

MARKET COMMENTARY

IF INFLATION IS FIZZLING OUT, CAN PROFITS BE FAR BEHIND?

For decades, experts at the US Federal Reserve, academic economists and portfolio managers have been at war with inflation — the phenomenon of price increases without commensurate productivity gains. Investors and policymakers alike hate inflation because it robs consumers of buying power and discourages money flows into long-term investments for fear that their value will be eroded. The remedy for inflation in past cycles has been for central banks to raise interest rates in order to cool off growth and end speculative investing, thus curbing broad-based consumer price increases. Usually inflation flare-ups occur a couple of years into a cycle, or at mid-cycle at the latest. This time, the cycle is getting old — very old — but inflation remains surprisingly tame, running well behind previous US cycles. Meanwhile, similar patterns are playing out globally. Chinese inflation is slowing...

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**This article was written by MFS Chief Investment Strategist, James Swanson. The article was first published and distributed by MFS and has been used with permission.*



Devon is delighted to have won the Fund Manager of the Year: Domestic Equities Category, New Zealand 2017.

Thanks to all our clients for your on-going support.

Morningstar Awards 2017©. Morningstar, Inc. All Rights Reserved. Awarded to Devon Funds Management for Morningstar Fund Manager of the Year 2017, Domestic Equities Category, New Zealand. Further details on the Devon Investment Funds can be found in the Devon Product Disclosure Statement available at www.devonfunds.co.nz

MARKET INDICES

| Index | Region | Monthly Return | 1 Yr. Return |
|---------------------|-----------|----------------|--------------|
| S&P/NZX50G | NZ | 1.1% | 4.7% |
| S&P/ASX200G | AUSTRALIA | 0.0% | 7.3% |
| MSCI World Index | GLOBAL | 2.4% | 16.8% |
| S&P500 | USA | 2.1% | 16.0% |
| FTSE100 | UK | 0.9% | 14.0% |
| NIKKEI 225 | JP | -0.5% | 22.5% |
| NZ 90 Day Bank Bill | NZD | 0.2% | 2.1% |



AT A
GLANCE

UNIT PRICES

DEVON ALPHA FUND

\$1.5735

DEVON AUSTRALIAN FUND

\$1.3434

DEVON DIVIDEND YIELD FUND

\$1.8712

DEVON DIVERSIFIED INCOME FUND

\$1.5477

DEVON TRANS-TASMAN FUND

\$3.6215

GLOBAL THEMES FUND

\$2.5304

Prices as at 31 July 2017

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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.

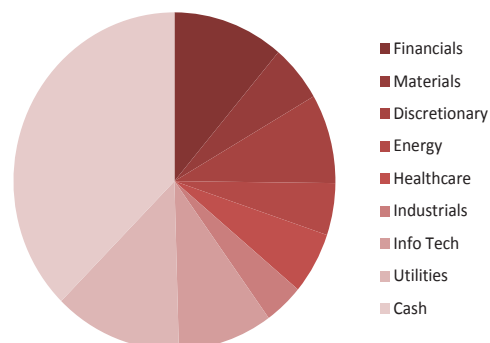
DEVON ALPHA FUND

During the month we participated in a capital raising by Pushpay. This business is a major participant in the provision of mobile commerce solutions to the faith sector and is now servicing many of the largest church groups across the US. The company raised US\$25m to accelerate their growth towards an FY18 revenue target of US\$70m representing year-on-year growth of greater than 100%. The fund raising will go to the development of a sales force in the US and the company expects to list in the US over the next 3-years. Its shares rallied by almost 40% from the price we paid for our stock during this process. Offsetting the contribution from this investment were negative returns generated by Westfield and Spark Infrastructure. We continue to hold a large cash balance in the strategy and hope opportunities for investment will present themselves over the upcoming Reporting Season.

