Zenith Investment Partners

Highly Recommended
Recommended
**Approved**
Not Rated
Redeem

# Product Assessment

## DDH Fixed Interest Fund

**Report data as at 31 May 2017**
**Rating issued on 15 Jun 2017**

### APIR Code
DDH0006AU

### Asset / Sub-Asset Class
Australian Fixed Interest
Bonds

### Investment Style
Core Plus

### Investment Objective
To outperform the Bloomberg AusBond Composite Bond (All Maturities) Index by a gross margin of 0.8% p.a. over rolling 3 year periods.

### Zenith Assigned Benchmark
Bloomberg AusBond Composite Index

### Net Returns (% p.a.)

| | 5 yrs | 3 yrs | 1 yr |
|---|---|---|---|
| Fund | 4.57 | 4.40 | 2.32 |
| Benchmark | 4.48 | 4.85 | 2.50 |
| Median | 4.45 | 4.54 | 2.43 |

### Income (% p.a.)

| | Income | Total |
|---|---|---|
| FY to 30 Jun 2016 | 6.02 | 6.08 |
| FY to 30 Jun 2015 | 5.35 | 5.17 |
| FY to 30 Jun 2014 | 5.62 | 6.38 |

### Fees (% p.a., Incl. GST)
Management Cost: 0.68%
Performance Fee: N/A

### VIEWPOINT & RATING

The Fund is distributed by DDH Graham Limited (DDH) and is managed by QIC Limited (QIC). Employing an active investment approach, the Fund provides access to a portfolio of Australian-centric fixed interest securities with the flexibility to invest in global opportunities. Zenith highlights that while the investment team is deep and well structured, the Fund has consistently failed to deliver competitive peer relative returns. Coupled with concerns over Fund longevity, Zenith has tempered its conviction in the Fund's medium-term prospects.

QIC is a Queensland government owned enterprise with investment personnel based in Brisbane, London, and the U.S. QIC manages approximately $A 81 billion in funds under management (FUM) as of 31 March 2017, which includes $A 6.5 billion in Australian fixed interest strategies. With only approximately $A 5 million in the retail Fund, Zenith highlights that at current FUM levels are loss making for DDH. While DDH has reiterated its commitment to the Fund, we believe the risk of wind-up is elevated. This risk has been previously flagged by Zenith, with little improvement in terms of FUM and distribution effort.

Comprising 29 members, the investment team is split between three key investment functions including Research & Strategy (R&S), Absolute Return and Fixed Interest (ARFI), Overlay Solutions (OS), and Global Liquid Markets Trading (GLMT). Each division has a dedicated lead with ultimate responsibility resting with Susan Buckley, Managing Director and Head of Global Liquid Strategies.

QIC employs a multi-step investment process that incorporates the following steps: Fixed Interest Research; Scorecard Process; and Strategy Based Idea Generation. QIC's fundamental research is expressed through its proprietary scorecards which seek to measure the relative strength of internally derived views. QIC currently produces over 20 scorecards that span global markets and aid in the development of active strategies including duration, inflation, yield-curve positioning, cross-currency and volatility.

The Fund is grouped into a 'Sector' portfolio and an 'Opportunistic' portfolio. The Sector portfolio comprises core long positions which seek to add value over the medium-term, which QIC defines as six to twelve months. The Opportunistic portfolio comprises of four sub-portfolios, including: Rates; Credit; Inflation: and Currency.

Consistent with its focus on capital preservation, QIC incorporates a number of strategies that place greater emphasis on trade sizing and contribution to risk, including the incorporation of a series of pre-defined Cumulated Loss Limits (CLL) which require QIC to progressively dial back active risk where certain performance thresholds are breached.

Zenith believes the incorporation of formal CLLs provides the investment team with greater discipline with regard to the review of active trades, particularly those that have a negative or unintended impact on broader portfolio performance. Notwithstanding this, QIC retains a high degree of flexibility in applying these limits, which has the potential to dilute their effectiveness. For example, each CLL can be dynamically adjusted on a weekly basis, subject to the assessed opportunity set.

Zenith highlights that the portfolio construction process is well structured and applied in a disciplined manner. However, given the disconnect between the quality of the investment process and the level of excess returns, we believe the process is over-engineered and lacking the 'art' of other managers in the peer group. This can extend to expressing duration views in a less binary or a more self-funding manner or capturing shorter-term trading opportunities outside of the scorecard process.

