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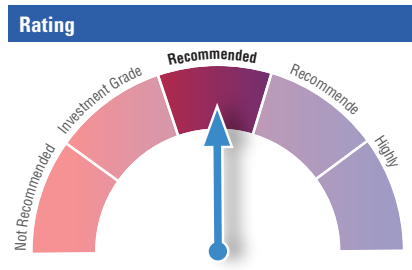
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The research is not financial advice.



Note: This report is based on information provided by the company as at May 2019



Key Investment Information	
Name of SMA	Nucleus Wealth Tactical Growth portfolio
Investment Manager	Nucleus Wealth
Investment Type	SMA / IMA
SMA Platform Availability	Xplore Wealth, Praemium SMA
Inception Date	31 July 2017
FUM	A\$50m
FUM Capacity	>A\$10bn
Benchmark	ABS – Australian Consumer Price Index + 4.5%
Return Objective	Outperform the benchmark by 5% p.a over rolling 5-year periods
FX Exposure	Unhedged
MER	0.64%
Performance Fee	None

Fees Commentary

SMA investment vehicles almost invariably have lower investment management fees than commonly used alternative investment vehicles (partly reflecting its lower operating cost model) and that is certainly the case with the Model Portfolio. Investors should note however that trading costs for investors through an SMA vehicle often differ by investor (if brokerage is partly based on a fixed cost component) and are generally higher than that of a managed fund, for example. We note the Investment Manager is mindful of this, seeking to limit annual portfolio turnover to a target 30%.

Benchmark & Current Asset Allocations		
Asset Class	SAA B'mrk	TAA Mar 2019
Cash & TDs	10%	21.6%
Bonds	5%	25.7%
Aust Equities	43%	13.1%
Int'l Equities	42%	39.5%
Growth	85%	52.7%
Defensive	15%	48.3%

The investment opinion in this report is current as at the date of publication. Investors and advisers should be aware that over time the circumstances of the issuer and/or product may change which may affect our investment opinion.

OVERVIEW

The Nucleus Wealth Tactical Growth model portfolio (the 'Model Portfolio') is managed by Nucleus Wealth ('Nucleus' or the 'Investment Manager'), a corporate authorised representative (CAR) of Integrity Private Wealth (AFSL 436298). Nucleus was established in November 2016 by the Model Portfolio's Portfolio Manager (PM), Damien Klassen. The Model Portfolio, which has an inception date of July 2017, is available to investors in the form of either a Separately Managed Account (SMA) or Independently Managed Account (IMA) structure, and is currently available on the Xplore Wealth and Praemium SMA platforms. The Model Portfolio is based on a multi asset investment strategy with a strategic asset allocation (SAA) to growth/defensive assets of 85%/15%, respectively. As such, in the realm of multi asset strategies it can be classified as 'High Growth'. Growth assets comprise large market cap Australian and International equities while defensive assets comprise cash and Australian Government AAA rated bonds. Around the SAA benchmarks, there is considerable latitude to implement tactical asset allocation (TAA) tilts for the purpose of generating alpha (relative to the SAA allocation) and preserving investor capital during periods of perceived heightened equities market risks. The investment strategy is based on a combination of quantitative and qualitative analysis in both the TAA and stock/sector selection investment processes. For stock/sector selection, the Investment Manager has a strong quality and value bias, as opposed to a growth focus. While the track record of the Model Portfolio is relatively short, we believe the Investment Manager has validated its investment models and processes through solid performance and a pattern of performance consistent with expectations.

INVESTOR SUITABILITY

With a benchmark SAA allocation of 85%/15% to growth/defensive assets, the Model Portfolio can be classified as 'High Growth' from a risk/return perspective. That said, the Investment Manager has considerable flexibility to tactically vary the growth/defensive asset allocation subject to its market and asset class outlook, creating a substantially different risk/return profile to that of a traditional 'High Growth' multi asset strategy. The equities asset class 'sleeves' will overwhelmingly comprise large market cap stocks selected according to a 'value / quality' investment selection methodology rather a process that emphasises 'growth' stocks. As such, it is reasonable to assume the Australian and International equities allocations may under and outperform the respective benchmarks depending on whether the 'growth' or 'value' style of investment is in favour. The respective universe of each of the four constituent asset classes have deliberately been selected to emphasise quality and, conversely, mitigate risks (large cap stocks, cash, AAA rated Australian Government bonds) as the Model Portfolio is designed to be a core High Growth multi asset investment vehicle for investors. The latitude permitted with respect to TAA facilitates the Model Portfolio being suitable to investors across varying market environments.

