Investment Portfolio Review

Ron and Marian McDonald

Willathoona Investment Superannuation Fund

6 February 2017

INSIGHT WEALTH SOLUTIONS

Investments I Superannuation I Insurance

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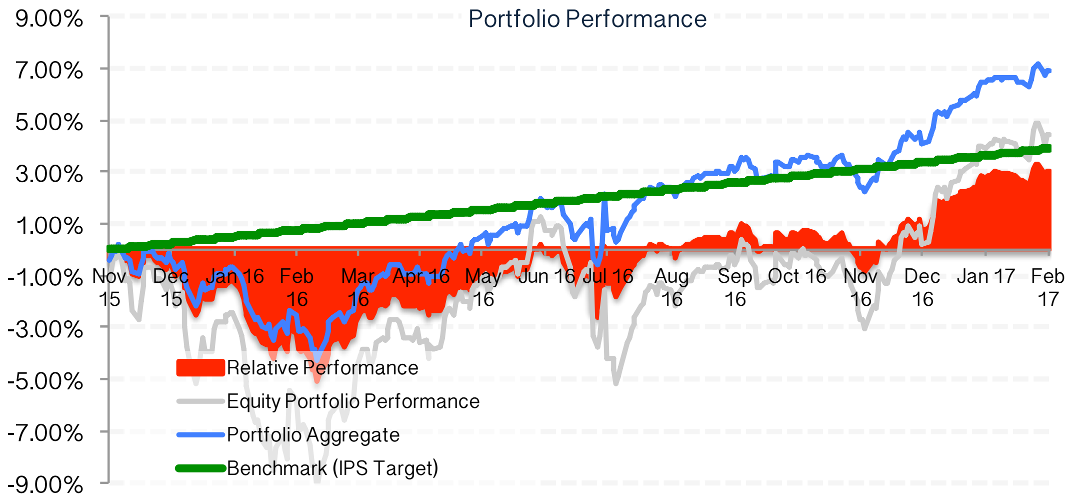
Scope of Advice

This investment review covers the investments and performance of Ron and Marian McDonald's investments, including those within the Willathoona Investment Superannuation Fund (ex cash) for the period 2 November 2015 to 2 February 2017 (15 months).

Portfolio Summary

In the fifteen months since the Willathoona Investment Superannuation Fund first commenced its investment strategy, the portfolio has achieved a total aggregate return of 6.9%, outperforming the static IPS target by 2.99%, or about $25,500 against the $855,000 invested across the Fund's equity and annuity portfolio.

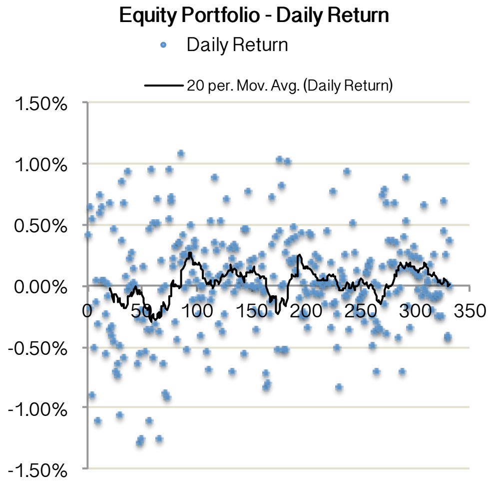


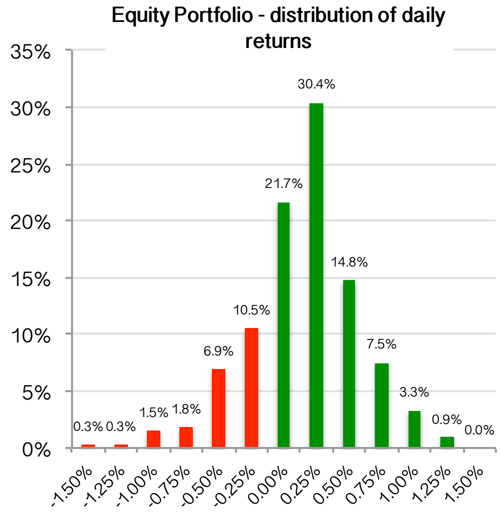
While this is a pleasing result, it masks what have been very challenging investment conditions, as characterized by an uncertain and surprising geopolitical environment that has seen surprising results with Brexit, OPEC production cuts, China's currency manipulation and last but certainly not least, the surprise election of President of the United States of America, Donald Trump.

