

Australian Shares Small Cap Managed Account Portfolio

Q4 2016

Quarterly Performance Update

All data and information as at Portfolio Date: 31/12/2016

Top Holdings

	Weighting %
Cash Account	9.3
iSentia Group Ltd	6.3
Tox Free Solutions Ltd	5.7
Ainsworth Game Technology Ltd	5.2
Nine Entertainment Co. Holdings Ltd	5.2
MYOB Group Ltd	5.2
Virtus Health Ltd	5.0
Platinum Asset Management Ltd	4.7
Hotel Property Investments	4.0
Chorus Ltd	4.0

Market Commentary

A wild year it was. Markets started 2016 with fear, exited with euphoria, and along the way it seemed like the unthinkable became the norm. A renaissance in most commodity prices helped drive a 43% rise in the basic materials sector, partly lifted by China's credit-fuelled economic growth - central planning allows imbalances to persist longer than economics and history predict. And then of course, there was politics. The UK voted to walk alone and Hillary - the candidate that couldn't lose - lost, so Donald "Tweeter" Trump will be sworn into office soon.

How has our investment process changed to accommodate these historic events? If there was a year to test resolve and make one question previously held truths, 2016 was it. But we haven't altered our approach. That's not to say the status quo shouldn't be challenged at times. Expanding economic inequality and self-serving politicians deserve renewed scrutiny. To remain relevant, businesses must innovate to varying degrees or risk losing to competition. But intrinsic-value investing, buying pieces of cash flow streams at a discount and holding them for the long-term should be an immutable investing truth through the unexpected. While there's no guarantee that our strategy will be successful every year, we believe it to be the most rational and consistent approach to deliver long term results. The challenge when uncertainty hits is to not be drawn into newly crafted caveats or "this time is different" thinking.

How the Portfolio Performed

After fees and before franking credits, the Small Cap Portfolio total return for the year was 8.5% (including 4.6% in income) compared to 13.2% for the S&P/ASX Small Ords. NIB Holdings, Beach Energy, and Mount Gibson were noteworthy contributors, while Platinum Asset Management, OFX, and Flexigroup detracted. Over the last three years, our 15.7% annualised mark is ahead of the benchmark's 6.2%, and over five years we've generated 18% annually versus the benchmark's 4.9%. At December month-end, the portfolio's net dividend yield was 4.8% and gross about 5.9%.

It's worth repeating part of our third quarter commentary. Investment strategies perform better or worse in different market environments and are highly dependent on the process followed and expertise applied. Honest and self-aware portfolio managers can readily describe markets where they tend to excel and those they tend to lag. Strong capital appreciation derived disproportionately from the materials sector (low quality, high uncertainty) is not a sweet spot for this strategy, but we've managed to perform well through the cycle.

Positioning

Over the course of 2016, we reduced the portfolio's exposure to companies that have benefitted greatly from falling interest rates and sold several others that had appreciated beyond reasonable valuations. This includes reducing basic materials, property, and telecommunications, realising gains on companies like Chorus, Mount Gibson, NIB Holdings, Pact Holdings, Trade Me, and Veda Group. We shifted this capital to consumer, industrials, technology, and others, such as new positions in Air New Zealand, GUD Holdings, iSentia, Myer, Nine Entertainment, Spotless Group, Tox Free, and Xero.

The portfolio's current profile aligns well with our primary objective - attractive total expected returns, using our analysts' estimates. We've adjusted investments to protect against the possibility that a strong tailwind is starting to turn, such as interest rates. As for other simmering threats to healthy markets, our expectation is that concentrating in above average quality businesses across sectors at reasonable prices will help us produce attractive performance through the cycle.

In 2016, we initiated on ten positions and exited eight bringing the net total number of stocks to 24. As a reminder, the Small Cap Portfolio targets between 15 and 30 positions so we're at the upper end of the range but still much more concentrated than most Australian equity strategies. We don't see much value in having a long tail of low conviction positions in this strategy. If market prices offer opportunities on exceptional businesses, we'll happily re-concentrate our investments in the future.