KEY HOLDINGS



ASSET ALLOCATION



GEOGRAPHIC ALLOCATION

| | |
|----------------------|--------|
| New Zealand Equities | 23.3% |
| Australian Equities | 39.0% |
| Cash | 37.7% |
| | 100.0% |
| Currency Hedge | 11.7% |

PERFORMANCE

As At 31/07/2017

| | 1 Mth | 3 Mth | 1 Yr | 3 Yr p.a | 5 Yr p.a |
|------------------|-------|-------|-------|----------|----------|
| Devon Alpha Fund | 0.2% | 0.0% | -0.3% | 6.6% | 13.5% |
| OCR | 0.2% | 0.5% | 2.0% | 2.7% | 2.6% |

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

PORTFOLIO MANAGER

Nick Dravitzki

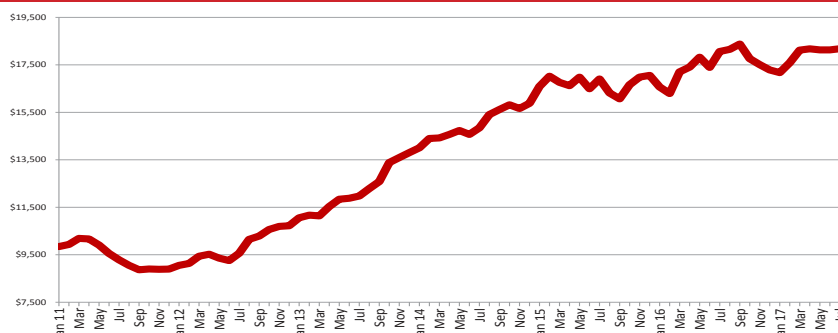


Over the last decade Nick has specialised in investing in high yield equities and is Portfolio manager for the Devon Alpha, Diversified Income and Dividend Yield Funds. At Devon, Nick has responsibility for the analysis of consumer staples, IT, consumer discretionary and property sectors. Nick is also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

NET PERFORMANCE

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

Devon Alpha Fund





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

During July one of the most significant positive contributors to performance was BHP Billiton. We lifted our weighting to this company in June after forming a view that its share price was trading at an attractive discount to our assessment of its fair value. Supported by stronger than expected economic data out of China the major mining stocks in Australia all performed well during the month but BHP was notable, rallying by over 11%. The company also reported a credible quarterly production report with iron ore shipments from the Pilbara rising by 14%. Other strong performance contributions came from our investments in ANZ and Woolworths. Unfortunately these returns were offset by the weaker share prices of CSL, GTN and Brambles. We are looking forward to the coming month as the Reporting Season will provide us with great insights into the current operating performances of our companies.

KEY HOLDINGS

Super Retail Group

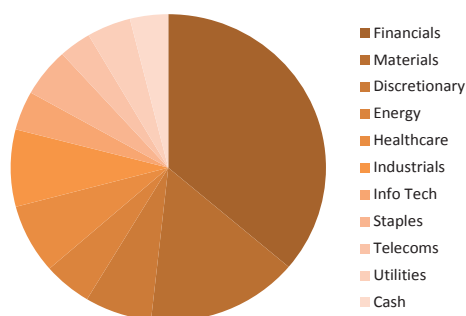


ResMed



GTN

ASSET ALLOCATION



GEOGRAPHIC ALLOCATION

| | |
|---------------------|--------|
| Dual Listed | 4.1% |
| Australian Equities | 92.0% |
| Cash | 3.9% |
| Total | 100.0% |
| Currency Hedge | 0.0% |

PERFORMANCE

As At 31/07/2017

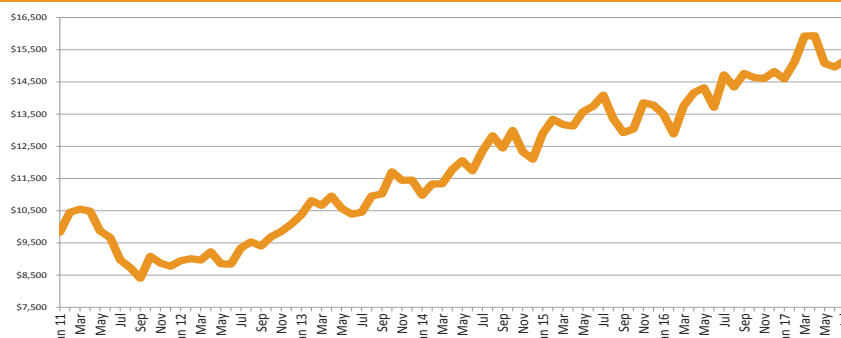
| | 1 Mth | 3 Mth | 1 Yr | 3 Yr p.a | 5 Yr p.a |
|--------------------------|-------|-------|------|----------|----------|
| Devon Australian Fund | 1.4% | -4.8% | 3.0% | 7.1% | 10.2% |
| ASX200 Index Gross (NZD) | 1.6% | -4.8% | 8.5% | 4.1% | 6.6% |

Devon Australian 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 Australian Fund



PORTFOLIO MANAGER

Tama Willis



After a long period in 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.



