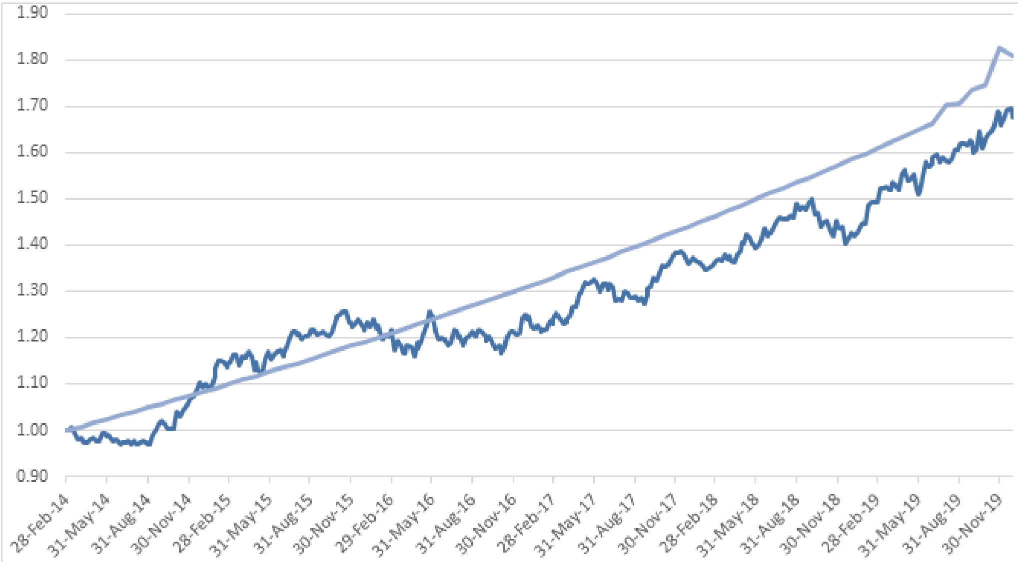
Clime International Fund

Quarterly Report December 2019

The Clime International Fund (CIF) aims to provide consistent capital growth and income over the long term (5-7 years) by investing in international securities. The Fund is intended to be a medium to high-risk fund, however the ability of the Fund to hold a significant cash position allows for capital preservation and the delivery of a smoother return profile. The Fund seeks to deliver a return in excess of the MSCI World Index.

Quarter Net Return (Wholesale)*	1 - Year Net Return (Wholesale)*	Inception p.a. Net Return (Wholesale)*	Total Fund Size
3.3%	18.0%	9.6%	$105.6m



	1 month	3 months	6 months	1 year	3 years*	5 years*	Inception*
Fund Net Return (Wholesale)*	-0.5%	3.3%	6.4%	18.0%	11.1%	9.3%	9.6%
Benchmark^	-0.9%	4.2%	9.0%	14.2%	11.4%	10.8%	10.7%
Excess Return	0.4%	-0.9%	-2.6%	3.8%	-0.3%	-1.5%	-1.1%

Inception: Wholesale Units: 4 March 2014. Retail Units: 11 March 2015.
*Performance figures for more than 1 year are annualised, calculated after all applicable fees and taxes. Performance figures compare unit price to unit price for the given period.
^10%p.a. from 4 March 2014 and then MSCI World Net Total Return Index in AUD from 1 July 2019.