### FUND FACTS

- Provides exposure to a diversified portfolio of domestic and global fixed interest securities
- A well-regarded investment team
- A moderate to high-risk investment strategy with an unconstrained investment mandate

**ABSOLUTE RISK (SECTOR)**

VERY HIGH
HIGH
MODERATE
LOW
VERY LOW

**RELATIVE RISK (FUND WITHIN SECTOR)**

Geared
Active - Benchmark Unaware
Active - Benchmark Aware
Index - Enhanced/Fundamental
Index

**INCOME DISTRIBUTIONS PER**

MONTH
QUARTER
6 MONTH
ANNUM

**INVESTMENT TIMEFRAME**

1-2 YRS
3-4 YRS
5-6 YRS
7+ YRS

## APPLICATIONS OF INVESTMENT

### SECTOR CHARACTERISTICS

The Zenith "Australian Fixed Interest - Bonds" sector consists of all long only funds investing in the Australian fixed interest market. The sector incorporates both benchmark aware and benchmark unaware strategies. Despite being a fairly competitive sector, the median Australian active fixed interest manager has historically struggled to outperform a passive index over the longer term. This can be attributed to the lack of opportunity to add value from active management in the fixed interest market, particularly the very efficient Australian market. Managers typically add value through duration, sector positioning and security selection.

Zenith benchmarks all funds in this space against the Bloomberg AusBond Composite Index, which is reflective of the underlying benchmark used by the majority of managers in this category. The index is market-capitalisation weighted, resulting in those entities with the most issuance receiving the heaviest weightings. Owing to the lack of longer dated securities the index has a relatively short duration of approximately 4.98 years.

The Australian fixed interest market, as represented by the Bloomberg AusBond Composite Index, consists of over 500 investment grade securities (BBB or higher rated) issued by the Commonwealth Government of Australia, State Government authorities and treasury corporations (Semi-government), Corporations and Asset-Backed Securities. Owing to the increased issuance by government in recent years the market is dominated by government and semi-government securities, which account for approximately 75% of the market. Given the high credit rating afforded to the Commonwealth government the market is also dominated by AAA rated securities (roughly 75%).

### PORTFOLIO APPLICATIONS

Bonds are longer-dated fixed income securities that seek to provide investors with a regular income stream and the return of capital at a predefined future date. Bonds can form a key component of an investor's portfolio and more specifically their exposure to the fixed interest asset class, owing to the defensive characteristics that they often exhibit.

An inverse relationship exists between the price of bonds and interest rates, the extent of which is not linear and varies according to existing market conditions and the perception of risk. Bonds generally exhibit a negative correlation with equities and will rise in price when growth assets are falling (and vice versa). Bonds are more likely to be favoured during times of heightened risk aversion and typically dampen investment portfolios against capital drawdowns.

The Fund's mandate is wide allowing QIC to invest in securities that are not included in or linked to the performance of the Fund's benchmark, such as syndicated loans, high-yield, sub investment-grade credit and active currency. QIC is permitted to invest up to 25% of the Fund's assets in global/offshore securities, however the principal driver of returns is expected to be local market factors.

Zenith considers the Fund a "Core Plus" style bond fund owing to its approach to portfolio construction i.e. the demarcation between a 'Sector' portfolio which is longer-term and more strategic in nature, and an 'Opportunistic' portfolio, which is shorter-term and trading-orientated.

The Fund is considered appropriate as a core exposure to domestic fixed interest for investors with a higher risk tolerance. It may be blended with international fixed interest strategies to produce a more balanced set of investment outcomes.

Due to the anticipated moderate to high levels of volatility, with the potential for capital loss, Zenith recommends taking a medium to longer-term investment time frame. We caution against the Fund being used by investors with shorter-term liquidity needs.

## RISKS OF THE INVESTMENT

### SECTOR RISKS

Funds within the "Australian Fixed Interest – Bonds" sector are exposed to the following broad risks:

**MARKET RISK:** Changes in economic, technological, environmental or political conditions and market sentiment may lead to a decline in general security prices and overall market volatility. During a general downturn in the securities markets, multiple asset classes may decline in value simultaneously.

**INTEREST RATE RISK:** Fixed interest securities are generally sensitive to changes in interest rates. An increase in interest rates may result in a fall in the value of these securities, while a decrease in interest rates can result in an increase in value.

**CREDIT SPREAD RISK:** In addition to being sensitive to general interest rate changes non-government securities are also sensitive to changes in credit spreads (commonly the difference in yield between a government bond and a corporate security). A widening of spreads results in a fall in the value of these securities.

**DEFAULT RISK:** Given fixed interest securities represent loans to borrowers (including governments, banks and companies) there is a risk that these borrowers may default on interest or principal repayments. Default risk is often reflected in credit ratings assigned by various credit agencies, which are subject to change.

**LIQUIDITY RISK:** Fixed interest markets can experience periods of illiquidity, which can result in difficulties in buying or selling securities without adversely impacting the price.

**DERIVATIVE RISK:** Derivatives are commonly employed by fixed interest managers to hedge currency and other risks and/or as an alternative to direct purchases or sales of underlying assets. There are multiple risks associated with the use of derivatives; for example, the value of the derivative may not move in line with the underlying asset, counterparties to the derivative may not be able to meet payment obligations or a particular derivative may be difficult or costly to trade.

