

## Armytage Enhanced Leaders Fund

28 Feb 2011

The Armytage Enhanced Leaders Fund is a unique and appealing offering to investors seeking strong income returns, whilst still gaining an exposure to Australian equities. The enhanced income is generated by writing or selling exchanged traded call and put options over physical stock positions and cash respectively. In Zenith's view the Fund is a specialist product, managed by a highly capable investment team, with a strategy designed to deliver attractive risk-adjusted returns over the market cycle.

Since Zenith's previous review, Peter Rudd joined the investment team in January 2011 as Research Manager. Rudd, a former geologist, has a strong background as a resource sector specialist, with over 25 years experience in investment analysis across a number of roles including acting as Research Manager at Tolhurst Noall. In addition, Armytage has indicated the Fund will be moving from semi-annual to quarterly distributions (expected to be implemented first-half 2011).

The Armytage investment team is led by laFrate who is a highly experienced practitioner with over 25 years of investment experience. McComb has over 12 years investment experience and prior to Armytage worked at Providence Funds Management Limited for 3 years as an investment analyst. Zenith considers the senior investment professionals, laFrate and McComb, to both be highly experienced investors with complementary skill sets.

The third member of the team is Bradley King (Investment Officer) who has 8 years of industry experience in stockbroking and funds management. Zenith considers the investment team to be adequately resourced to cover the Fund's investment universe based on the level of investment experience within the team and its strong continuity. Furthermore, the addition of Rudd strengthens the team considerably in Zenith's view, given the size of the resources sector in the Australian market.

The Fund aims to deliver to investors an income-focused, value-oriented exposure to Australian shares. Armytage's investment philosophy is based on the premise that companies with strong cash flows from operations, particularly those with the ability to distribute these to shareholders in the form of fully franked dividends, will ultimately deliver superior total returns to investors. This Fund will only buy stocks in the S&P/ASX100 although it invests predominantly in the top 25 stocks by market capitalisation (20-30 stocks held in the portfolio), which tend to have liquid option series available and monthly frequency. Armytage will generally write (sell) call and put options over up to 50% and 30% of the stock names in the portfolio respectively.

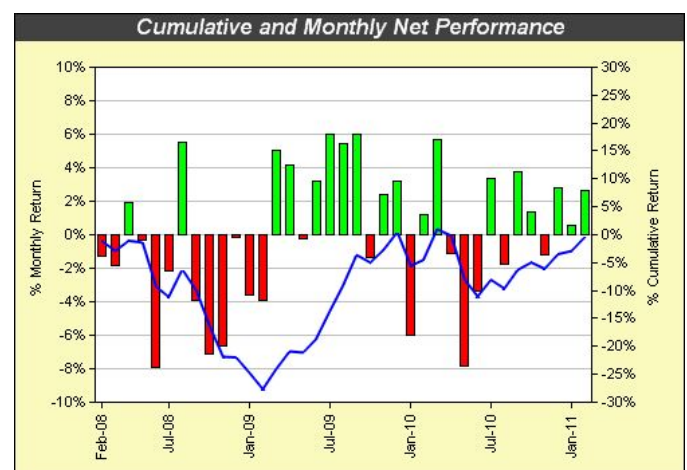
The major risk faced by the Fund, like most Australian equity funds, is a prolonged bear market. It does however have a relatively defensive structure with its option premium providing an additional layer of returns which provides a degree of protection in falling markets. The Manager's target volatility profile for this Fund is approximately 75% of that of the index, and a beta of 0.7 to 0.8 in rising market environments and a beta of 0.65 in falling markets.

The Fund has a management fee of 0.97% p.a. and a performance fee of 10.25% of investment returns made in excess of 10% p.a.

Zenith suggests the Fund is most appropriate for investors seeking income from their equities exposure. Investors should note the Fund will shift to paying quarterly distributions in the first-half of 2011, which Zenith believes to be a positive feature for investors targeting income.

Zenith rates the Fund **RECOMMENDED**.

Key Features	Description
APIR Code	ETL0148AU
Asset Class	Australian Shares
Sub-Asset Class	Specialist
Investment Style	Neutral
Zenith Assigned Benchmark	S&P / ASX 300 (Accum)
Recommended Investment Timeframe	5 + years
Executive Chairman	Lee laFrate
Investment Director & CEO	Campbell McComb



### Performance Analysis

Performance Statistics		3 Yrs	2 Yrs	1 Yr
Performance (% p.a.)	Fund	0.25	17.40	4.27
	Benchmark	-0.26	25.76	9.02
	Median	0.25	24.36	6.73

The Fund aims to deliver to investors a targeted income return of 7.0% p.a., plus any franking benefits and some capital growth. The Fund's target volatility profile is approximately 75% of that of the index, with a beta of 0.7 to 0.8 in rising market environments and a beta of 0.65 in falling markets. Since inception the Fund's income and volatility objectives have been achieved providing Zenith with confidence in the Fund's investment approach.

