CBG ASSET MANAGEMENT

Sky News Business
GOLDEN CALF
AWARD 2013
Best Boutique Australian Equities Manager

THE AUSTRALIAN FUND MANAGER AWARDS

CBG Australian Equities Fund – May 2016

The CBG Australian Equities Fund returned +4.2% in May, outperforming the S&P/ASX200 Accumulation Index return of +3.1%.

For the financial year to date the Fund returned 6.7%, ahead the index return of 3.1%, while over 3 years the fund has returned 10.2% per annum, compared to the index return of 7.7% per annum.

Australia outperformed most global equities markets in the month, assisted by a 25bp cut in the RBA cash rate to 1.75%. This followed a negative quarterly CPI release of -0.2% in April, which brought year rolling headline inflation down to 1.3%.

The S&P 500 gained 1.5% in the month, while the Shanghai Composite returned -0.7%, the Nikkei rose 3.4%, the German Dax gained 2.2%, the FTSE returned -0.3% and the NZ50 gained 3.2%.

Across the Australian market, the strongest performing sectors were Diversified Financials (+12.1%), Health Care (+9.5%) and Information Technology (+6.5%), while Resources (-5.3%), Consumer Staples (-0.9%) and Industrials (+2.4%) lagged the market.

Performance (to 31 May 2016)

Fund Objective:
To outperform the S&P/ASX200 Accumulation Index over a rolling five-year period before fees, taxes and expenses.

	Fund %	Benchmark %*	Excess
1 Month net	**4.2%**	3.1%	**+1.1%**
6 Months net	**-0.8%**	6.5%	**-7.3%**
1 Year net	**-0.7%**	-2.4%	**+1.7%**
3 Years net annualised	**10.2%**	7.7%	**+2.5%**
5 Years net annualised	**8.3%**	7.5%	**+0.8%**
Since inception net annualised **	**6.5%**	5.2%	**+1.3%**
Since inception net total return **	**90.1%**	67.6%	**+22.5%**

Note: Fund performance is post fees.
** S&P/ASX 200 Accumulation Index*
*** Inception date 27 March 2006*

Fund Commentary

Stocks which produced notable positive returns in the month included CYBG PLC (CYB, 0.7% weight), the demerged Clydesdale and Yorkshire bank, which returned 35.1% following a strong first result post separation from NAB. Headline net profit was impacted by one-off factors, but the company reported a 2% reduction in underlying operating expenses and indicated that full year costs would be 4% below the previous guidance. Cost management is central to the CYBG turnaround strategy as the company aims to reduce its cost to income ratio from 75% to below 60%. Management is set to provide further guidance on the cost outlook at a strategy update in September.

Magellan Financial Group (MFG, 3.9% weight) returned 14.8% in the month, assisted by positive equity market returns and a 4.9% depreciation of the AUDUSD. During the month, MFG reported inflows of $487m for April. Over the past 12 months, the business has recorded inflows equivalent to 11% of funds under management, including higher margin retail inflows equivalent to 22% of retail funds under management.

Class (CL1, 0.9% weight) returned 14.4% in the month. Class is Australia's leading provider of cloud based self-managed super fund (SMSF) administration software. During the month, the company announced a contract win with Findex, which is CL1's largest contract to date and is expected to see over 8,000 SMSFs loaded onto Class over the next couple of years.

Stocks which detracted from performance in the month included Speedcast (SDA, 1.1% weight), which returned -13.3% following AGM commentary on headwinds in the oil and gas sector and weak earnings results from peers with greater exposure to this sector. SDA reported several contract wins during the month and continues to target double digit organic earnings growth with upside from acquisitions.

IOOF Holdings (IFL, 2.1% weight) returned -7.7% after providing net profit guidance for the 2016 financial year which implied a second half result 7% below consensus. The softer result was attributed to a lower average level of equity markets in the current half year. Net profit for the full year is expected to be broadly in line with the prior year.

Top Ten Holdings (as at 31 May 2016)

	ASX Code	Stock Name	Weighting	
			Fund %	ASX 200%
1	CBA	COMMONWEALTH BANK OF AUSTRALIA	10.5%	9.4%
2	WBC	WESTPAC BANKING CORPORATION	7.7%	7.3%
3	MQA	MACQUARIE ATLAS ROADS GROUP	5.8%	0.2%
4	TCL	TRANSURBAN GROUP	5.6%	1.7%
5	ANZ	ANZ BANKING GROUP	5.1%	5.3%
6	HGG	HENDERSON GROUP	4.7%	0.2%
7	MFG	MAGELLAN FINANCIAL GROUP	3.9%	0.2%
8	NAB	NATIONAL AUSTRALIA BANK	3.9%	5.1%
9	SYD	SYDNEY AIRPORT	3.5%	1.1%
10	AIA	AUCKLAND INTERNATIONAL AIRPORT	3.5%	-

Market commentary

On the 3rd of May, the RBA reduced the official cash rate by 25bp to a new record low of 1.75%, noting that "this follows information showing inflationary pressures are lower than expected". The RBA targets an inflation rate of 2-3%, on average, over the cycle. In the May Statement on Monetary Policy, the RBA indicated that its current forecast is for underlying inflation of around 1-2% this calendar year, picking up to 1.5-2.5% by 2018. With inflation running below the target range, this provided a strong argument to reduce the cash rate. It has been historically rare, although not unheard of, for the RBA to move by only 25bp in isolation, with this occurring a total of 3 times in the past 20 years. Consequently, markets are currently anticipating a further interest rate cut post the next CPI release at the end of July, while this probability was reduced post a strong GDP release in early June.

Three of the four major Australian banks reported earnings for the half year to 31 March during the month (Commonwealth Bank reported in February). The sector outperformed the market, returning 4.7%, despite ANZ rebasing its dividend lower (by -7%) as it targets a long term sustainable payout ratio of 60-65%. Westpac increased its dividend by 1cps compared to the first half of last year, while Commonwealth Bank and National Australia Bank held their dividends flat. Commonwealth Bank and Westpac have been the best placed in relation to dividend sustainability, given higher returns on capital, while Commonwealth Bank is also running at a lower payout ratio. National Australia Bank remains at risk for a reduction to its dividend. Net profit growth for the sector was a modest 1.4%, while earnings per share declined by -3.6% given equity raisings over the past 12 months. The market reacted positively given that bad debt charges were no worse than expected. In particular, ANZ's charge came in at the low end of company guidance and WBC guided to the charge being lower in the next half.

The federal budget for the 2016-17 financial year was handed down during the month, which included tax relief for small businesses, namely an increase to the small business tax discount from 1.5% vs 2.5% and an allowance for up to a $20k asset write-off for new investment. The government also increased the $80k marginal tax threshold to $87k to offset bracket creep for wage earners. The budget saw modest slippage in deficit estimates, which was driven by downward revisions to forecast receipts. The 2016-17 forecast budget deficit is $37.1bn or 2.2% of GDP.

Domestic economic data was generally positive in May, with residential building approvals rising 3.0% on the prior month to a 243k annual rate and capital city dwelling prices gaining 1.7%. The unemployment rate held steady at 5.7% and the NAB survey of business conditions remained relatively strong at +9.2. Conversely, the wage price index increased by only 2.1% over the past twelve months.

Ronni Chalmers
Chief Investment Officer

Responsible Entity Equity Trustees ABN 46 004 031 298 AFSL 240975
Investment Manager CBG Asset Management Limited ABN 12 098 327 809 AFSL 246790
Level 3, 8-10 Loftus St Sydney NSW 2000
Tel: 61 2 8599 1160 Web: www.cbgam.com.au Email: enquiries@cbgam.com.au