

MONTHLY REPORT: FEBRUARY 2019

Taxing our Future

The recently released Tax Working Group (TWG) report "Future of Tax" should more correctly have been labelled "Taxing our Future". Tax is an incredibly important component of a well-functioning economy and it is good to review our tax structures periodically. Unfortunately, rather than being a visionary document as we might have hoped, the TWG have produced a report that is economically naïve and would, in our view, shift more of the tax burden onto aspirational younger people.

Before looking at some of the problems with the report's recommendations it might be useful to shed some light on NZ's current tax framework. Let's start by looking at the amount of tax that New Zealanders pay. The best measure of this is the tax to GDP ratio which in NZ sits at 32.0% or just below the OECD average of 34.2% and above countries like Australia and the USA at 27.8% and 27.1% respectively. Relative to OECD averages the NZ structure is characterised by higher taxes on personal and company income, rates about average on property taxes and contains no separate taxes relating to payroll or social security contributions. So, all in all, our overall tax burden looks about right.

Where it gets very interesting in NZ is when we look at who pays the tax. One measure is the amount of net tax paid, which is the amount of tax paid less transfer payments (like benefits, Working for Families etc) ... [Read More](#)

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MARKET INDICES

Index	Region	Monthly Return	1 Yr. Return
S&P/NZX50G	NZ	3.8%	11.4%
S&P/ASX200G	AUSTRALIA	5.1%	3.7%
MSCI World Index	GLOBAL	3.3%	1.3%
S&P500	USA	3.5%	4.9%
FTSE100	UK	2.3%	2.1%
NIKKEI 225	JP	3.0%	-1.1%
NZ 90 Day Bank Bill NZ		0.1%	2.0%

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AT A GLANCE

Prices as at 28 February 2019

DEVON ALPHA FUND	\$1.681
DEVON AUSTRALIAN FUND	\$1.382
DEVON DIVERSIFIED INCOME FUND	\$1.552
DEVON DIVIDEND YIELD FUND	\$1.843
DEVON TRANS-TASMAN FUND	\$3.849
GLOBAL THEMES FUND	\$2.787

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DEVON ALPHA FUND

FUND OUTLINE

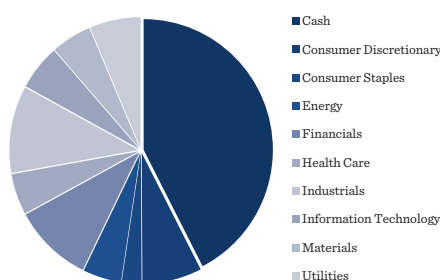
The **Alpha Fund** invests in a concentrated portfolio of approximately 10 to 15 select companies predominantly listed on the NZ and Australian share markets.

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.

