

MARKET COMMENTARY



INFINZ
2015 CATEGORY
AWARD WINNER

Fund Manager of the Year – Equities

Devon Funds Management is delighted to have won the INFINZ 2015 Award for Fund Manager of the Year – Equities.

Time right for big banks to list NZ assets

We've rightly started to debate the merits of foreign ownership of land and houses, but what's clear is that no other advanced economy in the world would allow almost all of its banking system to be owned overseas. It's no fault of the Australians that they were smart enough to understand how good the long-term returns were from banking and either bought or built their banking businesses in NZ.

The big four banks in NZ, which are all Australian owned, have a combined market share of about 90 per cent and will make combined after tax profits out of NZ of more than \$4.5 billion in 2015. To put that in context, if you add up the profits of all the companies listed on the NZ Stock Exchange you get to a similar number...[Read More](#)

MARKET INDICES

| Index | Region | Monthly Return | 1 Yr. Return |
|---------------------|--------|----------------|--------------|
| NZX50 Gross | NZ | 0.9% | 12.9% |
| S&P/ASX200 | AU | 0.4% | 9.9% |
| MSCI World Index | GLOBAL | 1.4% | 13.8% |
| S&P500 | USA | 1.3% | 11.8% |
| FTSE100 | UK | 0.7% | 5.7% |
| NIKKEI 225 | JP | 5.3% | 42.7% |
| NZ 90 Day Bank Bill | NZ | 0.3% | 3.7% |



AT A
GLANCE

UNIT PRICES

DEVON ALPHA FUND

\$1.5732

DEVON AUSTRALIAN FUND

\$1.2990

DEVON EQUITY INCOME FUND

\$1.7075

DEVON TRANS-TASMAN FUND

\$3.3619

GLOBAL THEMES FUND

\$2.3807

Prices as at 31 May 2015

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IN YOUR FUND

DEVON ALPHA FUND

There were a number of important company events that affected the portfolio during May. These included a strong earnings result from Tower New Zealand and a disappointing clinical trial announcement from Resmed. At the beginning of the month Tower was in trading halt pending clarification of its exposure to the Christchurch earthquakes. The consequence of this review unfortunately saw additional provisioning required but this was offset by evidence of positive operating momentum and balance sheet strength that allowed the company to maintain its dividend and commitment to capital management. Resmed has been a great contributor to the portfolio over the past year but its share price reacted negatively to news during the month that the trial of its Adaptive Servo-Ventilation for chronic heart disease failed to meet objectives. Despite this news we remain confident in this investment. The Portfolio continues to have a cash weighting over 30%.

DEVON AUSTRALIAN FUND

The Australian Fund rose 3.4% over the month mainly due to a fall in the NZD. The most significant contributor was the weakness in Slater and Gordon (-5%) following the completion of the group's \$890m rights issue to fund a major legal services acquisition in the UK. The group has now completed the deal which gives it a 12% share of the UK's highly fragmented GBP2.5bn UK personal injury market. We remain confident management can deliver the >30% earnings accretion in FY16 with upside risk given synergies and trends in the GBP against the AUD. The Fund added a position in Ardent Leisure (AAD) during the month following a de-rating due to the appointment of a new CEO and weakness in the Gym business. Ardent owns premium leisure assets in Australia including Theme Parks, Bowling, Health Clubs, as well as Main Event, which is a growing portfolio of family entertainment assets in the United States.

DEVON EQUITY INCOME FUND

The Equity Income Fund provided another positive performance over May. A notable change to the portfolio was the adding back of Ardent Leisure. Ardent is a conglomerate of leisure businesses (theme parks, gyms, bowling alleys etc.) of varying quality but includes a very successful and very fast growing US division. Ardent has been a holding in the Equity Income Fund in the past but was removed after significant weakness emerged in the Health Clubs division. In the aftermath of that disappointing news the CEO was fired and replaced by a recent addition to the Board. The market reacted negatively to the change and the stock price fell significantly. Recent trading updates indicate the Health Clubs have stabilised, the balance of the Australian division is performing in line with expectations and the US business continues to deliver outstanding growth. The scepticism by the market of new management meant the stock is now priced very attractively for a large exposure to a potentially long term US roll out.

