

# Investment Update

January 2017

## INVESTMENT RETURNS to December 31, 2016

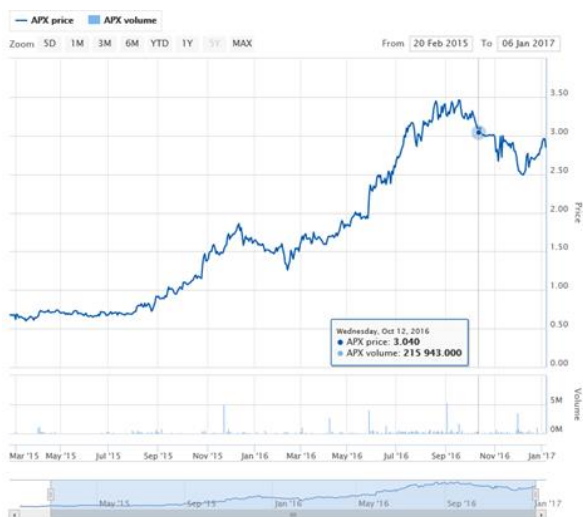
	3 Months %	1 Year %	3 Years % p.a.	5 Years % p.a.	10 Years % p.a.	Since Inception % p.a.
<b>ARA Investment Fund</b>						
<b>Defensive</b>	0.5	4.2	5.2	4.6	3.7	5.1 (April 2003)
<b>Growth</b>	-0.5	6.0	7.9	7.3	4.5	6.3 (April 2003)
<b>Equities</b>	-2.3	3.9	6.0	8.3	3.9	7.1 (August 2003)
<b>ARA Retirement Fund – Accumulation (taxed)</b>						
<b>Defensive</b>	0.4	3.4	4.7	4.1	3.4	4.2 (April 2005)
<b>Growth</b>	-0.5	5.2	7.3	6.7	4.4	5.6 (April 2005)
<b>Equities</b>	-1.7	2.7	5.4	7.4	4.1	6.0 (April 2005)
<b>ARA Retirement Fund – Pension (untaxed)</b>						
<b>Defensive</b>	0.5	4.0	5.2	4.7	3.8	4.7 (April 2005)
<b>Growth</b>	-0.5	5.9	8.0	7.6	5.0	6.3 (April 2005)
<b>Equities</b>	-2.1	3.7	6.3	n/a	n/a	6.5 (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 December 2016 and are not annualised. Past performance does not ensure or imply a future result.

First things first. You'll notice that the performance figures for the Retirement Fund (Accumulation and Pension) are back on the front page where they belong. The unit pricing (and hence return figures) are up to date. Processing of member accounts at the time of writing was up to early December, and we are receiving about four weeks' worth of updates each week now. So the end is in sight. Again, our sincere thanks for your patience – I know some of you have been quite concerned through this process, but you're a wonderful crowd and we apologise again for the delays and inconvenience.

As for those returns? Well, a subdued December quarter compared with the last one. The stock market ticked quite strongly, however returns early in the quarter were knocked around a bit. Two main reasons:

**Appen** – You might recall we've mentioned this one a few times, for other reasons – namely its outstanding performance. After buying into this company in October 2009, Anacacia helped grow the business substantially before it was listed on the Stock Exchange in March 2015. Since then its price went from \$0.50c a share to \$3.50 by September 2016.

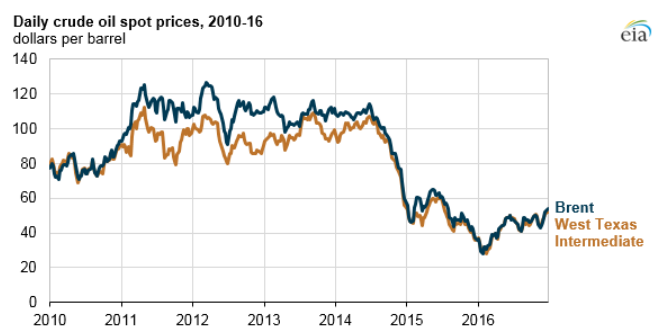


So it was a very strong contributor to the Fund's return in that time, but as you can glean from the chart it did give some back in the December quarter. Anacacia has progressively been selling down this stock as part of the exit strategy and, notwithstanding this hiccup towards the end of the process, it

remains one of the most successful investments the Fund has ever owned.