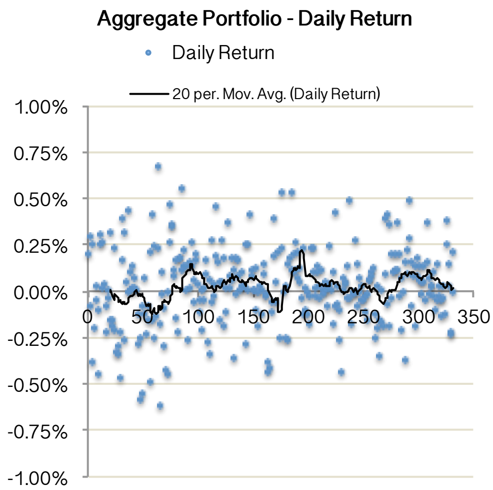
Speaking of Trump, nearly as surprising as the results has been the market reaction, or lack thereof. With exception of a couple of peaks and troughs, investment markets have remained relatively stable, with Standard and Poor's Volatility Dashboard indicating a general sense of apathy among most market participants.

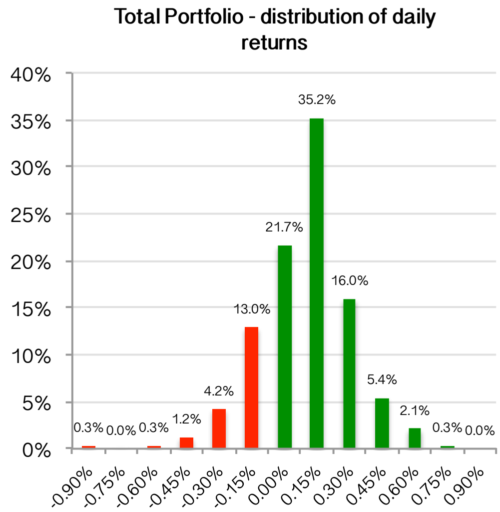
Portfolio Volatility

From a volatility standpoint, Willathoona's equity portfolio has achieved a since-inception volatility of 7.53%, which compares very favourably to the Australian All Ordinaries index (14.64%) and MSCI World Index (12.84%). At a portfolio-wide level, Willathoona's portfolio recorded annualized volatility of 4.19%, significantly lower than our IPS target of 5.66%. Managing volatility remains a focus of our strategy, as reflected by our bias toward "deep value", free cash flow and "low Beta" strategies.



