Australian Income Managed Account Portfolio

Quarterly Performance Update: Q2 2016

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Market Commentary

Resources rebounded, large capitalisation financials languished, and yield remained in fierce demand. In short, the rotation prevalent in the first quarter largely continued in the second. We've managed to perform reasonably well in this environment (more commentary in the next section). Another way to analyse recent trends is to consider that the S&P/ASX 20 has substantially underperformed the S&P/ASX Small Ords thus far in 2016 - by about eleven percentage points (-4% versus +7%). The big four banks were the primary difference as was BHP's relatively tepid response to higher commodity prices. In contrast, many small cap resources companies have doubled or more in a short timeframe.

The bank headwinds we summarised in our last quarterly letter still apply and seem to be slowly gaining steam: "Bad debts have bottomed, provisions are thin, regulatory capital requirements are on the rise, and the residential market is showing signs of age." We can add rising funding costs, as negative comments from credit rating agencies suggest Australia is at risk of a downgrade. This filters down to the perceived credit worthiness of the big four which need attractive wholesale funding rates in order to keep margins high, lending rates to customers reasonable, or both. Bank tailwinds are hard to find these days. As long as they struggle, the larger Aussie equity indexes will too. We have exposure to the banks, but have been underweight for a while and reduced our exposure during the quarter which contributed positively to performance.

How the Portfolio Performed

After fees and before franking credits, the Income Portfolio total return in the quarter was 3.8% compared to 3.9% for the S&P/ASX 200. For the trailing year, our total return was 2.6% compared to a slight gain of 0.6% for the index, outperformance of 2%. More importantly, over the last three years, our 9.2% annualised mark is ahead of the benchmark's 7.7%, and our five-year and since inception returns, both absolute and risk-adjusted, remain attractive. At June month-end, the portfolio's net dividend yield was 4.8%, and gross about 6.1%, representing attractive income in a low return world. Our positions in property, utilities, telecommunications, and Carsales.com have more than offset the drag of banks and BHP. Opportune purchases of Dexus and Vicinity Centres in January when the market swooned ("buy when others are fearful") contributed meaningfully.

More recently, adding Spark Infrastructure Group has contributed to performance despite only being in the portfolio for a short time. Reducing bank exposure in favour of this firm (and others) to diversify our dividend stream is off to a good start. Several other longer-term holdings, such as Scentre Group, Telstra, and BWP Trust, continue to support performance as interest rates head lower, economic uncertainty persists, and attractive yields remain in short supply.

Outlook

The quickest way to fall behind is to become complacent in past success. We constantly challenge our assumptions and positions, looking for threats to future performance. With this in mind, we see a conundrum developing. The quest for yield has been a strong theme for several years, with the price people will pay for reasonably safe companies outpacing their earnings and dividend growth. The emergence of "low volatility" strategies that simply buy stocks whose prices haven't fluctuated much in the past seems like a sure sign that we're closer to the end of this 'safety' theme than the beginning. "Stability breeds instability", as Hyman Minsky, an American economist once said. As this trend persists, the attractiveness of market darlings like property subsides and the potential for them to experience drawdowns (price declines) grows.

But for now, we remain happy with our (thus far) winning 20% property exposure. Finding the next win is a portfolio manager's never-ending task, but so is not selling winners too soon. Studies have shown that investors have a tendency to sell positions after modest gains and hold losers too long, known as the disposition affect in behavioural finance. Realising quick wins at the expense of long-term compounding can be severely detrimental to returns. Valuation-driven investors, as we absolutely are, prefer to sell a year too early than a minute too late, but excessive conservatism can keep investors from reaching their objectives nearly as well as unwarranted risk.

