

# WealthFocus Investment Advantage

## PERPETUAL BALANCED GROWTH

December 2018

### FUND FACTS

**Investment objective:** The fund aims to provide long-term capital growth and income through investment in a diversified portfolio with an emphasis on Australian and international share investments.

### FUND BENEFITS

Provides investors with access to a diverse range of growth and income producing assets. Active management and asset allocation techniques are employed in order to further enhance the fund's return and manage risk.

**Benchmark:** Balanced Growth Index (Internally generated composite)

**Inception Date:** June 1995

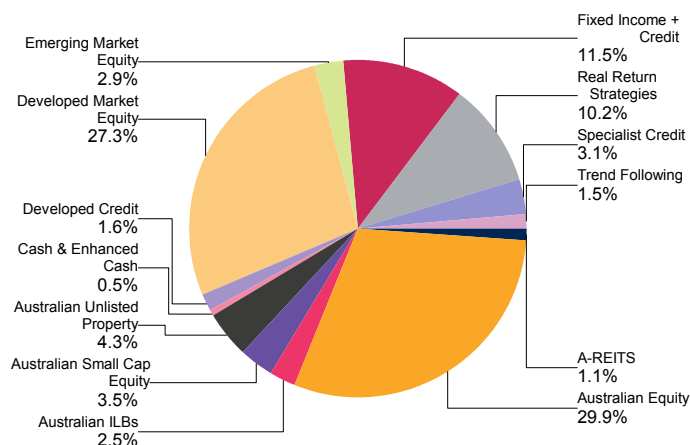
**APIR:** PER0036AU

**Management Cost:** 1.98% p.a.

**Investment style:** Active, fundamental, disciplined, value

**Suggested minimum investment period:** Five years or longer

### PORTFOLIO SECTORS



### INVESTMENT STYLE

Valuation is the key driver of investment decisions. We aim to extract the value premium within asset classes (stock selection) and across asset classes (asset allocation).

- Diversification, value and quality, as well as portfolio protection strategies, are key elements to protect on the downside during extreme events.
- Our economic cycle and momentum signals help time entry to, and exit from positions by supplementing the key value signal.
- A "total portfolio" approach is taken – seeking out excellent risk adjusted return opportunities (rather than asset classes) and risk management is embedded at every stage of the process.

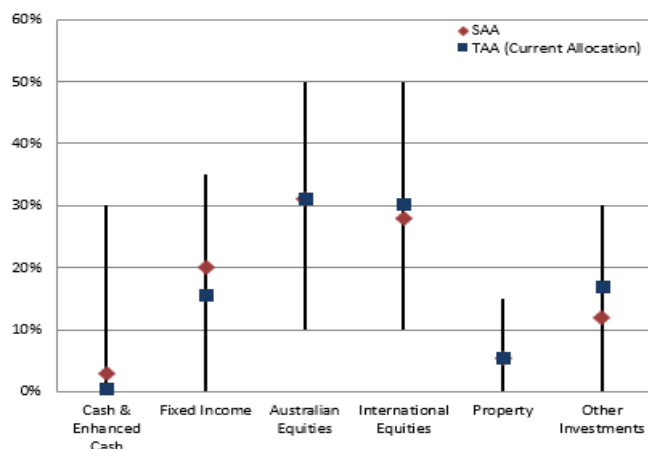
### NET PERFORMANCE- periods ending 31 December 2018

	Fund	Benchmark	Excess
1 month	-0.6	-1.4	0.8
3 months	-5.0	-6.0	1.0
FYTD	-2.8	-3.5	0.6
1 year	-2.5	-0.1	-2.4
2 year p.a.	2.7	4.9	-2.2
3 year p.a.	3.6	6.0	-2.3
5 year p.a.	3.9	6.4	-2.5
10 year p.a.	6.7	7.7	-1.0

Past performance is not indicative of future performance. Returns may differ due to different tax treatments.

### ASSET ALLOCATIONS AND INVESTIBLE RANGES

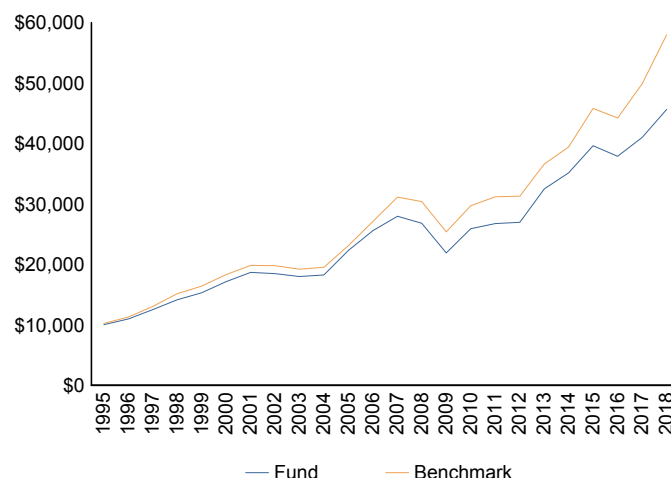
FUND TACTICAL AND STRATEGIC ALLOCATIONS INCLUDING ALLOWABLE MAXIMUM AND MINIMUM RANGES



### STRATEGIC AND TACTICAL ASSET ALLOCATIONS

The Strategic Asset Allocation (SAA) is the neutral allocation acting as an anchor for active positioning, while the Tactical Asset Allocation (TAA) process adjusts the asset allocation according to market opportunities and risks.

