JAMIESON COOTE BONDS

Recommended
Lonsec Research

Fund Update as at 31 December 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 $138 million

Fund Performance

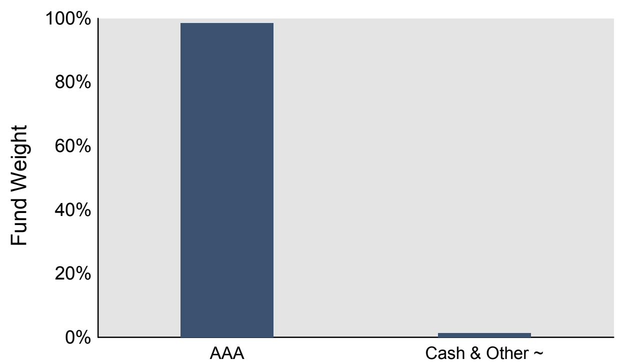
Returns	Fund*	Benchmark**	Active
1 Month	-0.47%	-0.73%	0.26%
3 Months	1.48%	1.59%	-0.12%
FYTD	1.45%	1.17%	0.28%
1 Year	3.88%	3.49%	0.39%
2 Years p.a.	-	-	-
3 Years p.a.	-	-	-
Inception p.a.	0.81%	-0.19%	1.01%

Fund Overview

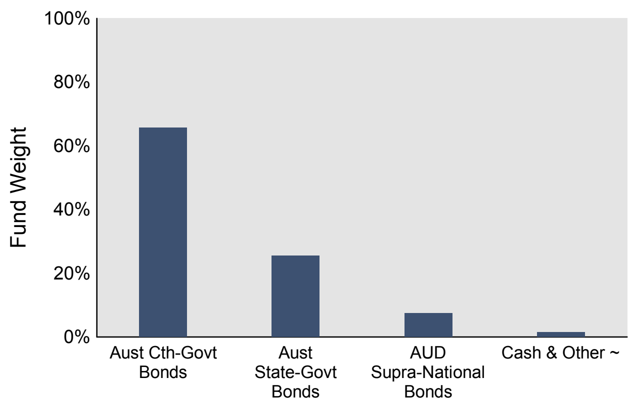
Characteristics***	Fund	Benchmark**
Modified Duration (yrs)	5.45	6.22
Yield to Maturity (%)	2.58	2.44
Weighted Ave. Credit Rating	AAA	AAA
Cash Weighting (%)	1.45	n/a

*** 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) Full steam ahead for now, but asymmetric monetary policy should complete the cycle in late 2018;
(2) Rates are rising – but which rates exactly? Don't fight 'the Fed' – in either direction;
(3) 2018: The year of the USD – U.S. Government 2 year bonds yield more than S&P;
(4) Reckless stimulation – late cycle deficit spending in the U.S.;
(5) Australia perhaps to enjoy a commodity bounce, but housing and consumers continue to bite;
(6) Better to remain 'on hold' than 'hike and retreat' like RBA's Stevens (who couldn't read the play in 2008 lifting rates into the world's largest financial crisis in three generations).

(1) Full steam ahead for now, but asymmetric monetary policy should complete the cycle in late 2018:

Markets finished 2017 on a strong note as global growth continued and the Goldilocks environment of low interest rates, ample liquidity and fluid credit markets pushed risky asset valuations forward with powerful momentum. However, as 2018 unfolds JCB caution that investors should be mindful of the asymmetric nature of monetary policy. Large cuts are required to generate a muted impact on the real economy, whilst a slight tightening of financial conditions goes a long way to curtailing economic activity. With well known, documented and growing high debt burdens across the world, this phenomenon is amplified due to extreme indebtedness and the rise in the cost of funding and debt servicing.

