Total returns

At 31 December 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 High Yield Australian Shares	1.98	6.20	5.55	11.35	9.78	13.21	11.43	8.27
Income return	*0.15*	*0.78*	*2.39*	*4.57*	*4.45*	*4.59*	*4.81*	*4.96*
Growth return	*1.83*	*5.42*	*3.15*	*6.78*	*5.33*	*8.62*	*6.62*	*3.31*
S&P/ASX 300 Accum. Index	1.86	7.74	8.60	11.94	8.76	10.15	8.13	5.26
Difference	**0.12**	**-1.55**	**-3.06**	**-0.59**	**1.02**	**3.06**	**3.30**	**3.01**

Performance review

- The S&P/ASX 300 Accumulation Index had a strong finish to the year, adding 7.74% for the December quarter. Energy and Information Technology were the top performers for the quarter with all market sectors delivering a positive return for the period.
- The Ralton High Yield portfolio returned 6.20% for the quarter, underperforming the benchmark by 1.55%.
- At a sector level our stock selection within each of Health Care, Consumer Discretionary and Industrials added value for the December quarter. Offsetting these gains was our underweight to both Financials and Energy for the quarter, together with stock selection within both Consumer Staples and Real Estate.

Performance attribution

The Ralton High Yield portfolio has underperformed the market over the past 6 months. Although this is very frustrating from our perspective, the key driver has been the portfolio's underweight exposure to both the Materials (principally resource stocks) and Energy sectors. Commodity pricing has been solid and global growth accelerating, both supportive of Resources and Energy. Most of the energy stocks are not paying dividends at all.

The balance of the underperformance has been driven by stocks such as Lendlease (LLC), Telstra (TLS) and Japara Healthcare (JHC) which we continue to hold. We expect the market to eventually realize the value in these stocks which we continue to view as undervalued. The exception was QBE Insurance Group (QBE) which we exited during the period.

During this period we have also had a number of opportunities to add yield to the portfolio at valuations better than we have seen for some time.

We will continue to follow our process for generating above market returns which has worked over the past 10 years.

Key contributors

Key contributors	Positioning
Aristocrat Leisure	Overweight
Boral Limited	Overweight
BHP Billiton Ltd	Overweight

Aristocrat Leisure (ALL, +12.9%) – ALL shares added value to the portfolio following a solid half year result and the acquisition of BigFish Social Gaming. Both announcements were made on the last day of November. The negative share price fall was a touch surprising as we highlighted during our November report, however by the end of quarter the shares had subsequently rebounded. Turning briefly, to the half year profit result, the numbers from our vantage were good quality and in line with expectations. Strong performance by ALL's Americas region, Gaming Ops, Digital and Class 3 outright sales segments contributed to some 36% growth in profit for the period. The market was maybe surprised by the softer tone around management's FY18 guidance – management have traditionally been conservative.

The main focus however was the acquisition of the BigFish Social Gaming Firm. This may also have had an impact on the share price. At an acquisition price of US$990m, this represents a material transaction for ALL. Once the deal completes ALL will become the No 2 player in social gaming globally, with ''digital'' revenue at ALL accounting for near 40% of revenue. Our initial view is that the transaction makes strategic sense and builds upon ALL's exposure to the broader digital segment, which itself targets a younger demographic than ALL's traditional end customers. The initial share price move (which as we write has somewhat recovered) is likely ''sticker shock" as investors digest the size of the acquisition. Given ALL's track record in terms of integrating large acquisitions, adding growth to the businesses they acquire and rapidly reducing debt, we have confidence, that in time the acquisition can add value for shareholders.

Boral Limited (BLD, +15.1%) – a positive trading update, including a modest uplift in FY18 profit guidance at the AGM in November helped BLD shares add value for

the quarter. A little over one year on from what was at the time the somewhat contentious acquisition of the US based Headwaters business, BLD shares are up a little under 44% on a rolling one year basis. With the acquisition completing during the middle of the year, FY18 will be a critical year for BLD management to deliver on the synergies from the Headwater's acquisition. We have a positive view on the potential for BLD's merged US operations. This includes a positive outlook for the FlyAsh business, including recent price rises which are expected to benefit the coming year. In Australia, as our regular readers will be aware, we have a constructive view of the ongoing east coast infrastructure pipeline and demand in turn for concrete, aggregates and the like. Rising energy costs remain a headwind and will temper profit growth in Australia, as the need to recover material input cost rises does consume some of the pricing benefits that were expected to accrue at this stage of the cycle.