### FUND RISKS

Zenith has identified the following key risks associated with the Fund; this is not intended to highlight all possible risks:

**KEY PERSON RISK:** In common with the majority of investment managers, there is a degree of key person risk associated with the senior investment staff responsible for the management of the Fund. Zenith has identified Buckley and Wilkes as key members in terms of managing this Fund, and either of their departure would result in an immediate reassessment of our rating. Notwithstanding this, the Fund is managed with a nucleus of senior investment professionals who could seamlessly step into the role.

**LONGEVITY RISK:** Funds which fail to grow FUM to a scalable level could be wound up and terminated by the Responsible Entity. The risks associated around a fund wind-up are principally that of timing, performance slippage, and forcing a crystallisation of tax consequences to investors which may not be suitable. DDH currently manages less than $A 5 million in the Fund as at 31 March 2017, which is well below the break-even level. Until the Fund reaches the requisite level of scale, there is a risk that the Fund could be wound-up.

**OFFSHORE RISK:** As part of the Opportunistic portfolio, QIC employs currency and other strategies that takes views on offshore markets. While these positions diversify the investment opportunity set, they also introduce risks that are not inherent in the benchmark or feature prominently in strategies of domestic peers.

**CREDIT RATING RISK:** The Fund's credit limits are based on the highest equivalent rating from Standard & Poor's, Moody's and Fitch. Zenith believes this approach is less common amongst peers who generally take a more conservative approach (being either the lowest of or average). As a consequence, the Fund's average credit quality may be overstated relative to that of equivalent rated funds.

**CONCENTRATION RISK:** Should strategy FUM fall below $A 200 million, the Fund's mandate permits its maximum exposure limits to be doubled (ie. sub investment-grade credit can rise from 10% to 20%). While this increased flexibility may prevent QIC from being a forced seller in the event of a significant redemption request, we believe this may increase the Fund's risk profile and as a consequence its loss potential.

## QUALITATIVE DUE DILIGENCE

### ORGANISATION

QIC Limited (QIC) is a Queensland government owned enterprise with investment personnel based in Brisbane, London, and in the U.S. QIC commenced operations in 1991, and has grown to be one of the largest institutional investment managers in Australia, with approximately $A 81 billion in funds under management (FUM) as of 31 December 2016. QIC continues to offer to market investment strategies that span multiple asset classes, ranging from low volatility to actively managed and bespoke capabilities. FUM continues to be concentrated in fixed interest (managed beta) and cash orientated strategies.

At the same date, QIC was managing approximately $A 6.5 billion in Australian fixed interest strategies. The QIC offered wholesale unit trust has approximately $A 611 million in FUM, of which approximately $A 5m is invested via the DDH Fund.

Zenith highlights that at current FUM levels, the Fund is loss making for DDH. While DDH has reiterated its commitment to the Fund, we believe the risk of wind-up is elevated. This risk has been previously flagged by Zenith, with little improvement in terms of FUM and distribution effort.

### INVESTMENT PERSONNEL

| Name | Title | Tenure |
|---|---|---|
| Susan Buckley | Managing Director, Global Liquid Strategies | 15 Yr(s) |
| Kent Wilkes | Director - Global Fixed Interest | 18 Yr(s) |
| Katrina King | Director - Research & Strategy | 11 Yr(s) |
| Phil Miall | Director - Head of Credit Research & Strategy | 6 Yr(s) |
| Scott Rissman | Director - Liability-Driven & Overlay Solutions | 13 Yr(s) |
| Alison Towers | Head of Liquid Markets Trading | 8 Yr(s) |

Comprising 29 members, the investment team is split between four key investment functions including Research & Strategy (R&S), Absolute Return and Fixed Interest (ARFI), Overlay Solutions (OS), and Global Liquid Markets Trading (GLMT). Each division has a dedicated lead with ultimate responsibility resting with Susan Buckley, Managing Director and Head of Global Liquid Strategies.

Buckley performs a diverse role, which encompasses investment, operational, business management and leadership responsibilities. Key amongst these includes oversight for the fixed interest team, process improvement, risk budgeting and the performance for QIC's suite of fixed interest capabilities.

Zenith considers Buckley to be a proficient fixed-interest investment professional. Having worked in a number of leadership positions during her career, we believe she brings experience and market tenure that is supportive of her position.

In terms of management of this Fund, Kent Wilkes is the Lead Portfolio Manager, whose responsibility extends to QIC's Global Inflation Plus, Bond Plus and Australian fixed Interest capabilities. Wilkes also leads QIC's Global Fixed Interest division, which includes oversight of the broader portfolio management team. Zenith maintains a high opinion of Wilkes investment capability noting his long tenure and expertise in rates and inflation positioning.

The R&S team is led by Katrina King and is demarcated into a Macro and Credit team, with Phil Miall responsible for the Credit team. Trading is undertaken by the GLMT team that is comprised of seven members and led by Alison Towers who is based in Brisbane, with further support from Thanula Wijeratne who manages QIC's London trading.

