Baillieu Holst
Since 1889

Investor Newsletter

October 2018

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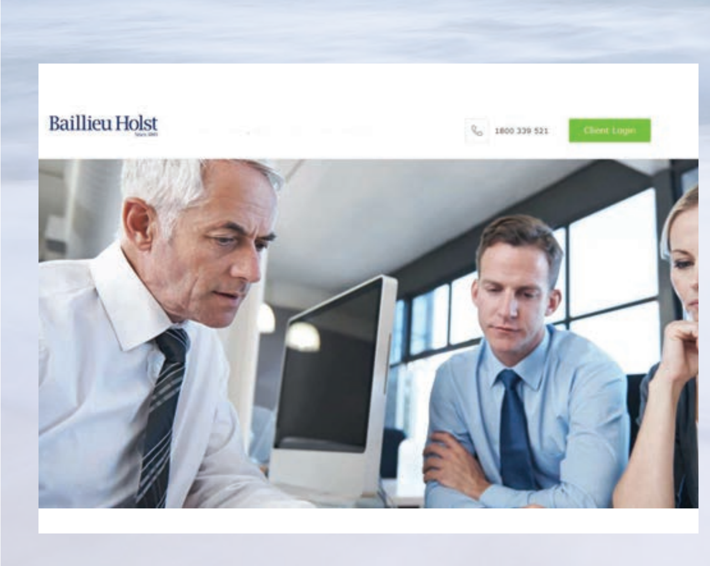

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From the CEO

Since our last newsletter the All Ordinaries Index has risen strongly, to the point where the Australian market is beginning to look a little expensive. Although the Australian economy has been resilient, it is likely to lag the rest of the world, where growth prospects look brighter. We continue to encourage clients to diversify their portfolios to take advantage of overseas growth opportunities.

Much of the recent news has focussed on the royal commission into the finance industry. This has been a wide-ranging enquiry into banking practices, insurance, superannuation and financial services in general. As expected, some horror stories have emerged, with customers being subjected to some questionable behaviour by financial institutions.

There is no doubt the stockbroking and financial advice industries will be caught up in the fallout from the enquiry. However, it is also worth noting that, generally, participants of our industry are not directly involved in many of the activities that have been called into question. As an example, our firm does not lend money to clients, does not sell insurance policies through outbound calls, and has had for many years a requirement to act in the best interests of its clients. We will continue to follow the royal commission closely and look forward to its preliminary findings that are due on 30 September and then the final report to be released in March next year.

I hope you enjoy this edition of our newsletter.

Gavin Powell

CEO/Managing Director, Baillieu Holst

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Beware of scammers

We receive regular updates from the ACCC / Scamwatch about investment scams that can result in a loss of money. Examples include:

- investors being scammed by an unlicensed company, resulting in the loss of a significant sum of money;
- scammers impersonating well-known businesses;
- scammers gaining access to computers to steal bank account information or money;
- investment scams offering “get-rich-quick” schemes.

There is little we can do once a scam has occurred, and we kindly remind clients of the need to be vigilant. You cannot be too careful.

If you are ever contacted out of the blue for investment matters, or if something simply sounds too good to be true, please first speak to your investment advisor before proceeding.

There are also a number of websites you can check yourself for known scams.

https://www.scamwatch.gov.au/

https://www.moneysmart.gov.au/scams/companies-you-should-not-deal-with

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CIO, Malcolm Wood

Equity strategy

After a pullback in early-2018, global equity markets have seen a divergence in performance, with renewed strength in the US and Japanese markets, solid returns in Australia, a sluggish performance in Europe and weakness in Emerging markets. Looking ahead, we foresee further strong returns from major developed markets, especially in Australian dollars, but are more cautious on the Australian equity market.

The global backdrop: Strong US fundamentals a challenge to "weak links"

The US private sector is displaying unusually strong economic fundamentals. Consumer confidence is near 50-year highs, reflecting strong 1.6% YoY employment growth, just 3.9% unemployment, real wages being up ~1% YoY, record wealth ratios and a 1.2% income tax cut. Core retail sales are up 5.2% YoY. Similarly, business sentiment is at 14-year highs, with 26% YoY profits growth driven by 10% YoY sales growth, rising margins and an 8% tax-cut benefit, while gearing is around average levels. Core capital goods orders are up 8% YoY and earnings expectations 23% YoY. A 2.2% YoY core consumer price index (CPI) is at the high-end of the range. In the year ahead, we expect 100bps of Federal Reserve tightening, 50bps rise in bond yields, 10% higher US dollar (USD) and double-digit earnings growth to drive high single-digit S&P 500 returns.

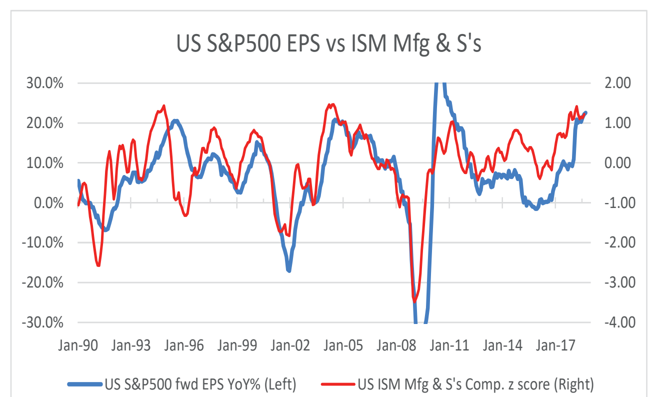
Meanwhile, Japanese economic fundamentals are improving. Business confidence is around 25-year highs, reflected in earnings expectations rising 17% YoY, despite strong oil prices and a flat yen. Consumer fundamentals are also improving, with unemployment around 25-year lows at 2.4% and wages growth at a 20-year high 2.3% YoY. Perhaps Japan is beginning to break out from deflation – core inflation is currently 0.6% YoY. Policy will remain super-accommodative for an "extended period", while valuation is an attractive 12.5x 12-month forward PE.

By contrast, European indicators have decelerated this year, with slowdowns in business surveys from 17-year highs (to still-positive levels) and in German factory orders to 1%, reflecting trade and Brexit uncertainties and Emerging Market challenges. Growth in earnings expectations has slowed to 6% YoY. That said, employment is up a solid 1.5% YoY, unemployment is back to pre-GFC levels, real wages are up 1%-plus YoY and Eurozone budgets are back to balance. Policy remains very accommodative and equity valuations are reasonable at 13.5x.

Emerging markets are under pressure from rising US rates and the US-China trade tensions. Countries with the worst fundamentals – Venezuela, Argentina and Turkey – are already in crisis, while China's key indicators have slowed to multi-decade lows. Broadly better fundamentals, when compared to prior crises, should limit contagion, though South Africa and, to some extent, Brazil and Indonesia remain vulnerable. Ongoing US rate increases and trade tensions could continue to pressure Emerging Markets, though at sub-11x much is discounted.

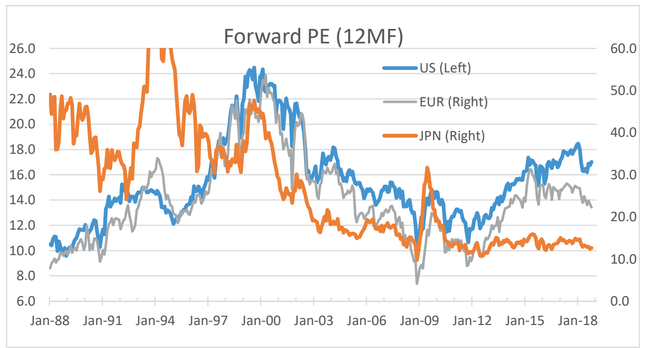
Altogether we see solid upside in international equities in the year ahead, led by double-digit US earnings growth, while a strong USD, accommodative policy and attractive valuations help Japan and the Eurozone. Emerging Markets are cheap, but face trade and US Fed challenges.

Fig.1: Strong US ISM Manufacturing and Services Indices are consistent with very strong earnings growth



Source: Datastream, Baillieu Holst

Fig.2: Markets outside the US are particularly cheap versus the US



Source: Datastream, Baillieu Holst

Please read the disclaimer at the end of this report.

