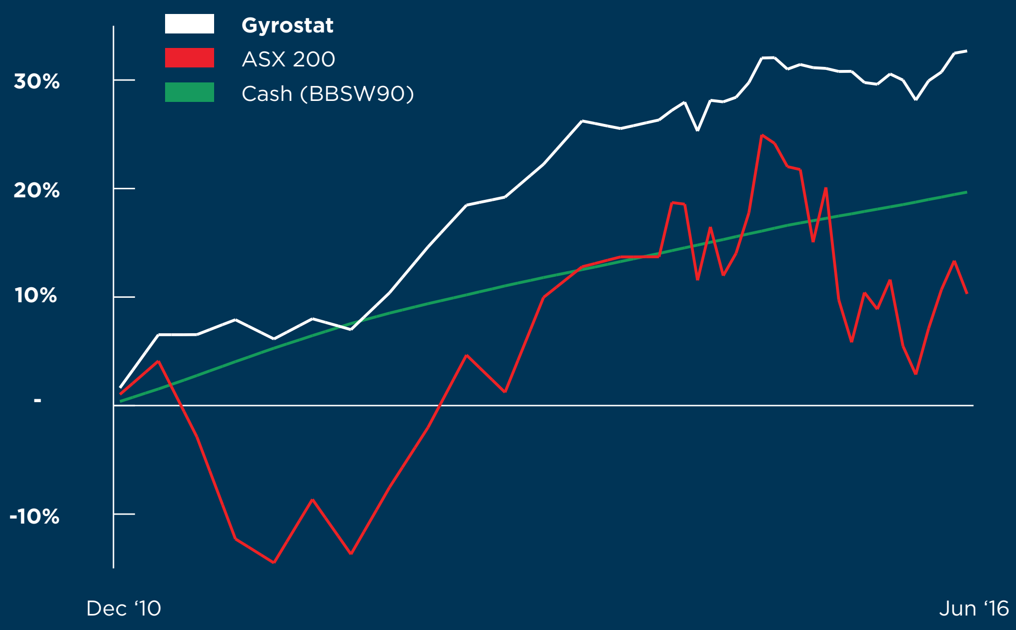
GYROSTAT

RISK MANAGED EQUITY FUNDS

"GYRATIONS"

Insights into risk management of an equity portfolio
Key data releases with market pricing of outcomes

30 June 2016



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There are references to past performance in this document. Past performance is no guarantee of future performance. Gyrostat or any of its officers, advisers, agents or associates do not in any way guarantee the performance of the Fund.

Investors should download and review the Information Memorandum available at www.gyrostat.com.au before making an investment in the Fund.

Gyrations – Insights into risk management of an equity portfolio

By Craig Racine, Managing Director and Chief Investment Officer, Gyrostat Capital Management

In this fortnightly report we provide insights into risk management of an equity portfolio.

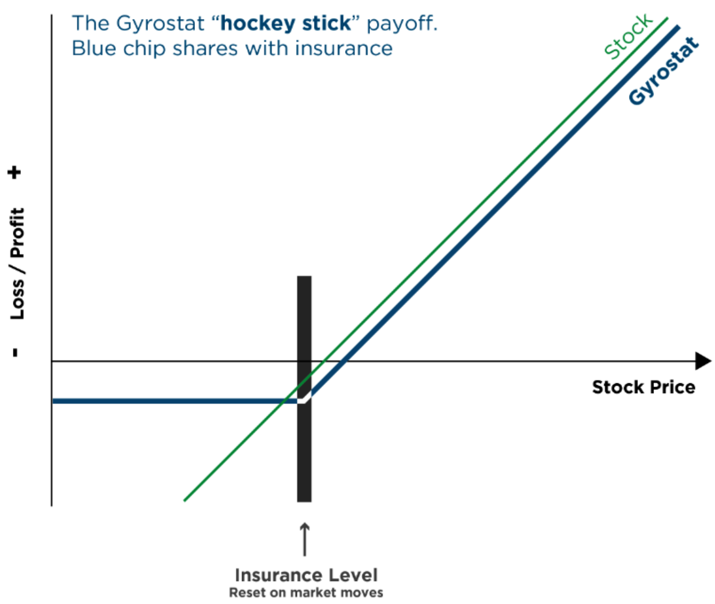
- Global macro conditions (in pictures) with key upcoming data release with market pricing of outcomes based upon the flow of money (where available)
- "Do it yourself" risk managed equity income with protection current market costs, varying the duration of protection and capital at risk.

