redpoint Investment Management

30 SEPTEMBER 2016

QUARTERLY REPORT

REDPOINT INDUSTRIALS SMA

Model Portfolio performance as at 30 September 2016	1 month (%)	3 months (%)	6 months (%)	1 year (%)	Since Inception (%) [4]
Model Portfolio return (net) [1]	-0.10	2.91	5.54	9.09	-0.69
Benchmark return [2]	-0.53	3.48	6.46	11.35	0.95
Active return [3]	0.43	-0.57	-0.92	-2.26	-1.64

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

For the three-month period ending 30 September 2016, the net return of the Model Portfolio was +2.91%. Over the same period, the total return of the Benchmark was +3.48%. The Model Portfolio underperformed the Benchmark by -0.57% (active return).

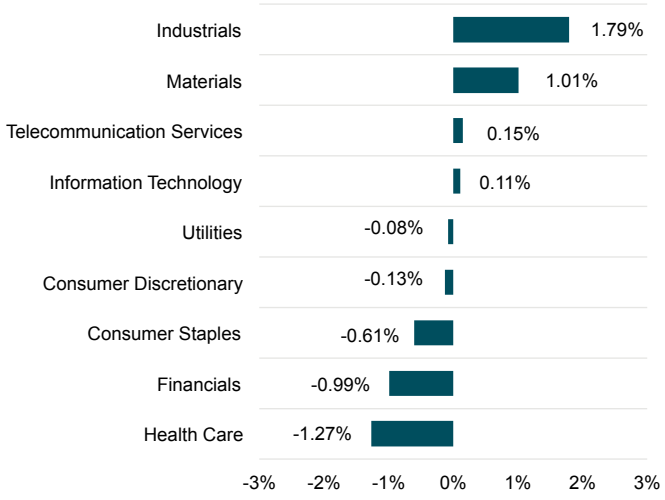
Over the quarter, the best performing sectors in the Benchmark were Consumer Staples (+13.16%), Information Technology (+8.57%) and Consumer Discretionary (+8.29%), while the worst performing sectors were Telecommunication Services (-6.39%), Utilities (-2.22%) and Industrials (-0.22%).

The September quarter delivered a cash yield of 1.30% for the Model Portfolio versus 1.27% for the Benchmark (on an ex-dividend basis). This was in line with our forecasts made in the June 2016 quarterly investment performance report.

Equity markets across the globe rose further in the September quarter. A key driver was ongoing supportive action from central banks assuring investors that interest rates will remain relatively low. These actions continue to support an increased risk appetite for investors – an environment where our long horizon view of holding a subset of better quality companies is not as well rewarded. While the focus of the Model Portfolio is to invest in industrial companies we note that commodity prices continued to make gains during the quarter resulting in the Materials sector of the Australian equity market being the best performer (+14.25%).

The local reporting season ended up being reasonably quiet with a few exceptions. Telecommunication Services was the worst performing sector (-6.39%) thanks to a surprise downgrade from TPG Telecom Ltd (not held by the Model Portfolio). The Consumer Staples sector was bouyed by better than expected results from Coca-Cola Amatil Ltd (also not held) and Treasury Wine Estates Ltd (also not held) along with a rebound in Woolworths Ltd (held at an overweight position) as it continues to regroup and process the closure of its failed foray into the hardware business.

SECTOR ACTIVE WEIGHTS



TOP 10 HOLDINGS

Company	Model Portfolio (%)	Benchmark (%)	Active (%)
Commonwealth Bank	11.75	11.13	0.61
Westpac Banking Corporation	9.02	8.85	0.17
ANZ Banking Group Ltd	7.78	7.25	0.53
National Australia Bank Ltd	6.89	6.64	0.25
Telstra Corporation Ltd	6.42	5.68	0.74
Wesfarmers Ltd	4.77	4.45	0.33
CSL Ltd	4.02	4.38	-0.36
Woolworths Ltd	3.21	2.67	0.54
Macquarie Group Ltd	2.98	2.50	0.48
Sydney Airport Holdings Ltd	2.40	1.40	1.00

