JAMIESON COOTE BONDS

Fund Update as at 28 February 2018
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 $143 million

Fund Performance

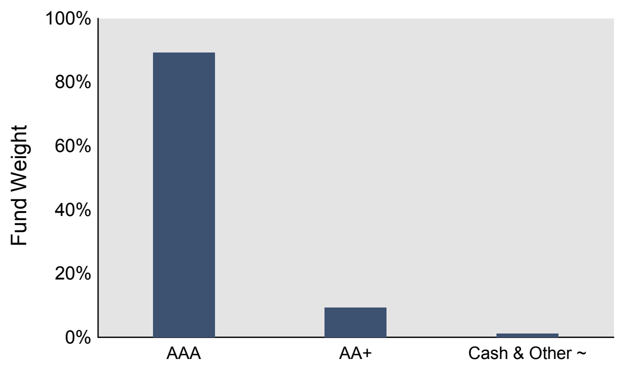
Returns	Fund*	Benchmark**	Active
1 Month	0.19%	0.27%	-0.08%
3 Months	-0.56%	-0.89%	0.33%
FYTD	1.36%	1.00%	0.36%
1 Year	2.69%	2.58%	0.11%
2 Years p.a.	-	-	-
3 Years p.a.	-	-	-
Inception p.a.	0.67%	-0.28%	0.95%

Fund Overview

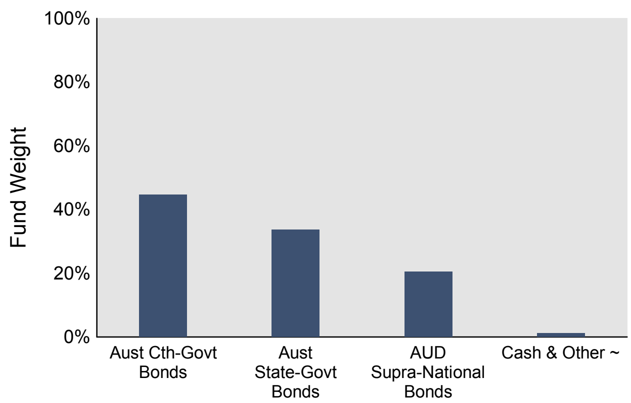
Characteristics***	Fund	Benchmark**
Modified Duration (yrs)	5.64	6.14
Yield to Maturity (%)	2.51	2.50
Weighted Ave. Credit Rating	AAA	AAA
Cash Weighting (%)	1.22	n/a

*** 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) Volatility explodes in February bankrupting short volatility funds
(2) Credit ETF's have systemic weakness and can be easily targeted in the right (adverse) conditions
(3) Global data peaking – velocity turned negative as higher rates are biting
(4) Stock becomes flow – Quantitative Tightening still produces a massive bond buyer
(5) AUD rates now below U.S. Treasuries across the curve on differing cycle and budgetary outlooks

(1) Volatility explodes in February bankrupting short volatility funds:

The bankrupting of the short volatility fund XIV (Velocity Shares Daily Inverse VIX) in February is a classic market moment and could very well be the Bear Sterns peak behind the curtain before a larger Lehman crescendo. Now released, the volatility genie is unlikely to go back in the bottle as reckless late cycle fiscal expansion in the U.S. combined with higher global funding rates from the U.S. Federal Reserve will have markets on their toes going forward. The now liquidated XIV product did exactly what it was designed to do, making a small amount of money each day being short volatility until in one single day everything was lost. Any ETF owners (particularly credit ETF's) should be wriggling in their chairs right now, for the XIV was a complete victim of its own success. Having a public mandate to be one way only in a risky market combined with very large amount of money makes a product highly vulnerable to adverse market movements which force mandated short covering. The volatility community knew full well the thresholds required to trigger a XIV liquidation and surely helped themselves to a grand feast pushing volatility higher and higher until the XIV fund was forced to enter the market and cover risk at one off spike high prices, thereby guaranteeing its own death spiral.

(2) Credit ETF's have systemic weakness and can be easily targeted in the right (adverse) conditions:

Credit markets often re-price in an asymmetrical manner, you need look no further than Macquarie's highly leveraged U.S. infrastructure fund that recently lost around 40% of its value in a day after provisioning for higher funding and debt obligation costs (whilst an equity product, the asymmetry is credit (debt) and funding related). JCB has long argued that higher funding costs will be a huge problem for lower quality assets in a highly leveraged world, as higher funding costs create an income shock in the near term, but also lift refinancing hurdles over time. Warren Buffet's famous quote of "we will see who has been swimming naked when the tide goes out" is a great illustration for a leveraged environment. In adding large U.S. fiscal deficits to a late cycle environment, plus the addition or continuation of higher funding pressure via U.S. rates hikes, the tide is most certainly going out right now for credit. Often at the end of the cycle we get a systemic shock, a company or group of companies that fail unexpectedly from sailing close to the wind. The danger for credit ETF's comes from the massive credit liquidity gap that now exists between credit debt outstanding (which in the U.S. has roughly doubled since GFC) and primary dealer inventories which have shrunk more than six fold. To put that in context the credit liquidity gap is now twelve times the size it was going into the GFC when credit products froze and were gated for long periods on one twelfth of the liquidity mismatch. The rise of credit ETF's gives the market a host of products that they can collectively target in adverse circumstances, forcing them to rebalance into weakness (the XIV stop out above will look like a Christmas party) without any circuit breakers seen in equity markets. As funding costs are rising and liquidity is being withdrawn (see also LIBOR rates rising) investors need to think through liquidity sources going forward as the tide goes out, their own liquidity needs through this period and the asymmetry of some current portfolio holdings.