QIC's typical remuneration structure includes a fixed salary which is based on domestic and global benchmarks and is typically in line with the median salary. Employees are also eligible for a short-term incentive payment (STI) which is payable on an annual basis and is based on an employee's role and level of seniority. The STI payment is a fixed percentage of salary, and is payable if an employee achieves their key performance indicators (KPIs). KPIs vary depending on the job function, and include specific performance related objectives and qualitative KPIs, such as overall team contributions.

In addition, QIC has a long-term incentive (LTI) program for senior investment professionals, with allocations based on contributions to investment performance and other executive team objectives. The LTI program is subject to a three-year vesting period, which Zenith considers appropriate, ensuring key employees are locked in for the medium-term and at the same time, providing sufficient linkage between reward and effort.

Overall, Zenith maintains a positive opinion of QIC's investment team, particularly with respect to managing domestic fixed interest strategies. The investment team has displayed improved continuity, which extends to both investment personnel and team configuration. Zenith notes that while the team presents sound and cogent views on Australian fixed interest markets, there appears to be a persistent disconnect between the quality of insights and the Fund's performance.

## INVESTMENT OBJECTIVE AND PHILOSOPHY

The Fund's investment objective is to outperform the Bloomberg AusBond Composite Index by 0.7% p.a. to 1.0% p.a. (gross of fees) over rolling three-year periods with Tracking Error of less than 4% p.a.

To achieve this, QIC's investment philosophy is premised on the belief that fundamental factors such as growth, inflation, cash rates, determine the performance of fixed interest markets over medium to longer timeframes. However, over the shorter-term, other influences such as political, central bank commentary and supply/demand imbalances, cause deviations from fundamental ‘fair value’, providing exploitable opportunities. To this end, QIC seeks to construct a diversified portfolio that captures investment opportunities across multiple sectors, in a risk-controlled manner.

QIC employs a multi-step investment process that incorporates the following steps:

- Fixed Interest Research
- Scorecard Process
- Strategy Based Idea Generation

The following section provides an overview of each stage of the process.

### Fixed Interest Research

To set the framework for more detailed research, the R&S team undertakes macro fundamental research to determine the the outlook for interest rates, credit and inflation. This includes the generation of forecasts for GDP, inflation and forward cash rates across a number of geographies. These are determined with input from QIC's in-house economists (who maintain a series of bond models) and members of the R&S macro team (who are responsible for ratifying any changes made by the economists to underlying assumptions).

Once these forecasts have been agreed, these then serve as inputs into QIC's propriety 'fair-value' models, which form the foundations upon which the portfolio managers seek to identify rates and curve trading opportunities. Credit research aims to identify the credit allocation, industry allocation, and individual corporate security selection for the Fund. QIC produces scorecards for investment grade credit and high yield credit and assigns either an overweight, underweight or neutral status to the underlying industries.

These are broadly split between investment grade and high yield, and also across market sectors including industrials, infrastructure, telecommunication, energy, consumer, financials, industrials, resources and structured. Inflation research enables QIC to formalise its views on real yields, inflation outlooks, risk premia and global break-even markets.

In addition, QIC manages an active currency sleeve, which includes a basket of seven currencies, and is underpinned by the Scorecard process. While Zenith is supportive of the introduction of potential diversifying strategies, we are cognisant of ensuring that domestic influences are the primary drivers of investment outcomes.

A quarterly investment forum serves as the primary conduit for the investment team to formalise their views and determine 'fair value' for yields relative to market expectations. As part of this determination, QIC will discuss a range of macro and micro factors, that cannot be captured in quantitative models, such as geopolitical risks, central bank rhetoric, and economic data announcements.

### Scorecard Process

QIC's fundamental research is expressed through its proprietary scorecards which seeks to measure the relative strength of internally derived views. This is achieved through a scoring metric that aids in the sizing of active trades and ranges from +5 (most conviction) to -5 (least conviction), the extremes of which represent a two Standard Deviation move from fair value.

Scores are assigned through the simple aggregation of outputs across fundamental, technical and transitory factors (i.e. an equally-weighted approach), and adjusted for by a 'scaler' factor based on a forward assessment of market volatility.

QIC currently produces over 20 scorecards that span global markets and aid in the development of active strategies including duration, inflation, yield-curve positioning, cross-currency and volatility. Scorecard responsibilities rest with the portfolio management team, and are assigned based on key areas of expertise.

### Strategy Based Idea Generation

Based on the output of the scorecard process, the R&S team produces independent research and trade ideas. Trade ideas can be generated by either Research Analysts or Portfolio Managers, however for a trade to be included in the portfolio, final approval must come from a Portfolio Manager. In selecting trades, the Portfolio Managers will give consideration to the expected return, Value-at-Risk (VaR) usage, and its correlation structure to the rest of the portfolio.

Trade sizing is determined by the level of conviction in the trade and the profit and loss target at the Fund level. QIC places a strong emphasis on the consistency of the return stream. Zenith believes that this is an aspect of the investment process that could be improved, particularly given the wide fluctuations observed in the Fund's historical return outcomes.