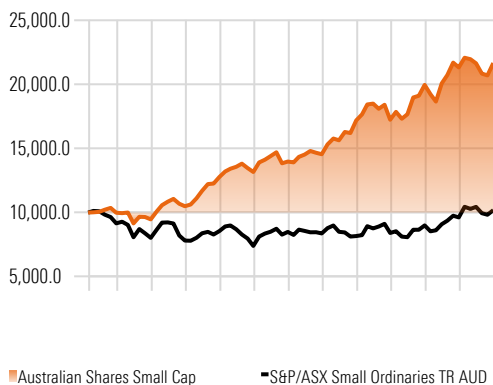
Portfolio turnover has increased due to market volatility and our desire to adjust the portfolio's composition as described. Turnover should moderate, with the obvious caveat that we're always looking for opportunity. Long-term valuation-driven investors like ourselves welcome market volatility as it often generates mispricing - a key ingredient for future performance. Nonetheless, our multi-year portfolio churn remains below industry averages, and we prefer it that way. We like our current positioning - company valuations in the portfolio are reasonable overall, and we have a nice spread of earnings generated by a variety of sectors.

Outlook

We prefer to assess the merit of individual businesses rather than speculate on the macro. But given historically subdued interest rates and inflation, and their impact on market prices, a view seems necessary. Our belief is they'll normalise to long-term averages, eventually. If nothing else, this outlook is supported by the unjustifiable market prices for interest-rate sensitive companies that have appreciated beyond what cash flows can support. When rates will fully normalise or exactly what that path will be is unknowable with any precision. We simply have conviction that the next five years are likely to be less favourable to the valuation of "yield trade" securities. This area has generated noteworthy returns for us over the last few years, but that opportunity has likely passed.

