Devon
FUNDS MANAGEMENT

MONTHLY REPORT

Keeping you up to date with Devon Funds and the markets — December 2015

MARKET COMMENTARY

Welcome Back

On behalf of everyone at Devon we would like to take this opportunity to thank you all for your support in 2015.

It was a busy year at Devon on a number of fronts and we are pleased to advise that we have been granted a Managed Investment Scheme Licence under the Financial Markets Conduct Act 2013. While there has been significant regulatory change in financial services since the inception of the FMA, we believe that manager licencing is a very important step forward for the industry in New Zealand. We believe that lifting the standard in funds management will benefit clients and the industry in the long term.

It was also a strong year for our client's portfolios with our retail managed funds all substantially out-performing their investment benchmarks. Markets were challenging in 2015 due to uncertainty over the economic prospects for China and the first increase in US interest rates in almost a decade, but the volatility that resulted was a positive environment for careful stock picking. Looking ahead in 2016 we are encouraged by comments from our investment team that they expect another productive year by employing their fundamental primary research to find attractive investment opportunities across the New Zealand and Australian stock markets.

We were also successful in winning a number of industry awards in 2015 and this, in addition to being granted a MIS licence and strong fund performance, completes another good year for the firm.

From all the team at Devon we hope you had a happy and relaxing holiday period, and we look forward to working with you in 2016.

MARKET INDICES

Index	Region	Monthly Return	1 Yr. Return
S&P NZX50 Gross	NZ	3.7%	13.6%
S&P ASX200	AU	2.7%	2.6%
MSCI World Index	GLOBAL	-2.1%	2.6%
S&P500	USA	-1.6%	1.4%
FTSE100	UK	-1.7%	-1.3%
NIKKEI 225	JP	-3.5%	11.0%
NZ 90 Day Bank Bill	NZ	0.3%	3.4%

AT A GLANCE

UNIT PRICES

Fund	Price
DEVON ALPHA FUND	$1.5573
DEVON AUSTRALIAN FUND	$1.2932
DEVON DIVIDEND YIELD FUND	$1.7899
DEVON TRANS-TASMAN FUND	$3.3778
GLOBAL THEMES FUND	$2.3233

Prices as at 31 December 2015

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IN YOUR FUND

DEVON ALPHA FUND

During the month the Alpha strategy purchased shares in Healthscope Limited. This business is Australia's second largest private hospital group operating 46 hospitals as well as a large number of medical centers and international pathology services. Recent financial results highlighted that hospital sales are benefiting from utilisation gains and margin improvement through effective cost-management and changes to casemix. Looking forward we believe that volume growth and operating margins will be supported by brownfield expansions which should see a succession of openings from CY16 resulting in an additional 1,000 beds and 50 theaters by FY18. Also of relevance to the portfolio during the month was CSL's R&D investor briefing in Sydney which highlighted that all major product launches remain on track while Vista Group announced a strategic partnership transaction with Share Dimension, a Dutch software company which specializes in predictive analytical solutions for cinemas to assist them in maximizing profitability through better scheduling films.

DEVON AUSTRALIAN FUND

The S&P ASX200 Accumulation index rose 2.7% (-0.7% in NZD) in December while the Devon Australian Fund fell 0.5% in NZD. On the positive side oOh!Media, Touch Corp and Telstra added to Fund performance while Oil Search , Rio Tinto and Sonic Healthcare detracted. For the 12 months to December 2015 the Fund delivered +13.9% in NZD terms against the Index of 4.1%. Over the month, the Fund move from an underweight to overweight position in Telstra as the share price retreated towards $5. We believe the defensive nature of earnings and the group trading at a sub market multiple is attractive while concerns around a Philippines investment look to be fully factored in the share price. The Fund also added a position in Healthscope Limited, Australia's second largest private hospital group. We anticipate a period of strong earnings growth ahead driven by brownfield expansions (1,000 beds and 50 theatres to be opened by FY18).

