Stonehouse Core Value Portfolio

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Monthly Update – November 2018

November Performance Overview

The Stonehouse Core Value Portfolio (CVP) posted a return of -1.48% in November. The month saw further equity market weakness with the MSCI World Ex Australia Index losing -1.8% and the Australian equity market losing -2.8%.

Within the domestic equity component of the Portfolio, the largest detractor was Allan Gray Australian Equity (-4.7%), a contrarian manager whose energy and commodity positions fell during the month. This was followed by SGH ICE (-2.2%) and the beta exposure held in the Macquarie Australia Shares True Index (-2.2%). The defensive domestic equity manager, IML Equity Income Fund (-1.0%) performed its role by providing some cushioning in a falling equity market.

Performance of the global component of the Portfolio's equity investments was mixed. The top performing strategy was the emerging markets exposure held in Northcape Emerging Markets (+1.1%) followed by Old Mutual World Equity* which was flat (+0.0%). The worst performer within global equities was Wingate Global Equity (-3.2%) which held a US utility negatively impacted by the Californian wildfires. This was followed by the Platinum International Fund (-2.7%), Blackrock iShares Japan High Dividend Yield ETF* (-1.5%) and Lansdowne European Equity* (-1.5%).

The exposure to Alternatives detracted from the portfolio returns with the largest detractor being the Bennelong Long Short Equity Fund (-3.1%). This was followed by Watermark Australian Market Neutral (-3.1%), Ellerston Australian Market Neutral (-1.9%), GMO SGM Major Markets Trust (-1.3%) and Invesco GTR (-0.6%). Although Invesco have since exited the Portfolio the Investment Committee remains confident in the ability of the remaining Alternatives to add value, particularly in longer equity downturn periods as they've demonstrated in the past.

Performance of the Property and Infrastructure sector was mixed. The best performing strategy was Resolution Global Property (+0.9%). The remaining two managers posted negative returns led by Lazard Global Infrastructure (-0.8%) which was also negatively impacted by US utilities holdings, followed by Cromwell Phoenix Property Securities (-0.7%).

Performance of the domestic and global bond managers was also mixed. The top performing manager was Ardea Real Outcome (+0.5%). The remaining managers posted negative returns led by CQS Multi-Asset Credit (-0.6%) and followed by T Rowe Dynamic Global Bond (-0.2%), YBR Smarter Money Active (-0.2%) and lastly Payden & Rygel Global Income Opportunities (-0.1%).

The investment committee remains cautious leading into 2019 and has continued to take measures to ensure the Portfolio provides a ballast to future expected volatility and can take advantage of opportunities as they arise. The Japan High Dividend ETF and Invesco GTR were exited by the end of the month and cash and fixed income exposures were increased via CQS and a new Australian credit manager AquAsia.

*In local currency terms.

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Portfolio Summary

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Unit Price at 30 November 2018	$1.0564

Asset Class Ranges & Current Allocations[1]		Current Exposure
Cash & Fixed Interest	15% - 60%	41.9%
Property	0% - 25%	4.7%
Equities	25% - 65%	39.4%
Alternatives	5% - 35%	14.0%

[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.	Old Mutual World Equity
2.	Platinum International
3.	Wingate Global Equity
4.	Macquarie Australian Shares True Index
5.	T Rowe Dynamic Global Bond
6.	Ardea Real Outcome
7.	Payden & Rygel Global Income Opportunities
8.	Northcape Emerging Markets
9.	SGH ICE
10.	IML Equity Income

Market Performance and Outlook

Speculation about US monetary policy was the key factor driving markets in November. Comments from senior Fed officials led the markets to think the Fed is close to the end of its tightening cycle. This triggered a rally in bonds and equities, along with a lower US$. The resulting flattening of the US yield curve prompted speculation the US is heading for a recession in 2020. A sharp drop in the price of oil and signs of slowing outside the US reinforced the view that the Fed cannot afford to tighten much further.

However, the markets appear to be getting ahead of themselves and have been very selective in how they have interpreted the latest news from the Fed and the economy. The odds are that the Fed has more work to do than the markets expect and that we will see more volatility and weakness in both bonds and equities as we move into 2019. Furthermore, the weakness in the oil price has more to do with supply factors than demand factors associated with slower economic growth.

Meanwhile conditions here in Australia show some slowing of economic activity, with weaker capital expenditure data, further falls in house prices and a weaker than expected GDP report for the September quarter. The labour market remains in reasonable shape, but wages growth is still muted. Under these circumstances, the Reserve Bank has kept the cash rate unchanged at 1.5%.

The trade dispute between the US and China waxed and waned through November, causing some volatility in equity markets. By early December, progress had been made on working towards a deal. The Chinese economy is starting to feel the impact of US trade policy, with signs that growth is slowing significantly. The authorities have started taking steps to offset this.

Theresa May managed to agree a Brexit plan with Europe, but now needs to get it through the UK Parliament. It looks like this will be unsuccessful and may even trigger a General Election.

Despite the falls in equities in October and November, we do not believe enough value has been restored to warrant increasing equity weights in the portfolios just yet. We see the main risk to equities coming from the US bond market. We believe the markets are underestimating US growth, inflation and monetary policy tightening. Higher bond yields and US$ will follow from this and drag equity valuations down some more.

Given our caution about the outlook, we will maintain our focus on capital protection through well-diversified portfolios with below average equity allocations and above average allocations to cash, floating rate and short duration fixed income, high-alpha active managers and selected absolute return strategies.