Wealth Defender Equities

Wealth Defender Equities Limited
ACN 602 517 528

INVESTMENT PORTFOLIO UPDATE & NTA REPORT

August 2016

WEALTH DEFENDER EQUITIES AS AT 31 AUGUST 2016

Investment Objective

The Company aims to outperform the S&P/ASX 300 Accumulation Index by investing in a diversified portfolio of predominantly Australian shares while using protection strategies including derivatives and cash to dynamically protect the portfolio through market cycles, thereby cushioning the magnitude of negative returns when equity markets fall significantly.

ASX Codes:

WDE
WDEO (Loyalty options)

Net Tangible Assets (NTA) 31 August 2016

NTA before tax: $0.8941^β$
NTA after tax: $0.9335^β$

Listing Date:

21 May 2015

Shares on Issue

125.7 million

Share Price 31 August 2016

$0.79

Loyalty Options

Expiry date: 23 November 2016

Dividend Frequency

Half Yearly

Number of Stocks

35 to 100

Cash Limits

0 to 50%

Suggested Investment Timeframe

5+ years

β The NTA does not include or adjust for outstanding Loyalty Options. The NTA per share is at 31 August 2016. The after tax numbers relate to the provision for deferred tax on the unrealised gains and losses in the Company's investment portfolio.

INVESTMENT OVERVIEW & PERFORMANCE

NTA PERFORMANCE AS AT 31 AUGUST 2016	1 MONTH %	3 MONTHS %	FYTD %	1 YEAR %	SINCE INCEPTION^ % P.A
S&P/ASX 300 Accumulation Index	-1.56	2.15	4.70	9.69	2.27
Wealth Defender Equities*	-0.20	1.07	3.84	-1.54	-4.99

*** Returns shown for the Company have been calculated on the growth of Net Tangible Assets (NTA) after taking into account of all operating expenses (including management fees) and assuming reinvestment of dividends. ^ Inception date 21 May 2015. Performance is annualised.**

- The market fell in August, with the S&P/ASX300 Accumulation Index (the Index) down 1.56%.
- Reporting season was the highlight of the month, seeing a rotation into value.
- Wealth Defender Equities (WDE) fell 0.20%, outperforming the Index by 1.36%.

In line with the objective, WDE is invested in a diversified portfolio of financially sound companies and carries a level of protection sufficient to reduce the magnitude of significant negative returns during sharp equity markets falls.

CONTRIBUTION TO RETURN AS AT 31 AUGUST 2016	1 MONTH %	3 MONTHS %	FYTD %	1 YEAR %	SINCE INCEPTION^ % P.A
Portfolio Gross Return (WDE) ^{α}	-0.04	1.54	4.10	-0.01	-3.24
Stock Portfolio#	0.18	2.36	5.86	4.96	-0.97
Protection Portfolio#	-0.22	-0.82	-1.76	-4.97	-2.27

α Gross Investment Portfolio performance before fees and tax. # Contribution to Return.

MARKET ACTIVITY

The international markets were mixed with the S&P500 down 0.1%, FTSE100 up 0.9%, Nikkei 225 up 1.9% and the Shanghai Composite up 3.6%. Metal prices eased post their recent rallies, with nickel down 8.6%, copper down 5.2%, gold down 3.4% and iron ore down 2.8% over the month. The oil price closed up 8.4%, having rallied up 21.0% intra-month. The Federal Reserve left rates unchanged and the Reserve Bank of Australia (RBA) reduced rates by 25 basis points to 1.5%, with the Australia Dollar (AUD) finishing the month down 0.5 cents at 75 US cents.

Reporting season was the highlight of the month. As expected, results were generally subdued, with soft revenue growth, an ongoing focus on cost control and weak earnings growth. Industrial earnings were mixed but overall flattish, while bank earnings declined slightly and resource earnings fell sharply on lower commodity prices.

PORTFOLIO UPDATE

The reporting season saw a reversal of the trends of the past twelve months, with many of the "expensive defensive" parts of the market underperforming, having failed to meet the market's very high expectations of them. Notable examples of stocks which we have not held on the basis of overvaluation include Blackmores (down 21.5%), REA Group (down 9.5%), Transurban (down 8.8%), Brambles (down 8.4%) and CSL (down 8.4%). Interestingly, despite the share price falls, these stocks are still trading on demanding valuations, with FY17 price to earnings (P/E) ratios of 20 to 30 times, suggesting further downside risk.

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By contrast, we were pleased to see strong performances from some of the out of favour stocks we hold which we believe offer very good value. Holdings which performed particularly strongly included Downer EDI (up 20.4%) which delivered a solid result in challenging conditions and guided for FY17 profits significantly higher than market forecasts, as it manages the transition from a mining services focus towards public infrastructure and services provision. Flight Centre (up 14.6%) performed well despite reporting slightly lower earnings as a result of discounting by airlines. Despite this headwind, the company is continuing to invest and expand its global footprint to underpin future growth. Harvey Norman (up 11.2%) outperformed after delivering a very strong result, with profit up 20.0% and the dividend increased by 50.0%. All of these businesses have strong market positions, good management and are trading at attractive valuations. Further, they are underpinned by strong balance sheets which allowed them to maintain or increase their dividends.

Resource stocks Woodside Petroleum (up 9.6%) and BHP (up 4.7%) performed well. Despite reporting earnings which were down significantly on last year, the large resources companies have achieved significant unit cost and capex reductions. Combined with recent rally in commodity prices this should see stronger cash generation going forward. CBA (down 4.3%) was the only major bank to report, with flat earnings per share (EPS) and dividends highlighting the earnings pressure the sector is facing as well as the reason the portfolio is underweight the banks.