Income distributions occur semi-annually with an expected 7% p.a. plus franking (2% - 5% from option writing). Zenith expects the Fund to perform best in gradually rising market conditions, given these conditions lower the risk of option positions being 'called away', while still providing some upside capital growth.

#### Income/Growth Returns (Financial Year):

- 1/7/09 - 30/6/10: Growth 4.05%; Income 5.22%; Total 9.27%
- 1/7/08 - 30/6/09: Growth -17.80%; Income 7.44%; Total -10.36%

### Consistency Analysis

Consistency Statistics		3 Yrs	2 Yrs	1 Yr
Excess Rtn - All Mkts (% of Mths)	Fund	36.11	25.00	25.00
	Median	47.22	52.08	50.00
Excess Rtn - Rising Mkts (% of Mths)	Fund	20.00	17.65	28.57
	Median	55.00	54.41	57.14
Excess Rtn - Falling Mkts (% of Mths)	Fund	56.25	42.86	20.00
	Median	56.25	42.86	40.00

The consistency of outperformance statistics highlights the Fund's ability to outperform the benchmark in falling market conditions. Whilst Zenith aims to identify managers that can outperform their respective index in greater than 50% of total months, we acknowledge that Armytage employs a differentiated investment approach that may struggle to achieve this during some time periods.

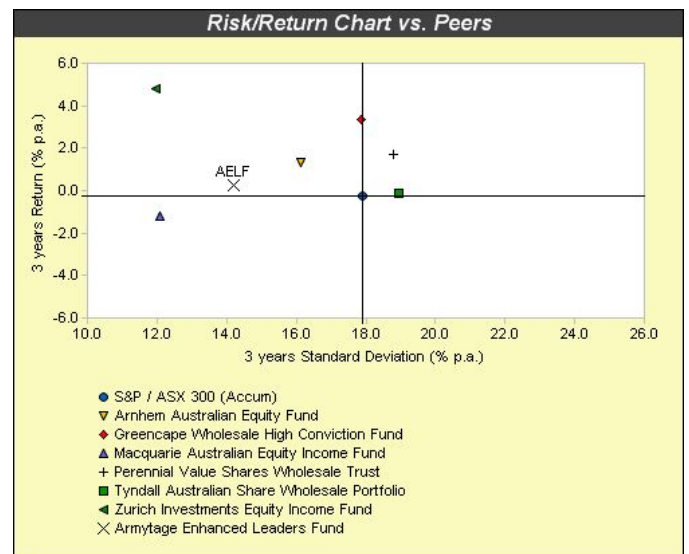
Armytage uses a value based investment approach and uses options strategies to increase the income distribution of the Fund at the expense of some upside growth. As a result of these factors investors should be aware that this Fund is likely to lag peers and the index in bull market environments, but it should outperform in weaker markets.

### Risk / Return Analysis

Risk / Return Statistics		3 Yrs	2 Yrs	1 Yr
Information Ratio	Fund	0.08	-2.89	-2.66
	Median	-0.12	0.03	-0.40
Sharpe Ratio	Fund	-0.34	1.06	-0.04
	Median	-0.34	1.39	0.11
Standard Deviation (% p.a.)	Fund	14.19	12.53	12.30
	Median	17.81	14.30	12.67
Tracking Error (% p.a.)	Fund	6.31	2.89	1.79
	Median	8.73	7.60	4.63

Due to falling markets, the Fund's negative Information and Sharpe ratios do not presently provide a reliable comparison with the median manager. Given the Fund's defensive attributes, Zenith expects standard deviation levels to be lower than the Median Manager, which to date has been observed.

The risk/return chart below highlights the Fund's risk adjusted performance relative to other income orientated managers in the universe.



