JCB

JAMIESON COOTE BONDS

Recommended
Lonsec Research

Fund Update as at 30 September 2017
CC JCB Active Bond Fund (APIR: CHN0005AU)

Fund Benefits

Active Management:
JCB is a specialist fixed income manager with significant global investment management experience and expertise.

Access:
The Fund provides access to investment knowledge, markets, opportunities and risk management systems that individual investors may not be able to obtain on their own.

Diversification:
When bonds are held as part of a broader portfolio of different asset classes, diversification may assist in managing market volatility. Bond securities in general are considered a defensive asset class.

Income:
The income generated by bond securities is consistent and regular (usually semi-annual).

Fund Facts

Investment Manager	JamiesonCooteBonds Pty Ltd or JCB
Portfolio Manager	Charles Jamieson
Structure	AAA or AA rated bond securities issued in Australian dollars
Inception Date^	3 August 2016
Benchmark	Bloomberg AusBond Treasury (0+Yr) Index
Management Fee#	Base Fee of 0.45% p.a.
Administration Fee#	Administration Fee of 0.10% p.a.
Buy / Sell Spread	0.10% / 0.10%
Distributions	Semi-annual
Fund Size+	AUD $72 million

Fund Performance

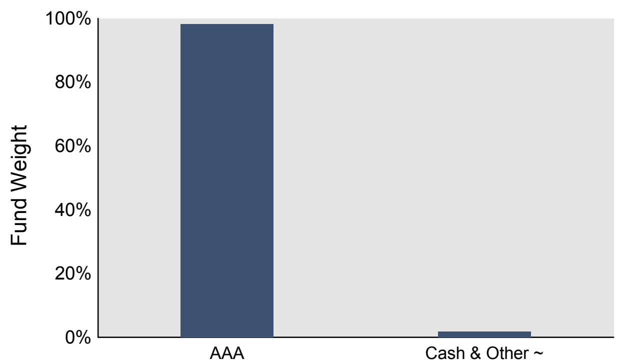
Returns	Fund*	Benchmark**	Active
1 Month	-0.38%	-0.47%	0.09%
3 Months	-0.02%	-0.42%	0.39%
FYTD	-0.02%	-0.42%	0.39%
1 Year	-0.71%	-2.03%	1.33%
2 Years p.a.	-	-	-
3 Years p.a.	-	-	-
Inception p.a.	-0.28%	-1.59%	1.31%

Fund Overview

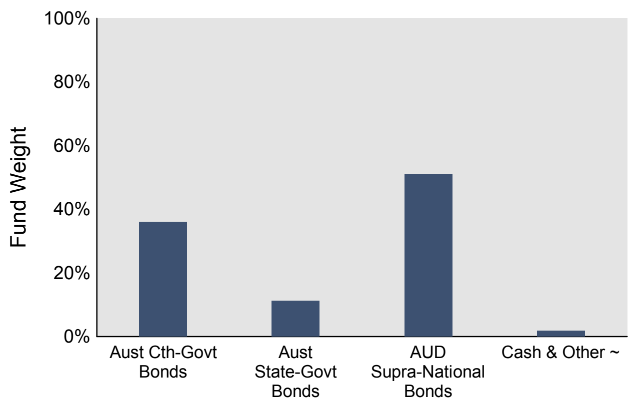
Characteristics***	Fund	Benchmark**
Modified Duration (yrs)	5.64	5.91
Yield to Maturity (%)	2.80	2.50
Weighted Ave. Credit Rating	AAA	AAA
Cash Weighting (%)	1.81	n/a

*** Refer to Definition of Terms.
Source: JamiesonCooteBonds Pty Ltd.

Credit Rating Allocation



Sector Allocation



Platform Availabilty

Asgard	BT Panorama	BT Wrap
HUB24	Macquarie Wrap	Mason Stevens
Netwealth	PowerWrap	

Further Information

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All figures disclosed include the net effect of GST and RITC. ^ Inception Date for performance calculation purposes. + Fund size refers to the CC JCB Active Bond Fund ARSN 610 435 302. * Performance is for the CC JCB Active Bond Fund (APIR: CHN0005AU), also referred to as Class A units, and is based on month end unit prices before tax in Australian Dollars. Net performance is calculated after management fees and operating costs, excluding taxation. This is historical performance data. It should be noted the value of an investment can rise and fall and past performance is not indicative of future performance. ** Benchmark refers to the Bloomberg AusBond Treasury 0+ Yr Index. ~ Cash & Other includes cash at bank, outstanding settlements and futures margin accounts.

