Devon
FUNDS MANAGEMENT

MONTHLY REPORT

Keeping you up to date with Devon Funds and the markets

January 2016

MARKET COMMENTARY

Volatility Returns to Global Equity Markets

Global stock markets experienced a tumultuous start to 2016 with indexes falling across the board. At one stage the US S&P500 had recorded its worst start to a year in history. China was one of the worst performing markets again with the Shanghai Composite falling 23% over the month. There were a range of reasons for this volatility, including commodity price weakness and a divergence in policies by some of the major central banks but it has been the deceleration in Chinese economic activity that has probably been the major influence to investor sentiment. It was because of these issues that we sent one of our senior portfolio managers to China during January so that we could confidently form an independent view of what is happening in the world's second largest economy. His views are detailed below:

The daytime temperature in Beijing in January struggles to get into positive figures and as the evening wears on it plunges into the negatives. In recent weeks a thermometer measuring those fluctuations could have been mistaken for the returns of the Chinese share indices. The worryingly poor performance of stocks and broader concerns about the Chinese economy have dominated news in the first weeks of the new year so it seemed an excellent time to try and get some closer insight. To that end I spent last week in Beijing and Chongqing attending presentations, talking to investors and officials and touring property projects.

There is no doubt that China is front and centre of people's thoughts. The response of global equity markets to volatility in China has been…Read more

MARKET INDICES

Index	Region	Monthly Return	1 Yr. Return
S&P NZX50 Gross	NZ	-2.4%	7.4%
S&P ASX200	AU	-5.5%	-6.1%
MSCI World Index	GLOBAL	-6.0%	-4.6%
S&P500	USA	-5.0%	-0.7%
FTSE100	UK	-2.5%	-6.5%
NIKKEI 225	JP	-8.0%	0.9%
NZ 90 Day Bank Bill	NZ	0.2%	3.3%

AT A GLANCE

UNIT PRICES

DEVON ALPHA FUND
$1.5128

DEVON AUSTRALIAN FUND
$1.2661

DEVON DIVIDEND YIELD FUND
$1.7420

DEVON TRANS-TASMAN FUND
$3.3019

GLOBAL THEMES FUND
$2.1739

Prices as at 31 January 2016

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IN YOUR FUND

DEVON ALPHA FUND

During the month the Alpha strategy performed broadly in line with Australian equity markets. Given the volatility that global stocks were experiencing during January the large cash weighting that the Fund held was beneficial but the underlying performance of some of our stock investments were mixed. Positive contribution came from Westfield which performed well after a number of market analysts upgraded their views on the stock reflecting its quality and portfolio repositioning. Investments which weighed on returns included Vista Group and Healthscope. Healthscope shares were impacted by a government review of the Australian Medical Benefits Scheme although we believe that the impact on utilisation levels will be moderate. The most significant change to the portfolio was the sale of our shares in National Australian Bank. We maintain a large cash weighting in this strategy and expect the upcoming reporting season to provide us with opportunities to identify investment ideas.

DEVON AUSTRALIAN FUND

The Australian Fund outperformed the S&P ASX200 over the month with good performance from Link, Scentre and Westfield offset to some degree by weakness in Vista and Rio Tinto. Overall an underweight position in the Banks and Resources sectors continued to be a positive contributor to relative performance. The most important changes to the portfolio over the month included reducing exposure to Macquarie after a very strong period of performance while increasing exposure to IAG after the stock was de-rated. IAG faces challenges on margins and growth near term but the decision to not progress an investment into the Chinese market and the quota-share agreement with Berkshire Hathaway leaves the group with significant surplus capital which is likely to be returned to shareholders in FY16 and FY17.

DEVON DIVIDEND YIELD FUND

The Dividend Yield Fund couldn't entirely escape the poor start to the year experienced across global markets but it did perform significantly better than local markets, down approximately 1.5% for the month. Much of the relative outperformance was provided by Australian companies that can be classified as high quality defensive names. In particular Scentre Group, the owner of Westfield branded retail malls across Australasia, and Sydney Airport, performed strongly – each saw their share prices rise more than 3.5% in a month where the Australian market was down nearly 5.5%. Sydney Airport reported traffic numbers for December which showed international passenger growth of 8.6% on the same month last year, boosted particularly by Chinese tourism growth of more than 31%. Scentre Group's share price performance reflected improving sentiment for its very high quality collection of retail assets (that continues to be improved by sales and redevelopments) and a cash yield above 5%.

