i Capital International Value Fund

ARSN 134 578 180

Q3

Quarterly Investment Report

For the period 1 January 2017 to 31 March 2017

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Investment Objective	To achieve long-term capital appreciation
Who should invest?	Investors seeking a value investing style, exposure to the global stock markets, who are able to adopt a long-term outlook and endure performance fluctuations
Buy / Sell Spread	Nil
Management Fee	1.5375% p.a.
Performance Fee	20.50% p.a. only chargeable if the following three criteria are met in the same period 1. Market value exceeds 6% annual rate of return ***and*** 2. Market value exceeds 6% annual compound rate of return ***and*** 3. Both annual and annual compound returns must still be above 6% if a performance fee is chargeable

Inception Date	1 Jul 2009
Minimum Investment (AUD)	$20,000
Additional Investment (AUD)	$2,000
Income Distribution	Annually (if any)

PERFORMANCE REVIEW

By 31 March 2017, the Fund has, from its inception in July 2009, delivered an annual compound return of 4.80%, net of expenses. This is commendable as the return was generated during a very turbulent period and is higher than the average return obtained from a 1-year time deposit. The cumulative total return of the Fund is 43.83%. Comparative benchmark figures are shown in **figure 3** and **table 1**.

During the 1 January 2017 to 31 March 2017 quarter, the Fund returned 2.42% after fees. This compares with the MSCI ACWI Index and ASX200 in AUD (benchmark) return of 1.00% and 3.51%, resulting in relative performance of 1.42% and -1.09%. For the year ending 31 March 2017, the Fund returned 1.44% after fees which compares with the benchmark returns of 13.65% and 15.37%.

MARKET REVIEW AND OUTLOOK

When it comes to fundamental investing, there are two main approaches: [1] a top-down/market-timing approach and [2] a bottom-up approach.

First, a quick recapitulation of the two approaches. A top-down approach starts its analysis at the macro-economic level, covering both global and national economic conditions and indicators. These would include GDP growth rates, inflation and interest rates, foreign exchange trends, fiscal policy, key commodity prices, etc. The investor then narrows it down to sector/industry analysis before zooming in on specific stocks. For many, this is enough for them to time the stock market, that is, to buy low and sell high. Many would also incorporate charting and technical analysis to improve the accuracy and reliability of their entry and exit points.

In contrast, a value investor is essentially a bottom-up investor. Such an investor analyses a specific company, business and industry and computes the company's intrinsic value based on these factors without incorporating macro-economic factors or charting and technical analysis. This explains what Warren Buffett is talking about when he says that even if the Federal Reserve chairman were to whisper to him what the interest rate is going to be, it would not affect his investment decisions.

The above distinction between a top-down/market-timing investor and a bottom-up investor is typical and, for most purposes, adequate. However, a deeper and closer look at these two popular investment approaches would show that the distinction is not always so simple and clear-cut.

At Berkshire Hathaway's recent AGM, an investor asked Warren Buffett about the usefulness of two popular market valuation indicators; namely, the market capitalisation-to-GDP ratio (which also happens to be his favourite), and the cyclically adjusted price-earnings ratio (CAPE), which was made famous by Yale professor Robert Shiller. Buffett replied: "Both of the things that you mentioned get bandied around a lot. It's not that they're unimportant… They can be very important … It's just not quite as simple as having one or two formulas and then saying the market is undervalued or overvalued." Buffett added, "The most important thing is future interest rates." He is not talking about the current interest rate but rather what the interest rate is going to be over the next 10, 20 or 30 years on average (Watch this in 2017 AGM proceedings: https://finance.yahoo.com/video/buffett-valuation-formulas-trip-investors-211849354.html)

