

Investors Mutual Concentrated Australian Share Fund

Quarterly report September 2017

Fund status: OPEN

- ▶ Global sharemarkets continued to rally over the quarter thanks to strength in the US markets, which hit new record highs
- ▶ The Australian sharemarket returned a modest gain, helped by a resurgent Resources sector
- ▶ We continue to be cautious given the competitive pressures impacting companies and the uneven economic environment

	1 month	3 months	1 Year	3 years [^]	5 Years [^]	Since inception [^]
Income	+0.0%	+0.0%	+2.5%	+3.0%	+5.4%	+4.8%
Growth	+1.1%	-3.1%	+2.4%	+8.4%	+7.7%	+7.7%
Total Return*	+1.1%	-3.1%	+4.9%	+11.4%	+13.1%	+12.5%
Benchmark**	+0.0%	+0.8%	+9.0%	+7.1%	+9.9%	+8.3%

[^]% Performance per annum. *Fund returns are calculated net of management fees, and assuming all distributions are re-invested. Investors should be aware that past performance is not indicative of future performance. Returns can be volatile, reflecting rises and falls in the value of underlying investments.

**The benchmark for this Fund is the S&P/ASX 300 Accumulation Index. (ASX300)

Sharemarket Commentary

Global equity markets finished the September quarter on a firm note with the MSCI World Index gaining +5.0%. Global bourses were led higher by the US, as the Dow Jones continued its run of record highs and the S&P500 Index finishing the quarter up +4.5%. Europe's Stoxx50 and Japan's Nikkei were similarly strong over the quarter finishing +4.8% and +2.2% higher respectively.

Sentiment improved late in the quarter as equity markets looked to brush aside geopolitical rumblings such as the threat of nuclear war with North Korea. With markets reacting positively as the Republican Administration finally released a blueprint of corporate tax reforms. Also in the US, the Federal Reserve minutes released in September highlighted the need for further policy normalisation by enacting a program to wind back its balance sheet, a move which pundits labelled QT (quantitative tapering). The Fed also flagged its intention for a further US rate increase by the end of the year. The Fed minutes coincided with a backdrop of stronger US macro data releases, such as the ISM manufacturing gauge hitting a 13 year high. The tax reform proposals, coupled with Fed normalization news buoyed the USD late in the quarter after it had fallen circa -10% over the past 6 months.

Domestically, the AUD lost -1.4% against the USD in September, a welcome reprieve given its strength over the previous 6 months. Commodities had a volatile month with the iron ore price falling -21.4% in the month of September, reversing its strong gains in the prior month. The oil price gained +7.5% in September and +14.5% over the quarter as production cuts by OPEC gained traction.

In contrast to its global counterparts, the broader Australian market as measured by the ASX300 Accumulation Index had a lacklustre quarter overall eking out a +0.8% gain. Despite weakness in the Resources sector late in the quarter, courtesy of a hefty correction in the iron ore price, the Resource sector was the best performing sector over the quarter gaining +9.3%. By contrast the Industrials sector was soft falling -0.8%. Reporting season in August proved lacklustre despite the fact that many companies met their FY17 expectations, their forward guidance and outlook for FY18 underwhelmed investors.

Within the Industrials sector, Telcos and the Utilities disappointed with falls of -14.8% and -5.8% respectively over the quarter. Telstra surprised investors in August by cutting their dividend from 31cps to 22cps for FY18 with disappointment over management's lack of clarity in their communication over the direction of the dividend going forward. Utilities came under pressure late in the quarter as investors reacted to upward pressure on short term interest rates and weakness in AGL as the Government held discussions with the company regarding its closure of Liddell. Despite falling -5.2% over the quarter, the Healthcare sector was the best performing sector in the month of September with sector heavyweight CSL rebounding following a mixed reaction to the FY18 guidance given in August.