Australia: Rising economic and political risks

Australia reported surprisingly strong 3.4% YoY real GDP growth in 2Q18. However, in our view this growth "borrowed" from the future, with an unsustainable decline in the savings rate to just 1% contributing 0.8% to growth and a 10% rise in business investment added 1.3%. Looking ahead, we see six warning indicators pointing to much slower growth in Australia, including: i) vehicle sales down 3.9% YoY; ii) home prices down 2.9% YoY; iii) investor housing finance down 15.8% YoY; iv) money supply growth, a 26-year low 1.9% YoY; v) business confidence down to a below-average 4, consistent with slower business investment; and vi) the drought, likely to take 0.4-0.8% off GDP.

Beyond these downside risks to growth and earnings, we see another five reasons for a flat-to-slightly lower Australian equity market: i) a peak in earnings momentum, reflecting the decline in business confidence to below-average levels; ii) elevated political risk, with current opinion polls and election odds pointing to a landslide ALP victory, with the potential early passage of the ALP's anti-investor and anti-business agenda; iii) limited policy flexibility, with rising risk spreads on Australian borrowings driving out-of-cycle rate rises; iv) valuation that is at above average levels, though recent underperformance has pushed the market back to an average discount to the US; and v) a lack of catalysts to lift relatively low investor sentiment.

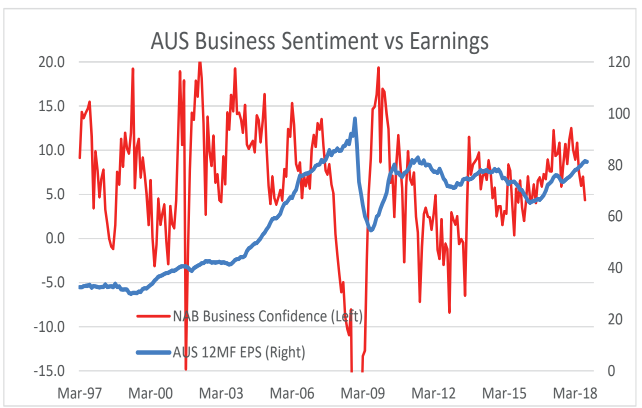
That said, the balance of risks appears, biased to the downside. Australian home prices are declining despite record low interest rates. Household debt is at a record 190% of income, with tightening lending standards lifting the debt burden. New housing supply continues at unprecedented levels, as it has for more than five years, with an additional year of supply under construction. Investors, despite a 23% decline in housing finance from the peak, are still taking 41% of new housing finance, even though only 25% of households live in private rental accommodation. The savings buffer, at a depleted 1%, offers no protection against these risks.

Whilst the downturn scenario is now a much higher risk, we still expect the Australian economy to muddle-through, assisted by a much lower Australian dollar (AUD). A lower AUD reinforces our preference for Australian multinationals and exporters. 'Australian Global Leaders', the key theme in our portfolios, are global industry leaders providing significant exposure to the boom US economy, as well as key parts of Europe.

We also emphasise the export-oriented energy and tourism sectors. We remain positive on the oil price outlook, supported by a tight supply-demand balance, inventories being back to normal and US sanctions on Iran. China's increased focus on its environment has lifted regional LNG demand, with a supply shortage expected to re-emerge from 2021-23. A resumption of LNG expansion projects is likely to favour brownfield projects by Oil Search and Woodside Petroleum, while strong prices deleverage Origin Energy's APLNG project. The tourism sector should also benefit from a lower AUD, with increased inbound and domestic tourism.

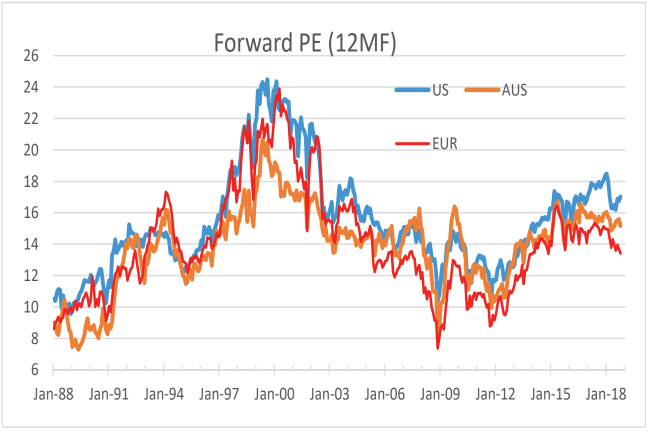
Finally, we remain underweight domestic sectors challenged by a sluggish demand outlook, intensifying competition and structural or regulatory change, including the banks, retail and housing related. We are also underweight bond-sensitive utilities, A-REITs and telecoms.

Fig.3: Lower Australian Business Confidence should moderate earnings growth



Source: Datastream, Baillieu Holst

Fig.4: The Australian market is not cheap versus Developed peers



Source: Datastream, Baillieu Holst

Asset Allocation

Equities are still the only game in town

Overall, our tactical-dynamic asset allocation recommendations are to overweight international equities and to underweight the Australian dollar (AUD), fixed income and Australian equities. We are slightly underweight property and cash.

The global economy is being led by a robust US economy, leading the US Fed to lift rates at a moderate pace and putting upward pressure on bond yields and the US dollar (USD). Growth in Europe and Japan has moderated, but fundamentals appear solid, and policy remains very accommodative. US rate rises, trade tensions, slower China growth and higher oil prices have pressured Emerging Markets.

Implications of strong US growth and fundamentals

Strong US private sector fundamentals – strong income and sales growth, rising labour and industry capacity utilisation and solid balance sheets – are driving robust consumer spending and business investment. US S&P 500 profits rose 26% YoY in 1H18, driven by around 10% sales growth and an 8% benefit from the tax cut, and reflected in a 23% YoY rise in earnings expectations. US core inflation has risen back to the high-end of the post-GFC range. The US Federal Reserve is expected to lift rates at a moderate 100bps rate over the next year, lifting US bonds yields about 50bps to the 3.5-4.0% range and the USD by ~10%. While higher rates should push US valuations lower, double-digit profits growth should drive further upside.

After a strong 2017, Europe and, to a far lesser extent, Japan have seen a moderation in economic momentum, albeit still at high levels. Europe has been impacted by trade and Brexit uncertainty, slower China growth and surging oil prices. Earnings momentum has slowed to 6% and 17% YoY respectively. Looking ahead, policy should remain ultra-accommodative, even after the European Central Bank (ECB) ends its quantitative easing program, while a stronger USD would help competitiveness. Markets remain attractive at ~13x.

The combination of US rate rises, the trade tensions, slower Chinese growth and higher oil prices have pressured Emerging Markets in 2018. Poor economic fundamentals have been exposed in Venezuela, Argentina and Turkey. Pressure is being felt in South Africa, Brazil and Indonesia, forcing policy tightening. Emerging Market earnings momentum has slowed from mid-20s at year-end to 8.2% YoY currently. Valuation has fallen to sub-11x, the lowest level since China concerns in late-2015. Given most Emerging Market fundamentals are far stronger than in prior crises, we see limited risks of widespread contagion. But with rising US rates attracting global liquidity, the early return of capital to Emerging Markets seems unlikely.

We expect a continuation of flat-to-higher bond yields. While bond yields are flat-to-100bps higher so far this year, they remain expensive with real yields anywhere from -0.4% to ~0.8%, well below average levels. Other challenges for bonds include strong growth and rising inflationary pressures in the US, driving ongoing Federal Reserve tightening and a sharp deterioration in the supply-demand balance for US and Eurozone bonds.

In our view, this Federal Reserve tightening cycle is likely to uncover problems in countries which have rapidly expanded their use of debt and inflated asset prices. Countries on our watch list include China, Canada, Australia the Nordics and Switzerland (the C-CANS).

Australia facing home-grown challenges

While pressure on Australia's key trading partner China is a risk, Australia also faces significant internal challenges. Political risk is elevated, with leadership instability and opinion polls pointing to an ALP landslide victory in the looming election, which would lead to a swing toward anti-investor and anti-business policies.

Economic downside risks are also rising (see equity strategy section) reflecting constrained income growth, record leverage, rising pressures from falling home prices, and a depleted savings buffer. Australian household fundamentals are a stark contrast to the US. That said, strong government spending and LNG exports should enable growth to muddle-through.

