

# Wheelhouse Global Equity Income Fund

## Monthly performance update

As at 31 March 2019

### Performance

	1 month	3 months	6 months	1 year	Since inception p.a.
Income	1.45%	1.53%	2.88%	8.54%	6.75%
Growth	(1.34%)	3.88%	(4.48%)	2.23%	1.13%
<b>Total Fund return</b>	<b>0.11%</b>	<b>5.40%</b>	<b>(1.59%)</b>	<b>10.77%</b>	<b>7.88%</b>
<b>Benchmark*</b>	<b>1.49%</b>	<b>11.51%</b>	<b>(0.87%)</b>	<b>12.31%</b>	<b>10.18%</b>
Income Index**	1.43%	7.98%	(2.76%)	11.23%	7.73%

Performance figures are net of fees and expenses. Inception date is 26 May 2017.

\*Benchmark is the MSCI World Index ex Australia.

\*\*The Income Index is used to assess the performance of the Fund over a shorter period than the longer-term investment horizon of the benchmark. It comprises 50% of the Fund's benchmark (the MSCI World Index ex Australia) and 50% of the Put Write Index, an all income index which serves as a proxy for the Fund's income-generated returns.

### Monthly performance review

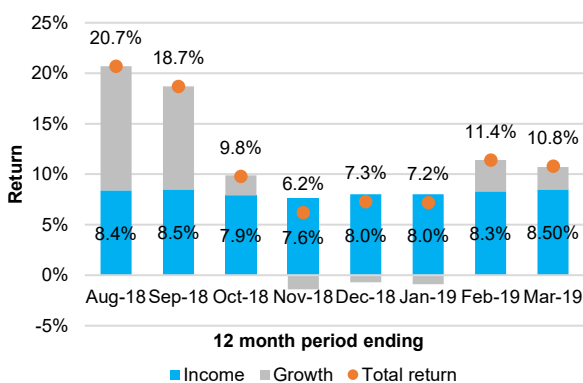
The Fund returned 0.11% in March, behind the benchmark return of 1.49%. This return comprised:

- A return of (0.18%) from the portfolio (in USD); and
- A positive return of 0.31% from the weakening of the Australian dollar versus US dollar.

### Lower risk returns

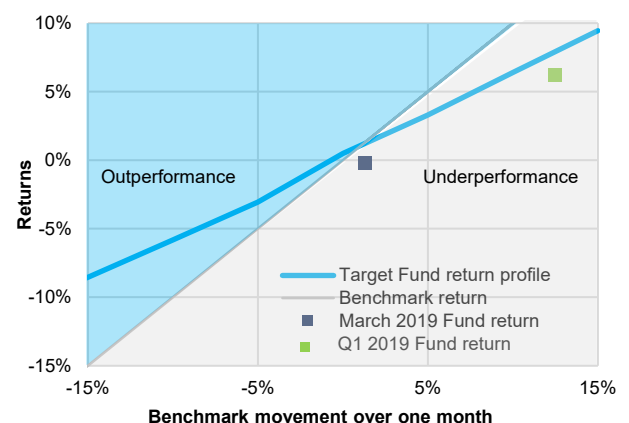
The strategy's high-income generation and active downside protection strategy are designed to lower risk and deliver equity returns with a smoother, more retiree-friendly return profile. As a result, returns are expected to add relative value in weak and low-growth markets, and to drag in more positive markets. We assess this targeted return profile in USD to strip out the influence of the AUD/USD currency movements.

### Income vs total return (12 month rolling)



Source: Wheelhouse

### Targeted monthly return profile



Wheelhouse is a retirement solution designed to deliver better investment outcomes to Australian retirees. Our philosophy is based on three pillars:

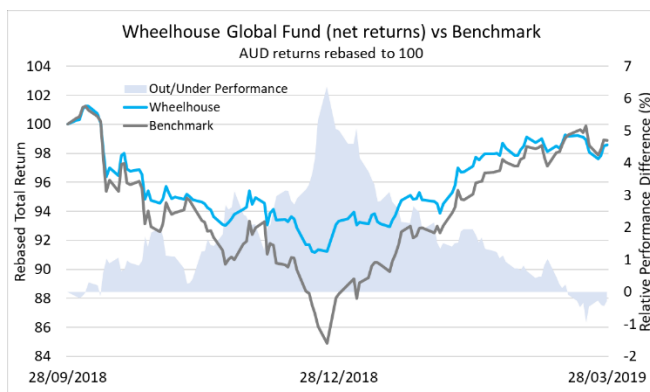
- investing in global equities as a **growth asset** to address longevity risk;
- shaping returns to be **retiree-friendly** with lower volatility, better capital preservation and consistent income; and
- delivering a **lower cost** solution to help improve outcomes.

