THE ALTERNATIVE VIEW

By Hugh Dive

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Mid-Season Report Card

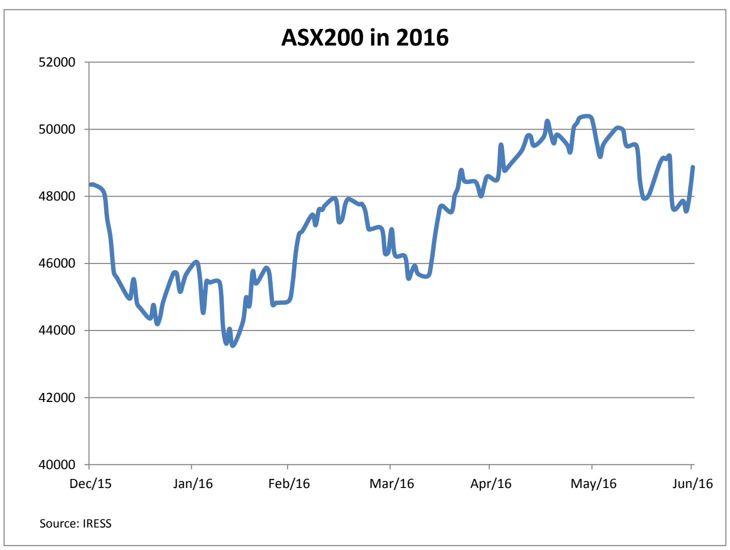
The last six months have been stressful for Australian equity investors and despite the ASX200 delivering a total return of 1.1% (capital appreciation plus dividends), it has been an emotional rollercoaster. December's Santa Claus rally turned into a brutal hangover in the New Year, similar to that given by excessive consumption of four litre cask white wine from Southern Queensland. The market then staged a recovery in March and May, before falling in a heap in June due to the surprising outcome of UK vote to leave the European Union.

In this week's piece we are going to look at what has happened over the first half of the year, some key themes and analyse the catalysts that contributed to the top and bottom performers.

Commodities Recover

After a poor year in 2015 and a tough start to 2016, the commodity-linked stocks have staged a recovery in 2016 with iron ore up +27% and oil gaining +30%. In hindsight both oil and key minerals such as iron ore were probably sold down too aggressively in 2015 and the moves in 2016 are most likely a correction. Additionally we have seen better demand than expected out of China and some supply discipline from producers. Looking to the second half of 2016 it is hard to see these sectors continuing to outperform as better prices will tempt some miners to restart or delay shuts and will encourage additional drilling, especially onshore in the USA.

Financials have had a tough start to 2016 in particular the banks (down on average 10%) that have been sold off on concerns about higher bad debts and also the potential for additional capital raisings that may come out of the upcoming Basel IV standards on capital reserves for banks, to mitigate against the risk of financial crisis. Investment bank ***Macquarie*** and insurer ***QBE*** also weighed down the performance of the financials sector particularly in June due to concerns regarding their profits generated in the UK.



Sector	Total Return in 2016
Listed Property Trusts	16.3%
Materials	16.0%
Utilities	11.9%
Industrials	9.1%
HealthCare	8.7%
Consumer Discretionary	5.7%
Energy	4.4%
Telecoms	3.9%
Consumer Staples	-5.3%
Financials	-9.4%
Australian Dollar vs United States Dollar Spot	2.2%
Oil	30.4%
Iron Ore	27.0%
S&P/ASX 200	1.1%
S&P/ASX 100	0.7%
Small Ords	6.9%

Hunt for Yield Continues

The two top performing sectors in 2016 have been the "yield" sectors of utilities and listed property, which have benefited from the RBA rate cut to 1.75% in May and expectations that interest rates globally will remain close to zero for the near future. Listed Property and in particular the trusts with domestic assets enjoyed a boost from the Brexit vote based on the theory that a portion of the real estate capital that has historically been invested in London property, will be invested in office towers in Sydney and Melbourne. As the Listed Property Sector in aggregate now trades at a 39% premium to net tangible assets with a yield of only 4.4% we are concerned about valuations in the sector.

Small Outperforms Large

Whilst the larger capitalisation stocks have been buffeted by macroeconomic concerns, the mood is far sunnier for investors in smaller companies with the Small Ords up +7% in 2016. The key drivers of small cap performance has been the strong share prices of the small gold, graphite and lithium explorers that are leveraged to gains in these commodities and the blue sky potential electric cars. Amongst the small industrial companies ***Seven West Media*** (+42%), ***NextDC*** (+46%) and ***Mayne Pharma*** (+44%) have contributed to the small capitalisation index outperforming the broader market mainly due to company specific factors.

