JCB
JAMIESON COOTE BONDS

Fund Update as at 31 March 2019
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#	0.45% p.a.
Administration Fee #	0.10% p.a.
Buy / Sell Spread	0.05% / 0.05%
Distributions	Semi-annual
Fund Size+	AUD $568 million

Fund Performance

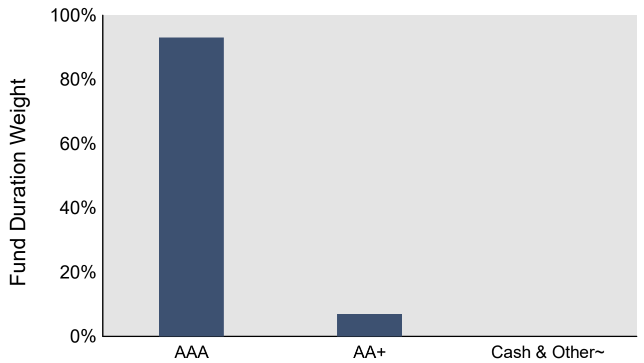
Returns (After fees)	Fund*	Benchmark**	Excess
1 Month	2.12%	2.15%	-0.03%
3 Months	3.83%	3.93%	-0.10%
FYTD	6.59%	7.29%	-0.70%
1 Year	7.30%	8.11%	-0.81%
2 Years p.a.	5.10%	5.68%	-0.58%
Inception p.a.	3.45%	3.27%	0.18%

Fund Overview

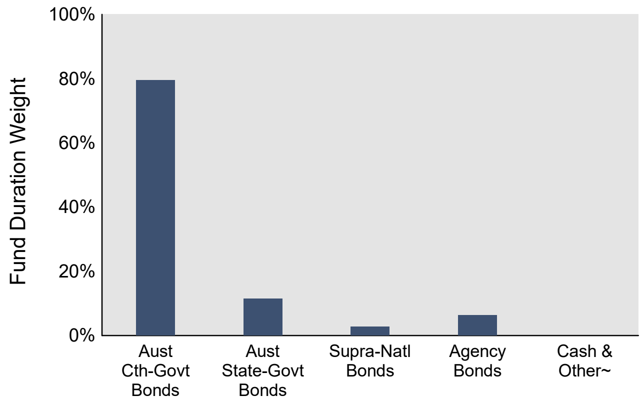
Characteristics***	Fund	Benchmark**
Modified Duration (yrs)	6.43	6.45
Yield to Maturity (%)	1.78	1.66
Weighted Ave. Credit Rating	AAA	AAA
Cash Weighting (%)	0.58	n/a

Source: JamiesonCooteBonds Pty Ltd.

Credit Rating Allocation (by Duration Weight)***



Sector Allocation (by Duration Weight)***



Platform Availabilty

Asgard	Ausmaq	Aust Money Market
BT Wrap/Panorama	Colonial First Wrap	HUB24
Linear	Macquarie Wrap	Mason Stevens
Netwealth	PowerWrap	U-Exchange

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. *** Refer to Definition of Terms. ~ Cash & Other includes cash at bank, outstanding settlements and futures margin accounts.

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Market Review & Outlook

• Global recession fears are in full swing as G-3 Purchasing Managers Index data collapses (worst since 2012).
• Consumer credit delinquencies force the US Federal Reserve to go all-in dovish.
• The irony of stubborn Australian employment data: making the patient bleed out. Rate cuts are coming.
• Modern Monetary Theory and QE4. A critical Sunday lunch conversation.

• Global recession fears are in full swing as G-3 Purchasing Managers Index data collapses (worst since 2012).

The incoming global macro data has suggested for some time that global growth is cooling quickly, however, March Purchasing Managers Index (PMI) readings from Asia, Europe and the US now confirm actual contraction across the G-3 complex. JCB believe this is most concerning as the dataset included the large rebounds in global equity markets over the Jan-Feb survey period. Was this weather effected, US government shutdown effected, US-China Trade War or Brexit effected? It is likely this has been some of the reasoning, but JCB cannot attribute all these events on such convenient exceptions.

Global growth is cooling, as the international cost of capital has risen and is now biting into credit serviceability. The incoming macro data from here requires elevated evaluation, because if there is more to this after such a large support program from central banks, investors will be entering this downturn from a terribly poor starting point - think of a European recession with negative 0.40% interest rates and an operating 4.7 trillion Euro Quantitative Easing program already in place. That doesn't make for a pretty picture.

• Consumer credit delinquencies force the US Federal Reserve to go all-in dovish.

Rising credit delinquency in the US consumer loan markets is the likely cause of an emergency reversal from the US Federal Reserve (the US Fed). The Fed’s full speed ahead in the opposite direction has all asset markets rejoicing, as accommodative policy and large central bank balance sheets look set to remain our new normal.

Why did the US Fed pull the emergency parachute? What did they see that concerns them? The abrupt rise in credit delinquency at a consumer level in the US is alarming, but not surprising for followers of JCB’s monthly commentary. After raising interest rates since late 2015 in combination with quantitative tightening (reducing Federal Reserve balance sheet), JCB believe the seeds of the next slowdown/recession were sown long ago. The theme is easy to identify, but often in markets, the timing proves difficult. The average borrower has lent too much money and can no longer service those borrowings, or the collateral on the loans is quickly declining in value. The “credit cycle” moves with a significant lag effect to monetary policy. JCB remain on high alert for further or accelerated credit delinquency, as the asymmetry of the cycle sling shots asset performance or underperformance once credit starts to crack. There are cracks in the dam wall of credit and the US Fed knows it. JCB will be monitoring housing and auto loans for key leading indicators.

