BMO Pyrford Global Absolute Return Fund (AU$)

ARSN 168 994 205

For wholesale investors only

Q2 2019 Commentary

Performance The fund returned +2.43% over the quarter. Since inception in June 2014, the fund has delivered +5.15% per annum. All returns quoted above are net of fees.

The aim of the fund is to provide a stable stream of real total returns over the long term with low absolute volatility and significant downside protection.

Market Commentary Given all the political unrest throughout the world and the American-led attack on the global trade status-quo it is surprising that equity markets have remained relatively calm. No doubt they anticipate further central bank easing, including the start of a downward leg in rates set by the US Federal Reserve and a fresh bout of quantitative easing. We don't disagree – all of this is likely to occur, but it emphasizes the weak state of the global economy. Demand is sluggish and capital investment inadequate. Productivity growth is well below historic norms. Corporate earnings growth will undershoot market expectations, and this will eventually bite on equity valuations. Perhaps that is when the bond and equity markets will reach agreement.

Bond yields at the 10-year benchmark level are now, on average, at their lowest point in modern economic history. The movement in these markets is little short of astonishing. The market value of negative yielding bonds has now surged above US$11 trillion. Bond yields are so low they suggest the world economy must be in a state of collapse. Contrast the fixed interest markets to equities which have been strong over the last few years. The dichotomy is marked but it is difficult if not impossible for both markets to be right.

The major news during the quarter continued to centre on the trade dispute between the US and China. At the time of writing Mr Trump has deferred but not cancelled the latest round of tariff increases which would have impacted virtually all Chinese exports to the US. As things stand there is a 25% tariff on approximately US$200 billion of Chinese goods with a further US$300 billion (approx.) pending. The top three imports affected are telecommunications equipment, computer circuit boards and processing units.

Key Drivers & Detractors The key driver of returns over the quarter was the equity allocation with both overseas (+5.4%) and domestic Australian equities (+5.4%) posting strong returns.

Within the overseas equity allocation, our telecom names were notable contributors as investors searched for yield. Axiata (Malaysia) reacted positively to news they are planning to merge the majority of their Asian operations with Telenor's (also owned) operations in the region to create the biggest operator in South East Asia If the deal is approved it will provide the opportunity for greater cost efficiency and the potential to optimise marketing activity. KDDI (Japan) saw its share rise as they announced a 150bn JPY buyback and a commitment to increase payout ratio above 40%. KDDI had been under pressure from NTT Docomo and Rakuten but the market is pleased that they have responded in a restrained way with new pricing plans.

The domestic equity portfolio lagged the MSCI Australian Index by 3.3%. Negative contributors included Computershare and QBE Insurance. Computershare recently entered the mortgage servicing market for challenger banks. In the UK they are running dual platforms to allow for security tests to be administered by new clients which will increase initial costs in the near term.

Newcrest Mining, one of the world's largest gold producers, rose as the gold price hit a six-year high as investors fled to safe haven assets. Operationally, Newcrest continued to show stability as cost controls exceeded market expectations.

Brambles completed the sale of its IFCO (plastic food crate) operation to a subsidiary of the Abu Dhabi Investment Authority for US$2.5bn, a price higher than the market was expecting. The completion saw the start of a buyback program which underpinned support for the stock.

The sovereign bond portfolio also posted positive returns over the period. After a volatile year bond yields tightened further though short duration bonds tightened less than the wider market. Pyrford's Australian bonds were up 0.7% over the period compared to the wider market which rose 3.6%. Whilst we gave up some performance by being short duration, our priority is to protect capital from an expected increase in yields.

Enquiries

BMO Global Asset Management

Level 29, 2 Chifley Square, Sydney, NSW 2000

Telephone: 02 9293 2804

Email: michael.angwin@bmo.com

Email: jonathan.goll@bmo.com

BMO Global Asset Management

Pyrford

Our overseas sovereign bond allocation (US, Canada and UK) rose 1.8%. Currency provided a supportive tailwind for our Canadian bond allocation though GBP weakness reduced the contribution from our UK bond allocation.

The contribution from our US bond allocation was supported by the USD strengthening against the AUD. However, we have hedged our USD exposure meaning the overall effect of currency hedging was negative.

Asset allocation & positioning

In the quarter, there were no asset allocation changes made to the portfolio.

Pyrford remains defensively positioned. Our current allocation remains 62% government bonds, 35% equities, and 3% cash, reflecting our continued view that there is little fundamental value in either equities or longer duration quality sovereign bonds.

In bonds, Pyrford continues to adopt a defensive stance by owning short duration securities in order to protect the capital value of the portfolio from expected rises in yields, as witnessed in the quarter. At the end of the period, the modified duration of the fixed income portfolio stood at just 1.3 years. There was no change to the geographical allocation of the fixed income portion of the portfolio.

The equity portfolio remains positioned in defensive sectors such as utilities and telecommunications. These sectors offer predictable revenue streams and attractive valuations. The focus of the portfolio is on balance sheet strength, profitability, earnings visibility and value. In Asia, we have a preference for the Southeast Asian markets over Japan as the economies in Southeast Asia offer sustainable economic growth supported by increased labour output or productivity growth and trade at more reasonable valuations.

There was also no change to the portfolio's currency hedging exposures. The portfolio targets exposure of no more than 45% to non-AUD, unhedged currencies. Currently only the US dollar exposure of the portfolio is hedged to meet this target.

Quarterly ESG & Voting Summary

As long-term shareholders of companies, we have the ability, and in our view the responsibility, to try and influence the business practices of companies.

Pyrford voted 1,022 ballots in 72 company meetings in the quarter. We voted against management in 50% of meetings. We also engaged with 79 companies worldwide and ESG issues are a standing agenda item in every meeting we conduct.

For a detailed overview of ESG activity, please visit our website for all voting records and our latest annual ESG report.

Firm Update

In May we had one departure from the investment team as Bethan Dixon, who joined as an investment analyst 4 years ago, left the firm. Bethan provided research support for Australia, New Zealand, India and Malaysia. As a junior member of the Asia investment team, Bethan had no discretionary stock selection responsibility. We will fill the vacancy left by Bethan's departure in due course.

Firm AUM at the end of the period was AUD$ 16.2bn. Given we invest in large cap, liquid securities across all of our strategies; we are able to make investment decisions in a timely manner and at low transaction costs. We are not capacity constrained.

N.B. Returns are quoted in AU$ unless otherwise stated.