

## Total returns

At 31 May 2017	1 mth %	3 mths %	6 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	7 yrs % p.a.	Inception % p.a. (Feb 2008)
Ralton Leaders	-1.25	3.80	10.63	10.16	9.40	14.57	10.26	7.08
Income return	0.45	1.13	1.93	3.79	3.93	4.11	4.32	4.54
Growth return	-1.70	2.67	8.70	6.37	5.47	10.46	5.94	2.54
S&P/ASX 100 Accum. Index	-2.81	1.55	7.81	11.65	6.06	12.38	8.82	5.15
Difference	1.56	2.25	2.82	-1.49	3.33	2.19	1.44	1.92

## Performance review

- The S&P/ASX 100 Accumulation Index was down 2.81%, weighed down by the index-heavy Financials sector but offset to some degree by positive contributions from Industrials and Telecommunications.
- The Ralton Leaders portfolio returned -1.25% for the period, outperforming the benchmark by 1.56%.
- For the month, our portfolio benefited from being overweight Energy and Consumer Discretionary, and further, being underweight Financials (principally banks).

## Performance attribution

### Key contributors

Key contributors	Positioning
Aristocrat Leisure Ltd	Overweight
Boral Limited	Overweight
Caltex Australia Limited	Overweight

**Aristocrat Leisure (ALL, +11.0%)** – continued its strong rise, gaining a further 11% for May. ALL's half-year profit results were warmly received by investors. Highlights came from nearly every business segment, with North America, Digital and International Class III gaming results all above expectations. Market share gains were consistent with industry feedback that ALL's current product suite is being well received by both venue owners and end users alike. For Digital, ALL continues to add users and grow daily user fees, with market analysts now expecting earnings of \$160m for the full year from a business which was only established a few years ago after the acquisition of a fledgling player in the space for approximately US\$20m. The new CEO, Trevor Croker, has continued the group's commitment to strong product investment (R&D spend). This R&D spend continues to support ALL's core business, but also moves into adjacent categories such as the new Class II and Class III Stepper games scheduled for release in the US in 2H17.

**Boral Limited (BLD, +11.2%)** – shares in BLD rose again in May as investors continue to focus on the fundamentals

of the US-based Headwaters acquisition. Boral received US regulatory approval for the transaction, completing the final hurdle and formally closing the deal in early May. As we emphasised at the time of the announcement in November last year, the acquisition of Headwaters is consistent with the group's strategy of expanding its presence in the US to gain more exposure to the US housing cycle. With the transaction now having passed all regulatory hurdles, Headwaters' and BLD's existing US operations will account for 45% of BLD's profits. The housing cycle has recovered slowly post GFC but sits well below previous mid-cycle levels, creating potential for significant improvement in demand for Boral's services. This should prove favourable to Boral, combined with its exposure to infrastructure via its FlyAsh business, a key input in concrete products. Cyclical strength could well see US profits account for greater than 50% of total company profits in the near term.

**Caltex Limited (CTX, +10.7%)** – shares added value in the month as investors began to revisit this name. We bought the stock early this year when the share price fell after the loss of the Woolworths petrol station supply contract due to the business' acquisition by BP. CTX already has a strategy to replace the lost profits and it has recently made two small acquisitions that assist in partly filling the earnings gap. CTX is also expected to announce a broader restructuring program and productivity drive mid-year. We expect an enhanced emphasis on CTX's retail division with pilot programs around a new 'Foodary' convenience offer likely to be rolled out across its store network. CTX is well capitalised, providing potential for further acquisitions, further investment in CTX retail locations or alternatively capital management (there is large pool of franking credits).