BHP Billiton Limited (BHP, +14.7%) – rising commodity prices for copper, iron ore and oil saw BHP add value to the portfolio for the quarter. We have been progressively adding to our BHP holding since mid year, highlighting since that time the noteworthy election of Ken MacKenzie as Chairman of the BHP board, succeeding Jac Nasser, effective September this year. As CEO of Amcor Limited (AMC), MacKenzie delivered strong shareholder returns, driving a cultural change and heightening focus on return and use of capital. Under his leadership, the company went through a turnaround and period of strong growth from 2006-2015.

MacKenzie joins BHP at an interesting time for Australia's largest miner and the broader resources industry. Activist shareholders are agitating for change, highlighting the poor returns and capital losses incurred from BHP's incursion into the US onshore shale oil and gas sector under prior CEO, Marius Kloppers. We look to Ken MacKenzie and the BHP management team, led by CEO Andrew MacKenzie (no relation) to continue to focus on optimised returns and use of capital. Under the CEO, the BHP of today is a smaller, more focused investment proposition than its predecessor of five years ago. The bulk of BHP's smaller, non-tier one assets have been either sold or divested into S32 (S32), which holds the aluminum, alumina, manganese and other smaller assets in coal, silver and zinc.

Broad cultural change at a giant company like BHP will certainly prove a challenge, however we look for the new Chairman to strike the appropriate balance in terms of the need to invest capital across new projects, maintain current tier one assets, return money to shareholders and deliver a strategy that ensures sufficient diversity and growth options.

Key detractors

Key detractors	Positioning
Lendlease Group	Overweight
Ingham's Group Ltd	Overweight
IOOF Holdings Ltd	Overweight

Lend Lease (LLC, -8.8%) – LLC gave back prior share price gains following a market update in mid October. Although LLC's update broadly maintained profit expectations for the current year, the composition of earnings and issues within the Australian construction business were not well received by the market. Specifically, this division is now likely to deliver lower EBITDA than the prior year due to losses on some small, but problematic contracts. Our logic in revisiting LLC during May was focused on increasing the portfolio's exposure to the Australian east coast infrastructure theme. Lend Lease recently restructured its infrastructure team and aims to deliver $4-5bn in annual revenues from this division. This would nearly double current revenues, with LLC seeking a commensurate improvement in margins. Although these problematic contracts represent a step backwards for this division, these contracts were written and won several years ago, and hence we do not view them as representative of management and contract risk structures since put in place.

Ingham's Group (ING) – Recent portfolio addition, ING weighed on portfolio returns, underperforming since we added the stock in October. As Australia's largest poultry supplier with operations spread across the country, Ingham's is a household name. Long a family owned and managed business, ING recently listed on the public markets. The company culture and strategy is morphing from these family roots toward a modern, efficient fast-moving consumer goods company. The company has a well-respected CEO and has established clear targets around productivity and profit objectives across a range of business areas. These targets appear attainable, which is important as they form part of the prospectus figures. Beyond the initial phase, we expect ING has considerable scope to improve profits, margins and cash flows. As one of the dominant suppliers of poultry in Australia, including the key supermarkets, we believe ING has reasonable power against its customers and draw some parallels to Tassal Group (TGR) where supply constraints, breeding cycles and quarantine all provide protection against competition. BBQ chickens are one of the key suppliers of foot traffic into supermarkets and hence the Coles and Woolworths of this world need ING's chickens.

IOOF Holdings (IFL, -3.9%) – IFL shares traded lower in the December quarter against the back drop of a rising market. The major news for IFL during the quarter was

the proposed acquisition of part of ANZ's wealth division. In a near $1bn transaction, IFL has agreed to acquire ANZ's pensions and investment business, increasing debt and raising new equity to fund the transaction. Although initially well received by investors (including ourselves) the transaction will take some time to be approved and completed, which may weigh on investor sentiment.

