JAMIESON COOTE BONDS

CIO Insights - October 2018

- **The investment ground has shifted and isn't coming back soon** – markets face less liquidity, higher rates and tighter credit conditions.
- **October delivers a dose of reality into a 'restrictive' world** – some pockets of good news in Australia but the trade-off between strong economic conditions in this late cycle U.S. market, coupled with tightening monetary policy, will be a defining battle ground for markets.
- **Rolling asset correlation changes?** The commentary around correlations between fixed rate bonds and equities continues. These assets are prone to a positive skew in periods of very high inflation (5.00%+ CPI) or in a substantial interest rate hiking cycle. Not in Australia any time soon, but possible.
- **For the calendar year to date ending October, Australian Government Bonds produced a return of +2.78%, whilst the ASX 200 price index closed -3.87%.** This 6.65% differential seems negatively correlated to high grade bonds - which aim to defend and protect, whilst providing optionality and liquidity.

JCB Performance Since Inception*

PERFORMANCE*	GROSS RETURN	NET RETURN	INDEX	vs INDEX NET FEES
1 MONTH	0.45%	0.39%	0.50%	-0.12%
3 MONTHS	0.84%	0.66%	0.85%	-0.19%
12 MONTHS	3.33%	2.60%	3.14%	-0.53%
24 MONTHS	2.72%	1.98%	2.08%	-0.10%
36 MONTHS	3.34%	2.62%	2.74%	-0.12%
SINCE INCEPTION ANNUALISED	4.01%	3.29%	2.96%	0.33%

* Inception date of the unit trust is 1/12/2014. Inception date vs index is 31/12/2014. Past performance is not an indicator of future performance.

** Net Asset Values (NAV) are quoted after the deduction of all fees and expenses. JCB Active Fund aims to pay distributions semi-annually at 2% p.a. of NAV: a distribution of 1.0% was paid on 30/06/2018.

DATE	NET ASSET VALUE	ENTRY PRICE	EXIT PRICE	AVERAGE RATING
31st OCTOBER 2018**	1.0614	1.0625	1.0603	AAA

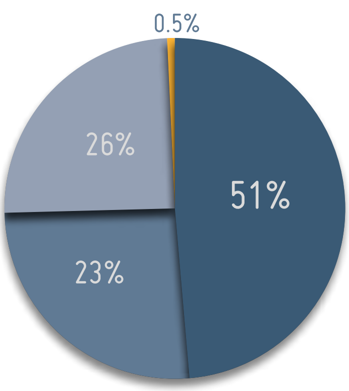
Jamieson Coote Bonds Active Fund (JCBAF) - October 2018

Month End Portfolio Mix

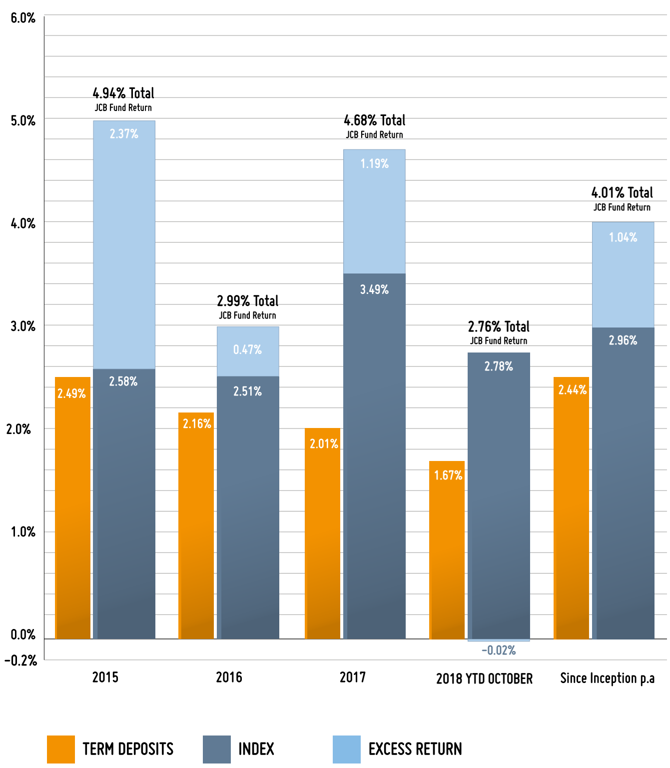
Australian Government Bonds	50.6%
State Government Bonds	22.8%
Supra National Bonds	26.0%
Cash	0.5%

