small loss.

Consistent with the performance of global equity markets, the global equity strategies posted negative returns in May. The defensive exposure, Talaria Global Equity (-1.2%) was the best performing global equity strategy. The largest detractor was Platinum International (-5.9%), followed by Merian World Equity* (-5.8%) in a difficult month for global equities. Northcape Emerging Markets was down -1.5% but outperformed the Emerging Market index by +4.5%. This brings its 12 month outperformance relative to the index to +10.2%, an impressive result in what has been a volatile year.

Within Alternatives, both managers detracted from Portfolio returns for the month. The largest detractor was Bennelong Long Short Equity (-2.5%), followed by GMO Major Markets Trust (-2.2%).

The performance of the property and infrastructure exposures was mixed in May. The best performing strategy was Resolution Capital Global Property (+1.8%). This was followed by Cromwell Phoenix Property Securities (+1.5%) and AMP Capital Core Infrastructure (+0.5%). Following a strong April, Lazard Global Listed Infrastructure (-1.3%) strategy posted a negative return in May.

The domestic and global bond managers contributed positively to portfolio performance during the month. The best performing exposure was the recently added Franklin Templeton Australian Core Bond Plus (+1.8%), continuing its solid performance. This was followed by Ardea Real Outcome (+0.9%), Payden Global Income Opportunities (+0.4%), Aquasia Enhanced Credit (+0.4%) and YBR Smarter Money Active Cash (+0.2%). The only slight detractor was CQS Multi-Asset Credit (-0.2%).

*In local currency terms.

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Portfolio Summary

Stonehouse Core Value Portfolio	
Unit Price at 31 May 2019	$1.1008

Asset Class Ranges & Current Allocations[1]		Current Exposure
Cash & Fixed Interest	15% - 60%	42.0%
Property	0% - 25%	9.3%
Equities	25% - 65%	41.7%
Alternatives	5% - 35%	7.0%

[1] The total exposure may not sum to 100% due to any direct derivative investments (such as options and futures).

Top 10 Investment Holdings (ex cash)	
1.	Franklin Templeton Australian Core Bond
2.	Merian World Equity
3.	Platinum International
4.	Talaria Global Equity
5.	IML Equity Income
6.	Macquarie Australian Shares True Index
7.	Northcape Emerging Markets
8.	Aquasia Enhanced Credit
9.	Ardea Real Outcome
10.	SGH ICE

Market Performance and Outlook

Global equity markets were driven lower in May. The prime source of concern was the escalating trade dispute between the US and China, leading markets to worry that slower global trade could push the US closer to recession in the near term. This was despite further signs of strength in the US labour market and household sector. The equity markets' recession fears were compounded by the bond market pushing yields down even further and delivering a flat/inverted yield curve once more. Despite reasonable arguments to the contrary, markets still believe an inverse yield curve is a sure sign of imminent recession. In the absence of a clear statement from the Federal Reserve that it would be prepared to cut interest rates if necessary, equity markets sold off quite aggressively.

The Australian equity market did better than the rest of the world. This was partly because of the surprise result from the 18 May Federal election, which allayed fears of new investor-unfriendly policies being imposed, and partly because of clearer signs from the Reserve Bank that interest rate cuts were imminent. Higher iron ore prices also helped local resource stocks. The Reserve Bank Board left the cash rate unchanged at its May meeting but left the door open to cuts in coming months. This, combined with the Federal Reserve's hold-the line stance on interest rates, helped push the A$/US$ rate down by nearly 2% in May.

Despite May's retracement, equity markets have had a good run since the start of the year. While no longer cheap, equity markets do not look overly expensive against the backdrop of lower interest rates and bond yields in the US and Australia. Risks that could trigger a bigger correction include Brexit, the China-US trade dispute, and sudden weakness in the Chinese economy. As always, we are monitoring these and other developments for potential impact on markets and the portfolio. For the moment, our expected returns across the major asset classes remain low, with their relative attractiveness driven more by income returns rather than capital growth.

In these conditions, we believe it is appropriate to run a well-diversified portfolio with risk asset allocations close to their long run neutrals. Within those risk allocations, where possible, we have used defensive investments which would help protect portfolio performance in the event of an equity market correction.

If such a correction were to occur, we would assess whether it is a potential buying opportunity. On the other hand, if equity markets were to keep moving up enough to push our expected returns into negative territory, we would assess whether to lighten up on those exposures.