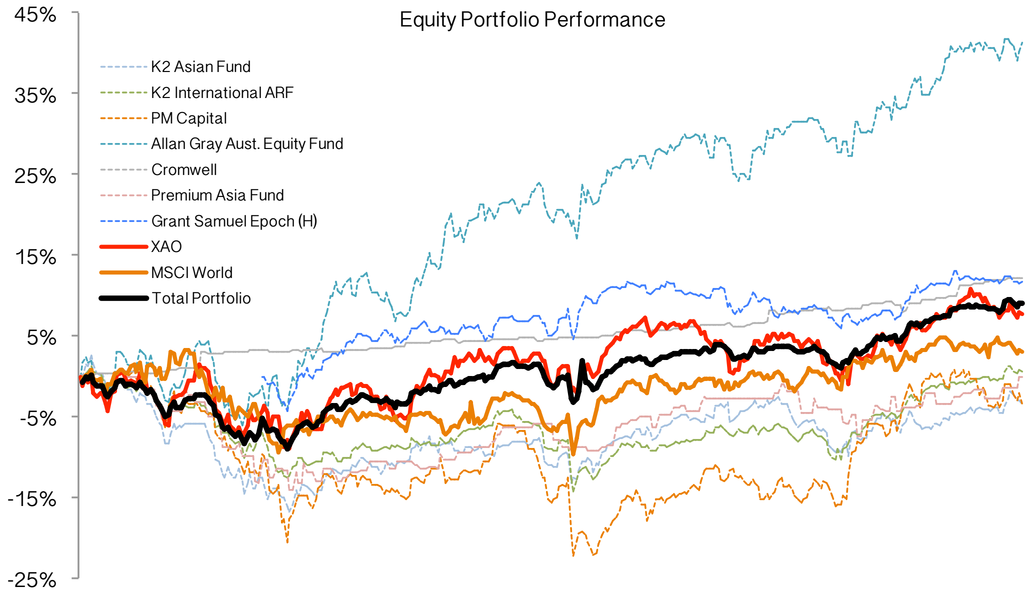




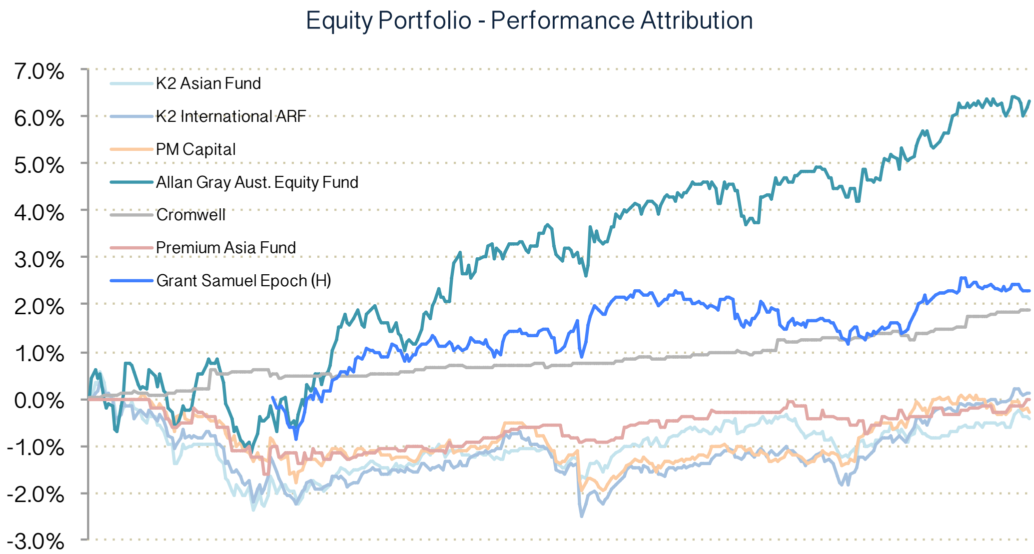


Portfolio Attribution

From a regional perspective returns have been mixed. Among developed markets the traditional safe-havens of the United States delivered the most value, while emerging markets – which struggled throughout 2015 – have recovered some of their losses to post decent full year results.



While our portfolio roughly tracked the underlying regional exposures, we did see a slight underperformance from our US equities portfolio, with our more conservative cash-flow focused strategies falling out of favour relative to growth oriented strategies. By the same token, however, we were helped by a stronger $AUD. Given the geopolitical landscape, we believe the case for cash-focused businesses (as is the foundation of our developed-markets strategy) is stronger than ever.



Of course our standout performer within our portfolio has been the Allan Gray Australian Equity Fund. The Fund was selected for inclusion in Willathoona's portfolio on account of their overweight exposure to the materials (and gold) sectors, plus "unloved" cyclicals; two areas that we believed had been over-sold. This has proven to be a stellar performer since its inclusion, delivering a total return of over 45% in the past twelve months alone, outperforming the S&P300 Accumulation Index by more than 27%. While impressive, it's important that we acknowledge that the Fund's exceptionally strong performance was in part due to a series of fortunate events throughout 2016, with an abnormally high number of divestments and takeovers helping the Fund to generate superior results. In other words, while we still like the Fund for it's strategy and approach, we don't expect the same level of outperformance to be replicated in the years ahead.

