redpoint Investment Management

30 JUNE 2018

QUARTERLY REPORT

REDPOINT INDUSTRIALS SMA

Model Portfolio performance as at 30 June 2018	1 month (%)	3 months (%)	6 months (%)	1 year (%)	2 years (%)	Since Inception (%) [4]
Model Portfolio return (net) [1]	3.04	6.47	3.02	7.20	9.96	6.64
– Model Portfolio cash income	*0.26*	*1.22*	*2.36*	*4.93*	*5.10*	*5.05*
– Model Portfolio price return (net)	*2.78*	*5.25*	*0.66*	*2.27*	*4.86*	*1.59*
Benchmark return [2]	3.42	6.59	2.52	7.01	9.98	7.32
Active return [3]	-0.38	-0.12	0.50	0.19	-0.02	-0.68

1. Redpoint Industrials Separately Managed Account (SMA) (Model Portfolio) – performance is before taxes and transaction costs, but after management fees (net return).
2. S&P/ASX 100 Industrials Accumulation Index (Benchmark).
3. Active return is the difference between Model Portfolio net return and Benchmark return.
4. The Model Portfolio was established on 30 April 2015.

INVESTMENT OBJECTIVE

The Model Portfolio aims to provide a return in line with the S&P/ASX 100 Industrials Accumulation Index (Benchmark), after management fees, over rolling five-year periods. The Model Portfolio seeks to deliver the key income and growth characteristics of the Benchmark while holding less than half the companies in the Benchmark. The Model Portfolio is specifically built to capture these characteristics with low turnover.

Redpoint combines long horizon sustainable quality metrics and risk management expertise to exclude or underweight poorer rated companies. The Model Portfolio will usually hold 30 to 40 companies and aims to deliver a portfolio with low active risk relative to the Benchmark while being tilted towards companies with better quality characteristics.

PERFORMANCE COMMENTARY

MARKET

The Australian equity market (as represented by the Benchmark) performed solidly over the June quarter (+6.59%), with total returns of +2.56%, +0.50% and +3.42% for April, May and June respectively, more than compensating for its poor performance in the March quarter (-3.82%). By contrast, the total return of the S&P/ASX 200 Index, which includes resources companies, was +8.47% for the quarter.

With the exception of Telecommunication Services (-16.0%), all sectors in the Benchmark had positive total returns for the quarter, with the most prominent of these being Health Care (+17.2%), Consumer Staples (+13.2%), Consumer Discretionary (+11.7%), Real Estate (+10.1%), Utilities (+9.6%) and Information Technology (+9.4%). The Telecommunication Services sector underperformed the broader market primarily due to Telstra Corporation Ltd (ASX: TLS), which represents approximately 95% of the sector. TLS experienced a total return of -16.6% for the quarter due to continuing concerns over the sustainability of its dividend in the face of heightened competition in the mobile and broadband markets.

MODEL PORTFOLIO

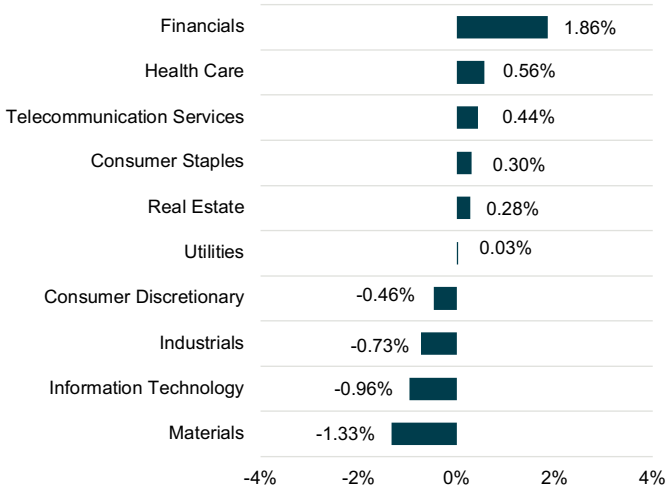
For the three-month period ending 30 June 2018, the net return of the Model Portfolio was +6.47%. The net return of the Model Portfolio is comprised of two (2) components: a capital (price) return of +5.25%; and an income (dividend) return of +1.22%. Over the same period, the total return of the Benchmark was +6.59%. As a result the Model Portfolio underperformed the Benchmark by -0.12% (active return).