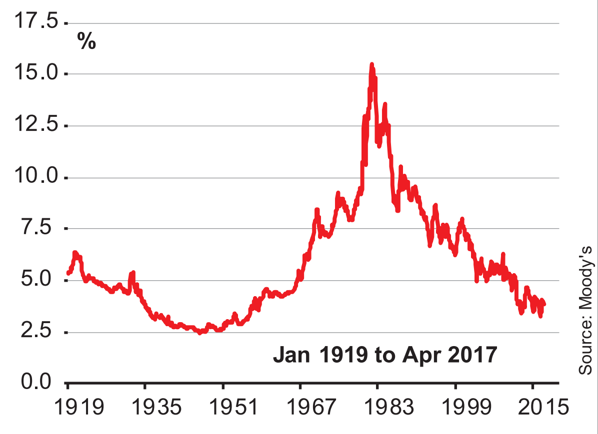
A summation of his approach is that he would not ask about GDP growth, or who was going to be the next president. He would rather ask what the average interest rate is going to be over the next 20 years. As Buffett shared in a recent Yahoo Finance interview: "Everything in valuation gets back to interest rates."

We now know it is not as simple as CAPE or market cap to GDP, but is it as simple as knowing interest rates? Not entirely, especially in the context of today's historically low interest rate environment. In a May 2017 interview with CNBC's Becky Quick, Buffett advised that if interest rates were guaranteed to stay low for 10, 15 or 20 years, then the stock market is still dirt cheap. His answer is not really helpful as the next logical question to ask is: will they stay low?

Over the long-term, interest rate can be very volatile (**figure 1**). We use Moody's Corporate Bond yield to illustrate this as it has a long history. From a low of 2.5% in the early Nineteen Fifties, the US Corporate Bond yield surged to more than 15% by Feb 1982. An investor buying a long-term bond in the early Nineteen Fifties would have made huge losses by the late Sixties and Seventies.

For the investor, what is interesting about **figure 1** is that the Moody's AAA Corporate Bond yield started

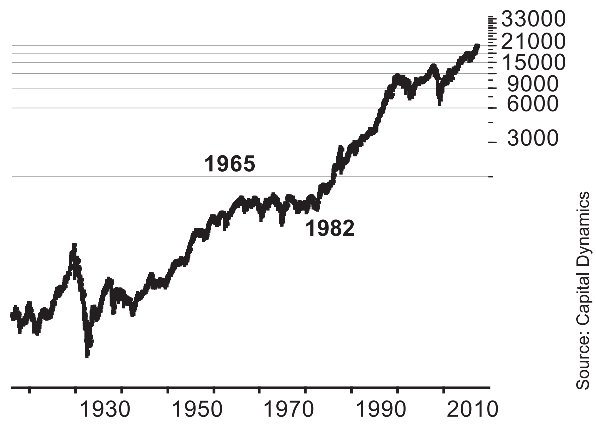
Figure 1 Moody's Seasoned AAA Corporate Bond Yield



to surge from 1965 onwards. When said corporate bond yield rose from 1950 to 1960, it was from a very low base, US inflation was low and under control, and the US stock market as a whole was still undervalued. Hence, the rise in interest rate did not harm the US stock market.

The surge from 1965 was a different story. US inflation was heading higher, and the US stock market as a whole was richly valued. As Buffett said, "the most important thing is future interest rates" and by the mid-Sixties, it was clear from macro-economic analysis that the US economy was entering a secular rising inflation era. It is not a coincidence

Figure 2 DJ Industrials



that the NYSE peaked around 1965 (**figure 2**). From then until mid-1982, interspersed with a few major bear markets, the NYSE ended up going sideways (**figure 2**).

The NYSE was only able to break out from the 1965 to 1982 bear market when US interest rate made a spectacular peak in 1982 (**figure 1** again). As Buffett said, "the most important thing is future interest rates" - by 1982, thanks to the very tough monetary policy taken by the then-Federal Reserve Chairman Paul Volcker, it became increasingly clear that the US economy was entering a secular disinflation era. The spectacular interest rate peak in early 1982 set the stage for an equally spectacular bull run on the NYSE.