**Condor Energy** – This is our only material exposure to the resources sector, primarily as a service provider to oil and gas producers.

We've had a stake in Condor since 2014. Early on it was performing strongly. In 2016 things slowed somewhat due to an unprecedented fall in prices - oil going from over \$100 a barrel to under \$30. Ouch! At the risk of understatement, this put a dampener on the industry's investment plans.



Under the circumstances and with a diminished pipeline of work (pardon the pun) it was prudent to significantly write down the value of the investment. Of recent times however, prices have bounced back somewhat and the order books are starting to fill again. For sure this one is still on "watch" status but the signs are improving.

On a brighter note, our food-based holdings (ProTen, Cobram Estate, Yumi's) continue to perform soundly – ProTen was up 20% in value for the quarter and upped its dividend by 78%. (That would be thanks to Rob and the Pot'n'Parma night at the Harp Hotel).

A few of the newer kids on the block are starting to make their moves as well:

**Big River** is a building supplies business in which Anacacia took a stake in early 2016. It has already returned about 50% to the Fund.

Another Anacacia investment, **LEDified**, which supplies LED lights principally to commercial users, was recognized in the Financial Review survey of Fast Starters in November as the fastest growing business to have commenced trading since 1 July 2012.

## So now what?

*"I have seen the future, and it is very much like the present, only longer"*

...Kehlog Albran, *The Profit*

2016 turned out ok for the Australian share market, thanks to a strong finish. And the US market hit all-time highs early in the New Year. The relentless media cycle and the industry spruikers need a good story, so there are lots of people calling this the new Bull market.

Hmmm.....

In a field always rich with things to worry about, a major concern continues to be the US market. It's big, the greenback is still the world's reserve currency, and like it or not what happens there matters for a small market like ours. While from time to time our markets appear to have "de-coupled", statistically it remains the case that if the US market falls, it's highly likely that ours will too, regardless of how good we think we've got it.

So why worry? For a start this is not about the Trumpet. We have no idea how to diagnose, predict the symptoms or prescribe a cure for PTESD (Post-Trump Election Stress Disorder). Two things cause concern however, regardless of who's in the White House.

### 1. What Wozza said

Remember one of Warren Buffet's lessons we discussed previously? In a nutshell, what investment markets really like (and what therefore what acts as a guide to likely returns) are:

- Falling interest rates
- Rising profit margins
- Low valuations

In the US, we have:

- Historically low interest rates, with strong indications the cycle has either stalled or turned up;
- Historically high profit margins;

- Valuations arguably as high as they've been in the past century. Interested maths masochists might like to look at:

<http://www.hussmanfunds.com/wmc/wmc161219.htm> )

The message being, the tailwinds from these three key determinants of future returns have just about run out of puff. Markets in general will be kicking into a strong wind.

### 2. The greenback



This little chart shows the trade-weighted US dollar index – a weighted average of its foreign exchange value against the currencies of its trading partners. The grey shaded areas signify recessions in the US. In a nutshell:

