Clime Australian Income Fund

Fund Performance - February 2020

The Clime Australian Income Fund is a multi-asset class portfolio that invests in high-quality income generating assets. The Fund provides exposure to higher yielding securities in both listed and over the counter (OTC) markets. The Fund aims to achieve a total return of RBA cash rate + 3% p.a. whilst maintaining price stability.

Risk and return are considered to be equally important. As such, we construct the portfolio such that the risk, as defined by the annualised volatility of the change in the unit price, is in the 3% to 5% range (or 4.0% ±1.0%). The Fund pays regular quarterly income distributions in September, December, March and June.

The three interim distributions (September, December and March) are consistent and the final distribution for the financial year (June) includes capital gains and franking credits (if any).

Month Net Return (Wholesale)	1 Year Net Return (Wholesale)	Inception p.a. Net Return (Wholesale)	Total Fund Size
-1.2%	**6.2%**	**6.5%**	**$38.1m**

	1 month	3 months	6 months	1 year	2 years (pa)*	3 years (pa)*	4 years (pa)*	Since Inception (pa)*
Net Portfolio Return (Wholesale)	-1.2%	0.1%	1.2%	6.2%	5.2%	5.5%	7.3%	6.5%
Income	0.0%	0.7%	1.1%	4.2%	4.1%	4.0%	4.0%	3.6%
Capital Growth	-1.2%	-0.5%	0.1%	1.9%	1.1%	1.4%	3.2%	2.8%
Franking				0.2%	0.2%	0.2%	0.3%	0.2%
Volatility				3.3%	3.0%	2.7%	3.0%	3.3%

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.

*1 July 2015. Performance figures for more than 1 year are annualised, calculated after all applicable fees and taxes.
**Portfolio return is based on the change of the unit price including distributions but excluding franking credits. Franking credits will enhance portfolio returns and historically, have added about 0.2% pa to Fund returns as shown in the last column of the table above.

Top 5 Holdings

Security	Weight%
MBL Income Securities (MBLHB)	2.1%
Charter Hall Social Infrastructure Trust (CQE)	1.8%
NAB Income Secuities (NABHA)	1.8%
Spark Infrastructure Group	1.8%
Ausnet Services Limited	1.7%