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(3) Global data peaking – velocity turned negative as higher rates are biting:

Global economic data has been nothing short of great over the back part of 2017 and early 2018. However, the velocity of that data has now turned negative. That is not to say the data will not remain good, but markets price subtle changes quickly and global data has rolled from improving in 2017 to decaying in 2018. Are higher interest rates starting to bite? Almost certainly the selloff in U.S. bond markets is having an impact. Some isolated global data points of late include: U.S. durable goods orders -3.6%, U.S. factory orders -1.4%, Germany factory orders -3.9%, global retail sales have been very weak, London house prices dropping at fastest pace since 2009 (Wandsworth/Fulham lost 15%), U.S. mortgage applications -6.6%. Whilst many in markets are still discussing yesterday's news of the weather affected January U.S. employment report, data has been decaying quickly with a large geographical reach. JCB retains its view that the U.S. Federal Reserve will likely hike interest rates three times in 2018 (this alone will keep pressure on low quality risk assets via funding costs). However, the extrapolation of the late 2017 environment is short sighted by some market pundits who need to consider the 'flow' of markets rather than just focusing on the 'stock'.

(4) Stock becomes flow – Quantitative Tightening still produces a massive bond buyer:

2018 is shaping up to be a pivotal year. Political policy is changing, monetary policy is being normalised and asset markets will be asked to stand alone with less Central Bank intervention. Higher volatility is almost certain to remain part of the market construct making investors demand more in return for the higher volatility risk they must endure. Many in markets have discussed the withdrawal of Global Central Bank balance sheet accumulation under the phrase "Quantitative Tightening (QT)". This term was first used in early 2016 when the Chinese Central Bank was selling $100 billion dollars of U.S. Treasuries a month to stem capital outflow from China. Many then wrongly assumed yields would rise sharply given the world's biggest bond buyer (in China) had become a net seller. In fact, yields fell and bonds rallied through this period as a "flight to quality" bid emerged from the private system as other risk asset markets decayed.

Fast forward to 2018 and QT is again topical, as Central Banks have telegraphed a decline in balance sheet growth. However, that isn't the full story for the bond market, because the existing "stock" of previous Quantitative Easing (QE) actually creates new 'flow'. When bonds on central bank balance sheets mature, their proceeds have to be reinvested just to keep the 'stock' of balance sheet from shrinking. In other words, in QE the 'stock' generates 'flow' itself, and as the stock gets bigger, so do the reinvestment flows. In 2018, total QE reinvestment flows will be some USD $990 billion, versus USD $600 billion in 2016 and 2017. Those reinvestment flows already outstrip balance sheet expansion, with global central bank balance sheet expansion slowing down, reinvestment flows have already become larger than 'new' QE flows.

(5) AUD rates now below U.S. Treasuries across the curve on differing cycle and budgetary outlooks:

The huge fiscal expansion in the U.S. (despite being in the tenth year of recovery – running hot now, cold later) has forced U.S. bond yields higher due to vastly increased U.S. bond supply. This has taken Australian interest rates below that of the U.S. across all key maturity points on term structure curves for the first time since 2000. The continued de-coupling of U.S. and Australian interest rates reflects the vastly differing economic outlooks and budgetary positions between the two nations. Interestingly, the last time these yield differentials were negative the AUD was around 0.50 cents to a USD, rather than today's 0.78 cents. With JCB's expectation that the RBA remains firmly on hold in 2018 whilst the U.S. Federal Reserve continue to lift interest rates, we expect this interest rate decoupling to continue and as a result pressure to build on the $AUD currency over the year.

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Recommended
Lonsec Research

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Fund Review

For the month of February, the CC JCB Active Bond Fund returned 0.19%, underperforming the Bloomberg AusBond Treasury (0+Yr) Index by 0.08%.

The Fund remained defensive in February, slightly underperforming indexes due to the swap spread widening that caused short dated Supra positions to underperform. JCB also missed its key long term buy targets on the intra month spike in yields, as they looked to add duration to the portfolio as valuations improved and before bond markets recovered and rallied from intra month high yields (lower prices). JCB did add a small amount of duration which quickly surpassed the team's internal expectations. This risk was then cut in keeping with JCB's disciplined portfolio management approach and targeted better levels to lift durations. JCB's lower beta position caused a mild drag versus index into the recovery rally.

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.