KEY HOLDINGS



ASSET ALLOCATION



ALLOCATION

New Zealand Equities	19.3%
Australian Equities	38.2%
Currency Hedge	29.5%

Cash	42.5%
Total	100.0%

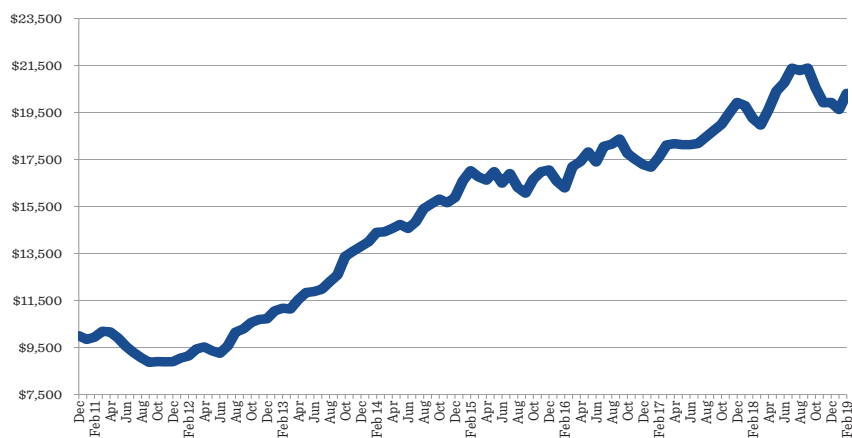
PERFORMANCE

	1 Mth	3 Mth	1 Yr	3 Yr p.a	5 Yr p.a
Devon Alpha Fund	3.5%	2.0%	5.5%	7.3%	6.9%
OCR	0.1%	0.4%	1.7%	1.8%	2.4%

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



NOTE: Further information on the Devon Alpha Fund can be found in our Quarterly Fund Updates by visiting <https://devonfunds.co.nz/alpha-fund> or by clicking [HERE](#)

COMMENTARY

The Alpha strategy generated strong absolute returns during February with a number of our positions making positive contributions. These included Brambles (up 11%), Janus Henderson (up 17%), Vista Group (up 13%) and the recently introduced James Hardie (up 15%).

After a strong performance in 2018 our longstanding key holding Vista, produced yet another stellar financial result propelling it into the position of one of New Zealand's premier listed technology companies. Its global leadership within cinema software enabled the business to grow its revenue by 23% and its operating cash flow by 150%. Whilst its Cinema division continues to perform well, and now has 48% of the global ex-China large cinema market, it was the growth in ancillary products that really excited investors. Key to this was Movio Media, its cinema data platform that allows movie studios to better connect with their audiences. Movio grew revenue by 47% and continues to sign contracts with the major studios.

During the month, Mark Brown, CIO of Devon Funds, assumed the role of Portfolio Manager for the Alpha strategy.

PORTFOLIO MANAGER

Mark Brown



Mark has primary responsibility for stock selection and portfolio construction for the New Zealand Equity and Alpha funds. Mark is also responsible for overseeing the overall research and investment process at Devon.

Prior to joining Devon, Mark was the Australasian Head of Equities at ANZ New Zealand Investments.

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DEVON AUSTRALIAN FUND

FUND OUTLINE

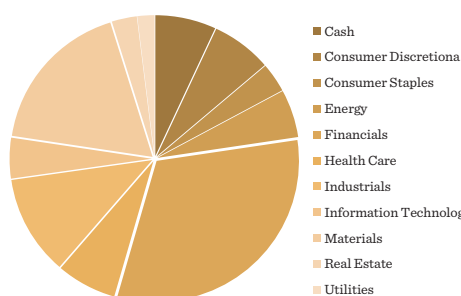
The **Australian Fund** is actively managed and invests in a select portfolio of approximately 25 to 35 companies which are primarily Australian listed companies

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.

KEY HOLDINGS



ASSET ALLOCATION



ALLOCATION

New Zealand Equities	4.7%	Cash	6.9%
Australian Equities	88.4%	Total	100.0%

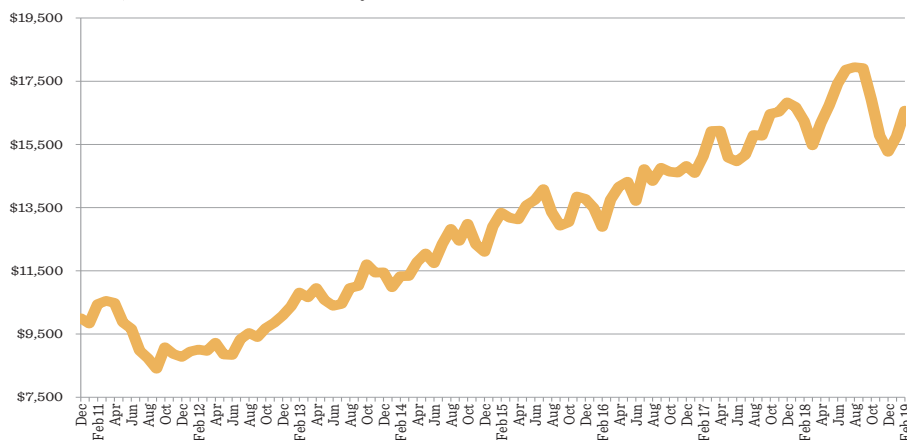
PERFORMANCE

	1 Mth	3 Mth	1 Yr	3 Yr p.a	5 Yr p.a
Devon Australian Fund	5.2%	5.0%	2.0%	8.7%	7.9%
ASX200 Index Gross (NZD)	5.2%	8.0%	3.6%	11.5%	6.9%