DEVON TRANS-TASMAN FUND

During the month there were some major sector issues influencing the performance of the Trans-Tasman equity markets. The most significant of these involved the Australian Banks where there is renewed focus on their capital positions. The regulator of Australia's financial services industry, (APRA), recently made a number of comments on this topic and it appears highly likely that we will see required capital levels being lifted soon. These changes should take the form of increases to housing risk weightings and an additional buffer being set in recognition of how systemically important the banking sector is to the Australian economy. Although it is difficult to quantify how much funding will be required or over what time period, we have already seen the banks move, for example NAB raising \$5.5bn through a rights issue during May. We are looking to take advantage of weakness in the sector.



QUARTERLY OUTLOOK

Outlook

As central banks around the world remain accommodative, equities continue to push higher. Despite the mixed economic backdrop, investors are continuing to allocate capital to equities as returns appear superior to fixed income markets. We expect that this dynamic probably has further to run but we are increasingly conscious that as markets have delivered multi-year positive returns, corporate earnings have not grown at the same rate.

New Zealand continues to report strong economic growth. We believe that this will moderate due to a decline in dairy prices, an elevated currency and tight fiscal consolidation. Corporate New Zealand is in good shape with our listed stocks enjoying robust margins, reasonably defensive earnings and relatively high dividend yields. These qualities have supported shareholder returns over the past few years but valuations are a concern. New Zealand is expensive and we are exposed to any potential lift in long-term bond yields during 2015.

In Australia, the equity market has started 2015 strongly as investors positively responded to an interest rate cut by the RBA and the reporting season delivered an acceptable level of earnings growth. This has been achieved despite a backdrop of political uncertainty and subdued demand. Looking forward we expect a more positive set of opportunities in Australia as their companies look to support profit margins through cost management and broad operating conditions stabilize. Valuations in Australia remain more attractive than in New Zealand.

Equity markets will likely be more volatile in 2015 than in 2014. This environment requires care when making investment decisions but we believe that our investment process at Devon is well positioned to benefit from this changing backdrop. We will continue to invest in a range of high quality businesses that are trading at a discount to our view of their intrinsic value.

VISIT: www.devonfunds.co.nz



MONTHLY REPORT

May 2015

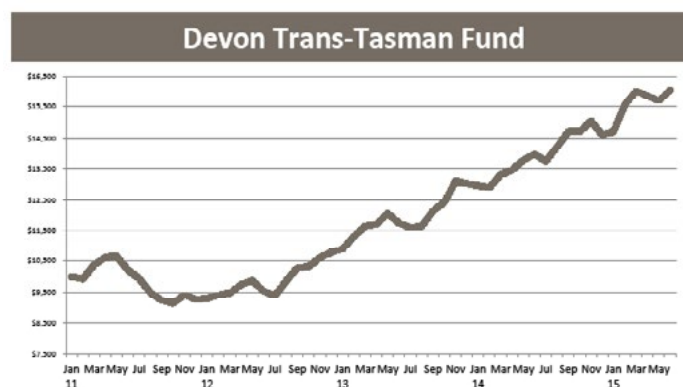
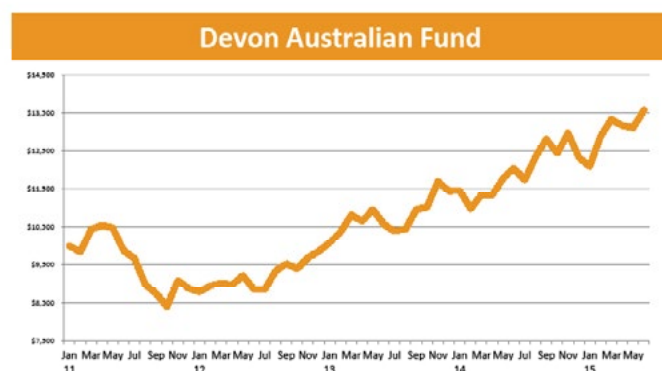
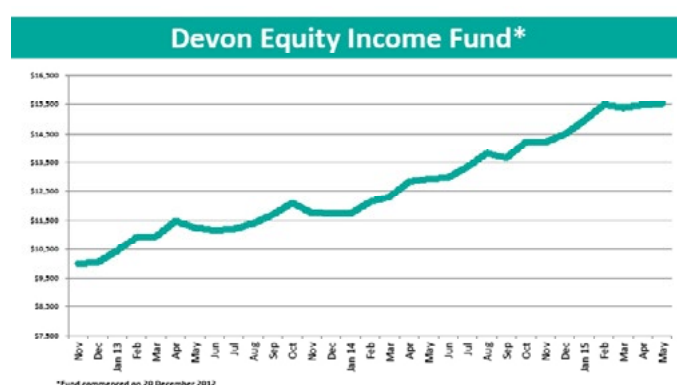
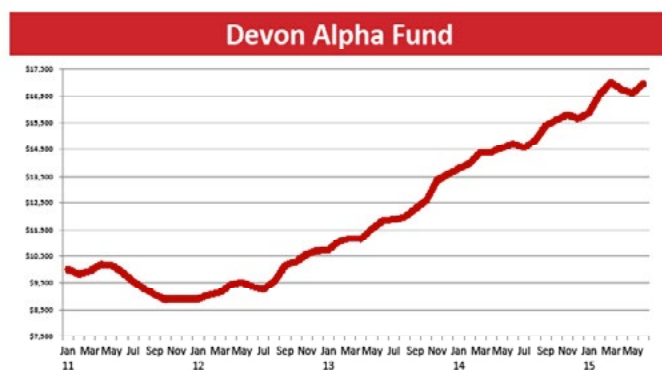
NET FUND RETURNS (AFTER FEES AND BEFORE TAX) *