Star Pupils and those that must try harder in the Michaelmas Term

Company	Sector	Price	Total Return in 2016	Company	Sector	Price	Total Return in 2016
Blackmores Limited	Consumer Staples	$ 131.39	-38.8%	Fortescue Metals Grp	Materials	$ 3.50	88.8%
Henderson Group	Financials	$ 3.77	-38.1%	Newcrest Mining	Materials	$ 23.00	77.3%
Sirtex Medical	Healthcare	$ 25.57	-36.2%	Primary Health Care	Healthcare	$ 3.95	71.2%
Qantas Airways	Transportation	$ 2.82	-31.1%	Cimic Group Ltd	Construction	$ 35.75	49.2%
Incitec Pivot	Chemicals	$ 2.97	-24.0%	South32 Limited	Materials	$ 1.54	44.6%
Bank of Queensland.	Financials	$ 10.59	-21.3%	BlueScope Steel Ltd	Materials	$ 6.37	44.5%
Computershare Ltd	Financials	$ 9.17	-19.7%	Medibank Private Ltd	Financials	$ 2.95	39.5%
Flight Centre Travel	Consumer Discretionary	$ 31.58	-19.3%	Aristocrat Leisure	Consumer Discretionary	$ 13.80	36.1%
Orica Limited	Chemicals	$ 12.33	-19.1%	ALS Ltd	Mining Services	$ 4.89	31.3%
Bendigo and Adelaide	Financials	$ 9.60	-16.8%	Spark Infrastructure	Utilities	$ 2.44	30.2%

Laggards and their negative Catalysts

In the table above on the left hand side we have listed the bottom ten performing stocks in the ASX100 for 2016 and a key factor that many of these companies share is that they were top performers in 2015 and were priced by the market in the expectation that favourable conditions and profit growth would continue. Vitamin manufacturer ***Blackmores*** fell heavily in April after China introduced changes to the rules and taxes of online purchases, ***Sirtex*** was weak after downgrading guidance for sales of its liver cancer treatments and high flyers ***Qantas*** and ***Flight Centre*** were hit by both a recovery in oil and a price war in international flights sparked by the entry of American Airlines, which has seen return flights from Australia to the US for less than $900. Fund manager ***Henderson*** and unit registry business ***Computershare*** were heavily impacted by the Brexit vote.

Stars and what caused them to Shine

In the table above on the right we have listed the top 10 stocks in the ASX 100 and the bulk of the list is comprised of commodity-linked companies that were extremely out of favour in 2015 and have enjoyed a tailwind of rising commodity prices in 2016. ***Fortescue***, ***Newcrest*** and ***S32*** have seen recoveries in iron ore, gold and base metals as well as the closure of higher cost mines by some of their competitors and the lagged impact of a Chinese stimulus plan from last September. Perennial healthcare underperformer ***Primary Healthcare*** has enjoyed a good start to 2016 due to the Australian government's plan to introduce legislation to control rents for pathology centre sites which is likely to boost earnings. ***CIMIC*** has been consistently strong during the first half of 2016 due to an on-market buy-back which is viewed by many as a precursor to the company being privatised by major shareholder (72%) Hochtief.

Health insurer ***Medibank Private*** continued to find favour with investors since listing in late 2014 and upgraded profit guidance in January due to better than expected claims expense outcomes. Poker machine manufacturer ***Aristocrat Leisure*** more than doubled its first half profit as it grew its premium gaming business in the U.S. and gained market share in Australia. Global minerals testing company ***ALS*** is on the leaders board despite reporting a 26% decline in profits courtesy of a takeover offer.

Our Take

Looking to the second half of 2016 we see that the market has been overtly negative on the Australian banks and are positioned for a recovery in this sector. Whilst having zero positive exposure to the miners has hurt us in the first six months of 2016, we expect both mining and energy to underperform as additional supply hits the market in the back half of the year. Additionally in March we made some fundamental changes to the Aurora Dividend Income Trust's portfolio construction process focusing on distribution sustainability and earnings quality. The Trust is now more concentrated on both the short and long side, has less volatility and is allowing me to sleep easier at night.

Hugh Dive
Senior Portfolio Manager

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- **Aurora Absolute Return Fund (ASX code: ABW)**
- **Aurora Fortitude Absolute Return Fund**
- **Aurora Global Income Trust (ASX code: AIB)**
- **Aurora Property Buy-Write Income Trust (ASX code: AUP)**
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