Stonehouse Core Value Portfolio
Monthly Update - October 2013

Performance overview

During October the Stonehouse Core Value Portfolio performed strongly – recording a solid +1.46% performance for the month. The Portfolio's asset allocation has retained its defensive characteristics with holdings in diversified positions being used to counter downside risk in equity exposures in readiness for the inevitable end to recent strong equity market performances.

The shift into emerging markets on an opportunistic basis - when the asset class was sold down aggressively in light of US Federal Reserve tapering fears - paid handsomely with the sector recording a very strong (+4.8% USD) monthly performance. In a similar vein, we are opportunistically looking for other value prospects should they present themselves with the Australian Resources sector presently coming under our spotlight. Each of these new exposures is complemented by an appropriate mix of diversifying positions through exposures to volatility traders, gold bullion and long/short managers aimed at bolstering the capital preservation aspects of the Portfolio.

Our recent review of the fixed income sector saw us begin proceedings to redeem the Portfolio's Macquarie Debt Opportunities 2 position and move in to the Schroders Fixed Income Fund given our more positive outlook for this holding. We also increased the allocation to equities from our cash reserves in favour of Platinum International, the ASX200 ETF and Australian equity high dividend yeild ETF, the while taking profits on smaller active positions that have performed well – notably Allan Gray and Denning Pryce. As mentioned above, this increased equity exposure was in turn followed by an increased allocation to diversifying alternatives – in particular, the Australian long/short manager Bennelong.

Finally, we have also sought to take profits on the hard running property and infrastructure sector within the Portfolio as the scope for further material gains in this segment of the market diminishes. At present we are looking to source a long/short manager for this asset class who has both the mandate and the skill to exploit any downside when this eventually materialises.

Asset class ranges & current allocations[1]	Range	Current exposure
Cash & Fixed Int.	15% – 60%	35.7%
Property	5% – 25%	8.3%
Equities	25% – 65%	36.6%
Alternatives	5% – 35%	19.4%

[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).

Top 10 investment holdings (ex cash)
1. Kapstream Absolute Return Fund
2. Ardea Australian Inflation Linked Bond Fund
3. 36 South Kohinoor Core Fund
4. Bennelong Long Short Equity Fund
5. DFA 5 year Diversified Fixed Interest Trust
6. Payden & Rygel Global Income Opportunities Fund
7. AQR DELTA Fund
8. Vanguard FTSE Emerging Market ETF
9. Platinum International Fund
10. Schroders Fixed Interest Fund

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Market Performance and Outlook

Equity markets continued to rally strongly over the month of October as market sentiment benefitted from the perception that central banks would continue to inject liquidity into the global financial system and a temporary solution was agreed to the government shutdown in the US. Domestic equity markets continued to move mostly in lockstep with their offshore counterparts delivering strong performance over the month.

Longer term we continue to anticipate offshore equity exposures should perform relatively better than domestic equities given that the Australian economy is slowing whilst the US, UK, Japan and even Europe are all in expansion mode (albeit in some instances off a very low base). Consistent with this view – even in light of the changes mentioned above – the Portfolio remains tilted slightly in favour of offshore equities.

The relative underperformance of the Australian economy also has implications for our outlook for the Australian dollar, where we anticipate a further softening from its present levels as we progress into 2014. In the interim, we continue to maintain the bulk of the Portfolio's overseas exposures as 'unhedged' which stands to benefit investors should (as we expect) the $A moves down against its US counterpart over the medium term.

Finally, in terms of our outlook for fixed income markets, we continue to harbour concerns that bonds may not provide the 'safe harbour' capital preservation attributes that they traditionally have in past market downturns. The reason for this is that developed world governments have been issuing considerable amounts of debt since the GFC and the rising yield aspects of this have been somewhat masked by central bank buying via their accommodative monetary policies. Once tapering takes hold, developed world yield curves stand to steepen even further and as a consequence fixed income exposures within the Portfolio remain short duration to minimise the associated downside risk.
