Investment Management

Fact sheet

Diversified Strategies
February 2018

→ BT Wholesale Moderate Fund

ARSN: 610 997 709

About the Fund

The BT Wholesale Moderate Fund (**Fund**) is an actively managed diversified portfolio that invests in Australian and international shares, Australian and international listed property securities, Australian and international fixed interest, cash and alternative investments. The Fund has a similar weighting towards defensive assets as it does towards growth assets.

Investment Return Objective

The Fund aims to provide a return (before fees, costs and taxes) that exceeds the Fund's benchmark over the medium to long term. The suggested investment timeframe is five years or more.

Benchmark

The benchmark for the Fund is created from a range of published indices. The benchmark is based on the asset allocation neutral position and the index returns for each asset class. Details of the particular market indices used for the Fund's benchmark can be found at www.btim.com.au/BT-Wholesale-Moderate-Fund

Investment Process

At BTIM, we actively manage our portfolios to meet their investment objectives by diversifying investments across both asset classes *and* strategies. We employ three main approaches to do this:

1. **Strategic asset allocation** – weighted asset class exposures designed to meet the investment objectives over the long term investment horizon
2. **Active management** – exploitation of market inefficiencies within asset classes
3. **Tactical asset allocation** – exploitation of market directionality across asset classes

The underlying investments in the Fund are managed by BTIM together with a number of external partners. BTIM manages investments in the asset classes of Australian shares, Australian fixed interest and cash, global fixed interest, Australian property securities and alternative investments. These investments are augmented by our arrangements with leading global investment managers who have a competitive advantage in the management of global asset classes.

The BTIM Diversified team also manages an active tactical asset allocation process designed to increase portfolio returns within a defined risk budget.

Investment Guidelines

Asset allocation ranges (%)	Neutral Position	Ranges Min	Ranges Max
Australian shares	24	10	30
International shares	17	0	20
Australian fixed interest	20	10	45
International fixed interest	15	5	40
Australian property securities	4	0	15
International property securities	1	0	15
Alternative investments	14	0	20
Cash	5	3	30

Investment Team

The Fund is managed by Stuart Eliot who has more than 26 year's industry experience. The team has a diverse skill set; combining a range of global and domestic market experience and drawing on the resources of BTIM's other specialist teams: Income & Fixed Interest Strategies and Equity Strategies.

Performance

(%)	Total Returns (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	-0.69	-0.63	-0.16
3 months	0.24	0.45	0.09
6 months	4.33	4.77	3.97
1 year (pa)	7.66	8.56	6.34
Since Inception (pa)	7.00	7.90	6.19

Asset Allocation (as at 28 February 2018)

Australian shares	23.6%
International shares	17.7%
Australian fixed interest	16.2%
International fixed interest	12.9%
Australian property securities	4.5%
International property securities	1.0%
Alternative investments	15.3%
Cash	8.8%

Other Information

Fund size (as at 28 Feb 2018)	$114 million
Date of inception	June 2016
Minimum investment	$25,000
Buy-sell spread[1]	0.24% (0.12%/0.12%)
Distribution frequency	Quarterly
APIR code	BTA0487AU

[1] The buy-sell spread represents transaction costs incurred whenever you invest or withdraw funds, and may vary from time to time without notice.

Management Costs[2]

Issuer fee[3]	0.85% pa
Estimated indirect costs[4]	0.06% pa

[2] You should refer to the latest Product Disclosure Statement for full details of fees and other costs you may be charged.

[3] This is the fee we charge for overseeing the operations of the Fund and managing the assets of the Fund. The Issuer fee is paid from the assets of the Fund and is reflected in the unit price of your investment.

[4] This is an estimate of the last financial year's indirect costs. These are reflected in the unit price of the Fund and are not charged to you as a fee or retained by us.

Risks

An investment in the Fund involves risk, including:

- **Market risk -** The risk associated with factors that can influence the direction and volatility of an overall market, as opposed to security-specific risks. These factors can affect one country or a number of countries.
- **International investments risk** – The risk arising from political and economic uncertainties, interest rate movements and differences in regulatory supervision associated with international investments.
- **Currency risk -** Currency exchange rate fluctuation risk arising from investing across multiple countries.
- **Credit risk -** The risk of an issuing entity defaulting on its obligation to pay interest/principal when due.
- **Liquidity risk -** The risk that an asset may not be converted to cash in a timely manner.
- **Counterparty risk -** The risk of another party to a transaction failing to meet its obligations.

Please read the Fund's Product Disclosure Statement (**PDS**) for a detailed explanation of each of these risks.

