Sestante Diversified Fund

Monthly Investment Report as at 30 June 2017

Asset Class

Diversified

Investment Objective

To provide an investment return of CPI +2.5% p.a. over rolling 5 year periods after fees and costs and before taxes

APIR Code

PAT0006AU

ARSN

613 157 387

Fund Inception Date

27 September 2016

Benchmark

CPI +2.5%

Buy/Sell Spread

+0.20%/-0.20%

Management Cost

0.7271% p.a.[1]

Distribution Frequency

Quarterly

Minimum Investment

$20,000

Fund Size

$6.1m

Exit Price

$1.0058

Number of Underlying Investments

20

Market Review

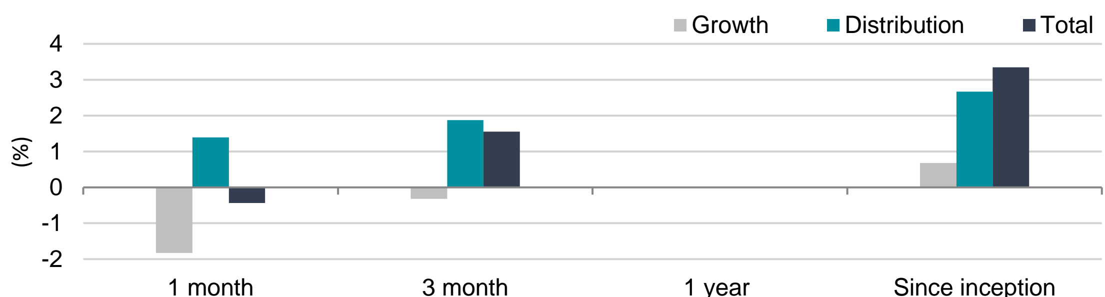
In June the Federal Reserve (Fed) raised its short term Fed Funds rates for the second time in 2017, bringing the benchmark rate to a range of 1% to 1.25%. The central bank also detailed its plan to scale back its balance sheet by allowing part of its Treasury and mortgage-backed securities portfolio to mature every month. The market expects the additional tightening measure to be formally announced in the fourth quarter of 2017. Despite the Fed's action and talk the US dollar continued to weaken when compared to all major currencies, with the Dollar Index (US dollar) down a further 1.34% during the month. In that context the Australian dollar was one of the strongest performers, rising 3.25%. The strength of the domestic currency weighted heavily on the returns of international equities and real assets expressed in Australian dollar terms.

The MSCI AC World TR in USD was up 0.45% in US dollar terms but down 2.71% in Australian dollar terms. Emerging markets and Japan managed to outperform the US market, while Europe closed down due to some profit taking activity. Infrastructure (-3.11%) and property (-2.23%) were both down, although the latter exhibited some resilience stripping out the currency impact.

The S&P/ASX 300 TR (up 0.22%) was modestly up overall, with wide dispersion in sector performance. Banks and small caps outperformed while yield stocks were pummelled, dragging down utilities and telecommunication services. This outcome was driven by the sharp rise in domestic interest rates, with the short part of the curve reacting to improving economic data and the long end moving higher in sync with global yields; the 2, 5 and 10 years yields were up 18, 27 and 21 basis points respectively.

The European Central Bank (ECB) expressed optimism on Europe's growth outlook and signalled that it might adjust its policy tools of sub-zero interest rates and massive bond purchases as the recovery progresses, prompting a worldwide sell-off in government bonds. Consequently fixed income suffered, with the domestic and the global (hedged back to the Australian dollar) markets down 0.90% and 0.22%, respectively. Commodity Trading Advisors (CTA) and managed futures strategies were another casualty. Their negative performance held down alternatives (up 0.26%) however ended the month up due to positive contributions coming from long/short equity and arbitrage strategies.

Performance



	Growth Return (net) (%)	Income Return (%)	Total Return (net) (%)	Benchmark Return (%)	Active Return (%)
1 month	-1.83	1.39	**-0.43**	**0.36**	**-0.79**
3 months	-0.32	1.88	**1.56**	**1.07**	**0.49**
1 year	n/a	n/a	**n/a**	**n/a**	**n/a**
3 Years (pa)	n/a	n/a	**n/a**	**n/a**	**n/a**
Since inception[2] (pa)	0.68	2.67	**3.35**	**3.80**	**-0.45**

Past performance is not an indication of future performance. Net performance figures are calculated using exit prices, net of fees and reflect the annual reinvestment of distribution. Retail investors should refer to net returns. If investing through an IDPS Provider, the total after fees performance return of your investment in the Fund may be different from the information in this report.

[1] As at 3 August 2016. Refer to PDS and website for a full breakdown of management costs.

[2] This figure represents the annualised performance of the Fund since inception.

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Performance Review

In June, the Fund returned -0.43%, underperforming the benchmark return of 0.36% by -0.79%.