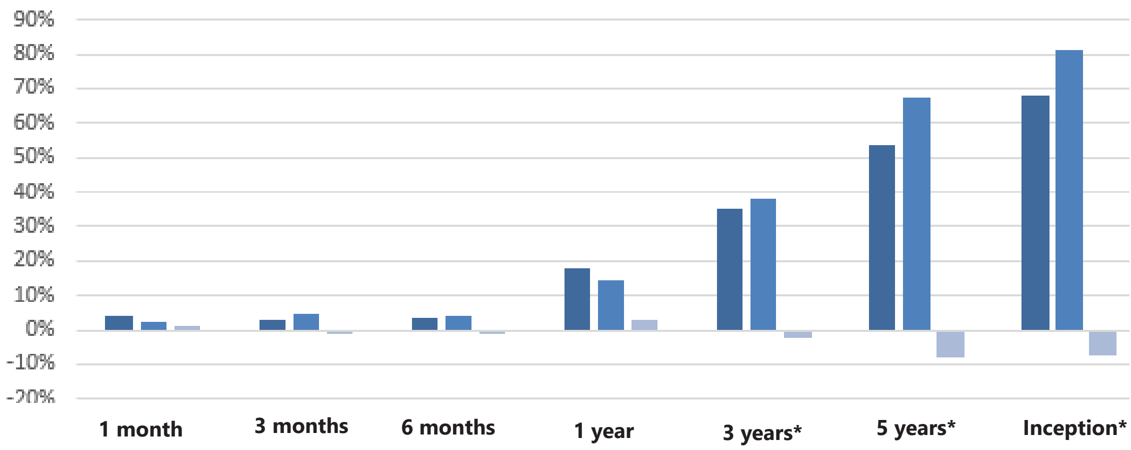
Fund Facts

Portfolio Managers	Pieter Fourie
Fund Inception	March 2014
Fund Size	$105.6m
Cash Distributions	Annually
Eligibility	Wholesale & Retail

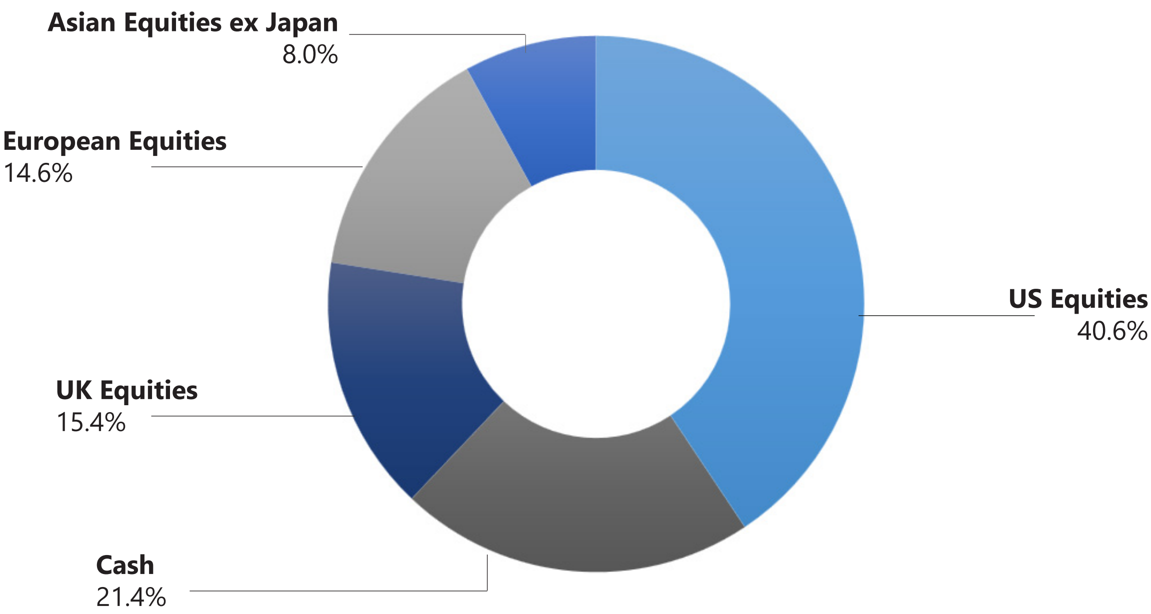
Top 5 Holdings

Company	Sector	Weight %
SDPR Gold Trust Gold Shares	Cash Proxy	5.3%
Bayer	Health care	4.5%
Medtronic	Health care	4.3%
Alphabet	Communications	4.2%
Tencent	Communicaions	4.2%