As such, we expect Australia's record low 1.5% cash rate, already in place for 25-months, to remain for an extended period. Bond yields should rise, pushed up by rising US yields, albeit at a much slower pace.

The Australian dollar should head much lower, given near-record low interest rate spreads, high foreign debt and growth risks.

The Australian equity market should be flat-to-slightly lower, underperforming global peers, held back by slowing earnings momentum, rising political and economic risks, limited policy flexibility and unattractive valuation. Yield support and low rates offer support.

Fig.5: The Baillieu Holst Tactical-Dynamic Asset Allocation Recommendations

Asset Class	Extreme Underweight	Underweight	Slight Underweight	Benchmark	Slight Overweight	Overweight	Extreme Overweight
Australian Equities							
Large Cap							
Small-Mid Cap							
International Equities							
United States							
Europe							
Japan							
Emerging Markets							
Property & Infrastructure							
AUS Property & Infrast.							
Fixed Income							
Australian Fixed Income							
Australian Credit & Hybrids							
Cash							
Cash							
Currency							
AUD							

Source: Baillieu Holst. Note yellow bars are neutral.

Financial Planning

Superannuation

Superannuation is a tax structure used to hold capital to assist in wealth accumulation for future use in retirement. It is compulsory for employers to make mandated contributions to superannuation for employees (Superannuation Guarantee Contributions) when earning above a certain level ($450 per month). Since the introduction of superannuation, the government has provided various taxation concessions including concessionally taxed investment earnings (generally earnings are taxed at a maximum rate of 15%) and capital gains concessions, to encourage individuals to provide for their retirement.

CHOICE OF SUPERANNUATION VEHICLE

There are many available structures that can be used to house superannuation assets. These can include:

- Industry Funds
- Wrap Superannuation Funds
- Retail Superannuation Funds
- Self-Managed Superannuation Funds (SMSF)
- Small APRA Funds

Industry Funds

Industry funds have been originally established to cater to workers from a specific industry. Since 2005, they have become open to most workers in Australia and the majority of funds have become not-for-profit. They remain the default option for many industries to be established for employees when commencing work.

Wrap Account

Wrap accounts essentially provide a central administrative hub for accessing investments and a single reporting structure at tax time. It is an all in one platform that is ideal for members who want to exercise a combination of greater control; transparency and range of investment options, but do not want the administrative and compliance burdens of managing a Self-Managed Superannuation Fund (SMSF). Wrap superannuation funds are advantageous when it comes to ongoing administration and compliance. Taxation on contributions and investment returns (income and capital gains) are managed by the Custodian/Trustee of the superannuation platform.

Retail Superannuation Funds

Retail funds are usually run by banks or investment companies. They are generally recommended by an investment adviser and are a pooled investment product. They can also be a default product established by an employer for their employees.

Self-Managed Superannuation Fund (SMSF)

A SMSF is a trust with increased duties, responsibilities and obligations than most other superannuation products. The SMSF is required to be established with either 2 individual member trustees or a company acting as a corporate trustee, with a minimum of one director. A Self-Managed Superannuation Funds must satisfy certain conditions:

- The fund must have fewer than 5 members (although this may be increased to 6, pending legislation).
- Each individual trustee/trustee director must be a member of the fund (there are special requirements for single member funds) and each member is a trustee/trustee director of the fund.
- Generally, no member may be an employee of another member unless the members concerned are related. There is an exception for non-related business partners who are directors of the same company.
- Trustees must not receive remuneration for their services.

Small APRA Fund

A small APRA fund is essentially a Self-Managed Super Fund with a professional trustee. It offers all the freedom and flexibility, in line with any restrictions determined by the trustee, of a Self-Managed Super Fund but without the associated trustee responsibilities and risk of compliance breaches. Instead, compliance obligations are passed on to a professional trustee company. The benefit of setting up a small APRA fund as opposed to an SMSF is that the approved trustee is responsible for the operation of the fund.

The following outlines some main areas of consideration when choosing the appropriate superannuation structure to meet your goals:

Insurance

Most super funds offer personal insurance for their members. Superannuation allows Life, Total and Permanent Disability (TPD) and Income Protection to be obtained by the member. There are many considerations when obtaining personal insurance and this should be reviewed by a Risk Specialist. Industry funds generally have some limited default

cover, where Retail, Wrap, SMSF and Small APRA Funds have greater flexibility in holding insurance cover.

Investment Options

Super funds invest your money to grow your nest egg over your working life and preserve your money during your retirement. Most super funds let you choose from a range of investment options, depending on how much investment risk you are willing to take and the type of superannuation product. Generally, each superannuation product will be able to invest in the same type of assets, although how you invest differs in each super product.

Industry Funds:

Industry funds generally have fewer investment options when compared to other superannuation vehicles. Investment options generally consist of pre-mixed pooled managed funds. In recent years, some bigger industry funds enable members to have more of a hands-on active approach, enabling more control over the asset allocation of their benefits, but this varies between funds.

Wrap Funds:

Generally, there is a wide choice of investment options that cater for all individuals and their risk preferences. Wrap accounts provide access to wholesale and boutique managed funds, as well as direct investments such as listed shares, term deposits and cash. This superannuation structure will enable an investment adviser the ability to provide appropriate portfolio asset allocation, in order to meet their specific investment goals.

Retail Funds:

Most retail funds only offer multi-mix managed funds with some funds offering single sector (i.e. Australian Share Fund) and others offering 'risk profile' style funds (i.e. balanced or growth).

SMSF:

A SMSF is the most flexible when it comes to investment choice. Available options may include Direct Shares (domestic and international), Fixed Interest, Cash, Managed Funds, Direct Property (with some limitations), collectibles and physical commodities.

Small APRA Funds:

Small APRA funds generally have the same investments options available as a SMSF however, some limitations may be provided by the trustee on the type of investments available. Investments may include, direct shares, managed funds and property however the final decision rests with the Trustee.

Fee Structures

The great debate in the media at the moment is around fees. Ultimately, the lower the fees the more money stays in your account and the better off you will be. The other side of the argument is if you get good superannuation advice and invest in the right option you can potentially be better off in the long run.

Industry Funds:

The administration fee is generally a low nominal flat dollar amount. The ongoing costs are dependent on which investment choice is invested in. These are called a Management Expense Ratio (MER) and covers the costs of operating and managing the investment.

Wrap Funds:

The administration fee is generally a tiered % amount, based on the level of funds under management. There are likely to be additional fees charged when investing in managed products like ETFs/LICS or managed funds.

Retail Funds:

As with industry funds, retail funds charge an ongoing investment management fee (MER). Administration fee rates vary from each fund but tend to be on a medium comparison level when compared to other superannuation vehicles. There are also adviser management fees to consider, if relevant.

SMSF:

The administration of the accounting, audit and financial statements are generally a flat rate fee not subject to the size of the fund. There may be additional fees subject to the investment products and associated adviser management fee, if obtaining professional investment advice.

Small APRA Funds:

The trustees of small APRA funds charge a wide range of fees to administer them and to look after regulatory matters such as preparing accounts, carrying out audits, paying pensions and responding to member inquiries. The details appear in the product disclosure statements and should be carefully analysed.

There are many considerations when choosing an appropriate superannuation vehicle. A combination of areas including; fees, investment choice, insurance availability, ease of estate planning and adviser access should all be analysed and considered, rather than simply focussing on which fund is the cheapest.

Baillieu Holst SMSF Solution

Take control with a Self-Managed Superannuation Fund

So, you've decided to set up a Self-Managed Superannuation Fund (SMSF) and want someone you can trust to assist not only with the initial setup but also the ongoing requirements. Traditionally, SMSF trustees relied on the suburban accountant to establish the fund and assist with meeting their compliance needs.

With the rapid growth of the SMSF sector, there are now a range of SMSF services on offer from the budget 'bare bones' offerings to customised and comprehensive solutions.

So, what type of service is right for you?

There is no simple answer to this question. Rather, your choice of SMSF administrator should be driven by your need for administrative and technical support, the type and complexity of your investments, and your fund balance. As with most things in life, the saying 'you get what you pay for' is just as relevant for your SMSF as it is with other products and services. To aid you in your evaluation, let's look at some of the different types of SMSF services out in the market.

Low-cost, online SMSF administration

The typical low-cost SMSF administration service is ideal for SMSF trustees who are cost conscious, have a minimum level of complexity and require year-end administration only.

