MONTHLY PERFORMANCE REPORT
October 2019

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

The portfolio returned -1.52% for the month, compared with -0.77% for the S&P/ASX200 Accumulation 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.

PERFORMANCE (Inception JUL-2018)	Arminius Capital ALCE Strategy	S&P/ASX200 Accumulation Index (AUD)
1 Month	**-1.52%**	-0.77%
3 Months	**0.11%**	-1.38%
Calendar YTD	**21.87%**	21.95%
1 Year	**16.23%**	19.74%
3 Years	**N/A**	N/A
5 Years	**N/A**	N/A
Cumulative since Inception July 2018	**3.37%**	**10.38%**

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%	0.99%	-3.17%	-7.46%	-2.66%	-4.58%	N/A
2019	1.97%	4.67%	2.58%	2.37%	0.95%	1.84%	4.09%	-0.39%	1.48%	-1.52%	-	-	21.87%

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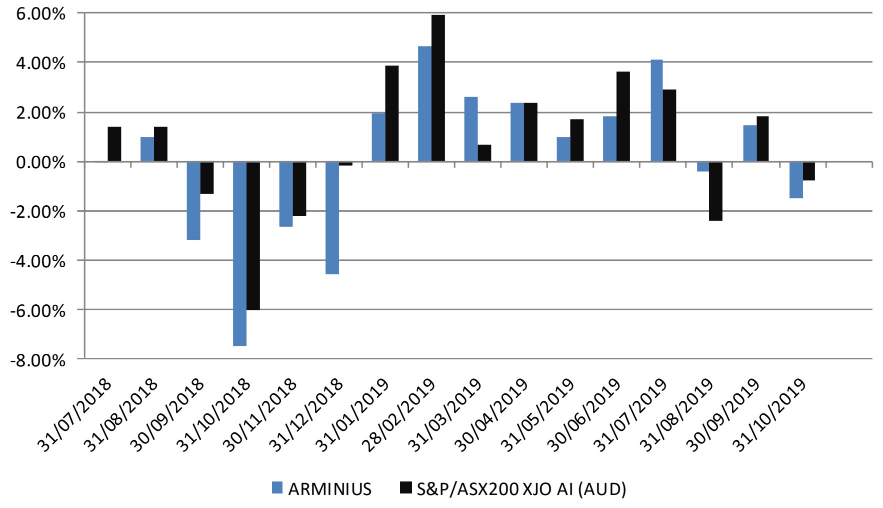
STRATEGY OBJECTIVES:
The aim of the ALCE (Australian Low Correlation Equities) portfolio is to outperform the S&P/ASX 200 (TR) Index over rolling 5-year periods. The portfolio will also aim to deliver above market dividend income and lower volatility than the S&P/ASX 200 (TR) Index. The investment process 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 PERFORMANCE

The ALCE portfolio fell by 1.52% in October, 75 basis points less than the negative 0.77% return from its benchmark, the S&P/ASX200 accumulation index. The main reason for the underperformance was that ALCE was underweight the healthcare sector, which recorded a 7% return in the month. The portfolio rarely owns healthcare stocks because they tend to be more volatile, with high price-earnings ratios and low dividend yields. The banking sector dipped at month-end when ANZ reported flat earnings on 31 Oct.

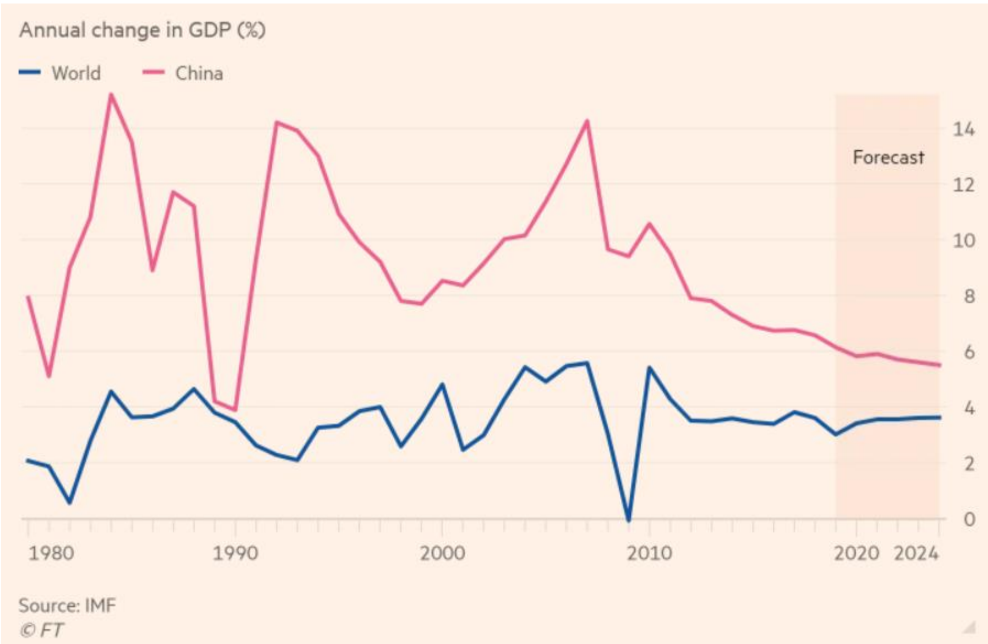
The five largest positive movements in the ALCE portfolio were **Stockland (+7.5%)**, **Orora (+7.0%)**, **Vicinity (+2.7%)**, **SCA Group (+2.3%)**, and **Macquarie (+1.4%)**. The five largest negative movements were GWA (-13.9%), ANZ (-6.8%), CocaCola Amatil (-5.9%), Nine Entertainment (-5.4%), and General Property Trust (-5.1%).