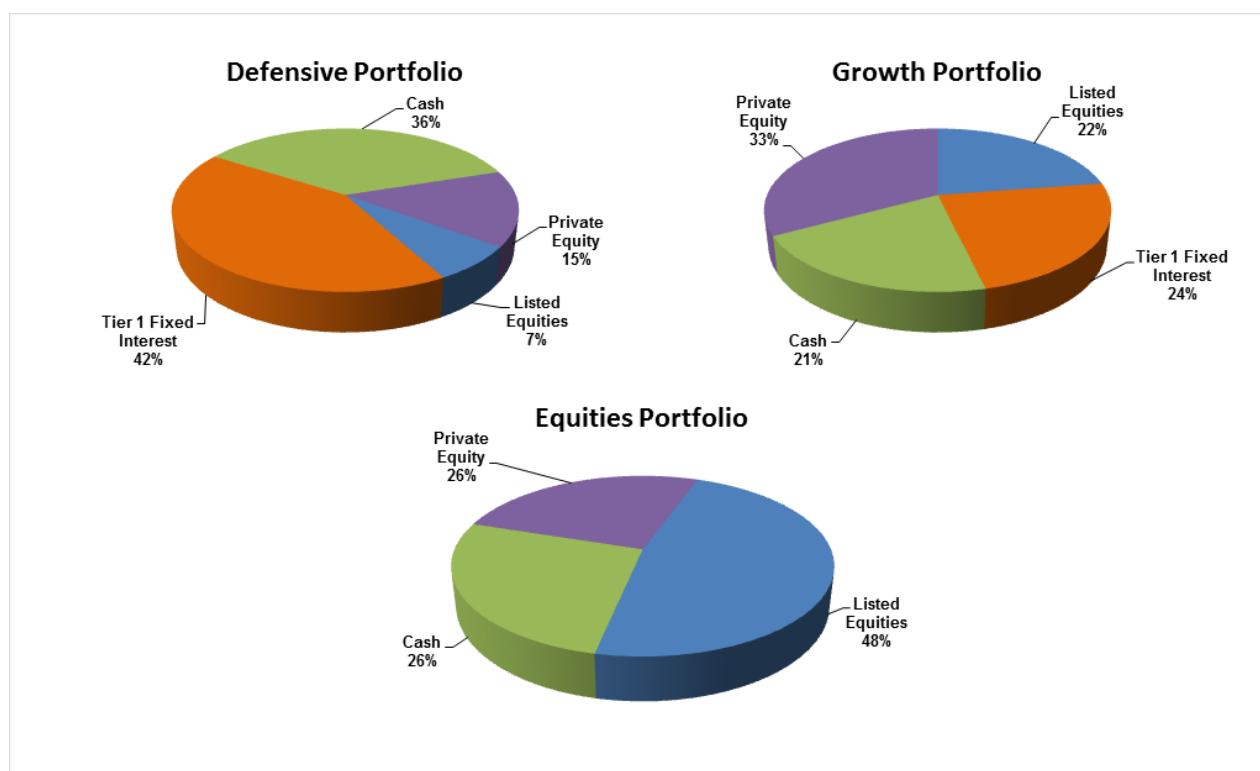
- The \$US is as high as it's been at any time in the past 20 years;
- This is bad for US exporters – tricky when you think how many of the world's big companies are US multinationals;
- It's bad for countries and companies who have debts denominated in \$US. At last count that total was about \$14 gazillion. The value and cost of servicing that debt has gone up 30% in two years, regardless of what happens to interest rates.

Sorry to be a killjoy, but none of that screams "Bull Market" to us. We will stick to the strategy that does not simply assume the markets will do all the work, because they probably won't. We'll continue to hold plenty in the safe haven of bank deposits, and be highly selective in the choice of assets, mainly Australian businesses, that aim to provide a bit of extra performance – without putting too much at risk.

### 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	35.5%	20.8%	26.6%
National Australia Bank Term Deposits		18.3%	8.0%	
Challenger Life Guaranteed Annuities		24.4%	15.7%	
RMBL Mortgage Fund	Fixed Interest	0.1%		
Macquarie Index Funds	Listed Securities			0.2%
River Capital Growth Fund		1.7%	10.6%	18.6%
Sterling Equity		2.2%	5.0%	19.1%
Anacacia Wattle Fund		2.8%	7.0%	9.9%
Anacacia Capital	Private (unlisted) Equity	3.2%	7.8%	4.3%
Cobram Estate		1.5%	2.2%	
Pro Ten		4.1%	7.9%	9.6%
Hastings Utilities Trust			5.2%	
Proserpine Capital Partners		5.1%	8.0%	11.7%
Warakirri Dairies		1.1%	1.8%	
		<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>



## 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, mainly businesses, 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	4.1%	7.9%	9.6%
Cobram Estate	Private company	Olive Oil producer	1.5%	2.2%	-
Condor Energy	Private company	Mining services	0.9%	2.2%	3.0%
Big River	Private company	Building supplies	0.8%	2.1%	1.1%
Polaris Marine	Private company	Marine services	0.8%	1.9%	3.7%
Warakirri Dairies	Unlisted trust	Dairy farms	1.1%	1.8%	-
LEDified	Private company	LED Lighting supplier	0.6%	1.7%	0.9%
Perth Airport	Infrastructure	Air transport hub	-	1.6%	-
Lotus Filters	Private company	Commercial cleaning	0.6%	1.5%	2.0%
Careers Training Group	Private company	Tertiary Training Institute	0.5%	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%	0.8%	3.1%
Fleetwood Corporation	ASX Listed company	Diversified industrial	0.3%	0.7%	2.7%
Australian Stock Exchange	ASX Listed company	Financial services	0.3%	0.7%	2.5%
Corporate Alliance Enterprises	Private company	Commercial fishing	0.3%	0.7%	1.0%
Melbourne Airport	Infrastructure	Transport hub Expensive parking	-	0.7%	-
Appen	ASX Listed company	Linguistics technology	0.2%	0.6%	0.8%
RISSafety	Private company	Building safety services	0.3%	0.6%	0.3%

