Integrity Transparency Conviction

Clime Australian Income Fund

Quarterly Investment Report - June 2018

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Investment Objective

The Fund's objective is to provide a level of income of 3% p.a. above the RBA cash rate and to grow capital in line with CPI. It seeks to deliver a strong risk-adjusted total return and is expected to have a level of total volatility of returns of less than half traditional equity indices.

Investment Strategy

The Clime Australian Income Fund seeks to provide an income stream above the RBA cash rate from a portfolio of Australian listed and unlisted securities, with a strong view towards capital preservation.

The portfolio will invest in select high quality individual investments which in aggregate create a best ideas portfolio for income generation. Portfolio yield is likely to be incrementally enhanced via franking credit.

Fund Profile

Investment Manager	Clime Asset Management Pty Limited
Investments	The Fund's goal is to select high quality individual investments that allow the creation of a best ideas portfolio for income generation.
Fund Size - Wholesale Inception Date	A$17.0 million 1 July 2015
Income Distributions	Quarterly. Unless otherwise requested, distributions are automatically re-invested.
Management Fee	1.03% p.a.
Contribution Fee	Nil
Minimum initial investment	$200,000
Minimum additional investment	$10,000
Expenses	0.21% p.a.
Withdrawal Fee	Nil
Benchmark	Achieve a return of 3% p.a. above the RBA cash rate and to grow capital in line with CPI with volatility of return less than half ASX200 Index.
Investment Horizon	Minimum 3 years

Performance and Volatility of Return (30/06/18)

	Portfolio Return^	Income	Capital Growth	Franking
1 month	1.09%	1.67%	-0.57%	-
3 months	1.62%	1.67%	-0.05%	-
6 months	-0.03%	2.36%	-2.34%	-
1 year	4.32%	3.62%	0.68%	0.18%
2 years*	6.63%	3.84%	2.69%	0.24%
Inception*	6.95%	3.70%	3.13%	0.26%

Note: Compound (geometric) returns are used in the above table's segmentation of Income and Capital Growth. This may result in small differences when compared with a simple addition of Income and Capital Growth components.

^Portfolio return is based on the change of the unit price including distributions but excluding franking credits. Franking credits will enhance this portfolio return, and historically this has added about 0.30% pa to the return of the Fund.

*Inception: Wholesale Units: 1 July 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. The returns do not include the benefit of franking credits.

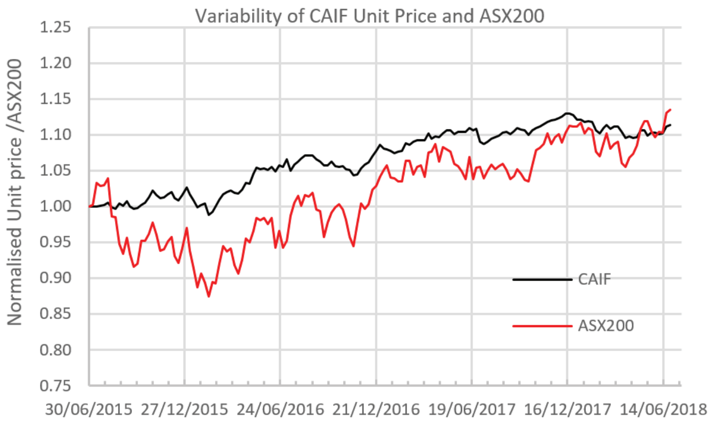
We have tabulated the volatility of the fund over 1, 2, 3 years and compared with the ASX200 Index below. The volatility of the Income Fund is far less than the equities market with the ratio at about 0.30 (or 30%) of the ASX200 over the entire measured period. This is consistent with the Fund's objective of providing capital stability while generating regular quarterly income.

Volatility^^

	CAIF	ASX200	Ratio of CAIF/ASX200
1 year	2.65%	8.37%	0.305
2 years	2.82%	10.55%	0.267
3 years	3.45%	12.33%	0.280

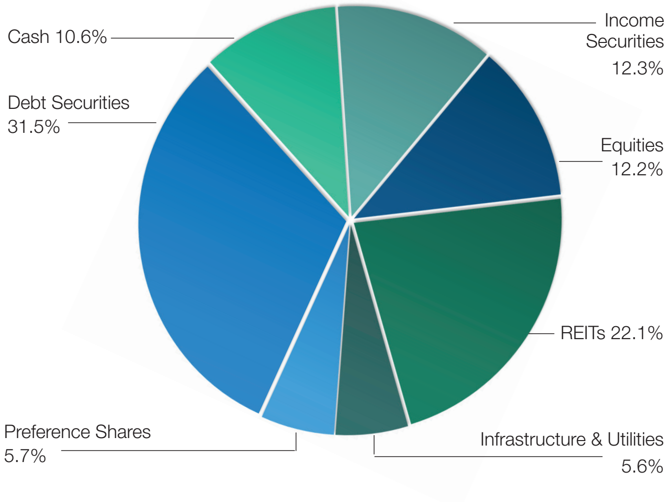
^^ Volatility is the annualised standard deviation of the NAV/unit as measured on a weekyl basis.