DEVON TRANS-TASMAN FUND

The Trans-Tasman strategy outperformed its Australasian benchmark during the month with good absolute contributions coming from Westfield Corporation, Scentre Group and Sonic Healthcare. Our underweight sector positioning in the Banks and Resources also contributed to our relative outperformance. The most significant changes that occurred to the portfolio included our sale of shares in Macquarie Group and increase in exposure to Spark New Zealand. Spark management have executed well in recent years in by addressing their cost base and by positioning their business to compete in the mobile and broadband markets. Although industry growth rates remain low we believe that operating margins will stabilise to support a high and sustainable dividend yield. This strategy remains exposed to high quality businesses across New Zealand and Australia and recent volatility across markets have contributed to improved opportunities for investment.

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)*

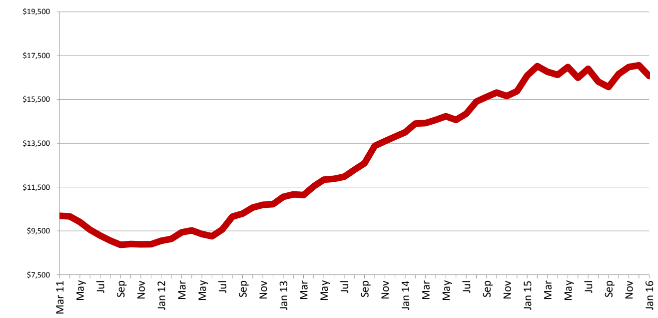
	1 Mth	3 Mth	1 Yr	3 Yr p.a	5 Yr p.a
Devon Alpha Fund	-2.9%	-0.6%	-0.1%	14.4%	11.0%
Devon Australian Fund	-2.1%	3.5%	4.6%	9.2%	6.5%
Devon Dividend Yield Fund	-1.5%	3.9%	9.9%	16.8%	-
Devon Trans-Tasman Fund	-2.3%	1.4%	3.3%	12.5%	10.1%
Global Themes Fund	-6.4%	-7.9%	2.8%	-	-

MARKET INDICES

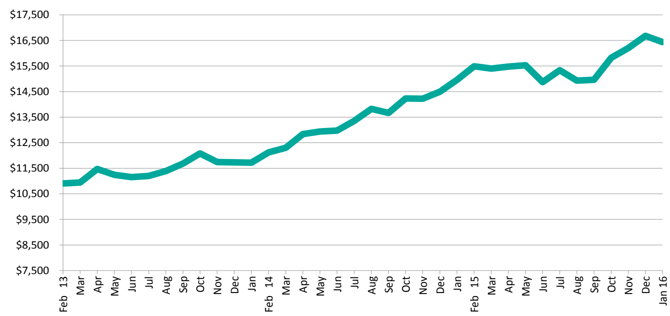
	1 Mth	3 Mth	1 Yr	3 Yr p.a	5 Yr p.a
OCR	0.2%	0.6%	3.1%	2.9%	2.8%
S&P NZX50	-2.4%	3.1%	7.4%	13.2%	13.1%
S&P ASX200 (NZD)	-2.8%	-0.0%	-4.4%	1.1%	2.3%
TT Index (Hedged)	-4.0%	-0.2%	0.6%	9.3%	-
TT Index (Un-Hedged)	-2.6%	1.5%	1.5%	7.1%	7.7%
All Country World Index (50% Hedged)	-2.7%	-5.4%	1.0%	-	-

