CONCENTRATED LEADERS FUND

ASX LISTED INVESTMENT COMPANY (TICKER: CLF)

MONTHLY INVESTMENT REPORT: JULY 2019

Fund Description

Concentrated Leaders Fund Limited (CLF) is a concentrated portfolio of leading Australian companies. The CLF investment team uses a top-down macro thematic, quantitative filters and bottom-up fundamental research.

Fund Objective

CLF is a geared listed investment company, which invests primarily in companies within the S&P/ASX 200 Accumulation index. CLF is focused on providing investors with capital growth and a consistent yield.

Net Tangible Assets (NTA) as at 31 July

Total Investments	**$112,160,746**
NTA	**$82,359,218**
Shares on Issue	**59,401,514**
NTA per Share (pre-tax) *	**$1.39**
NTA per Share (post-tax) *	**$1.33**
Share Price	**$1.30**
(Discount)/Premium to NTA (pre-tax)	**(6.47)%**
(Discount)/Premium to NTA (post-tax)	**(2.26)%**
Fully Franked Dividend Yield	**9.89%**

* On realised and unrealised gains.

Fund Information

ASX Code	CLF
Date of launch	September 1987
Benchmark	S&P/ASX 200 TR Index

Service Providers

Custodian	National Australia Bank
Administrator	Fundhost Limited
Banker	National Australia Bank
Auditor	Deloitte Touche Tohmatsu
Legal Advisor	Watson Mangioni Lawyers

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Portfolio and Market Review

Investment Performance

Performance as at 31/07/2019 **	1 Month	3 Months	6 Months	12 Months	Financial YTD	Since Inception *
CLF	3.07%	3.39%	12.85%	9.53%	3.07%	16.99%
Benchmark	2.94%	8.58%	18.66%	13.26%	2.94%	19.75%
Value Add	0.13%	-5.19%	-5.81%	-3.73%	0.13%	-2.76%

* Inception date reflects when management of the fund was internalized as of 1 January 2018

** Gross performance excludes all expenses, fees and taxes. Net performance is reflected in the NTA calculations.

The portfolio returned +3.07% on a gross basis (pre-fees and taxes) in July versus the benchmark return of +2.94%. This equates to a +2.96% increase in pre-tax NTA and a +3.10% increase in the post-tax NTA.

For the financial year to date, the portfolio has delivered a return of +3.07% on a gross basis versus the benchmark's +2.94%. This represents a relative performance of +0.13%.

Market Review

The S&P/ASX 200 Total Return Index gained 2.9% during the month, outperforming global equities by ~2% with the MSCI All Country World Index gaining just 0.8%. In the US, the S&P 500 index gained 1.3%. The S&P/ASX 200 Total Return Index has delivered a return of 23.3% for the calendar year-to-date.

In July, the Australian market appeared to primarily benefit from:

1. The Reserve Bank of Australia (RBA) lowering the cash rate by 25 basis points (bps) to 1.00% in the face of soft economic growth, increased global risk, insufficient inflation and sub-optimal wages growth,
2. The ongoing search for yield given lower bond yields, with the Australian 10-year bond yield ending the month at 1.19% from 1.32% at the start, and
3. A preference for lower-risk exposures given that Consumer Staples (+9.5%) and Healthcare (+6.0%) were the two best performing sectors.

Offshore, markets weighed up lower global interest rates against worsening macro conditions. After sharp falls in May and June, bond yields were mostly flat across the globe with Italian bonds being the exception. Italy's 10-year sovereign bond yield fell 55 basis points to 1.54% after it assured the European Union of its commitment to the bloc's fiscal limits. Markets are rejoicing in the lower rate environment with little concern that these lower rates reflect a multitude of higher risk factors and lower global economic growth.

These risk factors include:

1. The ongoing trade war between the US and China,
2. Protests in Hong Kong regarding democracy and China's leadership,
3. A slowdown in the European economy, and
4. A worse economic outcome for the UK as Brexit looms closer.

Unfortunately, each of these situations worsened as the month went on, but thankfully for equity investors, the pre-occupation with lower interest rates continued to drive markets higher. How long this monetary trust lasts is an important question for investors.

Portfolio Review

The portfolio modestly outperformed the market during July, which was a pleasing result given our defensive cash holdings (25.7%) and the strong outperformance of the local bourse relative to its global counterparts.

Our exposure to select Consumer Staple companies was a major driver of returns with the sector performing very strongly. A2 Milk (A2M) and Treasury Wine Estates (TWE) have both been in the portfolio for some time and while we are conscience of the risk exposure to a slowing Chinese economy, we continue to believe their specific target markets will continue to provide attractive earnings growth.