Fund Performance



Asset Allocation



Top Performers over the quarter

Total returns in AUD from 30th September 2019 to 31st December 2019	
Lloyds Banking Group	19.7%
Standard Life Aberdeen	19.0%
Sage Group	16.3%

Weak Performers over the quarter

Total returns in AUD from 30th September 2019 to 31st December 2019	
Yum! Brands	-14.3%
Oracle	-11.7%
Unilever	-7.1%

Positions Purchased

Bought ABI Inbev

We initiated a position in Anheuser-Busch InBev during November. Having underperformed both global equity markets and its competitors over the last 4 years we believe that investors might be too pessimistic about ABI at current share price levels.

With ABI trading at a 7% free cash flow yield and free cash flow set to grow by at least high single digits on a compounded basis over the next few years we find the stock attractive at current levels.

As the biggest beer brewer in the world ABI's vast global scale and near-monopoly dominance in several Latin American and African markets gives ABI significant fixed cost leverage and pricing power. These cost advantages plays out in the firm's excess returns on invested capital and best-in-class operating and cash cycles, asset turnover ratios, and working capital management.

ABI's balance sheet leverage has been a considerable concern for investors since the SABMiller acquisition in 2016, and led to the halving of the dividend last year. We believe management's target of lowering net debt to EBITDA to at or below 4 times by the end of 2020 is achievable without a further dividend cut. With a free cash flow to the firm run rate of $12 billion, and around $4 billion paid out in dividends, we believe 2.5 times net debt/EBITDA is achievable within five years.

Bought General Dynamics

We initiated a position in General Dynamics (GD) during December.

General Dynamics are the world's biggest producer of large-cabin business jets.

Their other main division is made up of three defence related parts and reports via three segments: Combat Systems, Marine Systems, and Information Systems and Technology (IS&T).

They are leaders in each of the divisions they operate in which aids consistent contract wins.

Defence spend in both the US and internationally is set to rise in the coming years which should allow for revenue growth and margin expansion.
In Combat we are confident that General Dynamics can continue to win big contracts abroad and we expect the backlog in Marine to remain at elevated levels for years to come.

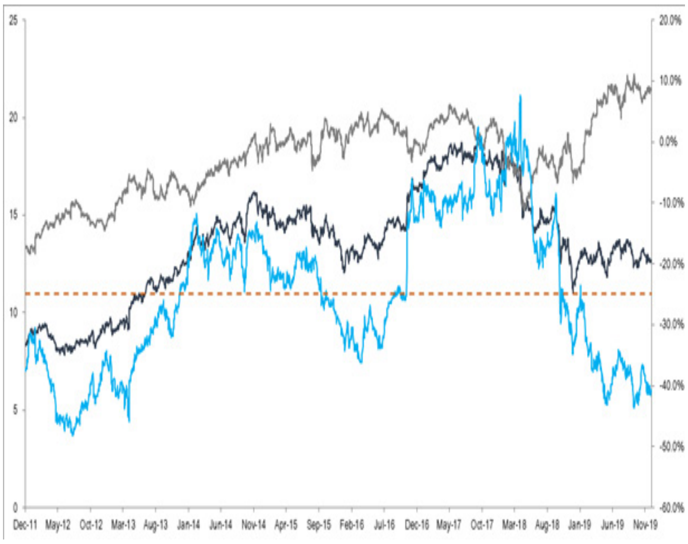
One of our concerns in 2016 when we first analysed the company was the company's ability to manage their margin during a product upcycle in their aerospace division, Gulfstream.

Now this is behind us, we think that the discount that GD trades at versus it's large-cap US defence peers is unwarranted.

Debt increased last year due to an acquisition they made in IT services but a 2020 free cash flow yield of 6.8% will mean speedy debt reduction. We forecast high mid-single digit compound growth in free cash flow over the medium term.

