CFS AZ Sestante Wholesale Conservative Fund

Quarterly Investment Report as at 31 March 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

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 – 1.0199

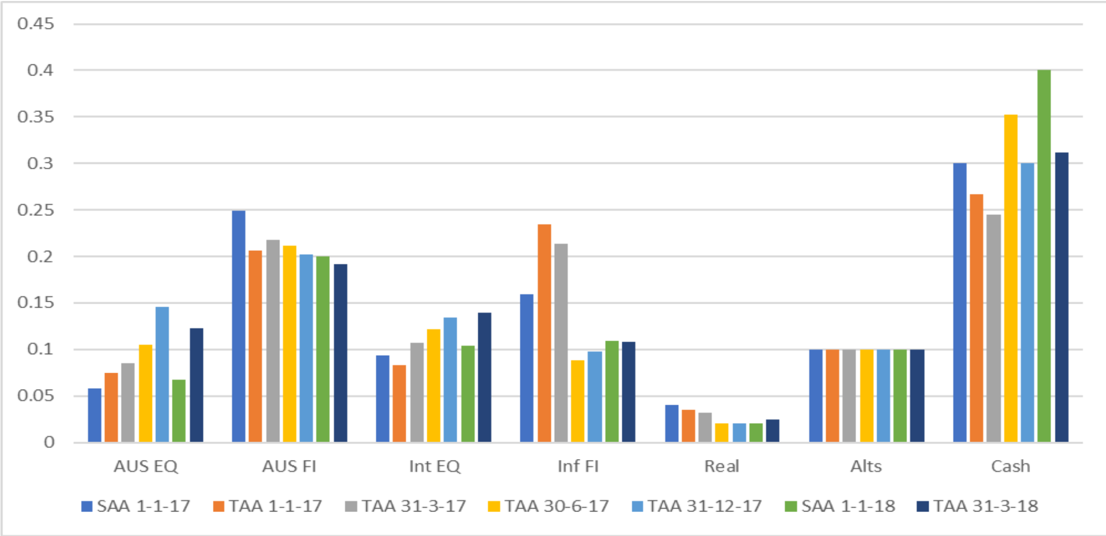
Pers. Super – 1.0516

Pension – 1.0571

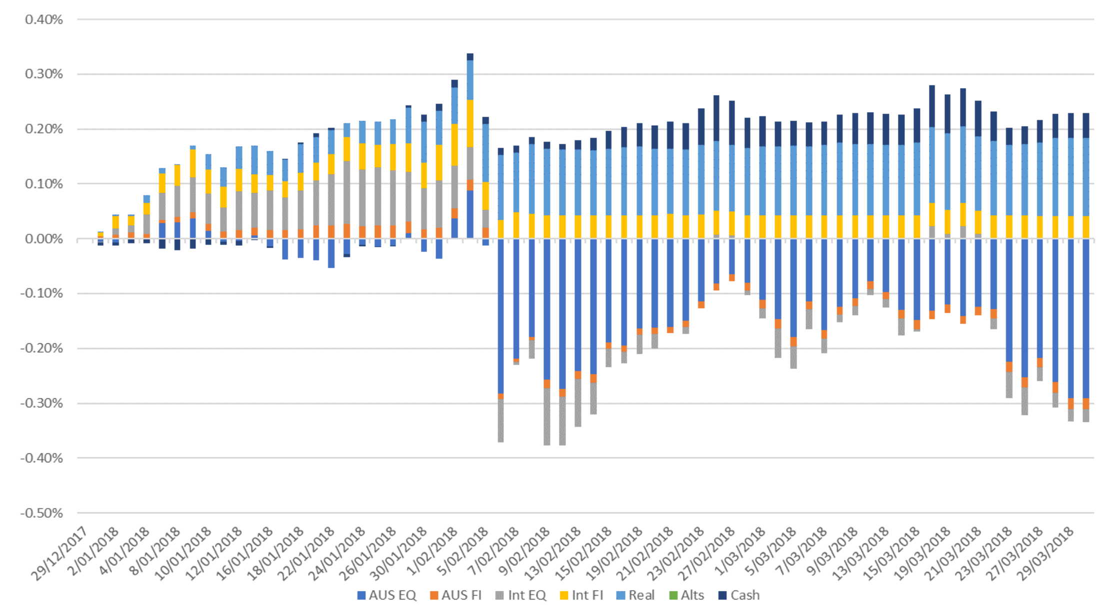
Number of Holdings

22

Asset Allocation



Performance Contribution from Tactical Asset Allocation



Performance

	1 Month (%)	3 Month (%)	6 Month (%)	1 Year (% pa)	Since Inception (% pa)
Investments	-0.16	-0.02	2.09	4.14	4.97
Personal Super	-0.15	-0.01	1.89	3.69	4.00
Pension	-0.15	0.00	2.17	4.27	4.42
Benchmark	0.37	1.12	2.24	4.08	4.09

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Analysis of Asset Allocation

As per our investment approach the Strategic Asset Allocation (SAA) of the fund was reset as at 1 January 2018. This resulted in a strong increase in the allocation to cash, slight increases in the allocation to Australian equities and international equities and slight reductions in the allocations to fixed interest and real assets. The allocation to Alternatives remained unchanged. In terms of the Tactical Asset Allocation (TAA) our exposure to Australian equities, Australian fixed interest was reduced and allocated to international equities, real assets and cash.