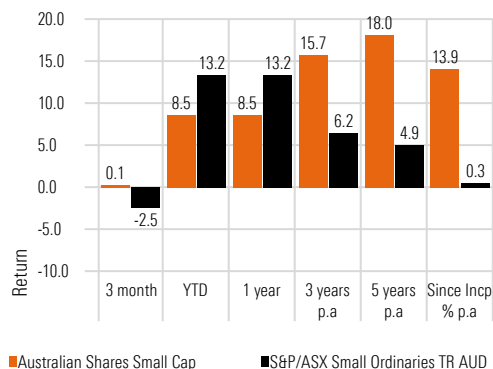
Investment Growth of \$10,000

Time Period: 01/02/2011 to 31/12/2016



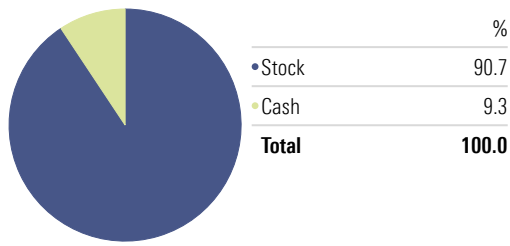
Returns Relative to Benchmark

As of Date: 31/12/2016



Asset Allocation

Portfolio Date: 31/12/2016

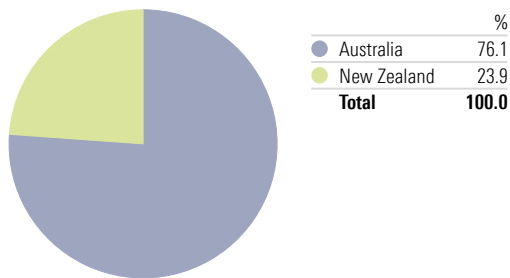


Transactions in the Quarter

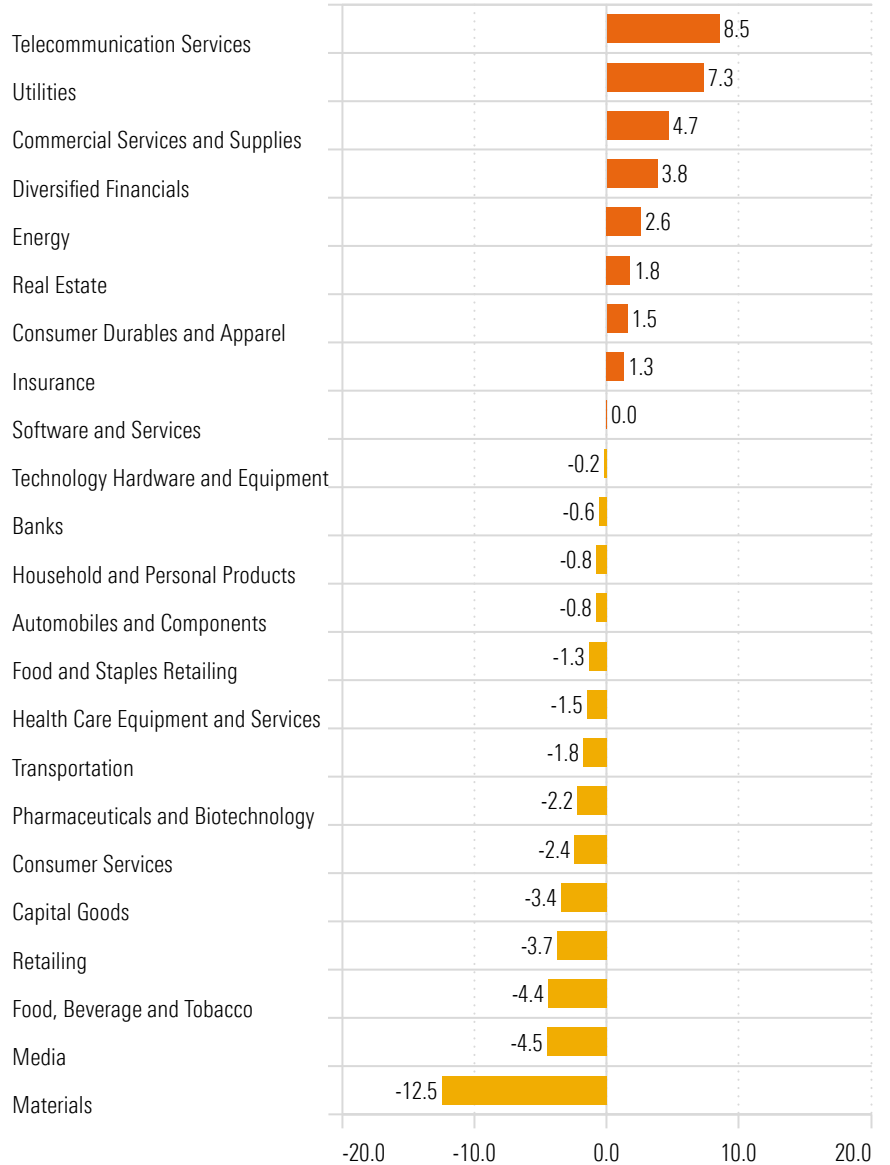
AIZ-AU	Air New Zealand Limited	Add
MYR-AU	Myer Holdings Limited	Add
NEC-AU	Nine Entertainment Co. Holdings	Add
XRO-AU	Xero Limited	Add
ISD-AU	Isentia Group Limited	Increase
MCY-AU	Mercury NZ Limited	Increase
VRT-AU	Virtus Health Limited	Increase
CNU-AU	Chorus Limited	Decrease
GNE-AU	Genesis Energy Limited	Decrease
HPI-AU	Hotel Property Investments Limited	Decrease
BPT-AU	Beach Energy Limited	Remove
MGX-AU	Mount Gibson Iron Limited	Remove
NHF-AU	NIB Holdings Limited	Remove
PGH-AU	Pact Group Holdings Limited	Remove