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



NOTE: Further information on the Devon Australian Fund can be found in our Quarterly Fund Updates by visiting <https://devonfunds.co.nz/australian-fund> or by clicking [HERE](#)

COMMENTARY

This Fund performed broadly in line with its benchmark over the month. Positive contributions came from our investments in the Mining sector with BHP Billiton and Rio Tinto rallying 6.9% and 10.5% respectively. The share prices of these companies rallied after a tragic accident occurred in Brazil which reduced the global supply of iron ore. This together with evidence that the Federal Reserve is unlikely to lift interest rates again this year, lifted investor confidence around economic growth and commodity prices.

Key position Brambles (BXB) also performed strongly over the month after it reported a solid interim result and is now up 25% over the past year. Positive aspects of the result included evidence of pricing power in the US market and signs that cost inflation is easing. BXB also announced the sale of their IFCO reusable plastic containers business for US\$2.51bn. Management have announced their intention to return US\$1.95bn of capital to shareholders (14% of market capitalisation).

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.

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DEVON DIVERSIFIED INCOME FUND

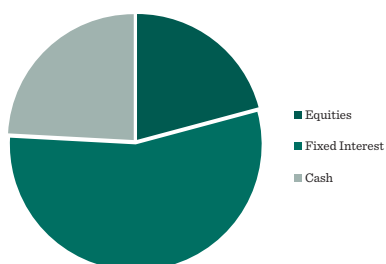
FUND OUTLINE

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.

KEY HOLDINGS



ASSET ALLOCATION



ALLOCATION

New Zealand Equities	12.9%
Australian Equities	7.1%

Bonds	55.0%
Cash	25.0%

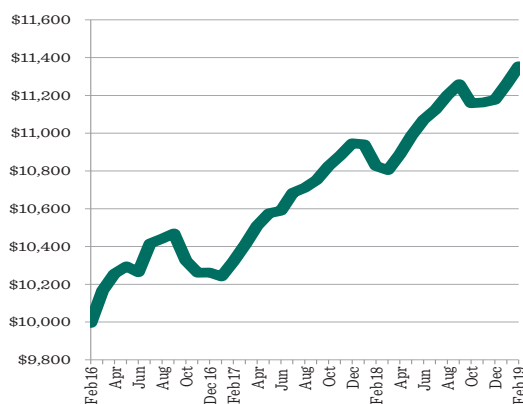
PERFORMANCE

	1 Mth	3 Mth	1 Yr	2 Yr p.a
Devon Diversified Income Fund	0.8%	1.7%	4.9%	4.9%
OCR + 1.5%	0.2%	0.8%	3.3%	3.3%

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



NOTE: Further information on the Devon Diversified Income Fund can be found in our Quarterly Fund Updates by visiting <https://devonfunds.co.nz/diversified-income-fund> or by clicking [HERE](#)

COMMENTARY

During February bond prices were reasonably stable with only small changes occurring to the global 10-year interest rates. Economic news in the US was mixed with consumer confidence levels improving despite Retail Sales falling 1.2% in December. Against this backdrop the Fed confirmed its increasingly dovish stance and more rate rises appear to be unlikely this year. Other Central Banks also highlighted concerns over growth in the year ahead.

In New Zealand our Government Bond curve is the flattest that it has been since October 2016 with less than 0.5% separating our 2-year and 10-year rates. In the US though, this difference is only 0.16%! Also during the month the RBNZ acknowledged that their proposed changes to the capital requirements for our local banks potentially could result in a tightening of credit conditions and as such they are prepared to cut the Official Cash Rate should they need to provide support.

