## Portfolio performance

We are excited to launch the Global Opportunity Strategy to external investors in 2015. The portfolio has been managed privately over the last five years and delivered 14.95% per annum for the period from January 2009 to December 2014.

For the last six months ending on the 30 June 2015, the fund returned 7.93%. Approximately 1.75% of the gain came from the performance of the strategy, with the balance from a stronger USD/AUD.

We consider valuations of our portfolio companies to be attractive relative to Australian equities. The earnings yield of the portfolio is 5.83% providing a margin of safety of 3.45% over the US 10 year bond rate.

## Investment Process

Each company has been selected based on its long term prospects. We judge those prospects by reference to each company's economic franchise and competitive position.

Fluctuations in economic conditions over the business cycle affect short-run profitability. Competition in an industry continually works to drive down the return on invested capital toward the competitive floor rate.

In the long run, profitability is governed by a business's ability to compete effectively. To compete effectively one must exhibit enduring competitive advantage, which comes through many factors including quality of service or product, patent, real estate location etc. We seek to own businesses displaying these qualities.

The top five holdings in the portfolio are listed below:

| | |
|---|---|
| Wells Fargo | 4.94% |
| Apple | 4.49% |
| Visa Inc. | 4.18% |
| US Bancorp | 4.06% |
| MasterCard | 3.76% |

One of our key responsibilities to investors is to manage portfolio risk. We seek to understand portfolio risk by utilising scenario analysis. We are able to stress market variables to gauge the potential impact on future performance. We test scenarios that would be best or worst for the portfolio.

If the S&P500 was to fall 10% we anticipate a negative 6.86% impact to our portfolio profit and loss (P&L). Conversely, if the S&P500 was to rise by 10%, we expect a positive 6.86% impact to our P&L.

Outperforming the S&P500 in a falling market is consistent with our expectation and capital preservation approach to security selection. We ask our investors to invest for seven to ten years. Over this period the effects of timing are significantly reduced.

## Investment Universe

Our Global Opportunity Strategy allows us to invest in a wide array of investment classes across the world. The investment strategy is predicated on the acquisition of outstanding companies at a discount to their intrinsic value conservatively stated.

In periods of speculative euphoria, we maintain the flexibility to invest in investment grade bonds and cash thereby insulating the portfolio against the risk of capital impairment.

We encourage our investors to invest for a minimum of seven to ten years. This time frame is consistent with an average business cycle thereby removing the element of timing and its impact on investment outcomes.

We believe the outlook for the Australian economy is challenged. The Reserve Bank remains open to the possibility of further policy easing, however we are concerned about the impact further interest rate cuts will have on the economy owing to the indebtedness of the household sector.

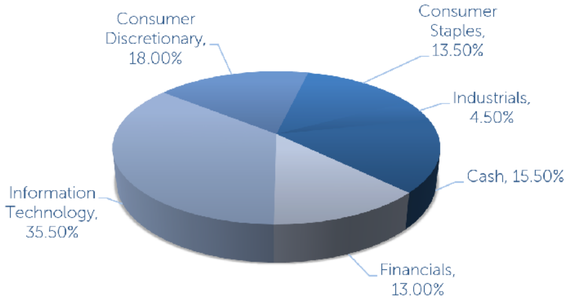
The main shock absorber for the domestic economy continues to be the Australian dollar, which has depreciated by 18% against the US dollar in the past twelve months. This, coupled with the US economy beginning to show signs of strengthening, provides confidence in the outlook for the strategy.

We are often surprised that although Australia makes up around 2% of global investable funds, it accounts for over 90% of the portfolios we encounter. We believe a depreciating AUD will demonstrate the effectiveness of a global asset allocation over the next few years.

# Investment Strategy

The portfolio weighting by GICS Sector is set out in the chart below. We also highlight some portfolio themes in the commentary below.

Global Opportunity Strategy - Sector Weightings - GICS




## Banks

With the banking industry such a dominant part of the Australian Stock Exchange (30.5% of the ASX200 index) most Australian equity portfolios are significantly exposed to the overall performance of Australian banks. Over the 12 months ending June 2015, Australian banks have had some of the lowest returns compared to banks in other major markets. We continue to think Australian bank valuations are stretched (13.8x FY16 P/E and 2.5% EPS growth) given the outlook for earnings growth and capital risks.

