Financial Year in Review

FY2017 was a fascinating period of financial market history to observe. In many regards the year was broken into two very distinct periods; the period before the election of Donald Trump to the US presidency, and the period after his election. Before November 8th 2016, global equity markets were seven years into a bull market that was increasingly looking fatigued. From 30th June until 8th November 2016 the MSCI All Country World Index (MSCI ACWI) rose 3.6%[4] in US$ terms, and throughout this period there was considerable market commentary arguing that valuations had become stretched and a meaningful correction was overdue.

The one constant in financial markets is that they never fail to surprise. Despite all the uncertainties that a Trump presidency represented, his shock election to the White House gave financial markets a new lease of life. From the 8th November 2016 until 30th June 2017, the MSCI ACWI rose by 14.7% in US$ terms, while the price of safe-haven, and inflation sensitive assets, such as developed market government bonds, fell considerably. For most of this period the new market narrative centred around the idea of a powerful “reflation trade”. The premise of this argument was that with the Republican party in charge of all three branches of the US government, the US economy would benefit from reform of the unwieldly US tax code, and the pro-growth agenda of Trump, who had made vast new spending promises on the campaign trail.

Financial market enthusiasm with the US reflation trade thematic resulted in strong gains in global equity markets over FY2017. In the US, the broad-based S&P500 index returned 17.9%, while the more growth sensitive Russell 2000 and Nasdaq indices returned 24.6% and 28.3% respectively. In Europe and Japan share markets rose 24.9%[5] and 31.1% respectively, while in Australia the local share market rose 14.1% and the MSCI ACWI rose 15.2% in Australian dollar terms.

While the prospect of accelerating US economic growth and huge (unfunded) spending promises put considerable vim into share markets, this came at the expense of significant falls in government bond prices in most developed market countries. Globally, developed market government bonds fell by 5.1% over the year, as measured by the Bloomberg Global Developed Sovereign Bond Index. While tax cuts and spending promises provide powerful short-term fuel to growth hungry share markets, the more sombre bond markets are tasked with pricing the longer-term effects such actions have on government finances and inflation.

In summary, FY2017 proved to be one of the better years on record for share market investors, though for reasons few could honestly claim to have predicted in advance.

Performance of the Portfolio

The premise of the Portfolio Manager is to invest into a diversified global portfolio of financial assets, all purchased at attractive discounts to their intrinsic value. This approach is then coupled with an active strategy designed to capture the value presented by these discounts.

Our belief is that this approach offers shareholders the prospect of equity like returns, but with a much greater level of protection built in on the downside when compared against a strategy that only invests into a portfolio of international shares.

While our asset class diversification provides us with insurance against any significant correction in global share markets, it also means that in periods where share markets are unusually strong, our portfolio should naturally be expected to lag general equity market indices. It is within this context that shareholders should consider the investment returns generated during FY2017.

[4] All returns quoted are total returns, including net dividends.
[5] European and Japanese share market returns refer to the Euro Stoxx 600 and the Nikkei 225 indices, while Australian returns refer to the ASX 200 index.
[6] Source: Staude Capital Limited
[7] Net investment returns are after manager fees and trading costs, but before company expenses and tax.

The investment portfolio generated net investment returns of 14.8%[6,7] during FY2017, a very strong performance considering the fund's see-through equity market exposure averaged just 28%[6] over the year.