PORTFOLIO MANAGER

Nick Dravitzki



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

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DEVON DIVIDEND YIELD FUND

FUND OUTLINE

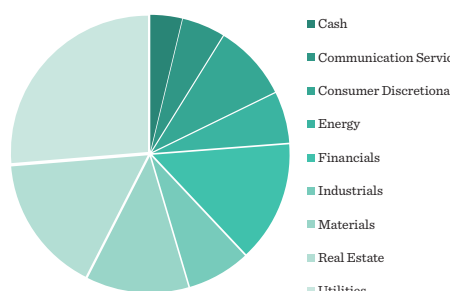
The **Devon Dividend Yield Fund** consists of a select group of up to 25-35 New Zealand and Australian listed companies.

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.

KEY HOLDINGS



ASSET ALLOCATION



ALLOCATION

New Zealand Equities	62.0%
Australian Equities	34.3%
Currency Hedge	91.4%

Cash	3.7%
Total	100.0%
Yield	6.1%

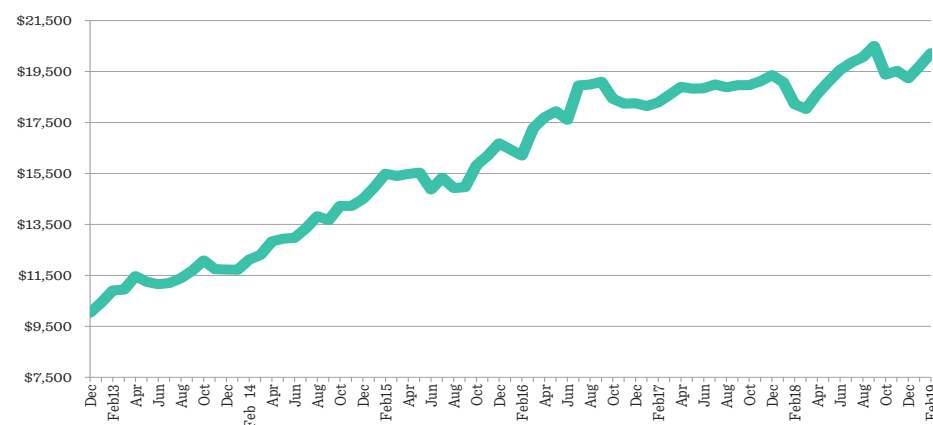
PERFORMANCE

	1 Mth	3 Mth	1 Yr	3 Yr p.a	5 Yr p.a
Devon Dividend Yield Fund	2.6%	3.5%	11.0%	7.6%	11.0%
TT Index (Hedged)	4.9%	7.8%	9.2%	13.6%	10.3%

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 1 January 2011



NOTE: Further information on the Devon Dividend Yield Fund can be found in our Quarterly Fund Updates by visiting <https://devonfunds.co.nz/dividend-yield-fund> or by clicking [HERE](#)

COMMENTARY

A highlight for the Dividend Yield Fund was Alumina Limited (AWC). AWC is a listed entity which owns 40% of Alcoa World Alumina and Chemicals, one of the largest miners and refiners of alumina in the world. AWC receives a pre-determined share of Alcoa's cash profits which it distributes in full to shareholders. The strong rise in global alumina prices over 2018 resulted in a bumper cash payment to AWC and a final dividend payment of 19.6c. This alone represented a cash yield on the pre-dividend price of 7%, and was in addition to an 11.7c dividend paid in August. The company's share price also rose more than 5% over the month, delivering a total return of 13%.

Whilst the Resource sector is not typically noted for high dividend yields, the current combination of strong commodity prices and unusually disciplined capital management across many companies in the sector has created a number of opportunities for this portfolio.