Over the quarter TAA underperformed by 11bps. We also noticed an increase in volatility of 77bps. The tilts that added value were in real assets (O/W), cash (U/W), emerging markets(O/W) and international fixed interest (U/W) whereas we lost value from our view on Australian equities (O/W) and European equities (O/W).

Analysis of Manager Performance

Australian Equities

Australian equities dropped -3.78% during the quarter. The negative performance is entirely ascribable to a late sell off in March, when the domestic market succumbed to the double whammy of the -14.58% drop in the price of the iron ore and the uncertainties around the Royal Commission weighing respectively on resources and banks. Not surprisingly, the latter was the worst performing sector for the quarter, together with energy, utility and telecom, which came under further pressure owing to an heightened level of competition in the mobile space. Consumer staples and healthcare bucked the trend as the stellar performance of infant formula manufactures boosted returns for the first, while a number of sector heavyweight companies within the second advanced on the back of strong results. Finally, mid and small caps outperformed the Top 20 despite closing in the red as well.

Our line-up of managers strongly outperformed the S&P/ASX 300 TR, with positive contributions coming from both the selection and the allocation effects. OC Wholesale Premium Small Companies was the best performing manager for the quarter as it bucked the trend, outperforming both the S&P/ASX Small Ordinaries Index which was down -2.48% and the S&P/ASX 300 TR. The fund benefited from its limited exposure to the domestic housing sector, where tighter credit standards seem to have finally slowed down markets in Sydney and Melbourne and stabilized those in other capital cities. Key conviction calls, at present, include selected names in the healthcare, technology, media, financials, consumer staples and consumer discretionary sectors. In addition, the portfolio holds a large exposure to industrial names that ought to benefit from an uptick in spending in east-coast based infrastructure projects.

Fidelity Wholesale Australian Equities fell to the bottom of the list once again in Q1 2018 on the back of a difficult February. Returns were negatively impacted by selected high-conviction holdings in the technology and the consumer discretionary sectors that were the subject of profit taking or declined due to weakness in their half-year earnings amid short term issues. The names were maintained as the manager remains confident in their long-term prospects. The fund is overweight the Australian technology sector and it is well exposed to the digital delivery of food, a trend that the manager considers to offer one of the strongest long-term growth opportunities. Conversely, he remains cautious on supermarkets, big box retailers and specialty retailers through 2018 on the back of the entry of Amazon into the domestic market.
In the first week of March the allocation to Australian equities was marginally decreased in the Conservative and the Diversified portfolios. Manager allocation was broadly unchanged, as positions were reduced proportionally, with the only exception of a minor cut in the Realindex Wholesale Australian Share in favour of the Antares Wholesale Elite Opportunities.

