Investment Update

April 2017

INVESTMENT RETURNS to March 31, 2017						
	3 Months %	**1 Year %**	**3 Years % p.a.**	**5 Years % p.a.**	**10 Years % p.a.**	**Since Inception % p.a.**
ARA Investment Fund						
Defensive	-0.6	3.7	4.7	4.7	3.4	5.0 (April 2003)
Growth	-1.7	5.5	7.0	7.2	4.0	6.1 (April 2003)
Equities	-3.0	3.1	4.5	8.1	3.0	6.7 (August 2003)
ARA Retirement Fund – Accumulation (taxed)						
Defensive	-0.4	3.2	4.1	4.3	3.2	4.1 (April 2005)
Growth	-1.4	4.9	6.3	6.7	4.0	5.3 (April 2005)
Equities	-2.8	1.9	3.6	7.2	3.2	5.6 (April 2005)
ARA Retirement Fund – Pension (untaxed)						
Defensive	-0.6	3.5	4.6	4.7	3.6	4.6 (April 2005)
Growth	-1.7	5.3	7.0	7.5	4.5	6.0 (April 2005)
Equities	-2.9	3.0	4.8	n/a	n/a	5.1 (October 2013)

Returns quoted are after all costs, and before the application of management fee rebates. Exclude commissions payable prior to 1/7/2006.

Return figures for the ARA Investment Fund are pre-tax and do not include the additional benefit of franking credits as the net result is dependent on individual investors' tax position. Assume the re-investment of distributions.

Return figures for the ARA Retirement Fund – Accumulation (Taxed) are net of all fees and tax on earnings at the statutory rate of 15%.

Return figures for the ARA Retirement Fund – Pension (Untaxed) are net of all fees and tax including the refund of franking credits.

3 month return figures are for the three months to 31 March 2017 and are not annualised. Past performance does not ensure or imply a future result.

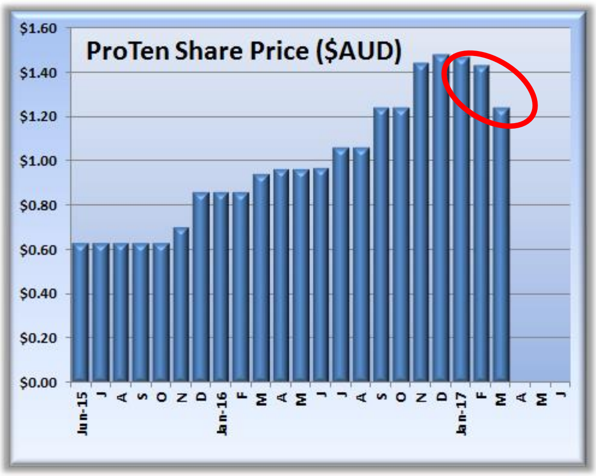
OK, it's been another challenging quarter returns-wise, at a time when stock and property markets seem to be bubbling along. So what gives? Let's get straight into it.

ProTen

It feels downright weird to be discussing one of our favourite investments in this context. ProTen is the country's premier broiler chicken grower and has been nothing but good news since Day One. Please explain.

ProTen is an unlisted public company – that is, it does not trade on any of the recognized national exchanges for listed stocks. However, it does trade (in very low volumes) on an exchange for unlisted companies in New Zealand – cunningly named the NZ Unlisted Exchange.

This provides at least limited trading opportunities to shareholders, and is therefore something we must take into account when valuing our shares. In $A, the price at which shares have traded on the Exchange since inception has gone like this:



After more than doubling over the previous 18 months, the share price has come off about 12%, exacerbated by a 5% devaluation in the $NZ, which we also must factor in. Most of this movement occurred in late March. Because the stock has grown to be quite a large chunk of the portfolio, this price dip has taken 0.6% off the quarterly performance of the Defensive portfolio and 1.1% from Growth and Equities.

Are we worried? Not for one moment! ProTen is an outstanding, well-run business. Its operating results are ahead of budget, it increased its dividend by 78% this year, and its growth is underwritten by contracted new work until well into the 2020s.

