Integrity Transparency Conviction

Clime Australian Income Fund

Quarterly Investment Report - September 2017

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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 credits.

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$11.1million 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

^The Australian Income Fund is currently in the incubation phase and at this time the manager is not charging the full management fee. With effect from 13 July 2017, the management fee was revised to 0.615% pa, which will be reviewed on a monthly basis.

Performance and Volatility of Return (30/09/17)

	Portfolio Return^	Income	Capital Growth	Volatility**
1 month	0.35%	0.55%	-0.19%	-
3 months	1.83%	0.55%	1.28%	-
6 months	3.23%	2.25%	0.96%	1.96%
1 year	8.62%	4.12%	4.32%	2.60%
2 years*	9.41%	3.74%	5.47%	3.67%
Inception*	8.20%	3.57%	4.47%	3.65%

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.

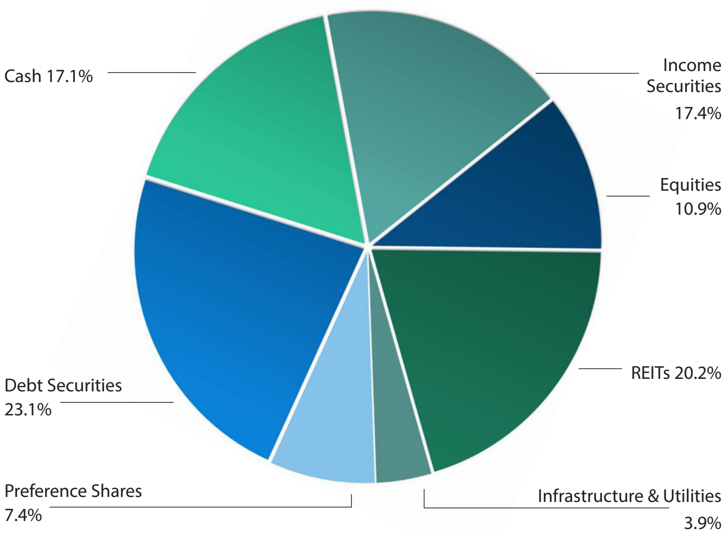
^Portfolio return is based on the change of the unit price including distributions but excluding franking credits. Franking credits will enhance this portfolio return, and historically this has added about 0.30% pa to the return of the Fund.

*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.

** Volatility is based on the annualised standard deviation of weekly price movements.

The 1 year volatility of the ASX200 is 10.5% over the same weekly measurement period; placing the Clime Australian Income Fund volatility significantly below that of the ASX200 Index. This is consistent with the Fund objective of providing capital stability while generating regular quarterly income.

Asset Allocation



Wholesale Units - Monthly Returns (since inception*)

Financial Year	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	CAIF FYTD
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%
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%
2017 - 18	0.4%	1.1%	0.4%										1.8%

*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.

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 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%
Bendigo Subs T2 FRN	2.81%
Macquarie Perp Notes	2.75%
National Bank Australia Ltd	2.69%
National Bank NABHA FRN	2.64%
Australia & New Zealand Banking Group	2.53%

Quarterly Investment Commentary

As at 30 September 2017, 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 3.0%.

During this quarter, we have incrementally added to AMP Limited (AMP) and Wesfarmers Limited (WES) ahead of distribution/dividends which provides an additional income benefit via franking credits. We also incrementally increased existing holdings in income securities (i.e. NABHA, MBLHB) with fund inflow. We have added a new position, MyState Limited (ASX:MYS) during the September quarter.

Furthermore, we have made a modest asset allocation tilt towards the REITs sector because we believe there is value emerging due to the following reasons:

- The 12 months to FY17 return was -6.26% for ASX200 property accumulative index; while the ASX200 accumulative index was +14.10%; implying the general equity market has outperformed the REITs sector by more than 20% last financial year. On a contrarian basis, we see relative value in the REITs sector compare to ASX200 (ex-REITs).

- The negative REITs sector return in FY17 came about despite distribution growth for the sector over the past year and albeit small, the sector is still forecasting some distribution growth this financial year.
- There are still lots of investors seeking stable yield given the aging demographic and we see this trend unlikely to diminish over the short to medium term.
- Recent transactions from DXS for part ownership of MLC and GPT for Highpoint suggest cap rate will continue to compress for at least another 6 to 12 months, we see the potential for NTAs to continue to increase. The premium to NTA is less compared to 12 months ago to June 2017 given the sector's negative return. Looking toward FY18, with further compression of cap rate and some distribution growth, it is likely that there is no or marginal NTA premium in the REITs sector (ex-GMG, CHC and WFD); i.e. NTA is a backward indicator if cap rate is still compressing and vice-versa.
- The Australian (and global) economy seems to be travelling reasonably well, as we elaborate further below.
- The average gearing for the REITs is around 30% which from a risk perspective, we see as constructive.

In the September quarter 2017, Goodman Group (ASX: GMG) announced the redemption of their Goodman Plus preference shares (ASX: GMPPA) likely due to its low gearing, strong balance sheet and its ability to source lower funding elsewhere. This is reflective of the REITs sector in general, particularly at the larger market capitalisation, 'top tier quality' asset end where the gearing has been in the mid 20% to low 30%. From a risk perspective, we view this as positive. We tend to steer clear of highly geared REITs (loosely defined as more than 40%), second tier property assets in an environment where the interest rate is likely to have bottomed; especially when household debt is still high. We exited Gateway Lifestyle Group (ASX: GTY), which after further assessment, formed a view that it does not suit an income focused low volatility portfolio.