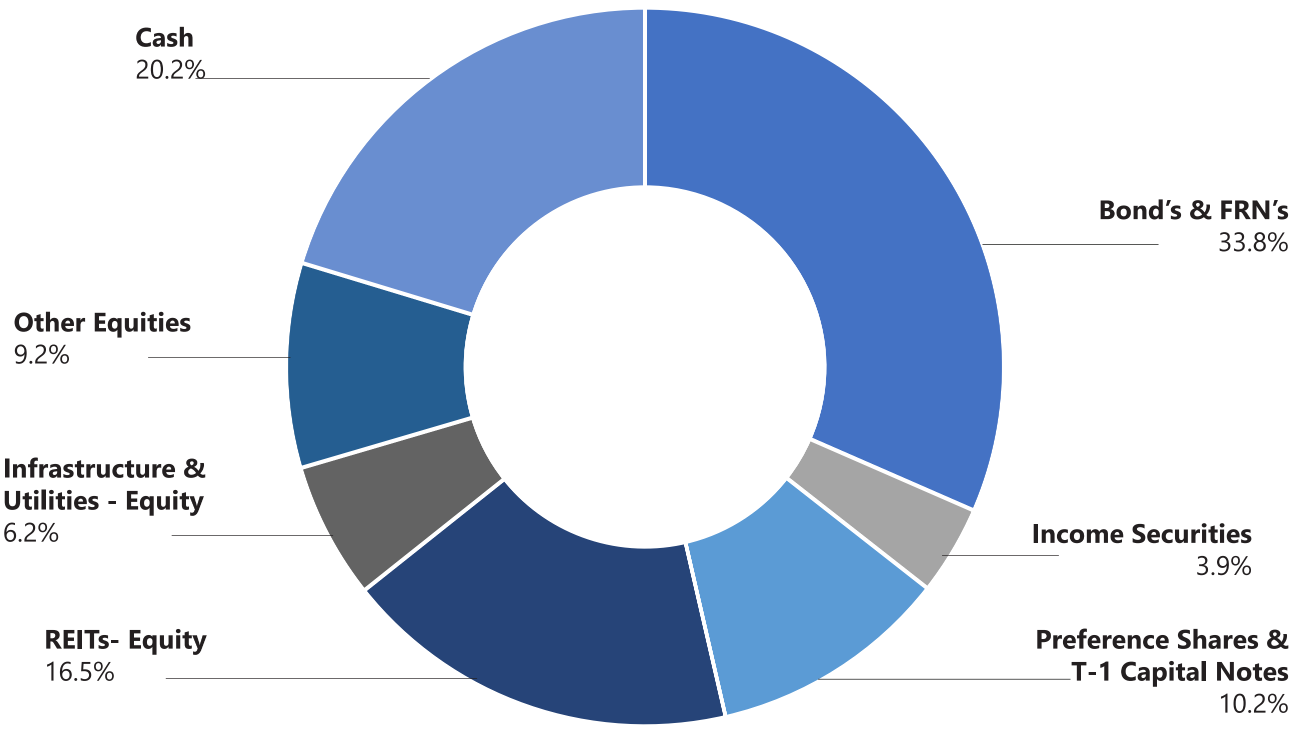
Fund Facts

Portfolio Manager	Dr Vincent Chin
Fund Inception	1 July 2015
Fund Size	$38.1m
Cash Distributions	Quarterly

Distributions

Period Ending	Wholesale Units (cents)
31 December 2019	0.7480
30 September 2019	0.5160
30 June 2019	2.584 + 0.2533 franking credits
31 March 2019	0.8096

Asset Allocation



Portfolio Commentary

Encouraged by ample liquidity provided by the US Federal Reserve and fears of missing out, in the first half of the month equity investors here and overseas continued to push markets higher. Locally, this drove the S&P/ASX 200 Index to an all-time intraday high of 7,197 by the end of the third week of February, before it sharply reversed, playing catch-up with bond investors in assessing the risks of the COVID-19 outbreak. We now know that bond investors tend to read the risks better than equity investors; the coronavirus has gained footholds in South Korea, Italy and Iran with numbers of confirmed cases and fatalities rapidly rising in these nations.

Due to the rapid spread in Italy and Iran, COVID-19 is now threatening to move rapidly across Europe and the Middle East. Both locally and overseas, we note the first fatalities in the USA, Thailand and Australia. Moreover, with the open door policy across Europe and poorer health systems in the Middle East, the picture looks menacing: by the end of February, 60 countries (from 22 at the end of January) across all continents (bar Antarctica) are infected with COVID-19, with fatalities and confirmed cases increasing sharply outside China. By month end, the S&P/ASX 200 accumulative index had fallen by 7.7% (and by 10.5% from the February peak).

There are lots of unknowns with COVID-19, but what is quite certain is that it is more contagious (although less deadly) than SARS or MERS (because it tends to bind easier to human cells). Human to human localised cluster transmission in countries outside China has begun to take hold, including in Singapore, Japan and South Korea, and now Italy and Iran as noted above. Aside from Iran, many of these countries are major trading partners of Australia. The absolute and relative size of China's GDP is significantly larger than it was during the SARS epidemic in 2003, and we expect the impact of COVID-19 combined with the bushfires will dampen the Australian economy. The Australian economy grew 0.5% in seasonally adjusted terms in the December quarter 2019 and 2.2% through the year, according to figures released by the ABS.

The risk of Australia falling into recession has increased, and Australian 10-year bond rates are starting to reflect this. The Australian 10-year bond yield finished the month at 0.82% (from 0.95% at the beginning of February). A recovery in Australia is likely to be more gradual than the "V" shaped scenario many will be hoping for. US 10-year Treasuries compressed as global investors sought safe havens: the flight to safety saw Treasury yields compressing by 35bp to 1.15%.

The Fund posted a return of -1.2% for the month of February. During the month, the Fund turned defensive by introducing Growth Point Property (GOZ) and Sonic Healthcare (SHL), while exiting Premier Investments (PMV). We purchased several short-dated senior debt securities including Macquarie Bank, Credit Union Australia, Members Bank and Liberty Financial. We also participated in Macquarie Bank Capital Notes (MBLPB), an issue which was 4 to 5 times oversubscribed. That said, this was priced prior to the sharp deterioration of the COVID-19 news, and margins have since widened.

The objective of the Fund is relative capital stability while generating regular quarterly income. The Fund's 1-year portfolio volatility rose slightly to 3.3% (from 2.9% the previous month), while the S&P/ASX 200 Index volatility increased even more to 13.2% (from 11.6%) over the same period. The absolute risk of the Fund remains at the low end of our target range.

