

MARKET COMMENTARY

What to do with IPO's?

The most common way for a private company to be listed on a stock exchange is through an Initial Public Offering (IPO). There are a number of reasons why companies come to the listed market. The first, and typically the most attractive reason for us as investors, is that some businesses find themselves on a path of growth and opportunity that requires additional funding. These IPO's are often a great chance for us to invest into exciting new companies, as long as they are sensibly priced. Another motivation though, and one that we need to be more careful about, is where the private owners of these companies look to an IPO as a mechanism to sell their position. Where this process occurs we need to be particularly careful about investing because there is always an unfavorable asymmetry in the information available. It is important to remember that a public market investor almost always know less about a business than those who currently own it, work in it and are now selling it.

One of the reasons that we are writing on this topic today is that as investors we are currently being asked to consider a large number of IPO's in Australia and, to a lesser degree, New Zealand. This isn't very surprising because, after the strong run that share markets have enjoyed over the past 7 years, the value that vendors can now achieve through selling their privately held businesses to the listed market is now often far higher than trade buyers are willing to pay. The appetite for investors to participate is also currently high because of their recent positive experiences in shares. When we consider IPO's it's difficult to prescribe a reliable framework of black-and-white rules. For example at the moment it is commonly accepted wisdom that investors should avoid floats coming from private equity vendors. The perception is that private equity buys a business then excessively leverages the balance sheet, starves new initiatives of capital and strips costs from operations to an unsustainable level. The private equity operator then, the theory goes, turns to the public markets to exit their position by proposing that the company's recent profit experience is a reliable platform for...[Read More](#)

MARKET INDICES

Index	Region	Monthly Return	1 Yr. Return
S&P/NZX50G	NZ	-0.5%	31.6%
S&P/ASX200G	AUSTRALIA	0.5%	13.2%
MSCI World Index	GLOBAL	0.6%	12.0%
S&P500	USA	0.0%	15.4%
FTSE100	UK	1.8%	18.4%
NIKKEI 225	JP	-1.9%	-3.6%
NZ 90 Day Bank Bill	NZ	0.2%	2.7%



AT A GLANCE

UNIT PRICES

DEVON ALPHA FUND

\$1.6374

DEVON AUSTRALIAN FUND

\$1.3580

DEVON DIVIDEND YIELD FUND

\$1.9757

DEVON DIVERSIFIED INCOME FUND

\$1.5770

DEVON TRANS-TASMAN FUND

\$3.7034

GLOBAL THEMES FUND

\$2.1849

Prices as at 30 September 2016

FMCA UPDATE

On the 14th of October (Friday) Devon Funds will transition into the Financial Markets Conduct Act (FMCA) regime. The FMCA regime governs how financial products are created, promoted and sold. Under the new regime Devon will be replacing the current investment statements with our new Product Disclosure Statement (PDS). Our PDS will be made available in due course on our website www.devonfunds.co.nz. If you would prefer to be sent a hard copy, please notify us at admin@devonfunds.co.nz. Devon welcomes the FMCA regime and looks forward to providing you with further updates as we transition. Please note, all new applications will need to be completed via our new application forms from 14 October 2016.



DEVON ALPHA FUND

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, is actively managed and aims to generate capital growth over the long term. Currency exposure is actively managed.

DEVON ALPHA FUND

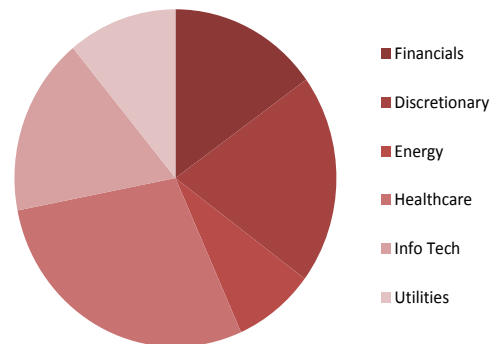
We were pleased with the performance of the strategy during the month and it was well positioned for the volatility that was evident in the underlying markets. The stock holdings that we have in Alpha are a well diversified selection of high quality businesses with some in particular offering significant upside potential. This was evident during September with investments such as GTN Limited whose share price rallied over 30% after it delivered a strong set of financial results in August.