This price movement occurred on very low volumes of sales, and it is quite probable it is a single investor who has decided he wants or needs his money, and is taking advantage of any offer that comes up.

If we didn't already have such a large holding in this company, we would be considering using this inexplicable price weakness to buy more. Please rest easy on this one.

Condor Energy

We've given this some airplay already in previous newsletters and the Investor Updates held recently, and it continues to play out.

To briefly recap, Condor provides drilling services to oil and gas producers. This sector has been hit by extraordinary market volatility in recent years – firstly an unprecedented drop in oil and gas prices, and now a supply crisis that even has the Prime Minister putting in his two bob's worth.

For industry participants this saw a sudden drying up of investment and a painful squeeze in a capital-intensive business. Out of prudence we were obliged to write down the value of our investment. In the March quarter this shaved 0.23% off the Defensive portfolio and 0.6% from Growth.

But now – it appears – the clamouring for new exploration might be underway. In late breaking news, we are advised that Condor has secured contracts with the country's largest producer, Santos – a small initial contract but with a huge backlog behind it. All going well this should shore up the company's operations and restore value to the company. Not out of the woods yet, but the outlook is the most (cautiously) optimistic it has been for some time.

We are working very closely with the fund manager and the company on this asset – it will be worthwhile if it comes good but there's a way to go. Watch this space.

What about the share market?

The share market on the whole had a good quarter, and a good financial year to date. The table below shows how the market has gone, along with the performance of our share fund managers.

	6 months to December 31	Quarter to March 31
All Ordinaries Index	11.80%	4.50%
River Capital	3.40%	0.20%
Sterling Equities	12.60%	-0.40%
Anacacia	8.30%	-0.80%

So, a mixed bag, although all our managers had an indifferent March quarter.

It's important to understand that, while many managers select share funds that are designed to match the market average, ARA does not. We believe that in the long run a good manager will outperform the average by astute selection of a relatively concentrated portfolio of stocks, and in the case of our group of managers, that has long been true. Just not lately.

Why? Well, much of the strength in the market this year has been in the larger stocks, particularly banks and the big resources companies. None of our managers own any of these stocks.

We don't dictate stock selection criteria to our managers, but as a general rule they all prefer the earnings certainty of industrials to the volatility of resources and the commodity price cycle. As for banks, their general comment is that banks are very highly geared, and hugely exposed to the housing market.

That is, banks borrow many times their asset base, from depositors and overseas lenders, to fund the loans they then provide to their customers – the largest proportion being residential property buyers. Hence high gearing and heavy exposure to housing.

Ironically, this time last year we were busily explaining why our fund had performed well while the broader market was tanking. The reason was the same – no banks or resources, which at the time were being smashed. Fickle game, this.

On the good news side of the ledger, **Big River** - a building supplies business that we mentioned last time, is proceeding with plans to list on the Stock Market. The fully underwritten IPO provides a valuation uplift to the Fund, and we would hope for a successful listing delivering a further uplift and favourable exit opportunity.