Dr Vincent Chin
Portfolio Manager

Market Commentary

With February 2020 came the first half reporting season and a significant equity market correction, reflecting growing global fears pertaining to the spread of the coronavirus (COVID-19). When coupled with a somewhat elevated level of equity pricing, the scene was set for a swift reassessment of risk asset exposure. Key indices delivered the following returns for the month:

- S&P/ASX200 Accumulation Index: -7.7%
- All Ordinaries Accumulation Index: -8.1%
- S&P 500 Index (US): -8.2%
- Small Ordinaries Accumulation Index: -8.7%
- FTSE 100 Index (UK): -9.0%
- Emerging Companies Accumulation Index: -14.1%

Many global indices, including those in Australia and the US, corrected in the space of just five days in the final week of February (a correction being a greater than 10% fall). This was the first such occurrence since October 2008 during the depths of the Global Financial Crisis (GFC). It has been an unusual time to say the least!

With the rolling news cycle omnipresent these days, you would be hard pressed to go a day without hearing anything of COVID-19. News of the virus' spread well beyond Chinese borders saw global markets sell off sharply and bond yields collapse, in turn reflecting expectations for a significant slowdown in global growth. While yet to flow through in many datasets, the first insight was provided via China's PMI (Purchasing Managers' Index, a measure of manufacturing trends) release.China's official PMI fell to a record low of 35.7 in February, from 50 in January. Incredibly this was the fastest pace of contraction on record for the survey, surpassing the decline registered during the GFC. Non-manufacturing PMI came in at 29.6, versus the prior reading of 54.1, also the lowest on record. We note that 50 is the level that separates expansion from contraction.

The Current Situation in Context and the Outlook for 2020

Clime's investment strategist Paul Zwi recently noted 'As investors, we are required to deal with probabilities rather than certainties.' While evergreen in nature, this is particularly the case when assessing the degree of social and economic dislocation to be felt in 2020.

We are obviously not epidemiologists, but what happens in the near term will likely depend on several factors, including the tenure of the pandemic, its geographic spread, when a vaccine is prepared for human use and whether the arrival of the northern hemisphere summer provides a degree of abatement. We can observe that all major outbreaks to date (Wuhan, South Korea, northern Italy and Iran) have occurred in geographies with an average maximum February temperature of no more than 11 degrees Celsius.

Travel

In terms of first order effects, we expect the near-term restrictions imposed on travel to adversely impact all travel and tourism related businesses. In the past week alone, leading Australian companies including Lendlease, Telstra, the major banks, and IAG (to name a few) have all banned staff from international travel for work.

Our recent investment management meetings with travel focused businesses suggest a significant curtailment of forward bookings, with employees being requested to use all annual leave and/or cut back to part time for the next few months. We also perceive some risk to the collection of receivables, so balance sheet strength in this sector will never be more important for those exposed.

Education

The education sector forms a significant backbone of Australia's services sector and still represents a fantastic long term opportunity for our country and its plethora of well-respected tertiary institutions. With the imposition of travel bans and a general reluctance to travel, we expect this sector to also be directly impacted.

Manufacturing & Retail

From various recent management meetings and company outlook statements, it is clear that manufacturing and broader supply chains are being directly impacted. Even if goods are not being manufactured in China, significant amounts of componentry are sourced from within China. Some retailers and hardware technology businesses that we have spoken to added inventory prior to the Chinese New Year, so are fortuitously better placed to ride out short term impacts to supply chains. We expect retail more broadly to be impacted by soft consumer sentiment, itself already under pressure from Australia's tragic bushfire season.

Commodities

While the outlook for commodities appears to wax and wane on an almost daily basis, with ongoing monetary support soon to be coupled with significant fiscal stimulation, we remain constructive on exposures to dominant low cost producers with strong balance sheets and healthy cash flows, most notably BHP Group (BHP) and Rio Tinto (RIO).

Concluding Thoughts

The maintenance of focus on investing in quality companies with strong valuation discipline, which when given time allows the wonders of compounding to take place, has to remain the cornerstone of successful long term investment (as opposed to speculation).

We are not seeking to downplay COVID-19 and the likely flow on effects for the global economy in the near term. This will be an especially difficult period for economies and markets. Some counterbalance may be provided by further central bank support (globally co-ordinated) and fiscal stimulus.