### Investment Personnel

Name	Title	Tenure
Lee laFrate	Executive Chairman	14 Yr(s)
Campbell McComb	Investment Director & CEO	10 Yr(s)
Bradley King	Investment Analyst	8 Yr(s)
Peter Rudd	Research Manager	3 Mth(s)

#### Manager Background:

Armytage Private Limited (Armytage) was established by Lee laFrate in 1997 as a boutique firm specialising in Managed Discretionary Accounts on behalf of high net worth individuals. In June 2005, Armytage established a funds management operation with the creation of its first fund offered to the public via a product disclosure statement. In 2008, Campbell McComb (CEO & Investment Director) acquired the equity stake of a previous joint venture partner Primestock Financial Group (PFG), increasing his ownership to 55%, with the remaining 45% held by Lee laFrate. In January 2009 the firm purchased a 30% stake in Absolute Asset Management (now

Armytage AAM) which specialises in running macro trading and Asian FX and REITs funds. It is anticipated that Armytage will move to full ownership of Armytage AAM over the next 3 to 5 years.

Armytage currently manage a number of capabilities across the product suite including the Enhanced Leaders Fund, the Strategic Opportunities Fund (essentially this fund blended with opportunistic exposure to smaller companies) as well as its IMA capabilities and AAM products. The overall business has grown steadily since inception and as at December 2010 had funds under management (FUM) of approximately \$310 million (of which ~\$40 million is in this Fund).

The business is run similar to other boutiques, with several non-investment functions outsourced to specialist firms. In addition to investment responsibilities, laFrate and McComb also manage client relationships and product marketing (with support from Bradley King). Although Zenith typically prefers having dedicated marketing/client services personnel, we are comfortable that the role is not onerous given that the business is not seeking to raise a significant amount of funds in the short - medium term.

Overall, Zenith considers Armytage to be a stable and well-established investment firm, with an appropriate structure and level of resourcing in place to manage this Fund.

#### Investment Team:

The Armytage investment team is led by laFrate (Executive Chairman) who is a highly experienced practitioner with over 25 years of investment experience. laFrate was the founder and former Chairman of the Treasury Group Limited (stepped down in 2006) and prior to establishing Armytage held a senior executive position at Tolhurst Noall for 9 years as an institutional and corporate broker. McComb (CEO and Investment Director) has over 12 years investment experience and worked previously at Providence Funds Management Limited for 3 years as an investment analyst. Zenith considers the senior investment professionals, laFrate and McComb, to both be highly experienced with complementary skill sets.

The third member of the team is Bradley King (Investment Officer) who has 8 years of industry experience in stockbroking and funds management. In January 2011, Peter Rudd joined the investment team as Research Manager. Rudd, a former geologist, has a strong background as a resource sector specialist, with over 25 years experience in investment analysis across a number of roles including acting as Research Manager at Tolhurst Noall.

In addition to these resources the team leverages off the research conducted by Armytage AAM. This includes top-down (macro) and technical trading analysis from Andrew Mckay (Armytage AAM CEO) as well as bottom-up stock research conducted by Michael Ffrench (COO/Company Secretary) on the domestic property and infrastructure sectors (although his focus has shifted to managing the business)

The investment team's incentive package is salary based plus a performance bonus (1/3 of the Fund's accrued performance fee). The performance bonus will range from 0-50% of base salary, to be determined by McComb. The team at Armytage has been relatively stable over the longer term and this indicates that the firm maintains a reasonable incentive structure and working environment.

Armytage's investment approach is focused and opportunistic in nature and the manager does not attempt to acquire a detailed knowledge on all stocks in its investible universe, only those that it identifies as compelling investment opportunities. Given this concentrated approach, research responsibilities are not allocated along formal industry lines and instead the team will often visit companies in groups of two. Stock selection and portfolio allocation decisions are assessed jointly by laFrate and McComb, guided by the analyst's best ideas and recommendations.

Zenith considers the investment team to be adequately resourced to cover the Fund's investment universe based on the level of investment experience within the team and its strong continuity. Furthermore, the addition of Rudd strengthens the team considerably in Zenith's view, given the size of the resources sector in the Australian market.

#### Investment Process

The Fund aims to deliver to investors an income-focused, value-oriented exposure to Australian shares. In line with this objective, the Manager has indicated the Fund will be moving from semi-annual to quarterly distributions (expected to be implemented first-half 2011). Armytage's investment philosophy is based on the premise that companies with strong cash flows from operations, particularly those with the ability to distribute these to shareholders in the form of fully franked dividends, will ultimately deliver superior total returns to investors.

A buy-write strategy is also appealing to certain investors given it represents a sound, low risk approach to investing while offering a stable income stream and enhanced overall yield. Zenith considers the investment process to be well structured robust, given the Manager has established a strong track record of delivering attractive levels of income for investors.

#### Security Selection

There are essentially 2 components to the Armytage investment process:

##### 1. Stock Selection

Armytage conducts an initial qualitative screen of its investible universe (based primarily on market knowledge, financial ratios and recent share price performance) to identify stocks that it believes may be worthy of further investigation. From here, Armytage undertakes a more detailed screen of around 60-70 stocks (drawn from the initial top 100 focus).