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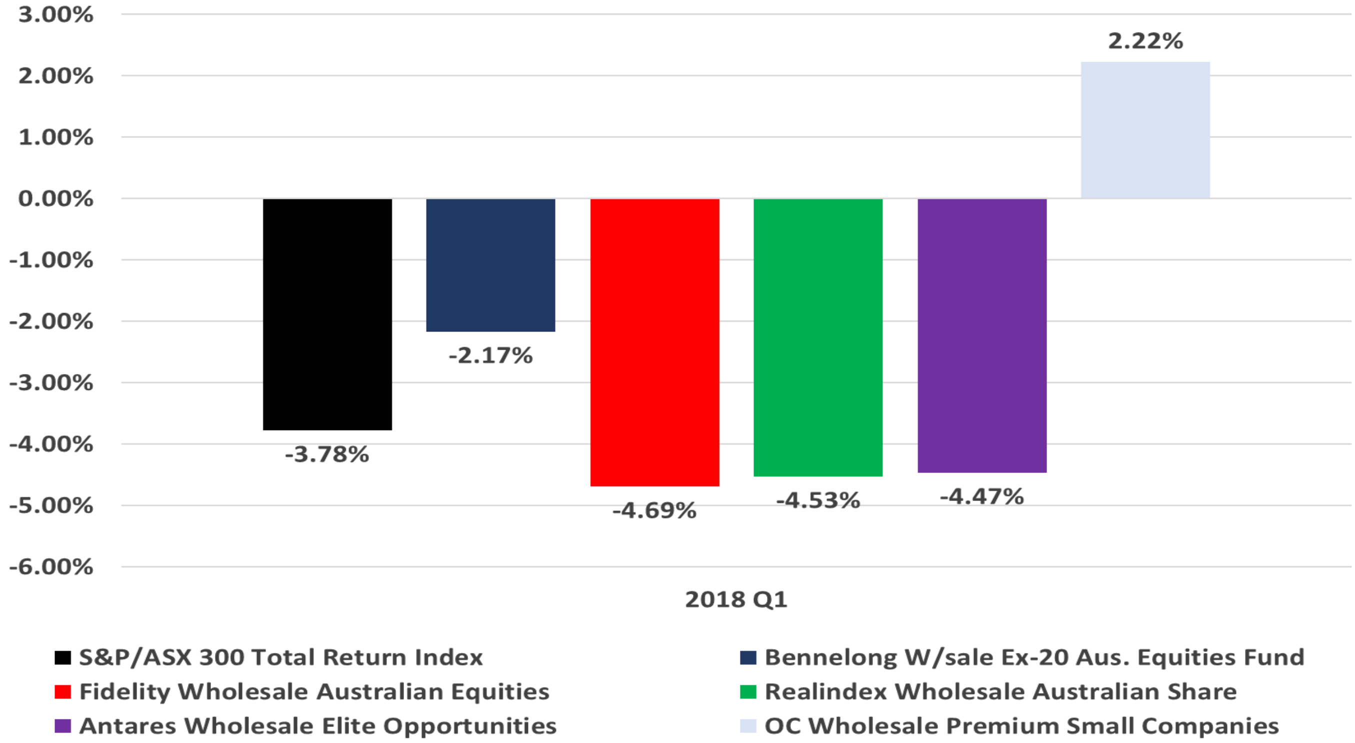
Quarterly Investment Report s at 31 March 2018



International Equities

International equities were down -0.96% in USD terms but up +0.65% in AUD terms as the Australian Dollar weakened -1.61% vis-à-vis the greenback, cushioning the negative impact of falling stock markets. The "risk-on" behavior of the domestic currency was highlighted once again as it rose above 0.81 at the end of January, in conjunction with the top of the S&P 500, only to fall back below 0.77 at the end of March.

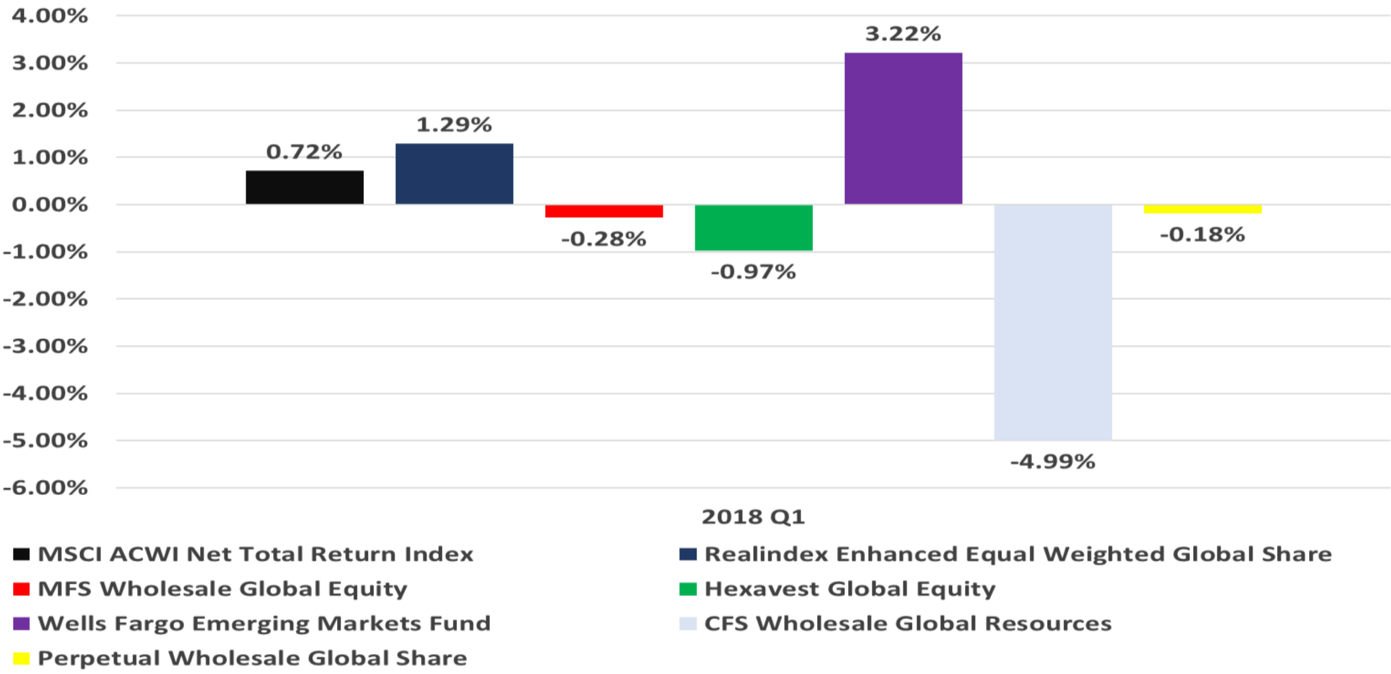
Emerging markets and Japan strongly outperformed the rest of the world, the former due to the strength of their exchanges, the latter due to the strength of its currency. Europe underperformed as it continued to suffer from a limited exposure in its major indices to technology and consumer discretionary, the best sectors during the quarter. In fact, the "Big Tech" complex that is, the e-commerce and social network giants, maintained its market leadership despite the increased volatility. Cyclicals dropped sharply after two consecutive quarters of strong absolute and relative returns, giving back all the outperformance accrued over that period of time. However, they remain well supported as the global economy appears to be entering into its late-cycle phase characterized by higher inflation and higher rates, which historically favours the investment in financials and resources.