Each proposed trade is accompanied by either a short form or long form recommendation. A short form recommendation is required for proposed trades that are an output of the scorecard process, while a long form recommendation is used for large credit positions or exotic options strategies.

## SECURITY SELECTION

In terms of credit research, Miall is responsible for determining the Fund's active credit strategies. This extends to the level of credit market beta (ie. how much credit risk to assume), sector rotation (investment grade or high yield), industry selection, and relative value (via its bottom up research effort). Consistent with QIC's macro strategies, the credit team derive micro trade ideas through the various scorecards that they retain accountability for.

Once the team has made an assessment on a particular industry and sector, issue and issuer selection are determined through fundamental bottom-up research. This research also aids to support investment recommendations which are ultimately determined having regard to factors including relative-value assessments and broader mandate constraints.

Overall, Zenith is supportive of QIC's investment process, noting the well structured and disciplined approach to implementation. However, the process continues to deliver investment outcomes below the stated return objectives. Zenith believes more consistency could be achieved by placing a greater emphasis on relative value trades, as opposed to directional trades.

## PORTFOLIO CONSTRUCTION

Responsibility for portfolio construction ultimately rests with Buckley, who will review active portfolio trades in light of the Fund's broader risk characteristics. On a day-to-day basis, Wilkes is responsible for constructing the portfolio, albeit with input from each divisional unit. Portfolio positioning and trade sizing is however broadly driven by the GFI team who recommends active trade ideas based on conviction scores as determined through QIC's scorecards.

The Fund is grouped into a 'Sector' portfolio and an 'Opportunistic' portfolio. The Sector portfolio comprises core long positions which seek to add value over the medium-term, which QIC defines as six to twelve months. The Sector portfolio also includes an allocation to QIC's hedging strategies, which are used to provide downside protection and/or manage portfolio exposures i.e. offset factor concentrations, change portfolio correlations etc.

The Opportunistic portfolio comprises of four sub-portfolios, including: Rates; Credit; Inflation: and Currency. Each of the sub-portfolios (excluding Currency) include a directional and relative value component. A portfolio manager is delegated to manage risk and trading strategies in each of these sub-portfolios.

As mentioned earlier, QIC manages an active currency sleeve, which currently includes seven currency pairs which are traded on a directional basis. The currency portfolio is expected to generate approximately 5% of the Fund's excess return target.

Each sub-portfolio has an annual return target, subject to not exceeding their respective annual volatility, VaR and cumulative loss limits (CLL's). QIC uses a risk budgeting approach where each portfolio/sub-portfolio is allocated a percentage of total risk (or capital usage), which includes pre-agreed VaR limits, duration limits and drawdown limits (defined as CLL's).

Zenith believes the explicit targeting of excess returns, volatility and loss limits, embeds a high degree of accountability into the portfolio construction process. Notwithstanding this, QIC retains a high degree of flexibility in applying these limits, which has the potential to dilute their effectiveness. For example, each limit and CLL can be dynamically adjusted on a weekly basis, subject to the assessed opportunity set.

Before a recommended trade can be ratified, it must first be supported by a detailed research paper which takes into consideration factors such as expected return, volatility, entry levels, stop losses, horizon analysis (including cost of carry, roll down) and execution methodology. Portfolio impact is a further area of assessment and aids the team in determining position sizing based on factors such as contribution to risk and correlation with other active trade strategies.

The final portfolio will typically hold approximately 100 positions across the respective sub-portfolios. Portfolio positions will generally be enacted through derivatives, with trade execution occurring following authorisation by at least one senior member of the investment team. Zenith notes that QIC commonly holds a meaningful level of 'cash' in the Fund.

Zenith highlights that the portfolio construction process is well structured and applied in a disciplined manner. However, given the disconnect between the quality of the investment process and the level of excess returns generated, we believe the process is over-engineered and lacking the 'art' of other managers in the peer group. Zenith believes a more flexible and dynamic approach, potentially capturing shorter-term inefficiencies, could contribute to more competitive returns.

## RISK MANAGEMENT

| Portfolio Constraints | Description |
|---|---|
| Australian Fixed Interest (%) | 75% to 100% |
| International Fixed Interest (%) | 0% to 25% |
| Duration ( Yrs ) | Index Duration +/-1.5 Yrs |
| Sub Investment-Grade (%) | max: 10% |
| Tracking error (% p.a.) | max: 4% p.a. |

The risk function is overseen by QIC's Compliance and Risk Management team. The approach is centred around managing investment risk via its CLLs with risk reduction techniques employed when pre-defined losses are incurred. This includes closing positions and/or introducing portfolio hedges. The overarching objective of the above-mentioned process is to control drawdowns to less than four per cent over rolling three-month periods.

Each of the underlying sub-portfolios is managed to an annual volatility limit, 20 day Value-at-Risk limit and a CLL. While Zenith is supportive of the above-mentioned approach, as mentioned previously, QIC retains a high degree of flexibility in applying these limits, which has the potential to limit their effectiveness.