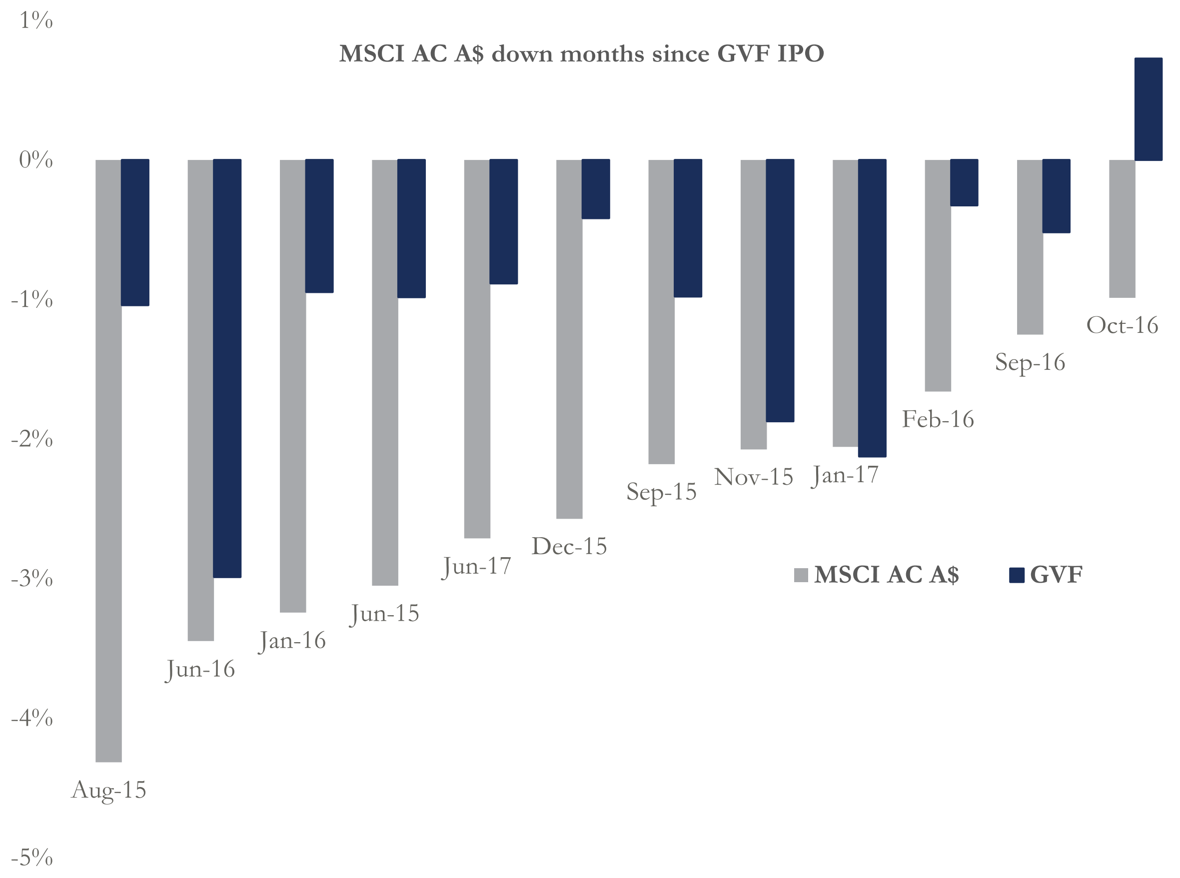
The positive returns generated were dominated by a very successful year for the application of our discount capture strategy. During FY2017 our discount capture strategy generated 15.0%[6] (gross), which represents significant outperformance (or alpha) over the fund's underlying market and currency exposures. In contrast, the portfolio's underlying market exposures - which comprise a mixed portfolio of equities, bonds and other financial assets - generated positive returns of 6%[6]. The portfolio's currency exposures detracted from performance during FY2017 due to a broad-based appreciation of the Australian dollar over the year.

We believe the most appropriate reference point for shareholders to benchmark our investment performance against is an index that comprises half the return of the MCSI ACWI in Australian dollar terms, and half the return of Australian cash interest rates. During FY2017 this reference index returned 8.4%[6].

Risk management remains a key focus for the team and I when it comes to investing the portfolio, and while our investment performance will not always live up to the targets that we set for ourselves, to date the portfolio has demonstrated a resilience to periods of market stress that is in line with our aims.

The chart below shows the draw down history of the fund since IPO. The first column shows months where the MSCI ACWI fell in Australian dollar terms, and beside this is the corresponding net investment return of the Global Value Fund in the same month.

Exhibit 1: MSCI AC A$ and Global Value Fund down months



[6] Source: Staude Capital Limited

Despite managing a significantly lower risk portfolio than one invested solely in international share markets, since IPO the fund's investment returns (after all fees and expenses) have exceeded those of the MSCI All Country World Index in Australian dollar terms (before fees).

Outlook

The Company begins FY2018 with an investment portfolio full of attractive underlying value that the team and I are excited about unlocking. We do not pretend to know what broader markets will do in the year ahead and thus continue to run with lower levels of portfolio risk compared to general share market portfolios. This approach means that we should tend to underperform equity markets during periods when they are very strong, while expect to outperform them when they are weak. Over the longer-term, we believe this approach should deliver a superior investment return profile to shareholders.

The team and I would like to thank all our shareholders for their support throughout FY2017, and especially for the many kind messages that we received over the year.

Miles Staude
Director and Portfolio Manager
London
29 August 2017