The Wash Up

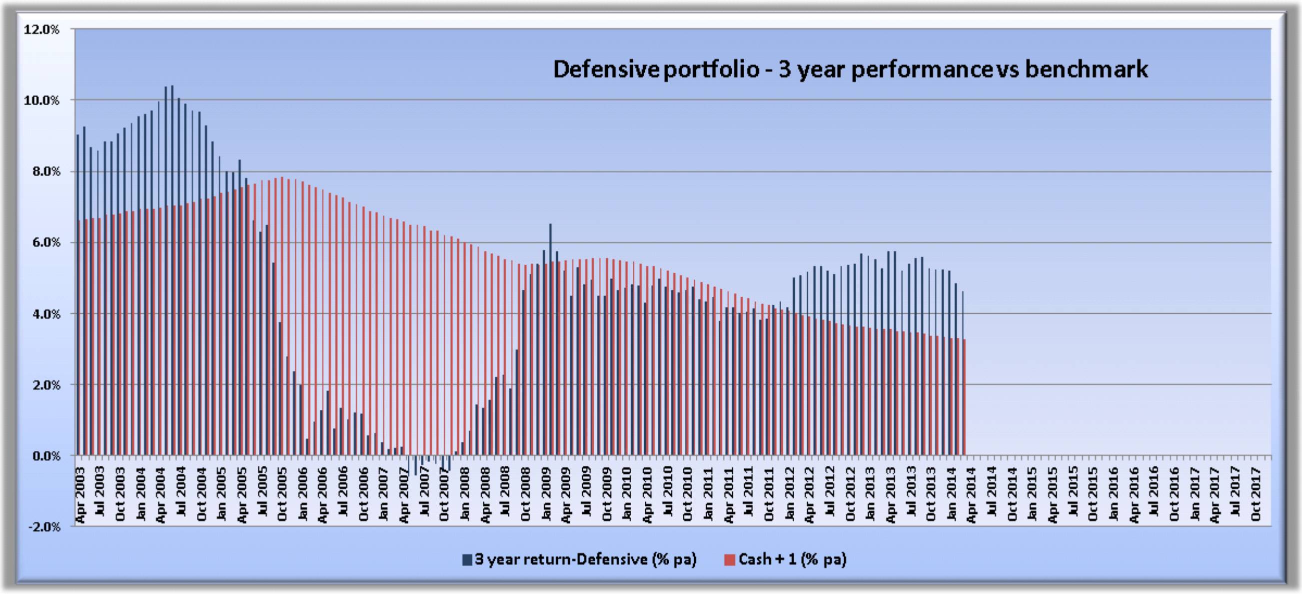
So, where does that leave us?

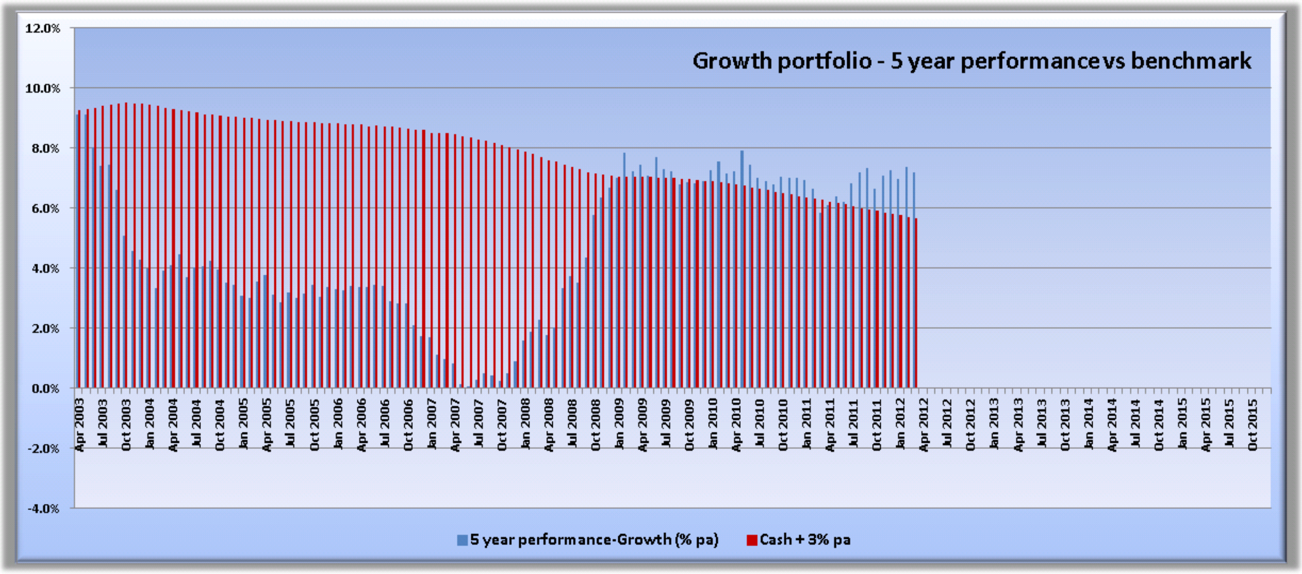
It's no fun reporting one flat quarter, let alone two in a row. The chart below shows how the portfolios have performed in each of the last five financial years (in blue), with the five-year average shown by the red line. The orange bar is <u>**this**</u> financial year-to-date. At least they're positive, but clearly there is some work to do to get this year's full return up to that of recent years.