DEVON DIVIDEND YIELD FUND

With the US Federal Reserve taking the decision this month to raise its target rate for the first time in more than 9 years, it is pertinent to consider the potential implications for the higher yielding elements of the Australian and New Zealand share markets. In the immediate aftermath of the Fed rate hike, the United States interest rate curve has actually flattened, with longer dated bonds rallying. It is those longer term rates that are most closely linked to New Zealand and Australian long term interest rates and if they increase (which will mainly depend upon the strength of the United States economy) then history suggests that local longer dated bonds will also rise. In that environment there is a real chance that some of the higher yielding equities will be seen to be relatively less attractive. The Dividend Yield Fund has looked to avoid those stocks that look most like bonds (expensive property companies in particular) but it has not changed its fundamental investment style and will continue to seek quality yield across the local markets.

DEVON TRANS-TASMAN FUND

There were a number of notable contributions during the month with positive performance from Metlifecare, oOh!Media, Isentia Group and Trade Me while negative performance came from stocks including AMP and Oil Search. We also made some small changes to the Portfolio with a reduction in our exposure to Estia Health and oOh!Media after both stocks have rallied strongly during the course of 2015 and have purchased Contact Energy and Sonic Healthcare. Both these investments were made after their respective share prices fell during the month with Contact Energy suffering after the company published its November operating stats which included earnings guidance below market expectations while Sonic was sold down post the Australian Federal Government announcing funding changes as part of their Mid Year Economic and Fiscal Outlook. We believe that the risk adjusted valuations in both businesses are now sufficiently attractive for this strategy to invest.

QUARTERLY OUTLOOK

Now that the United States Federal Reserve has finally initiated their program of policy interest rate normalisation, financial markets are likely to face a fresh set of questions in 2016. However, given the absence of inflationary pressures around the world, any interest rate increases will be reasonably constrained and therefore, the environment will continue to be supportive to equity market returns. It is currently quite a unique situation for central banks with the US Federal Reserve tightening at a time when the ECB, Japan and China are continuing to take a more accommodative approach. A bigger risk from our perspective next year is Chinese growth. Although we believe in the current consensus, which is for GDP growth to be at or close to 6%, investors will need to remain conscious of the broad market challenges that would arise if we see a more significant slowdown, as a result of a decline in fixed asset investment or a credit crisis, in that part of the world.

The Australian economy remains reasonably subdued but we are encouraged by some of the recent data which suggests that a rebalancing of activity away from the resources sector is gradually occurring. Consumption is expected to improve at a moderate pace and business confidence levels suggest that the recent depreciation of the Australian Dollar is having a constructive effect. The pace of recent weakness in the terms-of-trade is likely to moderate from here but this will depend on China's economic fortunes. We continue to believe that the Australian equity market will provide a decent set of opportunities for us in 2016 and we expect that the marked underperformance of this market relative to New Zealand will begin to mean revert over the next few years. At a sector level we suspect that the broad consensus trades of investors being underweight resources and banks while also being overweight offshore earners will experience periods of unwind this upcoming year which will be associated with volatility and opportunity.

In New Zealand, the RBNZ recently cut the overnight cash rate in response to data that shows that domestic growth slowed during 2015. Unemployment has risen for three quarters and the dairy sector has enormous challenges given its debt burden. We expect conditions to…Read More

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NET FUND RETURNS (AFTER ALL FEES)*

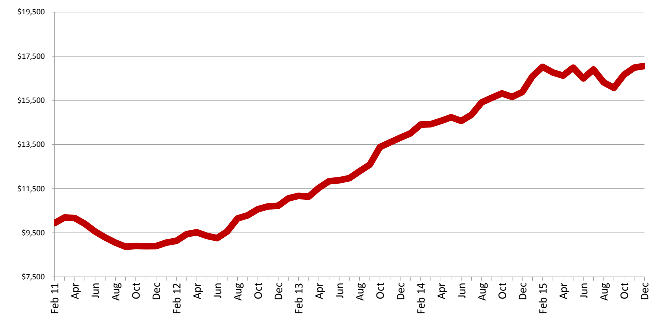
	1 Mth	3 Mth	1 Yr	3 Yr p.a	5 Yr p.a
Devon Alpha Fund	0.4%	6.2%	7.4%	16.8%	11.3%
Devon Australian Fund	-0.5%	6.6%	13.9%	11.0%	6.6%
Devon Dividend Yield Fund	3.0%	11.5%	16.5%	-	-
Devon Trans-Tasman Fund	0.2%	7.1%	11.8%	14.8%	10.5%
Global Themes Fund	-4.4%	3.6%	12.5%	-	-