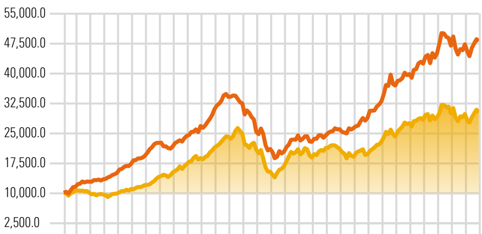
Given still reasonable property dividend yields, a lack of contrarian yield plays (other than those we own), and an interest rate easing bias, property seems like a good place to be for a while longer. As an important aside, we've avoided property companies with material exposure to apartment development in Australia which looks like an accident waiting to happen. Sustainable yield and preserving capital remain etched at the top of our priority list. All else equal, we also aim to keep turnover low and franking credits high, but all else is rarely equal. With the imbalances present in markets globally today, keeping a sceptical eye on valuations is paramount, as there is rarely a consolation prize when overpaying for assets.

Top Holdings

	Weighting %
Telstra Corp Ltd	9.8
Cash Account	9.7
Scentre Group	6.2
Spark New Zealand Ltd	5.2
Wesfarmers Ltd	5.2
Carsales.com Ltd	4.8
Dexus Property Group	4.7
Vicinity Centres	4.5
APA Group	4.3
Platinum Asset Management Ltd	4.2

Investment Growth of $10,000

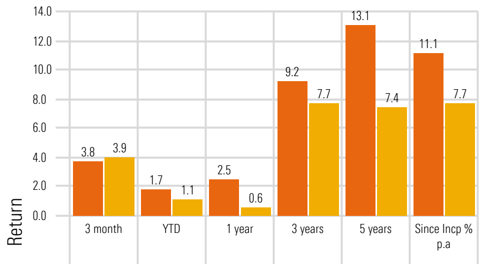
Time Period: 01/08/2001 to 30/06/2016



Australian Income   S&P/ASX 200 TR AUD

Returns Relative to Benchmark

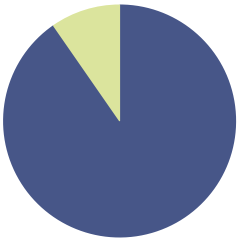
As of Date: 30/06/2016



Australian Income   S&P/ASX 200 TR AUD

Asset Allocation

Portfolio Date: 30/06/2016



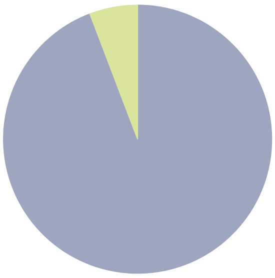
	%
Stock	90.3
Cash	9.7
Total	**100.0**

Transactions in the Quarter

ANZ-AU	Australia & New Zealand Banking Group Ltd	Decreased
BHP-AU	BHP Billiton Limited	Decreased
CBA-AU	Commonwealth Bank of Australia Limited	Decreased
CCL-AU	Coca-Cola Amatil Limited	Added
CYB-AU	Clydesdale	Removed
MYO-AU	MYOB Group Limited	Added
NAB-AU	National Australia Bank Limited	Decreased
PTM-AU	Platinum Asset Management Limited	Increased
SKI-AU	Spark Infrastructure Group Limited	Added
WBC-AU	Westpac Banking Corporation Limited	Decreased