The June quarter delivered a cash yield of 1.22% for the Model Portfolio versus 1.18% for the Benchmark (on an ex-dividend basis). This was in line with our forecasts made in the March 2018 investment performance report (1.21% for the Model Portfolio and 1.13% for the Benchmark respectiively).

MODEL PORTFOLIO FACTS

Model Portfolio code	RISMA
Model Portfolio size ($)	107,112,842
Number of holdings	39
Inception date	30 April 2015

SECTOR ACTIVE WEIGHTS



TOP 10 HOLDINGS

Company	Model Portfolio (%)	Benchmark (%)	Active (%)
Commonwealth Bank of Australia	10.87	10.59	0.28
Westpac Banking Corporation	8.37	8.28	0.09
ANZ Banking Group Ltd	7.60	6.75	0.86
CSL Ltd	7.18	7.20	-0.02
National Australia Bank Ltd	6.64	6.15	0.49
Wesfarmers Ltd	5.16	4.62	0.54
Macquarie Group Ltd	4.23	3.23	0.99
Woolworths Group Ltd	4.08	3.31	0.77
Telstra Corporation Ltd	3.16	2.57	0.59
Aristocrat Leisure Ltd	2.59	1.63	0.97

redpoint Investment Management

30 JUNE 2018

QUARTERLY REPORT

REDPOINT INDUSTRIALS SMA

SECTOR ATTRIBUTION

Sector	Model Portfolio Average Active Weight (%)	Sector Allocation (%)	Stock Selection (%)
Consumer Staples	-0.36	0.00	0.30
Consumer Discretionary	-0.55	-0.01	0.21
Health Care	0.15	0.01	0.12
Materials	-1.24	0.08	0.00
Energy	0.00	0.00	0.00
Financials	2.53	-0.06	0.01
Information Technology	-0.87	-0.03	-0.04
Real Estate	0.33	0.02	-0.11
Telecommunications	0.46	-0.11	-0.04
Utilities	0.18	0.01	-0.23
Total	**0.00**	**-0.06**	**-0.06**

Note: Contributions shown here are to the active return of the Model Portfolio.
Period: 29 March 2018 to 29 June 2018.

ATTRIBUTION COMMENTARY

For the June quarter, stocks in the Benchmark held by the Model Portfolio contributed +0.69% to active return, whereas stocks in the Benchmark not held by the Model Portfolio detracted -0.81% from active return.

A returns-based attribution shows that active return is comprised of two (2) key components: sector allocations, which detracted -0.06% from active return; and stock selection within the sectors, which also detracted -0.06% from active return.

From a sector allocation perspective, overweight positions in the Telecommunication Services and Financials sectors and an underweight position in the Information Technology sector collectively detracted -0.19% from active return. This negative outcome was partially offset by an underweight position in the Materials sector, which contributed +0.08% to active return.

Stock selection in the Consumer Staples, Consumer Discretionary and Health Care sectors added the most value, contributing +0.30%, +0.21% and +0.12% respectively to active return (collectively +0.63%). On the other hand, stock selection in the Industrials, Utilities and Real Estate sectors subtracted the most value, detracting -0.27%, -0.23% and -0.11% respectively from active return (collectively -0.62%).

Some of the best performing stocks for the quarter were overweight positions Macquarie Group Ltd (Financials), ResMed Inc (Health Care), Woolworths Ltd (Consumer Staples), Lend Lease Group (Real Estate), ASX Ltd (Financials), Wesfarmers Ltd (Consumer Staples), Aristocrat Leisure Ltd (Consumer Discretionary) and Flight Centre Travel Group Ltd (Consumer Discretionary) and underweight positions (i.e. not held) in Boral Ltd (Materials) and Ramsay Health Care Ltd (Health Care), which collectively contributed +1.14% to active return. Macquarie Group Ltd and ResMed Inc had total returns of +23.6% and +14.5% respectively for the quarter and the overweight positions in these stocks contributed +0.38% to active return.