Our line-up of managers marginally underperformed the MSCI AC World TR in AUD, with the negative contribution coming from the selection effect only partly mitigated by the positive contribution coming from the allocation effect. The underperformance was entirely accrued in January, as our portfolio struggled to keep pace with the parabolic ascent of global stock markets. In February and March, both negative months, our line-up of managers generated a full 100 Bps of outperformance, closing the quarter on a strong note in relative terms.

Realindex Enhanced Equal Weighted Global Share outperformed the MSCI AC World TR in AUD owing to its overweight in smaller companies in Europe and Japan and to a favorable stock selection in the consumer staples, healthcare and financials sectors. Conversely, the underweight to mega-capitalization companies in US was a detractor, together with an underweight in the technology sector and a negative stock selection in the consumer discretionary sector. The portfolio maintains its positioning largely away from index-heavy names and tilted towards value orientated stocks.

A highly defensive positioning was detrimental to Hexavest Global Equity in Q1 2018. The manager has maintained a negative stance on the market in the past 12 months on the back of their negative reading of the valuation and the sentiment factors. They have consistently expressed their view by maintaining an overweight in cash, healthcare, utilities, telecom and real estate for fear of a market correction. Portfolio tilts eventually started to work in February and paid off in March, as real assets bounced back after a 6 months de-rating while interest rates sensitive sectors came out of a record underperformance only seen at the height of the dot-com bubble.

In the first week of March the allocation to International equities was marginally increased across all portfolios. Manager allocation was broadly unchanged, as positions were increased proportionally, with the only exception of a minor rise in the value tilt via the Perpetual Wholesale Global Share and to the exposure in cyclicals via the CFS Wholesale Global Resources.



Alternatives

Alternatives were down -1.25% in the quarter, on the back of heavy losses generated in February and March. That outcome did not come as a surprise to us as the correlation between risk assets and alternatives had steadily increased during 2017. In particular, certain strategies such as CTA and trend following were running sizeable equity and fixed income exposures, well above their historical average. When the S&P 500 dropped a record -10.2% in the space of just 9 days in February as the so called “volatility risk premium” trade was abruptly wound down, those funds compounded the losses of the market rather than acting as an hedge, in some cases doubling or even tripling them.

Our line-up of managers bucked the trend in Q1 2018, strongly outperforming the HFRX Global Hedge Fund Index, with positive contributions coming from both the selection and the allocation effects. Each single position posted gains during a very challenging quarter, a testament to the defensive nature of our alternative allocation and to its ability to function as a hedge, providing much needed diversification to the overall portfolio.

FirstChoice Wholesale Alternatives outperformed the HFRX Global Hedge Fund Index by more than 250 Bps in Q1 2018. Such a positive outcome, both in terms of absolute and relative return, is wholly explained by the manager selection. Positive contributions came from 6 out of the 8 underlying managers, with tail hedge / volatility long bias, macro / quantitative and discretionary macro strategies providing the largest positive contributions. Both CTA and Long / Short Equities managers closed in the black, despite their reference indices posting steep losses.

In the first week of March the allocation to Alternatives was marginally decreased in the Diversified and the Growth portfolios in favour of international equities in the former and international equities and property in the latter. The allocation to AQR Capital Management LLC was slightly reduced in the Diversified portfolio and fully liquidated in the Growth portfolio.