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

Fixed interest markets were reasonably stable during the month although we did see bond yields in Europe lift on speculation that the ECB will soon look to follow the Federal Reserve's lead and begin a process of interest rate normalisation. This sentiment is broadly consistent with the change of tone being seen by many central banks around the world as an increasing amount of policy guidance is being tilted towards the gradual removal of stimulus. This is despite a world without much evidence of inflation. In New Zealand, second-quarter CPI was reported as 0.0% which was below market expectations of 0.2%. With annual inflation currently running at 1.7% it is unlikely that the RBNZ will be lifting rates domestically in the short-term. Compounding this position is the strong New Zealand Dollar which rallied almost 2.5% during the month to finish above \$0.75.

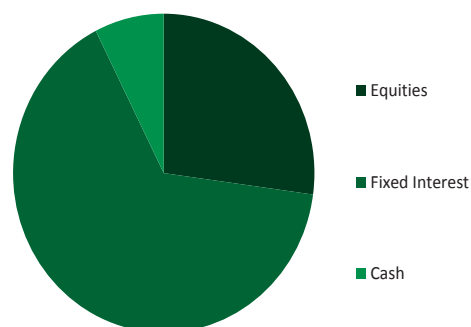
KEY HOLDINGS



GROWTH

| | |
|-------------|-------|
| NZ Equities | 14.1% |
| AU Equities | 11.9% |

ASSET ALLOCATION



DEFENSIVE

| | |
|---------------------|-------|
| Cash | 8.6% |
| NZ Corporate Bonds | 65.4% |
| NZ Government Bonds | 0.0% |

PERFORMANCE

As At 31/07/2017

| | 1 Mth | 3 Mth | 1 Yr |
|-------------------------------|-------|-------|------|
| Devon Diversified Income Fund | 0.9% | 1.7% | - |
| OCR + 1.5% | 0.3% | 0.9% | - |

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 | 5.0% |
| Commenced | January 2016 |
| Total strategy | \$5.4m |
| Distributions | Target distributions of 1.5 cents per unit after tax paid quarterly |

PORTFOLIO MANAGER

Nick Dravitzki



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

Funds. 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 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

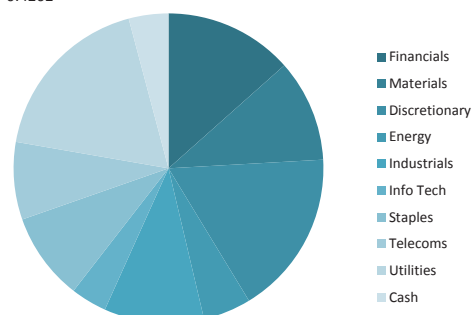
During the month our portfolio holding Super Retail Group made a number of announcements which were well received by the market. On the earnings front the company has highlighted that they believe FY17 earnings will be at the top end of their previous guidance. This was important given investor concerns over Amazon developing its presence in Australia. Also management announced a strategic initiative to convert its network of Amart Sports stores into new Rebel stores and focus on building one retail sports brand. Our exposure to the Australian banks also generated positive performance during the month after the banking regulator, APRA, delivered a softer-than-expected capital target for the sector. Although the major banks all currently have Core Equity levels which are below the new requirement, it is expected that all of them will be able to achieve compliance organically. This was a positive surprise for the market.