MARKET INDICES

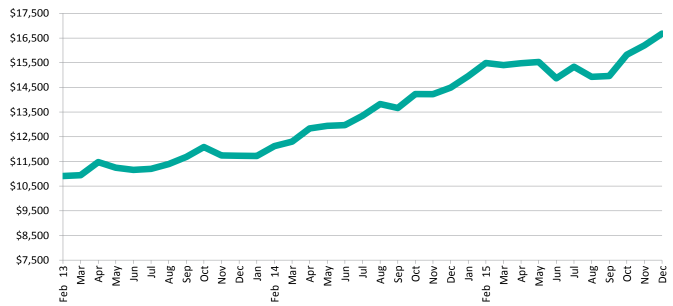
	1 Mth	3 Mth	1 Yr	3 Yr p.a	5 Yr p.a
OCR	0.2%	0.7%	3.2%	2.9%	2.8%
S&P NZX50	3.7%	13.1%	13.6%	15.9%	13.8%
S&P ASX200 (NZD)	-0.7%	3.1%	4.1%	3.2%	2.6%
TT Index (Hedged)	3.2%	9.8%	8.1%	-	-
TT Index (Un-Hedged)	1.5%	8.1%	8.8%	9.5%	8.2%
All Country World Index (50% Hedged)	-3.8%	1.8%	6.5%	-	-

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

Devon Alpha Fund

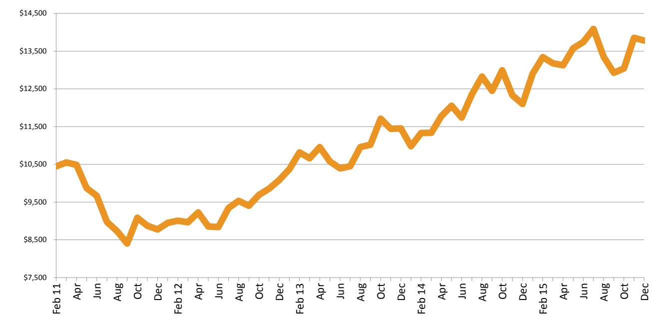


Devon Dividend Yield Fund*

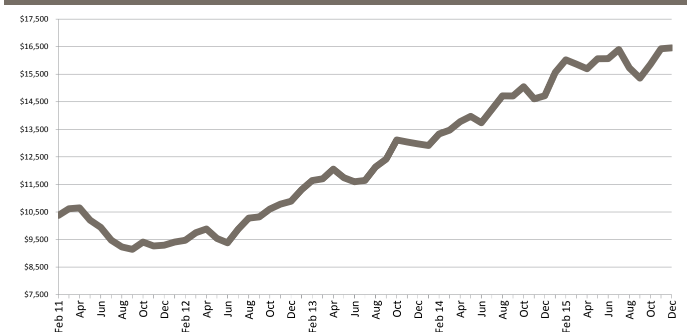


*Fund commenced on 20 December 2012

Devon Australian Fund



Devon Trans-Tasman Fund



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

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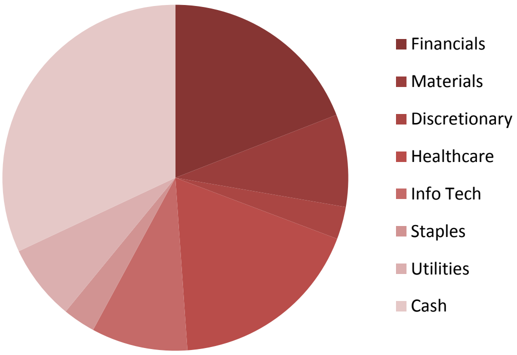
Devon Alpha Fund