(2) Rates are rising – but which rates exactly? Don't fight 'the Fed' – in either direction:

During 2017, the U.S. Federal Reserve (the Fed) raised funding rates three times (in March, June and December). Interest rates are indeed rising, but which rates exactly – specifically, the short-end or the long-end? Markets expect further rate hikes in 2018 and have re-priced short-dated bond yields significantly (with U.S. 2 year government bonds rising 80 basis points or 0.80% over 2017). Meanwhile, longer dated yields have hardly budged in keeping with JCB's major secular themes (with the difference between short-dated rates and longer-dated rates contracting as the yield curve 'flattens'). JCB believe this dynamic looks set to continue into 2018 as short-dated international yields remain under pressure. The Fed seems intent on rising rates at a measured pace of once a quarter, which should continue to push shorter-dated rates higher and further flatten yield curves. It has remained futile to 'fight the Fed' and markets should continue to pay attention to the engineered slowdown which is transpiring.

(3) 2018: The year of the USD – U.S. Government 2 year bonds yield more than S&P:

Is 2018 the year of the USD? As global interest rate differentials continue to shift, with short-dated interest rates in the U.S. rising, one would be expected to see a flight of capital into USD to seek higher incomes on offer. One of the largest misses by market forecasters in 2017 was the selloff in the USD, despite ongoing rate hikes. An easing of financial conditions is highly unusual as the central bank hikes interest rates, but the U.S. enjoyed easier financial conditions over 2017 as a lower currency made the U.S. more competitive combined with higher equity markets and tighter credit spreads. With short-dated bonds in the U.S. Treasury market now yielding more than the dividend yield of the S&P, investors now have a credible alternative to generate income using short term fixed interest securities.

(4) Reckless stimulation – late cycle deficit spending in the U.S.:

As we enter the tenth year of recovery, JCB find it staggering to see a fiscal push of US$ 1.5 trillion dollars in unfunded liabilities (tax reform) taking the U.S. deficit to 3.5% of GDP. Keynesian economists would argue for deficit spending during a recessionary period to stabilise the economy but to add additional fiscal spending in the tenth year of a recovery is questionable. There is little evidence to suggest such a move generates anything other than a short-term sugar hit for economies. In other words, it appears to JCB that this seems like reckless stimulation of an already strong but late cycle economy. U.S. fiscal policy is acting as if the U.S. is in the depths of a recession despite being at the peak of the economic cycle.

(5) Australia perhaps to enjoy a commodity bounce, but housing and consumers continue to bite:

The Australian economy continues to muddle along with below average growth, tepid inflation but robust employment. The start of 2018 looks brighter as the commodity cycle looks set to lift. However, this should be offset by a mild decline in capital city property prices driven by Sydney and Melbourne. JCB continues to expect Australian consumers will remain defensive as 'out of cycle' mortgage rate hikes drive debt servicing higher over the course of 2018 into the higher cost of global capital.

(6) Better to remain 'on hold' than 'hike and retreat' like RBA's Stevens (who couldn't read the play in 2008 lifting rates into the world's largest financial crisis in three generations):

JCB does not expect the RBA to move interest rates in 2018 (a continuation of our 2017 view). This follows, as the underlying economic pulse remains below potential and monetary policy is asymmetric (stated above). The domestic economy will be curtailed by out of cycle mortgage hikes and macro prudential measures which are generating an orderly normalisation of housing gains in leading capital city markets. Rate hikes at this point would do significant longer-term damage to the economy and the RBA would prefer to hold than be forced to retreat into rate cuts quickly thereafter. JCB recalls that then RBA Governor, Glenn Stevens, hiked interest rates in late 2007 and twice in 2008 into the largest financial calamity of three generations. What followed was a full about face with 300bps of cuts in late 2008. Thankfully, JCB believes RBA Governor Lowe understands the asymmetry and is unlikely to repeat his predecessor's shocking error which rattled consumer and business confidence unnecessarily.

Fund Review

For the December quarter, the CC JCB Active Bond Fund returned 1.48%, slightly underperforming the benchmark by -0.12%.

The Fund did outperform its benchmark in December after taking a deliberately defensive approach to the year-end period. In particular, JCB were mindful of key market dynamics (such as low liquidity). JCB have retained a curve steepening position which benefited from a mild sell-off in yields. JCB lightened spread exposures ahead of new issue supply (and hopefully supply concessions) which is often generated into the new calendar funding year for supra national issuers.

JCB remains constructive on the short-end of the AUD rates complex which is again priced for rate hikes in 2018 which is against our core views.

<u>Definition of Terms:</u>

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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