RECOMMENDATION

IIR ascribes a **"RECOMMENDED"** rating to the Nucleus Tactical Growth model portfolio. While the track record is relatively short, IIR views the quantum and pattern of performance as being consistent with the Investment Manager's stock selection investment style and inherent biases of its quantitative models. Importantly, it also indicates the ability to add value through its TAA investment process. The ability to generate stock selection returns in a manner consistent with the Investment Manager's expectations (which are largely derived from quantitative models it utilises) plus the ability to add alpha through TAA (which places a greater emphasis on qualitative assessments) should not only aid total returns but serve to smooth returns as the inherent ability to generate alpha from the two separate components will vary over a market cycle. While the team is small, notwithstanding the resources in the three investment committees, the Investment Manager partly mitigates potential issues through a 'quant heavy' process and sensible focus of time and resources.

SWOT ANALYSIS

Strengths

- ◆ While the Model Portfolio has a limited track record, the key investment team and investment committee members have a substantial amount of relevant experience as well as generally having worked and/or known each other for a significant amount of time. The latter, when combined with equity ownership, augurs well for team stability.
- ◆ The performance of the Model Portfolio to date has been solid. The Investment Manager has added value through the TAA component and the two equities sleeves have broadly performed in line with the respective MSCI indices, a commendable achievement given the marked 'value' bear market in domestic and global equities over this period.
- ◆ The three internal Investment Committees comprise a broad range of relevant skills and expertise, facilitating a diversity of views. Furthermore, the PM's long standing relationships with the committee members combined with their equity ownership augurs well the stability of the composition and effectiveness of the committees.
- ◆ There is a strong alignment of interest with investors, with key members of the investment team and investment committees having equity ownership or, through options programs, a pathway to equity ownership
- ◆ The Model Portfolio is provided to investors through an SMA / IMA investment vehicle. Investors benefit from such vehicles in the sense of real-time transparency of portfolio holdings, generally materially lower investment management costs, and a tax treatment that pertains only to their personal holdings rather than a fund as a whole.
- ◆ The Investment Manager's client portal provides a high degree of transparency for investors. We note the Investment Manager was a finalist in the IFA Fintech and IFA Innovator of the year (2018).

Weaknesses

- ◆ Almost all boutique fund managers are characterised by a degree of key person risk. In relation to the Investment Manager, this applies primarily to founder and PM Damien Klassen. We note the majority equity interest the PM owns; the risk pertains to being hit by the proverbial bus, so to speak.
- ◆ While the Model Portfolio has recorded solid performance to date, potential investors must recognise the track record is relatively short, thereby providing a lesser indication of investment manager skill and investment process repeatability than may otherwise be the case with a longer track record.
- ◆ While the inherent ability to generate alpha from the two separate components of the investment process are likely to vary over the market cycle, we expect the greater source of value add or detractor over the longer term will be the TAA component. This is predominantly a qualitative process for the Investment Manager. While the relevant Investment Committee has solid experience, it is 'under gunned' relative to larger, more established players in the multi asset, global macro segment.

Opportunities

- ◆ The Investment Manager has a distinct Quality / Value investment bias, as opposed to Growth. This is both an opportunity and a threat, depending on which style happens to be in favour in equities markets. Investors should realise that there will be periods where this style may outperform and underperform the equities market as a whole.
- ◆ The ability thus far to generate alpha through TAA and patterns of returns through stock selection consistent with expectations may make the Model Portfolio suitable as a core High Growth investment vehicle in a broad range of market environments.
- ◆ An advantage of an SMA is the ability to tailor individual portfolios. The Investment Manager permits investors to "knock out" only sectors that do not match their ethical preferences, enabling investors to maintain as large of an opportunity set as possible.

Threats

- ◆ The last few years have been characterised by a bear market in value investing. A prolonged continuation of this dynamic, which IIR sees as unlikely, may present headwinds for the Investment Manager.
- ◆ Business sustainability risks is invariably a consideration for relatively low FUM, early stage fund managers. We do not perceive business sustainability risk to be particularly high. However, should there be a sustained period of poor relative performance it is conceivable there be a reversal in FUM growth, changing our perception of this risk.

Nucleus Core International - Top 10 Holdings		
Company	Position	Sector
Apple	4.1%	Tech Manufacturing
Johnson & Johnson	4.0%	Health Technology
Microsoft Corp	3.8%	Technology Services
Aena SME	3.0%	Utilities & Infrastructure
Merck	2.8%	Health Technology
Kimberly-Clark	2.8%	Consumer Non-Durables
Alphabet	2.7%	Technology Services
AbbVie	2.6%	Health Technology
Neste	2.5%	Refiners
Paychex	2.5%	Technology Services
Top 10=	30.7%	
Top 30=	69.0%	
Ttl # of stocks	61	

Nucleus Core International - Portfolio by Sector	
Sector	Position
Health Technology	21%
Technology Services	15%
Electronic Technology	11%
Finance	11%
Consumer Non-Durables	9%
Transportation	6%
Retail Trade	5%
Process Industries	5%
Consumer Durables	4%
Producer Manufacturing	4%
Industrial Services	3%
Energy Minerals	3%
Utilities	2%
Consumer Services	1%

