Vertium Equity Income Fund

Fund Update | December 2019

VERTIUM ASSET MANAGEMENT

Key Facts

Investment objective vs benchmark

1. Greater income yearly
2. Lower absolute risk yearly
3. Greater returns over 5 years

Benchmark index

S&P/ASX 300 Accumulation Index

Inception date

April 2017

Number of stocks

20 - 40

Distribution

Quarterly

Management fee

0.97 p.a.

Buy/Sell spread

+0.25 /-0.25

Minimum investment

$50,000

APIR

OPS1827AU

External ratings

Lonsec "Recommended"
Zenith "Investment Grade"

Suitable investors

1. Low-risk or low-tax investors
2. Pre-retirees and retirees
3. Endowments and charities

Key Platforms

Asgard | BT Wrap | BT Panorama
CFS | HUB24 | IOOF | Netwealth
Praemium | MyNorth | Macquarie

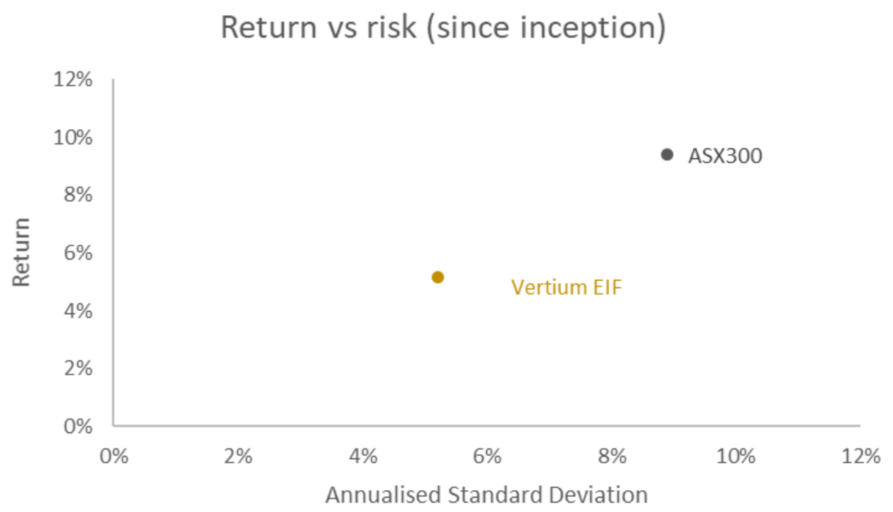
Capital preservation metrics (since inception) ^

	Fund	ASX300
Outperformance frequency in down markets	80%	N/A
Down market capture ratio	44%	N/A
Beta	0.49	1
Maximum Drawdown	-5.4%	-9.5%

Performance (%)

	1 Mth	3 Mth	6 Mth	1 Yr	2 Yr pa	Since Inc. pa
Income	1.0	1.0	2.1	8.8	7.3	6.2
Growth	-2.3	0.4	1.9	4.7	-3.1	-1.1
Fund Total Return	**-1.3**	**1.4**	**4.0**	**13.5**	**4.2**	**5.1**
Income	0.2	0.8	2.0	4.3	4.3	4.4
Growth	-2.2	0.0	1.2	19.5	5.3	5.0
Index Total Return	**-2.0**	**0.7**	**3.3**	**23.8**	**9.5**	**9.4**
Average market exposure	65%	57%	55%	63%	69%	68%
Fund beta	N/A	0.65	0.60	0.47	0.52	0.49

Return versus risk (since inception)