Knowing what the interest rate is going to be over the next 10, 20 or 30 years on average is also critical in terms of determining the discount rate. This rate, which is used to determine the intrinsic value of a company, is tied to the market interest rates that Buffett has been talking about. The problem with discount rate in long-term valuation is that a small variance in estimating the discount rate can lead to a substantial divergence in valuation. Discounting $1.00 by 10% leads to a $10.00 valuation whereas discounting the same dollar by 12% would lead to only $8.33, a drop of 17% in valuation. Discounting over a 10, 20 or 30-year period would lead to even larger variations.

It is clear that knowing future interest rates can lead to spectacular investment performance. The question then is, how does one know future interest rates? The answer is by understanding global and local macro-economic and political conditions. By this, we do not mean being able to accurately forecast GDP or inflation or foreign exchange rates; by this, we mean understanding the underlying dynamics, broad or secular trends and how various factors interact.

This brings us back to our earlier statement regarding the distinction between a top-down/market-timing investor and a bottom-up investor and that the distinction is not always so simple and clear-cut. This is because these two differing investing approaches are joined at the hip by interest rates.

At the time of writing this commentary, your Fund's cash holding is about 35% of its NAV. The NAV of the *i* Capital International Value Fund can be viewed at either www.capitaldynamics.com.au or www.funds.icapital.biz.

Best wishes,

陳鼎武

Tan Teng Boo
Capital Dynamics (Australia) Limited
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15th June 2017

FUND PERFORMANCE 1

Figure 3 Total return (%)

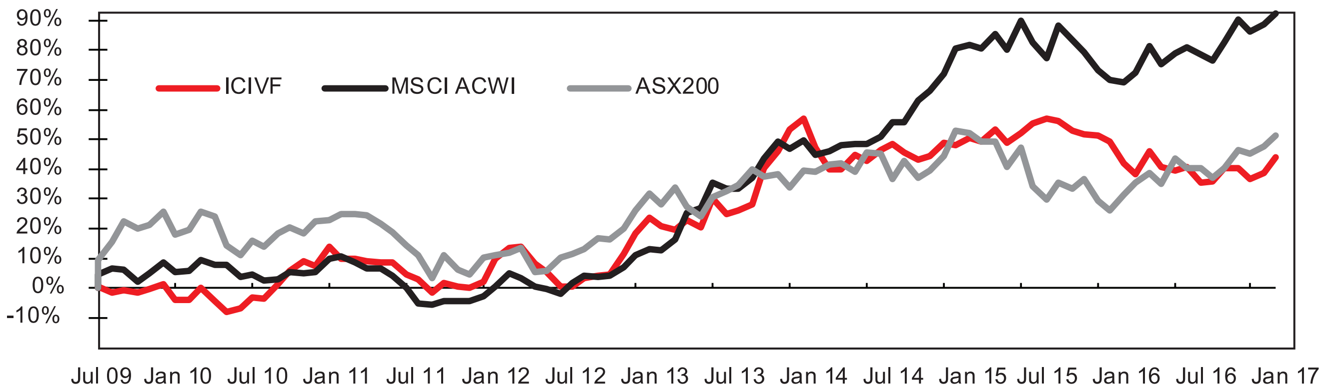

Table 1 Cumulative Total Return and Compound Return

	Cumulative Total Return (%)			Coumpound Return (%)
	1-Year-Return	2-Year-Return	Since Inception	Since Inception
ICIVF (AUD)	1.44%	-4.40%	43.83%	4.80%
MSCI ACWI (AUD)	13.65%	5.83%	92.19%	8.79%
ASX200 (AUD)	15.37%	-0.47%	51.37%	5.49%

Note : Past performance is not a reliable indicator of future performance. Performance is calculated in Australian dollars, net of ongoing fees and expenses and assumes reinvestment of distributions.

