CONCENTRATED LEADERS FUND

ASX LISTED INVESTMENT COMPANY (TICKER: CLF)

MONTHLY INVESTMENT REPORT: JANUARY 2019

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 Accumulation index. CLF is focused on providing investors with capital growth and a consistent yield.

Net Tangible Assets (NTA) as at 31 January

Total Investments	**$106,668,682**
NTA	**$76,565,126**
Shares on Issue	**59,401,545**
NTA per Share (pre-tax) *	**$1.29**
NTA per Share (post-tax)*	**$1.24**
Share Price	**$1.225**
(Discount)/Premium to NTA (pre-tax)	**(5.04)%**
(Discount)/Premium to NTA (post-tax)	**(1.21)%**
Fully Franked Dividend Yield	**7.00%**

* On realised and unrealised gain or loss

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

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Portfolio and Market Review

Investment Performance

Performance as at 31/01/2019 **	1 Month	3 Months	6 Months	12 Months	Financial YTD	Since Inception *
CLF	5.03%	2.41%	-2.97%	3.46%	-1.11%	3.64%
Benchmark	3.87%	1.45%	-4.55%	1.37%	-3.23%	0.92%
Value Add	1.16%	0.96%	1.58%	2.09%	2.12%	2.72%

* 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 +5.03% on a gross basis (pre-fees and taxes) in January versus the benchmark return of +3.87%. This equates to a 6.61% increase in pre-tax NTA and a 5.08% increase in the post-tax NTA.

For the financial year to date, the portfolio delivered a return of -1.11% on a gross basis versus the benchmark's -3.23%. This was a meaningful outperformance of +2.12% in what has been a volatile environment for equity investors.

Market Review

The S&P/ASX 200 Total Return Index (including dividends) gained 3.87% during January delivering one of the strongest January's on record. However, the Australian market was not alone with global equity markets almost universally rallying on a more dovish US Federal Reserve (Fed), additional Chinese stimulus, a strong rebound in the price of oil and arguably oversold conditions following a shockingly volatile Q4 2018. The MSCI AC World (USD) finished up 7.1% with US equities driving the bulk of this upside.

Following the markets negative reaction to the Fed's 25 basis points hike in interest rates in December, Fed Chair Jerome Powell delivered a much more dovish message to the market in January. The Fed will now be patient in assessing the impact of the recent rate hikes and it would also be pragmatic with its effort to reduce its balance sheet. The market reacted positively, believing that the Fed will remain on hold in 1HCY19 and if economic conditions deteriorate, quantitative tightening could soon be finished as well.

Oil was the other major market driver with the price of WTI Crude up ~19% and Brent Crude up ~ 20% in US dollar terms. Despite rising concerns over a slower global growth, oil prices rose as traders reacted positively to a fall in US stockpiles after eight weeks of increases, OPEC members demonstrating compliance with output restrictions and new U.S. sanctions on Venezuela designed to transfer control of its oil wealth away from socialist dictator Nicolas Maduro in favour of the leader of Venezuela's National Assembly, Juan Guaido.

Energy (+11.5%) was the best performing sector on the back of the rise in oil prices with **WOR** (+21.5%) being the standout performer. Technology also outperformed due to the strong rally in the Nasdaq Index (+6.3%) with **APT** (+28.3%) performing well. Materials (+7.0%) rallied strongly on the announcement of further Chinese stimulus in response to economic weakness. **FMG** (+34.8%) was the major beneficiary given its leverage to the iron ore price and a closing of the pricing gap between high and low-grade iron ore. Financials (-0.3%) was the worst performing sector as weaker housing data and the pending release of the Hayne Royal Commission's final report kept investors pensive.

Portfolio Review

The portfolio's outperformance in January was pleasing given that the gains were reasonably well spread across our holdings. We benefitted from being overweight to both the technology and offshore orientated consumer discretionary sectors. Conversely, having limited exposure to the Materials, Energy and REITs sectors has been a drag on performance.

