MONTHLY PERFORMANCE REPORT
October 2018

The portfolio returned -7.46% for the month, compared with -6.05% for the S&P/AX200 (TR) Index. The Fund has achieved its returns with lower volatility than the S&P/ASX 200, as a consequence of the stocks selected by the investment process which is designed to eliminate high risk stocks therefore avoiding the chance of permanent loss of investor capital.

GENERAL INFORMATION

Base Currency: AUD

Entity Type: Strategy

PMs: Neill Colledge
Marcel von Pfyffer

Launch date: Jul-2018

Benchmark: ASX200 TR

Fees: 0.8% and 10% +GST

Domicile: Australia

Close of Financial Year: 30th June

Dealing: Daily

PERFORMANCE (Inception JUL-2018)	Arminius Capital ALCE Strategy
1 Month	**-7.46%**
3 Months	**-9.48%**
Calendar YTD	**N/A**
1 Year	**N/A**
3 Years	**N/A**
5 Years	**N/A**
Cumulative since Inception July 2018	**-9.52%**

Arminius Capital ALCE Strategy (Inception July-2018) Returns are net of fees

%	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	CY
2018	-	-	-	-	**INCEPTION =>**		-0.05%	1.19%	-3.33%	-7.46%	-	-	N/A

INVESTMENT MANAGER
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STRATEGY OBJECTIVES:

The aim of the portfolio is to outperform the S&P/ASX 200 (TR) Index over rolling 5-year periods. The portfolio will also aim to deliver above market dividend income and lower volatility than the S&P/ASX 200 (TR) Index. The investment process starts with taking the constituents of the investment universe, the S&P/ASX200, and applying quantitative filters to screen out companies which have high volatility or low dividend yield or low earnings quality. The objective is not to maximise returns, but rather to eliminate high risk stocks.

INVESTMENT STRATEGY: The investment strategy underlying this portfolio is founded on the belief that (i) stocks with above-average dividend yields tend to outperform in the long term, provided that a filter for earnings quality is applied and (ii) low volatility stocks tend to outperform in the long term, especially if a valuation measure is added to the stock selection process.

The portfolio is designed for investors who (i) are seeking exposure to a concentrated core portfolio of Australian equities with returns comprising of both capital appreciation and income; (ii) accept the risk of price fluctuations particularly over periods less than the minimum investment timeframe and accept that capital preservation is not guaranteed; and (iii) are prepared to invest for the minimum investment timeframe of five years.

Portfolio performance statistics will be provided as soon as the ALCE portfolio has sufficient history to be meaningful.

INVESTMENT UPDATE

The S&P/ASX200 accumulation index fell by 6.05% in October. This was less than the declines in most global markets, including the US, China, and Japan. The fall in the Australian market was its biggest since October 2015, which was the last time that global markets were having a panic attack about a Chinese slowdown. No ASX sectors rose during the month: the ones which fell the least were Real Estate (-3.8%) and Utilities (-4.0%), while those which fell the most were IT (-11.3%) and Energy (-10.4%). Sharp price falls were evident across the board, including past winners such as Cochlear, CSL, and Resmed.

The Fund fell by 7.46% in October, 141 basis points more than its benchmark. The majority of stocks in the portfolio fell by less than the market, but three large falls drove the portfolio into underperformance: Boral (-18.8%), GUD (-14.7%), and Stockland (-13.0%). In all three cases, negative corporate remarks provoked strong investor reactions. We consider that the companies' underlying fundamentals have not deteriorated as much as the price falls suggest, therefore we will continue to hold the stocks. The Fund's largest holdings are Westpac, ANZ, Wesfarmers, Macquarie Bank, and Woodside.

The portfolio is cheaper than the market, with a prospective P/E of 12.9 and yield of 5.5% for FY2019. Consensus forecasts for the S&P/ASX200 currently imply a P/E of 14.4 and yield of 4.9%.