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DEVON TRANS-TASMAN FUND

FUND OUTLINE

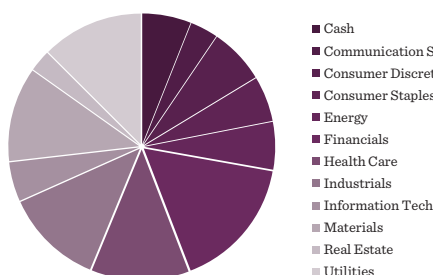
The **Trans-Tasman Fund** provides a broad and actively managed exposure to the NZ and Australian equity markets.

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.

KEY HOLDINGS



ASSET ALLOCATION



ALLOCATION

New Zealand Equities	49.3%
Australian Equities	44.7%

Cash	6.0%
Total	100.0%

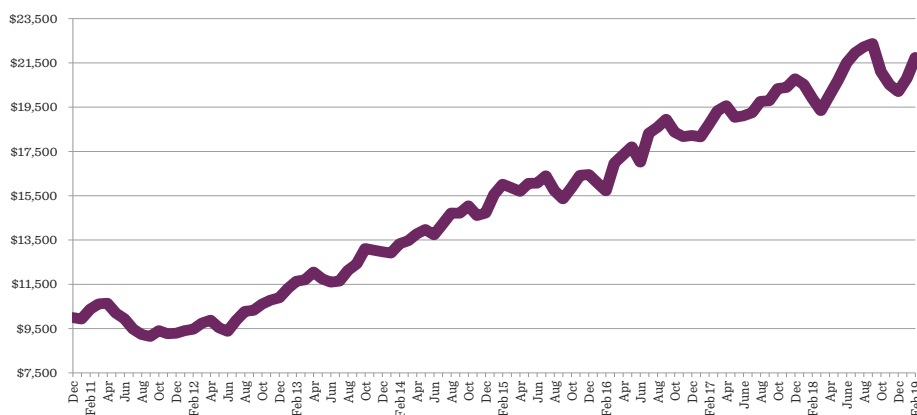
PERFORMANCE

	1 Mth	3 Mth	1 Yr	3 Yr p.a	5 Yr p.a
Devon Trans-Tasman Fund	4.4%	5.9%	9.2%	10.3%	9.6%
Trans-Tasman Index Gross	4.5%	6.8%	7.5%	13.0%	10.1%

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



NOTE: Further information on the Devon Trans-Tasman Fund can be found in our Quarterly Fund Updates by visiting <https://devonfunds.co.nz/trans-tasman-fund> or by clicking [HERE](#)

COMMENTARY

We were pleased with the returns that this portfolio generated during February. There were a number of investments which made positive contributions including Rio Tinto, James Hardie, BHP Billiton and Vista Group. We remain positive on the outlook for Rio Tinto as strong commodity prices look set to deliver further earnings upgrades. At their 2018 full-year result the company announced an additional US\$7.1bn capital return to shareholders (7% of market capitalisation) due to strong operating cash flow and recent divestments. This brings the total capital return for the year to US\$13.5bn.

We also recently added James Hardie to the portfolio. James Hardie makes a range of fibre cement products which are used in the construction of new homes, renovations and restorations across many different countries and markets. The opportunity to make this investment presented itself after a period of share price weakness due to concerns over possible interest rate hikes in the US.

PORTFOLIO MANAGER

Tama Willis



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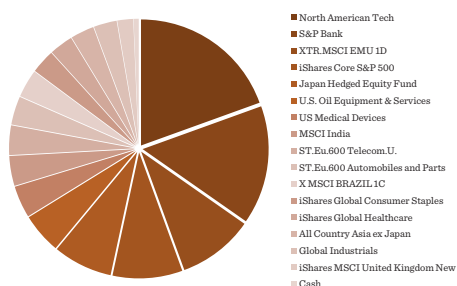
DEVON GLOBAL THEMES FUND

FUND OUTLINE

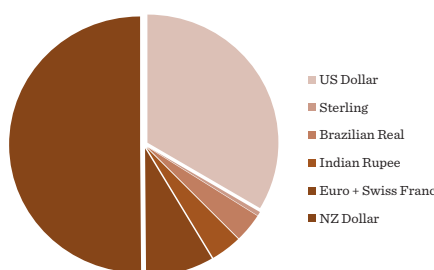
The **Global Themes Fund** invests in Global Financial Assets predominantly Global Exchange Traded Funds (ETF's). We identify macroeconomic or thematic investment ideas with a 2-5 year time horizon, and implement the investment ideas through appropriate high quality assets.