Generally, these providers come equipped with a processing system that inputs data into an accounting software and provides a set of accounts at the end of the year without review or oversight. The types of investments may be restricted and there is no opportunity to engage with SMSF professionals for advice or education.

The suburban accountant

Another traditional SMSF administration and compliance approach involves meeting with the suburban accountant to set up the SMSF and provide end-of-year tax returns. This approach generally involves a more personal touch as the family accountant is familiar with the SMSF trustee's financial situation but does not offer day-to-day administration or portfolio management systems.

Costs and service offerings vary for each accountant and SMSF trustees need to ensure that the services provided are suitable to their own needs. They also need to be mindful that not all accountants are well versed in SMSF and superannuation. Compliance breaches and excess contributions can cause significant problems and costs for those unfamiliar with the rules.

The complete SMSF administrator

Many firms now offer the complete SMSF administration package. These offerings provide a comprehensive solution and generally includes management of the initial set up process through to the ongoing annual administration and accounts. What you get with the higher-end SMSF services is a level of oversight and review of your financial accounts, ensuring that everything is as it should be, and an SMSF contact to help with the organisation.

SMSF administrators may also package strategic and investment advice together with the administration or may offer these services as an added optional cost for the client to use when required.

The Baillieu Holst SMSF Solution

The Baillieu Holst SMSF Solution is our revamped comprehensive SMSF administration service which is designed to save you time and allow you to outsource the day-to-day operations of your SMSF while you retain control.

Some of the key features of the Baillieu Holst SMSF Solution include:

- A dedicated SMSF Solution liaison for all your queries;
- Tailored investment advice through your Baillieu Holst Adviser;
- Our SMSF mailbox service which receives all documents and correspondence, saving you from paperwork;
- Management of day-to-day administration such as making contributions, processing pensions and paying invoices;
- SMSF documentation including trust deed updates and trustee minutes;
- Annual SMSF tax return and audit;
- Portfolio administration and quarterly reporting; and
- 24-hour online access to view portfolio reports.

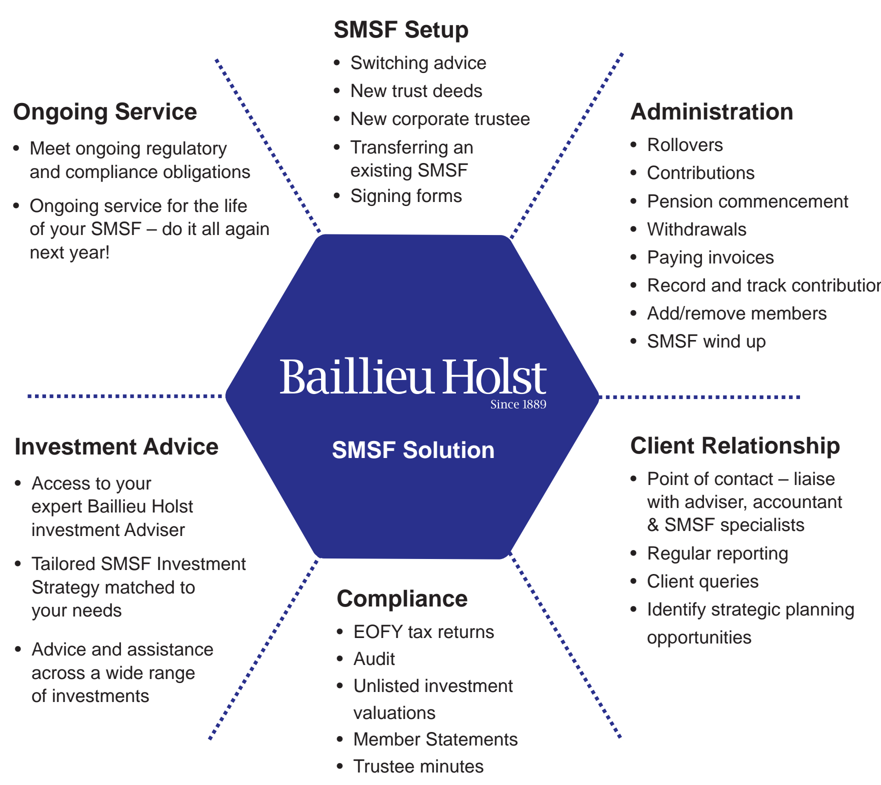
Tailored financial planning advice is available for Baillieu Holst SMSF Solution clients (as an added option for a fixed cost) and allows SMSF trustees to pay for strategic advice, only when required.

In an environment of continual change, the Baillieu Holst SMSF Solution can assist you in keeping up to date with legislative and compliance requirements and save you time so that you can spend it on the more important things in life.

Next steps

The decision about which SMSF administrator to use can have a significant impact on whether you fully utilise all the advantages of having an SMSF. Price should not be the sole determinant about which professional to engage.

SMSF trustees should choose a service in line with their needs and should determine the level of personalised service they wish to receive, how much of the administrative burden they are willing to take on, their need for tailored investment advice, and their chosen SMSF administrator's level of technical know-how and expertise.



Contact a Baillieu Holst Investment Adviser today to discuss how we can help.

Fixed Income

Risks remain high in fixed income

Major market bond yields have been flat-to-higher YTD, with a ~60 bps increase in US yields on the back of strong growth and rising inflation. Slower growth and ongoing easy monetary policy, as well as some flight-to-safety in Europe, has kept yields about flat elsewhere. Looking ahead, we see five continuing sources of risk that are likely to push yields materially higher:

- Expensive absolute valuations: real yields are well below average levels, with the US real 10-year yield of 0.8% low compared to the long-term average 2.1%; Europe at 0.3% versus an average 2.2%; Japan -0.4% versus an average 1.6%; and Australia 0.8% versus an average 3.2% (Figure 6).

- Relatively unattractive valuations: bonds remain very expensive when compared to equities (Figure 7). In our view, this means that equities can absorb at least some of the rise in bond yields.

- Growth outlook: despite a loss of global economic momentum, business activity indicators remain at healthy levels, especially in the US, a negative for defensive assets.

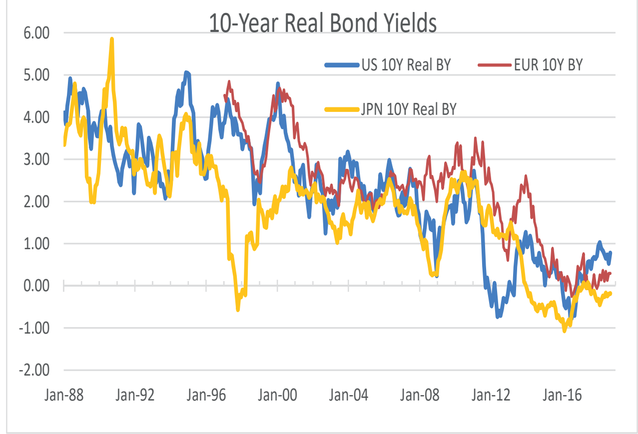
- Inflation outlook: US inflation is rising, albeit very gradually, driven by rising wages amid a tightening labour market.

- Deteriorating bond market supply-demand: the supply-demand balance is deteriorating as the Trump tax cut lifts the US budget deficit, the Fed gradually accelerates its balance sheet normalisation program and the ECB winds down its asset purchase program.

In our view, this combination will drive US bond yields to 3.5-4.0% over the next year, lifting yields another ~50 bps. The further rise in US yields may pressure yields elsewhere – US-German spreads are already at 30-year highs, the ECB is moving to end QE, and Australian-US spreads are at 37-year lows – and/or propel the US dollar higher.

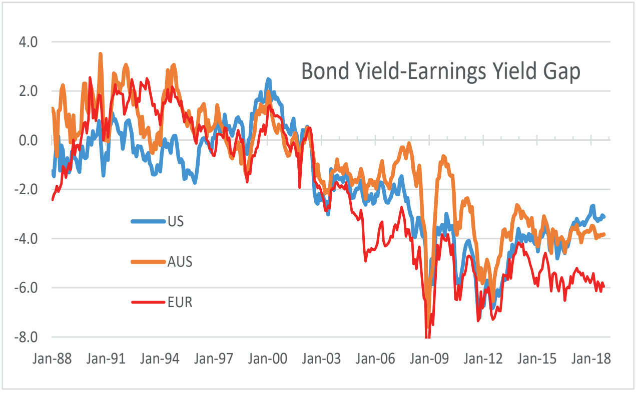
Given this outlook, we expect the sluggish-to-weak performance of fixed income to continue. Within our asset allocation we have a strong preference for floating rate securities, which offer protection against duration risk (long-term bonds have a relatively high duration, a technical term which means that their price declines relatively more when interest rates rise).