LARGEST CONTRIBUTORS

Company	Model Portfolio Average Weight (%)	Benchmark Average Weight (%)	Contribution (%)
Macquarie Group Ltd	3.99	2.98	0.21
ResMed Inc	1.85	0.57	0.17
Woolworths Ltd	3.97	3.13	0.12
Lend Lease Group	1.72	0.91	0.11
Boral Ltd	0.00	0.67	0.09
ASX Ltd	1.67	0.98	0.09
Wesfarmers Ltd	4.88	4.26	0.09
Ramsay Health Care Ltd	0.00	0.67	0.09
Aristocrat Leisure Ltd	1.87	1.50	0.09
Flight Centre Travel Group	0.96	0.29	0.07

LARGEST DETRACTORS

Company	Model Portfolio Average Weight (%)	Benchmark Average Weight (%)	Contribution (%)
APA Group	0.00	0.85	-0.23
AMP Ltd	1.55	1.01	-0.18
Telstra Corporation Ltd	3.59	2.97	-0.12
Xero Ltd	0.00	0.36	-0.11
Seek Ltd	0.00	0.60	-0.10
CSL Ltd	6.41	6.74	-0.09
CSR Ltd	1.10	0.23	-0.08
Vicinity Centres	0.00	0.69	-0.07
GPT Group	0.00	0.74	-0.07
Brambles Industries Ltd	1.76	1.27	-0.07

Note: Contributions shown in the above tables are to the active return of the Model Portfolio.
Period: 29 March 2018 to 29 June 2018.

Some of the worst performing stocks for the quarter were underweight positions (i.e. not held) in APA Group (Utilities), Xero Ltd (Information Technology), Seek Ltd (Industrials), Vicinity Centres (Real Estate) and GPT Group (Real Estate) and overweight positions in AMP Ltd, Telstra Corporation Ltd (Telecommunication Services), CSL Ltd (Health Care), CSR Ltd (Materials) and Brambles Industries Ltd (Industrials), which collectively detracted -1.11% from active return. APA Group and Xero Ltd had total returns of +28.1% and +34.6% respectively for the quarter and the underweight positions in these stocks detracted -0.34% from active return. The overweight position in AMP Ltd, which had a total return of -28.7% for the quarter, detracted -0.18% from active return. The CEO and Chairperson of AMP Ltd were forced to resign recently amid shocking revelations of bad corporate behaviour at the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission).

30 JUNE 2018

QUARTERLY REPORT

REDPOINT INDUSTRIALS SMA

redpoint Investment Management

POSITION CHANGES

As at 30 June 2018, the Model Portfolio holds 39 of the 83 companies in the Benchmark universe. Turnover for the Model Portfolio continues to be relatively low.

During the quarter the Model Portfolio established a new position in Coca-Cola Amatil Ltd and closed out positions in Tabcorp Holdings Ltd and Westfield Corporation (a takeover by Unibail-Rodamco SE to form Unibail-Rodamco-Westfield). The Model Portfolio also added to existing positions in Aristocrat Leisure Ltd, CSL Ltd, National Australia Bank Ltd, Mirvac Ltd, AMP Ltd and Brambles Ltd. Smaller amounts were added to existing holdings in ANZ Banking Group, Lend Lease Ltd, Telstra Corporation Ltd, Commonwealth Bank of Australia (ASX: CBA) and Goodman Group.

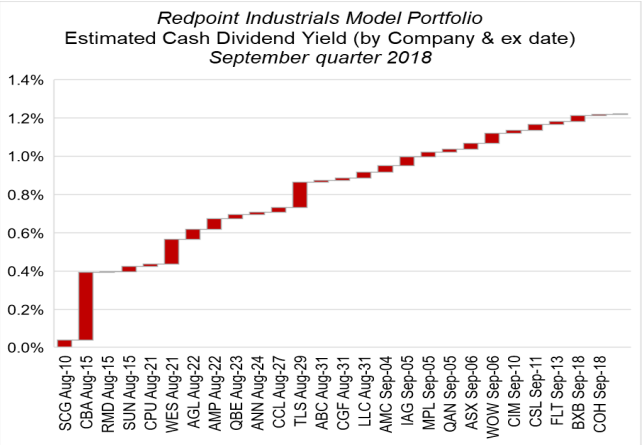
The S&P/ASX will review index memberships in September 2018 and any additions/deletions to the Benchmark may prompt a rebalance of the Model Portfolio at that time. The main change expected is a reclassification of some information technology and media companies to join telecommunications firms in a new communication services sector. Our current analysis indicates that the Model Portfolio is unlikely to require any trading for risk management purposes.

DIVIDEND INCOME

A key characteristic of the Model Portfolio is its focus on capturing the key income and growth drivers of the Benchmark over the longer term in a low turnover, risk managed portfolio. To deliver this outcome we utilise a combination of risk management and long horizon quality metrics to select a diversifed set of companies that we wish to hold for the longer term.