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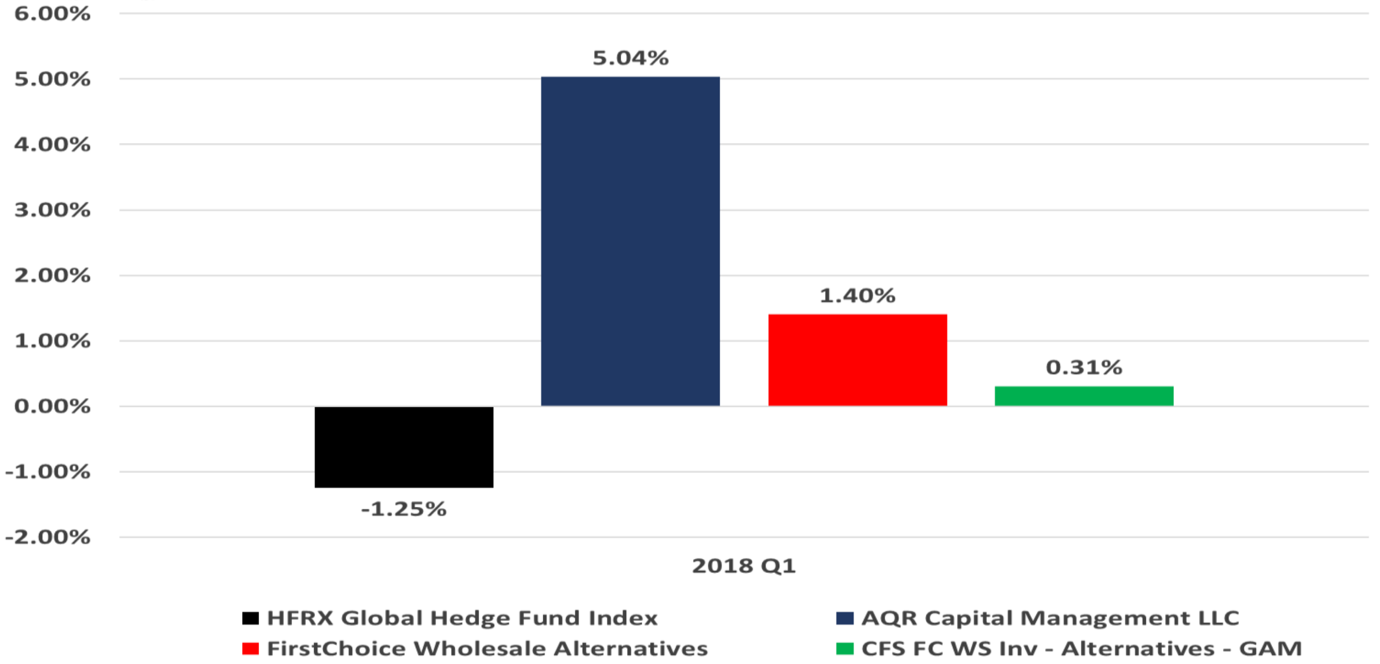

Australian Fixed Income

After a difficult start of the year, Australian fixed income initiated a recovery in the second half of February to close Q1 2018 up +0.87%, a result that confirms the strong showing of Q4 2017. The interest rate curve flattened further as the 2 year and the 5 year moved 4 Bps and 1 Bps higher at 2.01% and 2.30% respectively while the 10 year was 3 Bps lower at 2.60%. The RBA again left the cash rate unchanged in early March as CPI and GDP readings remained weak, causing market participants to move their expectations of the timing of the first hike from Q4 2018 to the middle of 2019. Australian Fixed Income outperformed Global Fixed Income hedged back to AUD for the second quarter in a row, with the latter generating a slightly negative return in Q1 2018 as in February the entire US interest rate curve out to the 10 year traded at a higher yields than its Australian counterpart, a condition which has no precedent in at least the last 30 years.

Our line-up of managers slightly underperformed the AusBond composite index with negative contributions coming from both the selection and the allocation effects. Our preference for high grade credit risk over interest rate risk was a detractor, as corporate bond spreads continued to underperform, although moderately, while Australian government longer-term bonds rally.

After 15 consecutive months of positive returns, Kapstream Wholesale Absolute Return suffered a small loss in March, giving back all the outperformance cumulated in January and February and ending the quarter on a low note. The manager continued to decrease the fund's risk by increasing both rate duration and the liquidity bucket of cash and government-related securities. At the end of March the former reached approximately 0.7 years while the latter amounted to 10%. The fund's credit spread duration was trimmed as well to 3.1 years and the currency positions were removed by taking profits on short USD trades. The manager expects the RBA to remain on hold for some time and Australian rates to remain the most attractive globally; that said, he is looking to increase exposure to US issuers (hedged back to AUD) in the coming months on the back of rising LIBOR rates.