Sector Allocation



Top Companies

CSL

Healthscope

Metlifecare

Geographic Allocation

New Zealand Equities	35.2%
Australian Equities	32.8%
Cash	32.0%
	100.0%
Currency Hedge	48.9%

FUND OUTLINE

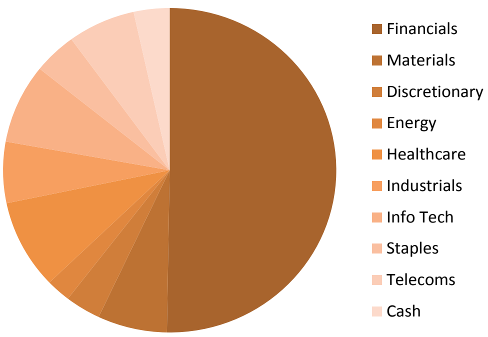
The Alpha Fund invests in a concentrated portfolio of approximately 10 to 15 select companies predominantly listed on the NZ and Australian share markets. The Fund does not follow any index and is actively managed. The Fund aims to generate capital growth over the long term. Currency exposure is actively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

PORTFOLIO MANAGER - SLADE ROBERTSON

Slade has a long and succesful 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 opportunites for his clients.

Devon Australian Fund

Sector Allocation



Top Companies

IT'S HOW WE CONNECT

VISTA GROUP

Westfield

Geographic Allocation

Dual Listed	5.7%
Australian Equities	90.8%
Cash	3.5%
	100.0%
Currency Hedge	0.0%

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.

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Devon FUNDS MANAGEMENT

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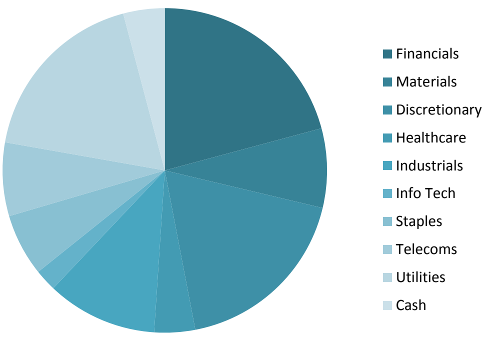
Devon Dividend Yield Fund

Sector Allocation



Top Companies

Spark

trademe Where Kiwis Buy and Sell

meridian

Geographic Allocation

New Zealand Equities	56.2%
Australian Equities	39.7%
Cash	4.1%
	100.0%
Currency Hedge	96.4%
Yield	6.8%

FUND OUTLINE

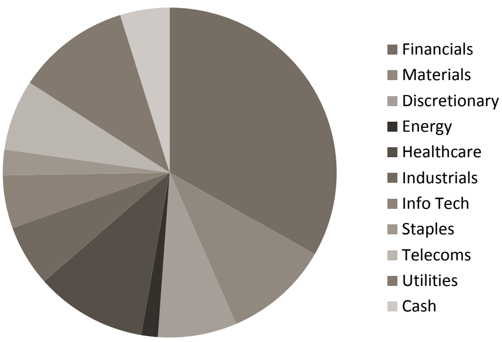
The Devon Equity Income Fund consists of a select group of up to 25 New Zealand and Australian listed companies. These stocks are chosen for their attractive dividend yields and growth prospects with the aim of maintaining the dividend yield and capital value in real terms. The Australian dollar currency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



Top Companies

SCENTRE GROUP

trademe Where Kiwis Buy and Sell

SONIC HEALTHCARE

Geographic Allocation

New Zealand Equities	42.1%
Australian Equities	53.1%
Cash	4.8%
	100.0%
Currency Hedge	0.0%