Equity Region Exposure

Portfolio Date: 31/12/2016

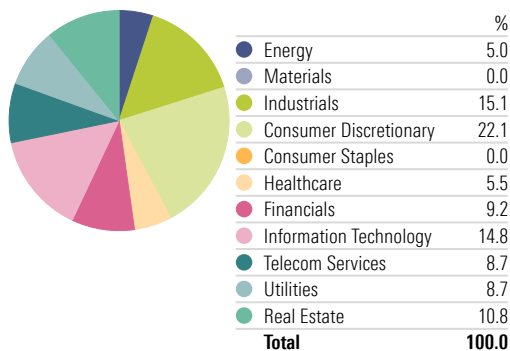


Average Relative Weights over the Quarter



Equity Sectors (GICS)

Portfolio Date: 31/12/2016



Performance Relative to Peer Group

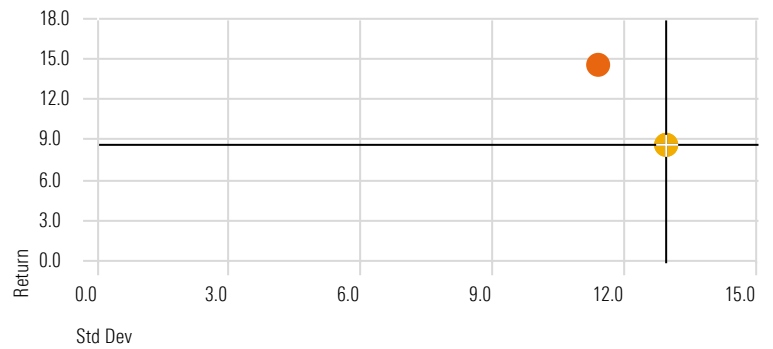
Peer Group (5-95%): Open End Funds - Australia - Equity Australia Mid/Small Blend



• Australian Shares Small Cap • S&P/ASX Small Ordinaries TR AUD

Risk-Reward

Time Period: 01/02/2011 to 30/09/2016



• Australian Shares Small Cap • Australia Fund Equity Australia Mid/Small Blend

Market Performance

Time Period: Since Inception to 31/12/2016

	Inv	Bmk1
Up Period Percent	64.79	52.11
Down Period Percent	35.21	47.89
Best Month	7.58	9.81
Worst Month	-8.47	-10.61
Best Quarter	14.56	14.98
Worst Quarter	-8.30	-15.30