Nucleus Core Australia - Top 10 Holdings	
Company	Position
Amcor	6.8%
Woolworths	6.3%
Coles	6.3%
Brambles	6.3%
Computershare	5.5%
Rio Tinto	5.2%
Sonic Healthcare	5.1%
National Australia	4.8%
Aristocrat Leisure	4.6%
AGL Energy	4.6%
Top 10=	55.4%
Nucleus #of Stocks	28
MSCI(Aust) #of stocks	68

Nucleus Core Australia - Portfolio by Sector	
Sector	Position
Finance	19%
Retail Trade	13%
Non-Energy Minerals	12%
Health Services	9%
Process Industries	7%
Commercial Services	6%
Technology Services	5%
Consumer Durables	5%
Utilities	5%
Consumer Services	4%
Communications	4%
Health Technology	4%
Consumer Non-Durables	4%
Energy Minerals	3%

Cash / Bond Allocation	Position
AUD Cash	8.40%
USD Cash (ETF)	9.60%
Aust Govt Bonds	24.60%
Aust Govt Indexed Bonds	1.90%

Australian Govt Bonds	
Number of Issuers	1
Number of Holdings	8
Portfolio Duration	9.19
Wghted Avg Coupon	4.05%
Wghted Avg Maturity (yrs)	11.5

Ethical Overlay

A distinct advantage of an SMA investment vehicle is it permits investors to tailor a portfolio to match their preferences. The Investment Manager offers a comprehensive ability for investors to knock out sectors that do not match their ethical preferences. This categories include climate change, war, human rights, vices, health, animal rights, and religion.

In a few categories, investors can distinguish between "High Impact" and "Broad" exposures. For example, in the Carbon category this lets investors choose to either knock out just the worst offenders (tar sands and brown coal) or the entire sector depending upon the strength of their convictions.

To our knowledge, the degree to which investors can implement their ethical preferences in the Model Portfolio is unique in Australia.

PERFORMANCE ANALYTICS

Due to the nature of Separately Managed Accounts, there will invariably be portfolio differences between clients. Nucleus has outsourced the management of the Separately Managed Accounts to both Xplore Wealth and Praemium, whose role it is to allocate trades and ensure portfolios are structured consistently. Additionally, Nucleus has internal systems to monitor portfolio construction and check that clients hold the correct weights. The returns above include fees and trading costs on a \$500,000 portfolio. Note that individual client performance will vary based on the amount invested, ethical overlays and the date of purchase.

The performance of the Model Portfolio is dissected in a number of ways below and overleaf. The key conclusion we draw from the analysis below is that the investment model and processes have been validated, both with respect to the TAA process and the stock selection process, albeit recognising the limitations of the relatively short track record to date. The key points:

- ◆ In a market environment characterised by a value investing bear market, the ability to marginally underperform the MSCI World Index is a solid achievement and augurs well for when the value bear market inevitably ends. We note the Model Portfolio has markedly outperformed the benchmark.
- ◆ Volatility and drawdowns have been comparatively low, reflecting the Investment Manager's view that the economic cycle has, and remains close to the top. The performance is consistent with the Investment Manager's objective to preserve capital during periods of heightened equity market risk so as to provide investors with a core high growth multi asset investment.
- ◆ The Investment Manager has shown an ability to add value with respect to both the TAA and stock selection processes. Furthermore, stock selection value add has derived from the international equities sleeve, with the Australian equities sleeve generally performing more in line with the market. Both aspects are consistent with the Investment Manager's expectations of the investment model, which has an inherently greater ability to generate alpha with international equities relative to Australian equities.

Tactical Growth Returns (as at 31 Mar 2019)				
Index / Model Portfolio	6-mths	1-year	Incept (% pa.)	Volatility
Nucleus Tactical Growth (Net)	5.2%	9.0%	10.3%	6.9%
Benchmark (Post Fees)	2.8%	6.0%	6.1%	0.8%
Value Add (Net)	3.4%	3.0%	4.2%	N/A

In assessing the performance of the Model Portfolio, it is important not only to assess overall performance but equally to separately assess the Investment Manager's performance in relation to the two key components of that process, specifically the TAA and stock selection components.

Tactical Asset Allocation Selection Performance

One way to evaluate the Model Portfolio's performance with respect to the TAA process is to use a notional index made up of the same asset classes used by the Model Portfolio and according the benchmark SAA allocations of the Model Portfolio. In the case of the notional passive fund, it has been assume that the underlying asset categories are rebalanced every six months and have similar costs to the Model Portfolio.

Tactical Growth Returns (as at 31 Mar 2019)				
Index / Model Portfolio	6-mths	1-year	Incept (% pa.)	Volatility
Nucleus Tactical Growth (Net)	5.2%	9.0%	10.3%	6.9%
Static Strategic Allocation	6.2%	11.2%	9.4%	7.7%
Value Add (Net)	-0.9%	-2.2%	0.9%	N/A

In aggregate the Investment Manager is 1.8% in cumulative returns (0.9% annualised) in front of the passive strategy, indicating the Investment Manager has been able to add value through its TAA selection processes.

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