Market review

A spike in market volatility and sell-off in global and domestic equities early in the month prompted some market concern of a sharp correction following a sustained period of strength. However, the falls were arrested swiftly in most markets, which then spent the remainder of the month clawing back lost ground. At its low point for the month, the S&P 500, had fallen a touch over 10% in US$ terms from its peak in late January, but had regained half of this by the end of February.

The Australian market demonstrated its relatively defensive nature during this episode. It had fallen just over 4% from the start of the month to its lowest point on the 12th of February, but managed to regain all of this by the month's end to finish 0.3% higher. As a result, the local bourse was among the best performing markets globally, ahead of the S&P 500 (-3.9%), German DAX (-5.7%) and Japanese Nikkei (-4.5%).

A key point to consider in the context of this divergence is that Australian equities have not enjoyed the same surge as other developed markets over the last year. For example, the S&P/ASX 300 had gained roughly +7.5% for the 12 months to end January 2018 – versus around +23.8%% for the S&P 500. This partly reflects the more defensive nature of the ASX and the different market composition, with technology stocks – which have outpaced the rest of the US market on valuation re-rating comprising a much lower proportion of the local market.

The proximate cause of the sell-off was stronger than expected wage data from the US, which prompted speculation of an uplift in inflation and the possibility that the Fed might raise rates faster than previously anticipated. It was therefore the bond-sensitives sectors which bore the brunt of the market's early weakness and telecommunications (-6.2%), REITs (-3.2%) and utilities (-1.6%) all ended the month down. For the telecommunications sector, the challenging macroeconomic backdrop was exacerbated by a disappointing result from Telstra (TLS), which fell -5.7% for the month. Crude oil also edged lower, down 4.8%, which weighed on the Energy sector (-3.8%).

Global equity markets experienced a sharp correction early in February, following a period of relatively sustained bull market conditions that have been in place particularly in the US since October 2016. Markets took a sharp rise in bond yields as a catalyst to sell down equities, which was precipitated by a stronger than expected reading of US labour market data which led to investor concerns over rising inflation, together with the expansionary impact of the US tax cuts package. Key commodity prices were also impacted, with crude oil dipping below the US$60 mark before partially recovering late in the month, while iron ore made modest gains.

Stocks in the US were carried down with the broader market correction, despite a positive backdrop of resilient corporate earnings and a favourable environment for corporates. The latest earnings season saw a continuation of the positive earnings growth momentum, with a large majority of companies in the S&P500 exceeding the market's consensus expectations. Investors honed in on the prospective risks to growth from more aggressive increases in interest rates by the US Federal Reserve (Fed) and took that as a signal to take profits. Within sectors, there was a fair degree of performance dispersion, with Information Technology being the standout performer, while Energy was the weakest amid rising concerns of high production levels of shale oil in the US and the prospective impact on the oil price. The S&P500 recovered some of its earlier losses to end the month 3.7% lower while the Nasdaq declined by 1.9%.

The major European equity markets were not immune to the US-led global correction in values, which saw the German DAX (-5.7%), the French CAC (-2.9%) and the UK FTSE100 (-4.0%) fall into negative territory. Again, these declines came amid a backdrop of relatively favourable indications for growth in the euro-area economy. Unemployment continued to trend lower, while private sector activity surveys moderated in February following a trend of healthy levels of investment. Within the region, Information Technology was the best performing sector, while the Health Care and Consumer Goods were the worst performers.

The Asian region also followed the path of major developed markets, falling early in the month before retracing some of the losses. Hong Kong (-6.2%) and Japan (-4.5%) were notable laggards this month, while the south-east Asian markets fared better. This group includes Singapore (-0.5%), Malaysia (-0.7%) and Thailand (+0.2%). China dominated most of the region's attention this month, owing to an expected major shift in the country's constitution to remove the current limitation of two terms on the positions of President and Vice President, thereby providing greater control on growth plans and economic outcomes.

The Australian dollar weakened on currency markets in February, reversing its prior month advance against the US dollar to close 3.6% weaker. The local unit was also 5.9% weaker against the yen, 0.6% lower against the British pound and 1.9% weaker against the euro. Market noise in relation to trade protections and the ramifications for commodities played its part in weakening sentiment towards the local currency.

Within the fixed interest sector, Global bond markets witnessed a further steepening of sovereign curves as yields rose at the long end. Bonds experienced reasonable volatility, however their swings were much less pronounced than their equity counterparts, particularly in the US. The shift in volatility was sparked by a stronger-than-expected rise in US wages, which in turn fed fears of faster monetary tightening. This was compounded by positive comments on the health of the economy by new Fed Chair Jerome Powell. A strong US corporate earnings season and fiscal spending increase were not enough to turn sentiment around. Similarly in Europe, investors found little comfort in another round of dovish comments from ECB President Mario Draghi. That said, risk sentiment did improve towards month-end as the market reassessed the potential impact of higher inflation and outlook for rates. In Asia, confidence in China's economic health was dampened to some degree with weaker-than-expected leading indicators like manufacturing activity. Finally in terms of market movements, US yields were higher across the curve with the 2 year and 10 year rising by 11 basis points and 15 basis points to 2.25% and 2.86% respectively.

