CI PENSIONS FUND

QUARTERLY COMMENTARY REPORT

Cooper Investors Pty Limited AFS Licence Number 221794 ABN 26 100 409 890

June 2016

	**PORTFOLIO	#BENCHMARK	VALUE ADDED
ROLLING 3 MONTH	5.82%	4.23%	1.59%
ROLLING 1 YEAR	9.21%	2.21%	7.00%
ROLLING 2 YEAR	11.29%	4.71%	6.58%
SINCE INCEPTION*	10.71%	4.79%	5.92%
SINCE INCEPTION^	26.74%	11.53%	15.21%

*Annualised
^Cumulative (3 March 2014)
**Before fees and expenses and adjusted for franking credits
#S&P ASX200 Accumulation Index – adjusted for franking credits

The purpose of the CI Pensions Fund is to provide a conservative equities portfolio that may be suitable for investors who are in the pensions/ decumulation phase. The portfolio may also be suitable for charities, foundations and others who are looking for a conservative equities exposure.

Whilst return is important the portfolio also aims to perform much better in down markets and to exhibit lower than market volatility.

Market and Portfolio Performance

The ASX 200 Accumulation index (adjusted for franking credits) rose by 4.23% over the June quarter and this pulled the annual market return up to a meagre 2.21%. The portfolio rose by 5.82% for the quarter and 9.21% for the year.

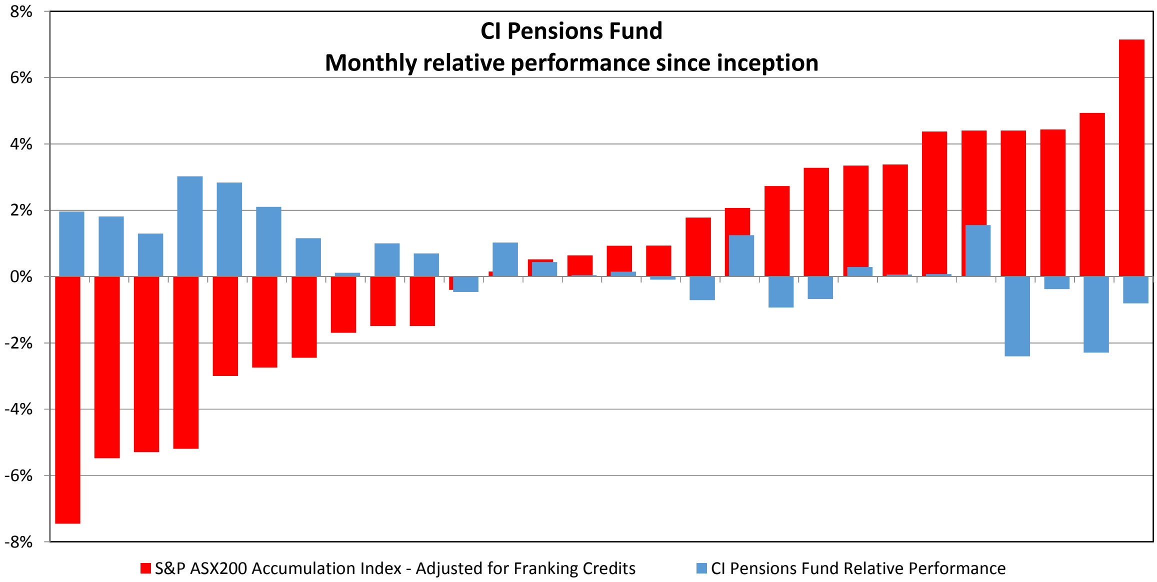
Stronger stocks over the quarter included Carindale Property, Ramsay Health Care, BHP, Macquarie Group and ASX, poorer performing stocks were AMP and Regis Healthcare. Over the year the best performing sectors were infrastructure, property and healthcare whilst the banks and large resource stocks fell by more than 10%.

The international stocks in the portfolio performed well as a group. The international stocks create a direct foreign currency exposure for the portfolio which adds to its diversification. Over the quarter the A$ fell against the US$ and the NZ$ whilst it rose substantially against the Pound.

We have previously reported the volatility and down market performance of the portfolio on the basis of daily portfolio and index returns. As the portfolio has been running for over two years we now calculate volatility and down market performance using monthly returns.

Since inception the portfolio's volatility has been around 78% of the market's volatility.

The chart below shows the portfolio's monthly relative returns. The red bars show each month's market return sorted from worst to best month and the blue bars show the portfolios return relative to the market for each month.



Since inception the index has shown a negative monthly return 11 times and the portfolio has captured 56% of this downside. The index has shown a positive monthly return 17 times and the portfolio has captured 92% of this upside.

The mix of the upside and downside capture has resulted in the portfolio return since inception being 10.71% pa compared to the markets return of 4.79% p.a.

The intention is that the portfolio captures a greater percentage of the upside than the downside. In reasonably flat periods as we have seen over the past few years if a portfolio captures more of the upside than the downside the result should be lower than market volatility, better performance in down markets and a return that at least keeps up with the market's return.

The Portfolio

The portfolio has held the US company **Danaher** since inception. In early July Danaher spun off its industrial assets into the newly formed Fortive Corp. While Fortive is a large and well-run company with over $6bn of revenues and a $16bn market cap it does not meet the criteria for the CI Pensions Fund as there is no dividend, no standalone track record and an emphasis on acquisitions to drive growth and shareholder value. The Fund subsequently sold its Fortive shares on listing while maintaining its investment in Danaher which is now predominantly a healthcare focused company within the life sciences, diagnostics and dental sectors. Without the industrial assets the remaining company should see a faster growing and more stable top line combined with a margin expansion opportunity to drive consistent earnings growth.

