CFS AZ Sestante Wholesale Conservative Fund

Monthly Investment Report as at 31 May 2018

Asset Class

Diversified

Investment Objective

To provide an investment return of CPI +2.0% p.a. over rolling 3 year periods before fees and taxes

Fund Inception Date

5 December 2016
(for Investments only)

Buy/Sell Spread

+/-0.15%

Management Costs

Investment - 0.70% p.a.[1]

Pers. Super - 0.74% p.a.[1]

Pension – 0.74% p.a.[1]

Exit Price

Investment – 1.0316

Pers. Super – 1.0626

Pension – 1.0692

Number of Holdings

22

Market Review

In May the S&P/ASX 300 TR (+1.19%) continued its recovery, closing above its end of 2017 level for the first time in 2018. Returns were primarily driven by resources, real estate and the sector heavyweights within the healthcare sector. Consumer discretionary was another winner, while financials and telecom underperformed, respectively, for the third and the fourth month in a row. The Top 20 outperformed the little changed mid-caps but it was eclipsed by the S&P/ASX Small Ordinaries Accumulation Index (+3.70%). The domestic equity market outperformed the MSCI AC World Daily TR in AUD (-0.12%) for the second consecutive month, although the latter remained well ahead of the former since the beginning of the year (+3.38% Vs +1.05%). International markets were rocked by the US 10 year bond yields spiking to a 7 year high and by the late month political upheaval in Italy, which caused a strong sell-off in emerging markets and in Europe. As a result, capital flowed from those areas into the relative tranquillity of the US market, pushing its technology heavy indices higher, in particular the Nasdaq, and strengthening the greenback. Global fixed income hedged back to AUD (+0.37%) managed to close in the black as yields moved lower during the second half of May. Italian government bonds posted steep losses for the month across the curve, however they had a limited impact on the broad index owing to their 6% weight, moreover, they started to stabilize going into June. Australian fixed income fared better, up +0.69%, leaving behind its international equivalent since the beginning of the year (1.21% Vs -0.10%), the exact reverse of what we observed in equities. Real assets were a mixed bag as property and infrastructure were the best and the worst performing asset class for the month, up +1.39% and down -2.22% in AUD terms respectively. Finally, Alternatives (+0.26%) continued to struggle to recover the losses suffered in February and March, in particular the CTA and managed futures strategies. In May event driven and arbitrage managers ranked first as they benefitted from a surge in M&A activities, while fixed income managers were hit by the whipsaw pattern of rates.

Performance Review

In May the fund returned +0.33%. 6 asset classes out of the 8 we invest in were positive, with property and Australian equities topping the list, while infrastructure and international equities closed in the red. Both growth and defensive assets posted gains, however, weighted average returns for the former, in which we maintained a significant overweight (+9.60%), were double those of the latter, helping our portfolio. Positive contributions came from our overweight in Australian equities (+5.59%) and underweight in cash (-8.78%), while the main detractors were our overweight in International equities (+3.56%) and underweight in Australian fixed income (-0.74%). All in all, the tactical asset allocation slightly underperformed the strategic asset allocation but that was more than compensated for by the manager selection which generated close to 2/3 of the total return for the month. Our line-up of managers in Australian equities continued to deliver outstanding performances increasing its excess return above the S&P/ASX 300 TR to more than 250 Bps for the first five months of the year. Stock picking in cyclical sectors, primarily energy and materials, and the exposure to high growth names were the largest driver of performance in May.

Performance

	1 Month (%)	3 Month (%)	6 Month (%)	1 Year (% pa)	Since Inception (% pa)
Investments	0.33	0.98	1.40	3.99	5.21
Personal Super	0.32	0.89	1.29	3.60	4.27
Pension	0.33	0.99	1.43	4.09	4.71
Benchmark	0.37	1.06	2.07	4.20	4.02

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 5 December 2016. Refer to PDS and website for a full breakdown of management costs.

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Performance Review (cont'd)

The overweight in the ex-20 part of the index has been particularly beneficial in the past 12 months but we are cognizant of the fact that those stocks have reached multiples above their historic level. That trend has been certainly driven by a prolonged period of subdued domestic rates, a condition that it is likely to persist going forward. However, we suspect that part of the explanation lies also in the relative unattractiveness of the largest index constituents, such as banks. Revenue headwinds and threats to the business have driven the stock prices of those names lower, and as a result valuation metrics have improved. If that trend continues we may reach over-reaction territory which may provide an opportunity for active investors.

Market Outlook

Between the end of May and the beginning of June Italy saw first the collapse and then the inauguration of a coalition government between the two major anti-system parties, the left-wing "Five Star" and the right-wing "League". Markets panicked, with the spread between the interest rates paid by the third largest economy in the eurozone and those of Germany jumping to its highest level since 2012 amid renewed fears of a euro break-up. In our opinion said concerns are grossly overstated. There simply is no "Italexit" or "Quitaly" on the horizon as Italians do not want to abandon the single currency nor did the newly elected government campaign on this issue. The reality is that the vote was a proxy for the immigration issue, and the evidence is that after the first attempt to form the government failed, disrupting markets, approvals for the Five Star decreased while those for the League increased. The former is advocating a loosening of the fiscal policy, while the latter is focused on border controls. Another interesting observation is that the balance of power between the European Union and Italy, unlike in 2011, today appears to be more tilted towards the latter. In fact, Italy does not want to leave the euro but at the same time the European Union does not want Italy to unilaterally leave it. We speculate that the same was not true when the Greeks voted to reject the bailout terms imposed by the Troika in July 2015. In the end, they had to back off because Greece had more interest in remaining than the EU in wanting Greece to remain. Actually, it may be argued that a euro without Greece, a weak economy, would have had more solid fundamentals, while a euro without Italy simply cannot exist. If our reasoning is correct, the implication is that the European institutions will be increasingly inclined to compromise on the policies pursued by the new Italian government; and if that meant more spending, and if other European countries were to follow through, that would put a cap on the appreciation of the single currency while European equities could see a resurgence.

Manager Allocation (%)

Fixed Income	**32.11**	**Australian Shares**	**12.32**
CFS Wholesale Australian Bond Fund	12.52	Fidelity Wholesale Australian Equities	2.76
Macquarie Wholesale Inc. Opportunities	4.87	Antares Elite Opportunities Fund	2.54
Colchester Fixed Interest	2.99	Realindex Wholesale Australian Share	2.47
PIMCO Wholesale Global Bond	3.01	Bennelong W/sale Ex-20 Aus. Equities Fund	2.72
Kapstream Wholesale Abs. Return Income	8.72	Zurich Small Companies Fund	1.83
Property and Infrastructure Securities	**3.56**	**International Shares**	**13.84**
Maple Brown Abbot	2.01	Perpetual Global Share Fund	1.90
SSgA Index Global Property Securities	1.55	Hexavest Global Equity	1.13
Alternatives	**8.01**	MFS Wholesale Global Equity	3.55
FirstChoice Wholesale Alternatives	2.99	Realindex Enhanced Equal Weighted Global Share Fund	3.80
AQR Capital Management LLC	2.01	BT Global Emerging Markets Opportunuties Fund	2.47
GAM	3.01	Janus Henderson Golbal Resources	0.99
		Cash	**30.16**
		CFS Wholesale Cash	30.16

Important Information

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