Wheelhouse Global Equity Income Fund

Monthly performance update

As at 30 June 2020

Performance

	1 month	3 months	6 months	1 year	2 year p.a.	3 year p.a.	Since inception p.a.
Income	1.85%	1.88%	3.33%	6.40%	7.24%	7.42%	7.24%
Growth	(4.23%)	(2.43%)	(1.72%)	0.61%	0.56%	1.65%	0.82%
Total Fund return	**(2.38%)**	**(0.55%)**	**1.61%**	**7.01%**	**7.80%**	**9.07%**	**8.07%**
Benchmark*	**(1.12%)**	**5.94%**	**(3.60%)**	**5.18%**	**8.50%**	**10.75%**	**9.46%**
Market Risk (Beta)**				0.54	0.58	0.59	0.58

Performance figures are net of fees and expenses. Inception date is 26 May 2017. *Benchmark is the MSCI World Index ex Australia.
** Market Risk is defined as Beta and sourced from Morningstar Direct. Beta is a measure of relative risk and can be used to assess the historical volatility of returns relative to the Benchmark (the Benchmark has a Beta of 1.00). For example, a Beta of 0.50 has had historically half the risk relative to the Benchmark. A minimum of 12 months data is required for this calculation.

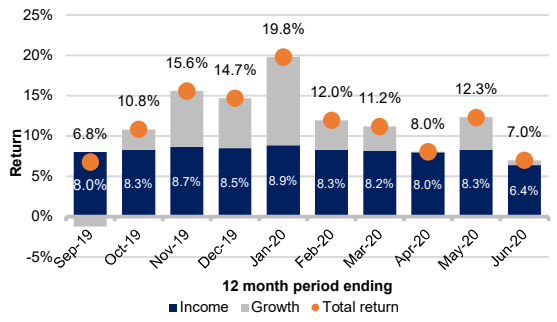
Monthly performance review

The Fund returned (2.38%) in June, behind the benchmark return of (1.12%). This return comprised:

- A return of 1.23% from the portfolio (in USD); and
- A negative return of (3.61%) from the strengthening of the Australian dollar versus US dollar.

Income distributions were 1.97c for the June quarter, taking the rolling 12-month income return to 6.40%.

Income vs Total return (12 month rolling)

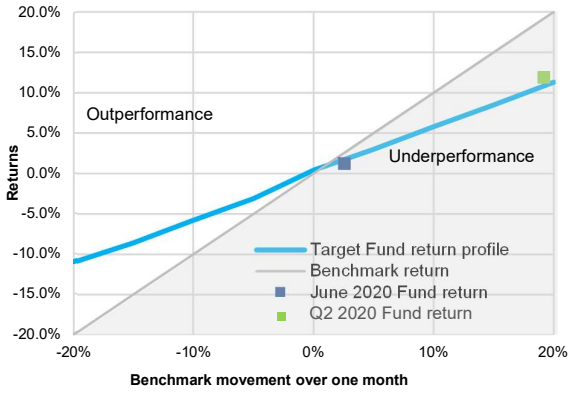


Source: Wheelhouse

Lower risk returns

The strategy's high-income generation and active downside protection strategy are designed to lower risk and deliver equity returns with a smoother, more retiree-friendly return profile. As a result, returns are expected to add relative value in weak and low-growth markets, and to drag in more positive markets. We assess this targeted return profile in USD to strip out the influence of the AUD/USD currency movements.

Targeted monthly return profile



Wheelhouse is a retirement solution designed to deliver better investment outcomes to Australian retirees. Our philosophy is based on three pillars:

- investing in global equities as a **growth asset** to address longevity risk;
- shaping returns to be **retiree-friendly** with lower volatility, better capital preservation and consistent income; and
- delivering a **lower cost** solution to help improve outcomes.

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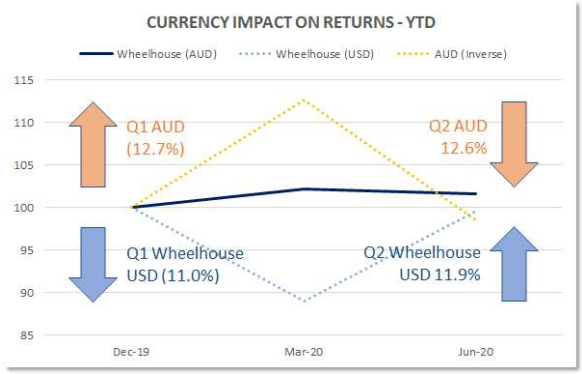
Wheelhouse PARTNERS

Performance

The Wheelhouse Global Equity Income Fund returned (0.55%) for the June quarter, taking YTD returns to 1.61%. The slight decline in value in the June quarter is entirely attributable to the strong appreciation of the Australian dollar, which offset strong gains in the underlying portfolio in local currencies.