At the end of the quarter the portfolio held 39 securities. 10% of the portfolio is held in five US and European stocks and the cash weighting was 7%.

Stock News

Summerset Group released their second quarter unit sales which showed a continuation of the strong operating momentum in the business. Second quarter sales of 108 new units gives us confidence that they are on track to deliver their 400 unit target build in 2016.

In June the Commerce Commission released its latest input methodologies review for the New Zealand airport sector's aeronautical weighted average cost of capital. As expected it appears that the Commerce Commission will set its weighted average cost of capital estimate at the 50th percentile, which is lower than the 75th percentile adopted for the prior period. Importantly, the Commerce Commission noted that airports can earn above the 50th percentile although this needs to be well justified. We do not think this review will significantly impact **Auckland International Airport's** business.

AMP shares fell over the quarter which seems to reflect the unexplained retirement of the Chairman in April, weak sales and continuing difficulties from wealth protection claims. The latter two issues are affecting all life insurers.

Vicinity Centres had previously announced it intended to reshape its shopping centre portfolio by selling off lower quality assets and reinvesting proceeds into higher returning development projects and acquisition opportunities. In May Vicinity announced the sale of four retail centres worth $841m. Vicinity has purchased one DFO Outlet Centre and announced its participation in the development of another DFO Outlet Centre at Perth Airport, as well as the redevelopment of Mandurah shopping centre in Perth.

The residential aged care sector has been under pressure recently, with share prices of **Regis Healthcare** and its listed peers having been de-rated sharply. The significant reform agenda of the Government, driving the sector to be more consumer-driven and market-based, has created a lot of uncertainty for operators and investors alike. This has been compounded by the measures announced in the 2016-17 Budget to reign in the growth of aged care funding, as well as claims that some of the industry has been over-servicing residents and incorrectly claiming Government funding. This reinforces our preference for the integrated retirement living operators, such as **Ryman** and **Summerset**, which have exposure to the ageing demographic without as much regulatory risk as residential aged care.

Portfolio Objective and Strategy

The portfolio is designed to be a conservative, lower risk equity portfolio.

The intended outcomes are that the portfolio should deliver a reasonable return compared to the overall market (the ASX 200 Index) but with lower than market volatility and better than market returns in down markets.

We aim to meet the risk and return objectives through a combination of portfolio construction and stock selection guidelines.

From a risk perspective, we are aiming to construct a highly diversified portfolio. Diversification can be achieved through country, industry, size, currency and stock characteristics. This desire for diversification is why the portfolio can include international stocks, smaller stocks, hybrid securities and have some currency exposure. The international exposure (excluding New Zealand) is limited to 20% of the portfolio.

Compared to the Australian stock market the portfolio has much less exposure to the 20 largest Australian companies, more exposure to mid-cap companies, more exposure to international companies and exposure to industries than are not represented on the ASX. The portfolio has relatively low exposure to the major Australian banks and the resource sector.

The analysis of individual stocks is centred on finding stocks that have lower inherent risk whilst still offering some growth potential.

We have developed a list of characteristics that based on our experience have been evident in higher performing and less risky companies. Some of these characteristics include:

- Being focused on a defined core competency
- Displaying a strong track record
- Not being over geared
- Paying sustainable dividends
- Reinvesting retained earnings into the company
- Having a strong industry position
- Not facing significant industry head winds
- Not being too keen on acquisitions
- Not being far too expensive

In addition to an individual stock's characteristics we are looking to include stocks that do not have high correlations of returns with other stocks in the portfolio. For instance the four major banks have very high correlations of returns with each other of 80-90%. Put crudely, they tend to go up and down together. Having a large weighting to these four stocks would reduce the diversification of the portfolio.

Bringing together the portfolio construction and stock selection guidelines should lead to the portfolio capturing a greater percentage of the upside periods than the downside periods. As noted earlier the portfolio has delivered around 56% of the markets return in down months and 92% of the markets return in up markets. The portfolio has been about 78% as volatile as the market. Pleasingly the returns have been higher than the market since the portfolio commenced, albeit market returns have been low over this period.

A portfolio of high quality stocks would usually appear more expensive than the overall market. In theory a more expensive portfolio would be expected to deliver lower than market returns, this is because lower risk should be accompanied by lower return. However many academic studies have indicated that there is an anomaly with respect to expected risk and return from equity portfolios in that lower risk portfolios have not delivered lower returns and in fact lower risk portfolios have for long periods delivered higher returns than higher risk portfolios.

There could be a number of reasons for this anomaly, including that it is just a random result, but we think it is more likely that the equity market is not that good at assessing future risks within stocks. If this is feasible, then based on history we believe a portfolio can exhibit lower risk without giving up too much return. It may even be possible there is no give up in return despite the lower risk taken on, however this would probably depend on being better able to avoid stocks that suffer major share price falls as risks emerge.

There are many things that can go wrong with any strategy, however we envisage the two major areas of potential concern for this approach are if the fundamental stock research fails to capture emerging risks adequately or if the portfolio contains too many stocks that are too expensive.

Amendment to Constitution

The Australian Government has enacted legislation which establishes a new tax regime for managed investment trusts that qualify as attribution managed investment trusts (“AMIT”). Cooper Investors intends to elect to apply the new AMIT regime from 1 July 2016. Under this new regime, taxable income will flow through to unit holders on an attribution basis, rather than a distribution basis and it will also facilitate Cooper Investors allocating realised capital gains arising from the sale of assets in order to fund a significant redemption to the redeeming unit holder. This is instead of a pro rata distribution of realised capital gains based on unitholdings.

In order for the Fund to be operated in a manner permitted by the AMIT regime, Cooper Investors has amended the Constitution of the Fund.