MODEL PORTFOLIO FACTS

Model Portfolio code	RISMA
Model Portfolio size ($)	32,412,456
Number of holdings	41
Inception date	30 April 2015

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SECTOR ATTRIBUTION

Sector	Model Portfolio Average Active Weight (%)	Sector Allocation (%)	Stock Selection (%)
Telecommunications	0.06	-0.01	0.15
Utilities	-0.18	0.01	0.08
Financials	-0.03	-0.02	0.10
Information Technology	0.08	0.00	0.04
Energy	0.00	0.00	0.00
Health Care	-0.89	0.01	-0.11
Consumer Staples	-0.58	-0.06	-0.05
Materials	0.77	0.01	-0.13
Consumer Discretionary	-0.93	-0.05	-0.23
Industrials	1.70	-0.08	-0.25
Total	**0.00**	**-0.17**	**-0.40**

Note: Contributions shown here are to the active return of the Model Portfolio.
Period: 30 June 2016 to 30 September 2016.

ATTRIBUTION COMMENTARY

For the September quarter, stocks in the Benchmark held by the Model Portfolio contributed +0.43% to active return, whereas stocks in the Benchmark not held by the Model Portfolio detracted -1.00% from active return.

A returns-based attribution shows that active return is comprised of two (2) components: sector allocations detracted -0.17% from active return, whereas stock selection within the sectors detracted -0.40% from active return.

From a sector allocation perspective, underweight positions in the Consumer Staples and Consumer Discretionary sectors and an overweight position in the Industrials sector detracted the most value (collectively -0.19%).

Stock selection in the Telecommunication Services, Utilities and Financials sectors added the most value (+0.33% in aggregate), primarily due to underweight positions in TPG Telecom Ltd, Vocus Communications Ltd (both Telecommunication Services), APA Group (Utilities) and overweight positions in Lend Lease Group and Macquarie Group Ltd (both Financials) (collectively representing +0.49% of active return).

Stock selection in the Industrials, Consumer Discretionary, Materials and Health Care sectors detracted the most value (-0.72% in aggregate). This was primarily casued by an overweight position in CIMIC Group Ltd (Industrials) and underweight positions (i.e. no holdings) in Aristocrat Leisure Ltd (Consumer Discretionary), Orica Ltd (Materials), Cochlear Ltd and Ramsay Health Care Ltd (both Health Care) (collectively representing -0.52% of active return).

LARGEST CONTRIBUTORS

Company	Model Portfolio Average Weight (%)	Benchmark Average Weight (%)	Contribution (%)
Ansell Ltd	0.75	0.28	0.11
TPG Telecom Ltd	0.00	0.33	0.10
Vocus Communications	0.00	0.42	0.09
Lend Lease Group	1.36	0.63	0.09
APA Group	0.00	0.91	0.07
Macquarie Group Ltd	2.76	2.32	0.07
Woolworths Ltd	3.13	2.61	0.06
GPT Group	0.00	0.85	0.06
Investa Office Fund	1.04	0.24	0.05
Star Entertainment Group	0.84	0.41	0.05

LARGEST DETRACTORS

Company	Model Portfolio Average Weight (%)	Benchmark Average Weight (%)	Contribution (%)
Treasury Wine Estates	0.00	0.67	-0.13
CIMIC Group Ltd	0.79	0.27	-0.12
Aristocrat Leisure Ltd	0.00	0.80	-0.11
Coca-Cola Amatil Ltd	0.00	0.44	-0.11
Cochlear Ltd	0.00	0.67	-0.11
Orica Ltd	0.00	0.46	-0.10
Ramsay Health Care Ltd	0.00	0.88	-0.09
Challenger Ltd	0.00	0.46	-0.09
Medibank Private Ltd	1.24	0.69	-0.08
Mirvac Group	0.00	0.71	-0.07

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POSITION CHANGES

As at 30 September 2016, the Model Portfolio holds 41 of the 86 companies in the Benchmark universe. Turnover for the Model Portfolio continues to be relatively low. There were no holdings changes to the Model Portfolio in July and August. However, there was a rebalance of the Model Portfolio in September. In the September rebalance we addressed both the risk positioning and some stock specific changes.