The chart below breaks down these two return drivers for the year to date performance, which highlights the almost perfect offset from currency and underlying market returns.

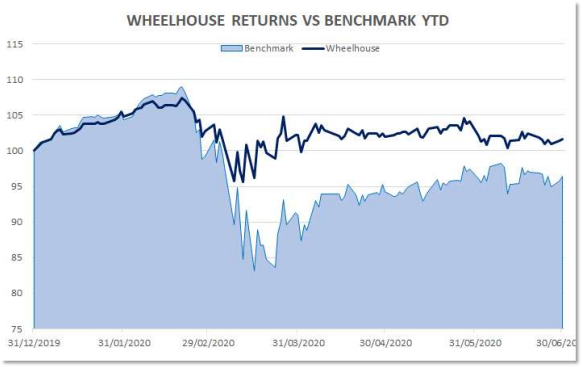


Source: Wheelhouse

From a risk perspective, we often analyse our returns on a US dollar basis as while we appreciate the 'insulation' benefits of the Australian dollar when markets fall, we don't attempt to manage the currency exposure (the fund is 100% unhedged for currency). During the two quarters this year the fund captured only 53% of the market fall in the March quarter, followed by capturing 62% of the market bounce in the June quarter.

Through capturing less of the market fall in a drawdown, but still participating in most of the recovery, we expect the fund will deliver equity returns over time, but with far lower risk. This favourable capture ratio is especially well placed to deliver meaningful value during periods of increased market volatility.

By way of example, and with Global equity markets back approaching their highs, the fund experienced a far shallower drawdown on the way through, but also has banked a 5% relative gain versus the benchmark for the roundtrip.

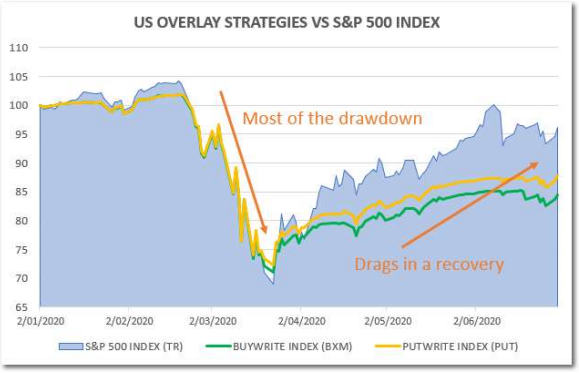


Source: Wheelhouse. Post fee returns.

A classic V-shaped recovery

Global equity markets this year have recovered so quickly off their lows the return profile really does 'spell out' V-shaped recovery. Historically these types of whipsaw market return profiles can be very damaging for investors in an overlay strategy, as risk can significantly increase into the drawdown, with these losses mostly locked in as upside is sold for a fraction of the recovery.

This unfavourable return profile is well evidenced by the calendar YTD returns of the US systematic index overlay strategies. Performance of the CBOE BuyWrite Index (BXM) and CBOE PutWrite Index vs the S&P 500 Index is illustrated below. Both strategies have lost around 10% of their value relative to the S&P 500 Index YTD.



Source: Wheelhouse

The reason whipsaw markets are unfriendly to overlay strategies is due to the capped upside that forms part of their risk profile. As markets decline, the risk level increases to 100% and near full losses are worn by the investor. Conversely as markets subsequently rally, the risk level decreases to 0% and upside participation is fully capped.

By the same logic, whipsaw markets can be beneficial for investors if the risk profile is reversed. Within our strategy we reverse the conventional overlay risk profile, with risk

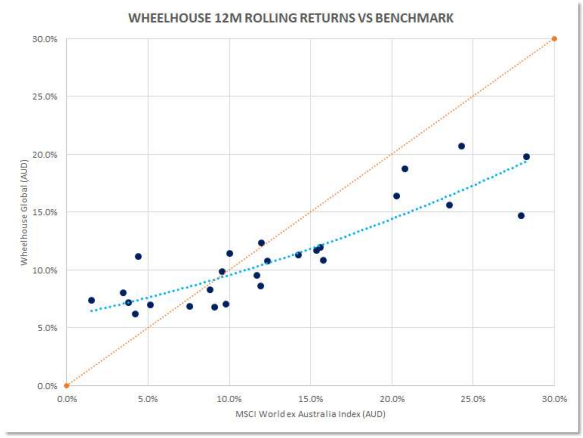
decreasing into a fall, and increasing into a rally. By way of example, for the month of March during the peak of the Coronavirus pandemic, we only shared in 43% of the market's decline on a US dollar basis as portfolio risk decreased into the acute drawdown. However as the market then snapped back in April and May, we captured 63% and 72% of the gains, respectively, during these months as our market risk increased into the rally. These are the opposite capture ratios to a conventional overlay strategy and meaningfully contributed to the 5% outperformance delivered during the year to date returns.