Expected yield over next 12 months, including franking **6-8%**

Portfolio Dashboard

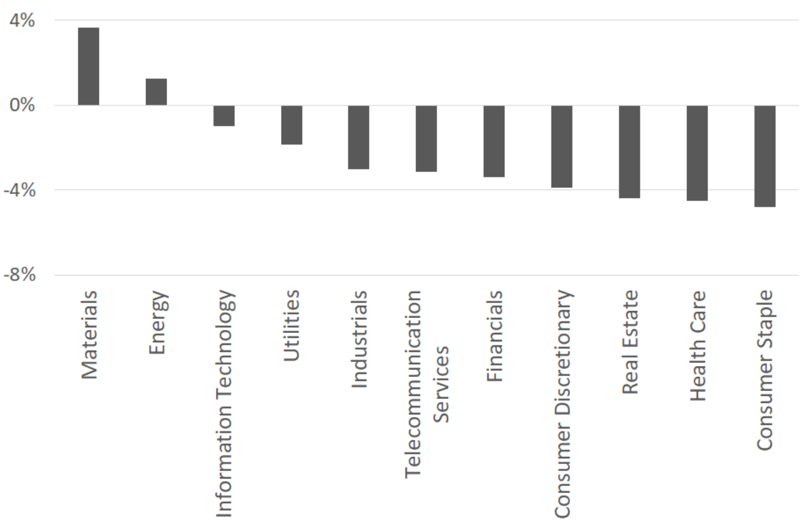
Top 10 holdings	ASX Code
BHP Group Limited	BHP
Westpac Banking Corp	WBC
CSL Limited	CSL
National Australia Bank	NAB
Qantas Airways	QAN
ANZ Banking Grp Ltd	ANZ
James Hardie Indust - Chess Depositary Interests 1:1	JHX
Lendlease Group	LLC
Computershare Ltd	CPU
Commonwealth Bank.	CBA

Number of stocks	29

Size exposure	%
Large Cap	60
Mid Cap	13
Small Cap	2
Effective Cash	25

Option exposure	%
Shares	76
Call Options	-3
Put Options	2
Effective Cash	25

Sector Weightings



"Our equity income fund is designed with conservative investors in mind. We seek to deliver the benefits of equity exposure including attractive, tax effective income - with a commitment and focus on capital preservation."

Jason Teh
Chief Investment Officer
Vertium Asset Management

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Notes of Performance: Due to participation in various off market buybacks, the headline performance was negatively impacted. On a tax-exempt basis, these buybacks contributed positively due to imputation credits. The following shows the negative impact on performance and the imputation benefit in brackets: Nov 2018 RIO -0.33 (+0.87); Dec 2018 BHP -0.63 (+1.25); Apr 2019 CTX -0.01 (+0.21) . ^Based on monthly data.

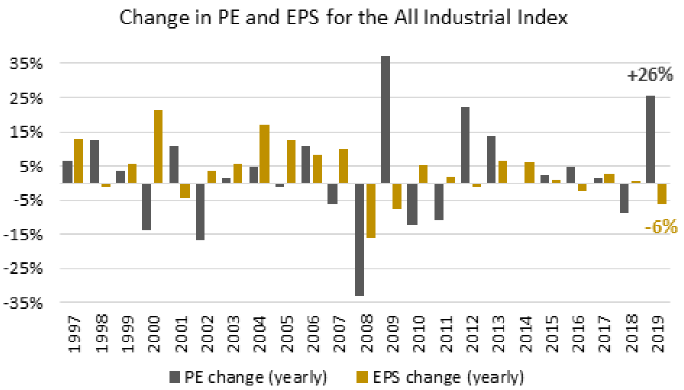
Quarterly perspective | the Markets

The S&P/ASX 300 Accumulation Index rose 0.7% as it mostly traded sideways during the December quarter. The best performing sector was Healthcare (+13.6%) driven by Australia's second largest company by market capitalisation, CSL (+18.0%). The worst performing sector was Financials (-6.3%) which were driven by Australian banks. Bank of Queensland (-23.8%) fared the worst as it reported weak operating results in October and subsequently raised equity in November. Westpac Bank (-15.6%) also raised equity to help bolster its balance sheet and was mired in the AUSTRAC controversy.

Australia's GDP annual growth rate stabilised to 1.7% in the third quarter of 2019, on par with the low growth rate during the Global Financial Crisis in 2009. The unemployment rate edged down to 5.2%. The annual inflation rate rose to 1.7% in the September quarter from a 2-year low of 1.3% reported two quarters ago. In response to the slowing economy and benign inflation outlook, the Reserve Bank of Australia (RBA) cut the cash rate by another 25 basis points to a record low of 0.75%. The RBA's cut marked the third reduction in the cash rate in five months. The 10-year bond yield rebounded from its record low of 0.9% to 1.7% as signs of an economic recovery are beginning to appear.