Borrowing from Clime Director John Abernethy's recent note in 'The View' (available to Clime Direct subscribers), in Australia, we note that the Government has relented on its promise to produce a budget surplus in FY20. We predict that if the coronavirus continues to affect the Australian economy into the June quarter, substantial tax payment relief will be given to small and midsized businesses. This would help business cashflows at a time when stock levels are falling, and consumer sentiment is challenged.

There is much that can be done by sensible fiscal governance and there is little that the RBA through monetary policy can do other than ensure liquidity is plentiful in financial market and that banks do not restrict essential credit. It will be an interesting few weeks and possibly months for markets. The coronavirus, the US election and the US China trade deal are amongst many other unknowns, but the likely behaviour or responses of central banks and governments is more predictable.

Is that a reason to be bullish in the short term? No. But it is a reason to remain calm, not panic and invest logically at a time when markets are being driven by wild speculation. The long term outlook for world growth looks good and that is what investors (not speculators) need to focus upon.

Specific to asset allocation, we remind investors that tilting asset allocation both across and inside of asset classes will act to build portfolio resilience. Further strategies to bolster resilience include diversifying across asset classes, including cash (even if the return from cash is only marginal); ensuring asset allocations are fit for purpose; focusing on high quality companies; and maintaining a focus on sustainable yield. These strategies have stood the test of time and will continue to do so in the future.

At a portfolio level, we look across our Australian All Cap, Small Cap and International equity portfolios and are excited about the long term opportunity sets for each of these businesses, many of which are executing well on a global scale. When coupled with strong balance sheets and capable management, we anticipate that in aggregate, earnings, dividends and ultimately valuations will be far higher in five to ten years' time. Of course, we remain vigilant and aware of new information but are determined to stay the course, remaining focused on long term objectives.

Thank you for investing alongside us and for your ongoing support of Clime.

Adrian Ezquerro
Head of Investments

Fund Information

Investment Objective

The Fund's return objective is to provide regular income above the RBA cash rate in the form of quarterly cash distributions and aims to achieve a return of at least the RBA cash rate + 3.0% pa. It seeks to deliver a strong risk-adjusted total return and is expected to have a level of volatility of returns significantly less than equity indices, with unit price stability along the way. The Fund's risk objective (as defined by the annualised standard deviation) is 4.0% ± 1.0%, with a rolling 12 months relative risk measure of less than 40% of the S&P/ASX 200 Index. In order to maximise the chance of achieving these objectives, the recommended investing time frame is at least 3 years.

Investment Methodology

The Clime Australian Income Fund seeks to provide an income stream above the RBA cash rate from a portfolio of Australian listed and over the counter (OTC) securities, with a view to price stability. The portfolio will invest in selected high-quality individual securities with consistent income generation. Portfolio yield is likely to be the bulk of the portfolio return and will likely be enhanced by franking credits.

Portfolio Managers

Dr Vincent Chin

Vincent joined Clime in February 2009. He has a wide range of investment experience spanning fixed income to equity. He has more than 10 years of portfolio construction and managing risk across multi-asset classes. Before joining Clime, he gained his investment experience in the late 1990s to 2000s at Ausbil Dexia and Maxim Asset Management (now wholly subsidiary of Charter Hall) where he has developed multi-factors quantitative models for stock selections and attribution performance analysis. Vincent is passionate about ethical investment across any assets including alternate investments. Prior to this, Vincent worked in semiconductor device and material research in academia and industry for more than 15 years. His research spanned III-V and IV groups semiconductor materials and its application. He specialised in transport properties (numerical modelling and characterisation) in these semiconductors for devices and solar cells applications. He has published about 50 international refereed scientific publications and co-edited a proceeding in opto-electronics.

Fund Information

Name	Clime Australian Income Fund	**Investor Eligibility**	Retail & Wholesale
Structure	Managed Investment Scheme	**Minimum Investment**	Retail: $10,000 Wholesale: $100,000
Investment Universe	Listed and OTC Markets	**Liquidity**	Weekly Unit Pricing Applications and Redemptions
Benchmark	3% p.a. above RBA cash rate	**Fees**	Retail: 1.13% management fee Wholesale: 1.03% p.a. management fee
Number of Positions	60-80	**Admin**	Mainstream Fund Services Pty Ltd
Fund Size	$38.1m	**APIR Code**	Retail: SLT1239AU Wholesale: CLA0002AU
Platform Availablity	Netwealth, HUB24		

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