Our underweight to resources companies in the Energy and Materials sectors also aided performance with both being market laggards. Our under-exposure to these sectors has been a major drag on the portfolio given Iron Ore's ~80% price rally since the Vale dam disaster. While we didn't expect the rally to be as strong as it was, we did expect the price spike to be temporary and the resultant price decline now looks to be occurring.

Major Contributors:

A2M (+23.6%) – Strong retail price growth in China reinforced management's growth outlook and the market's earnings expectations.

TWE (+13.5%) – No specific news, however the stock rebounded strongly after a lengthy period of underperformance which has seen its earnings multiple contract significantly since the start of the year.

Major Detractor:

AMC (-4.1%) – There was no meaningful company news, however despite being defensive, AMC is vulnerable to a slowdown in global growth and this seemed to have a negative impact after several months of strong performance.

Sector Exposure

Sector	Weight (%)
Consumer Discretionary	5.7%
Consumer Staples	6.4%
Energy	1.2%
Financials	18.7%
Health Care	6.6%
Industrials	14.1%
Information Technology	5.1%
Materials	10.6%
Real Estate	3.1%
Telecommunication Services	0.0%
Utilities	2.9%
CASH/LIQUIDITY	25.7%

Top 10 Holdings in alphabetical order

Code	Company Name	Sector
A2M	A2 MILK COMPANY	Consumer Staples
AMC	AMCOR LIMITED	Materials
ALX	ATLAS ARTERIA LTD	Industrials
BHP	BHP BILLITON LIMITED	Materials
CBA	COMMONWEALTH BANK OF AUSTRALIA	Financials
CSL	CSL LIMITED	Health Care
MQG	MACQUARIE GROUP LTD	Financials
NAB	NATIONAL AUSTRALIA BANK	Financials
NXT	NEXTDC LIMITED	Inform. Tech.
TCL	TRANSURBAN GROUP	Industrials

Outlook

Very little changed in July as to 1) our view on Australian equities, 2) our thoughts about the macro environment, or 3) our approach to the opportunity set.

Given recent tax cuts, lower official interest rates and a modest rebound in the housing market, the environment for domestic companies is marginally more favorable than it was 3-6 months ago. However, the economic backdrop remains underwhelming with net exports and government spending essentially the only things driving economic growth. In addition to private sector weakness, corporate earnings expectations remain subdued and many key market sectors are expected to come under pressure during the upcoming results season.

Our biggest concern however is the global environment and the potential for a major risk-off event to occur when markets are close to record highs and central banks have little 'dry-powder' left to support them. The global risk picture is worsening by the day with no solution in sight for the US-China trade war. It has clearly shifted to a technology IP (Intellectual Property) war and is likely to shift to a currency war in the not too distant future. Both parties remain committed to their cause, and it seems likely that US President Trump will impose even higher tariffs on China in September in an attempt to re-start negotiations. China also have a major problem in Hong Kong, where protests in June against a parliamentary extradition bill have morphed into full-scale protests regarding China's leadership and Hong Kong's democracy. How China deals with this uprising and how the global community reacts to its response are unknown at this stage, however China will need to tread very carefully given the delicate nature of the situation. In addition, there are growing concerns about the impact of Brexit on the UK economy, slowing economic growth across both Europe and Asia, heightened geopolitical risk via the US' sanctions on Iran and the real possibility that the US could go into a recession given the inverted yield curve.

Markets however appear confident that central banks can quell any potential volatility via both rhetoric and monetary easing. This has been their job since the global financial crisis because of the enormous amount of liquidity they have collectively created. However, we are less confident that they can continue muting risk given the current interest rate environment. This is especially obvious in Europe where German 10-year bund yields are already negative at -0.6%. In addition, there is a lack of experience in the leadership of both the US Federal Reserve and shortly, the European Central Bank once Mario Draghi retires in November.

With this backdrop, the S&P/ASX 200 index is up almost 25% year-to-date and is trading close to record highs. Some of this increase is warranted given the outcome of the Hayne royal commission, higher iron ore prices and lower interest rates. However, it is hard to argue that at current valuations, potential risks are being adequately priced in and we are wary of the consequences should markets lose faith in central banks.

As such, we do not think that this is the appropriate environment to be deploying our available leverage and we continue to have a large cash balance. We remain disciplined in our capital usage and will look to deploy the cash when valuations of companies that we think can deliver capital growth and/or cashflows to our shareholders are more attractive.

We remain overweight quality yield stocks which have and should continue to benefit from a lower interest rate environment. However, most of these companies have already rallied strongly with many being at all-time highs, so we are wary of their current valuations.

We also remain overweight offshore growth companies despite the weaker global economic environment as we think they can deliver superior earnings growth compared to domestically orientated companies and may also benefit from a weaker Australian dollar should the RBA continue to cut interest rates or if the price of iron ore continues to fall.

Important Information