Cash dividend income expectations for the Model Portfolio for the September 2018 quarter are currently estimated at 1.22% versus the Benchmark at 1.23%.

The Model Portfolio is forecast to receive dividends from 26 companies; the Benchmark is expected to have dividends declared by 53 companies. The larger cash dividends will be paid by CBA, Wesfarmers Ltd and Telstra Corporation Ltd. The diverisified nature of the Model Portfolio ensures that it captures a wide variety of dividend income from companies across a broad range of sectors and industries. At the same time last year, the Model Portfolio was forecasted to earn a cash yield of 1.25% for the September 2017 quarter. One year on the value of the portfolio is 2.3% higher (in price terms, net of fees) and yet the forecast cash yield is essentially the same. This highlights how a focus on better quality companies can deliver consistent dividend income that is expected to grow over time. The following chart shows the dividends expected to be earned by the Model Portfolio over the course of the September 2018 quarter.



Source: Redpoint, Bloomberg

YEAR IN REVIEW & OUTLOOK

Having completed a third financial year we are pleased to see that our approach to focusing on better quaility industrials companies over the long term is delivering consistent outcomes for investors.

Financial year to 30 June	Total Return (after fees) (%)	Dividend Yield (%)	Franking Credits (%)
FY 2016	-1.88	*4.95*	*1.64*
FY 2017	-0.26	*5.27*	*1.78*
FY 2018	7.20	*4.92*	*1.65*

Source: Redpoint

As we have seen, since the start of 2016 it was once again the resources sector that performed the strongest over the past year. Amazingly, we now see that the resources sector (energy and metals & mining) has doubled in value over the past two and half years. Placed in its proper context this reversal still sees resources behind where they were in 2013 and half their price relative to heights achieved prior to the GFC in 2008. While investors may feel some regret over our strict adhereance to industrials we remain confident that this focus will deliver more consistent long term performance coupled with a strong dividend flow for investors. That dividend yield, together with franking credits, is shown in the table above.

Within industrials overall it was the Information Technology, Health Care and Consumer Staples sectors that performed best, while Telecommunication Services, Financials and Utilities were the only sectors to deliver a negative return. Telstra Corporation Ltd (ASX: TLS) disappointed the market and was the worst performing telephony company, however, its two (2) counterparts, TPG Telecom Ltd and Vocus Group Ltd also fell in price during the year. The Model Portfolio maintains a holding in TLS at 30 June 2018. Within the Health Care sector our quality indicators have performed strongly ensuring that we have avoided the troubles within the hospital/clinics sector with no exposure to Ramsay Healthcare and Primary Healthcare. ResMed Inc was the best performing health care stock and has been a key holding for the Model Portfolio. Within Consumer Staples we have maintained our exposure to the larger companies like Woolworths Ltd and Wesfarmers Ltd, while avoiding Treasury Wine Estates Ltd and, more recently, the A2 Milk Company Ltd (ASX: A2M). While A2M has been a strong performer we remain wary of its growth profile, no dividends and stretched valuation. Both Wesfarmers Ltd and Woolworths Ltd were up more than 20% over the past 12 months.

While banks have dragged down the overall market we currently see that their dividend yield remains intact. Our main position within the sector remains Macquarie Group Ltd (ASX: MQG) and this has rewarded investors delivering a share price surge of more than 45% over the past year. In addition, MQG has also increased its dividend from a total of $3.30 per share in fiscal 2015 to $5.25 per share over the past 12 months: a 60% increase in just three (3) years. While the banks are actively assessing their business models, especially in relation to the provision of services such as wealth management and financial advice, they remain key providers of debt for households and corporates leaving them in a strong competitive position for the long term.

The past year has not been without its difficulties. The start of 2018 saw markets move into reverse before recovering in the second quarter. If we see more volatility going forward we believe that our focus on holding better quality companies for the long term is well placed to provide a consistent capture of dividends and earnings for investors. From a valuation perspective we see that the industrials market is slightly the wrong side of fair value with larger banks currently amongst the cheapest due to uncertainty surrounding the ongoing Royal Commission.

We are pleased to have seen the Australian Labour Party (ALP) backstep on its proposed policy to not refund excess franking credits to certain retirees. While the new policy has been described as a “step in the right direction” by the SMSF association, it is likley that the policy will be further amended as we approach the next federal election.

redpoint Investment Management

30 JUNE 2018

QUARTERLY REPORT

REDPOINT INDUSTRIALS SMA

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