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“Rebound” best describes the recovery from the market lows in late December, to now being within sight of their all-time highs. It’s important to take stock of this volatility. The December quarter was the *worst* market performance in over 10 years for many indexes, only to be immediately followed by the *best* quarterly returns in over 10 years.

In an almost perfect ‘tale of two halves’, the Fund’s returns were predictably defensive. The Fund outperformed at an increasing rate in December the more the market fell, only to steadily underperform as markets snapped back through to March.



Source: Wheelhouse

From point to point over the six-month period, it might be tempting to ask ‘why bother’ with defensive income generation and crash protection strategies. Indeed, if an investor did not require access to income over this period, then their investment balance would be in a very similar state in March 2019 as it was in September 2018.

However – and this is the reason our Fund exists – retirees typically require access to a regular income stream to fund their lifestyle. Life’s expenses don’t take a hiatus just because the market is in retreat, which means that income would have been taken out of the market across this period, including in December and close to the market bottom.

Every dollar removed from the market during this period also removed that dollar from the subsequent rebound in 2019. This explains why the retiree, who was relying on income over this six-month period, will almost certainly be left with an inferior balance come March, when compared to the investor who did not need income (even after all the income has been included). By protecting capital during these drawdowns, this impact is meaningfully reduced, meaning investors’ capital balances are left in a far healthier state.

While across this short six-month period the impact on a retiree’s savings might not have been massive, the same principle is evident, and multiplied, when similar drawdowns occur over extended periods such as the tech crash in 2000-2002 and the GFC in 2007-2012.

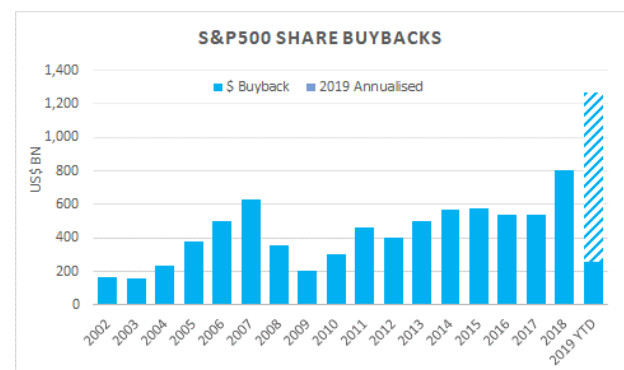
Our Fund is purpose-built for retirees and designed to minimise precisely these risks. From point to point our returns may look similar, but the real-world outcomes are designed to be significantly better.

### Market review

With markets circling all-time highs again, it appears to us that FOMO (fear of missing out) has again returned as the primary driver of market risk. Clearly the US Federal Reserve’s pivot from tightening to accommodative has been a key market driver, but despite this we observe a number of market characteristics that suggest all is not as blue-sky as first appears.

Firstly, investors redeemed US\$79bn from global equity funds in the US in the March quarter, the second worst month for Q1 outflows ever. While share prices might be moving up, it does not appear to be supported by a significant turn in investor sentiment, with no ‘new money’ being put to work. This cautious investor sentiment is also reflected in the growth of more specialised ‘defensive equity’ allocations, with the largest ‘low-vol’ ETF (which owns primarily utilities and REITs) seeing net inflows.

This defensive positioning contrasts with record buying by US corporates as part of their share repurchase programs. US corporates bought back US\$254bn of their own shares during the first three months of 2019, a rate that’s up 13% year on year.



Source: Bloomberg, Wheelhouse

We believe the contrast between external investor positioning and US corporate buyback activity is a cause for concern. For a start, US corporates are fairly price insensitive buyers, with somewhat different objectives to many external investors. US corporates are currently generating record cash profits following the Trump tax

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cuts last year, and are also enjoying cyclically high profit margins that are typical of late cycle economies.

While some say high buybacks are an indicator that management teams view their own stock as an attractive opportunity (after all, they should know their own company best), on average buybacks have actually proven a fairly reliable contrarian indicator. This was true in 2007, when buybacks set new records immediately before the GFC, and again in 2009, when buybacks were widely suspended at precisely the stock market lows. For this pro-cyclical reason, share buybacks were actually illegal in the US for most of the 20<sup>th</sup> century, as they were viewed by the SEC as a form of market manipulation.