Fund information

APIR	IML0010AU
Inception	1 Sep 2010
Size	\$62M
Application (Ex)	\$1.7047
Redemption (Ex)	\$1.6961
Cash	18.5%
Management fee	0.993% p.a.
Performance fee	10.25%
Holdings	10 -30 stocks
Stocks/sector limits	No
Investment horizon	4-5 years
Distributions	Semi-annually
Managers	Hugh Giddy

Level of Franking (%)*

FY12	112.8%
FY13	51.1%
FY14	28.5%
FY15	62.8%
FY16	50.6%
FY17	38.2%

*As per IFSA Standard

Performance & Strategy

The **Investors Mutual Concentrated Australian Share Fund** had a tough quarter with its unit price declining -3.1% against the benchmark's gain of +0.8%. Our caution to the volatile Resources sector held back our relative performance over the quarter with many mining stocks rallying significantly. In addition many of our mid cap Industrial holdings such as Events Hospitality had a disappointing quarter although we remain very comfortable with the management and long term outlook for these companies. On a positive note, Clydesdale Bank, Steadfast and Shopping Centres Australia all had a solid quarter.

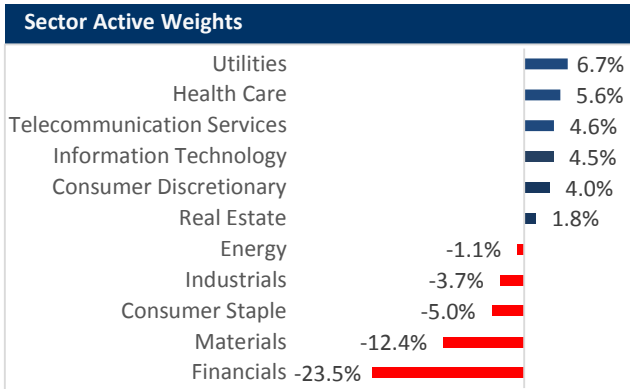
Telstra (TLS) fell -15.2% over the quarter after it surprised investors by cutting its FY18 dividend from the current level of 31cps to a lower than expected 22cps from FY18 onwards. Telstra stated that this new level of dividends represented a payout ratio of 70-90% post NBN earnings and also included an unspecified special dividend component. Subsequent announcements by management indicated that 22cps was a level that the company felt was sustainable for the foreseeable future and was a level from which the company felt it could look to grow from. We believe that the ongoing caution as to whether the 22cps dividend is sustainable is unwarranted and thus we used this weakness to add to our position late in the quarter. TLS now offers a 6.3% fully franked dividend yield which we believe is very attractive for investors looking for income. In addition, the lower dividend payout ratio means Telstra's balance sheet will be in excellent shape when all the NBN receipts are taken into account.

Myer (MYR) share price retreated -4.8% during the September quarter following a downgrade to earnings guidance. Australian consumer landscape continues to remain patchy with weakness across apparel retailing and department stores evident in the recent reporting season and ABS consumer data. Recent media attention has focused on Board renewal and whether MYR's Board has the right mix of retail experience to weather current conditions and navigate through the structural changes. We believe that with Premier Investments, a 10% shareholder agitating for change, that the company is effectively now in play. At current levels, we see fundamental value in the stock.

Clydesdale Bank (CYB) gained +9.1% in the September quarter following a market update in which the bank announced it was ahead of schedule on its cost out programmes. Furthermore, we are encouraged with the bank expecting to achieve capital efficiencies when it is granted advanced accreditation by the UK regulator which could result in a return of capital via a buyback. Furthermore, the Bank of England's announcement that UK rates may be raised later this year also led to strength in financials in the UK as this would help the sector's profitability.

Outlook

We remain cautious given the continued low growth and highly competitive economic environment which is making it difficult for many companies to grow their earnings. We continue to focus our attention on good quality companies that we believe are well positioned to sustainably grow their earnings and dividends in the years ahead while also maintaining a healthy level of cash in the portfolio as we await further opportunities to buy good quality stocks at the right level. We are still cautious on the Resource sector given the continued high levels of supply apparent in most commodity



Portfolio top holdings

Portfolio top holdings	ASX Code
CSL	CSL
Spark Infrastructure	SKI
Telstra	TLS
Fletcher Building	FBU
Commonwealth Bank	CBA
Clydesdale Bank	CYB
Westfield	WFD
AGL	AGL
Link	LNK
Z Energy	ZEL