At Wheelhouse while we highly value the reliable income generation that overlay strategies generate, we equally prize stability of capital. Through a number of enhancements in overlay design, and the integration of 'always-on' crash protection, we are able to capture most of the income generation but with a much more favourable capital profile.

3-year returns

This quarter the fund passed its 3-year performance milestone. As the track record grows, more meaningful performance analysis can be provided on the return profile and importantly how the fund has performed across an increased variety of market conditions.

In the chart below we plot 12m rolling returns since inception of the fund.



Source: Wheelhouse

While total returns of the fund are a little behind the benchmark return since inception, analysis of the return profile highlights the following characteristics:

- The pattern of returns exhibits a very defensive return profile, which we would expect to see. When annual returns for the benchmark have fallen below 5%, returns for the fund have consistently been higher and delivered incremental real returns closer to our targeted income return of 7-8%. This means the distribution yield is more likely to be consistently funded with real return, even in low-growth markets.
- The trade-off for this increased certainty of an equity-like return is relative underperformance when markets are strong, which has also been consistent.
- The range of performance outcomes is far narrower for the fund. Annual returns of 7-12% were nearly 2x more likely than the Benchmark, occurring 62% of the time versus 35%. This consistency means the return profile is far more predictable than pure equity returns.

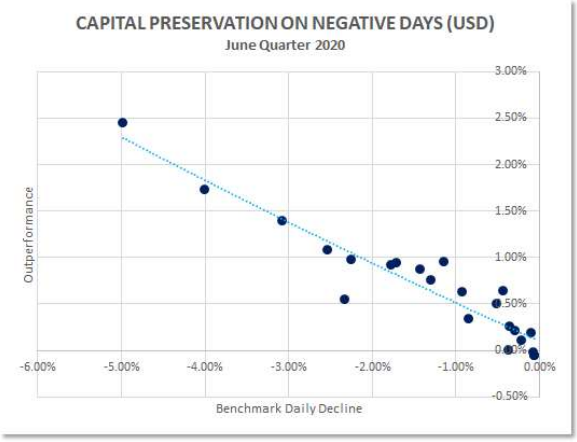
The annualised returns support our investment objective of 'reshaping' equity returns into a more consistent and far more certain return profile, paid out mostly as income.

Capital protection

In a quarter when the Benchmark rallied 19.2% in US dollar terms, preserving capital did not appear to be market's primary concern. This doesn't mean it wasn't a concern for us! One of the key differences in our approach is the value we place on preserving and protecting capital, regardless what happens in the market.

While there were only 23 negative days (on a USD basis) for the Benchmark during the quarter (out of 62), the fund preserved and protected capital on nearly every single negative print.

We seek to minimise risk on every single day we are invested and not attempt to try and time when the market may fall. The sudden 5% drawdown on the 11 June provides some evidence of our consistent defensive approach, with the fund only sharing in half of this loss despite the suddenness and severe magnitude of the decline. This is consistent with our approach of seeking to generate a 7-8% yield while assuming only half of the market's risk.



Source: Wheelhouse

Income

A critical objective of our investment approach is to grow the capital base alongside a 7-8% income yield. While the income returns for the 12 months to June have fallen a little short of our target at 6.40% yield, we are pleased that since inception of the fund we have consistently grown capital (reflected in an appreciating unit price), in addition to paying a +7% yield.

The reason we value capital growth, in addition to the income return, is due to our focus on real world outcomes. In the real world, bills are paid with dollars and not yields. This may seem like semantics, but the maths stacks up.

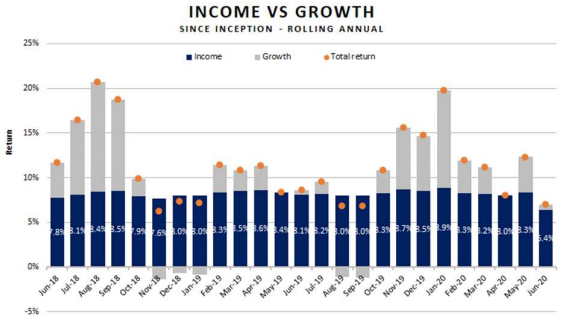
Without unit price growth, an 8% yield today is worth less in dollar terms next year. For example, if our unit price had declined 5% per year for the 3 years since inception, and assuming an initial investment of $100, then our capital base today would stand at $85.74. An 8% yield on this would pay $6.86 on a dollar basis.