Earnings revisions are already in focus with slowing GDP, and in our view it doesn't really matter if the next recession is shallow or deep-rooted – the current level of buybacks are difficult to justify with any version of margin contraction or economic slowdown. With such a major source of equity buying removed, it does question the staying power of current equity levels.

While this analysis may suggest we believe investors are best served increasing their allocation to cash, we should highlight one of our strongest underlying investing beliefs: future investment returns are notoriously difficult to predict, with the difference between being 'right' and being 'lucky' even harder to disentangle.

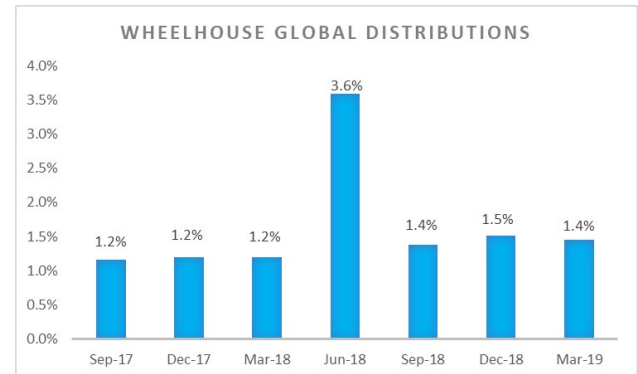
We are far more comfortable forecasting a return to more normal levels of volatility, which are extremely consistent with the tail-end of economic expansion periods, market turning points, and tighter market liquidity levels – all of which we are witnessing today. Our strategy converts elevated levels of market uncertainty into consistent income streams, and thus is well placed in an environment of elevated market volatility.

We are reminded of the saying that markets can remain irrational far longer than we can remain solvent, which we believe is especially pertinent for retirees today. Retirees need to generate meaningful real returns in order to avoid 'slow burn' capital erosion. Our strategy was specifically designed to address this investment issue – remain fully invested, generate high consistent income, but include a healthy element of 'crash protection' for when things inevitably go wrong.

### **Income generation**

In addition to downside protection, consistent income generation is another essential ingredient of a typical retiree-friendly investment strategy. At Wheelhouse the bulk of our investment returns are income driven. By relying less on capital growth (shares going up) and more on a regular income stream, the Fund's returns are expected to be far more stable and predictable, and a

source of real return in low growth environments. This income generation is reflected in the Fund's yield.



Source: Wheelhouse

### **Downside protection**

During market corrections or crises, the Fund's downside protection strategy is expected to come to the fore and provide the heavy lifting in terms of protecting capital.

It's important to clearly define what our downside protection strategy is designed to do.

- The strategy is designed to reduce losses in all market downturns, targeting 50-60% of the market's decline beyond a fall of 10% from its high. It is not designed to 100% insulate the portfolio from any loss. While we could design the strategy this way, the cost of such a 'risk-less' approach would likely offset all of the growth of the portfolio – for without some risk, there can be no return.
- The cost of this protection is expected to range between 100-150bps each year depending on market conditions, although with active management the hedge has cost meaningfully less.

In stronger markets with no corrections the strategy will likely be a mild drag on returns, and we witnessed this in the March quarter. However, we believe the value of having meaningful protection in the portfolio that is 'always on' – designed to engage as much for market overnight shocks (e.g. Black Monday 1987) as it is for more cyclical drawdowns (e.g. 4Q 2018) – will add significant value to our investors' outcomes where capital protection is paramount.

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#### \*Morningstar's 'Moats'

The Fund's underlying portfolio is based on the Morningstar® Developed Markets Ex Australia Wide Moat Index<sup>SM</sup>, a semi-active index that was constructed specifically for Wheelhouse Partners.

The stocks comprising the Index are based on the fundamental view of Morningstar's team of more than 100 stock research analysts. The Index composition changes quarterly, based primarily on selecting the most attractively-valued securities in the coverage universe.

The concept of economic 'Moats' underpins the Morningstar investment philosophy and can be categorised into the following five sources.