To replace some of the REITs sector exposure, we have participated in the IPO of Convenience Retail REITs (ASX: CRR) introduced Arena REITs (ASX: ARF), and increased model weight in GPT Group (ASX: GPT), Industria REIT (ASX: IDR) and Vicinity (ASX: VCX).

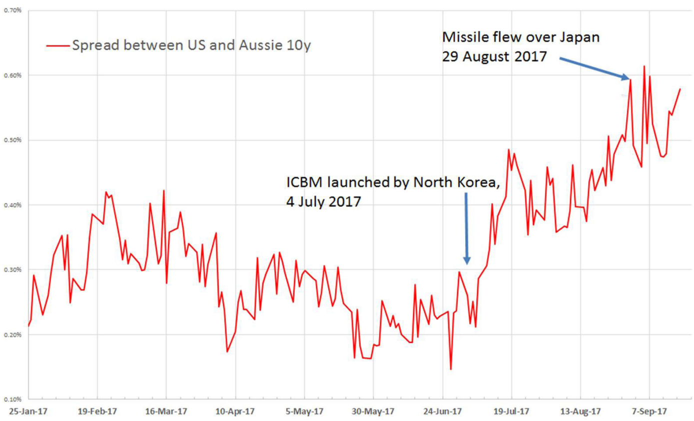
We have added one new income generating security in September quarter 2017: ANZPH. We participated in an ANZ security holder offer for the ANZ capital notes 5. The new capital notes have an optional call date over 7 years and are priced as 3.80% margin over the 90 day BBSW. This Capital Note 5 was listed on 29 September 2017; opened at $101.10 and closed at $101.69.

Lastly in the listed space, one of the long-held REITs in the Fund, Asia-Pacific Data Centre (ASX: AJD) is currently being taken over. There are two completing parties. As the result, the stock price moved up more than 10% over the quarter. We believe the end game is near and expect to accept the higher bidder's offer in the near term. This marks the second takeover of securities held in the Clime Australian Income Fund this calendar year, following acceptance of a significant takeover offer of Duet Group (ASX: DUE) in the June quarter, realising a significant capital gain for the Fund in FY17.

In the OTC market, we participated in a new 10.5y 5.25y non-call AMP B3 T2 notes which was heavily over-subscripted. Due to the strong demand, it was repriced twice with the final price at 180bp over the 90 day BBSW. We also increase our holdings in the Centuria 7% fixed bond.

The 10-year Australian bond yield finished at 2.84% at 30 September 2017 after starting the quarter at 2.60%. Both the yield curve here and in the US have steepened since June quarter 2017 indicating that at least through the lens of the fixed interest investors, the chance of a major slow down or recession in the near term has subsided. Near-term we see interest sensitive securities being weaker at the expense of the growth stocks as equity managers switch out of defensive into growth sectors.

The spread between the US 10y treasuries and the 10y Aussie bonds began to widen in early July 2017 to a 55bp mark at 30 September 2017 after touching a low of 15bp at the end of June 2017 (see chart below). We believe some of this widening is likely due to the increase in tensions between North Korea and US.



The steepening of the yield curve is likely to put some pressure on interest sensitive securities such as REITs, Infrastructure and Utilities, particularly on poorer quality names in the near term. We note the margin for a basket of the investment grade corporate bonds remains tight and at a low level, sitting below 70bp, where at the beginning of the quarter it was 85bp.

Based on these observations, it appears that:

- The normal yield curve suggests investors generally are assuming global growth will pick up; leading to equity managers focusing on growth stocks, while lightening their position in interest sensitive securities.
- The continued drop of the margin on a basket of investment grade corporate bonds suggest fixed interest managers are still buying investment grade fixed interest assets indicating that there is no major switching from fixed interest to equity (yet).
- The spread between US 10 year treasuries and Aussie 10y bonds widen by about 35 to 40 bp since the low in late June. This coincides with the acceleration of the geopolitical risk with the successful launch by North Korea of its ICBM missiles across Japan in early July and August. We believe the global fixed interest investors are pricing some of this risk even though equity investors, at this stage, have not.

The primary objectives of the Fund are to provide capital preservation, regular income generation beyond the RBA cash rate, steady capital growth in line with inflation over the midterm, while maintaining a lower volatility profile of returns. Consequently, the strategy Clime Australian Income Fund is currently adopting for the foreseeable future is:

- Tilt toward high-quality REITs as described above, taking advantage of the current weakness, but remaining focused on quality top tier assets with lower gearing.
- Slow accumulation of these securities as they weaken from pressure of possible switching out by the equity managers. We believe this weakening of the interest sensitive stocks has months to play out.
- Aside from slower accumulation of interest sensitive securities, we will adopt a more cautious approach to all investing activities due to pricing of the geopolitical risk observed in the fixed interest markets. Naturally, when we ascertain that this risk is subsiding, we will revert back to more normal trading activities and portfolio postioning.