Zenith notes that credit limits are based on the highest equivalent rating from Standard & Poor's, Moody's and Fitch. Where no rating has been assigned by any of these external agencies, a security or issuer is treated as unrated.

Zenith believes this 'highest equivalent' approach is less common amongst peers who generally take a more conservative approach (being either the lowest of or average). As a consequence, the Fund's average credit quality may be overstated to that of equivalent rated funds.

Investors should also be aware that the Fund's mandate permits QIC to double these exposure limits where strategy FUM falls below A$200 million. While this increased flexibility may prevent QIC from being a forced seller in the event of a significant redemption request, we believe this may significantly increase the Fund's risk profile and as a consequence its loss potential.

Zenith believes QIC's risk-management, monitoring and attribution systems are highly evolved and represent a significant investment in industry leading software. In Zenith's opinion, QIC is well positioned to generate real-time analysis of portfolio positions and at a more granular assessment of risk, whether this be at the portfolio, strategy or individual security levels. Independent compliance and risk-management divisions also exist to monitor and report on key factor exposures and adherence with mandate constraints.

## INVESTMENT FEES

The sector average cost (in the table below) is based on the average management cost of all flagship 'Australian Fixed Interest - Bond' funds surveyed by Zenith.

A management cost of 0.68% p.a. applies to this Fund with no performance fee. Zenith considers the Fund's fee level to be expensive relative to peers, particularly when assessed relative to the Fund's investment objectives.

QIC also charges a buy/sell spread of +/-0.04% which is payable by investors when both entering and exiting the Fund.

*(The fees mentioned in this report reflect the flagship version only. Fees may differ when the product is accessed through an alternate investment vehicle such as a platform.)*

| Fees Type | Fund | Sector Average (Wholesale Funds) |
|---|---|---|
| Management Cost | 0.68% p.a. | 0.46% p.a. |
| | Description | |
| Performance Fee | N/A | |
| | Buy Spread | Sell Spread |
| Buy / Sell Spread | 0.04% | 0.04% |

## PERFORMANCE ANALYSIS

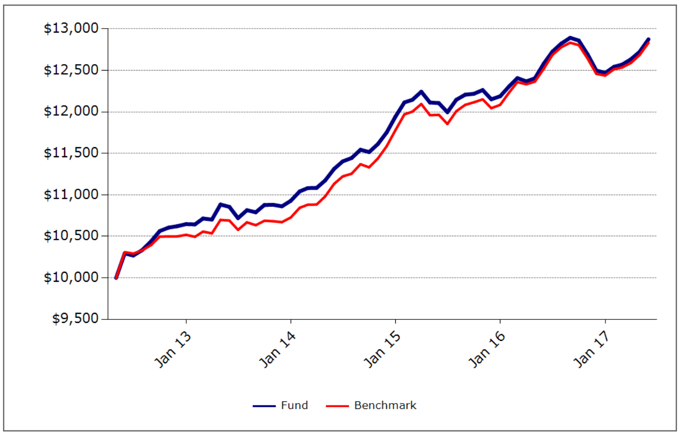
Report data: 31 May 2017, product inception: Nov 2006

### Monthly Performance History (%, net of fees)

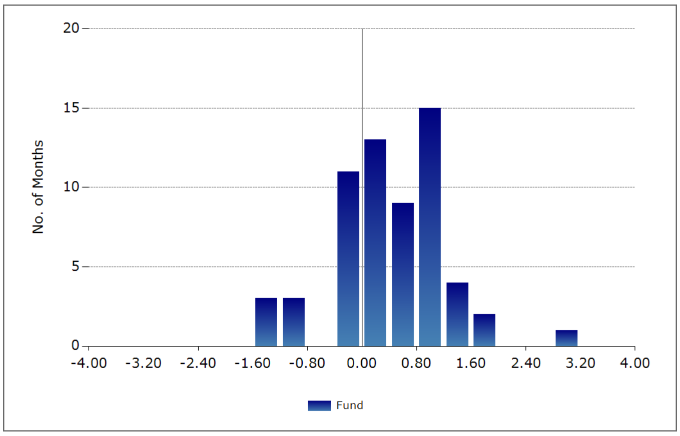
| | JAN | FEB | MAR | APR | MAY | JUN | JUL | AUG | SEP | OCT | NOV | DEC | FUND YTD | BENCHMARK YTD |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **2017** | 0.60 | 0.21 | 0.52 | 0.70 | 1.19 | | | | | | | | 3.25 | 3.18 |
| **2016** | 0.97 | 0.81 | -0.32 | 0.30 | 1.43 | 1.14 | 0.77 | 0.54 | -0.26 | -1.31 | -1.52 | -0.24 | 2.31 | 2.92 |
| **2015** | 1.43 | 0.26 | 0.80 | -1.06 | -0.06 | -0.91 | 1.25 | 0.50 | 0.09 | 0.37 | -0.91 | 0.30 | 2.05 | 2.59 |
| **2014** | 1.03 | 0.36 | 0.02 | 0.82 | 1.24 | 0.80 | 0.35 | 0.87 | -0.25 | 0.86 | 1.18 | 1.64 | 9.29 | 9.81 |
| **2013** | -0.03 | 0.67 | -0.12 | 1.70 | -0.26 | -1.25 | 0.89 | -0.23 | 0.82 | 0.02 | -0.17 | 0.62 | 2.64 | 1.99 |

