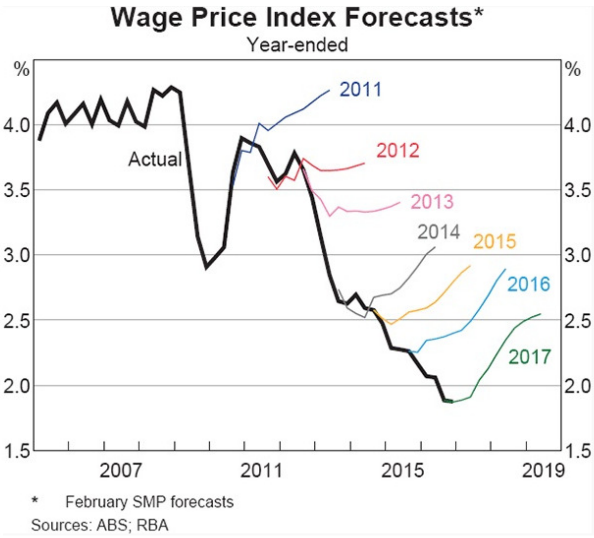
June 2017 — Over the Horizon Market Commentary by David Offer

The 2016 17 Financial Year has been a good one for share investors with the domestic share market performing well.

Despite a flat June, the All Ordinaries Index returned 8.5% for the financial year and 13.1% with the inclusion of dividends. This performance was largely driven by a return to favour of bank and resource shares, the two heavy weights of our share market. Pleasingly, this positive performance was reflected within our diversified investment portfolios, which tended to perform comparably to the Australia share market but with Australian share weightings generally at a lower exposure in the vicinity of 50% to 60% of the value of portfolios.

Notwithstanding buoyant share market returns, particularly when considering investment alternatives such as cash or a West Australian property market in the doldrums, we remain aware of what we view to be increasing risks to the investing landscape for listed investments. Domestically, we remain concerned that the typical Australian consumer is presently highly indebted, often due to speculating on an overinflated East Coast property market.

Likewise, we are concerned that Federal government debt will balloon in the years ahead, with the implications being less Federal Government spending available to stimulate the economy and higher taxes. Despite ongoing noise about bringing the Federal Government budget into surplus, this is based on excessively optimistic assumptions based on strong wage growth that that the Federal Government hopes will push Australian workers into higher tax brackets and hence pay more tax. However, as evidenced by the chart below, in the real world (both in Australia and globally) wage growth is simply not materialising. This is despite many economies operating at close to full employment.



With both consumers and governments indebted, this makes both susceptible to rising interest rates. Globally, as in Australia, interest rates remain at historically low levels and at some point this is likely to unwind. Rising global interest rates could place pressure on domestic rates to also rise and also for the Australian dollar to fall. Pleasingly, one area that is not excessively indebted is the corporate world, with the vast majority of listed Australian company balance sheets in excellent shape.

Another theme that we are mindful of going forward is the increasing influence of technology and in particular artificial intelligence (AI). AI is a phenomenon that has only recently come into existence. Off a low base advances are occurring at an expediential rate. This means that while changes are not so noticeable now, with the dramatic rate of change presently occurring, it is likely that within just a few years changes will surround everything we do.

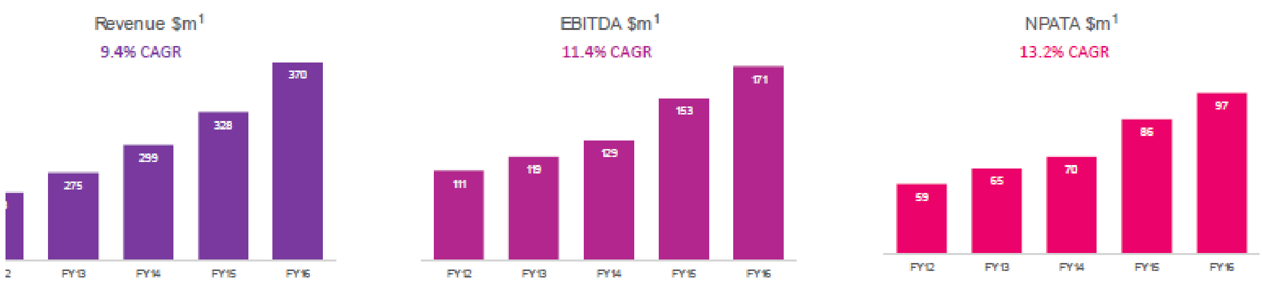
While in many ways this is highly exciting and presents many new opportunities, in the business world there will be losers in much the same way digital photos rendered film photos and companies like Kodak obsolete in just a few short years. Investment decisions now need to consider a future world that will include driverless cars and where computers will be empowered to make decisions … and where humans are likely to be not!

Increasingly investment portfolios will need to consider the impacts of technology and with a domestic economy likely to struggle, businesses will need to have access to offshore or new markets to provide future growth. Taking the above and other considerations into account we are presently reassessing many of our traditional portfolio investments. Ultimately not investing is simply not a viable long term options as alternatives such as cash and fixed interest are providing woeful returns and this will not change materially going forward.

We look forward to providing examples to you in the months ahead of investments that we consider will be well positioned to thrive in our rapidly changing investment landscape.

One example is MYOB, which at $3.35 we are comfortable buying. MYO is an accounting software provider that is successfully making the transition from supplying desk top accounting software to cloud based accounting software. In doing so, its customers who are predominately small to medium sized businesses, are going from historical reporting to real time reporting. As well as more timely information, this change is providing considerable time and accounting savings.

MYO is the largest accounting software provider in Australia and has a large legacy of desktop clients that it can convert to cloud based computing over the next decade. As a result, the strong and impressive profit growth the Company has experienced to date should continue going forward.



The real time data MYO will hold for over half of Australia's small and medium sized business should place the Company in an exceptional position to continue to roll out complementary products to its customers such as improved accounting services and payment systems.

MYO is aware of the opportunities for its business is investing heavily in R&D and this should enable the business to stay at the forefront of innovation into the future. While growth opportunities appear exciting, as a business MYO also has defensive characteristics. This includes strong recurring revenue and a reluctance by customers to change accounting systems that are increasingly integrated throughout their business.

Finally, we are also mindful of rising geopolitical risk. This includes rising nationalistic tendencies as evidenced by Brexit, the actions of a renegade North Korea and the diminishing role of America and rise of China and re-emergence of Russia in the global landscape. Any sudden shocks will be a negative for markets but may provide a buying opportunity for portfolios in a position to take advantage.

If you would like more information on these companies or have any broader queries with respect to your investment portfolio, please do not hesitate to contact our office.

Yours sincerely,

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