Each of these 60-70 stocks are assessed in regards to 3 key areas: economic & sector conditions (including general economic conditions, sector conditions etc); company specific financial ratios (including Return On Equity, ROIC, WACC, dividend growth, strong cashflow, Yield etc); and company structure (including management quality, sector consolidation etc). Each sub-factor within these 3 category groups is scored (between 1 and 5) and an overall score is assigned to each stock. The fewer points awarded, the more attractive the stock is deemed to be. These scores are used by the investment team in prioritising the fundamental research schedule.

Zenith believes that Armytage's stock screening process is soundly based and well structured, ensuring that a broad range of relevant factors are given due consideration.

Once an opportunity has been identified, further detailed research is undertaken, which will often involve face-to-face meetings with company management. The fundamental research process culminates in a valuation for each company, which is usually discounted cash flow (DCF) based.

The Manager has a low risk approach to investing with capital preservation and maintenance a fundamental consideration. Companies sought after tend to deliver high returns on equity with a focus on margins and asset utilisation. They also tend to have consistent and replicable earnings and strong cashflow feeding through to above average returns and dividend growth.

## 2. Options Selection

A further consideration within the initial screening process is the level of option activity on a stock. Armytage tends to invest mainly in the top 25 stocks, most of which are considered "tier 1" and have monthly liquidity. One of the attractions of monthly option liquidity is the risk of being "called away" is lowered given the shorter duration to expiry.

Armytage will generally write (sell) call and put options over up to 50% and 30% of the stock names and the total portfolio respectively. Call option positions are typically taken over half the holding and tend only to be written every second month, to ensure not all of the upside is capped. Put options can be used to capture potentially attractive entry levels on any market downturn and provide an additional source of income. The Manager will not write uncovered calls (i.e. must be backed by physical holdings) nor write put options that are not cash backed.

Option writing is done for income generating purposes with the aim to generate an additional 2%-5% p.a. in income from option premiums.

## Portfolio Construction

Portfolio construction decisions rest with laFrate and McComb, which feeds off the best ideas of the research stage. The scoring system used as part of the screening process does not feed directly into portfolio construction, with portfolio decisions, including the individual weighting of securities based on the following;

- Stocks relative weighting in the index;
- Stock beta versus the index;
- Option market volatility / liquidity;
- Portfolio's existing exposure to the sector / industry; and
- Cash holdings.

The starting point is to decide on a desired broad allocation to large capitalisation stocks, the option overlay and cash.

While allocation setting serves as a guide, the precise allocation to each sector will be a function of the bottom up research process and where the most attractive investment opportunities lie. The Manager will invest a portion of the portfolio in event driven investments (de-mergers, regulatory changes, consolidation), which have historically delivered value add.

In normal circumstances Armytage aims to hold between 20-30 securities in the portfolio (not including the various call and put option positions) and can hold up to 30% cash. Cash is regarded as an asset class and where value cannot be found the Manager will actively use this allocation up to its maximum constraint (max 30% cash). The Manager's target

volatility profile for this Fund is approximately 75% of that of the index, and beta of 0.7 to 0.8 in rising market environments and a beta of 0.65 in falling markets.

The options series selected in the portfolio construction process typically comprise the next monthly series with call options written up to 5%-15% "out of the money" while puts are written "a little bit further out". Armytage uses Paterson Securities as their sole option broker.

Armytage is highly disciplined in its portfolio construction approach, setting a strict target purchase price for all stocks and waiting patiently if the stock moves above this price before the order is filled. If necessary, positions will be filled over a period of a year or more and the manager will never pay more than the target purchase price. This disciplined approach also translates into the Manager's sell decisions and stocks will be diligently sold down as they reach preset price targets. As a consequence of this patient approach the Fund is expected to have a low level of portfolio turnover circa 30% p.a., which Zenith believes is ideal for a fund of this nature.

Zenith believes Armytage's approach to portfolio construction to be consistent with the Fund's investment objectives. In addition, the Fund's options exposure is expected to deliver income without introducing excessive risk into the Fund.

## Risk Management

Portfolio Constraints	Description
Stock Holdings	20 to 30
Individual Securities	max: 10
Cash	max: 30
Sector Limits	Nil
Naked Call Option Writing	Nil
Gearing	Nil

In Zenith's opinion the overall structure of a buy-write strategy has some strong embedded risk management benefits which should suit conservative investors. Call and put options written provide the portfolio with premium income (estimated at 2-3% p.a.) and an additional layer of return which is particularly attractive in falling market conditions. Furthermore the Manager does not write "naked" options, that is, call option positions are stock covered and put option positions are cash backed.