There were no changes to the portfolio during the month. At month-end the Fund's largest holdings were **National Australia Bank, ANZ, Macquarie, Wesfarmers**, and **Transurban**.

The ASX was one of the few global share markets to fall in October. Japan's Nikkei 225 price index was the strongest, leaping 5.4% as investors concluded that 1 October sales tax rise was not going to weaken the economy after all. Europe's Stoxx 600 price index gained 0.9%, as Mediterranean Europe grew faster than Northern Europe. Despite repeated delays, the US-China trade negotiations do seem to be heading towards a truce before Christmas. The US S&P500 price index gained 2.0% and Hong Kong's Hang Seng price index jumped 3.7%, although mainland Chinese markets barely moved.

MARKET OUTLOOK

For the last two decades, China has been the engine behind Australia's GDP growth, not only in resources, but also in services such as education and tourism. As the chart shows, China's growth has been slowing for a decade and will continue to slow.



A slowdown in China is not a disaster for Australia, because China's GDP is currently USD 13 trillion. There are many more exports which the USD 1.8 trillion Australian economy can send to China. In conjunction with weak commodity prices and drought-stricken agriculture, however, Australia's economic outlook is less than rosy, as recent data releases have confirmed.

Australian GDP growth in the year to June 2019 was a very modest 1.4%. Since then, the RBA has cut interest rates and house prices in Sydney and Melbourne have perked up. Buyers' enthusiasm has not spilled over into the rest of the economy. Housing credit growth hit a record low of 0.2% in the month of August, reaching only 3.1% for the year to August. Personal credit growth fell 3.4% in the year to August. The anaemic growth in retail sales suggests that homeowners have used their new interest rates to pay down their debts. Household debt has now reached 191% of household income, of which 140% is housing debt. The consensus forecast for 2020 is still 2.4% GDP growth, which we regard as optimistic.

Some form of truce in the US-China trade war now seems likely in the next few weeks, mostly because the US side has retreated from its demands for an end to Chinese subsidies and limited its goals to trade issues. A truce is good for the US and Chinese economies, but it may not be as good for China's other trading partners, such as Australia.

In the September report for ALCE, we repeated our pessimistic assessment of Australian banks, even though the sector had risen 5.9% during the month. We noted that bank profits had been flat since 2015 and that the banks' rate of return on equity would keep falling. The ALCE portfolio is underweight the sector, owning only ANZ and NAB. (Macquarie makes its profits in ways which are very different to the Big Four.)

On top of the usual economic cycles, banks globally are facing multiple challenges to their traditional business model. The biggest of these is the compression of net interest margins caused by falling interest rates, but the banks are also under pressure from fintech competitors, "neobanks", digital payment systems, and a regulatory push to open up banks' customer data. In addition, Australian banks are suffering self-inflicted wounds as they pay compensation to remediate the customers they have maltreated.

Under these circumstances, it is hardly surprising that the Australian banking sector has given up its recent gains as the market digested the dismal results for the year to 30 Sep 2019. We will analyse these results in the November report for ALCE, but it is already clear that the 2020 year will see falling profits for the banking sector as a whole. When 25% of the S&P/ASX200 is going backwards, the rest of the Aussie market will have to work extra hard to gain any ground.

Consensus forecasts for FY20 EPS growth continue to fall, because earnings downgrades continued to outnumber earnings upgrades by 5 to 1. The consensus forecast for FY20 earnings growth has slid down from 6% to 5%, most of which comes from the resource stocks, where EPS growth of 16% is expected. Property trusts are forecast to grow by 2%. The outlook for banking sector EPS growth had dropped to -1% even before the bad news of the ANZ result was released.

The ALCE portfolio has a FY2020 forecast P/E of 15.2x and yield of 5.0%, making it cheaper than the S&P/ASX200, where the consensus forecasts currently imply a P/E of 17.1x and yield of 4.1%. The ALCE portfolio remains defensively positioned.