CI PENSIONS FUND

QUARTERLY REPORT

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

MARCH 2015

	**PORTFOLIO	#BENCHMARK	VALUE ADDED
ROLLING 3 MONTH	10.41%	10.83%	-0.42%
ROLLING 6 MONTH	18.50%	14.61%	3.89%
ROLLING 1 YEAR	20.86%	15.87%	4.99%
SINCE INCEPTION*	20.26%	15.18%	5.08%
SINCE INCEPTION^	22.01%	16.47%	5.54%

*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 and foundations 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 March quarter saw the continuation of trends that have been evident for a number of years.

Interest rates continued to fall in Australia, the Reserve Bank cut the cash rate by 0.25% to 2.25%. The 10 year Government bond rate fell by 0.41% to 2.32%, and over the past year this rate has fallen by 1.77%. Falling interest rates have had a profound effect on equities' pricing and differing performance between sectors.

Commodity prices continued falling with oil and iron ore being particularly weak, falling by 11% and 17% respectively. The Australian currency continued to fall against most currencies, and this has provided some relief to the economy and benefitted companies who have substantial overseas operations.

The Australian stock market performed strongly, rising by over 10% over the quarter. There was a wide dispersion of sectors and stocks that rose strongly, whilst the energy sector and smaller resource related companies posted the worst returns.

The portfolio returned 10.41% for the quarter and 20.86% for the year, while the market returned 10.83% and 15.87% respectively.

Stocks that performed particularly well over the quarter included Regis Healthcare, Energy Developments, TPG Telecom and Macquarie Group, all of which rose by more than 30%. Poorer performers included Amcom, Oil Search and Woolworths.

The monthly performance of the portfolio and the market is set out below.

Month	CI Pensions Fund	ASX 200 Accum	Relative Performance
Mar-14	0.96%	0.52%	0.44%
Apr-14	1.07%	1.78%	-0.71%
May-14	1.07%	0.93%	0.14%
Jun-14	-0.79%	-1.49%	0.70%
Jul-14	2.00%	4.40%	-2.40%
Aug-14	0.85%	0.94%	-0.09%
Sep-14	-2.17%	-5.19%	3.02%
Oct-14	4.05%	4.43%	-0.38%
Nov-14	-0.16%	-3.00%	2.84%
Dec-14	3.32%	2.07%	1.25%
Jan-15	2.60%	3.28%	-0.68%
Feb-15	6.35%	7.15%	-0.80%
Mar-15	1.18%	0.15%	1.03%

Note: Before fees and expenses and adjusted for franking credits

On a daily basis the portfolio has consistently performed better than the market on down days. During the March quarter the portfolio performed better than the market on 24 of the 26 down days and since inception the portfolio has performed better than the market on 108 of the 123 down days.

One way of analysing the volatility of the portfolio is to calculate the standard deviation of daily returns. Since inception the portfolio's standard deviation has been 0.51 compared with the market's standard deviation of 0.73.

The Portfolio

We included **AMP** in the portfolio during the quarter.

AMP is one of Australia's leading financial institutions with a wide array of businesses including wealth management, life insurance, banking and funds management. Its operations are primarily in Australia and New Zealand and it has a number of interests in China and Japan.

For many years AMP was dealing with head winds including exiting the UK, changing regulations, increasing capital requirements and, more latterly, the integration of the AXA businesses it purchased in 2011. We believe that AMP's management did a good job addressing and dealing with these issues, however they did impact on the financial results and meant the share price was relatively weak.

In 2014 AMP announced a new leadership team with Craig Mellor appointed as CEO in January and Simon McKeon appointed Chairman in May. It appears to us that AMP is much more confident of its future now and that it is getting on the front foot more than it has been able to in the past. Evidence of this assertion can be seen in the investments the company has made in wealth management businesses in China and Japan, the proactive position it has taken in improving its financial planning businesses and in changing the commission structure in life insurance.

We believe that AMP has most of the building blocks to enable it to emerge as a leader in the financial services industry and that it should be better placed than the banks in wealth management in particular. One thing we can be sure of is that the financial needs of Australians will increase substantially as the population ages and AMP should be able help people achieve financial security.

We believe that AMP will add to the portfolio's diversification as we have no other pure stock exposure to the superannuation and wealth management industries.

We also added **Diversified United Investments (DUI)** to the portfolio. DUI is a listed investment company that was established in 1991. DUI manages an equities based investment portfolio worth approximately $850m. The portfolio is mainly invested in high quality Australian companies and in the last year DUI has added an international equity component of around 10%. The objective of DUI is to increase its income through portfolio diversification, professional management and within an acceptable level of risk. DUI has increased its dividend per share reasonably consistently since it was formed.

We purchased DUI at a discount of 9% to its net tangible assets which is a relatively wide discount and much wider than the discounts at which other high quality listed investment companies trade. We believe that the discount to net tangible assets provides some protection in weak markets.

No stocks were sold from the portfolio during the quarter.

Stock News

Cromwell announced the acquisition of Valad Europe from Blackstone Real Estate Partners for a price of A$208m (EUR145m), representing an EBITDA multiple of 6.4x. The transaction will be funded by the issue of EUR150m (A$216m) of Euro denominated convertible bonds, which will be naturally hedged by Euro denominated earnings.

The acquisition will lift the funds management contribution to earnings from 5% to 14%, a material step towards Cromwell's aspirational target of 20% of earnings to come from funds management. Similar to Cromwell, Valad Europe invests mainly in Core Plus type properties, with asset allocation evenly split between retail, office and industrial assets. We understand that the Cromwell CEO has known the Valad Europe Chairman for over 20 years. The acquisition should lead to an increase in Cromwell's distribution profile, however this comes with an increase in both complexity and in debt levels.