For those who prefer to visualize this price stability, we have provided the weekly unit price and compare that with the ASX200 (normalized from Fund's inception date) as shown in the exhibit below. Clearly the price stability of the Fund is superior to the ASX200 where the variability of the unit price is noticeably more modulated or smoother than the ASX200 over the entire period.



The variability of the Fund's and ASX200 weekly prices since inception. It can be easily observed that the CAIF's unit price is much slower moving which represent relative more stable capital price.

Asset Allocation



Wholesale Units - Monthly Returns (since inception*)

Financial Year	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	CAIF FYTD	Franking
2015 - 16	0.5%	0.6%	-1.3%	2.5%	-0.6%	1.5%	-1.6%	-0.3%	2.5%	1.3%	1.7%	0.7%	7.6%	0.3%
2016 - 17	2.5%	-0.0%	-0.3%	-0.7%	0.8%	2.7%	-0.3%	1.5%	1.2%	0.9%	0.1%	0.3%	9.0%	0.3%
2017 - 18	0.4%	1.1%	0.4%	0.9%	1.06%	0.5%	-0.5%	-0.4%	-0.8%	0.5%	0.02%	1.1%	4.3%	0.2%

*Inception date as at 1 July 2015 (Wholesale) at which point the Fund's units NAV was struck at an inception price of AUD 1.00.

^To be announced 30 June 2018

Note: FYTD represents net return for the given financial year, calculated after all applicable fees and taxes. Performance figures compare unit price to unit price for the given period.

Distributions

Quarter Ending	Wholesale Units (cents per unit)
30 June 2018	1.8352 +0.2025 franking credits
31 March 2018	0.7455
31 December 2017	0.7602
30 September 2017	0.6015
30 June 2017	1.8451 +0.3189 franking credits
31 March 2017	1.0082
31 December 2016	0.9706
30 September 2016	0.5123
30 June 2016	2.1483 +0.3153 franking credits
31 March 2016	0.8246
31 December 2015	0.2390
30 September 2015	0.5383

Top 5 Holdings

Security	Weight%
Macquarie Income Securities	3.2%
Elanor 7.1% 171022 Bond	3.1%
National Income Securities	3.0%
Multiplex SITES	2.7%
Westpac Capital Notes	2.7%

Quarterly Investment Commentary

At 30 June, the Clime Australian Income Fund was diversified across six underlying sub-asset classes: Domestic Debt, Income & Preferred Securities; REITs; Utilities & Infrastructure (U&I); Equities; and Cash. The underlying security weights in the portfolio ranged from around 0.5% to 3.2%.

In view of further movement in interest rates overseas, particularly in the US, and in order to mitigate further downside in the portfolio over the short-term due to the price declines in interest rate sensitive stocks, we took action to rebalance the fund's asset classes. As described in the previous quarterly commentary, we have:

- further fine-tuned our exposure to REITs,
- continued to actively switch our exposure to Banks' T1 capital notes (CNs); paying attention to below par papers, while taking profit on above par ones or switching to its ordinary equities;
- intended to introduce non-financial equities securities with reasonable dividend and sustainable growth, preferably franked dividend; and
- selectively introduced targeted holdings in good quality unlisted direct property assets.

We will discuss each of these changes below. Since the pullback in Australian property, we have gradually increased exposure to REITs, focusing on high quality names and / or higher yield REITs, including Australian Unity Office Fund (AOF), Arena REIT (ARF), Centuria Metropolitan REIT (CMA), Folkestone Education Trust (FET), GPT and Stockland Group (SGP) leading up to distribution. As a result, we have updated the yield for our REITs pool of assets below and the forward 12m running yield is 6.1%. We have also updated our 5 quantitative parameters we focused on for REITs.