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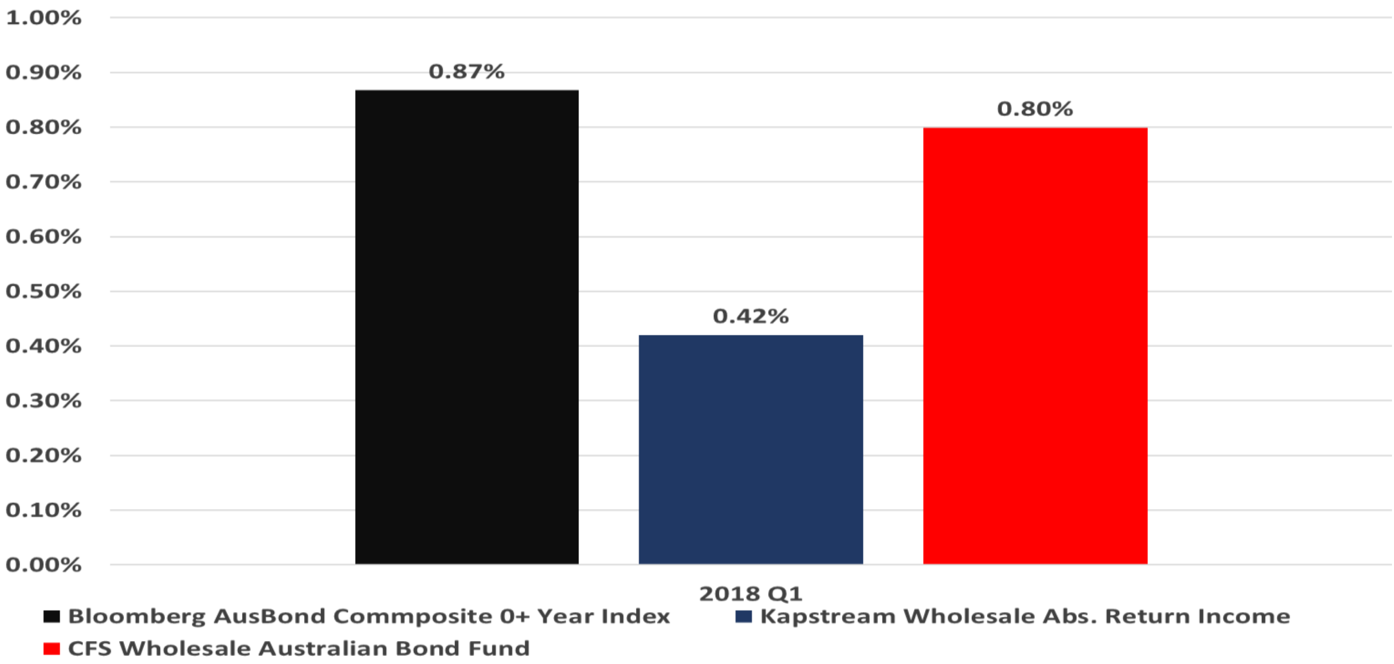

Global Fixed Income

US Interest rates moved sharply higher in January and February, with both the front end and the back end selling off, as US wages accelerated at their fastest pace in 9 years. As a consequence global fixed income hedged back to AUD was down for two months in a row, before starting to recover in March as volatility returned to markets and equity prices fell from their highs. Credit spreads widened during the quarter as investors started to question the synchronized global growth narrative in light of fears of a global trade war and concerns regarding incipient inflationary pressures. The US Dollar closed in the red for the fifth consecutive quarter, weakening vis-à-vis all the major developed and emerging currencies, with the significant exception of the Australian Dollar. The greenback became oversold in January, in conjunction with the top of the S&P 500, bounced back in February and appears to have stabilized since then.

All in all, global fixed income hedged back to AUD ended Q1 2018 with a small loss. Our line-up of managers bucked the trend, strongly outperforming the Barclays Global-Aggregate TR hedged in AUD, with positive contributions coming from both the selection and the allocation effects. Our fund selection was able to generate in a single quarter 70 Bps of outperformance as each single position posted gains, an amount superior to the 50 Bps of outperformance generated in the previous full calendar year. Colchester was the best performing manager for the quarter primarily on the back of favorable currency selection. The fund had exposure to 3 of the top 5 performing currencies vis-à-vis the US Dollar, namely the Mexican peso, the Malaysian ringgit and the British pound. Positive contributions came from the bond selection as well, with overweight positions in Mexican nominal bonds and Brazilian inflation-linked bonds and the underweight position in US nominal bonds all adding value.