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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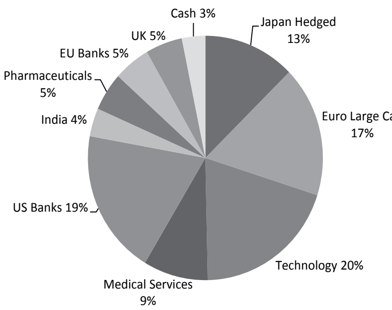
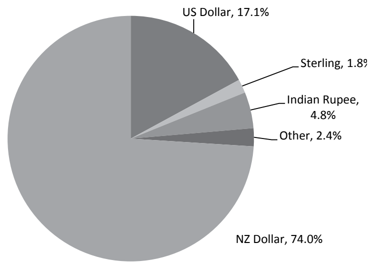
Global Themes Fund

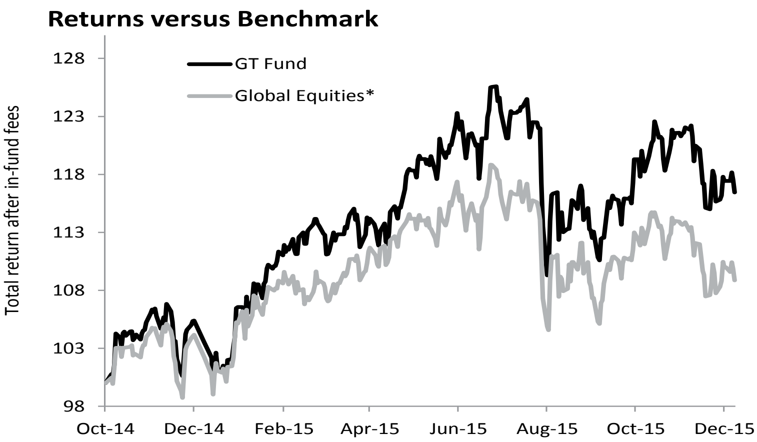
Sector Allocation



Currency Exposure



Net Performance Since Inception



* I-shares All Country World Index ETF, 50% hedged to NZD
Source: Datastream, Iress, JBWere Investment Strategy Group

FUND OUTLINE

The Global Themes Fund invests in Global Financial Assets predominently 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 INFINZ 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 we own it

Equities lost ground in December, completing the year on a weak note. 2015 ended as it had begun – with Central Banks the centre of attention. In January last year is was the ECB in the limelight, with a surprise move to Quantitative Easing. By December, all eyes had turned to the US Federal Reserve, which duly delivered the first US rate increase in almost a decade.

The Global Themes Fund ended the year 12.5% higher, about 6.0% ahead of the benchmark. Excess returns have come from some of our more opinionated tilts: Technology and medical devices were the strongest sector overweights, while Japan and Europe were the best performing country tilts. A virtually nil exposure to oil and materials was an important decision that paid off well in 2015. Against that, we struggled to make money in India and Taiwan (since removed). Both countries struggled to demarcate themselves from the weakness that weighed on almost all Emerging Markets.

2016 looks to be more of the same: we expect returns will need to be hunted down rather than delivered on a platter. In particular, a number of key questions for active investors loom:

How long will the Quantitative Easers, Europe and Japan, continue to outperform other markets? How long do we shun oil and other commodity equities? Will Federal Reserve tightening deliver the expected benefits to the US Financial sector? These issues are a focus for us as the first few months of 2016 unfold.

Our Returns

The Global Themes Fund fell 4.4% in December. This compared with a 3.8% decline in the global equity benchmark. The Fund has risen 16.4% since inception in October 2014, versus 8.9% in the Benchmark.

Our currency exposures

The NZD hedge remains at ~75%, which was a benefit to our portfolio in December, as the NZD rose almost 4% against the USD. We continue to watch with interest how far up its trading range the NZD can push, but for now remain comfortable with more hedging in place than our benchmark 50%.

Outside of the NZD, we continue to like hedging the Euro and Yen exposures, particularly with the Federal Reserve tightening cycle finally underway.

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