

Monthly Update – October 2018

October Performance Overview

The Stonehouse Core Value Portfolio (CVP) posted a return of -3.34% in October. The month produced the most significant pull-back in global equity markets since 2015 with the MSCI World Index losing (-5.4%) and the Australian Equity Market losing (-6.5%).

Within the domestic equity component of the Portfolio, the largest detractor was the beta exposure held in the Macquarie Australia Shares True Index (-6.2%). The active Australian equity managers all outperformed the market, led by IML Equity Income (-3.6%) and followed by Allan Gray Australian Equity (-5.4%) and SGH ICE (-6.0%).

Performance of the global component of the Portfolio's equity investments saw losses; however the top performing strategy was Lansdowne European Equity* (+1.1%) who managed to post a positive return thanks to low net exposure and an absolute return focus which saw many short positions paying off in the broad-based market sell-off. The worst performer within global equities was Old Mutual World Equity* which returned a disappointing -10.7% but has recovered some of those losses in the first half of November. This was followed by assets including Northcape Emerging Markets (-7.5%) and iShares MSCI Japan High Dividend Yield ETF* (-7.2%) which has been sold down in November. Finally, Wingate Global Equity (-1.9%) provided meaningful downside protection in what was a difficult month for equity managers.

With the increase in volatility for the month the Portfolio's exposure to Alternatives detracted from the portfolio returns. The Ellerston Australian Market Neutral (-2.6%) and the Watermark Australian Market Neutral (-1.6%) provided more subdued negative returns than the market as is expected from their strategies, however it is expected that better returns from the sector as a whole should be coming through in the near to medium term.

Performance of the Property and Infrastructure sector was mixed. The best performing strategy was Lazard Global Infrastructure (+0.2%) who pleasingly posted a positive return while the Resolution Global Property (-7.6%) strategy reversed some of its previous months' strong gains. The remaining manager, Cromwell Phoenix Property Securities (-3.9%) delivered a negative return in line with its respective index.

Performance of the domestic and global bond managers provided a small ballast to the Portfolio. The top performing manager was Ardea Real Outcome (+0.7%) followed by T Rowe Dynamic Global Bond (+0.4%) and YBR Smarter Money Active (+0.2%). Payden & Rygel Global Income Opportunities (-0.1%) and CQS Credit Multi Asset (+0.0%) were flat for the month.

Some regional and sector specific holdings have been redeemed from the Portfolio in the last few months and equities as a whole have been reduced, which has assisted the Portfolio. Following this volatile month, the Investment Committee is continuing to review asset allocations and manager selection to ensure the Portfolio can take advantage of further expected volatility in coming months.

* In local currency terms.

Portfolio Summary

Stonehouse Core Value Portfolio

Unit Price at 31 October 2018 \$1.0723

Asset Class	Asset Class Ranges & Current Allocations ¹	Current Exposure
Cash & Fixed Interest	15% - 60%	33.1%
Property	0% - 25%	4.6%
Equities	25% - 65%	43.5%
Alternatives	5% - 35%	18.8%

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

Market Performance and Outlook

A wide range of issues contributed to the October sell off, including the US/China “trade war”, the Italy/EU budget dispute, slower growth in China and disappointing earnings from some US tech stocks. But the most important cause was higher bond yields in the US on the back of further strong economic data, combined with statements from Fed Chair Powell that the US central bank remains on course to keep tightening monetary policy.

Although the Australian equity market recovered some ground towards the end of the month, the ASX200 still posted its worst monthly return since August 2015. For many equity markets, the losses in October have either wiped out any remaining gains for the year to date, or pushed returns even further into negative territory. This highlights that the volatility seen in February this year was not an isolated event, but rather the first stage of a more protracted correction in markets.

The local economy remains in reasonable shape, with business conditions improving and the unemployment rate falling to 5%. But some key measures of spending are slowing, underemployment remains high and inflation is still just below the Reserve Bank’s target range. In light of this it is not surprising the Reserve Bank has kept the cash rate unchanged at 1.5%. Unlike in the US, there is no pressing need for the Reserve Bank to tighten policy, which implies further weakness in the A\$/US\$ rate is to be expected.

As is often the case after falls like this, some investors see opportunities to buy, while others remain cautious, believing the risks have not yet passed. We are in the latter camp and see further US monetary tightening into 2019 as the biggest ongoing threat to both bond and equity markets. On top of this, there will be risks from the US/China trade dispute, Brexit, the Italy/EU budget dispute and the troubles in Saudi Arabia. The markets are not going to be short of things to worry about.

The developments in October vindicate a focus on capital protection rather than chasing returns. This is reflected in the portfolio return for October, which, although negative, is much better than those for the equity markets and for investment managers running old-style strategic asset allocation portfolios with structurally higher exposures to equities.