KEY HOLDINGS



ASSET ALLOCATION

0.4262



GEOGRAPHIC ALLOCATION

| | |
|----------------------|--------|
| New Zealand Equities | 52.1% |
| Australian Equities | 43.8% |
| Cash | 4.1% |
| Total | 100.0% |
| Currency Hedge | 100.0% |
| Yield | 6.3% |

PERFORMANCE

As At 31/07/2017

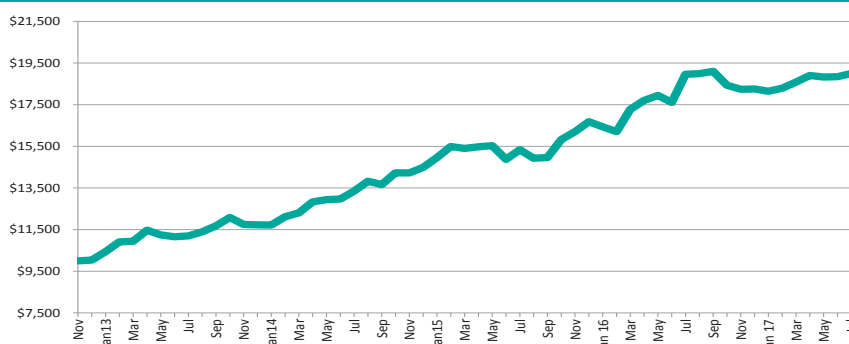
| | 1 Mth | 3 Mth | 1 Yr | 3 Yr p.a | 5 Yr p.a |
|---------------------------|-------|-------|------|----------|----------|
| Devon Dividend Yield Fund | 0.8% | 0.5% | 0.2% | 12.9% | - |
| TT Index (Hedged) | 0.5% | 0.8% | 6.0% | 9.6% | - |

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 Alpha, Dividend Yield and Diversified Income Funds.

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.

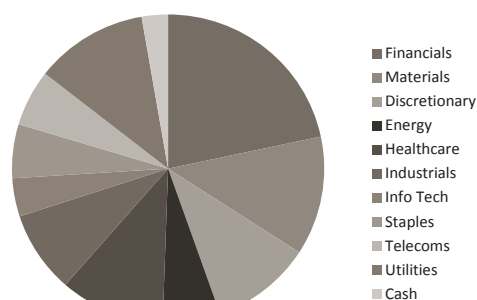
DEVON TRANS-TASMAN FUND

Vista Group is an exciting business that we own in the Trans-Tasman Fund. During the month our portfolio managers attended an Investor Day which was hosted by the company. It was an opportunity for their executives to discuss corporate strategy and highlight the opportunities currently available to them. Included amongst these is the transition of their Cinema division to a Cloud based architecture. This will be completed by early 2019 and will result in an improved customer experience and a reduction in operating costs. Also discussed was the progress being made in their MXticket business. This initiative creates a connection between ticketing vendors and Cinema Exhibitors and we believe has significant economic potential. Overall this business continues to leverage off its strong incumbent position and has a range of exciting opportunities ahead of it. There were no major changes made to this portfolio during the month.

KEY HOLDINGS



ASSET ALLOCATION



GEOGRAPHIC ALLOCATION

| | |
|----------------------|---------------|
| New Zealand Equities | 46.3% |
| Australian Equities | 51.0% |
| Cash | 2.7% |
| Total | 100.0% |

| PERFORMANCE | 1 Mth | 3 Mth | 1 Yr | 3 Yr p.a | 5 Yr p.a |
|--------------------------|-------|-------|------|----------|----------|
| As At 31/07/2017 | | | | | |
| Devon Trans-Tasman Fund | 0.7% | -1.6% | 2.0% | 9.5% | 13.6% |
| Trans-Tasman Index Gross | 1.4% | -0.3% | 6.6% | 9.1% | 11.7% |

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

PORTFOLIO MANAGER

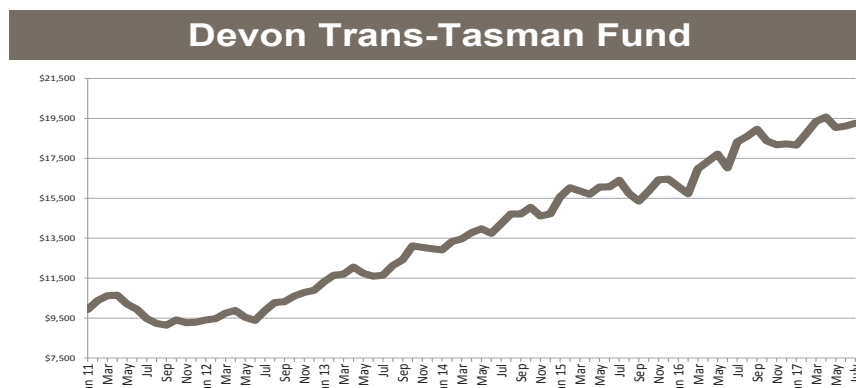
Tama Willis



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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