### Key detractors

Key detractors	Positioning
The Star Entertainment Group	Overweight
ANZ Banking Group	Overweight
AMP Ltd	Overweight

**The Star Entertainment Group (SGR, -7.7%)** – was one of several Australian consumer-facing stocks that underperformed across May. An investor update during the period highlighted a moderation in core revenue growth below the level expected by us and the market. Revenue growth for the period remains at a healthy 4.1%, marking a reversal from the first-half period where disruptions from significant capital works at the Sydney and Gold Coast casinos were a headwind to revenue growth. As we expect the soft consumer outlook to remain for a period (given low wage growth and rising interest rates, electricity costs, health costs, etc.), we have reduced the position in the portfolio. Medium term, we continue to expect SGR will benefit from growing tourism, with continued strong arrivals from China expected to drive continued demand at its casinos. Further, SGR's operational improvements should see it continue to win market share in the local Sydney market – a reasonable tailwind for Star's core asset, the Star Casino in Sydney.

**ANZ Banking Group (ANZ, -14.5%)** – the Federal Government's decision to introduce a 'bank levy' as part of the May budget was a key trigger for share price weakness across the banking sector. The bank levy is seeking to charge Australia's largest banks a cumulative \$6.2bn over the four-year 'forward estimates' period. While our holding in ANZ detracted from performance during the month, our underweight positioning in the banking sector was a solid contributor to the portfolio's outperformance during the period. This positioning reflected our struggles with the valuations given the headwinds all the banks face. However, the banks continue to offer an attractive yield and bad debts remain benign given the very low level of interest rates. With this backdrop, we are comfortable with our positions in the banks.

**AMP Limited (AMP, -5.8%)** – shares detracted from portfolio returns by underperforming in a down market. The company held its investor day during the month where the focus was on how to address current industry pressures, largely fee compression across the value chain. The company highlighted a series of growth avenues it will pursue in the coming years. At a headline level these were focused on 'Advice and SMSF initiatives', growth from AMP Bank and the start of profit generation from its investments in China. The market remains concerned about the capacity of management to deliver in a very competitive market. We are more optimistic, having watched management deal with some very tough structural reforms in the Wealth Management business and the structural issues that have confronted the Life Insurance sector.

## Portfolio changes

### Key additions and material adjustments

Bought
Evolution Mining (EVN)
Lend Lease (LLC)
Vicinity Centres (VCX)

We added **Evolution Mining (EVN)** to the portfolio as a gold exposure, replacing Newcrest Mining (NCM) post the recent mine damage at its Cadia operations in NSW. EVN has a strong capital position and a portfolio of low-cost mines in the first and second quartile of global production costs. Australian gold miners have benefited in recent times from the falling Australian dollar which increases the value of gold sales. With costs across the whole mining sector falling as miners seek large productivity improvements, higher gold prices have been highly favourable to the gold names. We expect EVN to participate in further industry consolidation as it arises.

**Lend Lease (LLC)** – we bought an initial position in LLC during May, increasing the portfolio's exposure to the Australian east coast infrastructure theme. As was evident in the recent Federal Budget, governments are intent on boosting infrastructure as a means of simultaneously driving economic growth, productivity and voter services. Lend Lease recently restructured its infrastructure team with a view to deliver some \$4-\$5bn in annual revenues from this division. This would imply a near doubling of current revenues, with LLC also seeking a commensurate improvement in margins. We retain a positive outlook toward LLC's other divisions, including US and UK construction and property funds management (Investments). LLC's domestic apartment division has likely peaked for this cycle. Pleasingly, LLC's mid to high-end apartment product has served the company well, with strong demand and no material evidence to date of defaults on settlement.

**Vicinity Centres (VCX)** – we added a position in the retail REIT, VCX, during the period. Vicinity owns multiple retail properties or shopping centres across Australia, although is perhaps best known for its ownership of Chadstone – a retail mega world with an emphasis on high-end fashion, located in Melbourne's south east. Shares in many of the retail-exposed REITs have been weaker since late last year, with global bond yields rising and concerns about the impact of Amazon's Australian entry on what has been a muted retail sector. These concerns provided an opportunity to acquire the shares below their current asset value. While there is likely downside to rental levels in the future, we believe the share price weakness has

been overdone. Tenant leases are typically long dated and will allow for change in tenant mix across time as Amazon and others force traditional retailers to adapt and change. We expect the quality of VCX's overall portfolio and focus on rental growth to support the shares and maintain its strong dividend yield.