It's not just papering over the cracks to say it's important to keep things in perspective. Exactly one year ago we were quietly celebrating in-house because the March 2016 and December 2015 surveys showed all our portfolios were in the top 10% of all funds in their respective categories, and in fact Growth was No. 1 in a field of almost 400 funds.

Things can change quickly in the short term, so it's best not to get carried away at either end of the scale. Very little has changed in a year, and we are comfortable that the reasons for recent lacklustre performance are short term in nature and not systemic.

The business of investing just doesn't move in a straight line, it ebbs and flows. For a longer term perspective on this, the following charts might help. We use them internally to monitor how the performance of the portfolios are tracking against their long-term benchmarks.





In a nutshell, the Defensive portfolio aims to beat the risk-free bank rate (as measured by the RBA 90-day bank bill index) by at least 1% p.a. over rolling 3-year periods, Growth by 3% p.a. over rolling five-year periods.

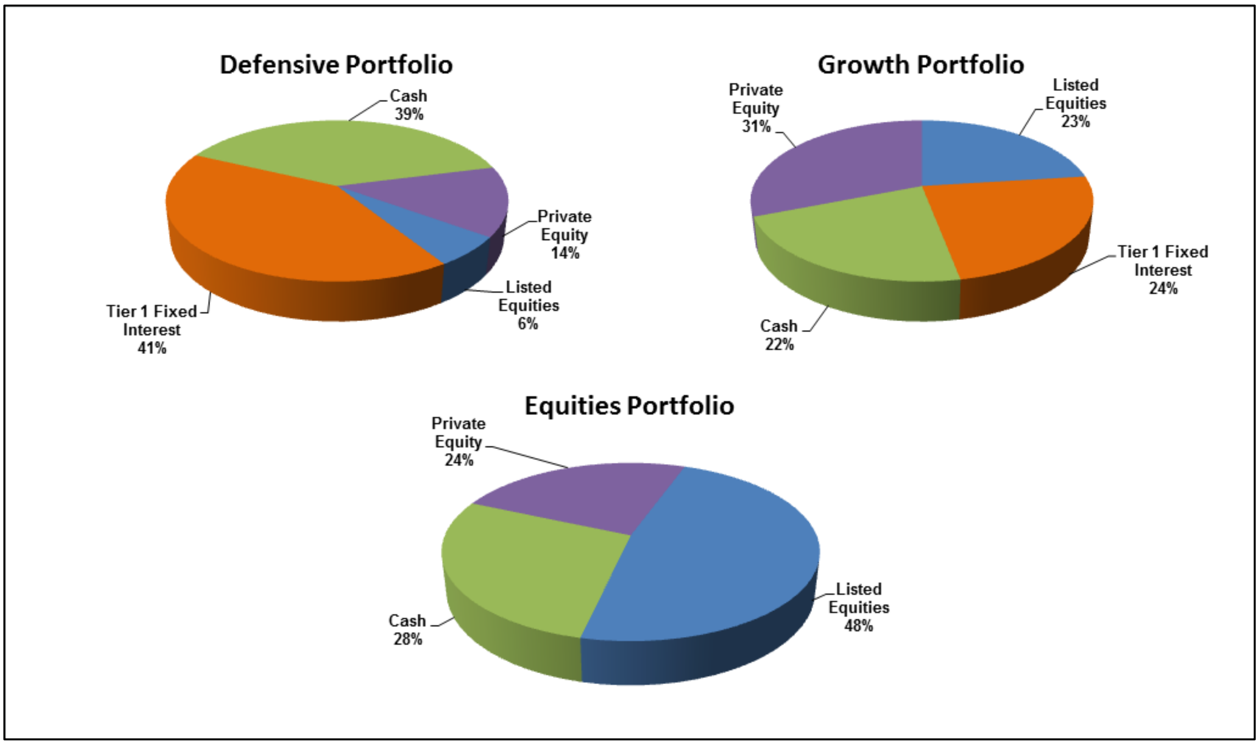
The benchmark is shown in red, the ARA portfolios in blue, and obviously we want the blue line above the red.

