

# Touchstone Index Unaware Fund

## Performance update

As at 31 March 2017

### Performance

March 2017	1 month	3 months	6 months	Since Inception**
Fund	+3.38%	+5.11%	+10.93%	+20.08%
Benchmark*	+3.28%	+4.71%	+9.88%	+22.31%
Value added	+0.10%	+0.40%	+1.05%	-2.23%

Performance figures are net of fees and expenses.

\*S&P/ASX 300 Accumulation Index

\*\*Inception date is 4 April 2016.

### Market Review

The Australian equity market, as measured by the S&P/ASX 300 Accumulation Index, continued to rally advancing by 3.3% in March and posting a solid gain of 4.8% for the quarter. Over both periods the market remained influenced by international events, specifically the rising interest rate setting of the US Federal Reserve and the uncertainty over policy implementation by the new US Government. Notwithstanding some pullback of the "Trump trade" in March and weakening commodity prices, our share market remained resilient and posted broad-based gains in the month.

International equity markets were mixed in March. The US market ended flat for the month as the failure to pass the Republican Healthcare Bill led to questions around the ability of the Trump administration to implement other promised policy changes. Notwithstanding this, the S&P 500 posted a strong rise over the quarter (+5.5%) as economic data pointed to continued strengthening of the US economy. The first quarter of calendar 2017 was also notable in that it was the least volatile in history, with the CBOE Volatility Index (an options-based measure of expectations for volatility over the coming 30 days) averaging 11.7 in the quarter, the lowest start to a year in its history. Other markets were also higher with the FTSE 100 rising (+0.8% mom, +2.5% qoq) despite the UK Government triggering Article 50 to formally begin the two year process that will lead to Britain leaving the EU. The German DAX30 (+4.0%, +7.2%) and French CAC40 (+5.6%, +5.4%) also posted solid gains in the month and quarter despite heightened political risks in France. Asian markets were mixed with the Chinese Shanghai Composite (-0.6%, +3.8%) and Japanese Nikkei (-1.1%, -1.1%) posting varied returns in contrast to the very strong return in Hong Kong (+1.6%, +9.6%).

The Australian Dollar weakened slightly against the US Dollar, ending the month at \$0.763 (from \$0.766) weighed down by weaker commodity prices. Australian economic data releases were mixed in March. On a positive note, 4Q 2016 GDP growth surprised to the upside, rising +1.1% qoq (versus the consensus rise of +0.8%), to be +2.4% higher over the year (versus consensus of +2.0%). Encouragingly, the rebound was broad-based and was the highest level since 1Q 2011. However, the February jobs data was weaker than expected reflecting a rising unemployment rate up 20bp to 5.9% (versus consensus of 5.7%), a contraction in employment by -6,400 (versus consensus of +16,000) and a decline in hours worked. The NAB survey of business conditions for March eased back from the decade high recorded last month (-7pts to +9.3), but remained at elevated levels. The Reserve Bank of Australia left the cash rate unchanged at 1.5% in the month. The statement remained largely unchanged from the prior meeting. In the release of the RBA March minutes during the month, the RBA cited a "build-up of risks associated with the housing market". However, the bank signaled that it's still not ready to raise the official cash rate as it remains worried about a strengthening currency, stating "an appreciating exchange rate would complicate the adjustment of the economy following the end of the mining investment boom." In addition, the labour market also remains a challenge.

Over the month and quarter, the Utilities (+6.3% mom, +10.7% qoq), Healthcare (+5.5%, +14.9%) and Consumer Staples (+5.4%, +10.8%) sectors performed strongly. In addition, the financial sector also outperformed with the major banks (+3.9% mom, +6.6% qoq) posting solid performances after they implemented out of cycle rate rises, which subsequently led to earnings upgrades. Traditional bond proxies, namely Telcos (+0.2%, -4.6%) and Property Trusts (+0.6%, -0.3%) were the laggards in the month and quarter as was the Materials sector (+0.4%, +1.8%), with the latter negatively impacted by declining commodity prices in the period. Discretionary retailers were also very weak in the period (the retail subsector declined -2.5% mom, -3.7% qoq), weighed down by concerns over the possible entry of Amazon into the Australian market.