A key change in September was to address a slight large capitalisation/small capitalisation imbalance in the Model Portfolio. This change was aimed at reducing the overweight positions in the largest stocks in the Benchmark in able to reduce the underweight positions in smaller stocks in our investment universe. This was achieved by slightly reducing exposure to CSL Ltd, Brambles Ltd and retail property manager, Scentre Group.

The Model Portfolio opened a new position in retailer Harvey Norman Holdings Ltd (HVN) in September. Our insights into the economic performance of HVN indicate both strong cashflow and continuing incremental improvements in revenue and margins. These metrics lead us to prefer HVN versus other retail peers such as JB Hi-Fi Ltd.

The most recent annual result for electricity and gas distributor DUET Group has prompted us to exit this position. Our indicators point to concerns over the use of accruals, volatility in free cashflow and disappointing environmental and social responsibility markers. While the stock currently trades at an attractive yield, forward estimates are pointing at a potential reduction. As a replacement, we have added AusNet Services Ltd to the Model Portfolio. This company has a strong operating performance across a range of financial metrics along with with impressive sustainability metrics.

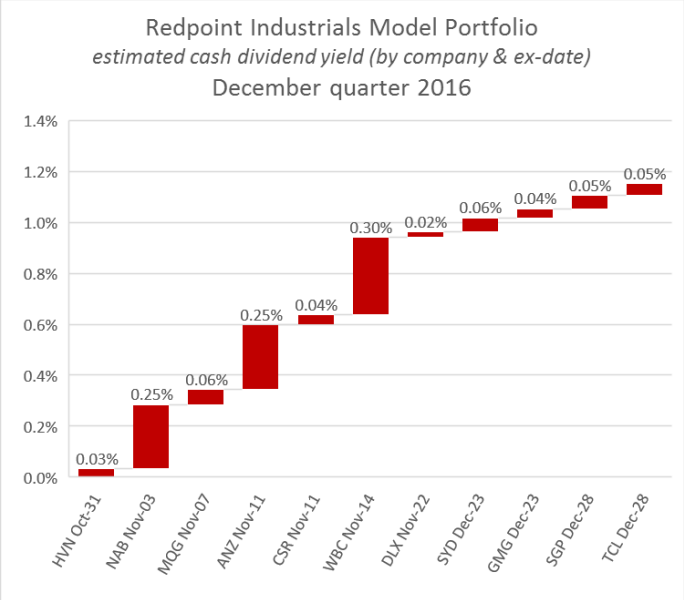
Other trades include: increasing exposure to ANZ Banking Group, CSR Ltd and Qantas Airways Ltd; and selling completely out of Henderson Group PLC. Overall these changes have made a slight improvement to the cash dividend yield forecast for the Model Portfolio from 4.99% pa to 5.01% pa (relative to the Benchmark forecast yield of 4.84% pa).

The S&P/ASX will review index memberships in December and any additions/deletions to the Benchmark may prompt a rebalance of the Model Portfolio at that time.

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.

Dividend income expectations for the Model Portfolio for the December quarter are currently estimated at 1.15% versus the Benchmark at 1.11%. The Model Portfolio is forecast to have dividends from 11 holdings, the Benchmark is expected to have dividends declared by 24 companies. Dividend income will be predominatly derived from the Model Portfolio's holdings in the Financials sector. Companies such as National Australia Bank Ltd, ANZ Banking Group (ANZ), Westpac Banking Corporation and Macquarie Group Ltd are all due to declare dividends in early November.



Source: Redpoint, Bloomberg

Investors will recall that ANZ cut is interim dividend in May 2016 to $0.80 per share (versus $0.86 as an interim dividend in 2015). There has been speculation regarding whether other banks will follow suit. There is always a possibility that this will eventuate. We note that current consesnus forecasts do not indicate that final dividends will be cut. In the event that they are we would expect only a modest cut. Furthermore, we note that forecasts are for ANZ to pay a slightly higher final dividend of $0.90 per share. This is higher than the interim dividend but slightly lower than the final dividend in 2015 of $0.95 per share.

KEY CONTACTS

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