If we compare the valuation of General Dynamics to a typical consumer staple name like Pepsi (which was sold last year) we notice the valuation is at a multi-year relative low

Even though General Dynamics has a more cyclical earnings stream than a business like Pepsi, we believe that the risk rewards is now in favour of the former versus the latter



Positions Sold

Sold Life Aberdeen

Standard Life Aberdeen was sold after a 43% rally this year.

Sold Lloyds Position

Lloyds was also sold after a 37% rally in 2019.

Both Standard Life and Lloyds entered the year with low valuations and weak sentiment.

Now that the market has discounted higher bond yields we believe the upside in these names are limited.

Portfolio Commentary

Outlook for the US: Despite economic growth slowing in 2019, the outlook for 2020 remains positive. Unemployment is at a 50-year low, which is driving consumer confidence, and an easing of monetary policy continues to give business a much-needed boost. That said, the autumn presidential election has the potential to unsettle markets, as could persistent political posturing around US-China trade negotiations. Any volatility may present tactical investment opportunities, but we will largely continue to invest in businesses with strong balance sheets that are well-positioned to deliver returns in a slow growth economy.

Outlook for the UK: Despite the Conservatives regaining power in the general election, there is a long way to go in resolving the Brexit issue. Even assuming the UK leaves Europe on the 31st January as currently planned, it will be some time before the dust settles on trade negotiations and new business regulations. Domestic stocks will continue to be under-valued, which could present short term opportunities, but we will continue to focus on businesses that are well-positioned to weather the storm and are not entirely domestically focused.

Outlook for Europe: European monetary policy continues to be a source of concern for investors. Negative interest rates have not helped to kick-start the economy, and a change in leadership at the European Central Bank (ECB) has so far made little impact. Europe's manufacturing sectors continue to suffer due to a decline in demand from emerging markets, and the domestic market has also softened. It's hard to see a compelling reason to invest heavily in Europe. Perhaps the ECB's proposed strategic review of monetary policy – the first of its kind since 2003 - will bring some better news in 2020.

Outlook on Emerging Markets: The US-China trade war, political unrest in Hong Kong, and concerns over the state of the Chinese banking system continue to bear down over emerging markets. The global easing of monetary policy should benefit this region in 2020, though – particularly if it stimulates global growth and consumer demand. Emerging markets have strong prospects for demand growth as consumers benefit from economic development. Exposure to this theme however can be achieved through global companies listed in developed markets.

Pieter Fourie
Portfolio Manager

Market Commentary

The S&P/ASX 200 Accumulation Index delivered a strong 23.4% return in 2019, while the S&P/ASX Small Ordinaries Accumulation Index delivered a return of +21.4% for the year. Though impressive, the ASX actually lagged most other developed countries sharemarkets. The healthcare and technology sectors performed particularly well, but the large banking sector was relatively weak.

A point made on Clime's end of year roadshows was the bifurcation in domestic earnings trends. Earnings revisions were in aggregate negative for the year, with initial projections for large capitalisation company earning growth receding from 8.8% to just 1.7% for FY2020. Smaller company earnings expectations remain significantly more robust, reinforcing our positive stance on an 'All Cap' approach to Australian equity investing, one focused on quality with strong valuation discipline.

Central bank policy and interest rate settings were significant drivers of risk asset returns during 2019. The Federal Reserve's dovish 'pivot' in early 2019, whereby the trajectory of US interest rates pivoted from higher to lower, calmed markets after a tumultuous December 2018 quarter and set investors up for a productive year.

It is however notable that much of these returns were generated in the first half of the calendar year, with mediocre domestic earnings trends and somewhat stretched valuations combining to halt the advance of Australian shares as the year progressed. The S&P/ASX 200 Accumulation Index delivered returns of 0.7% and 3.1% for the December quarter and six-month period respectively.