Metlifecare also performed well for us after the company released an Investor Update which highlighted their plans to accelerate their growth through an aggressive set of development targets. Management expect to sustainably deliver over 300 units/beds from 2019 and achieve a development margin of at least 15%. The Alpha portfolio currently has a cash weighting of almost 40% which is a position we have established due to elevated market valuations.

KEY HOLDINGS



ASSET ALLOCATION



GEOGRAPHIC ALLOCATION

New Zealand Equities	36.1%
Australian Equities	25.4%
Cash	38.5%
Currency Hedge	29.3%

PERFORMANCE

As at 30/09/16

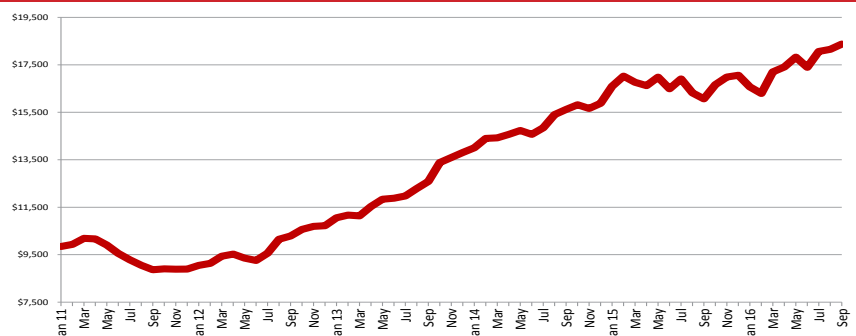
	1 Mth	3 Mth	1 Yr	3 Yr p.a	5 Yr p.a
Devon Alpha Fund	1.2%	4.6%	13.3%	13.1%	15.5%
OCR	0.2%	0.5%	2.4%	2.9%	2.7%

Devon Alpha Fund returns are after all fees and expenses, but before tax which varies by investor.

NET PERFORMANCE

Based on \$10,000 invested at 1 January 2011

Devon Alpha Fund



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

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 of this Fund is typically unhedged.

DEVON AUSTRALIAN FUND

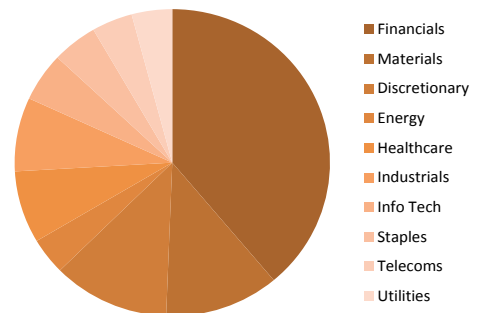
The Australian Fund rose 2.9% over the month, outperforming the S&P/ASX200G in NZD. The NZDAUD cross rate gave up the previous months gains which positively impacted absolute performance. The cross rate is above the long-term average and the Fund remains unhedged. GTN (+32%) was a key contributor to performance after reporting a strong FY16 result with the Australian and Canadian businesses performing well ahead of prospectus.

In terms of portfolio changes, the Fund increased exposure to the Resources sector, adding Aurizon (AZJ) to the portfolio and increasing the weighting to BHP Billiton (BHP). BHP's key divisions are Petroleum, Iron ore, Coal and Copper and recent strength in Chinese infrastructure spend and property sales along with supply discipline in a number of commodities suggests tighter markets and an earnings upgrade cycle, typically a supportive environment for resource equities. The Fund also exited a position in Motor Cycle Holdings on concern over regulatory intervention in the Finance and Insurance part of the business – the business has been a strong performer since IPO.

KEY HOLDINGS



ASSET ALLOCATION



GEOGRAPHIC ALLOCATION

Dual Listed	5.0%
Australian Equities	91.7%
Cash	3.4%
	100.0%
Currency Hedge	0.0%

PERFORMANCE	1 Mth	3 Mth	1 Yr	3 Yr p.a	5 Yr p.a
As at 30/09/16					
Devon Australian Fund	2.9%	7.7%	14.2%	10.2%	11.9%
ASX200 Index Gross (NZD)	2.1%	5.8%	8.5%	3.7%	7.1%

Devon Australian Fund returns are after all fees and expenses, but before tax which varies by investor.