Fig.6: The US real 10-year yield at 0.7% is still well below the long term average 2.1%



Source: Datastream, Baillieu Holst

Fig.7: US equities still appear attractive relative to bonds, albeit much less so than Europe or Japan (latter not shown)



Source: Datastream, Baillieu Holst

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Banks

All eyes on upcoming results, the royal commission

The last six months has a been a volatile period for the major banks, with the much-discussed royal commission driving negative sentiment alongside a softening housing market and increasing regulation that resulted in a tightening of underwriting standards. Below we outline the headwinds facing the sector.

- The Hayne royal commission has held rounds of hearings on Personal Lending, Wealth (advice and platforms), SME Lending, and Remote and Regional Australia, while hearings on Superannuation and Insurance are drawing to a close. The poor behaviours revealed by the hearings have led to actions in anticipation of further regulation to address revealed shortcomings. Already the robust application of responsible lending criteria has reduced loan volumes (through lower loan amounts and application rejections) and slowed the loan approval process as a result of greater due diligence.
- Macro-prudential regulation from APRA continues to make it a low growth environment. APRA first imposed macro-prudential guidelines on the banks in December 2014, which led investor loan growth to slow from 10.8% YoY to as low as 2.1% YoY. Then in March 2017 it imposed further guidelines, including a limit on new interest-only mortgage lending of 30% of new loans, a limit on the volume of interest-only lending at loan-to-valuation ratios above 80% (with strong scrutiny of loans at loan-to-value ratios above 90%) and the ensuring of serviceability metrics at appropriate levels. Since then, investor lending growth – the focus of interest-only lending – has slowed from 5.1% YoY to 2.0% YoY.
- The housing downturn, a key downside risk to the Australian outlook, has begun. Home prices are down 2-3% YoY, auction clearance rates are at six-year lows and investor housing finance is down 15.8% YoY. We believe there is significant further downside over the next 1-2 years which is a significant headwind for the banks. This is driven by oversupply, over-indebtedness, overvaluation and over-speculation.

At the stock level, there have been a number of fundamental trends to emerge following the commercial bank reporting season. These are outlined below:

- Revenues – financial markets income continued to soften from its 1H17 cycle peak, with non-interest income also generally lower due to a fall-off of lending and transaction fees.

  Lending growth – banks have generally grown their lending by less than system, stating that increased competition and regulatory restrictions were a drag to flows.
- Net interest margins – margins were generally lower to flat, with customer margins mixed and competitive discounting behaviour offset by deposit-repricing. Near-term margin headwinds mean further revenue pressure, with the target of flat margins viewed as a positive outcome.
- Operating costs – banks are struggling to keep jaws neutral (cost and revenue growth equal) with investment spend and increased regulatory provisions. Encouragingly though, banks recognise that in a low-revenue growth environment more focus on cost is required.
- Bad debts and loan loss provisioning - bad debt charges continued to improve, while collective provision levels have been restocked following the 1 July 2018 AASB 9 implementation. The banks referred to a benign credit environment for a low level of bad debts.
- Asset quality - corporate asset quality broadly improved. Within the household sector, mortgage & consumer delinquencies seasonally deteriorated, although mortgage delinquency rates continue to climb in Western Australia.
- Capital – major and regional banks common equity Tier 1 (CET1) ratios remain robust and unquestionably strong (i.e. over 10.5%).

In conclusion, the reporting season has highlighted the weakening revenue trends and, with the potential for further fee pressure to come from the royal commission admissions (superannuation in particular), the sector faces significant earnings headwinds.

On top of this, recent political developments cast a further shadow over the sector with potential impacts from policy decisions. In this environment, we prefer those banks with cost and capital flexibility. Our major bank order of preference is ANZ (BUY), WBC (BUY), NAB (HOLD) and CBA (HOLD).

Company	ASX Code	Rating	Last Price	P/E FY19	Yield FY19	Franking
ANZ	ANZ	Buy	$28.58	12	5.7	100
Commonwealth Bank	CBA	Hold	$71.57	13.8	6	100
National Australia Bank	NAB	Hold	$27.72	11.5	7.1	100
Westpac	WBC	Buy	$28.21	12	6.7	100

Data as of 24/09/2018

Energy

Global demand continues to support higher prices

We have had a positive view on energy and rising oil prices for the best part of a year. Our view remains unchanged as we continue to believe in the case for higher oil prices, underpinned by seven key drivers:

1) robust global demand; 2) very limited spare capacity within the Organisation of Petroleum Exporting Countries (OPEC); 3) internal OPEC pressures; 4) little non-OPEC or non-US supply growth; 5) inventories back to normal levels; 6) a shift to internally-financed US shale oil exploration; and 7)heightened geopolitical risks.

Our recommended exposure to this theme is obtained through oil and oil-linked LNG producers including Woodside Petroleum, Origin Energy and Oil Search.

Woodside Petroleum (WPL) reported a 12% increase in underlying first-half 2018 NPAT to US$566 million, which was above market expectations. Gearing also came in better than expected, while an improved first-half dividend of US 53 cents was in line with market expectations.

Woodside delivered 44.3 mmboe (million barrels of oil equivalent) of production in first-half 2018 and increased full-year 2018 guidance to 87-91 mmboe from 85-90 mmboe. Woodside is targeting production of 100 mmboe by 2020.

Looking ahead, the largest risk and opportunity faced by Woodside investors is future development. Output has grown substantially as Pluto's LNG ramped up and, while it is not yet the largest project in Woodside 's stable, the substantial 90% equity share makes incremental output more meaningful.

Each new additional LNG train at Pluto adds more than five times the equity LNG output that Woodside's NWS/JV stake contributes. After Pluto, production can continue growing strongly if the market is there as much development potential exists within the portfolio, including major gas resources at Browse and Sunrise.

However these opportunities will require exceptional capital investment, continuous execution in all phases of development and balance sheet gearing.

As proof of creditable discipline, in recent years Woodside has pushed out development expenditure and increased dividend payouts.

Oil Search's (OSH) result was significantly impacted by the massive earthquake and series of aftershocks that struck the Highlands region of Papua New Guinea in February, forcing the temporary shutdown of oil and gas operations. Oil Search's output for the six months was down by 31% to 10.24 million barrels of oil equivalent.

Oil Search reported a drop in net profit of 39% to US$79.2 million in the 2H FY18 from US$129.1 million last year, while half-year revenue declined by 18% to US$557.8 million from US$676.2 million a year earlier.

Regarding production guidance, record performance by the PNG LNG project since its late April restart saw OSH announce expected annual output of between 24 and 26 mmboe, which is towards the upper end of the previously announced range.

Origin Energy (ORG) recently reported its FY18 result which was below market expectations. EBITDA of A$2,947mn was approximately 6% lower than market consensus. Disappointingly, FY19 guidance for the energy markets business was for A$1,500 – 1,600mn.

Guidance for a modest increase in gas earnings, flat procurement costs and an increase in commercial prices implies that retail margins must be the cause of weaker-than-expected guidance, a similar conclusion to that which emerged from AGL's FY18 result. While we contend that retail margins are now below regulatory benchmarks, we do not expect a near-term improvement.

While dividends are set to resume in FY19, balance sheet debt reduction continues, albeit at a slower pace than we had forecast, leaving year-end net debt at A$6.5bn, higher than we had anticipated.

Post result, we downgraded Origin to a Hold from BUY, believing the magnitude of near-term challenges in energy markets can no longer be overlooked in favour of deleveraging.

Resources

China the key

In our view, the outlook for the mining sector moving forward primarily hinges on China, the world's dominant consumer of commodities, a key driver of global growth and a major player in the US' trade issues.

In 2018, some of China's key economic indicators slowed to levels not seen since the mid-1990s, including real retail sales and fixed asset investment, whilst industrial production is also at relatively low levels. This reflects a credit tightening, leading to record low money and credit growth. In addition, the US-China trade tensions represent a material threat to Chinese growth. A 25% tariff on US$250 billion of Chinese exports could directly lower growth by 0.4 -1.0%, and with hits to investment and employment could lower growth by 1-2%.