• The irony of stubborn Australian employment data: making the patient bleed out. Rate cuts are coming.

RBA deputy Governor Guy Debelle made the following comment in a speech on the 6 December 2018. "Leverage can turn a manageable macroeconomic event into a very hard to manage crisis."

The RBA is finally starting to acknowledge Australia’s economic woes. Consumption has been subsidised by rising housing values for many years, which in turn has been predicated on cheap and easy money (loose credit conditions). Now as cheap and easy money has been withdrawn, housing is on a slippery slope of repricing lower. This not only kills consumption but decays the value of the collateral (housing) pledged against those large loans. Big loans backed by little assets is a material problem, and as Debelle notes, “leverage turns the manageable into very hard to manage”.

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Looking at the raw data makes for bracing reading. Australia's household debt to GDP was 120.5% as at September 2018 year, according to the Bank for International Settlements, one of the highest in the world. In 2007, Ireland was sitting at around 100%. At the same time, the RBA puts Australia's household debt to disposable income at 188.6%. Ireland was 200% in 2007, while the US was only 116.3% at the start of 2008. Amazingly, it is estimated that two thirds of household wealth is invested in real estate. More than 60% of all lending by financial institutions is in the property sector. House prices have now fallen 10 to 14% in Melbourne and Sydney form their peak valuations, with no end in sight for a further decline. JCB have long expected that the pricing cycle accelerates at the end of the decay (driven by forced sellers) and generates a crescendo moment that is the final death knell. It is final because the financial pain will force unconventional policy responses thereafter that stabilise the system and allow for some recovery. Investors are yet to experience anything resembling a crescendo that triggers the policy response.

The irony of the domestic incoming data holding up is that it frustrates the RBA from delivering the medicine that is crucially needed to maintain the status quo. The longer they wait, the deeper the damage. Central Banking tends to be about taking the path of least regret. With the patient being critically wounded, any delaying of the blood transfusion could be terminal for the economy.

• Modern Monetary Theory and QE4. A critical Sunday lunch conversation.

Democratic socialism is on the rapid rise in the western world. In the US, Bernie Sanders is leading primary polling for the Democratic nomination to face Trump in 2020, with Democrat Alexandria Ocasio Cortez (AOC) whipping up huge amounts of support from millennials that have been left behind by recent asset appreciation from Quantitative Easing (QE) which has widened the gap between rich and poor. For those unfamiliar with the New Green Democratic Deal, JCB suggest you should take some time to orientate how fast modern day politics has morphed significantly left. As citizens, JCB totally agree that stimulus should be directed to those most in need. As a money manager, JCB cannot condone printing unlimited deficits to fund such actions, but do sympathise with the genesis of this thinking. This is a clear reaction to the abuse and selective policies of Trump (100% tax deductions on private jets) and the failure of previous QE to address this social imbalance. In the UK, opposition leader Jeremy Corbyn is also a democratic socialist.

With this new tilt towards socialism, political leaders (mainly in opposition for now) are taunting a new ideology for fostering economic growth. Modern Monetary Theory (MMT) suggests governments with control over their currency can print money, distribute newly printed wealth directly to those in need (basic social income) with little consequence for economies. Interest rates are low and inflation remains subdued after printing a collective $15 trillion, why not use this form of public funding to stimulate economies and foster direct outcomes for those most in need?

JCB will no doubt write about this at length in the coming months as it remains a hot topic. For now, investors should orientate themselves with these powerful offshore developments in markets considered the cradle of democratic capitalism. This will be widely debated at your next dinner party or Sunday lunch.

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Fund Review

For the quarter ending March, the CC JCB Active Bond Fund (the Fund) returned 3.83% (after fees), underperforming the Bloomberg AusBond Treasury (0+Yr) Index by 0.10%.

In March interest rates rallied powerfully with both the ECB, US Federal Reserve and RBNZ moving to highly dovish policy stances (lower interest rates, more policy accommodation), supporting all asset markets over the month. The Fund delivered strong absolute returns, help by some further concern that the Australian economy continues to suffer under a falling property market.

JCB remains adamant it will be difficult for rates to materially release higher. Investors seem very willing to own Government bonds, receive some income and hold optionality over further weakening in the global macro environment. There appears to be similarities with the period leading into the GFC. Many market participants expected rates to rise at that time given the incoming data, as equities rallied into November 2007 cycle highs. Fixed income pullbacks remained shallow and the performance was somewhat head scratching. The market was broadly aware of subprime credit debt issues but the prevailing thinking at that time was its was an "known" issue. Fast forward to 2019 and US consumer loan delinquencies on the rise, the market will likely continue to pay a premium to protect against an asymmetric decline in riskier asset values. As such, JCB remain a buyer of dips in bond markets, and retain structures that will perform well in a risk off scenarios with equities close to historical highs.

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.
Duration Weight - refers to the portion of the overall duration attributable to the segment (i.e. credit rating or sector). Contribution to duration is calculated by multiplying an instruments duration by the percentage weight of the instrument in the portfolio. This calculation includes the contribution to duration by holding futures contracts.

Jamieson Coote Bonds

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