Benchmark: Bloomberg AusBond Composite Index

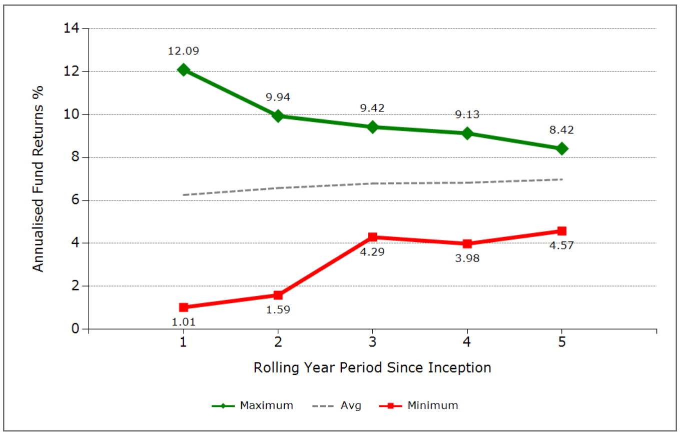
### Growth of $10,000




### Monthly Histogram




### Minimum and Maximum Returns (% p.a.)




### ABSOLUTE PERFORMANCE ANALYSIS

| Return | Incpt. | 5 yr | 3 yr | 1 yr |
|---|---|---|---|---|
| Fund (% p.a.) | 5.97 | 4.57 | 4.40 | 2.32 |
| Benchmark (% p.a.) | 6.18 | 4.48 | 4.85 | 2.50 |
| Median (% p.a.) | 6.09 | 4.45 | 4.54 | 2.43 |
| **Ranking within Sector** | **Incpt.** | **5 yr** | **3 yr** | **1 yr** |
| Fund Ranking | 16 / 23 | 8 / 31 | 21 / 31 | 21 / 32 |
| Quartile | 3rd | 1st | 3rd | 3rd |
| **Standard Deviation** | **Incpt.** | **5 yr** | **3 yr** | **1 yr** |
| Fund (% p.a.) | 2.64 | 2.52 | 2.71 | 2.90 |
| Benchmark (% p.a.) | 2.89 | 2.51 | 2.77 | 2.87 |
| Median (% p.a.) | 2.81 | 2.44 | 2.64 | 2.81 |
| **Downside Deviation** | **Incpt.** | **5 yr** | **3 yr** | **1 yr** |
| Fund (% p.a.) | 1.07 | 1.22 | 1.39 | 1.79 |
| Benchmark (% p.a.) | 1.02 | 1.17 | 1.37 | 1.72 |
| Median (% p.a.) | 1.07 | 1.17 | 1.36 | 1.70 |
| **Risk/Return** | **Incpt.** | **5 yr** | **3 yr** | **1 yr** |
| Sharpe Ratio - Fund | 0.72 | 0.80 | 0.80 | 0.17 |
| Sortino Ratio - Fund | 1.78 | 1.65 | 1.55 | 0.27 |

Zenith benchmarks funds within the "Australian Fixed Interest - Bonds" peer-group against the Bloomberg AusBond Composite Bond (All Maturities) Index. While this benchmark may not be consistent with the one adhered to by all sector participants, it has been adopted to provide investors with a common reference point against which the performance of similarly structured strategies may be assessed.

The Fund's investment objective is to outperform the Bloomberg AusBond Composite Index by 0.7% p.a. to 1.0% p.a. (gross of fees) over rolling three-year periods with Tracking Error of less than 4% p.a.

The following commentary is effective as at 30 April 2017.

Disappointingly, the Fund has failed to outperform both its return objective and the Zenith assigned benchmark over most periods of assessment.

In terms of volatility (as measured by Standard Deviation), the

Fund has displayed volatility that is slightly lower than the benchmark and in line with the peer group.

## RELATIVE PERFORMANCE ANALYSIS

| Alpha Statistics | Incpt. | 5 yr | 3 yr | 1 yr |
|---|---|---|---|---|
| Excess Return (% p.a.) | -0.21 | 0.10 | -0.45 | -0.17 |
| % Monthly Excess (All Mkts) | 51.97 | 50.00 | 36.11 | 41.67 |
| % Monthly Excess (Up Mkts) | 48.39 | 53.49 | 37.04 | 62.50 |
| % Monthly Excess (Down Mkts) | 61.76 | 41.18 | 33.33 | 0.00 |
| **Beta Statistics** | **Incpt.** | **5 yr** | **3 yr** | **1 yr** |
| Beta | 0.80 | 0.99 | 0.97 | 1.01 |
| R-Squared | 0.76 | 0.96 | 0.99 | 0.99 |
| Tracking Error (% p.a.) | 1.43 | 0.48 | 0.33 | 0.26 |
| Correlation | 0.87 | 0.98 | 0.99 | 1.00 |
| **Risk/Return** | **Incpt.** | **5 yr** | **3 yr** | **1 yr** |
| Information Ratio | -0.15 | 0.21 | -1.34 | -0.66 |

The commentary is effective as at 30 April 2017.