Our investment view is that interest rates will stay low for an extended period, and stock market volatility will increase. During 2012-2015 the level of volatility was low by historical standards. Our expectation is that volatility will increase, leading to "risk-on", "risk-off" investing market characteristics only distantly related to fundamentals. Volatility has started to increase in 2016.

With this view, there is a need to **expand the range of 'income' assets to include risk managed equity funds.** Re-allocating 'income' to 'growth' assets in search of higher returns exposes investors to substantial fluctuations in capital value.

In this macro environment, both asset classes, 'income' and 'growth', have fragilities. "Income" assets such as cash and term deposits provide **insufficient income with no prospect for any capital growth**. "Growth" assets, investing directly in blue chip high yielding shares, or equity funds, leave investors exposed to falls in the value of investments in this fragile and highly indebted global environment. **The traditional portfolio approach is to blend 'income' and 'growth' assets, which will produce portfolios with insufficient income and substantial fluctuations in capital value.**

There is a need for risk managed investments in growth assets. The ideal solution is to buy blue chip shares with insurance resulting in a "hockey stick" payoff always in place – always participate in the upside with minimal capital at risk. This delivers higher income while always protecting and growing the investors' capital. This forms part of an 'income' allocation of a portfolio and is suitable for all investors.



Outlook

Our investment view is that interest rates will stay low for an extended period, and stock market volatility will increase. During 2012-2016 the level of volatility was low. Historically volatility has remained low for periods of 4 years - 1992-1996, 2002-2006, and 2012-2016. Volatility has started to increase.

These are dangerous times for traditional investment approaches with global total debt outstanding as a percentage of GDP at historical highs. GDP growth remains below trend, interest rates are at historical lows, and central banks are implementing unconventional monetary policies.

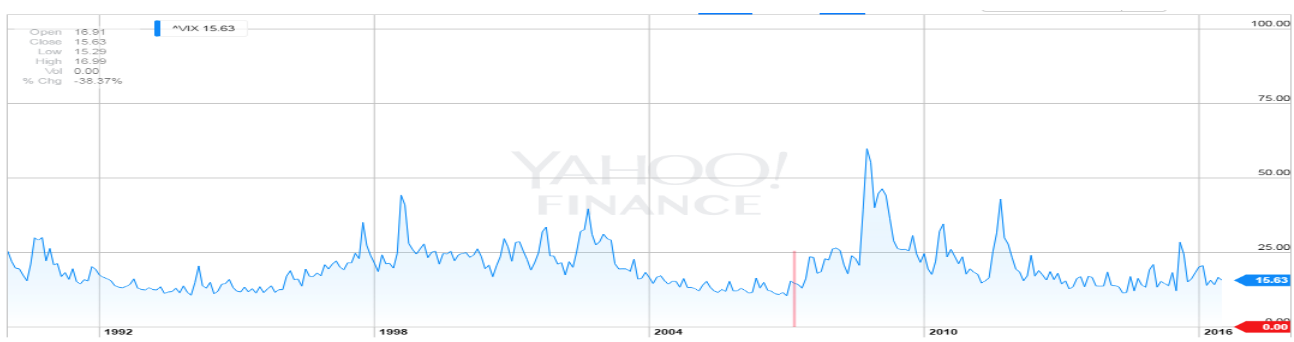
Increased volatility is often experienced around key data releases relating to interest rates, growth, inflation rates, and key political events. These dates are detailed in the report, along with market pricing of likely outcomes where available. We present data from futures markets, credit default swaps, and online betting odds.

Our expectation is that volatility will increase, with "risk-on", "risk-off" investing occurring only distantly related to fundamentals. Relying on market predictions, as is the traditional approach, with a 'straight line' pay-off leaves investors exposed to large capital losses.

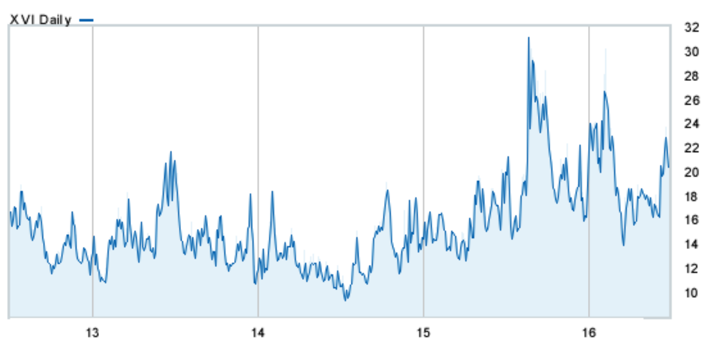
With a 'hockey stick pay off' investment profile, set to always participate in the upside with minimal capital at risk, investors can approach these markets with confidence.