However, as the Wheelhouse unit price has grown alongside the 7.24% yield paid, the capital base at 30 June had grown to $102.57 (assuming the same $100 initial investment). Even with our below target yield of 6.40% for the 12 months to June 2020 the dollar yield is $6.56, not far off the dollar yield of the 8% capital damaged strategy. Going forward we believe our 7-8% target yield is achievable, which would mean a $7.69 payout at 7.5% yield.

The critical point is that our capital base is not only intact, but has actually grown. We treat capital like gold, as we recognise that to generate a growing dollar yield, we simply cannot tolerate a capital base going backwards. Looking forward, we remain very comfortable that the targeted 7-8% income yield is achievable, in addition to continued growth being delivered via the unit price.

This is the only way dollar yields can grow to match the real world growth in bills and obligations.

The income versus growth chart highlights the relationship between capital growth and income generation since inception of the fund. The simple maths is that total return generation needs to be higher than the income return for capital to grow.



Source: Wheelhouse

Outlook

Perhaps unsurprisingly, equity valuations are beginning to look very expensive on a price/earnings basis given markets are nearing their pre-Covid highs whilst earnings have found a base materially lower. This relationship is consistent on both an absolute or relative basis.

At the same time, the level of uncertainty in the market remains high. This is reflected by the ~30% of US and European companies that have removed all earnings guidance since March. With the US earnings season about to commence this week, the market will clearly be looking for some assurances on the sustainability of earnings going forward to justify current share prices.

However, there is one measure against which equities valuations do look attractive and have the potential to propel the equity market higher – their relative value to bonds.

Relative to bonds, equities do appear to offer value. This relationship is meaningful as there are many trillions of dollars invested in the bond market, that have materially benefited as interest rates were slashed to zero and below. Although we do not anticipate this in the near-term, if the next move in interest rates is higher, it is difficult to see bond prices going any higher from here. On this basis, even a slight normalisation in interest rates would mean that many bond prices are likely to post negative returns in the future.

Faced with this prospect, many large pension funds may decide to increase their asset allocation from bonds to equities in the future. The decision is not obvious given the bleak forecasts for equity returns over the next ten years, however, the deciding factor may simply be that at least the equity returns are expected to be positive. We believe this is one of the main reasons why equity markets may be supported going forward, and present further dislocations between prices and more fundamental equity valuations.

In light of this, we believe the single biggest challenge for investors is achieving an acceptable real rate of return, without venturing too far out along the risk curve. For many of our investors who rely on their savings to fund their living expenses, the line between living off their investment returns, versus eating into their capital base, is likely to be a fine one in forthcoming years.

In this uncertain environment, we believe our highly defensive strategy that benefits from volatile and whipsaw markets, we are well placed to continue meeting real world investor objectives.

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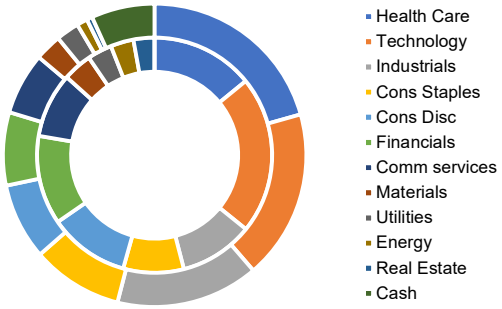
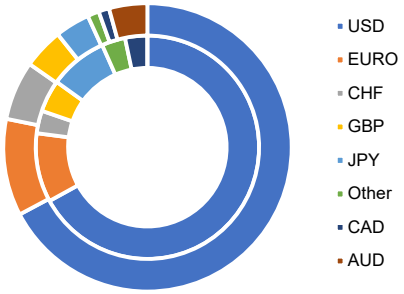
Sector exposure



Outer circles: Wheelhouse
Inner circles: Benchmark

Currency exposure



Contributors	Detractors
Adobe	Raytheon Technologies
ABB	Medtronic
Microsoft	Cerner Corp
Microchip Technology	Intel Corp
Veeva Systems	Zimmer Biomet

How to invest

The Fund is open to investors directly via the PDS, available on our website, or the following platforms.

Platforms
Hub24 (Super, IDPS), Netwealth (Wrap, IDPS), Powerwrap (IDPS)

Contact us

For more information, call 1800 895 388 or visit wheelhouse-partners.com

Fund at a glance

APIR Code	BFL3446AU
Benchmark	MSCI World Index (ex-Australia)
Stock range	50 to 100 stocks
Buy/sell	+/- 0.30%
Cash limit	0-10%
Recommended investment period	Medium to longer term (five years plus)
Investment amount	Initial investment minimum: $10,000
Fees and charges	0.79% p.a. (including GST net of reduced input tax credits) of the NAV of the Fund. There is no performance fee.
Inception date	26 May 2017

Note returns are expressed in AUD unless USD is specified, and are net of fees and expenses unless specified as gross.