#### Key disposals and material adjustments

##### Sold

AGL Energy Limited (AGL)

Shares in **AGL Energy Limited (AGL)** re-rated considerably in recent months as our thesis around rising electricity prices and the cash flow benefits that follow to AGL has unfolded. We are however cognisant this theme may have run its course. The 'forward curve' for electricity prices rose considerably in recent months based on expectations of a tight market for electricity and may well have peaked. As we previously highlighted, the sharp rise in power prices over the past couple of years is a result of the communities' decision to increase the level of renewable energy in the system and a failure to implement a strategic plan to undertake this transition. This has benefited AGL and other power generators whose cost of production is somewhat fixed. On top of regulatory risks from politicians keen to shield voters from rising power bills, we have seen a myriad of supply responses over recent months across the spectrum of solar, gas, pipelines, wind farms, battery storage and more. With this peak in pricing likely and AGL trading around fair value, we elected to take profits on this name.

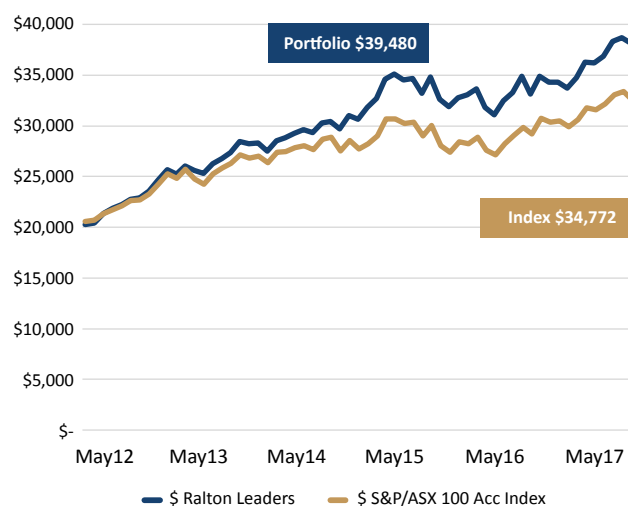
#### Sector allocation

GICS sector	Ralton	Index	+/-
Consumer Staples	11.4%	7.1%	4.4%
Energy	7.9%	4.3%	3.7%
Consumer Discretionary	7.1%	3.6%	3.5%
Information Technology	3.8%	0.9%	2.9%
Telecommunication Services	3.9%	4.0%	-0.1%
Materials	15.0%	15.9%	-0.9%
Utilities	1.4%	2.6%	-1.2%
Industrials	5.4%	7.3%	-1.9%
Health Care	5.2%	7.1%	-1.9%
Real Estate	4.2%	8.1%	-3.9%
Financials	34.6%	39.2%	-4.5%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>0.0%</b>

#### Top 10 holdings<sup>#</sup>

Company name	ASX code
Commonwealth Bank of Australia	CBA
ANZ Banking Group Limited	ANZ
BHP Billiton Limited	BHP
Westpac Banking Corp	WBC
Woolworths Limited	WOW
Aristocrat Leisure Limited	ALL
QBE Insurance Group Limited	QBE
Telstra Corporation	TLS
Suncorp Group Ltd	SUN
Computershare Ltd	CPU

#### Performance comparison of \$20,000\*



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Performance of the Ralton Wholesale Leaders Model Portfolio is based on a model portfolio and is gross of investment management and administration fees, but net of transaction costs. The total return performance figures quoted are historical and do not allow the effects of income tax or inflation. Total returns assume the reinvestment of all portfolio income. Past performance is not a reliable indicator of future performance.

\*The performance comparison of \$20,000 over 5 years is for illustrative purposes only. Performance is calculated on a gross basis. Actual performance will vary depending on the amount of fees charged by the relevant platform that a client uses to implement the portfolio. The comparison with the S&P/ASX 100 Accumulation Index is for comparative purposes only. Index returns do not allow for transaction, management, operational or tax costs. An index is not managed and investors cannot invest directly in an index. There is no guarantee these objectives will be met.

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