PORTFOLIO MANAGER

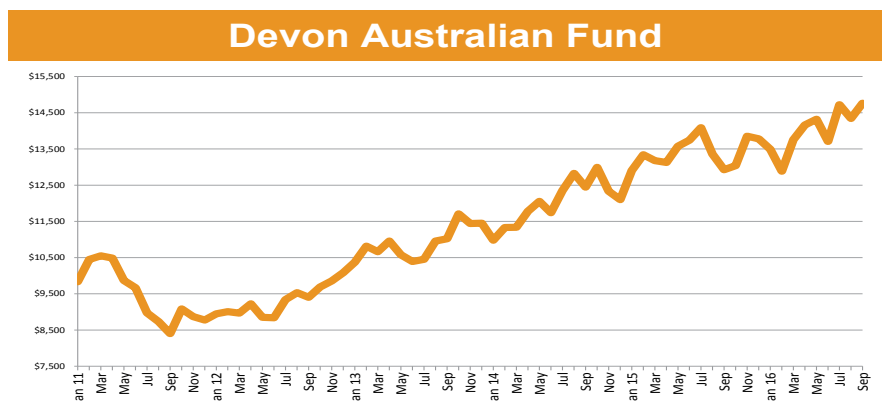
Tama Willis



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 and Trans Tasman Funds. Tama is widely regarded as a leading expert on resource and mining stocks.

NET PERFORMANCE

Based on \$10,000 invested at 1 January 2011





DEVON DIVERSIFIED INCOME FUND

FUND OUTLINE

The Devon Diversified Income Fund aims to give New Zealanders access to a diverse and good quality portfolio of high yielding investments.

The Fund aims to generate better-than-bank income rates by investing in a carefully selected portfolio of government and corporate bonds, cash, listed property, infrastructure, utility companies, high yielding equities, credit securities and other yielding financial assets.

DEVON DIVERSIFIED INCOME FUND

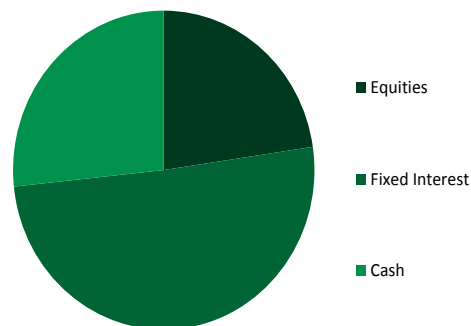
The US Federal Reserve left their interest rates unchanged over the month. In the accompanying statement, Fed officials highlighted that they were confident in their economic situation but felt it prudent to wait for further evidence of progress before tightening policy. Current market pricing suggests that the next move by the Fed is likely to be at their meeting in December with a lift of 0.25%. Similarly the RBNZ also left its overnight cash rate unchanged at 2.0% but in terms of future policy direction the next move by our central bank is expected to be a cut.

Although domestic growth is currently running at a healthy annualised rate of 3.6% the concern for Graeme Wheeler remains a frustratingly high NZ currency and a frustratingly low inflation rate. The Diversified Income Portfolio continues to be encouraged by the opportunities present across the domestic fixed interest market and in high yielding equities.

KEY HOLDINGS



ASSET ALLOCATION



GROWTH

NZ Equities	12.4%
AU Equities	9.7%

DEFENSIVE

Cash	27.2%
NZ Corporate Bonds	50.7%
NZ Government Bonds	0.0%

PERFORMANCE

As at 30/09/16

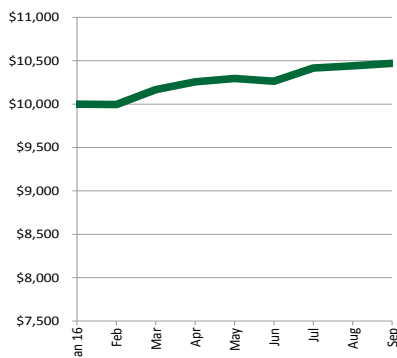
	1 Mth	3 Mth	Inception
Diversified Income Fund	0.3%	2.9%	5.8%
OCR +1.5%	0.3%	0.9%	2.8%

Devon Diversified Income Fund returns are after all fees and expenses, but before tax which varies by investor. Inception date for the Fund is 1 January 2016.

