CBG ASSET MANAGEMENT

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THE AUSTRALIAN FUND MANAGER AWARDS

CBG Australian Equities Fund – October 2016

The CBG Australian Equities Fund returned -3.3% in October, compared with the S&P/ASX200 Accumulation Index return of -2.1%.

The main theme of the month was the rise in bond yields, which weighed on equities generally and defensive sectors specifically. The US 10 year treasury yield reached its highest level since May, ending the month up 23 basis points at 1.82%. US stocks underperformed despite a better than expected US reporting season. Emerging markets and Japan outperformed.

At a sector level, Materials (+1.2%) outperformed the market with strong performances from key index weights Fortescue Metals Group (FMG, +11.1%) and Rio Tinto (RIO, +5.0%). Energy (-2.0%) finished down, unwinding a strong start to the month as concerns around OPEC adhering to production cuts emerged. Consumer sectors suffered sizable declines as did REIT's, the latter being impacted by rising bond yields. Consumer discretionary (-6.1%) was led lower by the casinos/gaming companies (Crown Resorts -16.9% and Star Entertainment Group -17.1%) following media reports of key staff being arrested. Consumer staples (-3.8%) were impacted by Wesfarmers (-7.0%) on below expectations 1Q17 sales. REIT's fell 7.4%, as index heavyweights were sold off heavily due to rising bond rates.

The Australian equity market underperformed most international markets, falling 2.1% while the S&P 500 fell 1.8%, the FTSE 100 rose 1.0%, the German DAX was up 1.8%, the Shanghai Composite was up 3.2% and the Nikkei was up 5.9%. The theme generally of the stronger indices was a weaker currency, in particular Japan, while in China, positive economic data was well received. Australia's underperformance was due to a relatively large weighting to interest rate sensitive stocks, and also weakness in energy, staples and telco's.

Across the Australian market, the strongest performing sectors were materials +1.2%, financials +0.7%, while weaker performers were healthcare -8.1%, real estate -7.4%, information technology -6.6% and consumer discretionary -6.1%.

Performance (to 31 October 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	**-3.3%**	-2.1%	**-1.2%**
3 Months net	**-6.1%**	-3.2%	**-2.9%**
1 Year net	**-1.4%**	6.1%	**-7.5%**
3 Years net annualised	**4.3%**	3.9%	**+0.5%**
5 Years net annualised	**9.9%**	9.2%	**+0.8%**
Since inception net annualised **	**5.9%**	5.0%	**+0.8%**
Since inception net total return **	**82.8%**	68.2%	**+14.6%**

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:

Millennium Services Group (MIL, 1.0% weight) returned 26.5%, driven by a positive market reaction to the materially earnings accretive acquisition by MIL of WA based cleaning business Airlite Group at a cost of $25m. The acquisition, which was debt funded, gives MIL exposure to the WA economy. With the announcement, MIL gave updated earnings guidance for FY17, which at the current stock price, implies an attractive valuation for the company.

Tamawood (TWD, 1.1% weight) increased 10.7% in the month. During October, TWD issued a brief ASX release stating adjusted pre tax profit for the 2016 September quarter will be in excess of 20% above the 2015 September quarter.

BT Investment Management (BTT, 1.1% weight) was up 4.0%. During the month, BTT released its September quarter flows and FUM. The update showed that despite concerns around sentiment towards equities products in the UK and Europe, the group continues to generate healthy inflows into its funds. In particular, the group said ~$2.0B of inflows will occur post 30 September.

Stocks that detracted from fund performance in the month included:

Auckland International Airport (AIA, 1.9% weight) fell 12.1% as investors sold off defensive assets. AIA has arguably been one of the biggest beneficiaries of the flight to defensives (having rerated markedly over the past 2-3 years) and we have been trimming our exposure over recent periods as its premium to historical multiples increased. We still see a positive industry thematic for airports (the real cost of travel continues to decline while disposable income and propensity to travel continues to increase, particularly in emerging economies) and see them as an attractive asset class over the longer term.