KPI Averages

Duration	6.06 years
Index Duration	6.26
Average Coupon Rate	3.35%
Tracking Error	0.6
Average Weighting	AAA



JCB Calendar Year Gross Returns vs Term Deposits



Source: Reserve Bank of Australia (as at October 2018) and Channel Capital (as at October 2018 as the fund's administrator). Assumes retail deposit & investment rates for amounts over A$10000 held for six months. Aus Govt Bond Index: Bloomberg Ausbond Treasury 0+ yr index and Excess Return is the return generated by the JCB Active Bond Fund (institutional, inception: 1 Dec 2014) over the index. Past performance is not an indicator of future performance.

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The investment ground has shifted and isn't coming back soon.

Just a year ago the world was enjoying a synchronised economic acceleration. In 2017, growth rose in every big advanced economy except Britain, and in most emerging economies. Global trade was surging and America was booming; China's slide into deflation had been quelled; even the Euro Zone was thriving. In 2018, the story is very different. Investors have fretted materially for the second time this year, concerned over trade wars and monetary policy tightening. Those fears are well-founded according to JCB. The world economy's major problem in 2018 has been uneven momentum. Leading economic indicators from Asian export nations have been in marked decline, coupled with weakening European data and fiscal drag in the U.S. into 2019. JCB believes all of this makes for a stark reality check and has lead the International Monetary Fund (IMF) to forecast slowing growth this year in most advanced economies (excluding the U.S.).

For 10 years, buying dips in risk markets has been rewarded via excess liquidity (QE), low interest rates and easy credit availability. All of those structural elements are now gone. The fundamental ground has disappeared. Looking ahead, JCB see that markets will face less liquidity, higher rates and tighter credit conditions, all of which should curtail economic activity looking forward.

October delivers a dose of reality into a 'restrictive' world.

October has historically been a shaky month for risk markets and this year was no exception, with wild swings intra-month before closing significantly lower. Markets look set to retain higher volatility into year-end ahead of U.S. mid-term elections and further U.S. rate hikes from the Federal Reserve. Domestically, the economy remains idiosyncratic with pockets of good news. Employment numbers have improved and terms of trade remain high. However, the property market remains soft with credit availability constrained and further tightening likely on the findings of Royal Commission in February 2019.

The acute trade-off between strong economic conditions in late cycle U.S. markets and the pressures for interest rates to rise, via a tightening of monetary policy, will be a defining battleground for markets. Strong economies support strong cash flows and earnings, but 'restrictive' policy settings bring higher discount rate assumptions which offset this. Eventually, tightening starts to flow through to weigh on economic conditions. JCB have begun to see this dynamic play out this year, as the fiscal boost has helped support economic conditions but has been offset by rising discount rates. As the pullback of liquidity continues and fiscal policy starts to roll over, this will increasingly become a drag on economic conditions as well, especially relative to market expectations.

Rolling asset correlation changes? Not in Australia any time soon, but possible.

There is some discussion by commentators around the correlation between asset classes, namely between fixed rate bonds and equities. These correlations are fluid and can be prone to a positive skew in periods of very high inflation (5.00%+ CPI) or in a substantial interest rate hiking cycle. Thankfully in Australia investors do not face either scenario, nor are investors likely to face such scenarios in this global business cycle, according to JCB.

One of the key product benefits of fixed rate bonds is they have zero volatility when held to maturity (investment is made at a 'fixed rate'), but often rally considerably in times of material stress before maturity - at exactly the point when investment portfolio's require a negative correlation benefit. This gives investors great flexibility and optionality to divest and take advantage of riskier assets that may have cheapened as a result.

As at October month end, Australian Government Bonds have produced a calendar year to date return of +2.78%, whilst ASX 200 price index closed -3.87%. This 6.65% differential seems pretty negatively correlated to JCB's high grade bond strategy. This indicates to JCB that government bonds are doing what they are designed to do, defend and protect, whilst providing optionality and liquidity.

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CC JCB Active Bond Fund performance in October

For the month of October, the CC JCB Active Bond Fund (the Fund) returned 0.42%, underperforming the Bloomberg AusBond Treasury (0+Yr) Index by 0.08%.

JCB lightened durations after a surprise stronger employment print during October, only for international equity markets to fall and lift bond valuations higher through the month. This caused some Fund underperformance versus the index within the month.