This combination of threats has led China to materially ease policy, cutting reserve requirements by 150bps, easing interbank rates by 150-175bps, allowing the Renminbi to decline ~9%, encouraging lending and announcing some fiscal stimulus.

These actions should limit downside risks, but it is uncertain whether they can lift growth. That said, the impact of a slower China on Australia and the major miners has been muted by a robust steel sector, where production has defied the slowdown.

With major cross-currents in China, we view earnings expectations as too positive and the above-average valuations unjustified. Sector specific catalysts such as cost-outs, asset sales and capital management appear to be exhausted or well-known. As such, we remain reluctant to embrace the sector.

On a stock specific level, Rio Tinto (RIO) reported EBITDA of $9.2bn at its 1H18 result, marginally missing market consensus.

The highlight of the result was the US$7.2bn worth of returns announced – US$2.2bn interim dividend (50% payout), US$1bn extra buyback, US$4bn commitment to return asset sales proceeds – and US$1.4bn still to go from the existing program. We would also flag that there is a further US$3.5bn which could potentially be returned to shareholders in future once the Grasberg sale is finalised.

A slight negative was the cost inflation impacting all divisions of the business, with management noting the 'reheating' of Western Australian cost pressure.

Overall, we remain positive towards RIO. We still can generate valuation upside for the stock and think that along with continued capital returns to come, RIO will remain on the watchlists of the generalists. In the same breath, however, it's becoming increasingly difficult to identify the catalyst that could push the stock towards our $89.00 price target near term. We retain our BUY recommendation.

BHP reported an underlying NPAT of US$8.9bn, in line with our US$9bn estimate and consensus. A final dividend of US$0.63/sh was declared, representing a 69% payout of FY18 earnings. Net debt of US$10.9bn was below consensus forecasts of US$11.6bn.

We also noted that there was no change to the <US$8bn capex guidance for FY20 as well as some positive developments within the conventional petroleum business, with eight projects in the pipeline with >25% forecast returns.

Overall, we believe BHP reported a clean set of numbers and our modest earnings changes reflect the sale of the onshore business. BHP clearly has organic latent capacity and value-unlocking options that many of its peers do not. However, the question is to what extent can these be executed and priced in.

Not unlike peers, BHP faces a rising cost base and a macro environment we should be somewhat cautious about. In the meantime, the downside risk looks limited given the likely returns to shareholders over the next 12-18 months.

South32 (S32) reported an underlying NPAT of US$1.3bn which was slightly ahead of our forecasts and consensus. The US$380mn approved capital management program remains on top of the announced US6.2cps fully franked final dividend.

Without singling out larger cap peers, we believe S32 has more for us to think about and potential upside catalysts, not to mention a more favourable commodities suite versus its major peers.

With earnings, cash, balance sheet and returns all ticking along nicely, we recently upgraded to a BUY from Hold with a $4.10 price target.

Company	ASX Code	Rating	Last Price	P/E FY19	Yield FY19	Franking
BHP Billiton	BHP	Buy	$33.83	12.1	4.2	100
Rio Tinto	RIO	Buy	$78.52	13.3	4.4	100
South32	S32	Buy	$3.85	11.9	3.2	100

Data as of 24/09/2018

Consumer Staples

Restructuring remains the focus

It has been a strong period for the major consumer staples names despite a tough economic environment that sees Australian consumers under significant pressure. We believe this environment is unlikely to improve in the short to medium term given seven sources of pressure on Australian households.

These include: 1) near-record low nominal wages growth; 2) flat real wages growth; 3) double-digit year-on-year increases in utility and petrol prices; 4) rising debt burdens from a record debt-to-income ratio at 190%, together with the shift away from interest-only borrowing; 5) tax bracket creep of 20-40bps pa; 6) a depleted savings buffer (a savings rate of just 2.1%); and 7) falling house prices (-1.6% YoY). In addition, foreign entrants like Aldi, Costco and Kaufman continue to expand, while in June, Amazon launched Prime at a deep discount and eBay announced Plus.

On the stock level, Wesfarmers (WES) has been a strong performer recently. Wesfarmers' financial position has been significantly strengthened of late following the divestments of the Kmart Tyre and Auto business for $350m and its 40% interest in the Bengalla Coal joint venture for $860m.

Following the Coles demerger, scheduled for November 2018, it is expected Coles will inherit about $2b in debt. Given WES had net debt of about $4.2b in April, and making adjustments for Bengalla, Kmart and the Coles demerger, WES' net debt is expected to decline to roughly $1b by the end of the calendar year.

We believe this will provide options for management with regards to capital management and acquisitions, or potentially both.

The ratings agencies have reportedly provided preliminary views on WES' financial position, although these are not likely to be formalised until post the Coles demerger later this year. Whatever the case, WES' financial position remains strong with most businesses showing positive momentum.

We also believe the management team will have been refocused given the portfolio clean-up of underperforming assets and businesses that had probably passed peak returns.

Meanwhile, Woolworths (WOW) reported an FY18 NPAT from continuing operations of $1,605m, an increase of 12.9%. WOW's Australian Food operations and its Hotel division reported double-digit earnings growth. However, the Liquor operations reported a modest 2.8% increase in earnings and Big W continued to post losses. The company declared a final dividend of 50cps and announced a special dividend of 10cps, which was a positive surprise.

The company indicated the likelihood of further capital management post the possible sale of its petrol operations. While some investors will be concerned by a slowdown in like-for-like sales growth within its core Supermarket business, which increased a modest 1.3% in the first seven weeks of the 1Q19, we note nothing fundamentally poor in the operating metrics and are not overly concerned.

Looking ahead, we think Woolworths is a solid long-term story, but with near term performance potentially held back by shorter term 'locked in' cost growth. With additional spending on e-commerce and food service initiatives central to refurbishments, Woolworths is committing to a view on value creation from these initiatives long term.

The company is also spending heavily on warehouse automation and its digital platforms, which are likely to continue to widen a competitive advantage with respect to Metcash. With all of that change happening, the cash demands of the business have been well-managed, as reflected in a rapid de-gearing of the balance sheet and the business moving to a sustainably higher payout ratio.

Company	ASX Code	Rating	Last Price	P/E FY19	Yield FY19	Franking
Wesfarmers	WES	Hold	$49.82	19.4	4.2	100
Woolworths	WOW	Hold	$27.65	20.9	3.5	100

Data as of 24/09/2018

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Telecoms

Three players better than four

The telecommunications industry has been facing significant headwinds in recent years, with mobile phone revenue peaking back in FY15. Even so, in FY19 Telstra (TLS) is still forecasting a decline in mobile revenue of 2-3%.

Recently, TPG (TPM) shelved plans to become the fourth mobile network operator in Australia. Instead, the company has moved down the M&A route, demonstrated by the announcement of a merger of equals with Vodafone Hutchison Australia. The merger will create the #3 telecommunications company in Australia (#2 in fixed-line and #3 in mobile) behind TLS and Optus.

The wider implications for the Australian telecommunications sector is neutral to positive, as the shift from an expected four players back down to three should lower the risk profile of industry returns. The proposed merger largely eliminates the price war that was expected to come from TPG entering as the fourth mobile network operator. However, the merged integrated telecommunications company is expected to compete aggressively across the consumer, enterprise and small and medium-sized enterprise (SME) segments through the bundling of mobile and broadband products.

From a stock specific perspective, we believe TPG's decision to merge with Vodafone Hutchison and take their relationship to the next level is recognition of the current competitive intensity in the mobile market.

While a combined Vodafone-TPG will be a formidable entity, the status quo of just three mobile operators is still better for the competitive dynamics than having an aggressive, price-led challenger such as TPG invading the market with its own network.

It is also possible that TPG had second thoughts about the feasibility of building a viable mobile network, using predominantly small cells, with just $600 million, at a time when the incumbents are spending $600 million to over $1 billion a year just to maintain their mobile infrastructure.

We believe these positive industry implications (at least compared with previous fears) have played as much a part as the actual merits of the merger in lifting TPG shares ~50% higher since mid-August.

Nonetheless, the rally in TPG has presented an opportunity for shareholders who may want to reassess their exposure to a structurally challenged sector.