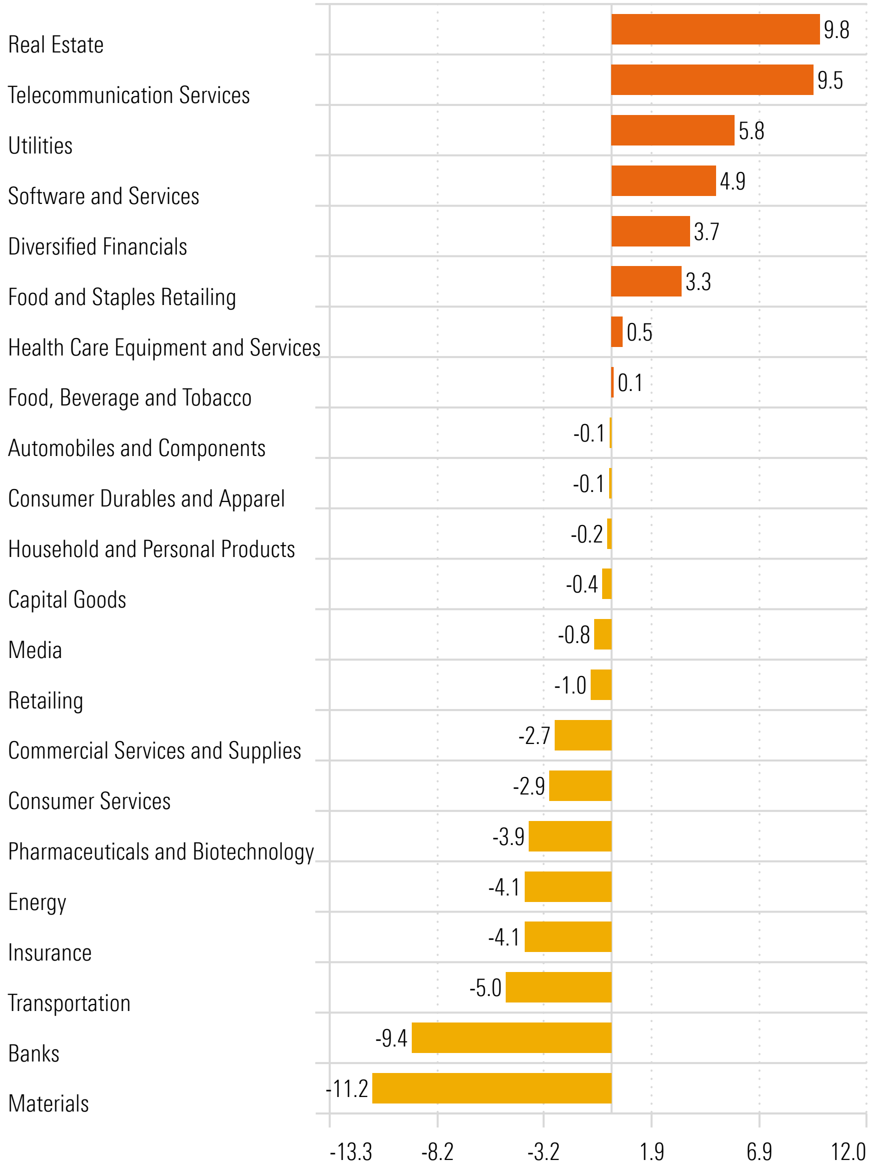
Equity Region Exposure

Portfolio Date: 30/06/2016



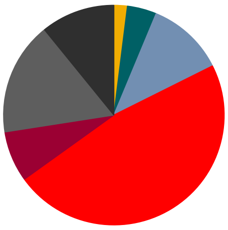
	%
Australia	94.2
New Zealand	5.8
Total	**100.0**

Relative Weights



Equity Sectors (GICS)

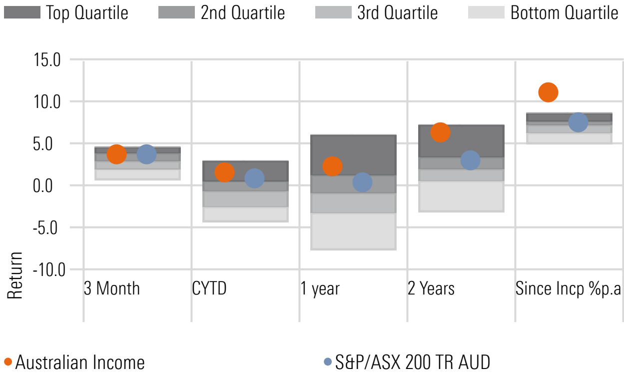
Portfolio Date: 30/06/2016



	%
Materials	2.0
Healthcare	4.3
Consumer Staples	11.3
Financials	47.4
Information Technology	7.5
Telecom Services	16.6
Utilities	10.8
Total	**100.0**