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

Devon Alpha Fund

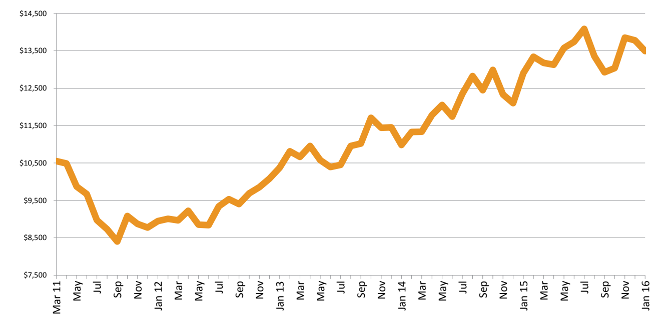


Devon Dividend Yield Fund*

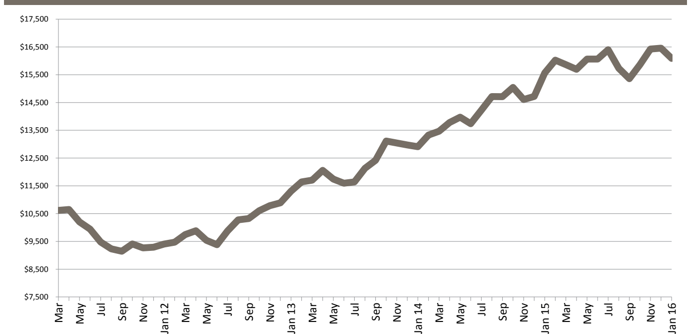


*Fund commenced on 20 December 2012

Devon Australian Fund



Devon Trans-Tasman Fund



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

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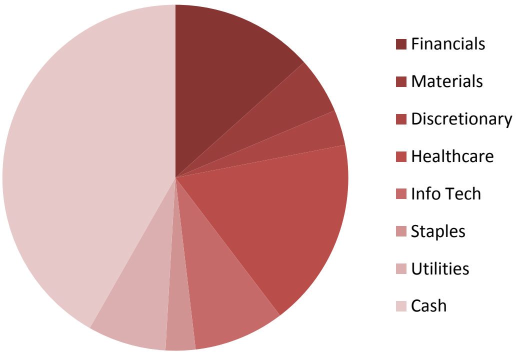
Devon Alpha Fund

Sector Allocation



Top Companies

Westfield

oh!media

CSL

Geographic Allocation

New Zealand Equities	31.2%
Australian Equities	27.1%
Cash	41.8%
	100.0%
Currency Hedge	33.8%

FUND OUTLINE

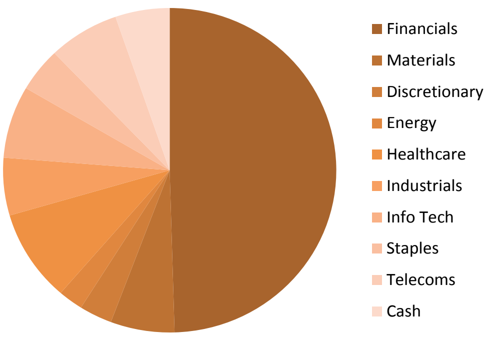
The Alpha Fund invests in a concentrated portfolio of approximately 10 to 15 select companies predominantly listed on the NZ and Australian share markets. The Fund does not follow any index and is actively managed. The Fund aims to generate capital growth over the long term. Currency exposure is actively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

Westfield

VISTA GROUP

IT'S HOW WE CONNECT

Geographic Allocation

Dual Listed	4.9%
Australian Equities	89.9%
Cash	5.3%
	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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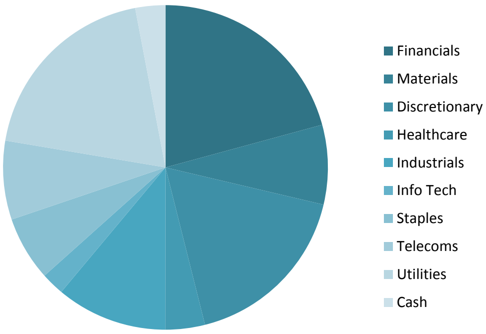
Devon Dividend Yield Fund

Sector Allocation



Top Companies

Sydney Airport

FLIWAY
DELIVERING TRANSPORT SOLUTIONS

meridian

Geographic Allocation

New Zealand Equities	56.4%
Australian Equities	40.6%
Cash	3.0%
	100.0%
Currency Hedge	99.4%
Yield	6.7%

FUND OUTLINE

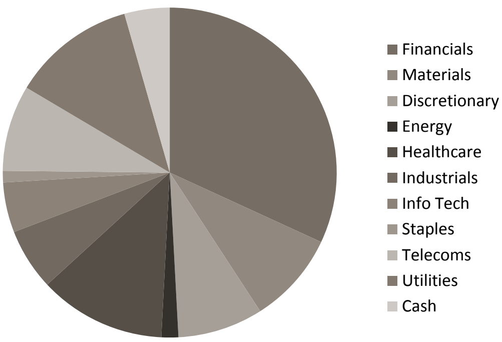
The Devon Equity Income Fund consists of a select group of up to 25 New Zealand and Australian listed companies. These stocks are chosen for their attractive dividend yields and growth prospects with the aim of maintaining the dividend yield and capital value in real terms. The Australian dollar currency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