Telstra has benefitted from this planned consolidation. At its full year result, Telstra reported FY18 net profit of $3.56bn, an 8% decline from the pcp amidst restructuring costs and a continued squeeze from intensifying competition. The market liked the result, with TLS shares gaining 5.9% on the day of the announcement, perhaps due to the fact it was the first result in two years not to contain a downgrade.

Looking ahead, Telstra expects income in FY19 to be in the range of $26.5 billion to $28.4 billion. Earnings before interest tax depreciation and amortisation, excluding restructuring, is expected be between $8.8 billion and $9.5 billion.

In June, Telstra Chief Executive Andy Penn unveiled fresh plans to restructure the company's operations to face up to heightened competition across wired and wireless businesses and the expected revenue hit as the federal government's nationwide broadband network continues to roll out.

While the share price has seen some relief, the business and industry still face headwinds, although the degree of severity seems to have reduced given the recent industry developments.

Stock Focus

Ideas towards the smaller end of town

Auswide Bank

Auswide Bank (ABA) is a long-established third tier regional bank with a network of 22 branches, primarily located in Central Queensland. ABA now has an Australia-wide lending presence supported through branches, business bankers, accredited mortgage brokers and online.

With full bank status, a range of business re-engineering initiatives to modernise the bank have allowed ABA to deliver above system profit growth.

At its full year result, ABA reported net profit of $17.1m – a 9% improvement on the prior corresponding period. The result was clean and in line with the expectations, meaning the company has effectively balanced loan growth and net interest margin management.

ABA paid a second half FY18 dividend of 18 cents per share, bringing the total FY18 dividend to 34cps, equating to an 83% payout ratio.

Looking forward, ABA is targeting loan growth across its whole product suite, with mortgages aimed to be above system. Continued investment in IT will help develop an end-to-end digital banking platform.

Industry regulation will remain very much in focus, including an Australian Prudential Regulation Authority (APRA) review into capital and risk weights for authorised deposit-taking institutions. ABA currently has a strong Tier 1 Capital ratio of 12.86%, well above the unquestionably strong level of 10.5% imposed on the major banks. In the current climate, it is worth noting that ABA has not been part of the royal commission.

Auswide is one of our top picks within the small and mid-cap space. Our positive investment view is built on the current industry trend of strong growth outside of the major banks, steadily improving cost ratios following a period of business investment, an improving Queensland economy and the attractive dividend yield on offer.

Reliance Worldwide Corporation

Reliance Worldwide Corporation (RWC) is a leader in the design, manufacture and supply of high quality water flow and control products and solutions for use in 'behind the wall' plumbing. 'Behind the wall' plumbing is a term used to describe plumbing infrastructure that enables water to travel leak-free from the water main to plumbing fixtures, such as taps and faucets, and are generally not visible within the building.

Reliance has grown to become a global business with established operations in the US, Canada and ANZ. Its recent acquisition of John Guest gives RWC an increased presence in the UK and Europe.

The innovative "SharkBite" branded brass push-to-connect fittings were introduced to the US in 2004 and is the cornerstone of the RWC growth story. RWC will also be a beneficiary of the lower US corporate tax rate given its exposure to US earnings.

At its FY18 result, RWC reported a 19.8% increase in net profit, with the company achieving strong top and bottom line growth. Sales were up 28% to $769m and underlying EBITDA (earnings before interest tax depreciation and amortisation) rose 25% to $151m.

Looking forward, we expect RWC's growth to be bolstered via Holdrite (acquired May 2017) and John Guest (acquired June 2018) as they become integrated into the existing business and offer exposure to new markets. Current strength in the US repair & remodel (R&R) market is likely to provide a tailwind for growth in the US.

Overall, RWC is well placed to deliver double-digit growth over the next couple of years given its unique growth characteristics, and is a top pick within the small and mid-cap space.

Company	ASX Code	Rating	Last Price	P/E FY19	Yield FY19	Franking
Auswide Bank	ABA	Buy/Med	$5.55	12.5	6.7	100
Reliance Worldwide Corp.	RWC	Buy/Med	$5.21	23.4	1.9	100

Data as of 24/09/2018

Please read the disclaimer at the end of this report.

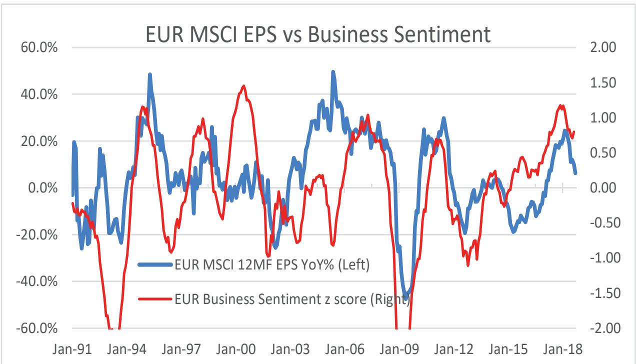
International

US still top of the pile

From a top down, asset allocation perspective we continue to prefer international growth asset classes, in particular global equity markets.

The European market continues to be our largest overweight position. In terms of valuation, it is just below the long-term average and, while European business sentiment has moderated, it remains at a high level, which is supportive of earnings growth. (Fig. 8)

Fig.8: European Business Sentiment has moderated but remains at a high level, supporting earnings growth

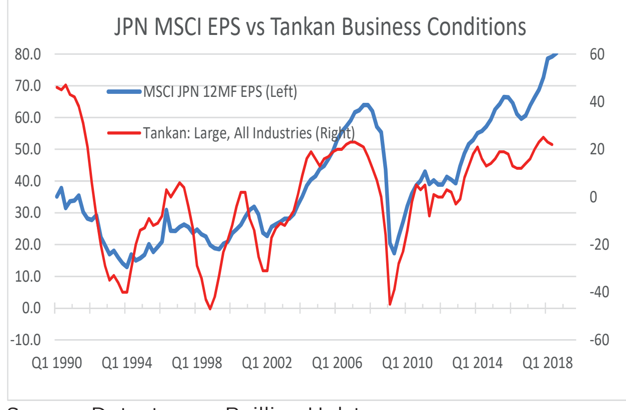


Source: Datastream, Baillieu Holst

We are also overweight Japan and note that after almost 30 years of deflation, and many false starts, recent economic data in Japan is pointing to acceleration in wages growth, the key precursor to a break out of the deflationary cycle.

If Japan is breaking out of deflation, the market on a forward PE of just 13x appears significantly undervalued. When compared to rates at about zero, the market appears extremely attractive. The dividend yield of above 2% is also attractive versus history and rates. (Fig. 9)

Fig.9: Japan 12MF earnings forecasts are at a record



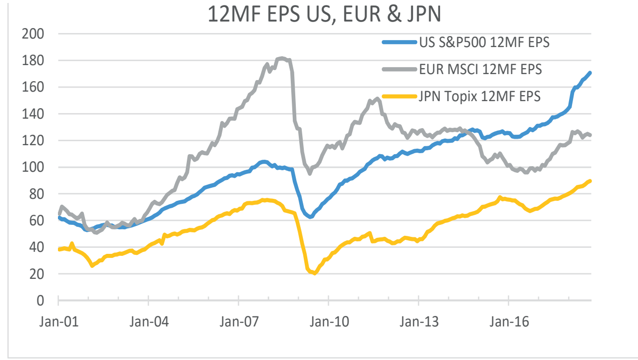
Source: Datastream, Baillieu Holst

We reiterate our overweight focus on Europe and Japan and, after the recent surge in Australia, we recommend reducing the position in Australian equities, adding to International by increasing our US exposure. US economic activity is humming, with second quarter real GDP up 2.8% YoY and nominal GDP up 5.4% YoY. In our view, US growth is back to pre-GFC norms, when real and nominal growth averaged 2.6% pa and 4.5% pa respectively.

Fundamentals remain robust, particularly in the household and corporate sectors. Households are enjoying strong jobs and real wages growth, the Trump tax cut and rising wealth. Wealth is at record levels and the debt burden is just above a record low. Corporate fundamentals are equally strong, while profits are booming, rising 25% YoY in 1H18. Sentiment is strong, helped by the tax cut, and reflected in rising business investment. Balance sheets, particularly interest coverage, appear solid.