NET PERFORMANCE

Based on \$10,000 invested at 1 January 2016

Devon Diversified Income Fund*



*Fund commenced on 1 January 2016

AT A GLANCE

Targeted Portfolio Yield	5.5%
Commenced	January 2016
Total strategy	\$5.6m
Distributions	Target distributions of 1.5 cents per unit after tax paid quarterly

PORTFOLIO MANAGER

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DEVON DIVIDEND YIELD FUND

FUND OUTLINE

The Devon Dividend Yield Fund consists of a select group of up to 25-35 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.

DEVON DIVIDEND YIELD FUND

In the most volatile month in Australasian equities this year the Dividend Yield Fund perhaps unsurprisingly saw significant divergence of performance from individual positions while providing a solid performance overall. The standout again was GTN which rose more than 30% over the month as the market began to imply value in its capacity to establish a meaningful business in the United States.

Some of the more defensive names were weaker as investors looked to reduce exposure to higher yielding names – both Meridian Energy and Spark Infrastructure saw decent share price declines. We remain relaxed with these positions - in an environment of modest economic growth and material risks, companies with defensive earnings, cash dividend yields above 6% and projected steady growth in distributions are to be prized. Changes over the month included a further reduction in exposure to property stocks, which now make up less than 1% of the Fund) and the addition of Fonterra Shareholders Fund.

KEY HOLDINGS

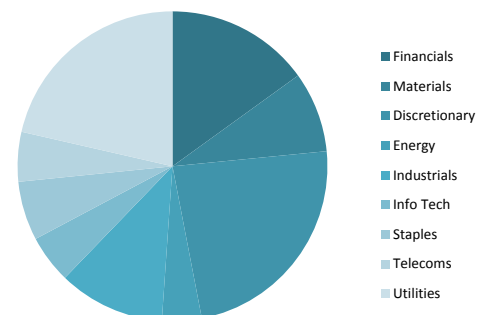


GTN



ASSET ALLOCATION

0.4262



GEOGRAPHIC ALLOCATION

New Zealand Equities	54.8%
Australian Equities	43.0%
Cash	2.2%
Currency Hedge	94.8%
Yield	6.2%

PERFORMANCE

As at 30/09/16

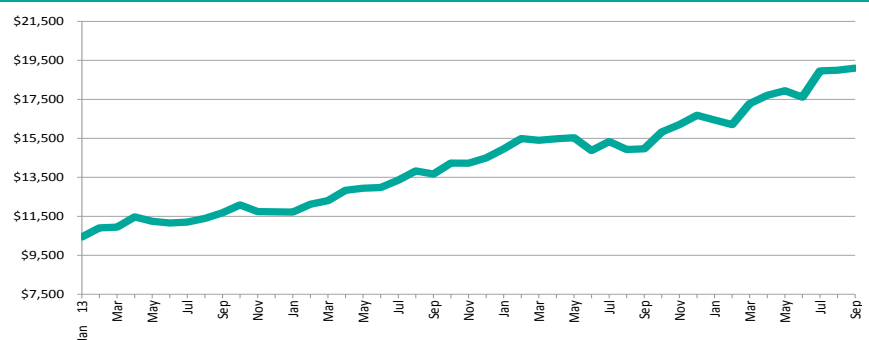
	1 Mth	3 Mth	1 Yr	3 Yr p.a	5 Yr p.a
Devon Dividend Yield Fund	0.6%	8.5%	27.6%	18.3%	-
TT Index (Hedged)	-0.0%	5.9%	22.4%	10.9%	-

Devon Dividend Yield Fund returns are after all fees and expenses, but before tax which varies by investor.