VISTA GROUP

meridian

Geographic Allocation

New Zealand Equities	45.4%
Australian Equities	50.2%
Cash	4.4%
	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

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

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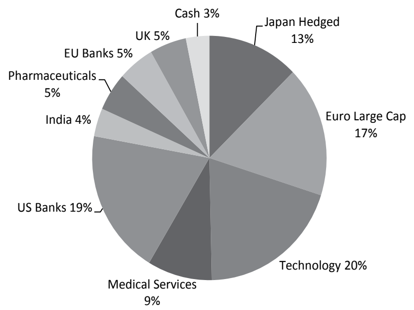
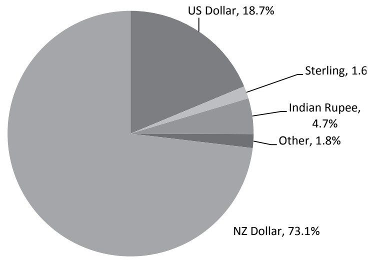
Global Themes Fund

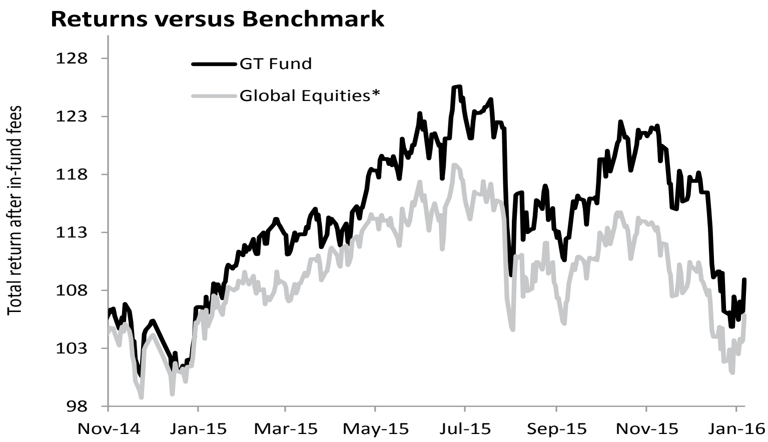
Sector Allocation



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

The Fund lagged the index for two key reasons in January: Firstly, our exposure to US and European banks; and secondly, our larger than benchmark currency weighting.

Banks around the world have been sold down heavily: a common thread is a reduced expectation for interest rate hikes. Markets are now pricing for less than one Federal Reserve hike in 2016. US 10 year bond yields have fallen well below 2% for the first time in almost a year. Moreover, for US banks specifically, a high conviction holding in the Fund, there is concern that falling oil prices could damage loan books if shale oil producers are forced into bankruptcy.

Notwithstanding a painful month – we feel strongly that our bank holdings have been oversold. Lending to the energy sector makes up only 2% of bank loans in the US – so even with a high level of impairment the impact on bank balance sheets is manageable. Our impression is that investors are seeing oil prices as a potential catalyst for "GFC II" – something we and our research partners see as unlikely.

We also believe markets are overplaying the impact of recent volatility on the Federal Reserve's rate path. Yes, a hike in March is unlikely. But it is a long bow to assume the Fed is "one and done" – raising rates once then pausing.

Accordingly, and consistent with the philosophy of our thematic approach, we will stick to our guns on our bank holdings unless we see a fundamental change in the 3 to 5 year investment case. In the same vein, for the first time in many months, we are looking at potential opportunities in the energy sector as markets begin to bake in "low oil forever" into equity prices.

Returns

The Global Themes Fund fell 6.4% in January to a unit price of $2.1739. This compared with a 2.8% decline in our global equity benchmark. The Fund has risen 5.3% since inception in October 2014, versus 3.6% in the I-Share All Country Exchange Traded Fund 50% hedged to NZD.

Currency exposures

The NZD hedge remains at ~75%, which was a drag on returns during the month. With the New Zealand dollar range trading in the mid-60's we see a hedge well above our benchmark of 50% as appropriate. If the NZD sees material weakness from here we will look to build our hedging further.

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