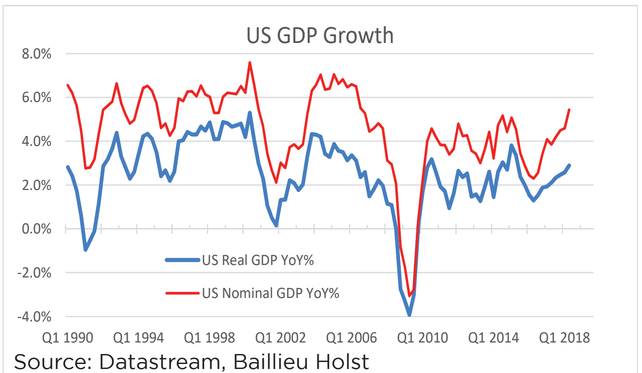
In terms of US equity markets, absolute valuations have fallen, although they remain modestly above average. Strong earnings growth should push PE valuations to average levels. Liquidity conditions, with Fed rate rises and the flatter yield curve, are no longer positive. Overall market appreciation should slow to a high single-digit pace, led by robust earnings growth.

Fig.10: US earnings are booming



Source: Datastream, Baillieu Holst

Fig.11: Strong US real and nominal GDP is heading back to Pre-GFC levels



Source: Datastream, Baillieu Holst

Listed Investment Companies

Top Picks

This report contains a LIC sector update and performance review of our coverage universe for the month of August 2018.

Top picks: Our top picks refer to preferred exposures within each sector based on numerous quantitative and qualitative factors. However, they should not be treated as official stock recommendations but merely as a guide to where we would apportion funds at this particular point in time.

Traditional LICs: On average, traditional LICs performed in line with the All Ordinaries Accumulation Index (XAOAI) on a NTA basis during Aug-18 (+1.8%). Total shareholder returns (TSR) were mixed (DUI up 4.8%, DJW down 2.0%), which is typical as LICs trade ex-dividend following the dividend run up period. All traditional LICs have traded ex-dividend and we believe trading levels should now normalise and trade broadly in line with underlying NTA growth. Our current top picks include Australian Foundation Investment Company (AFI), trading at an estimated 0.4% premium to NTA, and Milton Corp (MLT) and Diversified United Investments (DUI), trading at estimated 6.5% and 3.6% discounts to NTA respectively.

Large capitalisation: Currently trading at an estimated 0.1% premium to NTA, WAM Leaders (WLE) is our top pick within the large cap space. Whilst we are cognisant that WLE has had a discount to NTA re-rating (one-year average: 3.2% discount) we believe the possibility for a further re-rating remains due to potential dividend increases (current yield of 3.7% fully franked). We note other LICs managed by Wilson Asset Management International (WAMI), WAM and WAX, are currently yielding 6.1% and 5.5% respectively. WAM and WAX current trade at a 20.9% and 27.7% premium to NTA respectively. Whilst we don't believe WLE will trade at these premiums, we believe trading level risk is to the upside if WLE can increase its dividend yield.

Small capitalisation: Acorn Capital (ACQ) is our top pick. TSR and NTA growth of 44.1% and 30.0% respectively for the year ended August 2018 outperformed the ASX Small Ordinaries Accumulation Index (XSOAI) by 21.8% and 7.7%. Despite this outperformance, ACQ is currently trading at an estimated 5.7% discount to NTA with a 3.7% fully franked dividend yield. Elsewhere, Westoz Investment Company (WIC) is managed by a specialist LIC manager with a focus towards mid to small cap resource companies. WIC has been a top performer in the small cap space on both a TSR and NTA basis, up 19.9% and 27.9% respectively for the year ended August 2018. Trading at an estimated 11.3% discount to NTA with a 5.3% dividend yield, WIC is a top pick for investors looking for exposure to the resources cycle.

International: International LICs continue to be a top performing sector in our LIC coverage universe, with AUD deprecation against the USD providing a positive currency tailwind for a number of LICs that are unhedged. Our current top picks include MFF Capital Investments (MFF), PM Capital Global Opportunities Fund (PGF) and Templeton Global Growth (TGG). MFF is our top US orientated international LIC (>85% of the portfolio in US-listed companies). PGF provides exposure to a broader basket of global securities (US 58.4%, Europe 30.3%, UK 5.2% and Asia 6.0%), whilst TGG is overweight Europe and underweight US (when compared to the MSCI World Index). We believe the recent NTA performance of MFF and PGF (one-year NTA growth of 42.3% and 23.2% respectively) justifies the discount to NTA re-rating, but believe the current estimated 7.2% and 8.2% discounts to NTA respectively provides an attractive entry point for investors. Trading at an estimated 6.8% discount to NTA, TGG is also a top pick in the international sector.

Top Picks	Code	Share Price	Market Cap. ($m)	Dividend (cents)	Dividend Yield	Grossed Up Yield	Current Est. NTA	Current Estimated Disc/Prem	Aug NTA	Aug Disc/Prem	1 Yr Ave Disc/Prem	3 Yr Ave Disc/Prem	MER
Australian Foundat.	**AFI**	6.22	7414.4	24.0	3.9%	5.5%	6.20	**0.4%**	6.29	-0.8%	0.6%	1.8%	0.14%
Diversified United	**DUI**	4.18	877.1	15.0	3.6%	5.1%	4.47	**-6.5%**	4.56	-3.9%	-5.0%	-5.7%	0.13%
Milton Corporation	**MLT**	4.62	3072.0	19.0	4.1%	5.8%	4.79	**-3.6%**	4.83	-3.5%	-1.0%	-0.2%	0.12%
WAM Leaders Limited	**WLE**	1.22	854.4	4.5	3.7%	5.3%	1.21	**0.1%**	1.21	3.1%	-3.2%	-1.6%	1.00%
Acorn Cap Inv Fund	**ACQ**	1.28	67.2	4.7	3.7%	5.2%	1.35	**-5.7%**	1.37	-5.4%	-13.6%	-14.4%	0.95%
Westoz Inv Ltd	**WIC**	1.13	149.9	6.0	5.3%	7.6%	1.27	**-11.3%**	1.31	-11.2%	-10.5%	-12.4%	1.00%
MFF Capital Invest.	**MFF**	2.85	1541.8	2.5	0.9%	1.2%	3.07	**-7.2%**	3.05	-6.1%	-10.2%	-9.7%	1.25%
Pm Capital Fund	**PGF**	1.29	452.7	3.6	2.8%	4.0%	1.41	**-8.2%**	1.43	-8.6%	-4.3%	-9.1%	1.00%
Templeton Global	**TGG**	1.42	314.0	8.0	5.6%	8.0%	1.52	**-6.8%**	1.62	-6.3%	-9.0%	-10.4%	1.20%

Data as of 18/09/2018 Source: Company releases, Bloomberg, BH estimates

Corporate

The Baillieu Holst Corporate Department is pleased to announce the completion of several primary and secondary capital raisings over the last quarter.

On the back of stronger equity capital market volumes, and subsequently greater investor confidence, Baillieu Holst was involved in three successful Placements, having acted as Lead Manager for Bigtincan Holdings' A$15.0 million Placement and Rex Minerals' A$6.0 million Placement & Share Purchase Plan (both in June 2018), as well as Joint Lead Manager for Empire Energy's A$15.0 million Placement in August 2018.

Baillieu Holst also acted as Lead Manager to block trades for two large, globally held stocks, being Hansen Technologies' (A$13.8 million block trade) in March 2018 and Afterpay Touch Group (A$15.0 million) in August 2018.

In addition, Baillieu Holst acted as a Co-Manager to WAM Global's A$466.0 million Initial Public Offering in June 2018 and Envirosuite's A$10.0 million Placement in August 2018.

We are currently working on a strong pipeline of corporate mandates and potential opportunities which we hope to announce in due course.

A$13.8 million Block Trade	A$466.0 million Initial Public Offering	A$6.0 million Placement & SPP	A$15.0 million Placement
Lead Manager **March 2018**	**Co-Manager** **June 2018**	**Lead Manager** **June 2018**	**Lead Manager** **June 2018**

A$15.0 million Placement	A$10.0 million Placement	A$15.0 million Block Trade	A$1.8 million Underwritten DRP
Joint Lead Manager **August 2018**	**Co-Manager** **August 2018**	**Lead Manager** **August 2018**	**Lead Manager &** **Underwriter** **September 2018**

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