CBG ASSET MANAGEMENT

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CBG Australian Equities Fund – December 2016

The CBG Australian Equities Fund returned 2.0% in December, compared with the S&P/ASX200 Accumulation Index return of 4.4%.

For the financial year to date, the fund has returned 3.4%, compared to the index return of 10.6% per annum.

The underperformance of the fund in 2016 relative to the broader market largely reflected the rally in resources, in which the fund is underweight, combined with the impact of the unexpected Brexit vote on our holdings in the funds management space. The year also saw a strong rotation into value type stocks, whereas the fund maintains a quality, growth focus. The fund benefited from an underweight position in the resources sector from late 2011 through to the end of 2015, which has been driven by our concerns around the growth in supply and macro uncertainty in regards to Chinese demand. However, the sector rallied strongly in 2016. Resources account for 20.4% of the weight of the ASX 200 and returned 42.4% for the calendar year.

While we have not changed the investment process or philosophy, as we head into 2017 we note that 19 of the 47 holdings currently in the portfolio were not held this time last year. We are confident that the portfolio will produce above benchmark returns over the medium and long term, as reflected in our longer term track record.

The Australian market finished 2016 strongly, while the S&P/ASX 200 at 5665 is 6% below the 2015 high of 5997 and 21% below the all-time high of 6851 in November 2007.

For the month, the German DAX led gains, rising 7.9%, the FTSE 100 rallied 5.3%, the Nikkei 225 gained 4.4% and the S&P500 was up 1.8%, while the NZ50 was slightly down, -0.2% and the Shanghai Composite lagged, -4.5%, following two strong months for the Chinese index.

Across the Australian market, the strongest performing sectors were Utilities (+8.7%), Property (+6.8%) and Energy (+6.1%), while Telecommunications (+0.4%), Healthcare (+0.4%) and Consumer Staples (+1.8%) lagged.

Performance (to 31 December 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	**2.0%**	4.4%	-2.4%
6 Months net	**3.4%**	10.6%	-7.2%
1 Year net	**-4.1%**	11.8%	-15.9%
3 Years net annualised	**5.3%**	6.6%	-1.3%
5 Years net annualised	**12.2%**	11.8%	+0.3%
Since inception net annualised **	**6.0%**	5.7%	+0.3%
Since inception net total return **	**88.2%**	80.8%	+7.4%

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

Fund Commentary

Stocks that delivered strong performance for the portfolio in the month included Duet Group (DUE, 2.4% weight), which returned 19.0% after receiving a non-binding proposal from Cheung Kong Infrastructure (CKI) to acquire the company for $3.00 per share in cash and making an announcement regarding the planned construction of a gas storage facility in Western Australia. CKI is currently undertaking due diligence prior to lodging an expected binding offer and any deal will be subject to approval by FIRB. DUE has been a core holding since 2012, having been first purchased at $1.97.

Sealink (SLK, 1.7% weight) returned 13.6%. CBG attended an investor in Queensland in November, which highlighted a strong outlook for the Transit Systems Marine assets, including tourism upside for North Stradbroke ferries. However, the fund has subsequently reduced its holding in the stock on valuation grounds.

Speedcast (SDA, 2.7% weight) returned 12.5% as the market began to view the acquisition of major competitor Harris CapRock more favourably. The acquisition makes SDA the largest satellite services provider globally and the company has guided to double digit EPS accretion from the deal in FY17, with further material synergies to be realised beyond this financial year. Harris CapRock has been negatively impacted by the decline in energy sector activity over the past two years. However, the recovery in the oil price in 2016 and evidence of improving rig counts suggest that headwinds are abating for that area of the business.

Commonwealth Bank (CBA, 11.9% weight) returned 4.8% as the banking sector continued to rally on firming expectations that there are no imminent capital raisings for the sector. In a November speech, APRA Chairman Wayne Bayres confirmed that the goal of the Basel Committee is for revisions to the capital framework to result in no significant increase in capital requirements overall. Moreover, Bayres indicated that 2017 will be a year of consultation, with new standards to take effect at least a year after that.

Stocks that detracted from fund performance in the month included Sirtex (SRX, 0.7% weight) which fell 48.7% after the company guided to 1H17 dose sales growth of only 4-6%, compared to guidance for double digit growth and prior corresponding period growth of 16%. With management having set spending budgets based on higher revenue growth expectations, earnings are consequently expected to decline in the FY17 year.

Dose sales growth has been impacted primarily by increased competition, both from direct competitor BTG and also from a new oral drug, Lonsurf. Lonsurf's overall survival benefit of only 1.8 months suggests that the impact on SRX growth may be temporary. However, competition from BTG is expected to be ongoing.

SRX's Sir-Spheres treatment and the abovementioned competing treatments are currently primarily used at salvage stage, which is after patients have stopped responding to standard therapy (e.g. chemotherapy). Importantly though, SRX is several years ahead of BTG on its clinical trial program to demonstrate efficacy of Sir-Spheres in earlier stage treatment, which would increase SRX's target market by approximately 10-fold. SRX has three major studies due to report results in the first half of this calendar year. Given the strong improvement in progression free survival within the liver shown in the earlier SIRFLOX study, SRX's prospects for these trials look good. With the stock now trading on only a 17x FY17 PE, the risk reward equation supports continuing to hold the position.