Clearly the GFC had its impact (which prompted us to re-define our approach to risk management as we have discussed previously). Since coming out of that slump, the portfolios have consistently stayed above their benchmarks and the impact of the past two quarters is relatively immaterial. We firmly believe our current strategy and portfolio settings remain appropriate – I guess time will tell.

So, who's got what?

The table below shows the ARAIF's investments as at the time of writing. Please note, the percentages refer to the proportion of each portfolio allocated to that investment, not its rate of return.

	Asset Class	Defensive Portfolio	Growth Portfolio	Equities Portfolio
National Australia Bank	Cash & Tier 1 Fixed Interest	38.3%	22.3%	27.9%
National Australia Bank Term Deposits		17.8%	8.0%	
Challenger Life Guaranteed Annuities		23.7%	15.7%	
RMBL Mortgage Fund	Fixed Interest	0.1%		
Macquarie Index Funds	Listed Securities			0.3%
River Capital Growth Fund		1.7%	10.6%	18.9%
Sterling Equity		2.1%	5.0%	19.3%
Anacacia Wattle Fund		2.7%	7.0%	10.0%
Anacacia Capital	Private (unlisted) Equity	3.0%	7.8%	4.3%
Cobram Estate		1.5%	2.2%	
Pro Ten		3.3%	6.6%	8.1%
Hastings Utilities Trust			5.4%	
Proserpine Capital Partners		4.8%	7.6%	11.2%
Warakirri Dairies		1.0%	1.8%	
		100.0%	**100.0%**	**100.0%**



Major Holdings

Apart from bank deposits and other fixed-term interest-bearing accounts, the Fund invests in a range of assets through the fund managers listed in the table above. If we drill through to the assets selected and overseen by those managers, there are in fact over a hundred individual securities providing diversification of risk and exposure to a wide range of opportunities.

The table below shows the twenty largest individual holdings and what proportion of each portfolio they represent. These are the investments that will have the biggest impact on the return of your portfolio.

Investment	Type	Principal Activity	Defensive Portfolio Exposure	Growth Portfolio Exposure	Equities Portfolio Exposure
ProTen	Private company	Chicken farming	3.3%	6.6%	8.1%
Big River	Private company	Building supplies	1.0%	2.4%	1.4%
Condor Energy	Private company	Mining services	0.9%	2.2%	3.0%
Cobram Estate	Private company	Olive Oil producer	1.5%	2.2%	0.0%
Polaris Marine	Private company	Marine services	0.8%	2.0%	3.8%
Warakirri Dairies	Unlisted trust	Dairy farms	1.0%	1.8%	-
Perth Airport	Infrastructure	Air transport hub	-	1.6%	-
Yumi's	Private company	Dips and snack foods	0.6%	1.6%	0.9%
LEDified	Private company	LED Lighting supplier	0.5%	1.3%	0.7%
Lotus Filters	Private company	Commercial cleaning	0.4%	1.1%	1.5%
Careers Training Group	Private company	Tertiary Training Institute	0.4%	1.1%	0.6%
Transgrid	Infrastructure	Electricity transmission	-	1.0%	-
Quota Trust	Unlisted Trust	Statutory Fishing rights	2.3%	0.9%	-
Schaffer	ASX Listed company	Diversified industrial	0.4%	0.9%	3.5%
Fleetwood Corporation	ASX Listed company	Diversified industrial	0.3%	0.8%	2.9%
PMP	ASX Listed company	Printing & marketing	0.3%	0.8%	1.2%
NearMap	Private company	Aerial mapping services	0.3%	0.6%	2.3%
Melbourne Airport	Infrastructure	Transport hub Expensive parking	-	0.7%	-
Appen	ASX Listed company	Linguistics technology	0.2%	0.6%	0.8%
Australian Stock Exchange	ASX Listed company	Financial services	0.2%	0.6%	2.1%

