

Monthly Update – July 2018

July Performance Overview

The Stonehouse Core Value Portfolio (CVP) returned +0.29% in July. Negative sentiment vied for prime position in global markets through the month but in the end both Australian markets (+1.2%) and the MSCI World Index (+2.5%) posted gains.

The domestic component of the Portfolio's equity investments performed well in July with IML Equity Income (+1.6%) the strongest performer, followed by the beta exposure held in Macquarie Australia Shares True Index (+1.3%) and smaller cap exposure through SGH ICE (+0.6%). The portfolio's Asian specific investments via J O Hambro Asia Ex Japan* (+2.2%) and iShares Japan High Dividend ETF* (+2.0%) rebounded after a difficult period, posting the strongest gains in the international equity component. Performance of other global managers was mixed with positive returns from Old Mutual World Equity* (+1.9%) and Wingate Global Equity (+1.6%). The main detractors were regional specific exposures Lazard Global Small Caps (-0.3%) and Lansdowne European Equity* (-0.2%). Northcape Emerging Markets (+0.5%) continues to invest in pockets of value and celebrated 10 years of best of breed performance.

Alternatives exposures delivered mixed results with Acadian Diversified Alpha (+1.3%) followed by Invesco Global Targeted Returns (+1.0%) contributing to performance. The remaining managers detracted from returns with Bennelong Long Short Equity (-3.6%) the worst performer; however most of that negative performance recovered in the early days of August. Blackrock Absolute Return and JP Morgan Global Macro returned -0.5% and -1.1% respectively.

The Property and Infrastructure sector continues to deliver solid returns with Lazard Global Infrastructure (+2.4%) the best performer followed by Cromwell Phoenix Property Securities (+0.8%) and Resolution Global Property (+0.2%).

Both domestic and global fixed income delivered a positive albeit subdued month of returns, with CQS Multi Asset +0.7% along with T Rowe Dynamic Bond Fund (+0.5%), Payden & Rygel Global Income Opportunities (+0.4%) and Smarter Money Active Cash (+0.3%).

As equity markets continue to reach new highs, interest rate and inflation expectations continue to disturb fixed interest markets and geopolitical tensions add an additional layer of concern. It is increasingly difficult to find areas that present compelling value and the Investment Committee is reviewing asset allocations and manager selection to ensure the Portfolio can take advantage of expected volatility in coming months.

Portfolio Summary

Stonehouse Core Value Portfolio

Unit Price at 31 July 2018 \$1.0981

	Asset Class Ranges & Current Allocations ¹	Current Exposure
Cash & Fixed Interest	15% - 60%	32.1%
Property	0% - 25%	4.7%
Equities	25% - 65%	45.4%
Alternatives	5% - 35%	17.6%

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

Market Performance and Outlook

July was something of a tug of war for financial markets. On the one hand, investors are worried about tariff disputes escalating into trade wars which could undermine global growth. On the other hand, latest data showed the US economy still running very strongly and some good corporate earnings reports. Market sentiment waxed and waned through the month according to how these factors played out but on the whole there was enough good news to see equity markets post gains in July.

Economic data released during the month showed the Australian economy operating at a reasonable pace but still with no signs of emerging inflationary pressures. Growth in the US continued at a strong pace which is adding to pressure for higher inflation over the coming year. The Chinese economy showed signs of slowing which led the authorities to respond with some stimulatory measures. The A\$ traded within a fairly narrow range, around US\$0.74 through the month, and the recent upward momentum of the US dollar was blunted by trade disputes and President Trump criticising the Federal Reserve for lifting interest rates.

Once again, the Reserve Bank of Australia has left the cash rate unchanged at 1.5%. The European Central Bank indicated that it is likely to keep interest rates low until well into 2019. The Bank of Japan also left its cash rate unchanged and announced some measures to enhance the flexibility of how it implements monetary policy. The Bank of England was an exception, lifting its cash rate from 0.5% to 0.75% but at the same time indicating there may not be much more to come.

Our core investment themes of slower global growth and rising US inflation and interest rates are coming to pass and will become clearer as we move into 2019. We still do not believe financial markets have priced how high the US Federal Reserve will lift the cash rate and the impact this will have on bond markets around the world, as well as the US dollar. As bond yields and the US dollar rises further in coming months, expensive equity market valuations will be challenged and the sort of volatility we saw at the start of 2018 will likely return.

Under these conditions it is appropriate to focus on protecting clients' capital rather than just trying to chase returns in increasingly vulnerable markets. Capital protection requires well-diversified portfolios with appropriate management of equity market risks. In the CVP the Investment Committee has acknowledged these concerns in recent times by reducing equity allocations and by increasing allocations to cash and short duration fixed income. Exposure to foreign currencies, and high-alpha active or selected absolute return strategies are also important approaches and well-accepted measures to take in these circumstances.

*In local currency terms.