### GROWTH OF \$10,000 SINCE INCEPTION



## MARKET COMMENTARY

Global equity markets corrected sharply in the December quarter to the point where more than half of global equity markets were in a bear market (having declined more than 20% from their recent peak). Credit markets have also weakened notably and liquidity in these markets has become extremely poor. A number of factors coalesced to force a reassessment of the outlook. In particular:

- The liquidity backdrop for markets has changed profoundly over the past year – from massive expansion a year ago to marginal contraction now. By early 2019, only the Bank of Japan's QE program is in place and it has been scaled back substantially under its "Yield Curve Control" policy. The European Central Bank's (ECB) program has stopped and the US Federal Reserve (the Fed) is 'on autopilot' in selling assets to gradually reduce its balance sheet.
- The global economic expansion is slowing as the US economy moves past the peak fiscal stimulus and Chinese economic growth continues to moderate due to its deleveraging policies.
- Oil prices fell dramatically in the quarter which, as usual, is a double-edged sword – it provides some relief for consumers and businesses that are energy users, but it might also be an indicator of weakness in the global economy and it causes intense pressure on energy related companies in equity and debt markets.
- The uncertainty created by the trade war between China and the US (notwithstanding some more positive rhetoric from President Trump recently) and the growing strategic rivalry between these super-powers continues to hang over the markets.
- Finally, in Australia, house prices in Sydney and Melbourne are finally falling which is a very good thing for housing affordability but the second-round effects on consumption spending and the economy could be significant.

As a result of these developments, global profit growth is expected to slow sharply in 2019 (and could even be negative) and recession risks in the next two years have increased significantly in our judgement.

In a quarter where major equity markets in the US, Europe and Asia were down by between 10 and 15% and credit markets were also much weaker, the Fund's defensive qualities were highlighted by several factors which added to outperformance relative to the benchmark.

The Fund's defensive strategies kicked in during the December quarter and added significantly to relative performance. These positions were managed actively over the quarter as the risk reward proposition changed. Profits were taken by rolling strike prices on bought option positions in equity and currency markets. Optionality added significantly to portfolio performance as volatility increased and key downside protection positions moved to be 'in the money'. The value bias of our global equity exposures served to enhance performance relative to the benchmark.

Overall, the portfolio is positioned to maintain exposure in risk rallies, while buying protection when and where it is cheapest to protect against both risk off and idiosyncratic events. This reflects our view that central bank policy withdrawal and declining 12-month forward earnings growth expectations will present challenges for risk markets into 2019. The portfolio relative underweight to duration was significantly reduced during the quarter. Although exposure to relative value positions remains in the portfolio, it has been reduced in recent months. These positions still held include exposure to equity alpha which provides the portfolio with a significant value and quality bias relative to the benchmark. The Fund retains significant foreign exchange exposure including a long dated AUDUSD put option alongside positions in USD and core Emerging Market currencies. The Fund also has exposure to a systematic trend following strategy alongside continued selective exposure to downside protection.

## OUTLOOK

Policy makers are showing some limited signs of responding to the deterioration in the growth outlook in 2019. The Chinese authorities continue to ease policy in an attempt to revive growth, but it appears a more dramatic intervention (like the fiscal easing in 2016) will ultimately be required. This means President Xi would have to back away from his policies to clean up the shadow banking system – a step he has been unwilling to take (so far). The Fed is likely to be on hold for some time as the sell-off in equity and credit markets late last year tightened financial conditions significantly (similar to the correction in late 2015 and early 2016 which caused the Fed to go on hold for 12 months). Moreover, a slowdown in growth is already underway and inflation will fall below target again (due to lower oil prices) in the next six months.

In Australia, the Reserve Bank (RBA) has long maintained that the next move in rates is likely to be up. Now it looks more likely to be down as the growth outlook becomes more uncertain and inflation remains at or below the bottom of the target band. The Federal election in the first half of the year will no doubt further complicate the outlook.

Notwithstanding these signs of adjustments by global central banks, the tightening in the liquidity of financial markets caused by the change in global central banks' balance sheet policy is likely to continue.

We remain cautious about the market outlook. A correction of the magnitude we have seen in the December quarter is usually enough to create the conditions for a renewed bull market if the global economy has a soft landing. At the same time, the economic outlook has clearly deteriorated and the risk of recession in the next two years has increased notably. Finally, as we have been observing for some time, the economic and market cycle are very mature and the market performance in the December quarter increases the risk that this very long bull market is over.

Accordingly, leading indicators for the global economy will be more than usually important in the months ahead.

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The Balanced Growth Fund gains its exposure to Australian Shares by investing in an underlying Australian Share Fund/s which primarily invests in Australian listed or soon to be listed shares but may have up to 20% exposure to stocks outside Australia. The investment guidelines showing the Fund's maximum investment in international shares do not include this potential additional exposure. Short positions may be part of the underlying Australian Share Fund's strategy. Currency hedges may be used from time to time.

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