Stonehouse Core Value Portfolio
Monthly Update - September 2014

Performance overview

The Stonehouse Core Value Portfolio (SCVP) was up +1.43% over the quarter despite a fall of -0.24% over the month of September. The September quarter proved a challenging period for financial markets with equity markets in particular selling off heavily toward the close (e.g. the ASX 200 was down -5.4% through September). Our defensive positioning in anticipation of a market sell-down paid off and indeed continues to do so in light of what appears to be another volatile month to date performance for equity markets in October.

For the quarter, positive performances came from our emerging markets exposure Northcape (+7.35%) and international equities managers Wingate (+5.48%), Platinum International (+3.57%) and Platinum Japan (+5.92%). Importantly our international equities contributed to positive performances over the month of September as well – during a period when most international equities markets began to fall. Trend following manager AQR Managed Futures (+11.61%) made a welcome return into positive territory and represents a key component within our selection of defensive investments in the SCVP that are aimed to preserve capital in the face of a distressed market backdrop – such as that which seems to be presently occurring.

Detractions over the quarter came from international property manager Brookfield (-8.66%), long/short Australian equities manager Bennelong (-2.21%) and international private equity manager Barwon (-2.39%). Interestingly some of our defensive positions – namely volatility traders 36 South Kohinoor (-5.35%) and Triple 333 (-3.44%) – were also detractors for the quarter as the difficult market conditions throughout September were not of a sufficient magnitude for these strategies to begin to generate positive returns. October however, may prove different.

In light of the current market situation, we continue to build our cash reserves (incrementally increased in anticipation of the current market retreat) while at the same time continuously scanning the market to see if there are any distressed selling conditions we can capitalise on. As always, we continue to monitor our defensive positions to ensure they are adequately sized.

Portfolio Summary[1]

	Stonehouse Core Value Portfolio
Unit price	$1.0274

Asset class ranges & current allocations[1]	Range	Current exposure
Cash & Fixed Int.	15% – 60%	33.6%
Property	5% – 25%	6.7%
Equities	25% – 65%	38.0%
Alternatives	5% – 35%	20.9%

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

[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. S&P / ASX 200 Accumulation Index ETF
2. 36 South Kohinoor Core Fund
3. Bennelong Long Short Equity Fund
4. Ardea Australian Inflation Linked Bond Fund
5. Kapstream Absolute Return Fund
6. Payden & Rygel Global Income Opportunities Fund
7. Wingate Global Equity Income Fund
8. Platinum International Fund
9. AQR Delta Fund
10. Vanguard FTSE Emerging Market ETF

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Market Performance and Outlook

The September quarter proved to be one of stark contrast. July and August were relatively upbeat months for markets overall as signs of the US economic recovery became more firmly entrenched. However with this also brought concerns that at some stage the US Federal Reserve would need to move away from its excessively accommodative monetary stance and raise interest rates. It was fears of the latter – what we have labelled as 'hike hysteria' - that sent a shudder through global financial markets over the month of September (and appears to be an on-going phenomenon in October).

Without question, at some point the US Federal Reserve will need to raise interest rates. Many indicators illustrate that the US economy is now in relatively good health and that interest rates will need to rise to provide a sufficient enough buffer to act again on the monetary front when the next crisis eventuates. As markets have had to come to grips with this necessity for interest rate 'normalisation' as it is known, they have also become increasingly volatile. We expect this pattern of heightened volatility to continue.

Interestingly, elsewhere the global economy appears to have softened a little over recent months. Growth concerns have manifested in Europe, China and more recently Japan in light of an array of different factors. For Europe structural rigidities are hindering its economic recovery and are forcing European Central Bank President Mario Draghi's hand to consider another round of quantitative easing. For China it is reform of its banking and property sector that is causing significant frictions in the allocation of resources to the productive sectors of the economy. For Japan it is the disruption to spending plans caused by the imposition of the 1 April Consumption Tax hike that is causing concern. Irrespective of the cause, this obvious disparity between the relative economic fortunes of the US and its major trading partners is creating an enhanced opportunity set for us to seek distressed sellers and to put some of our heightened cash reserves to work.

Finally, the relative disparity between the US interest rate outlook and that of Australia's is having a telling effect on the $A - and developments here too have benefitted the SCVP as well. As we have said many times in the past, a considerable portion of our international holdings within the SCVP remain unhedged and so stand to benefit from the valuation effect associated with a fall in the $A's value. The recent move from the $US0.94 cent range to $US0.86 cents has therefore been a welcome contributor to the performance of the SCVP and here to we are looking to be opportunistic and lock in some portion of the profits once the $A reaches an $0.85 cent level.