NET PERFORMANCE

Based on \$10,000 invested at 20 December 2012

Devon Dividend Yield Fund*



*Fund commenced on 20 December 2012

PORTFOLIO MANAGER

Nick Dravitzki



Over the last decade Nick has specialised in investing in high yield equities and is Portfolio manager for the Devon Dividend Yield 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

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.

DEVON TRANS-TASMAN FUND

The Trans-Tasman Fund performed well and ahead of benchmark over the month. GTN was a key contributor to relative performance while the Trans-Tasman Fund also benefited from weakness in the NZDAUD cross rate. For the first time in nearly a year the Fund has a greater allocation to Australia relative to New Zealand as we continue to find new investment opportunities in the Australian market. At Devon, a key part of our due diligence is to regularly meet with company management, and we are planning a further 3 visits to Australia before year-end.

The Fund increased its weighting to the resources sector over the month adding BHP Billiton, Woodside and Aurizon (AZJ). AZJ is an excellent example of an unloved business which looks cheap on 8.5x FY17 EBITDA with an attractive risk/reward profile. AZJ owns and operates a regulated coal network made up of 2,670 kilometres of heavy haul rail infrastructure. The Coal business segment transports around 210Mtpa of coal per annum. In the past quarter spot coking and thermal coal are up over 100% and 20% respectively on Chinese supply cutbacks. If a small portion of the price appreciation holds mining companies will look to grow tonnage which should see investors reassess the long-term potential of the business.

PORTFOLIO MANAGER

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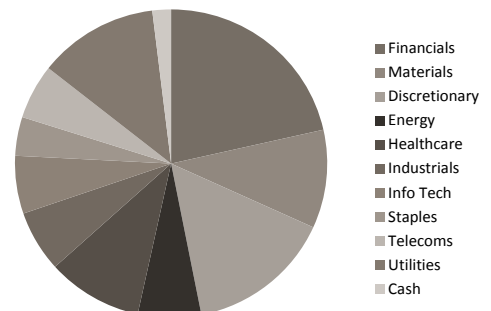
KEY HOLDINGS



VISTA GROUP



ASSET ALLOCATION



GEOGRAPHIC ALLOCATION

New Zealand Equities	47.2%
Australian Equities	50.9%
Cash	1.9%
	100.0%
Currency Hedge	0.0%

PERFORMANCE

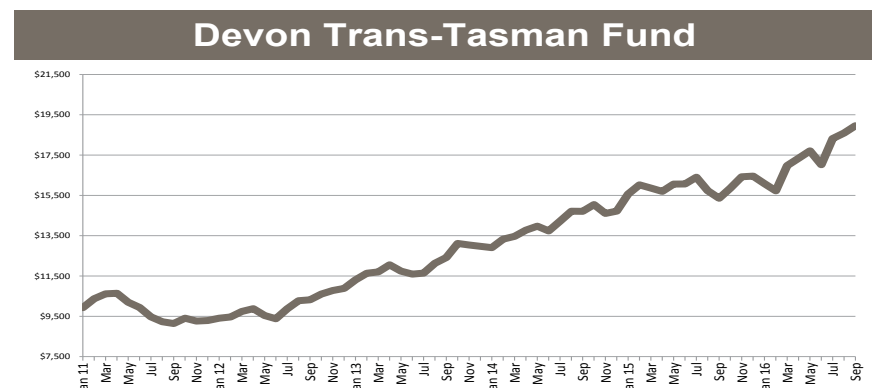
As at 30/09/16

	1 Mth	3 Mth	1 Yr	3 Yr p.a	5 Yr p.a
Devon Trans-Tasman Fund	1.9%	8.1%	19.8%	14.0%	15.0%
Trans-Tasman Index Gross	0.8%	6.3%	20.0%	9.8%	12.1%

Devon Trans Tasman Fund returns are after all fees and expenses, but before tax which varies by investor.

NET PERFORMANCE

Based on \$10,000 invested at 1 January 2011





GLOBAL THEMES FUND

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 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.