FUND PERFORMANCE 2

Table 2 Top 2 performing stocks (in local currency)

	Quarter ending 31 Mar 2017 (% of change)
ZHEJIANG EXPRESSWAY CO LTD	37.30%
AIR CHINA LIMITED	27.07%

The table above presents the top 2 performing stocks your fund held at some time within the referenced quarter. The stocks do not necessarily need to be bought at the start of the quarter (i.e. 1 January 2017), and held till the end of the quarter (i.e. 31 March 2017). Stock performance will only be measured over the specific period that your fund held the stock in the referenced quarter. This means that, for example, if Air China Limited was bought on 21 January 2017 and sold on 31 March 2017, its performance is only measured over 21 January 2017 to 31 March 2017 and not over the full quarter. Similarly, if it was bought on 1 January 2017 and sold on 11 March 2017, its performance is measured over the period 1 January 2017 to 11 March 2017.

FUND PERFORMANCE 3

Table 3 shows the percentage gain or loss of each company held by your Fund as at 31 March 2017. This table assumes no impact from currency movements or constant exchange rates.

Table 3 Percentage gain or loss arising from stock price changes

Security	Average Cost (A$)	Price Mar 2017 (A$)	% Change
AIR CHINA LIMITED	1.01	1.06	5.17%
CHINA NEW TOWN DEV NPV	0.05	0.07	42.72%
CLOVER CORPORATION LIMITED	0.35	0.50	44.04%
CONCORD NEW ENERGY	0.05	0.05	-0.67%
GUANGDONG PROVINCIAL EXPRESSWAY DEVELOPMENT CO LTD	0.95	0.95	0.89%
NATIONAL AUSTRALIA BANK LIMITED	31.04	33.34	7.42%
OVERSEAS EDUCATION LTD	0.43	0.37	-14.39%
PICO FAR EAST HLDG LTD	0.48	0.53	10.69%
PRIMA INDUSTRIE SPA	25.65	33.43	30.32%
QBE INSURANCE GROUP LTD	16.19	12.89	-20.40%
REXLOT HOLDINGS LTD	0.10	0.02	-82.15%
ZHEJIANG EXPRESSWAY CO LTD	1.28	1.72	33.89%

FUND PERFORMANCE 4

Table 4 shows the percentage gain or loss arising from currency movements as at 31 March 2017. This table assumes no change in stock prices or constant stock prices.

Table 4 Percentage gain or loss arising from currency movements

Security	Average Cost (A$)	Price Mar 2017 (A$)	% Change
AIR CHINA LIMITED	1.01	1.01	0.17%
CHINA NEW TOWN DEV NPV	0.05	0.05	0.37%
CLOVER CORPORATION LIMITED	0.35	0.35	0.00%
CONCORD NEW ENERGY	0.05	0.07	40.37%
GUANGDONG PROVINCIAL EXPRESSWAY DEVELOPMENT CO LTD	0.95	0.95	0.55%
NATIONAL AUSTRALIA BANK LIMITED	31.04	31.04	0.00%
OVERSEAS EDUCATION LTD	0.43	0.41	-4.58%
PICO FAR EAST HLDG LTD	0.48	0.48	0.11%
PRIMA INDUSTRIE SPA	25.65	26.02	1.45%
QBE INSURANCE GROUP LTD	16.19	16.19	0.00%
REXLOT HOLDINGS LTD	0.10	0.11	13.31%
ZHEJIANG EXPRESSWAY CO LTD	1.28	1.28	-0.10%

PORTFOLIO INFORMATION

Table 5 Percentage of assets held as cash

	Cash (%)	Equities (%)
End of Jun 2016	85.21%	14.79%
End of Sep 2016	68.30%	31.70%
End of Dec 2016	68.68%	31.32%
End of Mar 2017	41.65%	58.35%

