Investors Mutual Equity Income Fund

Quarterly report September 2017

INVESTORS MUTUAL LTD

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	+1.7%	+1.7%	+8.8%	+8.1%	+8.4%	+9.2%
Growth	-0.9%	-2.5%	-1.0%	+1.2%	+2.5%	+1.6%
Total Return*	+0.8%	-0.8%	+7.8%	+9.3%	+10.9%	+10.8%
Benchmark**	+0.0%	+0.8%	+9.0%	+7.1%	+9.9%	+7.3%

^% 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. The Fund has twin objectives of delivering (i) income greater than the S&P/ASX 300 Index yield +2% and (ii) returns with less standard deviation than S&P/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	IML0005AU
Inception	1 Jan 2011
Size	$681M
Application (Ex)	$1.0715
Redemption (Ex)	$1.0661
Management fee	0.993% p.a.
Investment horizon	4-5 years
Distributions	Quarterly
Manager	Anton Tagliaferro Michael O'Neill Tuan Luu

Level of Franking (%)*	
FY13	41.3%
FY14	48.2%
FY15	37.3%
FY16	37.1%
FY17	53.4%

*As per IFSA Standard

Security Category	Effective Exposure
Ordinary Shares	83.2%
Call Options	-14.4%
Put Options	1.8%
Cash	29.4%

Performance & Strategy

The ***Investors Mutual Equity Income Fund*** had a lacklustre quarter with its unit price declining -0.8% 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 of the mining stocks rallying significantly. In addition, many of our mid cap Industrial holdings such as Sonic Healthcare and Ansell had disappointing quarters although we remain very comfortable with the management and long-term outlook for these companies. On a positive note, Clydesdale Bank and Shopping Centres Australia both had a solid quarter.

The Fund declared a distribution of 1.8 cents per unit for the September quarter thanks to income received from dividends and option premium earnt during the quarter in the portfolio, setting up what should be another good year income wise for the Fund's investors.

The rise in 10-year bond yields in July allowed us to selectively accumulate sound retail trusts such as BWP Trust, SCA Property and Charter Hall on distribution yields of 6%+ as the sector was sold off. We also used the increased volatility during the August reporting period to target attractive entry and exit prices for our key industrial and financial investments. As companies that we research such as Ansell, Caltex and IAG dropped in price temporarily, we wrote put options to implement our target buy prices. Conversely, as the stocks we own such as Amcor, Sonic Healthcare and Transurban rallied towards full valuation, we wrote call options to capture good income for our investors at our target sell prices.

We also put together attractive buy-write investments in stocks like Westfield and Woolworths as these companies moved toward reasonable valuation levels over the quarter. Our conservative positioning in the market coupled with solid option income worked well as the market whipsawed during the September quarter on geopolitical and earnings concerns.

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.

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 the given the continued high levels of supply apparent in most commodity markets.

Researcher	Rating
Lonsec	Recommended
Zenith	Recommended
Morningstar	Bronze

Portfolio top holdings	ASX Code
National Australia Bank	NAB
Commonwealth Bank	CBA
Telstra	TLS
Spark Infrastructure	SKI
IAG	IAG
Transurban	TCL
Westpac	WBC
CSL	CSL
Sonic Healthcare	SHL
Caltex	CTX

Value and Income portfolio update

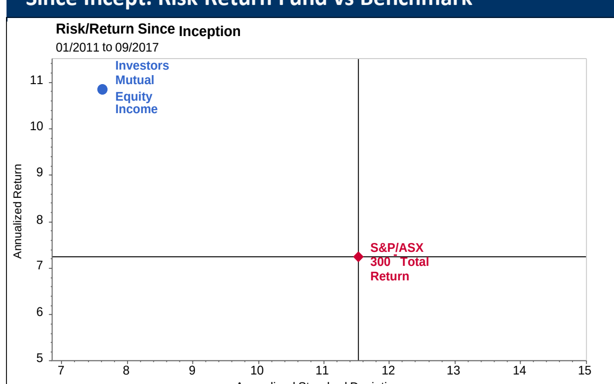
As of 1 January 2011 the Value and Income Fund was restructured and its name was changed to the IML Equity Income Fund. The combination of the historical performance numbers for the Value and Income Fund and the present performance numbers for the Equity Income Fund is presented below.

Fund information	
Inception	1 May 2004
Size	$681M
Application (ex)	$1.0715
Redemption (ex)	$1.0661

Period	Fund return	Benchmark
1 year	+7.8%	+9.0%
3 years^	+9.3%	+7.1%
Since Inception^	+8.4%	+8.5%

^ % 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. Fund returns are the Value and Income Fund prior to 31 December 2010 and the Equity Income Fund from 1 January 2011. ** The benchmark for this Fund is S&P/ASX 300 Accumulation Index. The benchmark returns is the UBS Bank Bill+2% benchmark prior to 31 December 2010 and S&P/ASX 300 Accumulation Index from 1 January 2011.

Since Incept. Risk Return Fund vs Benchmark*



*Benchmark = S&P/ASX 300 Accumulation Index, Source: Factset

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