OUTLOOK

October's slide in global markets represents the start of the correction which we have been forecasting for several months. The US market was led downward by the tech sector, in the same way as it has led the market up since the GFC. By the September peak in the S&P500, the tech sector had grown to account for 25% of the S&P500. In fact, six stocks – Facebook, Apple, Amazon, Netflix, Microsoft, and Google – have accounted for more than one-third of the total rise in the S&P500 since 2013.

We do not expect the S&P/ASX200 to fall as far as the US market will, partly because the tech sector is much less important here, but mostly because our proprietary quantitative models suggest that the Australian market is neither expensive nor cheap at present. Unfortunately, the Australian market has a weaker outlook than the US. The consensus forecasts for EPS growth here are about 11% in FY2019 (mostly from the resource sector), dropping to about 3% in FY2020, and earnings downgrades have recently overtaken earnings upgrades. The August figure for building approvals recorded a 13.6% decline year on year, and the coming slide in housing activity is already weighing heavily on banks, building materials, and other stocks with any housing exposure.

Australia's exposure to China super-charged our economic growth since the 1990s, but it has now left us dependent on an economy which was slowing down even before The Donald started his trade war. Perhaps the one positive outcome of the trade war for us is that China has abruptly decided that it needs all the friends it can get, so it has warmed up relations with Australia (along with Japan, Russia, and several other countries who had offended the Chinese leadership). For global currency investors, the importance of China to Australia makes the Australian dollar a good proxy for the Chinese renminbi (which is not permitted to trade freely). Australia's outlook will improve significantly if Xi Jinping and The Donald manage to kiss and make up in the near future.

THE BIG FOUR BANKS – NO BETTER THAN THEY OUGHT TO BE

"No better than she ought to be" was how my grandmother used to describe a woman of doubtful virtue, and the description fits the big banks very well. The results for the year to September 2018 revealed the banks' past sins – sector cash earnings fell 5% – but they were no worse than expected, because the banks had pre-announced all their costs for restructuring and customer remediation. No dividends had to be cut, and three of the big four are getting out of the financial advice businesses which caused most of their embarrassment in front of the Royal Commission.

It will be a long road to restoring the banks' reputations, however. Loan growth has slowed to a crawl, and the deterioration in house prices will lift bad debt provisions over the next couple of years, so it is premature to rule out dividend cuts. On top of these gloomy banking fundamentals, there is the certainty of additional regulation. Regardless of the actual content of the Royal Commission's final recommendations, the next government (of either stripe) will be obliged to enact some of them, and for once the cross-bench Senators and MPs will not stand in the way. (No one loves a banker, except possibly his mother.)

The sector return on equity fell to 12.5% in 2018, its lowest level since the GFC. This level of return is probably near the medium-term average for the new era of higher equity capital and tighter regulation in banking, and most non-banks would regard this as a decent return. Most importantly, the banking sector is still a cartel protected by complex regulation – there is no Aldi offering discounted products and no industry super funds offering unconflicted advice, and the fintech start-ups are more likely to sell out to the banks than to compete with them. Although Australian banks still have serious risks to overcome, their share prices are slowly adjusting to the new reality.