FUND UPDATE

We weren't surprised to see some nervousness creep back into markets during September as investors awaited clarity from major central banks as to the path of monetary policy into an action-packed year end – particularly as we move towards US elections on November 8. That said, equities remain elevated, with quality commanding a premium valuation. Against this backdrop it's not difficult to understand why investors are becoming jittery, and further highlights our comfort with holding an elevated level of cash. This serves two purposes: a) risk management, and b) it leaves us with some dry powder to reinvest in opportunities as they arise.

During the month, we rebalanced part of the Fund, bringing some of our holdings closer to their target weights. As part of this process, we increased our European Telecoms exposure. This theme provides the fund with a defensive element in case of any market correction, while still exhibiting attractive growth characteristics.

Our highest conviction theme remains US Banks, which should perform well in an environment of rising US bond yields rise. With the US Federal Reserve's dual targets around full employment and inflation nearly met, and growing concern around the risk of financial instability caused by low interest rates, further

rate hikes are on the near-term horizon. We reiterate our view that the US is not an economy needing interest rates at their current levels.

Our Japan theme also received a shot in the arm from the Bank of Japan, which made meaningful changes to its monetary easing package, in turn giving the market confidence that it remains committed to a reflationary strategy. Alongside the government's previously-announced fiscal stimulus package, we remain convicted on Japanese equities.

Returns

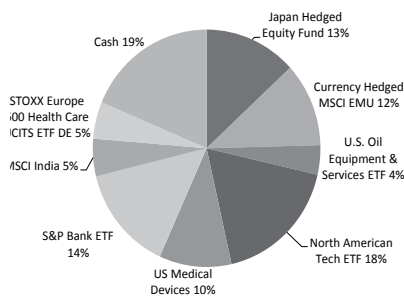
The Fund rose 0.1% in September com-

pared with a 0.8% rise in our benchmark. The Fund has risen 9.5% since inception in October 2014, versus a 13.9% increase in the benchmark.

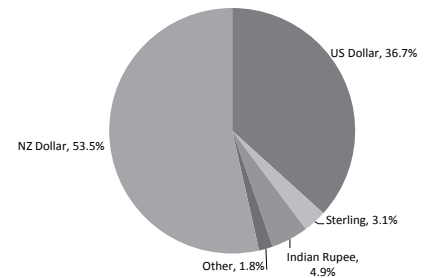
Currency exposures

We maintained the currency hedge level in the Fund at its benchmark weight of 50% throughout the month. We are comfortable with this position at present; however we are actively seeking opportunities to increase the hedge level given that we believe the market is overpricing the risk of further interest rate cuts from the Reserve Bank of New Zealand. Our currency hedge added ~0.1% to returns during September.

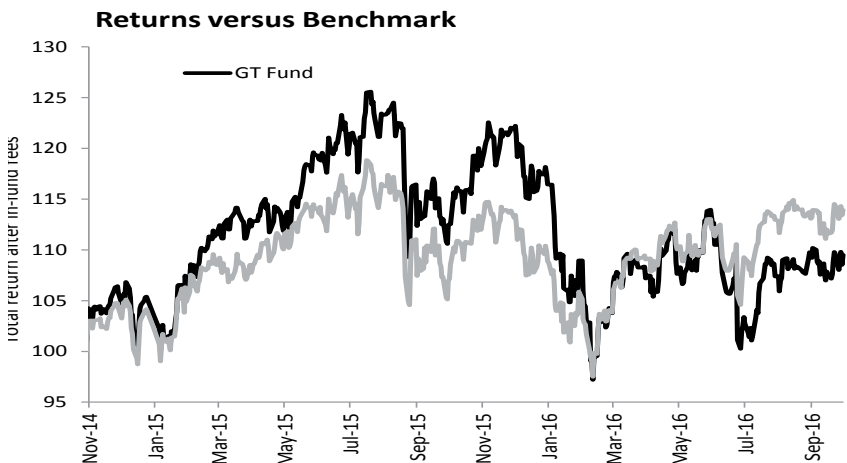
SECTOR ALLOCATION



CURRENCY EXPOSURE



NET PERFORMANCE SINCE INCEPTION
Returns versus Benchmark



* iShares MSCI All Country World Index ETF, 50% hedged to NZD
Source: Datastream, IBESS, JBWere Investment Strategy Group

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.

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