CI PENSIONS FUND
QUARTERLY REPORT

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

MARCH 2014

	**PORTFOLIO	#BENCHMARK	VALUE ADDED
ROLLING MONTH	0.96%	0.52%	0.44%
SINCE INCEPTION^	0.96%	0.52%	0.44%

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

Background to the Fund

The CI Pensions Fund was launched on 3 March 2014. It is a wholesale unit trust governed by its Constitution and Information Memorandum. The Fund is managed by Cooper Investors Pty Limited. Information on Cooper Investors and the Fund are available on the Cooper Investors website (www.cooperinvestors.com).

This is the first quarterly report and we would like to explain why we have launched the Fund, its objectives and how we intend to manage the Fund.

We decided to start the Pensions Fund for two main reasons:

- Over the past year a number of our clients have asked whether we have a product that would be more suitable for people in the pension phase. The basis for these queries is that most superannuation funds have an increasing portion of their total assets representing people in the pension phase and they are progressively moving to manage the pension assets separately from the accumulation assets. An increase in pension assets is almost certainly going to occur based on the demographics of the Australian population.

- After thinking more deeply about appropriate investments for people at different stages of their life, we felt that structurally an investment portfolio should change over a person's lifetime. As people become older they are less likely to be able to earn back any investment portfolio losses through salary and superannuation contributions, and therefore it follows that most people would want to move towards a lower risk portfolio as they age. As such the equities portion of a person's investment portfolio should also become more conservative as they age. This Fund will aim to have a more conservative approach than an average equities portfolio which is likely to be implicitly designed for people in the accumulation phase of their investment life.

The CI Pensions Fund is an equities portfolio and we expect that it would normally form part of an overall investment portfolio. Whilst the portfolio aims to exhibit lower volatility and perform relatively better than the stock market in down markets, it cannot avoid losses in down markets.

We are making an assumption that investors in the Fund are in the pension phase and therefore, under current taxation legislation, they pay zero income and capital gains tax (at least on their assets held in superannuation funds). There is also an assumption that investors will be able to claim Australian franking credits. As such, we will be reporting returns which include franking credits generated by the Fund and the benchmark (S&P/ASX 200 Accumulation Index) will be adjusted for franking credits. Investors who are not actually classified as being in the pension phase can still invest in the Fund. For instance, it may be also appropriate for a charity looking for a more conservative equities portfolio.

MARCH 2014

Portfolio Structure

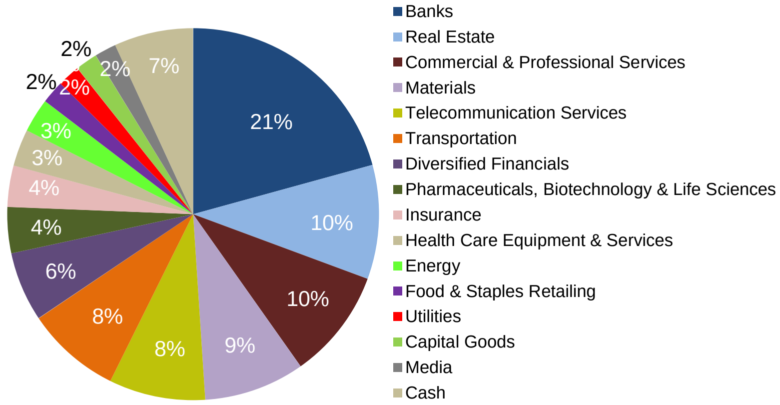
It is expected the Fund will operate within the following guidelines:

- generally hold between 35 and 40 stocks;
- hold up to 10 international stocks;
- be well diversified by number of stocks and sector diversification;
- generally hold less than 10% cash;
- have a bias to stocks that produce yield;
- generally not hedge foreign currency; and
- generally not hold individual stock positions at greater than 6% of the portfolio.

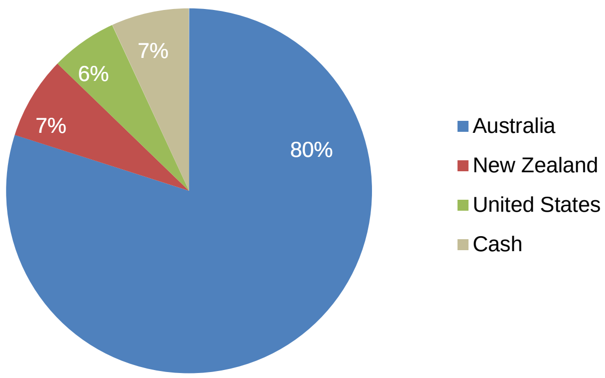
The current portfolio structure is as follows:

- 37 securities
- 3 foreign stocks representing 6% of the portfolio (not including New Zealand securities)
- Cash of 7%
- 3 hybrid securities representing 6% of the portfolio
- The four major banks are 21% of the portfolio
- There are three resource stocks representing 10% of the portfolio
- There are 3 property trusts that are 7% of the portfolio
- There are 5 infrastructure stocks that are 10% of the portfolio.