Long term volatility – period since 2012 low by historical standards, starting to increase in 2016

Volatility S&P500 (VIX) 1990 – 2016



Australian volatility A-VIX 2012-2016



Understanding the A-VIX

The S&P/ASX 200 VIX (A-VIX) is a real-time volatility index provides an insight into investor sentiment and expected levels of market volatility. The index tracks S&P/ASX 200 index option prices as a means of monitoring anticipated levels of near-term volatility in the Australian equity market.

The level of implied volatility has been rising, but is still low by historical standards.

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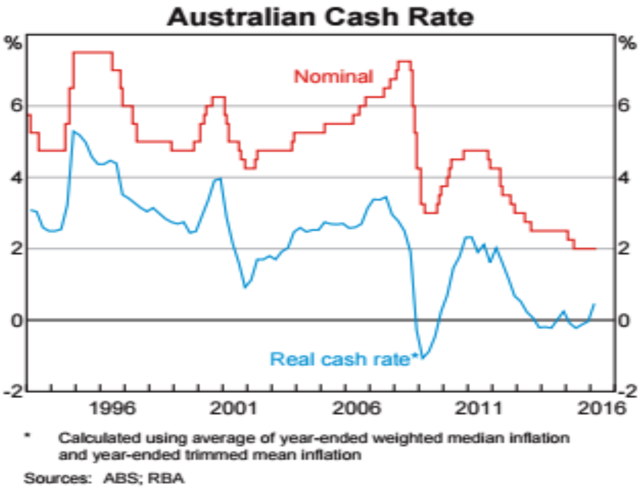
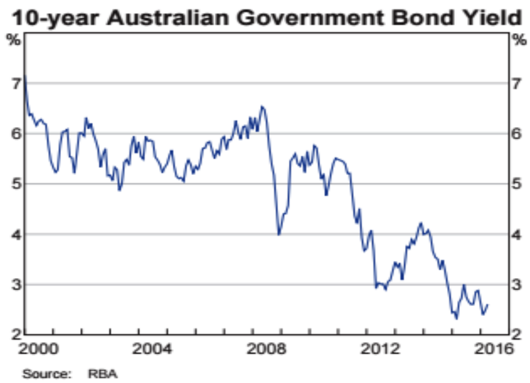
Cash Rate - Australia



- The RBA cut cash rates to 1.75% on 3 May 2016
- Upcoming RBA meetings:
  - July 5
  - August 2
- Market pricing of interest rate cut to 1.5% at July meeting based on inter-bank cash rate futures
- No cut: 88% Cut 12%

http://www.asx.com.au/prices/targetratetracker.htm

Bond Yield - Australia

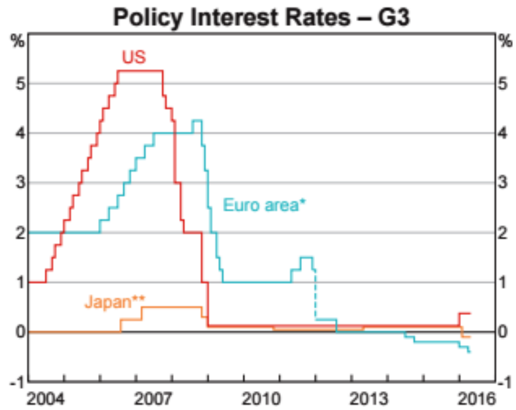


- The Australian Government 10 year bond rate on 16 May 2016 fell to 141 year lows.

http://www.bloomberg.com/market/rates-bonds

Interest Rates – International

- Upcoming US Federal Reserve decisions:
    - Jul 28
    - Sep 22
- Upcoming Bank of Japan decisions:
    - Jul 29
    - Sep 21
- Upcoming European Union decisions:
    - Jul 21
    - Sep 8
- Upcoming Bank of England decisions
    - Jul 14
    - Aug 4



* Main refinancing rate until the introduction of 3-year LTROs in December 2011; deposit facility rate thereafter
** Since April 2013, the Bank of Japan's main operating target has been the money base
Source: central banks

GDP Growth– World

* Weighted using Australian export shares
** PPP-weighted; accounts for 85 per cent of world GDP
Sources: ABS; CEIC Data; IMF; RBA; Thomson Reuters

GDP growth remains below trend, see IMF April world outlook "Too slow for too long."

July 14: Australia unemployment. Previous 5.7% in line with consensus.

July 15: US retail sales. Previous + 0.5% MoM to May above consensus.

August 12: Euro zone GDP growth. Previous annualised 1.7% in line with consensus.