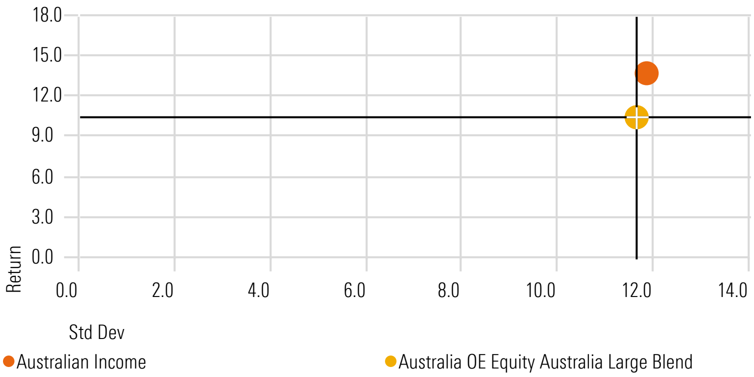
Performance Relative to Peer Group

Peer Group (5-95%): Open End Funds - Australia - Equity Australia Large Blend



Risk-Reward

Time Period: 01/07/2012 to 30/06/2016



Market Performance

Time Period: Since Inception to 30/06/2016

	Inv	Bmk1
Up Period Percent	64.80	62.57
Down Period Percent	35.20	37.43
Best Month	8.47	7.98
Worst Month	-11.51	-12.61
Best Quarter	17.12	21.50
Worst Quarter	-15.78	-18.25

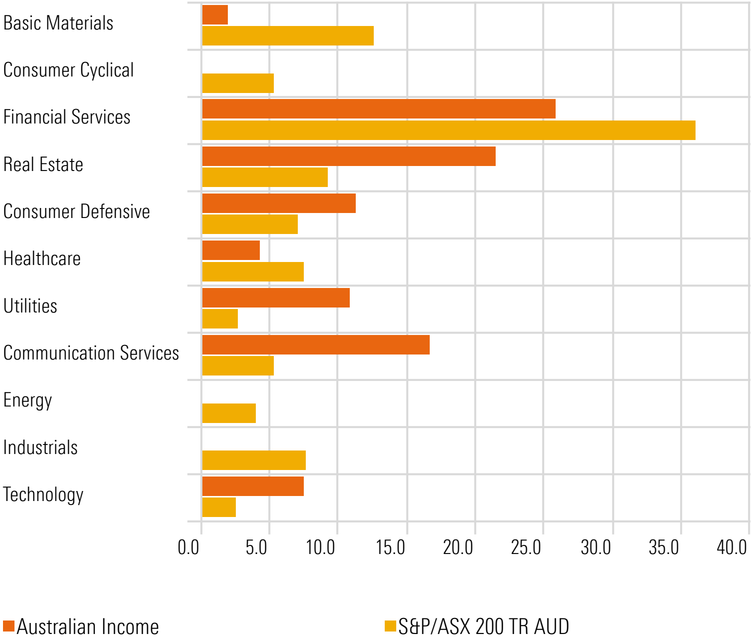
Risk

Time Period: Since Inception to 30/06/2016

	Inv	Bmk1
Return % pa	11.10	7.67
Std Dev	11.65	13.06
Max Drawdown	-46.34	-47.18

Multiple Investment Sector Exposure Chart

Portfolio Date: 30/06/2016



Australian Income - Complete List of Holdings

Portfolio Date: 30/06/2016

Franking (%) (est): 61.9% | Forecast Div Yield (%): 4.8%	Code	Style Box	Total Ret 3 Mo (Qtr-End)	Portfolio Weight %
Telstra Corp Ltd	TLS		4.32	9.8
Cash Account			0.56	9.7
Scentre Group	SCG		10.81	6.2
Spark New Zealand Ltd	SPK		2.43	5.2
Wesfarmers Ltd	WES		-3.26	5.2
Carsales.com Ltd	CAR		4.76	4.8
Dexus Property Group	DXS		16.32	4.7
Vicinity Centres	VCX		6.87	4.5
APA Group	APA		7.43	4.3
Platinum Asset Management Ltd	PTM		-9.29	4.2
BWP Trust	BWP		8.89	4.0
Commonwealth Bank of Australia	CBA		-0.73	4.0
Australia and New Zealand Banking Group Ltd	ANZ		7.69	3.9
Sonic Healthcare Ltd	SHL		14.75	3.9
AMP Ltd	AMP		-10.88	3.9
Westpac Banking Corp	WBC		1.29	3.7
National Australia Bank Ltd	NAB		2.30	3.7
Spark Infrastructure Group	SKI		17.87	3.5
Woolworths Ltd	WOW		-5.48	3.2
AGL Energy Ltd	AGL		4.84	2.0
MYOB Group Ltd	MYO		5.50	2.0
Coca-Cola Amatil Ltd	CCL		-6.90	1.9
BHP Billiton Ltd	BHP		10.62	1.8