Sector weightings (GICS Level 2) as at 31 March 2014 were:



Country weightings as at 31 March 2014 were:



Portfolio Construction

Portfolio statistical analysis is undertaken by looking at stock monthly returns and correlations over the past four years. The current portfolio's statistical analysis indicates that the expected portfolio volatility is lower than the market and the beta of the portfolio is 0.85. This analysis does make an assumption that history is a useful guide to the future. We use this analysis to assist in portfolio construction but the portfolio is certainly not created using historical simulations or other financial engineering techniques.

Stock analysis is undertaken by the entire Cooper Investors investment team and the portfolio manager uses this information to create a portfolio designed to meet the investment risk and return objectives outlined in the Fund's Information Memorandum.

The portfolio's yield is currently 4.1%, including franking this grosses up to a 5.1% yield. The Fund will make quarterly distributions. Yield alone is not a primary aim as high dividends can sometimes be associated with an unsustainable capital structure or a financially engineered yield. We do prefer to own stocks where dividends are expected to rise over time.

Whilst the portfolio returns will be reported against the S&P/ASX 200 Accumulation Index (adjusted for franking credits), our explicit objective is that the portfolio will exhibit lower volatility than the market and perform relatively better in down markets. Finance theory postulates that a lower risk portfolio will deliver lower returns as investors expect to be rewarded for higher risk. While this may be the case, there are reputable studies that show, over a number of decades, that higher risk is not necessarily accompanied by higher returns. Or put another way, investors in higher quality, lower risk companies have in fact received both better returns and lower volatility. Whilst history may not repeat itself, we are aiming to deliver at least market returns but with less volatility and greater downside protection than the market.

The main way we hope to achieve these objectives is by constructing a portfolio with greater diversification than the overall Australian market. We believe greater diversification can be achieved a number of ways.

1. Uncorrelated stocks

The first way to achieve greater diversification is by constructing the portfolio with stocks that are as far as possible uncorrelated to each other. This is achieved by having stocks that operate in different industries, have a range of market capitalisations, operate in different countries, and have different capital structures.

For instance some hybrid securities offer reasonable yields but have much less downside risk than the market. To achieve this attractive risk and reward trade off each individual hybrid security needs to have a particularly attractive feature. The Fund owns the **Australand** hybrid security. If nothing changes this security will yield 7%, probably lower than the markets return, however, if Australand is taken over in the next year (as appears likely) the return on this security will rise to over 10%.

2. International stocks

The inclusion of international stocks allows the portfolio to have exposure to some industries that are not represented on the Australian market, as well as adding foreign currency exposure, both of which add some diversification benefits.

One of the international stocks held in the portfolio is **Johnson and Johnson (JNJ).** JNJ owns over 100 drugs in their pharmaceutical portfolio and manufactures medical devices and health care products such as Band Aids. None of these products or industries is represented in the Australian stock market. JNJ is one of the few AAA rated companies. It has net $11b of cash on its balance sheet and has 50 years of uninterrupted dividend increases. The historical correlation between JNJ and other stocks in the portfolio is very low. As the JNJ share price has been strong over the past few years, the low correlations indicate that JNJ has risen on average at different times than other stocks in the portfolio, thus its inclusion should help returns and lower the volatility of the portfolio.

It is noted that poorer performing stocks also have low correlations to other portfolio stocks but they would detract from the portfolio's returns, in other words the attraction of low correlations and diversification are only beneficial if the stock in question is a good performer.

3. Low weighting in the banking sector

The desire for diversification is also behind the portfolio having a relatively low weighting to **bank stocks**. The four major banks' share price correlations to each other range from 0.71 to 0.9. These are extremely high and show that their share prices all move by approximately the same amount at the same time. In practical terms, if something bad happened to the Australian banking sector it is likely that all four stocks would be affected similarly and their share prices would fall by broadly similar amounts. If the portfolio has say 40% in these bank stocks the effect on the portfolio would be severe.

The other main way to achieve the objective of protecting the portfolio downside is to avoid stocks that are:

- Over-valued;
- Over-geared;
- Facing industry head winds;
- Poorly managed;
- Too keen on acquisitions;
- Have poor track records; or
- Paying unsustainable dividends.

Stocks that exhibit some of the above features will look cheap, and stocks that do not exhibit these characteristics will appear expensive, so the craft in what we are aiming to do is balancing this continual trade-off between quality and price.

The ability to hold up to 20% of the portfolio in cash also offers some downside protection in weak markets. At the present time the yield on cash is 2.5%, so in normal markets the cost of holding a lot of cash is high. Therefore we would need to feel very nervous about stock markets before the cash weighting would rise above 10%.

As the portfolio commenced on 3rd March there is little to report on the performance of the Fund, other than that the return was 0.96% against the market return of 0.52%.