On the other hand, we consider Wells Fargo (NYSE:WFC) and US Bancorp (NYSE:USB) to be attractively priced. Both stocks currently trade on FY16 P/Es of 12.8x, offering 8.2% and 8.8% EPS growth respectively. We expect both companies will be key beneficiaries of an improving US economy and rising rates.

Why is a global perspective important?

Being able to fish in a larger pond often highlights valuation anomalies. For example, Wells Fargo is a lower risk and higher return proposition when compared to CBA (ASX:CBA). Wells Fargo holds more tier 1 capital (a key measure of bank safety) and is rated higher by Standard & Poors. It also trades on a lower price to book ratio of 1.67x v 2.74x for CBA.

## Cashless Transactions

The shift from cash to cashless based transactions is well progressed in Australia. Few people realise that by global standards, Australia leads the world in cashless transactions.

It has been no secret that payment processing firms have taken off since the financial crisis, especially the "pure" payment processors Visa (NYSE:V) and MasterCard (NYSE:MA).

These companies have seen sustained double-digit top and bottom line growth, which has delivered consistent returns over the last few years. Both are well positioned to continue their growth by capturing market share in emerging and developed markets in the future.

## Rail Vs. Road

Moving freight long distances by rail is achieved at a significant cost advantage over road. Rail stocks also own thousands of miles of train tracks which represent an asset that is not easily replicable – if at all.

Rail is leveraged to a strengthening US economy as the economy and population growth create a strong growth foundation for rail stocks. Our investments in rail are well positioned to key growth markets like Mexico. Mexico's access to cheap labour is helping it close the gap with China as a low cost supplier of manufacturing goods to the US.

We are attracted to the competitive advantage of rail stocks and their high barriers to entry. The headwinds they currently face are short term and cyclical in nature and we will use any weakness to increase our positions at more attractive prices.

## Corporate Reorganisations

### PayPal

We acquired EBAY ahead of the spin off and intend to divest our interest post the corporate reorganisation. We believe Ebay's marketplace will remain challenged due to competitive forces.

PayPal will emerge with a business boasting 165 million active customer accounts, US$235 billion in TPV, and 4 billion transactions each year including 1 billion mobile transactions.

PayPal has unique and defensible assets. It is also exposed to an explosion of online and mobile payments which will see the market grow to over US$25 trillion.

We are encouraged by the acquisition of remittance company Xoom. Money remittance volumes in developing countries are still quite large, estimated to be about $440 billion in 2015 by the World Bank. Xoom has around 1% market share transferring about $6.9 billion during the 12 months ending December 2014. Xoom opens up PayPal to its 37 nation network that services the major remittance markets including China, India and Mexico.

# Value in US markets

The typical US household is significantly better capitalised than its Australian counterpart. US households currently hold around $10 trillion dollars in cash deposits. On the liability side, most household have long term fixed interest rates. This means an upward move in interest rates can lead to a significant boost in consumer spending. Assuming households have about US$7 trillion of their $10 trillion dollars exposed to short term interest rates, a 1% change in rates adds about US$70 billion to annual household income.

We are also encouraged by the wealth effect which is yet to meaningfully influence US GDP. The Fed expected the wealth effect would drive growth to 3-4%. Despite the stock market rising about 50% over the last three years and tripling over the last six, GDP growth has stagnated at around 2%. This remains a positive lever for continued strengthening of the economy.

Globally the two issues increasing market volatility are the potential Greek exit from the EU and instability in China. Chinese authorities are currently engaged in a raft of emergency measures to halt the sell-off in equities, which has the ability to shake global confidence. As a consequence, we feel it prudent to maintain higher cash levels at around 15%.

The increase in US interest rates from record lows will not occur without a few hiccups. However we expect the US economy to absorb the speedbumps and continue to strengthen. There are a number of positives aiding the US economy, a low oil price, a stable US dollar and an improving jobs market.