In June the Fund registered it first negative month for 2017. Five asset classes out of the eight the Fund invests in were negative, with both growth and defensive assets ending down for the month. However, the defensive assets still managed to outperform the growth assets. Positive contributions came from the Fund's underweight position in infrastructure (-5.62%) and property (-0.41%) and from the Fund's overweight position in global fixed income (up 11.32%) and alternatives (up 7.63%). Negative contributions came from the Fund's underweight positions in Australian equities (-3.93%) and cash (-0.99%) and from the overweight position in international equities (up 1.01%). All in all, the tactical asset allocation outperformed the strategic asset allocation. That outcome was reinforced by the Fund's strong manager selection in both growth and defensive assets, tactical tilts and manager selection were responsible for 80% and 20% of the extra return, respectively. In fixed income, a higher credit/lower duration exposure compared to the indices substantially curbed losses. In Australian equities, an overweight position in mid cap growth stocks and in selected, non-consensus single stock positions drove the Fund to outperform a rising market. In International equities both the selection and the allocation effects were positive, despite only two managers out of four outperforming the index. The Fund's sizeable overweight position in emerging markets proved decisive in that regard once again.

At the end of the month, the investment manager reduced the Fund's exposure to global fixed income by 13.81%, reducing government and corporate equally to maintain an unchanged duration for this component of the Fund, while taking some profits in credit after a further contraction in spreads. The proceeds were allocated to Australian equities (up 8.29%), International equities (up 5.21%) and alternatives (up 3.35%). As a consequence, the exposure to growth assets has increased to 68.1% from 51.19% (up 16.91%). Within growth assets, the exposure to equity has increased to 44.57% from 31.07% (up 13.50%). The composition of defensive assets has undergone an even greater change, as the exposure to fixed income has declined to 19.91% from 34.80% (down 14.89%), while the exposure to cash has only decreased to 11.99% from 14.01% (down 2.02%). As a result, the sensitivity to interest rate risk of the overall Fund has been significantly reduced. Finally, in alternatives the investment manager liquidated the Fund's positions in Ironbark LHP Long/Short Fund and Henderson Absolute Return Australian Equity Fund, zeroing the Fund's exposure to long/short equity strategies, to concentrate on discretionary macro.

Manager Allocation (%)

Fund	%
Australian Fixed Interest	**14.25**
CFS Australian Bond Fund	3.62
Henderson Tactical Income Trust	7.04
Omega Core Australian Bond Fund	3.59
Global Fixed Interest	**5.09**
Macquarie Income Opportunities Fund	1.16
Omega Global Corporate Bond Fund	1.48
Pimco Diversified Fixed Income Fund	2.45
Property	**0.95**
Vanguard International Property Securities Index	0.95
Alternatives	**17.01**
AZ Multi Asset Institutional Macro Dynamic Trading	17.01
Infrastructure	**1.76**
MBA Global Listed Infrastructure Fund	1.76

Fund	%
Australian Equities	**20.89**
Bennelong Ex-20 Australian Equities Fund	6.35
BT Wholesale Core Australian Share Fund	3.23
Fidelity Australian Equities Fund	6.08
Ironbark Karara Australian Share Fund	5.23
Global Equities	**22.64**
Capital Group New Perspective Fund	2.85
Ironbark Royal London Concentrated Glbl Share Fund	2.72
Vanguard Emerging Markets Shares Index Fund	3.67
Vanguard FTSE All-World ex-US ETF	9.68
Vanguard International Shares Index Fund	3.72
Cash	**17.41**
BetaShares Australian High Interest Cash ETF	11.28
Cash	6.13

Market Outlook

The first hike in the Fed's Fund rates occurred on the 15th of December, 2015. Three more rises have followed so far, and this will become four by the end of December 2017 if the central bank maintains its current course of action. It is interesting to note that 18 months ago the US Dollar Index (DXY) was trading around the 98 level while today it is 3% lower, at 95. Similarly, US inflation has moved higher on the same time horizon, from 0.7% to 1.6%, briefly touching a top of 2.7% in February of this year. In other words, since the Fed has embarked on its plan to normalise its monetary policy, US inflation has grown while the value of the greenback has decreased on the foreign exchange market. The investment manager believes that this will persist going forward. Since the beginning of the year the DXY has shed roughly -7% in a steady fashion and the investment manager estimates a short-term bounce is overdue. Once it occurs, the investment manager expects the downward trend to resume.

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Market Outlook (cont'd)

A world of higher US inflation and interest rates and lower US dollar is positive for commodities, cyclicals and financials, that is, the themes of the "reflation trade" may soon be back after a 6 month pause. Incidentally, the US "big tech" group of stocks, as exemplified by the Nasdaq 100, dropped while the rest of the market remained steady in June 2017. That event could be a signal of a coming change in the market regime. In fact, the technology sector is considered to be one of the primary beneficiaries of low (and falling) interest rates as it is largely constituted of "long duration" growth stories, however more underperformance could be in store for the sector. On the other hand, oil is currently trading at $46 per barrel (in US dollar terms), down almost 15% since the beginning of the year, and after having recovered from a low of $42 per barrel (in US dollar terms) reached in the middle of June. The investment manager suggests it may be time to revisit the ailing energy sector.

Important Information

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