clime capital

Net Tangible Assets Report

May 2019

Market Commentary

During May, the Australian share market strongly outperformed weak global markets. This followed the surprise election victory of the Scott Morrison led Coalition Government on 18 May. The domestic share market was relieved that there would be no changes to negative gearing, franking credits or capital gains tax. This relief was in contrast to falling overseas markets, which were concerned with slowing economies and the worsening of trade tensions between the US and China. While the ASX managed a small rise over the month, most developed country indices fell around 5% or 6%. Meanwhile global bonds rallied strongly, with rising bond prices reflecting the softening global economic outlook.

Australia's RBA to cut rates

Australia's central bank indicated it could cut its key policy rate for the first time in almost three years when it meets on 4 June, amid an economic slowdown and tepid inflation growth. The RBA is intent on supporting employment growth and bringing forward the time when inflation is consistent with its 2% to 3% target.

At the time of writing (end May), the RBA has held its cash rate at a record low of 1.5% since August 2016 but calls for an interest rate cut have been getting louder, and the market now regards it as almost definite.

Australia reported lower than expected growth last year, as the steep housing downturn and lacklustre consumer spending sparked concerns about the outlook. Perhaps the election result will turn that around: newspaper headlines suggest the correction in residential housing is over. We are not as certain.

The RBA has downgraded its growth forecasts for the second time in six months. While the labour market generally has strengthened over the last year, unemployment ticked up to 5.2% in April and recent wage growth has come in under expectations. Inflation remains benign, and below the target band.

Australia outperforms during May, as global growth slows

Despite strong global share markets, major economies are losing momentum. Weakening business and consumer sentiment, geopolitical uncertainties and trade tensions have dampened business investment and are hurting growth prospects. Conventional monetary policy remains constrained in many economies where policy rates are close to or below zero, while further unconventional monetary policies present risks and uncertainty.

The US expansion has moderated as the tax cut stimulus wears off and the rate of growth in employment and retail sales weakens. Waning business and consumer confidence, along with a yield curve that remains flat despite prospects of large US budget deficits, suggest further weakness ahead. Muted wage and inflationary pressures have led the Federal Reserve to pull back from its rate tightening plans, with the debate shifting toward rate cuts and a halt to the unwinding of the Fed's balance sheet.

Growth in Europe is deteriorating with its largest economy, Germany, losing momentum and weaknesses emerging in other parts of the eurozone. Business and consumer sentiment seem to have soured across the eurozone, which could keep growth low. Brexit-related uncertainties are coming to a head in the UK, although the economy has so far held up better than expected.

In China, retail sales, fixed asset investment and industrial output point to slowing expansion. Exports and imports have both fallen relative to a year ago, reflecting subdued global demand and lagging domestic growth. The Chinese government's recent monetary and fiscal stimulus measures, while modest, indicate that policymakers are concerned about the economy's growth trajectory.

Against this rather gloomy macroeconomic backdrop, international trade has taken a hit. The WTO predicts a further slowdown of global trade growth in 2019, while the Baltic Dry Index, a bellwether trade indicator based on shipping rates for dry bulk commodities, is down 40% since August last year.

The Trade War

The US-China trade talks appear to be closing in on a "make it or break it" moment. President Trump renewed his threat of heightening tariffs on Chinese imports on 5 May, and Chinese officials responded by threatening to pull out of the talks.

While the talks meander with claim and counterclaim, it's worthwhile remembering that the costs of a trade war are not prohibitive to either the US or China, and that domestic politics will play a big role in any agreement. The trade grievances at the root of the trade war with China – namely corporate espionage, hacking, forced technology transfer, intellectual property theft, and the restrictions on Chinese telecoms firm Huawei – were always going to be extremely difficult to settle. Markets in both China and the US are feeling the ebbs and flows of the trade talks in their stock prices.

But there is more to this conflict than just trade. Tensions have flared across the entire range of US-China strategic disagreements, including North Korea, Iran, and China's "One Belt, One Road" initiative. In late April, President Xi Jinping called for China to embark on a new "Long March" and "start all over again", in the most dramatic sign to date that Beijing has given up hope of reaching a trade deal in the near term.

Can either country win a trade war? External trade between the two countries is of greater importance to China than it is to the US. Exports of goods and services represent about 20% of China's GDP, whereas they only make up about 12% of US GDP. US exports to Europe are roughly double its exports to China, whereas the US is the largest destination for China's exports. On the other hand, China has a strongly growing internal market.

A protracted conflict between the world's two largest economies puts at risk the future of a digitally enabled globalization from which China has profited more than any other country. A full-scale cold war could trigger a new stage of de-globalization, or at least a division of the global economy into two incompatible economic blocs. This is not a comfortable situation for Australia, squeezed between our largest trading partner and our most powerful political ally. In either scenario, trade in goods, services, capital, labor, technology, and data would be severely restricted and long-term growth compromised.

Concluding remarks

We are in a world of low growth, high private and public debt, and geopolitical risk. The populist backlash against globalization, trade, migration and the power of technology and social media

Market Commentary

platforms may well have a negative impact on future growth and markets. Protracted trade wars are not conducive to strongly rising global sharemarkets.