While financial markets are strong, economic fundamentals remain relatively soft. Since the start of 2019, Australian consumers have benefited from three interest rate cuts, tax cuts, strong commodity prices and a bottoming in the housing market. Nevertheless, wages growth has been absent, consumer confidence weak, and retail spending flat. Drought, bushfires and "eco-anxiety" have certainly not helped, and further revelations about banks behaving badly coupled with recent soft profit results have soured the mood of bank shareholders.

Downturn ending, but recovery weak

Financial markets experienced an upbeat year end, signalling rising optimism; this was somewhat surprising, coming only a few weeks after the IMF described the global economy as "precarious". Indeed, 2019 looks likely to post the weakest global economic performance for a decade. This reflects rising US-China trade tensions, their dampening impact on exports, industrial production, and a global manufacturing recession; yet investors are appearing to see green shoots of recovery next year.

The IMF and other forecasters expect to see an improvement in 2020, but mixed data in recent weeks raise the question whether the outlook is much improved. It is possible that investors' enthusiasm may be overblown. So far, the evidence of a robust recovery in the global economy is unconvincing; while most data suggest the slide in the global economy is coming to an end, the pace of recovery in the new year is expected to be weak.

Financial markets are forward-looking, generally catching on to trends before they become obvious in the economic data. Markets have been pointing towards a broad recovery, and many are close to all-time highs. There are two broad explanations for this: firstly, there are few alternative investments available, with rates so low; and secondly, investors expect that prospects for corporate profitability have improved in recent months.

Government bond yields, usually a good indicator of economic momentum, have risen slightly across advanced economies. Global trade is showing signs of stabilisation. Much of the nervousness regarding the global economy in the last quarter of 2019 stemmed from the fear that global trade wars would intensify. Yet during the last couple of months, the news has been mostly positive.

A disruptive no-deal Brexit now looks less likely, and while tensions between the US and China ebb and flow on a daily basis, the most recent news suggests a deal will be signed in coming weeks. We expect ultimately it will be in both sides' interests to agree to a deal. A recent uptick in Middle East tensions following the US assassination in early January of a leading Iranian general may however create further market volatility: we noted spikes in the oil and gold prices following this development.

More positive trends have become visible in global trade data, with volumes growing in recent months. In November, investment bank JP Morgan noted that its index of global purchasing managers' orders improved by the largest amount in four years — albeit from a low base.

Australian Economy

Going into the new year, the Reserve Bank of Australia continued to provide an upbeat refrain: the Australian economy is benefiting from low levels of interest rates, tax cuts, spending on infrastructure, the upswing in housing prices, and a brighter outlook for resources. Given the significant reductions in interest rates over the past six months and long lags, the RBA made its intention clear to hold the cash rate steady as it assesses the growth momentum both here and elsewhere around the world.

The RBA is "committed to maintaining interest rates at low levels until it is confident that inflation is sustainably within the 2 to 3 per cent target range". It sees the central scenario for the Australian economy for economic growth to pick up and reach around 3% in 2021. This pick-up in growth should see a reduction in the unemployment rate and a lift in inflation. However, we point out that the RBA has consistently been too optimistic in its growth forecasts.

Nevertheless, the important statement for the markets remains the following: "Interest rates will remain low for an extended period – certainly, much lower, on average, than before the global financial crisis", as stated by Governor Lowe.

Australia's service and manufactured exports have continued to grow steadily, supported by a depreciation of the Australian dollar over the past year, reasonable growth in our trading partners and, in the case of service exports, an increase in student and tourist arrivals. However the support provided by a declining currency may be coming to an end – the AUD looks like it bottomed at around US$0.67.

One downside risk to the Australian economy is housing construction activity. A larger-than-expected contraction in investment could delay the gradual improvement in GDP growth. In the year to the end of September, the economy managed to grow at just 1.7% - well below the long-run average of around 3.3%. Looking forward, the outlook is more balanced. Mining activity has some upside risk. That said, the overall outlook for the Australian economy is unexciting, and the devastating bushfires around the country coupled with a general lack of rain will probably have a depressing effect on consumer spending.