- **Cost advantage** - Matters most when price is a big factor in a purchase decision. Typically sourced from cheaper processes, better locations or unique assets.
- **Efficient scale** - Absolute size is less important than relative size (better to dominate a niche market).
- **Intangible assets** - Brands, patents and regulatory licences. Often found in Consumer and Industrials, and less so in Financials.
- **Network effect** - Extremely powerful, where the product value increases with the number of users. Dominant networks get larger at the expense of smaller.
- **Switching costs** - Sticky customers, spans many industries but particularly present in Financials.

#### New addition – Comcast

Comcast is a major global media business spanning cable TV, internet access and filmed content production across the globe. Shares of Comcast were added to the portfolio in March. The following is reproduced with permission.



#### \*Investment thesis – Comcast

Comcast is made up of three parts. The core cable business owns networks capable of providing television, Internet access, and phone services to roughly 58 million U.S. homes and businesses, or nearly half of the country. Comcast acquired NBC Universal from GE in 2011, which owns several major cable networks amongst other assets, including Universal Studios and several theme parks. Lastly, Comcast acquired Sky in 2018, the dominant television provider in the U.K.

Comcast's core cable networks have provided a significant competitive advantage versus its primary competitors, phone companies like AT&T and Verizon, as high-quality Internet access has become a staple utility in more households. The vast majority of U.S. homes today can receive fixed-line Internet access service from only two providers: the traditional cable or phone company. Across nearly half of the U.S., that cable company is Comcast. The firm's market share has steadily expanded in recent years, driving cash flow sharply higher. The cost to enter this market is enormous. Several firms have attempted to enter the fixed-line market over the years, but failures far outnumber successes. Most notably, Alphabet sharply curtailed its Google Fiber plans in 2016 after six years of effort ended with likely less than 1% of the U.S. connected, despite the firm's deep pockets.

We've increased our fair value estimate to \$45 from \$42 after reviewing Comcast's 2018 results. Our fair value estimate assumes that Comcast remains the dominant Internet access provider in the markets it serves and that the television businesses within NBCU and Sky remain relevant, albeit slow-growing, operations. Reported revenue will increase sharply in 2019 because of the Sky deal, but we don't expect growth excluding this transaction will exceed a mid-single digit rate over the next several years.

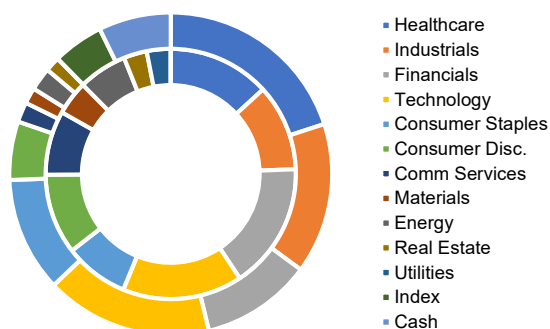
Source: Morningstar Equity Research, as at 10 April 2019

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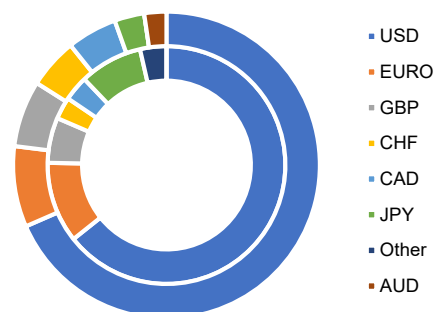
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#### Sector exposure



Outer circles: Wheelhouse  
Inner circles: Benchmark

#### Currency exposure



Contributors	Detractors
Amazon	Biogen
Unilever	EssilorLuxottica
Guidewire Software	Jones Lang Lasalle
Microsoft	Charles Schwab
Novartis	John Wiley & Sons

#### How to invest

The Fund is open to investors directly via the PDS, available on our website, or the following platforms.

#### Platforms

Hub24 (Super, IDPS), Netwealth (Wrap, IDPS), Powerwrap (IDPS)

#### Contact us

For more information, call 1800 895 388 or visit [wheelhouse-partners.com](http://wheelhouse-partners.com)

Fund at a glance	
APIR Code	BFL3446AU
Benchmark	MSCI World Index (ex-Australia)
Stock range	50 to 100 stocks
Buy/sell	+/- 0.30%
Cash limit	0-10%
Recommended investment period	Medium to longer term (five years plus)
Investment amount	Initial investment minimum: \$10,000
Fees and charges	0.79% p.a. (including GST net of reduced input tax credits) of the NAV of the Fund. There is no performance fee.
Inception date	26 May 2017

Note returns are expressed in AUD unless USD is specified, and are net of fees and expenses unless specified as gross.

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