While investors' present complacency with equity markets may continue for some time, markets will probably remain fickle and volatile. Any number of disappointments could trigger a correction, and it will pay to be alert to the risks, with both eyes focused on high quality assets and strong underlying value.

Thank you for your continued support of Clime.

Adrian Ezquerro
Head of Investments

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Portfolio Update

The Clime Capital portfolio returned +0.9% in May, net of fees and taxes, compared to a +1.7% return for the S&P/ASX All Ordinaries Accumulation Index.

Key contributors and detractors to the CAM return for the month were:

- Australian Equity Large Cap Sub-Portfolio: Positive contributors National Australia Bank (+8.0%), Australia and New Zealand Banking Group (+5.6%) & Rio Tinto (+5.2%), only detractor Treasury Wine Estates (-12.5%).
- Australian Equity Mid Cap Sub-Portfolio: Positive contributors Seek (+14.8%) & Credit Corp (+4.4%), detractors Reliance Worldwide (-25.8%), Webjet (-11.9%) & GUD Holdings (-11.7%).
- Australian Equity Small Cap Sub-Portfolio: Positive contributors Electro Optic Systems (+39.9%), Hansen Technologies (+29.9%), Audinate (+28.2%), Lovisa Holdings (+13.1%) & Austal (+9.7%), detractors Citadel (-37.1%) & Navigator Global Investments (-5.5%).

Major banks rallied strongly during the month, particularly post the Australian election result.

Electro Optic Systems (EOS) provided a strong market update, guiding to over 45% compound growth in both revenue and profit for 2020 and 2021. Hansen Technologies (HSN) announced the acquisition of Sigma Systems, which is expected to be materially accretive in the first year of ownership. Audinate (AD8) continues to attract investor interest to its strong leading market position in digital audio networking.

Citadel (CGL) downgraded earnings guidance for the current financial year on lower than expected client demand. Clime Capital has maintained its position based on the potential for demand to recover and the opportunity presented by CGL's software as a service (SaaS) business.

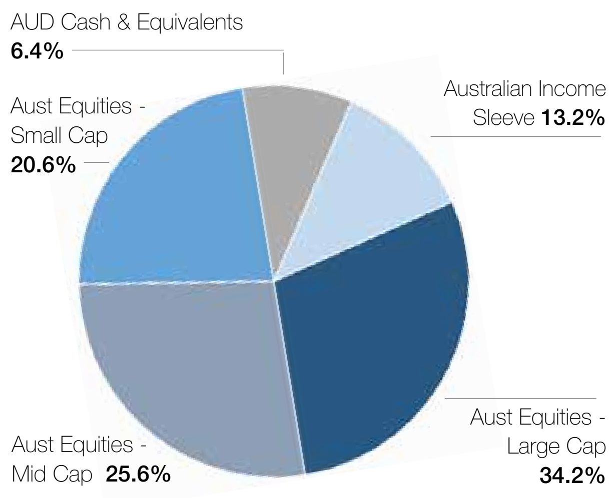
Webjet (WEB) has been impacted by indications of soft travel demand in both Australia and Europe, though long term prospects remain sound. Treasury Wine Estates (TWE) affirmed earnings guidance of approximately 25% for FY2019, while the share price was affected by "trade war" concerns.

NTA before Tax	Total Portfolio Including Cash	Rolling 12 Month Dividend	Historical Dividend Yield
$0.96	$109.2m	5.0cps	5.6%

Top Holdings (% of Gross Assets)

National Australia Bank Limited	5.2
Amcor Limited	4.9
Westpac Banking Corporation Limited	4.9
Wesfarmers Limited	4.2
BHP Billiton Limited	4.0
AUD Cash	*6.4*

Gross Asset Allocation



Net Tangible Assets (NTA)

	May	*April*	*March*
NTA before tax	$0.96[2]	$0.95[1]	$0.92[1]
NTA after tax	$0.94	$0.92	$0.90
CAM Share Price	$0.89	$0.88	$0.88
Yield Excl. Franking	5.6%	5.7%	5.7%
Yield Incl. Franking	8.0%	8.2%	8.2%

[1] On 21 February 2019, the Board declared a fully franked dividend of 1.25 cents per share in respect of the Company's ordinary shares for the period 1 January 2019 to 31 March 2019, paid on 26 April 2019. NTA before and after tax disclosed above for April 2019 is after, and March 2019 is before, the effect of this dividend payment.

[2] On 3 June 2019, the Board declared a fully franked dividend of 1.25 cents per share in respect of the Company's ordinary shares for the period 1 April to 30 June 2019, payable on 26 July 2019. NTA before and after tax disclosed above for May 2019 is before the effect of this dividend payment.

Company Overview ($m)

Australian Equities	$87.73
Australian Income Sleeve	$14.43
AUD Cash & Equivalents	$7.01
Total Portfolio including Cash	$109.17
Notes Payable at face value of $0.96	($21.39)
Net Tangible Assets	$87.78