Stonehouse Core Value Portfolio
Monthly Update - October 2014

stonehouse
ASSET MANAGEMENT

Performance overview

The Stonehouse Core Value Portfolio (SCVP) rose +0.48% over the month of October in what proved to be quite a tumultuous period for financial markets. Equity markets sold off heavily during the first two weeks, only to recover most of their ground toward the end of October. Fears of US Federal Reserve tightening, the Ebola outbreak and generalised seasonality / valuation concerns appeared to grip markets early on. These concerns then began to abate almost as quickly as they arose. Our defensive positioning in anticipation of a market sell-off continued to pay off with a considerably smoother performance profile over the month SCVP as compared to most other financial assets.

For the month, positive performances came from our Australian market ETF exposure, the State Street ASX200 ETF (+4.59%) and the UBS Preferred Australian Share ETF (+3.47%), as well as domestic property exposures SG Hiscock Property Income (+6.09%) and Phoenix Property Securities (+4.80%). Importantly our defensive positions also benefitted with volatility traders 36 South (+2.86%) and Triple 333 (+0.34%) both doing well.

Detractions came from our Gold Bullion ETF exposure (-2.42%), Platinum International (-2.84%) and Platinum Japan (-2.68%), as well as another surprising fall in Australian long/short equities manager Bennelong (-4.30%). Note we have since met with Bennelong to discuss this performance and the management strategy – reflecting the SCVP investor's rightful expectation that we keep all underlying asset manager's accountable. The manager has relayed to us that the recent poor performance reflects a rally in expensive / income-oriented Australian stocks more than a failure of their strategy. They are staying 'true to style' in remaining 'value' focused and are positioned to provide downside protection in light of a market correction as expensive stocks (of which the manager is 'short') are likely to fall considerably should the market take a turn for the worse. Based on this we continue to hold this asset manager and will keep a watchful eye moving forward.

We are continuing to deploy our cash reserves (incrementally built up in anticipation of market volatility) in areas where we see value / opportunities we may be able to capitalise on. Key to mandate of the SCVP, we are also constantly monitoring our defensive positions to ensure they are adequately sized to help minimise losses in the event of a market downturn.

Portfolio Summary[1]

	Stonehouse Core Value Portfolio
Unit price	$1.0323

Asset class ranges & current allocations[1]	Range	Current exposure
Cash & Fixed Int.	15% – 60%	32.2%
Property	5% – 25%	6.5%
Equities	25% – 65%	40.4%
Alternatives	5% – 35%	20.7%

0% 20% 40% 60% 80% 100%

Top 10 investment holdings (ex cash)
1. S&P / ASX 200 Accumulation Index ETF
2. 36 South Kohinoor Core Fund
3. Bennelong Long Short Equity Fund
4. Kapstream Absolute Return Fund
5. Ardea Australian Inflation Linked Bond Fund
6. Payden & Rygel Global Income Opportunities Fund
7. Wingate Global Equity Income Fund
8. Platinum International Fund
9. AQR Delta Fund
10. IML Future Leaders Fund

[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).

Market Performance and Outlook

As stated above, October lived up to its reputation of being a volatile month for international financial markets. Why this is so remains a mystery. Some say it has to do with quarter three earnings season in the US being a period where 'negative earnings shocks' are traditionally disclosed, others say it has to do with Northern Hemisphere fund managers coming back on line after their typical August/September holiday period and having a large directional influence on the market. No matter what the cause most market crashes seem to occur in October (October 1907, October 1929, October 1987, October 1997 Asia Crisis, October 2007 China Equity Bubble Crash and Sep/Oct 2008 GFC crash are all cases in point).

In anticipation of this seasonal effect, in addition to our growing concern as to elevated US equity market valuations, we built up cash reserves during August / September and with hindsight this strategy has worked well. The SCVP was insulated from the worst of the market downturn and in addition we were able to start deploying our cash reserves back into the market at new (much more attractive) valuations.

Going forward we are continuing to look for opportunities to put this cash to work and it is interesting that some segments of the market, notably Australian small caps and emerging market equities, haven't recovered to anywhere near the same extent as the major indices. In our opinion, these segments of the market, in addition to some other small pockets of asset classes, still represent considerable value.

Obviously the timing of the first rate hike by the US Federal Reserve is set to preoccupy markets in the near term and this 'hike hysteria', as we have labelled it, is likely to invoke additional volatility (and therefore buying opportunities) over coming months. The US economy continues to go from strength to strength with the recovery now firmly in place. Elsewhere there are concerns about Europe's economic recovery fading and a necessary downgrading of China's growth potential but all up the world economy still looks to be on a much firmer footing today than it was in either 2012 or 2013.

Finally, this improved growth outlook for the US, in addition to the relatively 'soft' growth outlook domestically, is having a telling effect on the relative interest disparity between two countries and therefore on the $A/$US exchange rate. Regular readers will know we have been patiently waiting for the $A to depreciate in value and in October the recent downward trend was extended. Our international holdings within the SCVP remain unhedged and therefore we have received some benefit from the $A's on-going fall.