Touchstone Index Unaware Fund

Performance update

As at 30 June 2017

Performance

June 2017	1 month	3 months	6 months	1 year	Since Inception** p.a.
Fund	-0.03%	-1.06%	+4.00%	+17.03%	+14.93%
Benchmark*	+0.22%	-1.57%	+3.07%	+13.82%	+16.16%
Value added	-0.25%	+0.51%	+0.93%	+3.21%	-1.23%

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 200 Accumulation Index, rose modestly by 0.2% in June as lower oil prices and higher bond yields negatively impacted returns in Energy and interest rate sensitive sectors such as REITs and Utilities. The market weakened by -1.6% over the quarter and underperformed most major global equity markets.

Major international equity markets were mixed in June. The US S&P 500 (+0.5%), Dow Jones (+1.6%) and Nasdaq (-0.9%) all reached new record highs in the month. However, gains were tempered toward month end after statements from a number of major global central banks indicating that they would gradually wind down monetary stimulus weighed on financial markets. European and UK markets were softer following those comments with the German DAX30 (-2.3%), the French CAC40 (-3.1%) and UK FTSE 100 (-2.8%) all trading lower. In contrast the Shanghai Composite rallied (+2.4%), buoyed by the decision by MSCI Inc. to add Chinese shares to its emerging markets index. In addition, the release of stronger economic data (the May PMI) at month end eased market fears that China's growth might be adversely impacted by the tough liquidity measures implemented by the Chinese Government.

The Australian dollar rose to $0.769 (from $0.743) versus the US Dollar (USD) and was a beneficiary of the USD weakness. The USD was a causality of stronger reflation talk by global central bankers with the prospect of stronger non-US growth and potentially higher interest rates driving up demand for European assets.

Australian economic data remained mixed in June. The Q1 GDP rose 0.3% q/q, (largely as expected) with the year on year growth slowing to 1.7% from 2.4% at the end of calendar 2016. During June, the RBA made no change to the cash rate of 1.5% for the ninth consecutive month.

Commodities in general remained weak over the quarter before rebounding from their lows at month end after the release of better economic data from China. Iron ore traded lower in the quarter, declining towards $US50 before rallying at the end of June to $US65/t. Oil also fell in the month with Brent down a further -4.0% to $US49/bbl taking the fall in the quarter to -8.8%.

Over the month, the Australian equity market was pressured by falls in the Energy sector (-6.9%) and interest rate sensitive sectors such as Property Trusts (-4.8% mom) and Utilities (-2.7%). Resources (-2.1%) were also weak due to falling commodity prices for much of the month. However, these losses were tempered at month end as underlying commodity prices posted gains. Consumer Staples (-2.6%) were also soft due to weakness in consumer spending. Conversely, Healthcare (+6.1%), Financials (+1.6%) and Technology sectors (+1.4%) were better performers in the month.

The main stock specific news in the month came from within the Insurance sector with QBE (-8.5%) falling after management slightly lowered its insurance margin outlook due to adverse experience and weather related claims in its Emerging Markets operations. Conversely IAG (+6.6%) upgraded expectations for its insurance margin due to higher reserve releases from its long tail insurance classes. In addition, Vocus (+19.5%) was a strong performer in the month following the receipt of a takeover bid from Kohlberg Kravis Roberts & Co. LP.

Top 5 Shareholdings

Company
National Australia Bank
Telstra Corporation
QBE Insurance Group
Wesfarmers Limited
Insurance Australia Group

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TOUCHSTONE Asset Management

Touchstone Index Unaware Fund

Monthly performance update

As at 30 June 2017

Performance Review

The Fund underperformed the market over the month, declining by -0.3% versus the benchmark return of +0.2%. For the June quarter the Fund fell by -1.1% which was less than the market decline of -1.6%. Even with the large cash holding, the Fund has posted strong double digit returns since inception in April 2016.

Our large position in IAG performed very strongly in the month and quarter (+6.6% mom, +12.1% qoq) driven principally by an upgrade to its FY17 earnings late in the month. In addition, the market gained confidence that IAG's earnings growth would benefit from cost savings, a stronger pricing environment and very strong reinsurance cover.

Our holding in Resmed (+6.7% mom, +8.6% qoq) rallied in the month with positive momentum reported on its new product launches and rectification of recent production issues.

James Hardie (+6.7% mom, +1.6% qoq) was also a solid contributor as the market gained confidence that the factors impacting margins for their US Fibre-Cement division should abate going forward. We continue to believe that FY18 should be very strong for JHX, driven by continued US housing market growth and margin expansion due to normalising production costs.

The largest detractor in the month was QBE (-8.5% mom, -8.4% qoq) which fell after management cited weakness in its Emerging Markets (EM) business. The share price decline following the downgrade effectively wiped out the entire EM division's value. This is clearly a disproportionate reaction to what is a small part of QBE's portfolio, and one which we expected to be volatile. While the losses in EM were disappointing, there is no change to our investment thesis. We expect that QBE will continue to benefit from a recovery in the global insurance market and also higher interest rates. In the short term, QBE's share price should also be supported by the company commencing its A$1bn buyback.

Our investment in Wesfarmers (-6.0% mom, -11.0% qoq) suffered from small earnings downgrades in the month relating to increased price investment in Coles. In addition, the general weakness in consumer stocks also saw the company suffer from selling pressure along with other companies in the retail sector. Despite these short term negatives, we remain of the view that WES is a company with a portfolio of high quality businesses with strong management and robust financial capacity and undemanding valuation.

Our investment in Goodman Group (-5.9% mom, +3.3% qoq) fell along with interest rate sensitive shares in the month. However, the company has posted very strong gains in the quarter outperforming both the broader market and the REITs sector.

Market Outlook

Despite the pullback in the quarter, we remain cautious on the Australian equity market. Valuations remain high and growth expectations for the broader market (excluding resources) remain modest, yet may still prove to be optimistic. To this end, the forthcoming domestic reporting season will be an important signal as to the outlook for corporate profitability and the sustainability of the market at current levels.

Furthermore, risks remain elevated globally. International financial markets have continued to rally, some to ever increasing highs, yet uncertainty in terms of policy settings and geopolitical risk generally remains high.

We also note that volatility has edged back into financial markets in recent weeks as fears over tighter monetary policy settings and higher stock market valuations have clouded the outlook for the year ahead.

Our thesis remains unchanged that 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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