ASX LISTED INVESTMENT COMPANY (TICKER: CLF)

MONTHLY INVESTMENT REPORT: DECEMBER 2018

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 Total Return Index. CLF is focused on providing investors with capital growth and a consistent yield.

Net Tangible Assets (NTA) as at 31 December

Total Investments	**$102,256,234**
NTA	**$71,677,584**
Shares on Issue	**59,401,545**
NTA per Share (pre-tax on realised & unrealised gains)	**$1.21**
NTA per Share (post-tax on realised & unrealised gains)	**$1.18**
Share Price	**$1.165**
(Discount)/Premium to NTA (pre-tax)	**(3.46)%**
(Discount)/Premium to NTA (post-tax)	**(1.29)%**
Fully Franked Dividend Yield	**7.05%**

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

Contact Information

Telephone	+61 2 9357 0788
Email	info@clfund.com.au
Registered Office Address	2 Paddington Street, Paddington NSW 2021
Principal Office Address	Level 12, 37 Bligh Street, Sydney NSW 2000

Portfolio and Market Review

Investment Performance

Performance as at 31/12/2018 **	1 Month	3 Months	6 Months	12 Months	Financial YTD	Since Inception *
CLF	-1.90%	-6.75%	-5.58%	-1.07%	-5.58%	-1.07%
Benchmark	-0.12%	-8.24%	-6.83%	-2.84%	-6.83%	-2.84%
Value Add	-1.78%	1.49%	1.25%	1.77%	1.25%	1.77%

* 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 -1.90% on a gross basis (pre-fees and taxes) in December versus the benchmark return of –0.12%. This equates to a 3.97% decrease in pre-tax NTA and a 3.28% decrease in the post-tax NTA.

For the calendar year, the portfolio delivered a return of -1.07% on a gross basis versus the benchmark's -2.84%. This was a meaningful outperformance of 1.77% in what was a difficult environment for equity investors.

Market Review

The S&P/ASX 200 Total Return Index (including dividends) fell -0.12% during December to cap off the worst year in Australian equities since 2011. Typically, a 'Santa Rally' is expected during December, but a -9.12% fall in the headline US equity benchmark, the S&P 500 Index, created a headwind which was too strong for the domestic market to overcome.

Given the magnitude of the decline in US equities during December, it is important to outline four of the key reasons for the underperformance of US equities during December:

1. Recession risk - One part of the US yield curve (3-5 years) inverted early in the month and historically this has been considered a lead indicator of an upcoming recession.
2. No monetary easing – The market was expecting the Fed to deliver more 'dovish' forward rate guidance and rhetoric considering recent economic data and market volatility however this was not forthcoming until much later in the month.
3. US government uncertainty – The escalation of the battle between Republicans and Democrats relating to the budget to build President Trump's Mexican wall saw the US government enter shutdown mode.
4. Increased trade tensions – While nothing was formally discussed in terms of tariffs, the detainment of a senior Chinese telco executive in Canada created fears that tensions between the US and China would escalate.

While Australia was impacted negatively by the global risk-off sentiment, it was insulated by a number of key sectors performing exceptionally well. Materials (+5.1%) was the strongest performing sector, buoyed largely through a rebound in iron ore prices (+10.1%) upon bullish expectations of upcoming Chinese stimulus in addition to **BHP** (+11.5%) conducting a large share buyback. Health Care (+2.7%) was also a strong performer, as major constituent **CSL** (+4.4%) rebounded after falling 23.7% from its highs in early September. Information Technology (-4.1%) was one of the worst performing sectors as heavy selling in US technology stocks (Nasdaq Index fell -9.5%) impacted technology companies globally including the local companies.

Portfolio Review

The fund's underperformance in December was primarily driven by both our overweight position in Technology stocks and companies leveraged to the global economy. While this was disappointing last month, it has been the correct positioning over most of last year. We continue to believe that the better opportunity set for corporate earnings growth lies offshore rather than domestically and that risks to the domestic economy via housing, the upcoming federal election and a slowdown in the China economy are at least as great as those which impacted US equities and our portfolio during December.

In terms of companies, there was very little stock specific news during the month which impacted our portfolio holdings and hence the vast majority of price movements was due to market and risk sentiment at the macro level. **Mayne Pharma** (-20.1%) was the worst performer in the portfolio despite news that the US Food and Drug Administration (FDA) has approved the New Drug Application (NDA) for its Tolsura 65mg capsules. The key problem for the stock was a broker report from Macquarie which noted that Mayne's acquisition of control of the SUBA-itraconazole program may increase R&D expenditure and regulatory risk. **QBE Insurance** (-10.8%) was negatively impacted by US 10-year bond yields falling from 2.99% to 2.68% during the month in addition to cost cuts and insurance portfolio simplification disappointing market expectations. **Aristocrat Leisure** (-6.6%), and **Atlas Arteria** (-6.6%) were also major detractors.