The Australian government bond curve steepened further in February, which was in sympathy with its global peers. While bond markets experienced reasonable volatility, their swings were much less pronounced than their equity counterparts, particularly the US. Front-end yields in Australia fell as RBA communication suggested the current policy setting would remain appropriate in the near-term. The central bank's Statement on Monetary Policy also revealed its forecasts for inflation and GDP growth were unchanged. Economic data was mixed: Retail sales fell 0.5% and consumer confidence eased back to 102.7.

The monthly labour force report revealed 16,000 jobs were added, however this was significantly skewed to part-time roles and quarterly wage figures reported a 0.6% increase for the fourth quarter. Meanwhile, business conditions and confidence numbers rose to a strong +19 and +10 respectively. The local reporting season was also encouraging with more companies beating earnings estimates than missing them. Based on those that had reported by the end of February total EPS had risen 8% for the half year versus the prior corresponding period. Finally in terms of market movements, Australian 3 year yields finished 4 basis points lower at 2.13% while the 10 year maturity ended flat at 2.80%. At the front-end, 90 day BBSW rose 1 basis point to 1.79%.

Fund performance

The Fund underperformed its benchmark over the month of February. The Fund's performance in February was impacted by weak or negative returns from bond-sensitive assets. Equity markets also weakened, however the Fund's asset selection outcomes within Australian and global equity markets delivered positive returns. Exposure to alternatives detracted from returns, while some capital preservation was afforded through the Fund's exposure to cash.

Tactical asset allocation contributions were driven by the Fund's overweight exposure to Australian and global equities and an underweight to Australian and international fixed income.

The key factors influencing our active management returns were strong stock selection outcomes within Australian equities and the concentrated global equity component. Within the Australian equity strategy, overweight positions in Nine Entertainment and Qantas, and underweight positions in Woodside and Souh32. Partially offsetting these contributions were overweight positions in JB Hifi and CBYG, and underweight positions in A2Milk and Insurance Australian Group.

Active returns from our global equities portfolio were sourced primarily from stock selection by concentrated manager, with contributions from positions in CME Group and Boeing, while our holding in Wells Fargo detracted from returns.

Our Alternatives portfolio detracted from returns this month, whereby six of the eight underlying strategies within the core component of the sector generated negative returns. The Alternatives strategy delivered a total return (before fees) of -3.20% vs a cash return of 0.13%. A minor contribution was generated from the Event Driven strategy, which benefitted from low deal cancelations. The Managed Futures strategy suffered from reversals in equity, commodity and currency markets, although losses were offset somewhat by gains within Fixed Income markets. Within the Equity Market Neutral strategy, positioning within all major regions generated losses over February, though most pronounced in the US. Thematically, Value was the main detractor over the period, with Quality themes also underperforming during the market sell off.

Within the Dedicated Short Bias strategy, while the directional short equities component generated profits, these were outweighed by the underperformance of the market neutral stock portfolio. The Alternatives core strategy is operating at slightly less than its long-term risk target, with the largest underweights being Convertible Arbitrage and Fixed Income Relative Value. The sole overweight as at the end of February was Long/Short Equity.

February was the first negative month for our tactical positioning within alternatives since the 3bp detraction in May of last year. Detractions occurred from our managed futures and commodity exposures. This outcome is considered normal behaviour for TAA during short-term market pull-backs. Within our managed volatility strategy, given the record movements and unpredictable volatility of this market over the course of the month, an underperformance of around 10bp is considered a respectable result.

Strategy and Outlook

February's market volatility has again illustrated the importance of diversification. While equities are a critical component in delivering long term growth to a portfolio, this exposure needs to be balanced by assets that are diversifying – bonds, foreign exchange exposure, and alternatives can all help to stabilise returns. Despite the short-term pullback, we remain overweight in all three equity markets as one-year momentum remains strong. We retain an overweight to Australian 10-year bonds, but our models have turned to a short signal in both US and Germany. We are implementing this change incrementally over the course of March as we see these markets vulnerable to a short-term squeeze higher. As with equities, we remain overweight all three commodity markets despite the short-term pullback as one-year momentum remains strong.

We recognise the inherent uncertainty of financial markets and continue to hold a broad range of diversifying exposures to defensive and alternatives assets to preserve capital and diversify the asset base.