## Legislation Update

It's been a big year for the regulators in the financial services arena.

The changes to Centrelink means tests have come and gone as of January 1. We reckon we've got just about everyone covered who was affected, however if anyone has any remaining queries around eligibility for benefits or concessions please let us know.

The long-awaited and debated changes to super, including caps on contributions and super pensions, finally look settled. A number of our members will be affected, and we have put together a project plan to identify and contact all those members, prepare recommendations and an implementation plan, in plenty of time for D-Day, July 1.

## Portfolio changes

To be honest, this has become a far more complex undertaking than was envisaged at the outset.

As it's happened, the project coincided with the industry regulator – bless 'em – greatly increasing their scrutiny of super funds' investment governance. To cut a long story short, our proposals are now with the regulator awaiting response and approval.

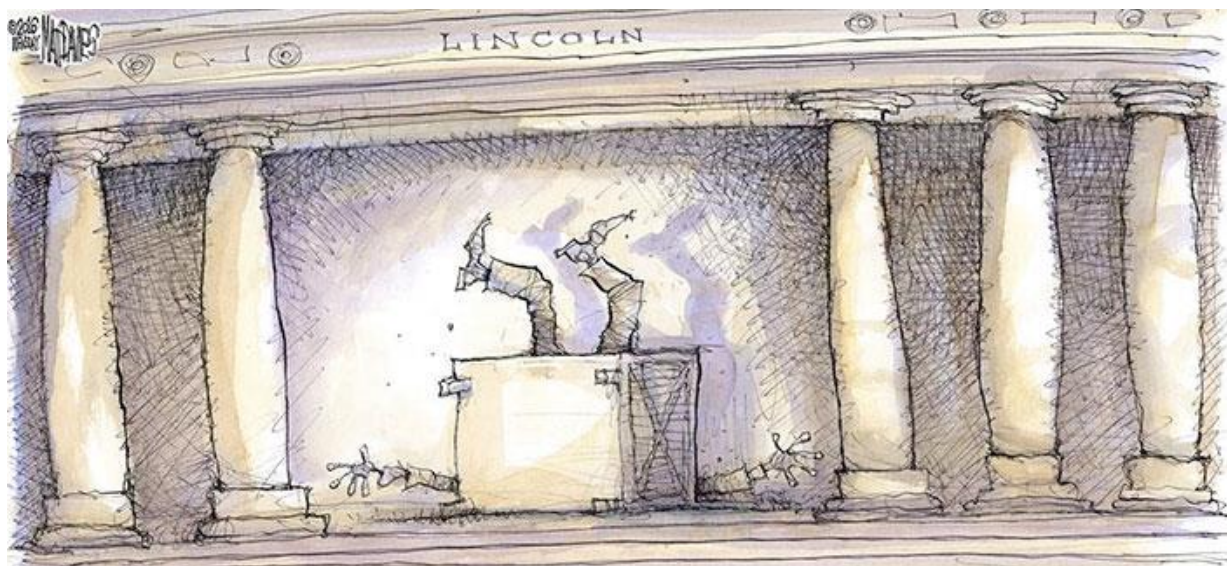
Watch this space.

## Client Nights

As foreshadowed, we plan this time to have a series of smaller sessions in our great new space in Kew. This will allow us to show you around, discuss the usual stuff about investments, update you on current projects and to let you in on future developments at ARA – and get your feedback.

We're planning to run these over a couple of weeks in late February and early March, with afternoon and evening session options. Dates to be announced.

To our friends in the bush – fear not, we'll still come to Shepparton.



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Name (Please print) \_\_\_\_\_

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