Mixed picture overseas - trade war cools

Somewhat against expectations for an early resolution, the trade war between the US and China intensified during the course of 2019, although recent announcements suggest at least a partial "Phase One" resolution. Yet it remains possible that trade disputes could flare once again, and in such circumstances, many companies may be forced to make disruptive adjustments which threaten to spill over into the broader economy.

A serious and protracted trade-war could cause a global recession, but most forecasters and economic indicators still suggest this is improbable. Tariffs, like other disruptions (such as an oil shock) could become inflationary, a dangerous accompaniment to a slow global economy. To date, the most obvious effects of the trade war have been declining business confidence, a global manufacturing slump and lacklustre investment trends. Inflation expectations have been steadily falling, as have long-term interest rates.

International trade tends to be a good barometer of how the world economy is doing and where it is headed. This is why twists and turns in the US-China trade war, and other developments in world trade, receive so much attention.

What do recent trade data portend?

Much will depend on US trade policy and the political cycle, and whether the Trump administration chooses to settle or further escalate its trade disputes, not just with China, but with other major US trading partners.

International trade volumes tend to grow in line with or slightly faster than global GDP growth. The World Trade Organization late last year slashed its forecast for global trade growth in 2019 from 2.6% to just 1.2%. For 2020, the forecast has been cut from 3.0% to 2.7%. The Baltic Dry Index, a closely-watched indicator based on bulk commodities shipping that serves as a reliable indicator of future trade activity, has fallen by nearly 50% since August (after doubling in the first eight months of the year), suggesting hopes for a rebound in global trade may be unduly optimistic.

The level of uncertainty about macroeconomic growth prospects, exacerbated by trade tensions, has driven down business investment around the world. This has had adverse effects on cross-border trade of machinery and equipment. While household consumption has remained strong in most major economies, due to high levels of employment, the stagnation of trade portends a weakening in this key driver of GDP growth.

Slow global growth means that economies need ongoing stimulus. The US Federal Reserve has already cut interest rates aggressively, the European Central Bank has re-started quantitative easing, and Chinese and Japanese policymakers have eased both monetary and fiscal policy. Yet developed world central banks are running up against limits on monetary policy: rates in many places are already negative or close to zero, central banks cannot buy bonds for ever, and the Fed has little room to cut rates further.

The USA

In the US, the seasonally adjusted manufacturing Purchasing Managers' Index posted 52.6 in November, up from 51.3 in October, to signal the strongest improvement in the health of the manufacturing sector in 6 months. US manufacturers have been under pressure amid slower economic growth globally, while prolonged trade negotiations between the US and China have weighed on business confidence.

November & December data indicated a slightly faster rate of improvement in operating conditions across the US manufacturing sector. Overall growth was supported by expansions in production and new orders, with both domestic and foreign client demand strengthening. Manufacturers also increased their workforce numbers. Yet business confidence remained muted as global economic uncertainty continued to weigh on expectations.

The manufacturing sector's struggles contrast with the larger services sector, whose growth accelerated in October versus the prior month, and upbeat consumer spending signals, creating a mixed bag of US economic data. Overall the US economy grew at an annualised rate of 2.1% in the third quarter, compared with 2.0% in the previous quarter.

China

Factory activity in China unexpectedly returned to growth in November for the first time in seven months, as domestic demand picked up on Beijing's accelerated stimulus measures. But gains were slight, and export demand remained sluggish. More US tariffs loom while Beijing and Washington are still haggling over a trade deal. With China's economic growth cooling to near 30-year lows and industrial profits shrinking, speculation has been mounting that Beijing needs to roll out stimulus more aggressively, even if it risks adding to high debt levels.