Zenith seeks to identify funds that can outperform in over 50% of months in all market conditions, as we believe this represents consistency of manager skill.

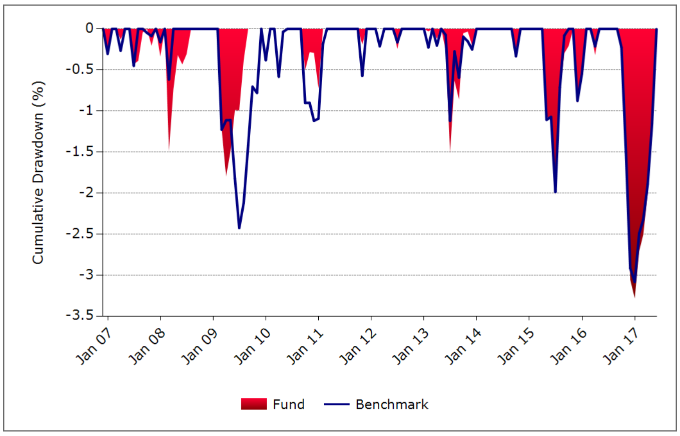
Since inception, the Fund has outperformed in over 50% of all market conditions, representing manager skill. However, over the short to medium term, the Fund has struggled to deliver this outcome. Interestingly, the Fund has tended to outperform in falling market conditions.

## DRAWDOWN ANALYSIS

*Drawdown analysis assesses the relative riskiness of a Fund versus the benchmark, in reference to capital preservation. The maximum Drawdown is recorded as the percentage decline in the value of a portfolio from peak to trough (before a new peak is achieved). All Drawdown analysis is calculated commencing from the inception date of the Fund in question, and Drawdown analysis for the Fund and benchmark(s) are calculated independently. That is, the largest drawdown for the Fund and benchmark(s) will not always refer to the same time period.*

| Drawdown Analysis | Fund | Benchmark |
|---|---|---|
| Max Drawdown (%) | -3.28 | -3.08 |
| Months in Max Drawdown | 4 | 4 |
| Months to Recover | - | - |

| Worst Drawdowns | Fund | Benchmark |
|---|---|---|
| 1 | -3.28 | -3.08 |
| 2 | -2.02 | -2.43 |
| 3 | -1.80 | -1.99 |
| 4 | -1.51 | -1.12 |
| 5 | -1.49 | -1.12 |




The commentary is effective as at 30 April 2017.

The Fund's most significant drawdown occurred in late 2016/early 2017. Zenith believes that the Fund has shown strong defensive characteristics, with all drawdowns being quickly recovered.

## INCOME/GROWTH ANALYSIS

| Income / Growth Returns | Income | Growth | Total |
|---|---|---|---|
| FY to 30 Jun 2016 | 6.02% | 0.06% | 6.08% |
| FY to 30 Jun 2015 | 5.35% | -0.18% | 5.17% |
| FY to 30 Jun 2014 | 5.62% | 0.76% | 6.38% |
| FY to 30 Jun 2013 | 5.34% | -0.96% | 4.38% |
| FY to 30 Jun 2012 | 9.65% | 1.19% | 10.84% |
| FY to 30 Jun 2011 | 7.92% | -1.47% | 6.45% |

The Fund has a quarterly distribution schedule but no specific income target. Given the lack of an income objective and distribution schedule the Fund is not suitable for income seeking investors.

However, given the nature of the asset class and underlying strategies, Zenith expects the majority of returns to be in the form of income.

## REPORT CERTIFICATION

Date of issue: 15 Jun 2017

| Role | Analyst | Title |
|---|---|---|
| Author | Rodney Sebire | Head of Alternatives Research |
| Sector Lead | Andrew Yap | Head of Multi-Asset & Income Research |

| | | |
|---|---|---|
| Authoriser | Andrew Yap | Head of Multi-Asset & Income Research |

## RATING HISTORY

| As At | Rating |
|---|---|
| 15 Jun 2017 | Approved |
| 23 Jun 2016 | Recommended |
| 9 Jul 2015 | Recommended |
| 9 Jul 2014 | Recommended |
| 16 May 2013 | Recommended |
| Last 5 years only displayed. Longer histories available on request. | |

## DISCLAIMER AND DISCLOSURE



Zenith has charged DDH Graham Limited a fee to produce this report.