AUSTRALIAN FIFTY LEADERS – MONTHLY DATA

Code	Name	Sector	30-Sep-18	31-Oct-18	ROR
AGL	AGL Energy Limited	Utilities	$19.50	$18.00	-7.69%
AMC	Amcor Limited	Materials	$13.68	$13.30	-2.78%
AMP	AMP Limited	Financials	$3.19	$2.47	-22.57%
ANZ	ANZ Banking Group Limited	Financials	$28.18	$25.93	-7.98%
APA	APA Group Units FP Stapled Securities	Utilities	$9.98	$9.60	-3.81%
ALL	Aristocrat Leisure	Consumer Discretionary	$28.44	$26.50	-6.82%
ASX	ASX Limited	Financials	$63.66	$59.17	-7.05%
AZJ	Aurizon Holdings Limited	Industrials	$4.11	$4.20	2.19%
BHP	BHP Billiton Limited	Materials	$34.63	$32.21	-6.99%
BXB	Brambles Limited	Industrials	$10.90	$10.62	-2.57%
CTX	Caltex Australia	Energy	$29.90	$28.26	-5.48%
COH	Cochlear Limited	Health Care	$200.64	$177.58	-11.49%
CBA	Commonwealth Bank	Financials	$71.41	$69.23	-3.05%
CPU	Computershare Limited	Information Technology	$19.95	$19.77	-0.90%
CSL	CSL Limited	Health Care	$201.11	$188.00	-6.52%
DXS	Dexus Units FP Stapled	Real Estate	$10.56	$10.20	-3.41%
FMG	Fortescue Metals Group	Materials	$3.92	$4.00	2.04%
GMG	Goodman Group Stapled Securities FP	Real Estate	$10.36	$10.38	0.19%
GPT	GPT Group Stapled Securities FP	Real Estate	$5.21	$5.16	-0.96%
IAG	Insurance Australia	Financials	$7.50	$6.83	-8.93%
JHX	James Hardie Indust Chess Depositary In	Materials	$20.96	$18.79	-10.35%
LLC	Lendlease Group Unit/ Stapled Securities	Real Estate	$19.66	$17.60	-10.48%
MQG	Macquarie Group Limited	Financials	$126.04	$117.20	-7.01%
MPL	Medibank Private Limited	Financials	$2.91	$2.79	-4.12%
MGR	Mirvac Group Stapled Securities	Real Estate	$2.41	$2.17	-9.96%

Code	Name	Sector	30-Sep-18	31-Oct-18	ROR
NAB	National Aust. Bank	Financials	$27.81	$25.21	-9.35%
NCM	Newcrest Mining	Materials	$19.41	$20.61	6.18%
OSH	Oil Search Limited 10 Toea	Energy	$9.03	$7.77	-13.95%
ORI	Orica Limited	Materials	$17.03	$17.16	0.76%
ORG	Origin Energy	Energy	$8.26	$7.29	-11.74%
QAN	Qantas Airways	Industrials	$5.90	$5.47	-7.29%
QBE	QBE Insurance Group	Financials	$11.12	$11.32	1.80%
RHC	Ramsay Health Care	Health Care	$54.93	$56.22	2.35%
RIO	RIO Tinto Limited	Materials	$78.76	$76.40	-3.00%
STO	Santos Limited	Energy	$7.26	$6.64	-8.54%
SCG	Scentre Group Stapled Securities	Real Estate	$3.97	$3.98	0.25%
SHL	Sonic Healthcare	Health Care	$24.91	$22.55	-9.47%
S32	SOUTH32 Limited	Materials	$3.92	$3.62	-7.65%
SGP	Stockland Units/ Stapled Securities	Real Estate	$4.15	$3.61	-13.01%
SUN	Suncorp Group Limited	Financials	$14.46	$14.01	-3.11%
SYD	SYD Airport FP Stapled Securities US Pr	Industrials	$6.89	$6.44	-6.53%
TLS	Telstra Corporation	Telecommunication Services	$3.19	$3.08	-3.45%
TCL	Transurban Group Ordinary Shares/Uni	Industrials	$11.22	$11.34	1.07%
TWE	Treasury Wine Estate	Consumer Staples	$17.49	$15.12	-13.55%
URW	Unibailrodawestfield Chess Depositary I	Real Estate	$14.12	$12.77	-9.56%
VCX	Vicinity Centres Ordinary/Units FP Stap	Real Estate	$2.62	$2.65	1.15%
WES	Wesfarmers Limited	Consumer Staples	$49.85	$46.62	-6.48%
WBC	Westpac Banking Corp	Financials	$27.93	$26.85	-3.87%
WPL	Woodside Petroleum	Energy	$38.58	$34.85	-9.67%
WOW	Woolworths Group Limited	Consumer Staples	$28.08	$28.43	1.25%

ROR = Rate of Return