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Market Review & Outlook

(1) Market prices in almost two rate hikes for RBA in 2018 despite continued rebuttal in RBA speeches;
(2) Large firebreak now established in current pricing, to remain underweight fixed rate debt is to expect a third RBA hike, which seems highly unlikely even under the most optimistic scenarios;
(3) Tax reform: Trumps legislative progress to date is essentially zero. Any actual tax reform should be severely reduced versus announcement if implemented;
(4) Careful what you ''Warsh'' for – favoured U.S. Federal Reserve Chairperson Kevin Warsh looks to break recent relationships with equity markets;
(5) Toys R Us bond holders lose 80% of capital – bonds from 97 cents to 18 cents on the dollar – a stark reminder about risk as credit hits cycle highs/tights.

(1) Market prices in almost two rate hikes for RBA in 2018 despite continued rebuttal in RBA speeches:

Despite continued pushback in speeches from a number of senior RBA officials, markets have moved to price in almost two rate hikes for the RBA in 2018. RBA Governor Lowe has been explicit regarding rate policy in recent speeches stating that the RBA will not follow other central banks into a tightening cycle whilst the domestic economy continues to have employment slack of 0.6% and below mandate inflation. Positive employment data, combined with renewed expectations of an additional U.S. Federal Reserve hike for year-end, plus recent rate hikes in Canada have resulted in a cautious mood for bond markets that have moved to add optionality for RBA policy outlook in 2018.

(2) Large firebreak now established in current pricing, to remain underweight fixed rate debt is to expect a third RBA hike, which seems highly unlikely even under the most optimistic scenarios:

In contrast to the predications of dire bond market returns as rates rise from many vested interested parties, the addition of nearly two RBA rate hikes into current market pricing has been entirely orderly, with the product continuing to generate solid returns in excess of RBA cash year to date. Importantly, as the market has already added the optionality of possible RBA hikes into current pricing, a large firebreak has been established for shorter dated fixed rate bonds (active managers don't always own long dated debt). Should the RBA complete on rate hikes in 2018, this is already reflected in the price of those bonds today, much like a particular stock having been discounted for some possible or expected future event. However, if the RBA fails to raise rates then bonds are historically cheap versus the RBA cash rate and should generate strong excess returns to RBA cash. For those expecting a further pullback in yields the market would then be pricing in the optionality of a third RBA rate hike. Such a scenario looks optimistic versus RBA commentary that continues to remain comfortable with current monetary policy settings and acknowledges the balanced risk outlooks for the Australian economy (with highly indebted consumers who are facing significant price rises in non-discretionary utilities). The RBA's Ian Harper made public comment early in October that the RBA are not ruling out an additional rate cut. Given nearly two hikes are priced in and the RBA are still discussing rate cuts, valuations look compelling at current levels, unless you believe the RBA could hike three times.

(3) Tax reform: Trumps legislative progress to date is essentially zero. Any actual tax reform should be severely reduced versus announcement if implemented:

Tax reform remains a critical theme for financial markets. Recent announcements for reform made headline statements without giving much detail – classic Trump. When Trump was elected last year, JCB wrote extensively about the difficulties Trump would face enacting legislation with the "swamp". To date, material legislative progress has been missing in health care, the border wall with Mexico, immigration bans and border adjustment tax. This is despite having control of both the House and Senate. Whilst all sides of politics agree the U.S. tax code requires reform, finding a common path forward remains extremely challenging. JCB hope to see progress here in coming months but we continue to believe that what will be delivered will not meet the markets grand expectations.

(4) Careful what you "Warsh" for – favoured U.S. Federal Reserve Chairperson Kevin Warsh looks to break recent relationships with equity markets:

Kevin Warsh is the current front runner to replace Janet Yellen as Chair of the U.S. Federal Reserve in 2018. A Federal Reserve headed by Warsh would be vastly different to the Fed under Bernanke and Yellen. Warsh has been publicly critical of current Fed policy (as has Trump) and believes the Fed has become a 'slave' to the stock market. This appointment is all speculation at this stage, but these announcements are a potential source of significant market volatility.

