Portfolio performance

Our global strategy delivered 16.64% return outperforming the All Ordinaries by 12.86% in calendar year 2015. Over the same period the All Ordinaries Index gained 3.78% in a year characterised by significant volatility.

Market conditions

Global financial market volatility was a feature in 2015. It was fuelled by diverging monetary policies of major central banks, declines in commodity prices and geopolitical tensions.

The US remains one of the few shining lights from a global perspective. Federal Reserve officials expressed confidence in the outlook by raising short term interest rates in December. The rate hike represents the first increase in over a decade.

Consumer sentiment continues to be a key factor in delivering economic growth. Sentiment has been aided by a significant fall in energy prices which has freed up billions of dollars for the household sector to spend on the consumption of goods and services. We presently do not see any deterioration in the US economy, as the US has been gradually improving since the fall of 2009 and we see no fundamental reason to change our view.

As the world's second largest economy, China plays an important role in global growth. As we noted in our last report; China is attempting to transition the economy from investment led to consumption led growth. In the long run, this is a slower and safer path to travel, less dependent on capital spending and debt. In the short term however, it poses risks to current growth projections.

China's economic growth has been facilitated by the transition of millions of people from farms to cities. It has also been aided by low cost exports and heavy fixed asset investment. These levers will not contribute to growth in the same way as they have done in the past.

As traditional growth engines of manufacturing and construction wane; services will need to pick up the slack. We continue to monitor the services sector for evidence of a successful transition.

We remain concerned about the prospect of further devaluation of the Yuan. A significant devaluation of the Yuan would serve to export China's domestic problems to the rest of the world.

As the Yuan falls in value Chinese exports become more attractively priced to the rest of the world. This serves to support the economic growth in China.

Portfolio Investments

The banks and large miners all came under heavy selling pressure as the commodity cycle unwound.

Our best performers over the year included Alphabet (formerly Google), Microsoft, Home Depot, Visa and Lowes. Our largest sector exposure continues to be in the Information Technology sector. Our portfolio companies in this sector include Visa, Mastercard, IBM and PayPal to name a few.

Our largest geographic exposure is the United States where our outlook continues to be positive.

While we acknowledge the uncertainty around the current environment, we believe investment in high quality global businesses will yield acceptable returns over the medium term.

Outlook

We are often asked about the likelihood of another 2008 style crash. We don't profess to hold any superior knowledge in this regard, but make the following observations:

- In both 1929 and 2007 the market enjoyed a significant boom that culminated in large returns and market exuberance;
- Leverage in the household sector was significantly higher stressing borrowers' ability to make repayments;
- Years of low inflation and stable growth fostered complacency;
- Leverage within the banking sector was significantly higher;
- Subprime mortgage backed securities do not exist in the same form as those in 2007. The core of the crisis exposed negative equity as house prices plummeted;
- Pooled mortgages were sliced and diced so many times that even the institutions who owned them could not assess their inherent risk.

The World Bank is forecasting global growth to accelerate slightly on the 2.4% earned in 2015. Underpinning this forecast is an assumption that China will engineer a soft landing. It also assumes the Federal Reserve will proceed with interest rate hikes without destabilising the growth in that economy.

Emerging economies that provided a tail wind to global growth during the 2000s look like delivering more muted growth in 2016. In addition, the global economy needs to adjust to a weaker China.

We remain open to the prospect that a slowdown in Chinese economic growth would lead to a deterioration in world growth. Much has been written about the impact a slowing China could have on the rest of the world. The IMF estimates that a 0.01% reduction in China's growth could reduce growth in advanced economies by 0.15% and has cut its outlook for the global economy by 0.20%.

We do not know what the future holds in the short term. However we are cautiously optimistic about the prospects over the medium term. For us – nothing changes. We will continue to focus our efforts on the acquisition of high quality businesses at reasonable prices.