IFL has also been very successful as a major consolidator in the wealth management space, where its integration skills allow it to retain the core value of its acquired businesses while stamping out unnecessary costs. Having consolidated multiple platforms, IFL is now targeting an improved service offering to financial advisers and clients. IOOF is particularly focused on the flexibility, or 'open architecture', of its investment platforms which allows advisers to personalise investment services, rather than being restricted to in-house product offers. We like IOOF's focus on the customer which differentiates it from the big banks and other large financial institutions, particularly at a time when community trust in the banks is increasingly questioned.

Portfolio changes

Key additions and material adjustments

We added several new stocks to the portfolio during the quarter.

Bought
Coca-Cola Amatil (CCL)
Healthscope Limited (HSO)
Macquarie Group (MQG)
TABCORP Holdings (TAH)

Coca-Cola Amatil (CCL) – share price weakness and a less negative view in respect to the impact of the container deposit scheme (CDS) led us to revisit CCL. Although pressure remains on the group's core CSD or carbonated soft drinks division, we expect that new product launches across a range of beverage options, together with further cost efficiencies, can see CCL deliver modest growth in profits. CCL's CSD headwinds are well known and indeed a global phenomenon, which means that the parent company (KO) is working overtime on new products to sell through its pipes. CCL in Australia and Indonesia is the beneficiary of these efforts.

The pending CDS would see a levy charged on drinks containers at the point of purchase to cover part of the recovery and scheme costs. Early indications are that the retailers will be passing this cost on to the consumer in full. We will be monitoring both pricing to the consumer and potential volume impacts to determine to what extent CCL is impacted in the short term.

Early expectations suggest that costs are being passed on to the consumer rather than the producer being forced to bear the extra cost. Should this be maintained and given many market analysts appear to expect that CCL will bear the cost, such an outcome could certainly be well received by a skeptical investment community.

Healthscope Limited (HSO) – We added Australia's number 2 hospital operator to the portfolio in October. The stock was relisted via IPO in mid 2014. The share price rallied circa 50% at its peak before recently reverting toward the IPO price, and we now view the valuation as more interesting. Recent concerns included the exit of long standing CEO Rob Cooke and a slow-down in hospital admissions during FY17 which coincided with HSO bringing more bed capacity onto the market. Broader economic driven affordability concerns for private health insurance (PHI) also weighed on the stock. We expect this to cap PHI participation in years to come, although expect that the core of HSO's patients, the 50 plus demographic, will attempt to maintain PHI to ensure access to preferred hospitals and surgeons. On this basis, and assuming that HSO can grow admissions around 2-3% per annum, we see HSO as reasonable value over the medium term.

We added a position in **Macquarie Group (MQG)** during the month. MQG under CEO Moore has materially reshaped the business over several years. The transformation of the MQG business to a higher 'annuity' share has changed the risk profile from its days as a more pure play investment bank. The annuity style businesses are heavily focused on funds management, with a range of asset classes managed by Shemara Wikramanayakeim, Head of Macquarie Asset Management. The cost-to-income ratio (CTI) is still transforming to reflect the change in profile of the business with a substantial reduction in CTI possible overtime. This provides a substantial amount of scope to drive/maintain earnings. MQG offers a good yield versus that of the broader market.

Finally, we acquired a stake in **TABCORP Holdings (TAH)** which recently completed its merger with Tattersalls (TTS) after a long and arduous process. The core lotteries business is a solid defensive business which displays many of the characteristics of an infrastructure asset. The margin in the lotteries business is also benefiting from the structural shift in the industry from buying tickets through a newsagency to online purchases. The wagering business is now the dominant operator in the country. The combined scale of the Tattersalls and Tabcorp businesses should provide substantial operational benefits. Further, we are starting to see a move by the state governments to defend their tax bases from wagering against online operators. This again would be a structural benefit to TAH.