(5) Toys R Us bond holders lose 80% of capital – bonds from 97 cents to 18 cents on the dollar – a stark reminder about risk as credit hits cycle highs/tights:

Toys R Us bond holders suffered significant losses in September as the company filed for bankruptcy. The household name of 1990's and 2000's is no more in an Amazon-ised retail world with a leveraged balance sheet. The classic joke of "How did you go bankrupt?" applies in full here. The answer: "Slowly, and then really quickly." The company's outstanding 2018 bond issue traded from 97 cents on the dollar to as low as 16 cents in September, representing more than 80% loss of capital.

This serves as a stark reminder that credit risk is the biggest source of losses in fixed income. Leveraged balance sheets need to be carefully considered and negotiated before investors lend money to corporations or governments. Thankfully, the Australian Government is still the envy of the world with low debt to GDP ratios and coveted AAA ratings.

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Fund Review

Over the quarter, the CC JCB Active Bond Fund (the Fund) managed to outperform its index by 0.39%.

Australian interest rate volatility ticked up for the month of September as the market more than doubled the range from the moribund August period (a range of 37.5bps this month versus 15bps in August). September also included the quarterly expiry of the SFE futures contracts which historically provides some turning points in the market and this month was no exception. JCB was positioned for a sell-off in interest rates around the early part of the month. However, JCB were forced to reduce the position following the hurricane's in the U.S., dovish Fed comments, concerns over debt ceiling extension in the U.S. and geopolitical events around North Korea early in the month (a possible missile launch on North Korea's national day). JCB added exposure early in the month after triggering stop loss levels which was ultimately frustrating in the corresponding pullback that followed later in the month. This initially detracted from alpha generation early in September versus the index. However, it is critical that JCB maintains a disciplined risk adjusted methodology in our process as we explore potential alpha generating opportunities within the Fund and when key levels are exceeded, discipline must be followed to stay on process

JCB added additional positioning in short dated rates into improved valuations later in the month as we continue to believe the RBA will have a very difficult time raising interest rates in the short term until additional employment slack has been removed and the inflation pulse picks up from below RBA mandated levels. JCB also added exposure to a new issue World Bank Supra position that it deemed cheap-to-fair value. This position subsequently performed 6.5bps better versus the index and was a large contributor to alpha generation in the back part of the month.

JCB has also been running some curve steepening exposure which helped contribute to the Fund's outperformance over the month, notwithstanding the initial necessary addition of exposure on geopolitical tension which proved a drag.

Looking ahead into fourth quarter, JCB believes that market volatility is possible around the appointment of a new U.S. Fed chairperson plus the composition of the Federal Reserve Board, combined with the anticipated ECB tapering of its quantitative easing program. No doubt domestic politics, international politics and geopolitics will also continue to remain at the forefront of investors' minds. JCB will continue to hold short and mid-dated exposures and its tactical overlay process to explore alpha opportunities as they present themselves.

Definition of Terms:

Modified Duration - is a systematic risk or volatility measure for bonds. It measures the bond portfolio's sensitivity to changes in interest rates.
Yield to Maturity - is the total return anticipated on the portfolio if the bond holdings were held until their maturity.
Weighted Average Credit Rating - is a measure of credit risk. It refers to the weighted average of all the bond credit ratings in a bond portfolio.

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The Lonsec Rating (assigned as follows: APIR CHN0005AU - October 2016) presented in this document is published by Lonsec Research Pty Ltd ABN 11 151 658 561 AFSL 421 445. The Rating is limited to “General Advice” (as defined in the Corporations Act 2001 (Cth)) and based solely on consideration of the investment merits of the financial product. Past performance information is for illustrative purposes only and is not indicative of future performance. It is not a recommendation to purchase, sell or hold Jamieson Coote products, and you should seek independent financial advice before investing in this product(s). The Rating is subject to change without notice and Lonsec assumes no obligation to update the relevant document(s) following publication. Lonsec receives a fee from the Fund Manager for researching the product(s) using comprehensive and objective criteria.

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