Table 6 Top 5 holdings as at end March 2017

	42.7%
ZHEJIANG EXPRESSWAY CO LTD	11.6%
NATIONAL AUSTRALIA BANK LIMITED	10.4%
AIR CHINA LIMITED	9.0%
GUANGDONG PROVINCIAL EXPRESSWAY DEVELOPMENT CO LTD	6.8%
CONCORD NEW ENERGY	4.8%

Table 7 Portfolio breakdown for equities by region as at end March 2017 (in AUD)

	100%
Europe	5%
Hong Kong	67%
Australia	27%
Singapore	1%

About *i* Capital International Value Fund

The *i* Capital International Value Fund invests in listed securities in Australia and internationally.

The strategy is driven by an intelligently eclectic “Bamboo value investing” philosophy with an emphasis on the margin of safety created by stock selections based on divergences between market prices and the underlying intrinsic values of the companies.

The objective of Capital Dynamics (Australia) Limited (CDAL) is to seek long-term capital appreciation whilst reducing the margin of error when investing. This is achieved with a rigorous, innovative and well-defined value investing approach.

Unlike conventional value investing, CDAL adopts a bottom-up approach to portfolio construction, overlaid with a macro view. The objective of CDAL is to obtain a sound investment framework that allows for a clear perspective of how economies, markets and sentiment interact and how this interaction influences its investments.

About the Group

Capital Dynamics is an independent global fund manager and investment adviser, not tied to any bank, insurer, stockbroker or political organisation.

Our managed funds and investment advisory service are all directly accessible by individual, corporate and institutional investors around the world, and we also offer individually managed accounts to wholesale investors. Currently we manage over US$300m, from our offices in Kuala Lumpur, Singapore, and Sydney. Our investment advisory service is provided via *i* Capital newsletter, a weekly publication, and www.icapital.biz. It is available in English and Chinese.

Philosophies

Independence, intelligence and integrity drive all business and investment decisions at Capital Dynamics. Integrity is central to our corporate culture, and to our loyal clients of many years, our word has proven to be our bond. Capital Dynamics has some of the most stringent compliance policies in the industry.

As a global fund manager, our “Bamboo value investing” philosophy is unique, and has enabled Capital Dynamics to generate sustained superior returns. Based on long-only investment principles, our value investing approach is given flexibility with the addition of macroeconomic factors and further investment intelligence from our team of fund managers and analysts. We go behind the commercial veneer of companies, travelling globally to research first hand.

GLOSSARY

Market Capitalisation-to-GDP Ratio

The percentage of GDP that represents stock market value. Typically, a result of greater than 100% is said to show that the market is overvalued, while a value of around 50%, which is near the historical average for the U.S. market, is said to show undervaluation.

Price-earnings Ratio

The ratio for valuing a company that measures its current share price relative to its per-share earnings.

Past performance is not a reliable indicator of future performance. Performance is calculated in Australian dollars, net of ongoing fees and expenses and assumes reinvestment of distributions.

Capital Dynamics (Australia) Limited (CDAL) (ABN 53 129 846 260 | AFSL 326283) is the responsible entity and issuer of *i* Capital International Value Fund ("Fund"). The Product Disclosure Statement dated 29 January 2016 ("PDS") is the current offer document for the Fund. You can obtain a copy of the PDS from CDAL's website www.capitaldynamics.com.au, or contact CDAL at 1300 798 655, or email CDAL at info@capitaldynamics.com.au.

Before making any investment decision you will need to consider your particular investment needs, objectives and financial circumstances. You should also consider the PDS in deciding whether to acquire, or continue to hold, units in the Fund.

Disclaimer: The information in this Quarterly Investment Report is not intended to provide advice. It has not been prepared taking into account any particular investor's or class of investor's investment objectives, financial situation or needs, and should not be used as the basis for making investment, financial or other decisions. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information. None of CDAL nor any of its related entities guarantees the performance of the Fund or the repayment of capital or any particular rate of return or any distribution.

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BY Capital Dynamics

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