Stonehouse Core Value Portfolio

Monthly Update - October 2017

stonehouse

October Performance Overview

The Stonehouse Core Value Portfolio rose strongly in October (+2.46%), taking the 12 month rolling return to +8.5%, a welcome result for investors. The month saw the Australian share market finish up +4.0% and the MSCI World Index delivered a solid return of +2.7% (in AUD Hedged terms). The Australian Dollar (-2.2%) continued to weaken and Australian bonds were up (+1.1%) during the month.

All equity investments (Australian, International and Regional) produced positive returns. Outstanding performers during the month included Platinum International (+6.9%), Northcape Emerging Markets (+5.7%), Lazard Global Small Caps (+4.1%) and Old Mutual World Equity (+3.2%)[1]. Our Australian Equity managers SGH ICE (+4.1%) and Allan Gray (+3.9%) produced returns in line with the market, while LHC High Conviction (+1.2%) and IML Equity Income's (+0.6%) performance was muted, although still positive. The Japanese equity market continues to go from strength to strength; and outperformed after Prime Minister Abe was re-elected in a decisive victory. Our dedicated exposure via the iShares MSCI Japan High Dividend ETF returned +5.9%[1]; and the portfolio benefited from the Investment Committee's decision to increase exposure to this holding earlier in the year. The additional regional holdings through J O Hambro Asia ex-Japan (+2.6%)[1] and Lansdowne European Equity (+0.9%)[1] also contributed to the portfolio's performance.

The Property and Infrastructure sector also delivered positive returns. The standout performer being Resolution Global Property +3.3% followed by the Australian property manager Cromwell Phoenix (+1.7%) and Lazard Global Listed Infrastructure (+0.8%).

Overall, the Alternative managers made a solid positive contribution to the portfolio's performance. Strong performance came from AQR Managed Futures (+5.5%), JP Morgan Global Macro (+5.4%) and Bennelong Long Short (+5.3%); Invesco GTR recorded a modest positive return (+0.5%) while the Blackrock Absolute Return Fund posted a modest negative return (-0.6%).

Portfolio Summary

Stonehouse Core Value Portfolio	
Unit price	$1.0984

Asset class ranges & current allocations[2]		Current exposure
Cash & Fixed Int.	15% – 60%	26.9%
Property	0% – 25%	4.3%
Equities	25% – 65%	48.1%
Alternatives	5% – 35%	18.4%

Top 10 investment holdings (ex cash)
1. Old Mutual World Equity
2. Macquarie True Index Aus Shares
3. Platinum International Class A
4. Northcape Emerging Markets
5. Wingate Global Equity Income
6. Invesco GTR
7. T Rowe Dynamic Global Bond
8. iShares MSCI Japan High Dividend ETF
9. IML Equity Income
10. CQS Credit Multi Asset Fund

[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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October Performance Overview (continued)

Among Fixed Interest investments the CQS Credit Multi Asset Fund (+0.9%) posted a solid gain as credit continues to perform well. The other Fixed Interest assets recorded small negative returns: Ardea (-0.4%), Payden & Rygel (-0.1%) and T Rowe (-0.1%).

The Investment Committee remains cautious to new investment ideas while ensuring that cash levels are sufficient in order to opportunistically allocate on any future market weakness.

Market Performance and Outlook

Following on the strong September performance, equities around the world recorded sizeable returns in October as investor sentiment remained buoyant. Improving economic conditions, hopes for the passing of tax reform in the US and market friendly commentary by the European Central Bank led to a large “risk on” move. Simmering, high profile political risks – North Korea and Catalonia – failed to hurt investment sentiment.

The MSCI All-Country Equity Index posted a return of +2.6% in local currency terms. The US (S&P 500) rose +2.3% in October, Eurozone equities (MSCI EMU) returned +2.4%, while Japanese equities (Nikkei) and the rest of Asia (MSCI Asia ex Japan) were up +8.1% and +4.2% respectively. After being flat since the start of the year and significantly lagging offshore markets, the Australian share market (S&P 200) delivered a strong return in October (+4.0%). Gains were broad-based with all the major sectors advancing between +2% and +6%.

Broad based commodity indices rose during the month, led by industrial metals (Copper rallied +4.9% and Zinc gained +3.9%) and energy (as Brent crude was up +6.7%); precious metals, however were more subdued, with gold marginally lower for the month.

On the back of continued softness in inflation, bond yields both in the US and Australian fell during the month producing a small positive return. Nonetheless, in the 12 months to October Australian bonds were the worst performing asset class (+1.6%).

Recent economic news continued to paint a picture of the robust global economy with all major economies expanding simultaneously. Based on forward looking economic indicators such as purchasing managers indices (PMIs) risks of recession taking place over the next 12 - 18 months are very low. Yet, signs of inflation are generally absent leading the RBA to revise downward their shorter-term estimates. The bank now expects CPI to average 1.75% both in 2017 and 2018 (the previous forecast was 2%) and 2% in 2019 (previously 2.5%). The upshot of this is that the RBA is unlikely to raise interest rates any time soon.

While global equity valuations remain stretched, especially in the US, global corporate earnings expectations have been upgraded. Coupled with low bond yields this should continue to support equity markets. Nonetheless, in our view, investors would benefit from a selective approach to investing in global equities with Emerging Markets, Japan and Europe offering a more attractive risk/return proposition relative to other markets. With Global Bond markets also continuing to be richly valued, we are looking to source return outcomes from a range of different Asset Classes.