Detracting from portfolio performance were our investments in K2 Asian Fund, (-3.4%), PM Capital (-3.33%) and Premium Asia Fund (-0.08%). At a portfolio-level, these assets reduced total returns by 0.45%, 0.29% and 0.01% respectively (-0.75% in total). A recent review of these assets found that each continues to provide Willathoona with key strategic exposures (*by strategy; Absolute Return Emerging Markets, Concentrated Small-Mid Cap Unconstrained, Asia long unconstrained Mid Cap).*

Asset Allocation

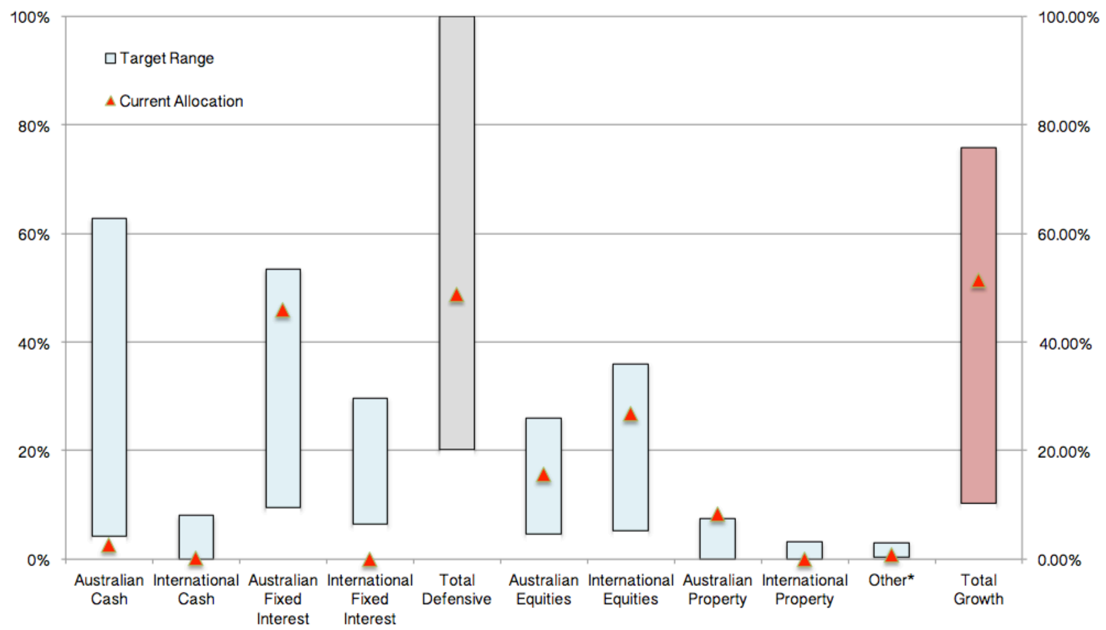
To date our strategy has seen the investment of $855,000 (current value: ~$913,982), with approximately 48.7% invested in cash and fixed income assets (including annuities) and 51.3% in market-linked assets, such as shares and property.

While these allocations are in line with our Long Term Asset Allocation (LTAA) targets, there are a number of imbalances worth mentioning.

1. Underweight Cash: we are presently holding 1.62% less cash than our lower-range limits (as discussed in Willathoona's IPS). As we know Willathoona still has significant cash, this imbalance is not of concern.
2. Underweight International Fixed Interest: With a LTAA of 12% and recommended minimum of 6.5% it is clear that our 0% holding of international fixed interest is significantly out of balance with our long-term objectives. Our reason for this is simple: uncertainty. By all accounts the US Federal Reserve will continue to raise rates, and if it doesn't it will be because of deteriorating economic conditions. This isn't to say we won't allocate to this sector, however we are unlikely to miss out on much by sitting on the fence.
3. Overweight Property: we are slightly (0.78%) overweight property on account of our exposure to Cromwell Direct Property Fund. Notwithstanding that this small overweight exposure will be defeased upon inclusion of Willathoona's cash in these calculations, we like the Cromwell Direct Property Fund's tenant profile and have recommended this for its income, not as a speculation on capital appreciation.