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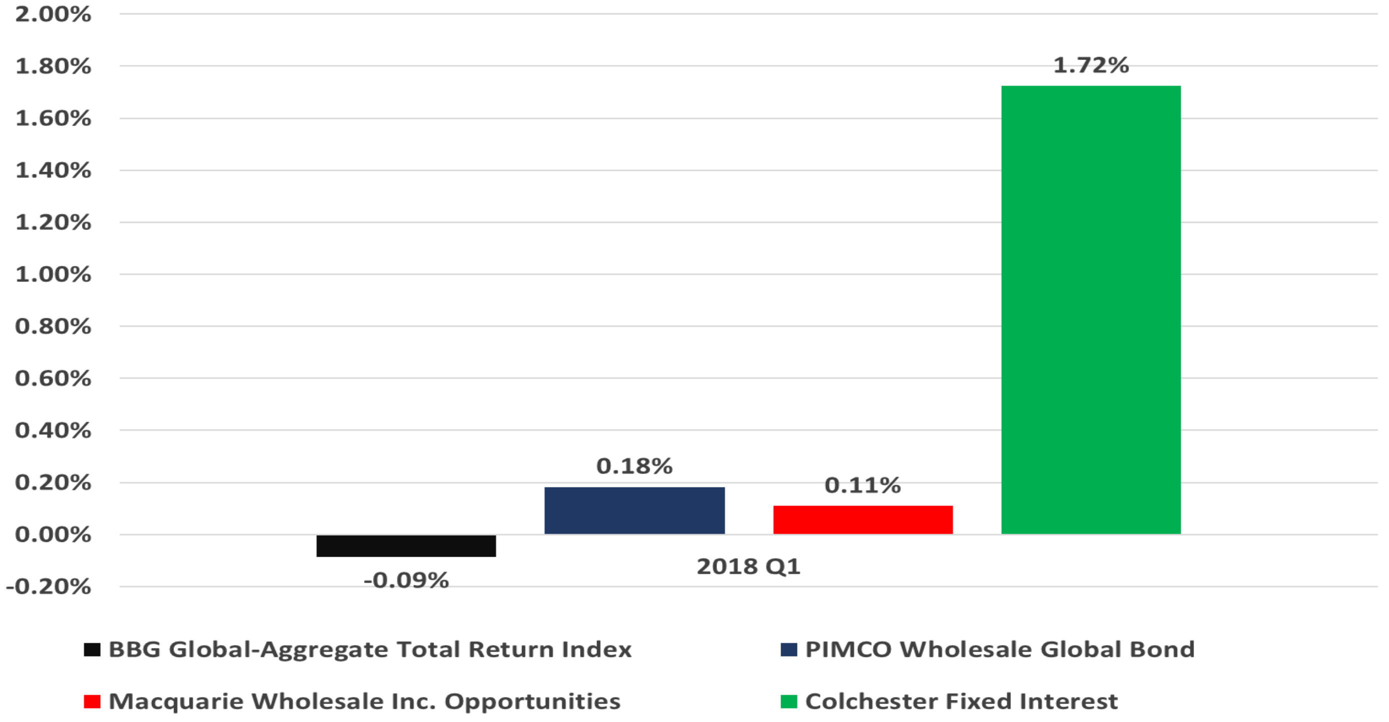
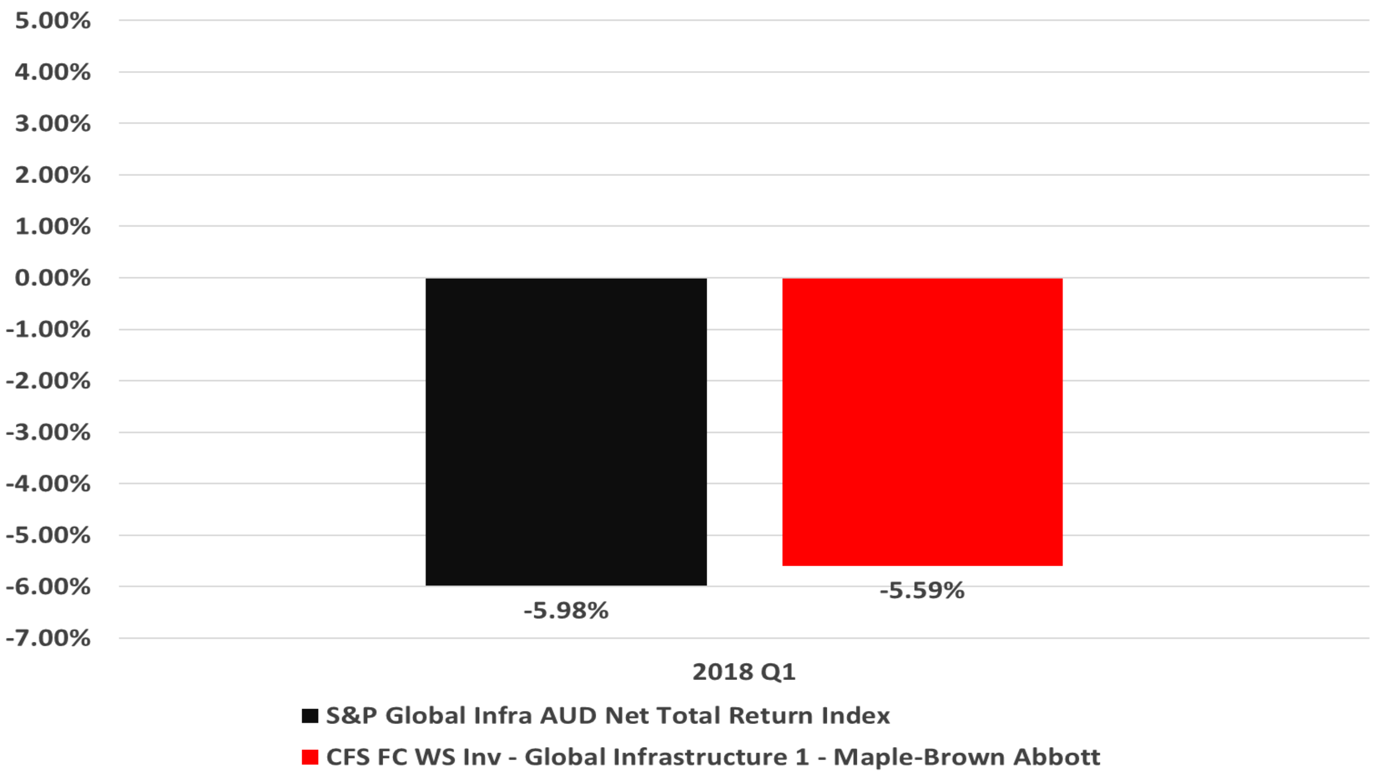