| | 1 Mth | 3 Mth | 6 Mth | 1 Yr | 3 Yr p.a |
|--------------------------|-------|-------|-------|-------|----------|
| Devon Alpha Fund | 2.2% | -0.2% | 8.5% | 15.3% | 22.0% |
| Devon Australian Fund | 3.4% | 1.8% | 10.1% | 12.6% | 15.3% |
| Devon Equity Income Fund | 0.3% | 0.3% | 10.6% | 21.5% | - |
| Devon Trans-Tasman Fund | 2.3% | 0.2% | 10.0% | 14.9% | 19.0% |
| Global Themes Fund | 6.7% | 7.0% | 12.8% | - | - |

MARKET INDICES

| | 1 Mth | 3 Mth | 6 Mth | 1 Yr | 3 Yr p.a |
|-------------------------|-------|-------|-------|-------|----------|
| OCR | 0.3% | 0.9% | 1.7% | 3.5% | 2.9% |
| NZX50 | 0.9% | -0.6% | 7.8% | 12.9% | 18.8% |
| ASX200 (NZD) | 4.3% | 2.6% | 10.0% | 7.9% | 10.5% |
| TT Index (Hedged) | 0.7% | -1.0% | 9.4% | 11.4% | - |
| TT Index (Un-Hedged) | 2.6% | 1.0% | 8.9% | 10.4% | 14.6% |
| All Country World Index | 3.6% | 5.1% | 9.3% | - | - |

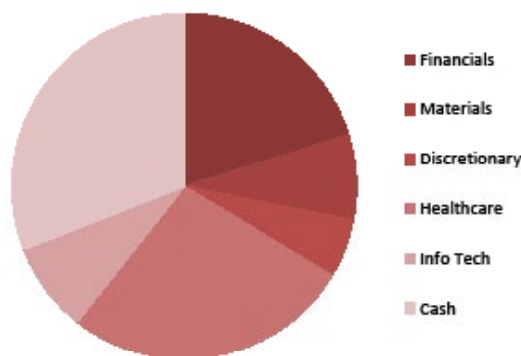
NET PERFORMANCE BASED ON \$10,000 INVESTED AT 1 JANUARY 2011



*Past performance is not a reliable indicator of future returns.

Devon Alpha Fund

Sector Allocation



Geographic Allocation

| | |
|----------------------|--------|
| New Zealand Equities | 27.4% |
| Australian Equities | 41.6% |
| Cash | 31.0% |
| | 100.0% |
| Currency Hedge | 97.6% |

Top Companies



FUND OUTLINE

The Alpha Fund invests in a concentrated portfolio of approximately 10 to 15 select companies predominantly listed on the NZ and Australian share markets. The Fund does not follow any index and is actively managed. The Fund aims to generate capital growth over the long term. Currency exposure is actively managed.

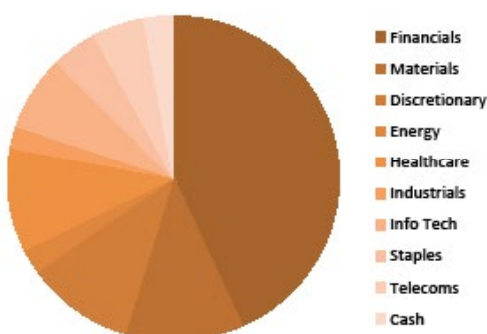
PORTFOLIO MANAGER - SLADE ROBERTSON

Slade has a long and successful career in investment management. With over 20 years experience in both the New Zealand and Australian investment industries, Slade's excellent track record is proof of his determination to pursue the best investment opportunities for his clients.