On New Year's Day, Beijing announced that the People's Bank of China would inject about US$115 billion into the economy by freeing up banks to lend more money. This stimulus is relatively modest given the overall size of the Chinese economy, but the timing suggests that the Beijing leadership is on high alert for any signs of further slowdown.

Recent developments in China underscore rising uncertainties in the trade conflict, which bodes ill for the outlook for external demand. New export orders fell for an 18th straight month in November, albeit at a slower pace. China's GDP growth in the year to end September was 6.0%, the slowest rate since 1992. China's gross domestic product growth is expected to slow further in 2020 – albeit off a much larger base.

Europe

Eurozone economic growth has been barely positive for the last 6 months; it was 0.2% in the third quarter of 2019, the same as in the previous quarter. Among the Euro bloc's largest economies, Germany narrowly avoided entering recession in the third quarter, largely driven by public and private consumption, while GDP growth rates were unchanged in France, Italy and Spain. The GDP growth rate in the Euro area has been moribund for 25 years: it has averaged just 0.4% pa from 1995 to 2019.

Christine Lagarde, the new president of the European Central Bank (ECB), speaking before members of the European Parliament's Economic and Monetary Affairs Committee, tried to explain why. The problem, she explained, is that "the world economy outlook remains sluggish and uncertain. This lowers demand for euro area goods and services and also affects business sentiment and investment."

As a solution, Lagarde offered that the ECB could "respond effectively even when growth is being dampened by external factors... by ensuring favourable financing conditions for all sectors of the economy and providing visibility on those conditions into the future." Presumably, this means that she wants to help banks get credit flowing strongly. One wonders, however, if this is anything different from her predecessors.

Conclusion & Outlook

What will 2020 bring?

What are our expectations for next year? We will have more to say in due course, but for now, we highlight in abridged and point form our thoughts.

The developed world has entered a period of Japan-style low growth. Thus, we expect the following:

• Periods of low growth to remain followed by mild downturns
• Bond yields stay low, the yield on quality assets is bid lower, followed by yields falling for inferior quality assets
• Equities are bid up (PE expansion) as required returns decline, albeit to a smaller extent than CY2019, and the time horizon is extended to value high growth opportunities, and
• Volatility increases but quality stands out and will generate superior returns.

A recession in 2020 is not probable. In many countries, especially America, healthy labour markets and confident consumers are bulwarks against a recession occurring. Yet these defences are beginning to show some vulnerabilities. In a worst-case scenario, the trade war intensifies, and becomes inflationary even as growth slows. The world economy in such circumstances could be subject to an unfamiliar type of downturn, with central banks out of ammunition.

The recent modest uptick in data does not yet provide convincing evidence for a broad-based global recovery. While we expect global growth to edge up over the course of 2020, the pace of recovery will probably be weak, and monetary and fiscal policies will have to remain accommodative. There needs to be a lot more movement in the data before economists will join financial markets in believing the worst of the global economic slowdown is over.

With this noted, investor sentiment is far from exuberant. As John Templeton said, "Bull markets ... die on euphoria". Currently, although markets are somewhat fully priced on various earnings multiples, and many are near all-time highs, we remain far away from euphoria. Cash positions of global fund managers remain well above average, and in general, investor positioning is defensive. Credit spreads are also within normal ranges. If anything, exuberance seems to have skipped equities and moved to less liquid, alternative investments like residential property, leveraged loans and private equity.

Indeed, equities do not look extravagantly expensive in a multi-asset world. While equity pricing remains elevated, this largely reflects record low global bond yields.

In the shorter term, a focus on rational asset allocation and on yield is essential. Compounding of returns will reward patience, but will also require active management across and inside asset classes to ensure that capital is neither lost nor devalued. As always, a watchful eye must be diligently maintained, but we perceive that the risk of a major market retraction is fairly low because interest rates are low and unlikely to rise. The offset is that returns will be lower than the historical norm.

Thank you for your ongoing support.

Adrian Ezquerro
Head of Investments