	Income Fund	ASX 300 REIT Sector
WALE (yrs.)	7.8	5.5
Gearing (%)	31.8%	28.3%
Occupancy (%)	98.5%	97.3%
Debt to maturity (yrs.)	4.6	5.5
Interest cover ratio	4.7	4.8
Yield	**6.1%**	**5.1%**

Source: Clime Asset Management, IRESS

We believe that our selected REIT portfolio is optimised for higher yield compared to the broader REIT sector, while having superior risk measures to withstand any anticipated short to medium-term macro shocks.

Over the quarter we have added WBC leading up to its dividend. We have topped up ANZ and NAB marginally with fund flow as they also approach their dividend distributions. In June we have taken advantage of the weakness within the financial sector to add CBA into the portfolio in time for August's dividend. At sub-$70, when we commenced buying, it is forecast to yield approximately 9% pre-tax. In exchange, we have exited ANZPH and CBAPF at pre-tax yields of around 5.8%, as they were both above face value at the time of disposal. This switching out of longer-dated Capital Notes to below face value short-dated CN's or to higher yield ordinary bank equities is discussed in past quarterly commentaries.

We are also active in the over-the-counter and unlisted market by participating in the Afterpay and Liberty Financial Bond fixed interest rate bonds. The Afterpay is a 2-year non-call, 4-year 7.25% fixed rate bond, while the Liberty Financial is a 3-year 5.1% fixed rate senior bond (rated BBB-). The latter has another 2.8 years to maturity. Whilst in an environment where interest rates are rising, it is best to avoid fixed rate bonds but since these bonds are short-dated we feel comfortable participating once we have evaluated their underlying businesses.

We have also initiated, and increased, positions in some direct property assets. Geelong Office Fund (GOF) is an unlisted single asset high yield commercial property managed by Centuria. We have also topped up our Elanor Commercial Office Fund (ECPF) as the Fund is entitled to more units as they acquire more assets into the fund. We are happy to invest In GOF and ECPF due to the stable tenants (State Government and large corporations), close to 100% leased, long WALE and much higher yield compared to listed property, after accounting for liquidity risk or unlisted peers on a risk-adjusted basis in these funds.

The 10-year Australian bond yield finished at 2.637% in the June quarter, after starting the quarter at 2.60%. This relative flatness masked a big swing as it peaked at over 2.90% in mid-May, which again saw some weakness in REITs and other interest sensitive securities at that time. While the 10-year bond price has rallied back since the low in mid-May, we note that REITs and other interest sensitive securities have been more cautious. Despite this, the Fund's 12-month annualised volatility has maintained at 2.56%, which is well below the ASX200 volatility of 8.37%. Furthermore, with the sell-off in interest sensitive securities, we believe these sectors are increasingly attractive when viewed from a medium-term perspective and we will look at further rebalancing of the portfolio shortly.

In the June FOMC meeting, as expected, the US Fed raised the interest rate target again by 0.25% and stated their intention to raise twice more this calendar year.

Outlook

The US economy has seen further improvement from the previous three months, with the unemployment rate at a 16-year low of 3.8%. There are more tangible signs that the US economy is indeed growing at a good clip. The Federal Reserve will continue to hike as they are keen to normalise. These anticipated rises in the US have resulted in Australia's bank bills following in suit. Although we believe the RBA is not ready to lift rates given our high household debt, low wage growth et. al. Local short-term borrowing costs have nevertheless moved up due in part to the fact that our banks tend to borrow from overseas for a major portion of their funding. Since US rates have moved, this higher cost of debt has impacted Australia (and other markets, particularly emerging markets). We believe the task of managing the cash rate has suddenly become much more challenging for the RBA. Despite this, the local economy remains steady with infrastructure, mining and housing appearing to be resilient and growing at a reasonable pace. However, the EU economy appears to be stalling slightly. Given this back-drop, we continue to be cautiously optimistic about the rest of this year.

Going forward, we expect volatility to increase because:

- there is a need to re-calibrate interest rates with the US Fed hiking rates. This is equivalent to reducing liquidity, i.e. debts are getting a bit more expensive;
- the US Fed is shrinking its balance sheet; this also implies it is withdrawing liquidity from the economy.
- US - China and the rest of the EU is determined to go ahead with some form of trade war.

These factors will increase volatility. As the business world loathes uncertainty, the likelihood of a global slowdown has increased.

With the primary objectives of the Fund to provide regular income in the short-term, steady capital growth in line with inflation over the medium-term, while maintaining a lower volatility profile of returns at all times, our strategy for Clime Australian Income Fund is unchanged. We will be taking advantage of higher volatility in the market to switch and accumulate quality low-risk securities.

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