Devon Australian Fund

Sector Allocation



Geographic Allocation

| | |
|---------------------|--------|
| Dual Listed | 6.4% |
| Australian Equities | 90.7% |
| Cash | 2.9% |
| | 100.0% |
| Currency Hedge | 0.0% |

Top Companies



FUND OUTLINE

The Australian Fund is actively managed and invests in a select portfolio of approximately 25 to 35 companies which are primarily Australian listed companies. The Australian market is much larger than the NZ market and offers exposure to a number of sectors that are not available in NZ. The Australian dollar currency exposure is typically unhedged.

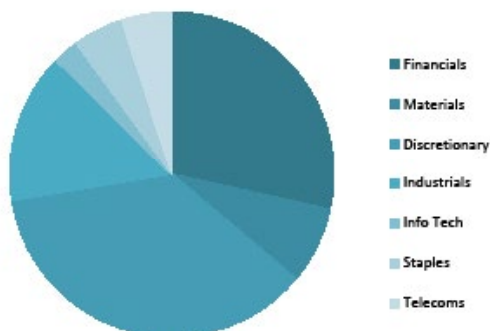
PORTFOLIO MANAGER - TAMA WILLIS

A 14-year veteran of international investment markets, Tama returned to NZ after a very successful career in London and Singapore to join Devon's investment team and holds responsibility for Devon's Australian Fund. Tama is widely regarded as a leading expert on resource and mining stocks.



Devon Equity Income Fund

Sector Allocation



Geographic Allocation

| | |
|----------------------|--------|
| New Zealand Equities | 52.7% |
| Australian Equities | 42.8% |
| Cash | 4.5% |
| | 100.0% |
| Currency Hedge | 98.7% |
| Yield | 6.7% |

Top Companies



FUND OUTLINE

The Devon Equity Income Fund consists of a select group of up to 25 New Zealand and Australian listed companies. These stocks are chosen for their attractive dividend yields and growth prospects with the aim of maintaining the dividend yield and capital value in real terms. The Australian dollar currency exposure is typically fully hedged.

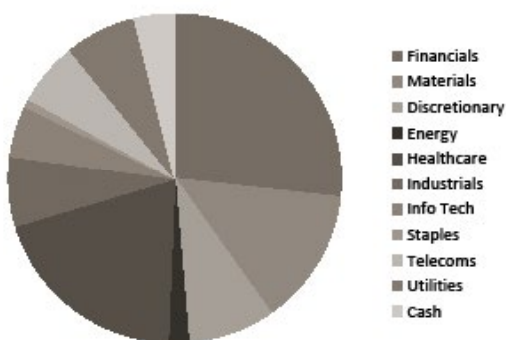
PORTFOLIO MANAGER - NICK DRAVITZKI

Over the last decade Nick has specialised in investing in high yield equities and is Portfolio manager for the Devon Equity Income Fund. At Devon, Nick has responsibility for the analysis of consumer staples, IT, consumer discretionary and property sectors. Nick is also responsible for our quantitative screening process.



Devon Trans-Tasman Fund

Sector Allocation



Geographic Allocation

| | |
|----------------------|--------|
| New Zealand Equities | 40.1% |
| Australian Equities | 56.0% |
| Cash | 3.9% |
| | 100.0% |
| Currency Hedge | 0.0% |

Top Companies



FUND OUTLINE

The Trans-Tasman Fund provides a broad and actively managed exposure to the NZ and Australian equity markets. This Fund typically holds 25 to 35 shares listed on the NZ and Australian stock exchanges which have been carefully selected as offering good value and attractive medium term growth prospects. The Australian dollar currency exposure is typically unhedged.

PORTFOLIO MANAGER - SLADE ROBERTSON

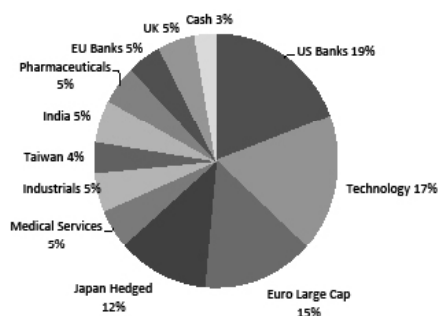
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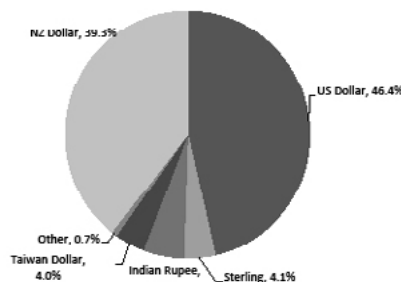