Glossary of Terms

Term	Description
Active Return	A performance measure of a portfolio relative to its benchmark.
Allocation Effect	Refers to the portion of an investment manager’s value-add attributable to the manager's decision on how much to allocate to each market sector, in other words, a manager’s decision to overweight and underweight certain sectors compared with the benchmark.
Alpha	A measure of the difference between a portfolio’s actual returns and its expected performance, given its level of risk as measured by beta.
Average Market Cap (mil)	Average Market Cap (mil) This is an estimation of the value of a business that is obtained by multiplying the number of shares outstanding by the current price of a share.
Best Month	The highest monthly return of the investment since its inception or for as long as Morningstar has data available.
Best Quarter	The highest quarterly (3-month) return of the investment since its inception or for as long as Morningstar has data available.
Beta	A measure of systematic risk with respect to a benchmark. Systematic risk is the tendency of the value of the fund and the value of benchmark to move together. Beta measures the sensitivity of the fund’s excess return (total return minus the risk-free return) with respect to the benchmark’s excess return that results from their systematic co-movement.
Debt to Capital % (TTM)	A ratio measuring a firm's financial leverage. This ratio is calculated by dividing long-term debt (excluding other liabilities) by total capitalisation (the sum of common equity plus preferred equity plus long-term debt).
Down Capture Ratio	Downside Capture Ratio measures manager's performance in down markets. A down-market is defined as those periods (months or quarters) in which market return is less than 0. In essence, it tells you what percentage of the down-market was captured by the manager. For example, if the ratio is 110%, the manager has captured 110% of the down-market and therefore underperformed the market on the downside.
Down Period Percent	Number of months below 0 divided by the total number of months.
Downside Deviation	This measures only deviations below a specified benchmark.
Moat Company Pct	Percentage of the portfolio, by market value, having a narrow or wide moat.
P/E Ratio (TTM)	A measure of value. It is the average price divided by latest earnings.
Portfolio Price/Fair Value	Ratio of the portfolio's market value to the fair value of the portfolio.
R2	Reflects the percentage of a portfolio's movements that can be explained by movements in its benchmark.
ROA % (TTM)	Return on assets (ROA) measures a firm's performance in using assets to generate earnings independent of how the firm financed acquisition of those assets.
ROE % (TTM)	Return on equity (ROE) is the percentage a company earns on its total equity in a given year. ROE shows how much profit a company generates on the money shareholders have invested in the firm.
Selection Effect	Represents the portion of performance attributable to the manager’s stock picking ability.
Sharpe Ratio (arith)	Is calculated using standard deviation and excess return to determine reward per unit of risk. The higher the Sharpe Ratio, the better the fund's historical risk-adjusted performance.
Std Dev	A statistical measurement of dispersion about an average, which, for a mutual fund, depicts how widely the returns varied over a certain period of time. Investors use the standard deviation of historical performance to try to predict the range of returns that are most likely for a given fund.
Tracking Error	A measure of the volatility of excess returns relative to a benchmark.
Turnover (2 Yr Avg)	Measures the portfolio manager’s trading activity by taking the lesser of purchases or sales (excluding all securities with maturities of less than one year) and dividing by average monthly net assets.
Up Capture Ratio	Upside Capture Ratio measures a manager's performance in up markets relative to the market (benchmark) itself. It is calculated by taking the security’s upside capture return and dividing it by the benchmark’s upside capture return.
Up Period Percent	Number of months above 0 divided by the total number of months.
Worst Month	The lowest monthly return of the investment since its inception or for as long as Morningstar has data available.
Worst Quarter	The lowest quarterly (3-month) return of the investment since its inception or for as long as Morningstar has data available.