CBG CAPITAL LIMITED

Net Tangible Assets Report

February 2019

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Market Commentary

Markets often behave in rather unpredictable ways – more so when the economic backdrop and outlook are difficult to pick. Today commentators are questioning, are we coming to the end of the long growth cycle? Are inflationary pressures starting to emerge? Is the risk of recession increasing?

It is our view that the world has entered a long cycle punctuated by moderate growth periods followed by moderate downturns. Excessive monetary stimulus has taken the world towards a Japanese-like cycle. That is a cycle where the world economy neither overheats nor contracts abruptly.

During the month of February, the global sharemarket index (MSCI ex Australia) was up a strong +3.1%. The Australian sharemarket rose +5.2% (S&P/ASX200), with financials delivering a total return of 8.1% following the release of the Royal Commission report earlier in the month. Offshore, the US was up almost 3% (S&P 500) while China's CSI 300 index rose almost 15% (buoyed by the hopes of a trade deal).

More impressive has been the recovery in the S&P 500 which has gained 16% over the nine weeks to end February. Since its December low, the ASX/S&P 200 was up 13% to the end of February. The strong rebound in markets coincided with a swift pivot from the US Federal Reserve in January. Dovish tones emanating from the Fed rippled across markets; bond yields have drifted lower while equity markets factored in a 'lower for longer' scenario once more.

Not surprisingly, the VIX index, the so-called fear gauge for equities, declined steadily in the first two months of 2019, falling to its lowest reading for four months at the end of February, suggesting that there is little to worry about. But we should not be complacent: there are signs of an increased risk of recession over the next couple of years, particularly in the US. In fact, more than 75% of business economists surveyed by Bloomberg in February expect the US to enter a recession by the end of 2021.

If there is a recession in 2021, and it remains a big "if", that is still some time away and will be well factored into markets if it does occur. Central banks will have prepared themselves to support their economies.

Today there are clear signs of a slowing down in economic momentum, virtually across the globe. Despite Presidents Trump and Xi Jinping postponing the trade war for the moment, one can't hide from the facts. In the US, business conditions declined in the February Philadelphia Fed Survey. In the last month, German manufacturing shrank the most in six years, Italy is in recession, Japan's factory sector contracted for the first time in three years, and South Korean exports have tumbled.

Chinese data show an economy beset with structural headwinds. China has struggled to contain a slowdown even as policy makers ramp up their stimulus measures to fire up growth. Much will depend on how durable the trade truce is, given the breadth of concerns that the US has regarding China's industrial and economic policies. And this issue will survive Trump – concern with China's trade practices is now bipartisan policy within the US establishment.

Against this somewhat sober background, during February, it was "risk on" for equity investors with rising equity markets, even though global growth is pausing. The stockmarket saying "don't fight the Fed" is showing its value once again. It is a case of bad news is now good news; weaker economic readings mean easier monetary policies and that keeps financial conditions loose.

We are reminded that most expansions don't die of old age, they are killed by aggressive monetary tightening. If aggressive tightening is off the table, recession fears may well be overblown. Of course, the irony is that should strong economic growth re-emerge, it would increase the chances of a Fed rate hike, tightening liquidity and potentially triggering corrections in asset prices, and a return to volatility.

Australian company earnings update

We are through the Australian company reporting season, which has broadly been in line with expectations that were lowered in the "confession season" in the months leading up to February.

Guidance has generally been slightly negative. Sixty percent of changes to forecast earnings have been down, which is the largest downgrade cycle for some years. Aggregate market EPS growth figures for FY2019 have been cut and now stand at +3-4%, with the increase driven by upgrades in the resources sector. Dividends have been a little disappointing. Key themes of the reporting season included commentary around cost pressures, anaemic revenue growth, limited expansion opportunities, and a consumer squeezed by tight credit conditions and a declining housing market.

Being an open economy, what happens in the rest of the world is of vital importance to the domestic economy – and that relates to credit conditions and interest rates, currency movements and commodity prices. Perhaps the paramount issue of broad concern in Australia this year will be whether the housing downturn deepens and causes a recession (it would be the first in 28 years).

A technical recession is defined by two consecutive quarters of negative economic growth. In 2008, with the onset of the GFC, Australia managed (only just) to avoid two consecutive quarters of negative growth. Seasonally adjusted, GDP contracted by -0.5% in the December 2008 quarter following the September 2008 Quarter GDP figure which saw the economy grow at a rate of just +0.1%. Over the year to December 2008, GDP rose by +0.3%, the weakest annual rate since the 1991 recession.