Global Infrastructure



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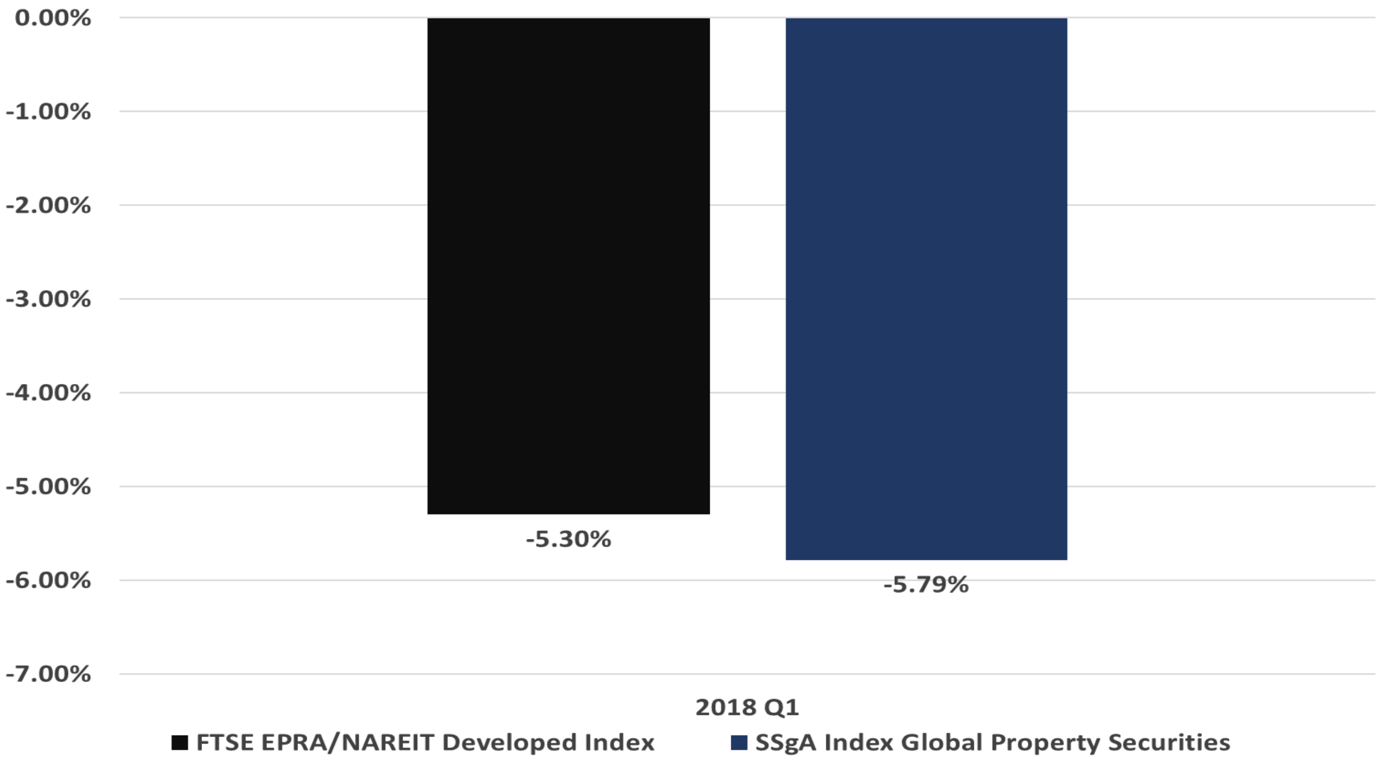
Global Real Estate



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[1]As at 5 December 2016. Refer to PDS and website for a full breakdown of management costs.

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