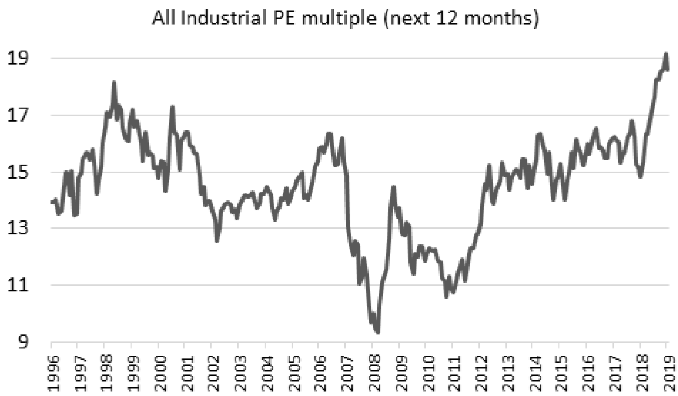
Commodity prices were mixed during the quarter. Brent oil price (+11.3%) rose as OPEC and its allies agreed to cut production by an additional 500,000 barrels per day. Copper price (+7.5%) also rose as fears of global growth concerns may have passed the worst. Both the iron ore price (-1.0%) and the gold price (+3.0%) were lacklustre.

The 2019 calendar year return for the benchmark of 24% was largely driven by a significant rerating in industrial stocks. The All Industrials Index delivered a total return of 23% (18% price return), which was anomalous in historical context. The All Industrial returns was driven by the greatest PE multiple expansion despite the worst earnings revisions over more than two decades (outside the Global Financial Crisis period in 2009).



Source: Vertium, FactSet, Macquarie Securities Research

The All Industrials also experienced an enormous PE multiple expansion in 2009 during the GFC, however, it only brought the multiple in-line with long term averages from an extremely oversold level in the prior year. The current PE expansion has driven the All Industrial index PE multiple to all-time highs.



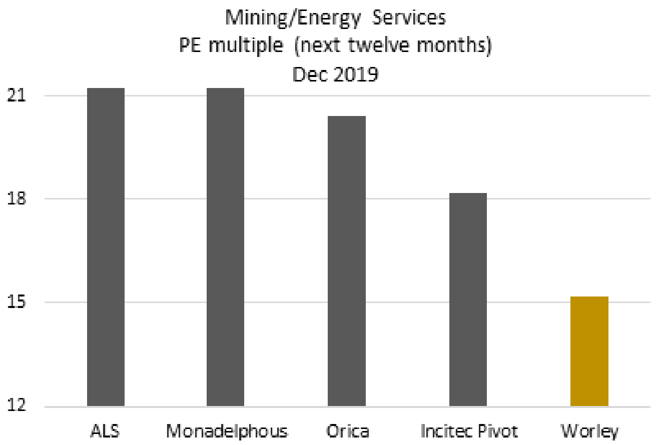
Source: FactSet, Macquarie Securities Research

To put the current valuation multiple in context, earnings would have to grow by 15% to bring the excessive multiple back to its prior 5-year PE range. In comparison, the All Industrial earnings has grown at a rate of 2% per annum in a low growth post-GFC world (December 2009 to December 2018). And the best single year of growth was in 2013 when earnings grew by 6%.

Quarterly perspective | **the Portfolio**

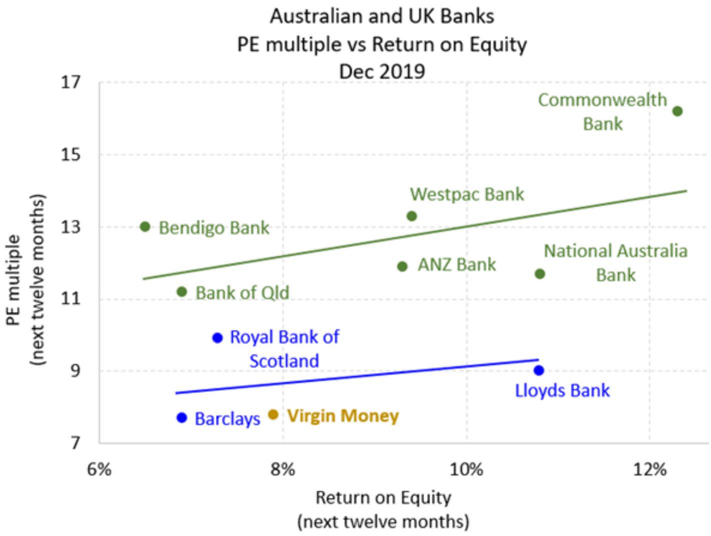
The Vertium Equity Income Fund delivered a 1.4% return during the quarter, outperforming the market return. The result was pleasing given our conservative strategy delivered returns with substantially less risk. The Fund also paid a 1 cent per unit distribution for the December quarter. This is in line with the Fund's objective of delivering higher levels of income than the benchmark over the coming year.