Our portfolio tread water in July, lagging broad markets. The US dollar extended its weakness through the month – now its worst run since 2011. A sense of political disarray in the White House, alongside signs of a resurgent Europe have encouraged investors to abandon the Greenback for other currencies. We have intentionally positioned our portfolio to benefit from rising US interest rates and a bull market in US dollars. Accordingly, our portfolio tends to lag when the US dollar is under pressure. Notwithstanding the travails of the USD in July, we firmly believe we are on the right track with our positioning. Importantly, the US economy is proving to be a formidable jobs engine, hiring an average of 200,000 new jobs per month for around five years now. This is pushing unemployment lower and lower, and consumer confidence higher and higher (the number of households describing jobs as plentiful hit a 16 year high in July). Ultimately we expect these conditions to lead to wage growth, rising interest rates, and a stronger US dollar. This will directly benefit our holdings in US Banks, which remains one of our favourite portfolio tilts. Indirectly, USD strength will also assist our European investments, which aren't enjoying the sharp rebound in the Euro. In our view ECB President Mario Draghi will look to stand in the way of Euro strength if it continues. Accordingly, the month to month ebb and flow of currency and interest rates does not perturb us. Our big picture is that the US will begin behaving like an economy that is in its third longest expansion ever (which it is). Investors will do well to not lose sight of this.

India was our best performing theme during July, on the back of continued progress in government reforms and a strengthening of Modi's government following key regional elections. Quarterly earnings season in the US and Europe is well underway, and we are broadly

pleased with what we are seeing. Our largest sector exposures in the US (Technology, Banks and Healthcare) have all delivered positive earnings surprises. While we have been somewhat disappointed with the composition of Banks' earnings, we are seeing solid growth in the Medical Devices space, as well as in those companies leading the "transition to the cloud" (Microsoft, Amazon, Alphabet). We saw this reflected in Technology stock prices this month, however uncertainty around healthcare reform in the US dampened Medical Device names. In Europe, earnings have beaten expectations broadly across market sectors. European banks in particular continue to report better than expected results, however of particular interest to us is the continued improvement we are seeing in Telco names, given our exposure to this sector. We see these companies as increasingly well placed to continue to deliver both revenue and earnings growth.

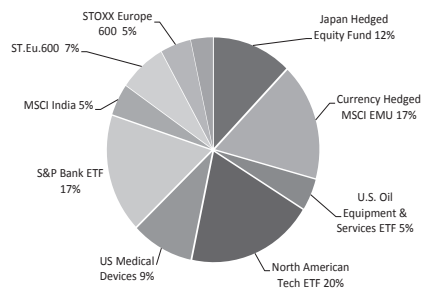
Returns

The Global Themes Fund was flat in July, finishing the month at a unit price of \$2.5304. This compares with a 1.5% rise in our global equity benchmark. Our fund has risen 9.0% per annum since inception net of fees, versus 10.3% growth in the iShares MSCI All Country World Index Exchange Traded Fund (50% hedged to NZD).

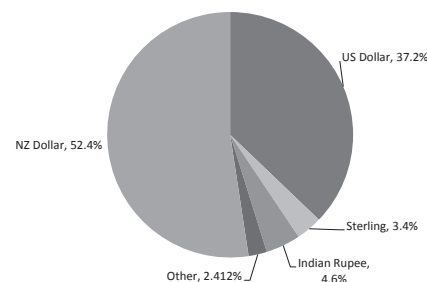
Currency exposures

We continue to hold the currency hedge level in the fund at its benchmark weight of 50%. New Zealand house sales have yet to show signs of life after posting ~20% declines off their highs. Until we see a turn here, further upside risk to the Kiwi dollar looks limited, particularly from current levels, as the RBNZ will feel reluctant to tighten policy quickly.

SECTOR ALLOCATION



CURRENCY EXPOSURE



NET PERFORMANCE SINCE INCEPTION

Returns versus Benchmark

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 INFIZ 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.

Returns versus Benchmark