The main stock specific news in the month came from Spotless Group (+32.3%), which rallied strongly after receiving an unsolicited takeover proposal from Downer EDI (-12.7%) at a significant premium to its share price. Myer Holdings (-3.6%) also rose after it was confirmed that Premier Investments had secured a 10.8% interest in the company.

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Fletcher Building (-16.1%) downgraded its guidance following the identification of additional losses in its Construction division in New Zealand, while Harvey Norman (-12.0%) and JB Hi Fi (-7.9%) also fell heavily on concerns regarding the Australian entry of Amazon, as discussed above.

### Top 5 Shareholdings

Company
National Australia Bank
Wesfarmers Limited
The Star Entertainment Group
Telstra Corporation
Westpac Banking Corporation

### Performance Review

The Fund slightly outperformed the market over the month, advancing by +3.4% versus the benchmark return of +3.3%. For the March quarter the Fund advanced by 5.1%, exceeding the market return by 0.4%.

The Fund benefited from its holding in Star Entertainment (+12.1% mom, +7.4% qoq) which has risen steadily since its interim result in February. Management commented that much of the worst of the disruption to its venues in Sydney and the Gold Coast is now behind them. We remain comfortable with the long term prospects of the company and anticipate that the disruption from extensive upgrades currently being undertaken will continue to dissipate over the year ahead.

QBE Insurance (+7.5% mom, +6.5% qoq) rallied higher following last month's pullback when regulatory changes in the UK saw the stock weaken at month end. The company has risen strongly over the quarter after it posted a strong FY16 result and announced a \$1bn buyback. Management have implemented premium rate rises and cost efficiencies which will continue to drive earnings from current cyclical lows.

The main detractor in the month was Trade Me Group (-3.0% mom, -2.4% qoq). TME was impacted in the month as its largest shareholder sold down part of its stake in the company. We regard TME as an attractive investment given its strong earnings growth outlook, robust balance sheet and focused management along with an undemanding valuation.

Resmed (-0.8% mom, +8.8% qoq) was also a negative contributor in the month as concerns around continuing production delays for its new mask range impacted. However, recent channel checks indicate that the worst of the disruption is now behind the company. RMD is expected to generate strong growth from its medical device and mask ranges, with market share gains from the new mask releases in late 2016 supporting already strong system growth.

### Market Outlook

Markets have rallied strongly over the last 12 months and have extended their gains in the quarter. As such we remain cautious on the sustainability of our market's advance. Valuations across both industrials and banking sectors have expanded over the year, resulting in few pockets of valuation appeal. In addition, while commodity prices have rallied from their lows, the market has now largely anticipated this in resources valuations. As such the broader company earnings cycle needs to improve in order to justify current valuations.

Added to our concerns is the fact that financial markets globally have rallied to new highs, yet uncertainty in terms of President Trump's policy settings, the outcome of the various European elections and geopolitical risks generally remain high. How Syria now plays out adds an additional dimension to this last risk, with its potential impact on financial markets unknowable.

Given the heightened uncertainty, the market remains very vulnerable to an exogenous shock. As such we remain cautious and have reflected this in our portfolio positioning.

Touchstone's takeaways:

- revenue growth remains difficult – tight cost management takes on added significance;
- highly geared capital structures are riskier in this environment, even with low interest rates; and
- heightened geopolitical uncertainty.

Downside protection remains at the fore of our investment decisions.

### Contact details

For more information, call 1800 895 388 (AU) or 0800 442 304 (NZ) or visit [touchstoneam.com](http://touchstoneam.com).

The Fund is managed by Touchstone Asset Management, a Bennelong Funds Management boutique.

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