Stocks which detracted from performance included Gateway Lifestyle (down 18.5%) with FY17 guidance lowered following a decision to bring forward the conversion programme of four tourist parks to retirement parks. AGL Energy (down 8.1%) declined after indicating the benefit of stronger wholesale electricity prices is expected to moderate, QBE Insurance (down 7.7%) fell on a rise in Australian claims costs and AMP (down 7.1%) slipped after a disappointing result from the life business. We remain comfortable with the outlook for each of these businesses and note that each has internal initiatives underway to address these issues and improve performance.

On the protection portfolio side, we saw the remarkable decrease in the level of volatility after the BREXIT situation continue through into August. Implied volatility has basically halved since that mini crisis. In one respect this is good for the portfolio as the cost of carrying protection is now significantly lower than it has been over the recent financial year. The reason the cost has decreased very recently is because we have had an uncharacteristically calm equity market. In fact, the S&P500 has had the narrowest six week trading range in fifty years.

The protection portfolio was down a small amount in August, mostly due to the lack of movement in the market, and the continuing fall in volatility. In the last year we have incurred a higher cost in protection given the very high levels of implied volatility and significant risk events during the year. The one year protection cost currently appears substantially above our longer term average this month partly because in the large sell off in August 2015 the protection portfolio added 2.5% to the portfolio performance in a market that was down almost 8.0% for the month. This positive result from last August is now not reflected in the one year number. There have also been a number of risk events that have been followed by significant market recoveries, such as the China Yuan devaluation in late 2015, the sell off and recovery in February, and finally the BREXIT short fall and significant rally in August. This has led to an increased the cost over these events. Volatility levels have now returned to normal.

As always our focus will remain on managing the long run cost which to date is annualised at 2.27% per annum. Most importantly we aim to ensure the portfolio is well protected in case of significant, sharp drawdowns.

OUTLOOK

The overall portfolio continues to exhibit the manager's (Perennial Value Management Limited) true to label value characteristics, with the portfolio offering better value than the overall market on each of our four valuation characteristics; price to earnings, price to free cash flow, gross dividend yield and price to net tangible assets.

We are waiting with interest to see what happens with the impending rate rises in the US, as well as commentary in the coming weeks from the European Central Bank (ECB) and Bank of Japan (BOJ). The market is overly sanguine as the chance of the Federal Reserve raising rates is increasing with the employment data in the US remaining strong. In addition realised volatility in the rates and foreign exchange (FX) markets remains high and the US Dollar Index (DXY) is one of the primary inputs to global asset prices and economies. Divergence in central bank policy between a more hawkish Federal Reserve and still dovish ECB / BOJ / BOE (Bank of England), who remain more accommodative, should make for increased volatility. In addition to live central bank meetings we have the Italian constitutional referendum, where Prime Minister Renzi has suggested he will resign if he loses. Further the US election is also coming up later this year. Low volatility periods can store up volatility for the future, therefore it makes sense to be positioned for this given the macro backdrop as well as the return from summer holidays in the northern hemisphere. We currently have a normal level of protection in place, although this is costing significantly less than it has over the past year.

As always, our focus will continue to be on investing in quality companies which are offering attractive valuations, while carrying a level of protection sufficient to reduce the magnitude of significant negative returns during sharp equity markets falls.

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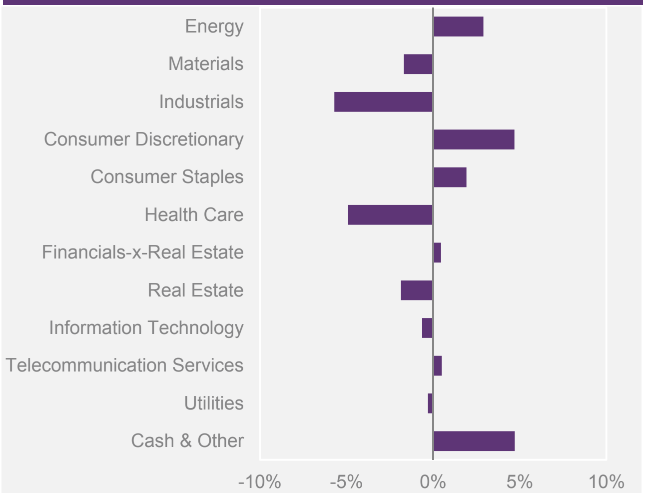
SECTOR ACTIVE WEIGHTS



Source: Perennial Value Management

TOP 20 HOLDINGS

Stock name	Portfolio Weight %	Index Weight %
Commonwealth Bank	6.2	8.5
Telstra Corporation	5.5	4.4
BHP Billiton Limited	5.5	4.5
Westpac Banking Corporation	5.2	6.8
National Australia Bank	5.1	5.0
ANZ Banking Group Limited	4.4	5.4
Wesfarmers Limited	4.0	3.3
Macquarie Group Limited	3.6	1.9
Woolworths Limited	3.1	2.1
AMP Limited	2.7	1.1
Woodside Petroleum	2.7	1.4
QBE Insurance Group	2.6	0.9
Rio Tinto Limited	2.6	1.4
Westfield Corporation	2.5	1.3
AGL Energy Limited	2.1	0.9
Amcor Limited	2.1	1.3
Cybg PLC	2.1	0.2
Stockland	2.1	0.8
Caltex Australia	2.0	0.6
Suncorp Group Limited	1.9	1.1

Source: Perennial Value Management