On the positive side, **BHP** (+11.5%) was the strongest performer for the month, gaining both on the back of the pre-mentioned iron ore price increase and upcoming special dividend. **Downer** (+7.8%) performed strongly with the company announcing a joint venture contract win in the Parramatta Light Rail project which will generate an additional $420m in revenue. **CSL** (+4.37%) also contributed positively to performance.

Top 10 Holdings in alphabetical order

Company	Ticker
A2 MILK COMPANY	A2M
ARISTOCRAT LEISURE LTD	ALL
AUSTRALIA AND NEW ZELAND BANKING GROUP	ANZ
BHP BILLITON LIMITED (BHP)	BHP
COMMONWEALTH BANK OF AUSTRALIA	CBA
CSL LIMITED	CSL
MACQUARIE GROUP LTD	MQG
NEXTDC LIMITED	NXT
SEVEN GROUP HOLDINGS	SVW
TRANSURBAN GROUP	TCL

Sector Exposure

Sector	Weight (%)
Consumer Discretionary	16.7%
Consumer Staples	8.3%
Energy	0.0%
Financials	24.0%
Health Care	8.5%
Industrials	11.5%
Information Technology	8.2%
Materials	9.2%
Real Estate	3.7%
Telecommunication Services	0.0%
CASH/LIQUIDITY	**8.3%**

Outlook

Markets have been oversold on global risk

There is little doubt that global risk has recently been heightened relative to the last few years, but we believe these concerns are somewhat overdone and is now likely priced into global markets. Focusing on the above-mentioned risks that primarily drove US markets, we believe:

1. The risk of a US recession over the next 12-18 months is low and that the yield curve inversion is more likely due to QE related market inefficiencies rather than heightened economic risk. While the economic data has weakened, manufacturing and non-manufacturing PMI's are still expanding, and employment remains exceptionally strong.
2. The Fed's monetary stance is appropriate given the tightness in the labour market and the associated strong wages growth. It would be a major policy error if the Fed were to disregard its inflationary focus because of short-term equity market volatility. We think the Fed is being responsive to market views but remaining true to its madate.
3. Whilst the US government shutdown is serious and represents a major concern for some 800,000 government workers, its impact on the economy is minor. In addition, we expect a solution in the near-term as the democrats agree to phase in funding over several years.
4. Increased trade tensions are a major concern for markets and Australia more broadly. However, the heightened concern in December seems overdone, particularly given that the US and China have agreed to freeze tariffs for 90 days and the fact that the US has sent a delegation to China to discuss a solution.

In addition to the US equity selloff, US bonds also rallied strongly with the US 10-year yield ending the year at 2.68%, which seems unjustifiably low given that the Fed Funds Rate current stands at 2.50%, the annual rate of inflation is expected to be between 2-2.5% and wages grew by 3.2% for the year to December.

Valuations are now more reasonable

December's correction in US equities has brought the overall market valuation back to what we consider a 'reasonable' level. While many investors and commentators have been focused on the US, they have ignored the fact that in countries such as Germany, Japan, China and Australia, valuations have been attractive for some time.

The Australian market is currently trading at a forward multiple of ~ 14.1x compared to a long-term average of ~14.4x. As such, while it is not excessively cheap, we do think it is attractively valued, even given the heightened risk profile. Additionally, a number of standout companies within the Industrials sector, which we expect to experience strong earnings growth, have been savaged in the recent downturn and look like good buying opportunities.

Valuations of the big four banks look particularly attractive relative to history, but we are very cautious of them given the macro headwinds (particularly the impact of the housing downturn) that they are likely to face through at least the first half of 2019.

Conclusion

Despite being cognizant of the macro risks, we are positive on Australian equities as we enter 2019.

We believe that the recent selling has increased the attractiveness of many Australian equities. As such, we used last quarter's sell-off as an opportunity to initiate a number of new positions and also to add to some existing holdings which we feel had been unfairly sold down. As a result, we have increased the market exposure of our portfolio and reduced our cash holding from over 22% at the end of September to around 9%.

We wish you and your families all the very best for 2019 and hope that you enjoy much investment success this year and into the future.

Important Information

This announcement has been prepared by CLF for the purposes of providing general information only and does not constitute an offer, solicitation or recommendation with respect to the purchase or sale of any securities nor does it constitute financial product advice and does not take into account your individual investment objectives, tax or financial situation or needs. Past performance is not indicative of future performance. Before making an investment decision an individual should assess whether it meets their own needs and consult an appropriately licensed financial adviser. No warranty (express or implied) is made as to the accuracy, completeness or reliability of any statements, estimates or opinions or other information contained in these materials (any of which may change without notice) and to the maximum extent permitted by law, CLF disclaims all liability for any direct or indirect loss which may be suffered by any recipient through relying on anything contained in or omitted from these materials.