Class (CL1, 1.3% weight) also detracted from performance, returning -8.3% in the month as the market questioned the valuation after a more than doubling of the stock in the first 9 months of the year. The company continues to record very strong growth within its target market of cloud-based SMSF administration, where it is the market leader. Consensus expectations are for the company to achieve 53% EPS growth in FY17.

Top Ten Holdings (as at 31 December 2016)

	ASX code	Company name	Fund weight %	ASX 200 weight %
1	CBA	COMMONWEALTH BANK OF AUSTRALIA	11.9%	9.3%
2	WBC	WESTPAC BANKING CORPORATION	9.0%	7.2%
3	NAB	NATIONAL AUSTRALIA BANK LIMITED	4.9%	5.3%
4	HGG	HENDERSON GROUP	4.3%	0.2%
5	ANZ	ANZ BANKING GROUP LIMITED	4.2%	5.9%
6	MQA	MACQUARIE ATLAS ROADS GROUP	3.7%	0.1%
7	LLC	LENDLEASE GROUP	3.5%	0.6%
8	TCL	TRANSURBAN GROUP	3.5%	1.4%
9	APA	APA GROUP	2.9%	0.6%
10	MFG	MAGELLAN FINANCIAL GROUP	2.8%	0.2%

Sector allocations

Sector	Fund weight %	ASX 200 weight %	Tilt
CASH	15.1%	0.0%	15.1%
INDUSTRIALS	11.5%	6.6%	4.9%
CONSUMER DISCRETIONARY	9.4%	4.8%	4.6%
DIVERSIFIED FINANCIALS	8.4%	5.1%	3.3%
UTILITIES	5.5%	2.6%	2.9%
INFORMATION TECHNOLOGY	3.6%	1.2%	2.4%
BANKS	30.0%	29.2%	0.8%
TELECOMMUNICATION SERVICES	3.3%	4.5%	-1.2%
REAL ESTATE	6.4%	8.5%	-2.1%
INSURANCE	1.6%	3.9%	-2.3%
HEALTH CARE	3.7%	6.3%	-2.6%
ENERGY	0.0%	4.2%	-4.2%
CONSUMER STAPLES	0.0%	6.8%	-6.8%
MATERIALS	1.6%	16.3%	-14.7%

Market commentary

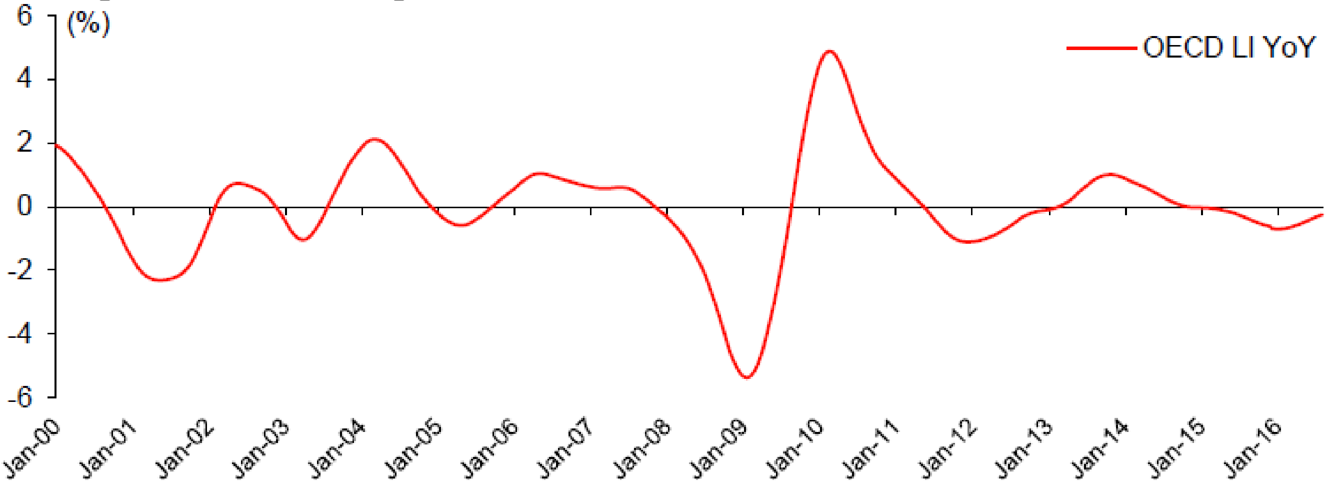
Australian economic data was soft in December. September quarter GDP fell by -0.5%, although it is widely expected by market economists to rebound in the December quarter. This reflects several non-recurring factors, including weak export volumes, a reversal of 2nd quarter strength in public demand and weather related softness in construction activity. On the positive side, employment growth accelerated in November, with a 39k rise reported, up from 15k in October. The unemployment rate nonetheless increased by 0.1%, given a 0.2% rise in the participation rate.