Asset Class	Asset Allocation			Recommended Asset Allocation		
	LTAA	Current	Variance	Lower Limit	Upper Limit	Range
Australian Cash	9.5%	2.58%	-6.92%	4.20%	62.70%	58.50%
International Cash	0.0%	0.20%	0.20%	-	8.00%	8.00%
Australian Fixed Interest	24.6%	45.89%	21.29%	9.50%	53.40%	43.90%
International Fixed Interest	12.0%	0.00%	-12.00%	6.50%	29.60%	23.10%
Total Defensive	**46.1%**	**48.7%**	**2.6%**	**20.2%**	**100.0%**	**133.5%**
Australian Equities	16.8%	15.58%	-1.22%	4.70%	26.00%	21.30%
International Equities	31.5%	26.77%	-4.73%	5.30%	36.00%	30.70%
Australian Property	4.5%	8.28%	3.78%	-	7.50%	7.50%
International Property	0.0%	0.00%	0.00%	-	3.20%	3.20%
Other*	1.1%	0.70%	-0.40%	0.30%	3.10%	2.80%
Total Growth	**53.9%**	**51.3%**	**-2.6%**	**10.3%**	**75.8%**	**65.5%**

Asset Allocation vs. Target Range - Summary



Portfolio Adjustments

Prior to recommending specific portfolio adjustments we will review Willathoona's cash position and drawdown requirements, however the following strategic changes are on our horizon:

1. **Buy $USD:** With the protectionist platform of President Trump and the several Federal Reserve rate hikes on the agenda for CY2017 we believe the $USD could strengthen significantly from its current level of AUD$1.30 (1 AUD = USD$0.77). On one hand, if Trump's policies go ahead we might expect that economic growth will slow, but total spending and inflation will rise, while higher tariffs on trade with China may dent Chinese exports (which in turn lower wealth, demand for Australian products). On the other hand, if the US economic recovery continues to march forward we will likely see the Federal Reserve raise rates while Australia continues to flounder. As the interest rate differential spread, so too will the value of our Dollar. The third option is that Australia's growth and inflation outpaces the United States, however in the event this happens we should be more than rewarded by a rally in our domestic equity-linked assets. Mid-term outlook (2 years) is for $USD > AUD$1.52 / $AUD = USD$0.66). To buy exposure to US Dollars we will unwind hedging on our global equities portfolios (Grant Samuel, etc.).
2. **Buy Oil:** While OPEC members have agreed to slow production, we believe that the lack of commitment by the swing producers (Iraq, Libya etc.) will continue to cast uncertainty over the financial viability of North American shale. With the marginal cost of production sitting at around US$65/bbl, and WTI trading at US$53 and Brent at $57, we see upside of around 20%. However three exogenous factors remain: (1) President Trump increases import tariffs, (2) demand for renewable energy increases faster than expected, or (2) conflict or terrorism in vicinity of Strait of Hormuz. With demand from China and India continuing to outstrip new production, there is more opportunity on the upside than risk on the downside. Oil ETF (ASX Code: OOO) currently trades at $15.90. Mid-term (2 years) outlook: Brent US$70, OOO $19.50.
3. **Emerging Markets:** There are still opportunities within emerging markets. Further discussion to follow separately, as appropriate.

Administration

To ensure the simple and effective administration of Ron and Marian's retirement income stream, the following actions should be taken:

1. Confirm retirement income requirements.
2. Confirm bank account balances; term deposit details where relevant.
3. Establish regular (automatic) monthly transfer of cash from Ron and Marian's ING Savings Maximiser account to their everyday savings account (whichever account is most regularly or easily used).
4. Ensure Savings Maximiser account is being used correctly to ensure the maximum rate of interest.
5. Share trading: consider opening a share trading account with Ron and Marian's preferred bank (ANZ?). Once established, transfer existing shareholdings to this account (CHESS Sponsor). Review shares and where appropriate commence sell-down.