Aconex (ACX, 2.0% weight) fell 16% in the month, despite releasing a trading update and forward looking earnings guidance that generally pleased the market. The stock has significant operations in the UK and Europe economies and in addition trades on an above average earnings multiple, which saw it sold off in the month.

Transurban (TCL, 4.9% weight) declined 9.0% as Australian 10-year bond rates increased by 44bp in the period. There has been much press about TCL’s status as a bond proxy and while TCL has been well supported through the low interest rate cycle, we believe the sell-off is over-done as the outlook for ongoing earnings growth remains solid and its interest rate sensitivity is modest in the short to medium term. The weighted average maturity of TCL’s debt profile is 8.7 years and it has 99.5% hedging of its entire debt book. This means that inflation can pick up before TCL sees a material impact on its cost of debt, but in the meantime toll increases drive top line growth (tolls increase generally at CPI/CPI+ levels on a quarterly basis). We continue to expect double digit DPS growth from TCL over the coming periods.

Top Ten Holdings (as at 31 October 2016)

	ASX Code	Stock Name	Weighting	
			Fund %	ASX 200%
1	CBA	COMMONWEALTH BANK OF AUSTRALIA	10.9%	9.0%
2	WBC	WESTPAC BANKING CORPORATION	8.4%	7.3%
3	ANZ	ANZ BANKING GROUP	6.1%	5.8%
4	TCL	TRANSURBAN GROUP	5.2%	1.5%
5	NAB	NATIONAL AUSTRALIA BANK LIMITED	4.4%	5.3%
6	MQA	MACQUARIE ATLAS ROADS	4.4%	0.2%
7	HGG	HENDERSON GROUP	4.0%	0.2%
8	MFG	MAGELLAN FINANCIAL GROUP	3.7%	0.2%
9	LLC	LENDLEASE GROUP	3.2%	0.5%
10	DUE	DUET GROUP	3.0%	0.4%

Market commentary

Australia's economic data remains patchy, with initial better than expected data (building approvals, retail sales and trade) offset by the weaker than anticipated housing finance approvals, and the surprise fall in employment in the September labour force data.

The 3Q16 CPI outcome delivered stronger than anticipated headline inflation due to a surprise jump in fruit and vegetable prices. While headline inflation outcomes, and oil prices, point to a continued pickup in inflation over the year ahead, key underlying inflation measures were in line, reflecting the narrowly-based rise in headline inflation.

The RBA left rates unchanged during the month. Expectations of further policy moves from the RBA were trimmed during October, with early expectations of a rate cut moving to a more balance view of the future monetary policy.

The Australian dollar continued to trade in a range between US$0.75 – 0.77 through the month. Support for the A$ from commodity prices was bolstered by the surge in coking coal prices. The Australian Government also received strong support for the inaugural 30-year bond issuance.
The Australian dollar generally rose against most major currencies (except the US dollar) on rising commodity prices. The US dollar was stronger driven by expectations of the Federal Reserve increasing interest rates. The main story for the month in currencies was the British Pound, which fell heavily against most major currencies on fears over a "hard" exit from the European Union, hitting a 31 year low against the US dollar. The Chinese yuan continued to weaken, hitting its weakest level against the US dollar since September 2010.

Commodities had another strong month. Hard coking coal was again up sharply (+20%) during the month, with thermal coal also up strongly (+33%). The other commodity highlight during the month was iron ore, which rose 14% in October to a six month high of US$63.10 per tonne. The gold price fell 3.1% on rising bond yields and rising interest rate expectations.
Oil fell 2.9% in the month, due to concerns around OPEC adhering to production cuts emerging. Copper was flat during the month, ending at US$4,841 per tonne.

With the ASX200 having declined in recent months, valuations are becoming increasingly attractive in our investment universe. The investment team remains focussed on identifying companies with strong business models and growing earnings streams run by capable management teams.

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