Expectations for improved global growth have pushed stock markets higher in 2016. This has been despite a sharp rise in bond yields in the fourth quarter, as the bond move has reflected increased growth and inflation expectations. Improved global growth is expected to be driven by the US, including from fiscal stimulus, and from emerging markets, in particular Brazil and Russia. Despite the recent recovery in the US housing market, the housing investment share of GDP remains around previous cyclical lows, providing scope for a multi-year improvement.

Europe is beginning to follow the US in delivering employment growth, while overall economic growth is expected to remain tepid. China's growth is expected to continue to reduce gently, at a still strong 6.5% in 2017[1].

The chart below combines leading indicators for aggregate GDP growth in OECD economies, with the indicator showing an upswing since March 2016.

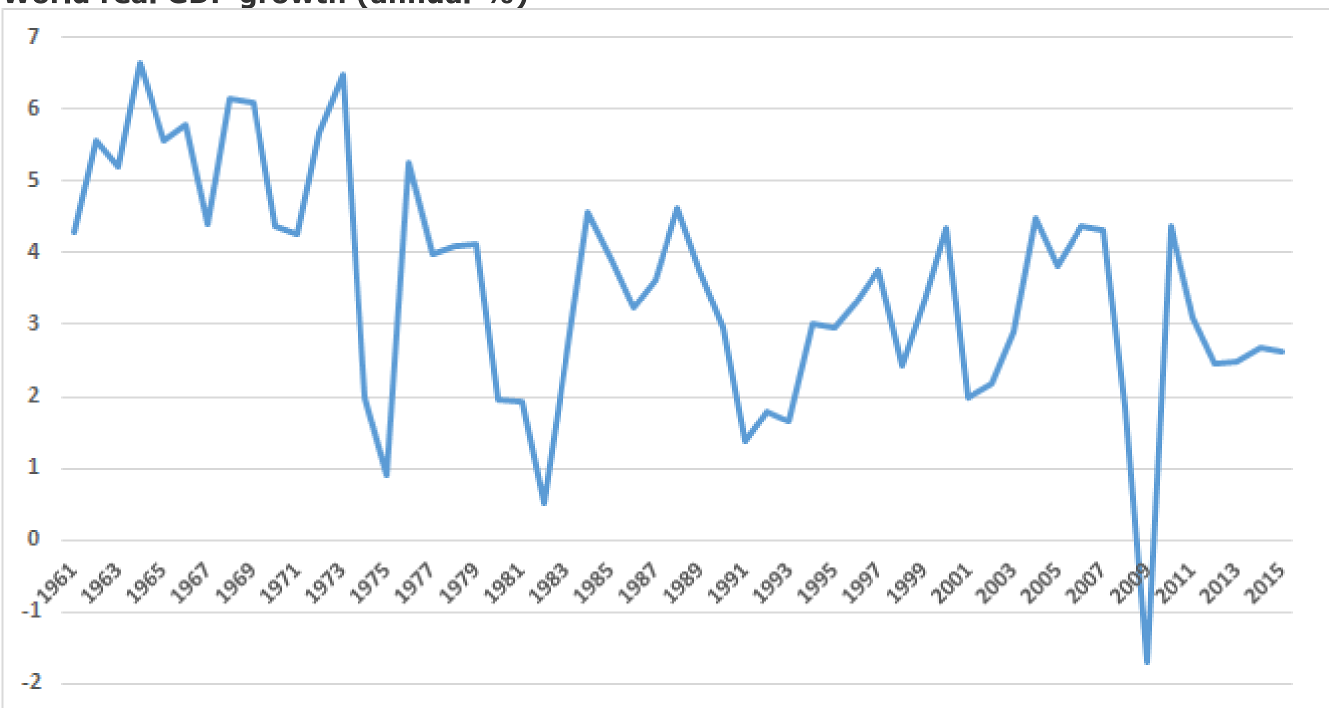
Leading indicator for GDP growth in OECD economies



Source: Macquarie

Expectations for improved global growth are also a reflection of the fact that we are coming from the longest stretch of sub-par global growth in 50 years. Using a simple average of individual years, global growth since 2007 has averaged 2.2% per annum. This compares to the previous 10 years' average of 3.4%, 20 years' average of 3.2% and 30 years average of 3.1%. This is illustrated in the chart below, noting that the rebound year in 2010 followed negative growth in 2009, with growth having remained in a subdued trend since the end of 2007.

World real GDP growth (annual %)



Source: World Bank

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[1] Source: World Bank

Team changes

CBG would like to farewell and thank Rob Gregory, who departed at the end of 2016 after 9 years as part of the investment team. Rob was a Portfolio Manager and was responsible for the resources, consumer and information technology sectors. We are pleased to announce the appointment of highly experienced Australian equities Portfolio Manager Scott Maddock, who will take over Rob's sectors. Scott brings over 30 years of Australian equities investment experience, including most recently as Portfolio Manager at Macquarie Private Portfolio Management, which won Money Management/Lonsec's SMA Portfolio of the Year Award for 2016. Scott was responsible for over $600m in FUM at Macquarie and we are excited about the contribution he will make to the CBG team.

Ronni Chalmers
Chief Investment Officer

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