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.

SECTOR ALLOCATION

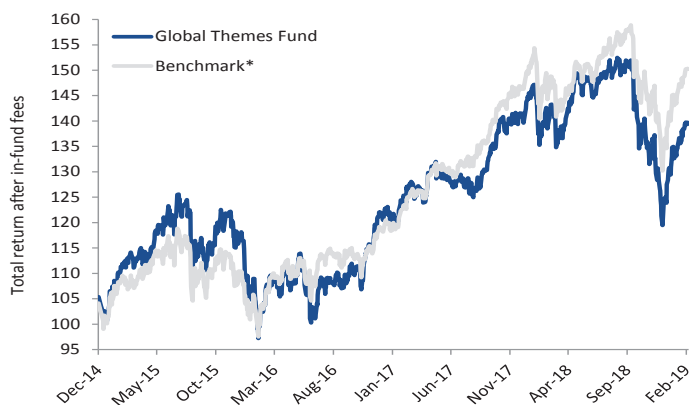


CURRENCY EXPOSURE



NET PERFORMANCE SINCE INCEPTION

Returns versus Benchmark



NOTE: Further information on the Devon Global Themes Fund can be found in our Quarterly Fund Updates by visiting <https://devonfunds.co.nz/global-themes-fund> or by clicking [HERE](#)

PORTFOLIO MANAGERS Andrew Thompson, Philip Borkin & Hayden Griffiths.

Andrew joined JBWere's Investment Strategy Group at the start of 2016, with a focus on global strategy and global equity portfolio management. Before joining JBWere, Andrew was an Investment Analyst at BNZ Private Bank, and prior to that a Supervisor in the audit division at KPMG.

Philip brings more than a decade worth of experience working alongside respected industry participants in roles which encompass economics and strategy. Before joining JBWere, Philip was employed as a Senior Macro Strategist for ANZ Bank.

Hayden joined JBWere in 1996 and has over 20 years experience working in financial markets as a quantitative analyst in investment research. Before joining the firm Hayden worked at The Reserve Bank of NZ and the investment bank Barclays de Zotte Wedd (BZW).

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COMMENTARY

February was another strong month for global equity markets, with investors cheering a better-than-expected earnings season in the US (particularly given the negative sentiment going in), alongside increased hopes of a resolution in the US-China trade dispute. However, equities have now largely recovered last quarter's fall and, as such, we remain cautious – though still constructive – for the remainder of 2019.

Our best performing theme during February was US banks, which continued its recovery from oversold levels in December. While mixed, US banks broadly reported well in the recent earnings season. Growth-focused technology and medical device stocks continued to perform well in the bounce back from last quarter's 'growth scare', and we expect these sectors to continue to outperform this year. Oil services had another good month as the oil price continued to tick higher.

Given where we are in the cycle, and the likelihood of more challenging and volatile markets from this point, our aim is to build some more defensiveness into the portfolio during 2019 as we set up the portfolio for the environment we're moving into. We will begin this process in March with some thematic tweaks, and will be in a position to provide more detail on these next month.

Our returns

The Global Themes Fund rose 3.8% in February, finishing the month at a unit price of \$2.7869. This compares with a 3.3% rise in our global equity benchmark.

Our fund has risen 8.0% per annum since inception net of fees, versus 9.8% per annum growth in the iShares MSCI All Country World Index Exchange Traded Fund (50% hedged to NZD).

Our currency exposures

The currency hedge level in the fund remains at its benchmark weight of 50%, which we are comfortable with for now given our view that the NZ dollar is trading around fair value.