In one of the largest sell downs on record in Australia, Chevron sold its 50% stake in **Caltex (CTX)**, worth $4.7B, in one fell swoop at a discount of circa 8% to the then prevailing Caltex price. It should have come as no surprise to the market in light of Chevron's well publicized strategy to sell non-core assets in order to realise cash in the current oil price environment. This will give Caltex the opportunity to accelerate the distribution of the $1B+ of franking credits on its balance sheet, which up to now have proven difficult to give to shareholders in light of the presence of a majority shareholder who had no interest in franking credits. We expect to see some action in this regard at the half year result later this year.

Macquarie Group announced the acquisition of a portfolio comprising 90 aircraft from AWAS Aviation Capital for a purchase price of USD$4B. The deal is to be earnings per share and ROE accretive. We participated in the placement of shares issued to fund the acquisition. The deal is firmly within Macquarie's areas of competency, complements the company's existing aircraft leasing portfolio, adds these aircraft to the AUD$29B of assets and loans under management across sectors including motor vehicles, mining equipment and real estate. Macquarie has a long and successful track record in aircraft leasing dating back to the late 1980's when it arranged leasing for airlines such as Qantas.

CSL conducted a site tour in the US at a plasma testing laboratory in Knoxville Tennessee, their Kankakee facility in Chicago, as well as a nearby plasma collection centre. The tour highlighted the continued focus on automation and efficiency, behaviour which appears to be deeply ingrained in the cultural DNA of the company. Immunoglobulin (IG) industry growth appears to be stable at 6%-8% per annum and nominal pricing increases will be put through during the year. CSL is also expanding capacity across its operations to meet expected future demand for their products. While there have been some concerns in recent years over industry capacity expansion, our impression was that CSL is confident about both its strategic planning and industry growth drivers. CSL is continuing to increase its plasma collection centre footprint to help feed its expanding capacity – as the CEO often remarks "you need the juice!" In terms of the R&D pipeline, management seemed quite upbeat on the outlook for its recombinant products as well as the ongoing growth of its specialty product franchise. Overall, we came away thinking that the CSL story remains very positive and note CSL has one of the best track records of any company in Australia.

We visited the **Transurban** operations in Virginia, which comprise the 495 Express Lanes toll road and the 95 Express Lanes toll road which opened in December. The operating momentum in Transurban's US assets appears to be improving and there are opportunities to enhance and expand the network.

The dynamic tolling used on Transurban's US toll roads is fundamentally different to traditional toll roads, whereby the busier the road the higher the toll price. Under dynamic tolling the customer proposition is centred around time saving (i.e. avoiding congestion) and reliability. Management noted they receive positive customer feedback when tolls are high because of the significant value customers derive from reliable and quick transit times. We wonder about the potential for this model to be exported to Australia in future years to help manage our congested road infrastructure. The US business should continue to move its EBITDA margin towards the Group average and we would expect improved free cash flow generation as the roads mature.

Summerset Group (SUM) reported its 2014 full year results which showed a step-up in operational performance as it opened four new villages and three new care facilities. SUM is on target to meet its build target of 300 units per annum this year and should at least meet its medium term development margin target of 17% this year. Our impression is that SUM is making good progress on growing its development expertise, which is critical for its self-funding business model and our investment proposition. While 2014 was a transition year for SUM, we expect that 2015 and 2016 should deliver step-changes in earnings growth as the groundwork laid over the last couple of years starts to bear fruit.

Strong demand for SUM's product is necessitating that development is brought forward, which has resulted in an increase in gearing. While SUM has no core debt, it does have working capital and development debt, which should run down over time as villages are sold and occupied. If SUM stopped development the debt would run down quite quickly, which means the debt is less problematic in a dire circumstance than debt in the average company. In addition, we gain comfort from the needs-based nature of their business, which we believe will make it more resilient in the next downturn compared with a 'lifestyle' business.

Retirement Income

In the December 2014 quarterly report we included a section on retirement incomes that noted the observation by Professor William Sharpe (winner of the Nobel prize in Economic Sciences) that "it's a really hard problem - the hardest problem I've ever considered because it's multidimensional". We concluded by commenting that there is unlikely to be one silver bullet solution to the retirement income issue and that the debate is far from finished.

The intensity of the debate is certainly increasing and is becoming even more complex and multi dimensional. Of interest, in particular:

- The Financial System Inquiry has only just closed for final submissions. This inquiry was centred around banking regulation, however it did make comments on superannuation and retirement incomes.

- The Treasurer has foreshadowed a comprehensive review of retirement incomes and the Secretary of the Australian Treasury has also strongly suggested a fundamental rethink of the system is needed given the changing interactions between superannuation, tax and the welfare system since the current superannuation system was introduced in 1992.

- The Intergenerational Report and a Tax Discussion Paper were also recently released which provide detailed information on topics such as the implications of the ageing of the population and the consequences of the current taxation model.

- We have also had many business groups and business leaders becoming more vocal and discussing the issues facing the Australian financial system.

- A new forum called the Committee for Sustainable Retirement Income headed by a former Secretary of the Department of Prime Minister and Cabinet has been established. This group says that it is going to undertake the first comprehensive review of Australia's retirement income system.

- The Head of Australian Super, Australia's largest superannuation fund, wrote an editorial piece in a newspaper recently lamenting the fact there have been 66 reviews around superannuation since the current system was introduced in 1992.

From a self funded retiree's perspective, the major issues to be concerned about include possible changes to tax on retirement income, changes to the dividend imputation system, changes to access to the aged pension and concession cards and changes to the treatment of housing and access to aged care.

It seems likely that there will be a proper Government endorsed review into retirement incomes. If that occurs, we hope that it will be conducted by a Committee separate to Government and that it receives bipartisan support from the major political parties.

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