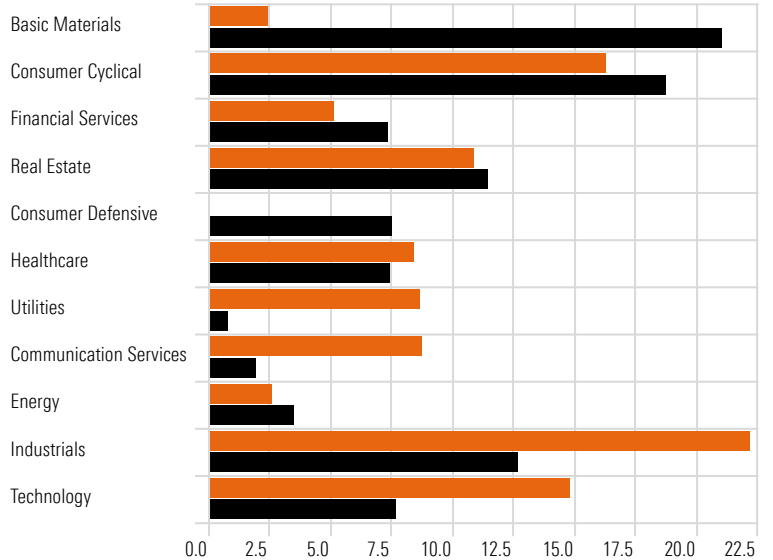
Risk

Time Period: Since Inception to 31/12/2016

	Inv	Bmk1
Return % pa	13.93	0.31
Std Dev	11.45	15.17
Max Drawdown	-11.63	-26.88

Multiple Investment Sector Exposure Chart

Portfolio Date: 31/12/2016



■ Australian Shares Small Cap ■ S&P/ASX Small Ordinaries TR AUD

Australian Shares Small Cap - Complete List of Holdings

Portfolio Date: 31/12/2016

	Code	Style Box	Total Ret 3 Mo (Qtr-End)	Portfolio Weight %
Cash Account			0.44	9.3
iSentia Group Ltd	ISD	■	-25.07	6.3
Tox Free Solutions Ltd	TOX	■	14.89	5.7
Ainsworth Game Technology Ltd	AGI	■	-6.22	5.2
Nine Entertainment Co. Holdings Ltd	NEC	■	0.95	5.2
MYOB Group Ltd	MYO	■	-0.40	5.2
Virtus Health Ltd	VRT	■	-18.96	5.0
Platinum Asset Management Ltd	PTM	■	4.97	4.7
Hotel Property Investments	HPI	■	2.07	4.0
Chorus Ltd	CNU	■	2.68	4.0
Spotless Group Holdings Ltd	SPO	■	-7.48	4.0
Genesis Energy Ltd	GNE	■	-1.46	3.9
Air New Zealand Ltd	AIZ	■	18.31	3.9
Mercury NZ Ltd	MCY	■	-2.05	3.9
Spark New Zealand Ltd	SPK	■	-4.36	3.9
ALE Property Group	LEP	■	-0.43	3.7
OFX Group Ltd	OFX	■	-9.47	3.7
GUD Holdings Ltd	GUD	■	-0.57	2.7
Myer Holdings Ltd	MYR	■	18.45	2.7
Greencross Ltd	GXL	■	6.52	2.6
AWE Ltd	AWE	■	0.00	2.4
New Hope Corp Ltd	NHC	■	-4.34	2.2
Folkestone Education Trust	FET	■	-1.32	2.0
Xero Ltd	XRO	■	-8.35	2.0
Automotive Holdings Group Ltd	AHG	■	-7.71	1.7

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.

Morningstar's Investment Principles



We put investors first. We believe the firms that put investors first win in the long term because their investors win.

Since 1984, Morningstar, Inc. has been helping investors reach their financial goals. Our fiduciary duty to our principals is paramount.



We're independent-minded. To deliver results, we think it's necessary to invest with conviction, even when it means standing apart from the crowd.

Our research shows that making decisions based on fundamental analysis, rather than short-term factors and sentiment, delivers better long-term investment results.



We invest for the long term. Taking a patient, long-term view helps people ride out the market's ups and downs and take advantage of opportunities when they arise.

Investing with a multi decade horizon aligns with investors focus on increasing their purchasing power over their lifetimes.

The long term is the only period where fundamental, valuation driven investing works.



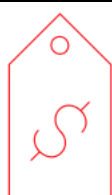
We're valuation-driven investors. Anchoring decisions to an investment's fair value—or what it's really worth—can lead to greater potential for returns.

Valuation-driven investing through a long-term focus on the difference between price and intrinsic value enables investors to get more than they're paying for.



We take a fundamental approach. Powerful research is behind each decision we hold, and we understand what drives each investment we analyse.

Fundamental investing incorporates a focus on the future earnings of an investment and not its prospective price change.



We strive to minimise costs. Controlling costs helps investors build wealth by keeping more of what they earn.

Investment returns are uncertain, but costs are not.

Lower costs allow investors to keep more of their returns.



We build portfolios holistically. To help manage risk and deliver better returns, truly diversified portfolios combine investments with different underlying drivers.

Portfolios should be more than the sum of their parts.

True diversification can have a powerful impact on a portfolio's risk-adjusted returns – but simply holding more investments isn't the same as true diversification.