Price movements in January were primarily driven by macro factors such as the large rally in oil and iron ore prices, the sharp fall in the Australian dollar, the rally in offshore equities and concerns around the Hayne Royal Commission's final report.

Technology companies – **APX** (+24.4%), **TNE** (+13.2%) and **NXT** (+12.1%) - were amongst the best performers in the portfolio despite little company specific news. These companies rebounded strongly in conjunction with the Nasdaq index, following a weaker December for global technology companies.

A2M (+17.1%) performed strongly during January having been under a cloud during most of Q4 2018 as a result of potential licensing issues selling into China. However, clarity on the issue in December and the appointment of a Chief Commercial Officer and Chief Technical Officer in mid-January has given the market confidence that its high growth rate can be maintained and hence justifying its earnings multiple.

ALL (+12.8%), **GEM** (+12.0%) and **SVW** (+11.4%) also performed strongly with the latter benefitting from the stronger oil price. **SVW** fell 41% during Q4 last year due firstly to the decline in oil prices (affecting its holding of Beach Energy) and then concerns on declining global growth (affecting its holding of Caterpillar).

On the negative side, **CGC** (-25.5%) was one of only two detractors in the portfolio. Costa Group fell sharply after informing the market that earnings growth would be flat for FY19 after previously guiding to low double-digit growth. Slower than expected December/January trading conditions saw subdued demand in several categories including tomatoes, berries and avocadoes. The downgrade was unexpected following AGM comments in late November that the company was "off to a solid start to the year". While we still like the fundamentals of the company and its thematic tailwinds, the competitive environment among producers and its vulnerability to weather related events are cause for consideration.

Sector Exposure

Sector	Weight (%)
Consumer Discretionary	17.3%
Consumer Staples	7.4%
Energy	0.0%
Financials	20.8%
Health Care	9.0%
Industrials	12.0%
Information Technology	8.6%
Materials	8.4%
Real Estate	2.3%
Telecommunication Services	0.0%
Utilities	2.1%
CASH/LIQUIDITY	**12.1%**

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

Outlook

Markets have rallied back….but maybe too strongly

In last month's letter we wrote that markets had been oversold due to heightened concerns about global risk and that we believed these concerns were somewhat overdone and likely priced into markets. January's rebound validates that thinking, however the strength of the rally (MSCI AC World (USD) up 7.1% in one month) may mean that equity markets have moved too far the other way.

Domestically, the S&P/ASX 200 TR Index had rallied 7.3% off its December lows by the end of January. At the time of writing, it is up 11.4% off its December low. This move appears excessive given the domestic economic backdrop in addition to the fact that several significant macro risks persist. The recent rally has seen several sectors – namely property and mining – become relatively unattractive from a risk/reward perspective given that:

- The S&P/ASX 300 Mining Metals and Mining Index is at its highest level since early 2012 – despite Chinese economic growth is slowing.
- The S&P/ASX 200 A-REIT Index is trading just below its 2016 peak which is its highest level since mid-2008 – as property prices and approvals weaken.

In addition, although the major banks came out of the Royal Commission very lightly in our view, they still have major obstacles to overcome with: 1) property prices continuing to fall; 2) funding costs remaining elevated; 3) potential capital raisings; 4) increasing remediation and regulatory costs and; 5) the potential for negative gearing and franking credit changes post the upcoming election.

As such, we have prudently taken profits in a number of our portfolio companies. We have added to very few positions and are instead adding to our cash holdings until a more attractive purchasing environment presents itself. Our cash holding has increased from 8.3% at the end of December to 12.1% at the end of January despite the strong market rally.

Conclusion

We continue to think that Australian equities represent an attractive investment opportunity over the medium term, but in the near term the risk/reward potential of the market has deteriorated given the recent rally and the presence of ongoing macro risks, especially the upcoming federal election and further weakness in the housing market.

We think our portfolio companies can continue to outperform the market in the current environment, but the broad market rally may run out of momentum.

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.