Client Functions

We recently put our new office space to the test as a venue by running several, smaller-group investor updates – and also offered a variety of session time options.

Lots of people kindly provided feedback afterwards and, but for a few rumblings about minor things like being boiled and blinded by late afternoon sunshine (easily remedied), the reaction was very positive. Almost universally people preferred the smaller group format, with more opportunity to ask pertinent questions and mingle with other clients and staff members.

Interestingly, one common concern was whether we would ever be able to lure guest speakers like fund managers and proprietors of investee companies to come and speak at several small group functions as opposed to one mega-event. Well, we reckon we've got that one sussed – clearly the content of the presentations is key and we've come up with some ideas as to how to provide lots of variety and interest even over several small sessions.

Other key messages from the update sessions that we would like to re-iterate:

- The new office space is proof positive that ARA is here for the long haul. It is a modern, up-to-date design that we expect will cater for our needs for the next decade and beyond.

- We are committed to independence, with ownership concentrated amongst people close to the business, not external institutions.

- While we believe the business and its clients can benefit from some further increase in scale, we are not interested in growth for its own sake, and will not sacrifice the qualities of personal service and accessibility just to meet some arbitrary growth target.

Lost and Found

There has always been lots of ways to lose your money. These days, though, there's also lots of ways to get it back!

The State Revenue Office website (see link below) is one such resource. Easy to use, performing a simple search is based on just name and address.

http://www.sro.vic.gov.au/unclaimed-money

ASIC (Australian Securities and Investments Commission) has a similar service to help track down misplaced money in shares and bank accounts

https://www.moneysmart.gov.au/tools-and-resources/find-unclaimed-money

And the following link explains ways to track down lost super accounts.

https://www.ato.gov.au/forms/searching-for-lost-super/

Recently we put Trevor’s son, Hugh, to the task of trawling these sites on behalf of our clients, and were able to re-unite about $9,500 Oxford Scholars with their rightful owners. That’s even better than finding a $5 bill in your jeans pocket.

We don’t always have the full suite of information necessary to do a thorough search (e.g. previous/maiden names, old addresses for instance) so it might be worth your while having a go at these sites yourself. Or try it on your friends and family – they’ll be your **best** friend if you have any luck.

And furthermore…………….

Here are a few extra bits you might like to check out.

- We’ve mentioned our investment in building supplies company **Big River.** Here is a link to an interview with the company’s MD, Jim Bindon.

http://www.anacacia.com.au/news/onmarket-interview-with-md-jim-bindon-big-river

- Investment Fund stalwart Boundary Bend, producer of **Cobram Estate** and **Red Island** olive oils, has just been awarded the NSW Agricultural Society’s President’s medal – for excellence in agricultural produce and for its achievements in innovation and sustainability.

- And attendees at our updates will have heard me blundering through evidence as to why the US sharemarket is looking pretty pricey. For the true masochists amongst you here is a link to an article that does a far more comprehensive and clear job than I.

http://www.mauldineconomics.com/frontlinethoughts/stock-market-valuations-and-hamburgers2

And few, if any, commentators were so consistently able to cut through nonsense of any persuasion as was the late, much-lamented John Clarke, ably partnered for decades by Bryan Dawe. Even in this, which turned out to be their last “episode”, no-one is spared.

http://www.abc.net.au/news/2017-04-20/final-curtain-call-last-clarke-and-dawe-episode-released/8459030