The Manager has implemented some risk management constraints at a portfolio level through its maximum constraint on individual stock positions, as well as stock number and cash guidelines. Whilst there is an individual stock weighting limit of 10% in place, there are presently no sector constraints. Zenith believes the introduction of formal sector diversification limits would provide further assurance to investors that exposure to a single sector does not become excessive.

Other forms of risk management can be found in the Manager's stock selection approach. Armytage has a strong focus on downside risk and capital preservation / maintenance. In this regard, we are comfortable that the Manager has an adequate focus on risk management and is cognisant of the individual risks within its portfolio.

## Risks of the Fund

The major risk faced by the Fund, like most Australian equity funds, is a prolonged bear market. It does however have a

relatively defensive structure with its option premium providing an additional layer of returns which provides a degree of protection in falling markets (relative to long only funds).

Investors should be aware that Armytage employs a differentiated and benchmark unaware investment process and that returns may deviate significantly from both competitors and the benchmark. Potential investors should ensure that they understand this aspect of the Manager's approach and are comfortable with the associated risks of higher tracking error funds.

Armytage employs a value based investment style and value managers tend to lag their growth peers in bull market environments. In addition Armytage uses options strategies to increase the income distribution of the Fund at the expense of some upside growth (i.e. this is a lower beta fund). As a result of these factors investors should be aware that this Fund is likely to lag peers and the index in bull market environments, but it should outperform in weaker markets.

The Fund is expected to hold between 20 and 30 stocks which is more concentrated than most Australian shares funds. Also whilst a maximum allowable constraint of 10% in a single security is reasonable, the Manager does not have any formal sector limits which could expose it to individual sector risk depending upon the composition of the portfolio.

Key person risk surrounds Lee IaFrate and Campbell McComb, however their ownership of the Firm (45% and 55% equity holding respectively), provides a strong incentive for them to stay with the business. Nonetheless, a departure of either individual would be a material loss for Armytage and would instigate a reassessment of Zenith's rating.

Armytage use exchange traded options in the Fund which carries numerous risks. Options may not move in line with the movement in the underlying asset. In addition, the market for a particular option may become illiquid due to an unforeseen event. Aware of these risks, Armytage seek to manage/mitigate them by only investing in exchange traded options and only those securities viewed as having adequate market depth.

## Applications of the Fund

3 years Excess Correlation Table	
Fund Name	Excess Correlation
Arnhem Australian Equity Fund	0.65
Greencape Wholesale High Conviction Fund	0.22
Macquarie Australian Equity Income Fund	0.51
Perennial Value Shares Wholesale Trust	-0.23
Tyndall Australian Share Wholesale Portfolio	0.16
Zurich Investments Equity Income Fund	0.79

The Fund offers investors a buy-write strategy aimed at generating strong income returns along with capital appreciation and should therefore suit conservative investors with an income focus. The Fund's broad constraints provide greater scope to add value in comparison to a long only manager with the Fund able to add value in a market downturn via option premiums - writing both call and put options. In addition the Manager has the ability to allocate up to 30% of the portfolio to cash, which is significantly higher than traditional Australian shares funds.

Zenith believes that an allocation to the Fund would compliment a portfolio's long-only Australian share allocation, with the position size dependant on the investor's risk profile and income and growth objectives. The Fund is focused predominately on delivering income, however with some capital growth. The Fund's target volatility profile is approximately 75% of that of the index, with a beta of 0.7 to 0.8 in rising market environments and a beta of 0.65 in falling markets.

The Fund has a long term investment approach and targets a portfolio turnover of approximately 30% p.a. (based on normal market conditions), which will provide capital gain concessions based on assets being held for 12 months.

Investors should note the Fund will shift to paying quarterly distributions in the first-half of 2011, which Zenith believes to be a positive feature for investors targeting income.

## Fees

The Fund has a management fee of 0.97% p.a. and a performance fee of 10.25% of investment returns made in excess of the performance objective is payable. The performance objective is an absolute return of 10% p.a. (after the management fee), paid on a 12-monthly basis. Importantly if performance is negative during the calculation period, it is carried forward and must be recouped in subsequent periods before the performance fee applies. In Zenith's view the management fee component of the fee structure is reasonable and in-line with peers. However, when taking the performance fee s into account the overall fees of the Fund are slightly higher than most peers.

Investors should also be aware that there is a 0.25% buy / sell spread charged on applications and redemptions to and from the Fund which is standard.

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