Global Themes Fund

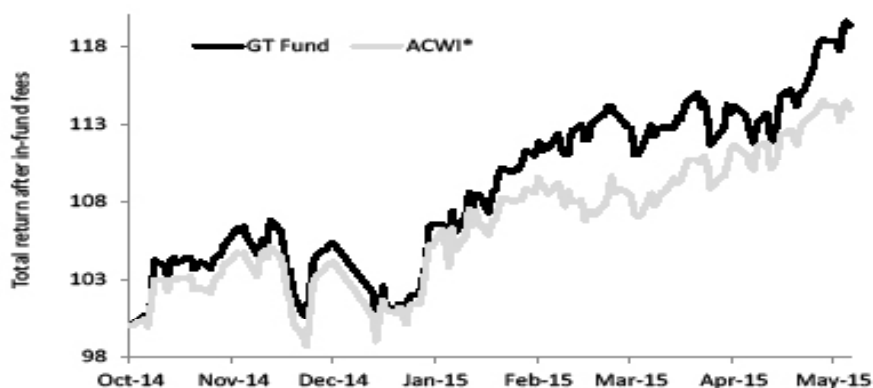
Sector Allocation



Currency Exposure



Net Performance Since Inception



FUND OUTLINE

The Global Themes Fund invests in Global Financial Assets predominantly Global Exchange Traded Funds (ETF's). We identify macroeconomic or thematic investment ideas with a 2-5 year time horizon, and implement the investment ideas through an appropriate high quality assets. Portfolio risk is managed by ensuring broad diversification, ample liquidity and close monitoring of tracking variation versus a passive equity benchmark. The Global Themes strategy has been run by JBWere since March 2005. In October 2014 Devon Funds Management created a NZ PIE Fund to follow the Global Themes strategy and has appointed JBWere as the adviser to the fund.

SENIOR INVESTMENT ADVISER - BERNARD DOYLE

Bernard oversees equity strategy and global tactical asset allocation for JBWere New Zealand. Prior to this role, Bernard was the New Zealand Equity Strategist for Goldman Sachs and Partners, where his team was rated #1 for Strategy and Economics by INFNZ for a number of years. Bernard has 18 years experience in financial markets. He graduated in 1993 with Honours in Economics from Victoria University of Wellington.



WHAT WE OWN AND WHY

Our Japanese theme was a highlight in May, rising 6% in local currency terms and 14% when converted back to New Zealand dollars. The May performance caps a strong year to date for Japan – the Topix is up 19% thus far. Two factors kept investors focussed on Japan through May: firstly, the Yen began to weaken anew, falling from 119 to 124 over the month; secondly, there is growing excitement at corporate governance reform in Japan. This has been manifested in a growing number of buybacks and dividend increases. We are yet to be convinced that Japanese corporates are becoming markedly more shareholder friendly – but are seeing enough to remain engaged in our investment.

Elsewhere we continue to see scope for catch-up in our biggest holding – US regional banks. This theme had a solid month (+3% in USD), and has benefitted from the increase in US bond yields. We see scope for further gains as the first Fed rate hike looms.

RETURNS

The Global Themes Fund rose 6.7% in May to a unit price of \$2.3807. This compared with a 3.6% increase in global equity markets. Our fund has risen 19.0% since inception in October 2014, versus 14.0% in the I-Share All Country Exchange Traded Fund 50% hedged to NZD.

CURRENCY EXPOSURE

The Global Themes Fund uses currency as another thematic lever. We continue to remain happy fully hedging our exposure to Euro and Yen.

During the month the NZD briefly rallied over 0.75 versus the USD. We took this opportunity to reduce our NZD hedging from 50% to 40%. Our decision to reduce our NZD hedge reflects two judgements: 1. We expect the Federal Reserve to hike rates in September, or, at the latest, December. Moreover we expect US economic news flow to improve ahead of the first Fed hike, which should be US dollar supportive. 2. Against this backdrop, the RBNZ has moved to a soft easing bias, suggesting a risk of a cut in September or beyond.

The combination of rising US rates and stable/falling NZ rates should keep pressure on the NZD. We will continue to look to lower our NZD hedge further as opportunities arise.