Key disposals and material adjustments

Sold
AMP Limited (AMP)
Incitec Pivot (IPL)
Macquarie Atlas Roads (MQA)

AMP Limited (AMP) – we funded our holding in MQG through the outright exit of AMP. A number of AMP's core businesses have underperformed in recent times with issues in Wealth Protection (insurance) arising from poor claims experience and fee headwinds from the implementation of MySuper, creating earnings headwinds. Although some progress has been made by management to offset these headwinds, through a series of cost-out drives, the progressive reinsurance of its exposures in its Wealth Protection business and the near completion of the back book for MySuper. The group has also outlined a range of initiatives to drive growth in future periods. However, we are less convinced as to what drives AMP from this point in the cycle. IOOF and MQG remain our preferred investments in the financial services sector.

With Incitec Pivot (IPL) shares rallying since our initial purchase, we decided to sell our holding and lock in some profits in October. As we had expected, the recent rally in the oil price somewhat supported pricing for urea and ammonia, which in turn supports IPL profits. There is some expectation of capital management building in the lead-up to November's full year result. We view this as a possibility, although note that with ammonia prices still somewhat depressed, the scope for any excess cash generation is modest.

Macquarie Atlas Roads (MQA) – We elected to sell our long held position in MQA during the quarter. MQA shares had rallied to an all-time high, following the recent capital raise to the support the purchase of an additional 4.9% in the APRR toll road network. News that long time CEO, Peter Trent, was set to resign in February 2018, replaced by James, Hooke, current CEO of Macquarie Infrastructure Corporation was also well received by the market. Trent has been integral to the restructure, simplification and now expansion of MQA in the last eight years. With the commensurate reduction in yield for MQA securities and the stock trading at what we felt was fair value we took the opportunity exit our holding in MQA.

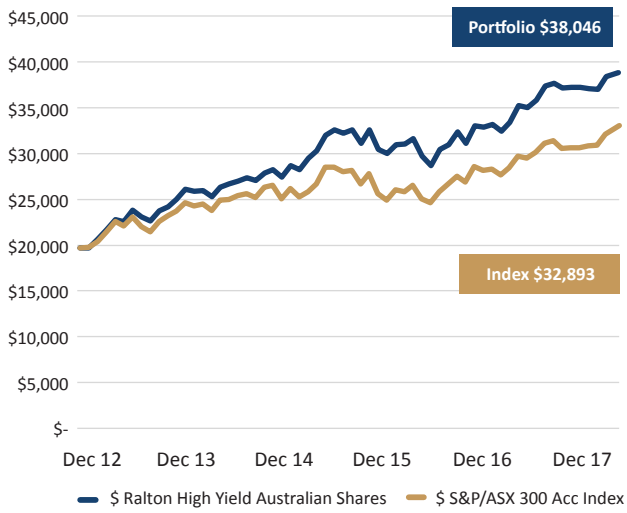
Sector allocation

GICS sector	Ralton	Index	+/-
Consumer Staples	12.4%	7.5%	5.0%
Materials	20.0%	17.7%	2.3%
Real Estate	9.3%	8.2%	1.1%
Consumer Discretionary	5.8%	4.9%	1.0%
Utilities	2.9%	2.0%	0.9%
Health Care	7.9%	7.1%	0.9%
Telecommunication Services	3.4%	3.0%	0.4%
Information Technology	1.7%	2.1%	-0.4%
Energy	3.4%	5.2%	-1.8%
Financials	33.0%	35.0%	-1.9%
Industrials	0.0%	7.4%	-7.4%
Total	**100.0%**	**100.0%**	**0.0%**

Top 10 holdings#

Company name	ASX code
BHP Billiton Limited	BHP
ANZ Banking Grp Ltd	ANZ
National Aust. Bank	NAB
Westpac Banking Corp	WBC
Woolworths Group Ltd	WOW
Aristocrat Leisure	ALL
Vicinity Centres	VCX
Commonwealth Bank of Australia	CBA
Boral Limited	BLD
Telstra Corporation	TLS

Performance comparison of $20,000*



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Performance of the Ralton Wholesale High Yield Australian Shares 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 300 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 an in index. There is no guarantee these objectives will be met.

#Portfolio holdings may not be representative of current or future recommendations for the portfolio. The securities listed may not represent all of the recommended portfolio's holdings. Future recommended portfolio holdings may not be profitable.