Worley (+17.7%) outperformed the energy sector (+6.1%) driven by the strength in the oil price and it was oversold in the prior quarter. Worley is one of the cheapest mining/ energy services company listed on the ASX.



Source: FactSet

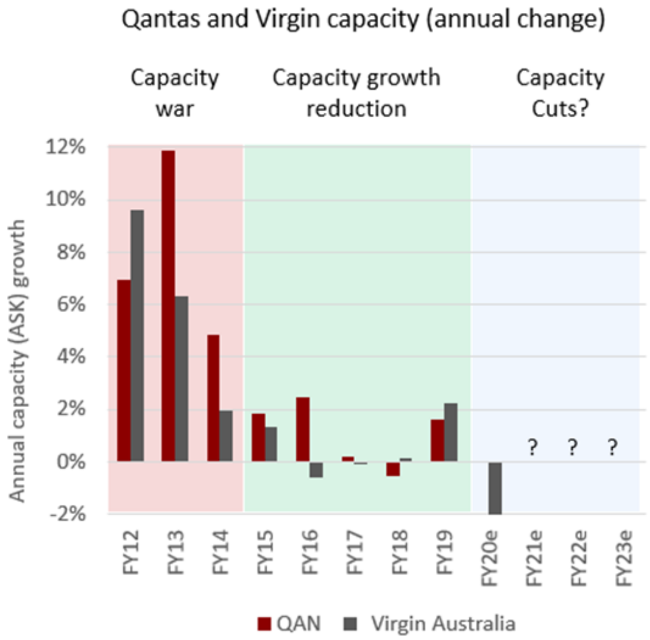
Virgin Money (+67.8%), previously called Clydesdale Bank, performed extremely well when it rerated from oversold levels in the prior quarter. Virgin Money along with other UK banks rerated as the Brexit uncertainty moved closer to resolution. Virgin Money remains one of the cheapest banks listed in the UK and in Australia.



Source: FactSet

Detractors of the portfolio (from an absolute performance viewpoint) included our positions in the Australian banks – Commonwealth Bank (-1.2%), Westpac Bank (-15.6%), National Australia Bank (-14.3%), and ANZ Bank (-10.8%). Weak operating results and another AUSTRAC controversy led to a general derating of the sector. We used the share price weakness to reduce the Fund's underweight positions when the banks offered more value.

During the quarter, the Fund bought Qantas. The company is trading on 11x PE multiple, not exactly a bargain for an airline business. However, our research indicates that the market is underestimating the potential uplift in future profits due to the industry becoming more rational. Over the last decade, the Australian airline industry has transitioned from a capacity war phase (FY12-FY14) to capacity growth reduction phase (FY15-FY19) and now may be entering a new phase of capacity cuts.



Source: Vertium, company accounts

Leading the charge in the current phase is Virgin Australia, Australia's second largest airline. Virgin's new CEO announced significant capacity cuts to help boost the company's future profits as it must reduce its elevated debt position. A more rational airline industry will likely benefit all industry participants including Qantas.

With the market trading at extreme valuation multiples the Fund is avoiding the hype. For many industrial stocks, the margin of safety to deliver reasonable returns in a low risk fashion remains poor. Expensive stocks tend to borrow from future returns. There are better value opportunities in some cyclicals and resource stocks because their valuations are undemanding. Accordingly, we have prudently invested further in those selected companies.

The Fund aims to provide a good exposure to equities with strong income and capital preservation characteristics. We are grateful for managing your capital and thank you for your support.