

Touchstone Index Unaware Fund

Performance update

As at 30 April 2017

Performance

April 2017	1 month	3 months	6 months	Since Inception** pa
Fund	+0.42%	+7.10%	+14.65%	+19.10%
Benchmark*	+0.98%	+6.57%	+13.43%	+21.79%
Value added	-0.56%	+0.54%	+1.23%	-2.69%

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 200 Accumulation Index advanced by 1.0% in April following a strong gain in the March quarter. Over the month, geopolitical risks heightened with the US missile strike in Syria early in the month, escalating tensions with North Korea, French elections and UK politics all dominating the headlines. In addition, commodity and oil prices weakened during the month with both the resources and energy sectors underperforming. However, our equity market proved to be resilient and posted another monthly gain with interest rate sensitive sectors, such as financials and property trusts, outperforming in the month.

Most major international equity markets were stronger in April. The US S&P 500 ended the month higher (+0.9%), boosted in the main by better corporate earnings, with the Nasdaq reaching all-time highs. However, US equities later retreated from near record levels in the month as the Trump administration's long-touted tax plan disappointed the market as it lacked concrete policy detail. Despite the increased geopolitical risks, the VIX volatility index touched its lowest levels since July 2014. European markets were buoyed by favourable market reactions to the first round of the French Presidential election with both the French CAC40 (+2.8%) and German DAX30 (+1.0%) trading higher. Other markets were mixed with the FTSE 100 falling -1.6% despite the favourable reaction to the snap election called by the UK Prime Minister. The Chinese Shanghai Composite fell -2.1% as growth data continued to moderate.

The Australian Dollar weakened against most major currencies, negatively impacted by falling commodity prices, in particular iron ore. Australian economic data releases remained mixed in April. The NAB survey of business conditions rebounded sharply in March 2017,

to a level of +14.2 from +9.3 in February (versus expectations of a steady level), the highest reading since early 2008, while business confidence remained steady. The CPI rose 0.5% q/q in Q1, slightly below consensus, with the yearly number of 2.1% (versus 1.5% previously) and now back inside the RBA's 2-3% target for the first time since 2014. Key drivers of the increase were fuel (+5.7% q/q) and housing (electricity +2.5% and construction +1.0%). However, underlying inflation of 0.43% QoQ (1.76% YoY) was softer than consensus at 0.5% QoQ (1.8% YoY) and remains subdued, consistent with soft wage growth and weakening retail sales. As such, there was little surprise that the RBA's guidance of a steady cash rate of 1.5% was unchanged.

Over the month, Industrials (+4.4%), Healthcare (+3.2%) and traditional bond proxies such as Utilities (+3.1%) and REITs (+2.6%) performed strongly. In addition the Financial sector (+1.9%) also outperformed after the major banks continued lifting interest-only lending rates independent of the RBA, which subsequently led to earnings upgrades. The Materials (-0.2%) and Energy (-0.6%) sectors were once again the laggards and were negatively impacted by declining commodity and oil prices in the month. In addition the Telcos sector (-9.9%) was weak following the announcement from TPG Telecom (-12.7%) that it was the successful bidder in the 700Mhz spectrum auction and the company had intentions of becoming the fourth major player in the mobile phone market. The Consumer Staples sector (-2.6%) was also soft, weighed down by Wesfarmers following the release of weaker than expected quarterly sales.

The main stock specific news in the month came from Coca-Cola Amatil (CCL) (-13.4%) which lowered its guidance from mid-single digit earnings growth to a decline in half yearly underlying net profit. Management indicated that trading in the Australian drinks unit for the year to date had been weaker than last year, with all channels experiencing volume and price pressure. Challenging consumer conditions also impacted The Reject Shop (-48.7%) which released a very soft Q3 trading update and materially downgraded its full year guidance. Ten Network Holdings (-52.6%) was also punished after a weak ad market and increased cost of content saw it lower guidance to a loss of between -\$25m to -\$30m for FY17. Management also cited in the ASX statement that there is material uncertainty that casts significant doubt on its ability to continue as a "going concern". In contrast, Brambles (+10.6%) rallied strongly after the company provided a trading update which reiterated its FY17 guidance.



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Top 5 Shareholdings

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

Performance Review

The Fund underperformed over the month, advancing by +0.4% versus the benchmark return of +1.0% and was adversely impacted by a pullback in a number of key positions.

The main detractor in the month was Telstra (-9.4%) which fell after TPG Telecom announced that it planned to become Australia's 4th mobile network operator after acquiring mobile spectrum assets in a recent Government auction. While we believe this is potentially a longer term negative for Telstra, we believe that any impact on earnings will be beyond a three-year timeframe, and is more than discounted into Telstra's share price at current levels.

Wesfarmers (-4.6%) reversed some of its recent gains after it posted weaker than expected Food and Liquor comparable store sales for the March quarter. Whilst the non-food businesses continue to trade well (and represent around 60% of earnings), the market is very focussed on the shorter term momentum within the supermarkets business. We continue to expect that competition will remain rational and market share moves between Coles and Woolworths will stabilise through 2HCY17. In addition to continuing strong performance from Bunnings, we also expect that sales of Coal and Officeworks could provide positive catalysts for unlocking upside to Wesfarmer's valuation.

The Fund benefited from its holding in James Hardie Industries (+10.2%) which has now regained all of its losses since its last quarterly result. The market has gained more confidence that the factors which have impacted their margins for the US Fibre-Cement division should abate going forward. We continue to believe that earnings for FY18 will be very strong, driven by continued US housing market growth and margin expansion as production costs normalise.

Henderson Group (+5.8%) also rallied in April, recovering some of its losses from the last quarter. During the month the company had a pleasing 1Q17 update, and received regulatory and shareholder approval for its merger with US based fund manager Janus Capital.

Market Outlook

Markets continued to rally in April and have extended their gains over the last 12 months. By comparison, corporate earnings growth for the broader market (excluding resources) has been modest with few meaningful upgrades. As such, 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 and are now trending lower for some, the market is now largely anticipating this in resources valuations. As such we continue to remain cautious on the sustainability of our market's advance. 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. The situations in North Korea and Syria add additional dimensions to this last risk, with unknown, albeit potential negative impacts on financial markets.

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
- Heightened geopolitical uncertainty.

Downside protection remains at the fore of our investment decisions.

Contact details

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

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