The factors requiring ongoing scrutiny include homebuyer sentiment (reflected in auction clearance rates), bank lending rates (new loan approvals), business and consumer confidence (both are relatively weak and likely to weaken further in the run-up to the

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Federal election), dwelling and construction activity, and, importantly, the labour market. The unemployment rate is 5.0% and closely watched by the RBA. It reached just 4.0% prior to the GFC in February 2008, and has averaged 6.85% from 1978 until 2019. Whether the unemployment rate has found its base and starts rising from here will be highly significant for investor sentiment.

We continued to take advantage of volatile markets over the past few weeks. In doing so, the portfolio has been incrementally repositioned to provide an improved balance of growth and sustainable income. As prices for select securities have approached or exceeded value, we have reduced exposure. Concurrently, we have also acted to deploy capital into other favoured high conviction positions at attractive prices. We retain somewhat elevated cash levels in the portfolio, thus providing "fire-power" for further purchases when opportunity becomes increasingly apparent.

When investing in the markets and the weight of evidence is pointing in one direction, it makes sense to be aggressive and take advantage of clear trends while they're intact. However, when conditions shift and the outlook becomes uncertain, a more neutral approach is appropriate. There are several ways to express a shift in bias from bullish to neutral, including being less aggressive in one's asset allocation, buying downside protection, over-weighting defensive stocks versus cyclicals, and so on. One of the simplest ways is to raise cash and retain a moderately high balance.

Thank you for your continued support of CBG Capital.

February 2019 Report

Portfolio Commentary

The CBG Capital portfolio returned +6.1% net of fees and pre-tax on unrealised gains/losses in February, compared to a +6.0% return for the S&P/ASX 200 Accumulation Index.

The strongest contributors within the portfolio for the month were: Webjet (WEB, +30.7%), Jumbo Interactive (JIN, +31.9%) and Lovisa (LOV, +38.8%).

Each of these businesses reported strong results in the February reporting season. Webjet is achieving particularly high growth in its global hotel room sourcing business, WebBeds, which is now the largest contributor to group earnings.

Jumbo Interactive upgraded full year earnings guidance as the company is benefiting from the shift to online lotteries and an increased incidence of large jackpots following a change to Powerball odds.

Lovisa gained after management announced that the company is proceeding to a full-scale store roll out in the US and France.

The largest detractors were:
Bingo Industries (BIN, -35.9%) which downgraded full year earnings guidance and was exited from the portfolio during the month. Citadel (CGL, -17.0%) missed earnings expectations, as did HUB24 (HUB, -10.1%), although in HUB's case this reflected increased investment to accelerate growth.

NTA before tax	Rolling 12 month dividend	Share price
$1.02	3.3cps	$0.95

Net Tangible Assets (NTA)

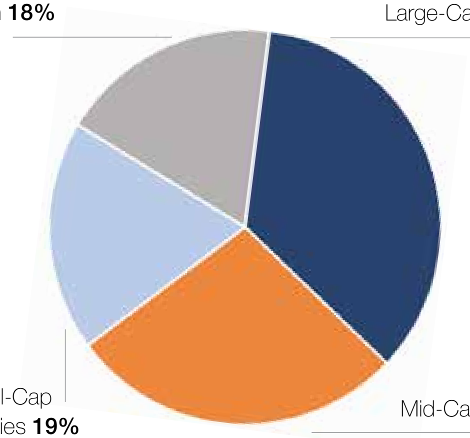
	February	*January*
NTA before tax	$1.02	$0.96
NTA after tax*	$0.99	$0.94
CBC Share Price**	$0.95	$0.90
Shares on issue (million)	26.2m	26.2m

* Please note that the post-tax figures are theoretical, assuming all holdings in the portfolio are sold and then tax paid on the gains that would arise on this disposal.
** Share price is cum 1.7c fully franked dividend, trading ex dividend on 2 May 2019.

Company Overview ($m)

Australian Securities	$21.3
Net Cash & Equivalents	$4.8

Gross Asset Allocation



Top Holdings (% of Gross Assets)

Australian Equities	
BHP Limited	6.5%
National Australia Bank Limited	4.9%
Webjet Limited	4.2%
Wesfarmers Limited	4.1%
Amcor Limited	4.0%
Other	58.0%
Cash	*18.3%*