Morningstar International Shares (Hedged) Fund

Quarterly Performance Update

Q42016

All data and information as of December 31, 2016

APIR Code (Class A)	INT0050AU
Inception	07 Jul 2000
Size $m	270.1
Unit Pricing	Daily
Distributions	Quarterly
Management Fee	Up to 0.56%
Buy/Sell Spread	0.12% / 0.12%
Minimum Investment	$20,000

Investment Objective

Aims to deliver a superior risk-return profile to the performance benchmark (MSCI All Country World exAustralia Index with Net Dividends Reinvested (A$ Hedged)) over rolling seven year periods by investing predominantly in listed international shares, supplemented by a passive currency overlay.

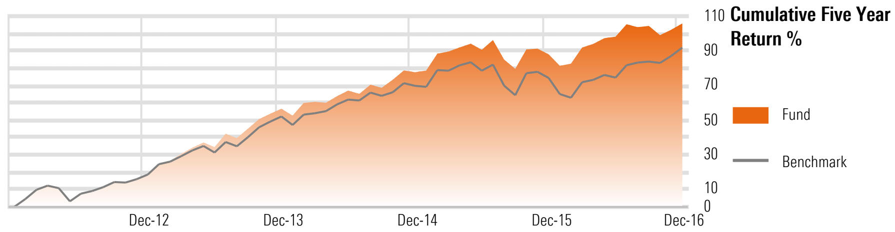
Investment Strategy

The Fund invests in listed international shares across developed and emerging markets and aims to deliver a superior risk-return profile to that of the performance benchmark. To achieve this aim, the Fund invests in an international equity strategy that is non-market cap weighted, incurs low turnover, and targets companies that exhibit desirable fundamental quality, value, and liquidity characteristics.

Key Features

Exposure to a diversified portfolio of international shares, provided at a low cost.

Performance [1]



Total Return %	3 Months	6 Months	1 Year	3 Years (pa)	5 Years (pa)
Fund (Net of Fees)	0.68	3.83	9.46	9.54	15.53
Benchmark	4.39	9.92	10.03	8.03	13.92
Active Return	-3.70	-6.09	-0.57	+1.50	+1.61

Portfolio Analysis [2]

Sector Allocations	%
Information Technology	19.8
Consumer Discretionary	18.3
Consumer Staples	15.2
Healthcare	14.9
Industrials	14.6
Telecommunication Services	4.6
Materials	4.1
Financials	3.8
Energy	2.2
Utilities	1.9
Cash	0.6

Regional Allocations	%
North America	54.6
Japan	13.9
Europe ex-UK	13.5
Emerging Markets	10.3
UK	4.7
Pacific ex-Japan	2.3
Cash	0.6

Top 10 Portfolio Holdings	%
Samsung Electronics	1.1
General Dynamics	1.1
Microsoft	1.0
Quest Diagnostics	1.0
Compagnie Financiere	1.0
Cisco Systems	1.0
Raytheon	1.0
NTT DoCoMo	0.9
Sysco	0.9
Philip Morris International	0.9

Notes

1. Performance measures are expressed after fees, costs and before taxes. Performance may not sum due to the rounding of individual components.
2. Allocations may not add up to 100% due to the rounding of individual components.
3. The Management fee is inclusive of GST (after taking into account Reduced Input Tax Credits) and can be negotiated for direct investors. Refer to the current disclosure document for more information on fees and costs.
4. Please refer to the Product Disclosure Statement on the Morningstar website for more information on how to apply.

How the portfolio performed

As the harsh shock of Brexit subsided, many investors were surprised with the outcome of the US election. In the weeks that followed the election, the narrative on market outcomes changed. Gone were the dire implications of Trump's protectionist views and polarizing opinions. These were stealthy replaced with the positive, inflationary outlook for the US economy following Trump's willingness to reduce corporate and income taxes, increase infrastructure spend and prevent further leakage of US jobs to other markets. That markets bought this narrative, Financial stocks rallied and more defensive sectors like Health Care, Consumer Staples and Property lagged. Despite the strategy being susceptible to these changing dynamics it still managed to generate 4.1% over the quarter underperforming the benchmark by 6.1%. Over the course of CY2016, the strategy generated 10.1%, slightly underperforming the underlying benchmark by 0.3%. Pleasingly, since inception in June 2013, the strategy has outperformed the benchmark by 1.7% p.a. after fees.

Looking at the strategy's performance over CY2016, we were pleased by the performance of Clarcor (+69.5%). Clarcor's filtration products are often concealed in our air conditioning, water filters or automobile engines. While something as innocuous as a filter manufacturer may be unexciting when compared to most other companies, we are attracted to its excellent fundamentals. The company has an uncanny ability to maintain its operating margins, return cash to shareholders through dividend payments and share buybacks. In recent times, the company has begun to pay down debt from already manageable levels. Sadly, the fund's direct exposure to this quality stock will soon be reduced, as Parker Hannifin (another holding of this strategy), entered into a definitive agreement to acquire all outstanding shares of Clarcor for USD83 each. The transaction has been unanimously approved by the board of both companies.

Parker Hannifin (+47.3%) is a global leader in the manufacturing of thousands of individual industrial parts required for motion, flow and process control. The diverse offering of high quality, precision end-to-end solutions greatly reduces the likelihood of customers switching to a competitor. Parker's store network is also a credible competitive edge that few competitors can match. Like Clarcor, Parker Hannifin (Parker) displays good control of operating margins, comfortably meets interest charges and still manages to pay dividends and buy back shares. It is for these reasons that the strategy has exposure to the company.

One stock that disappointed us this year was the UK's Capita (-61.5%). While the fund's exposure was small (0.08%), any loss of capital warrants further investigation. Capita offers outsourcing solutions to the UK public and private sector. As part of its offering, the company uses technology to streamline clients' business processes. The company has recently been plagued by underperforming operating units. Management is in the process of taking countermeasures to bring the company back to long-term sustainable profitability growth. Despite the difficulties facing Capita over the course of last year, it still managed to pay dividends and reduce debt. Going forward we will pay careful attention to the attempts to repair margins and continue reducing debt.

The portfolio retains its large exposure to US and Japanese listed multinational companies. We believe the portfolio's focus on quality and reasonable valuations, along with holistic diversification, will continue to deliver substantial reward for risk outcomes for investors over the long term.

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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.