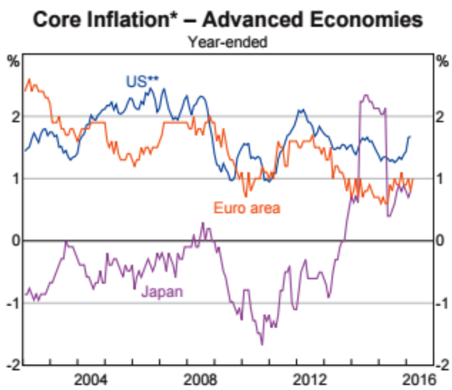
Sep 7: Australia GDP growth. Previous annualised 3.1% exceeding consensus. Highest since 3Q2012.

Inflation

July 10: China inflation. Previous 2.0% YoY to May below consensus.

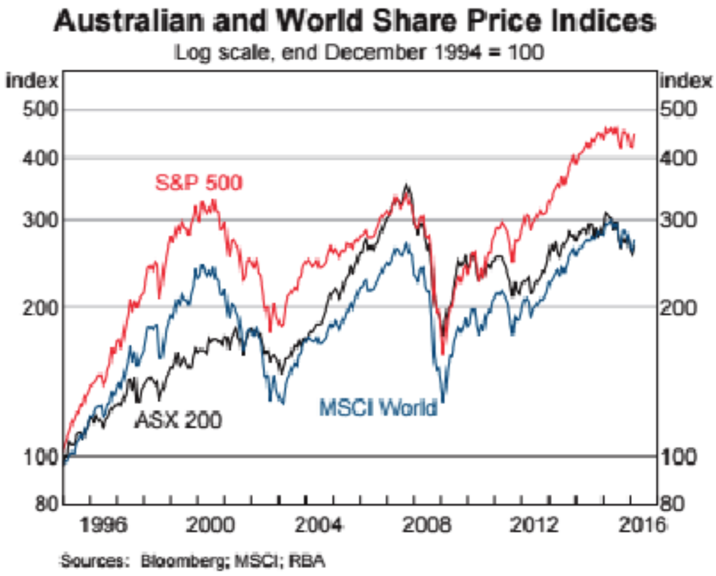
July 15: USA core inflation rate. Previous 2.2% in line with consensus.

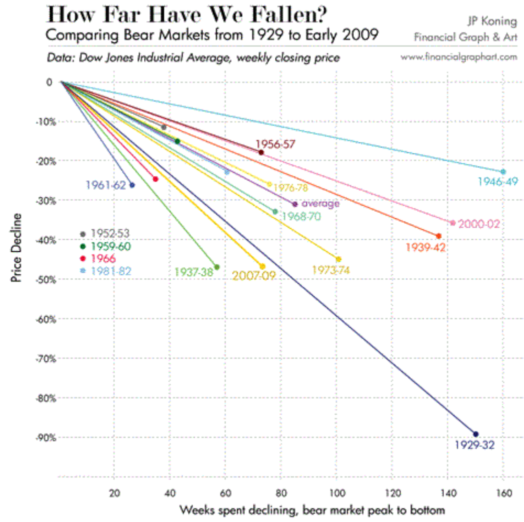
July 22: Australia inflation rate. Previous 1.3% below consensus.



* Excluding food and energy, and for the euro area also excluding alcohol and tobacco
** Core price index for personal consumption expenditures
Source: Thomson Reuters

Share Indices





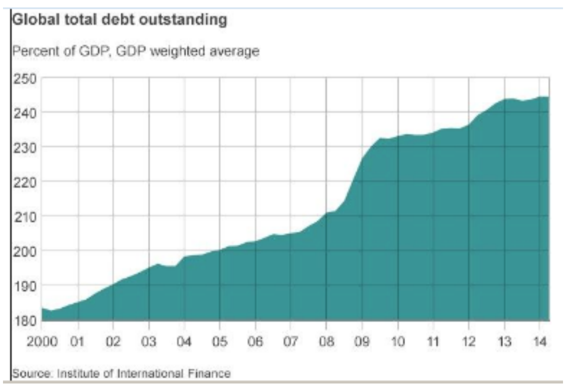
Bear markets historically occur every 4 ½ to 5 ½ years – the last US fall was in 2007-2009 with falls nearly 50%.

The graph shows price declines since 1929 (range 25% to 90%, average 38%) and duration of decline (22 to 160 weeks)

Global Debt

Global total debt outstanding as a % of GDP has grown from 180% in 2000 to over 240%, and is at historical highs.

This increases the fragility to market sell-offs.



Potential market triggers

July 2: Australian Federal election

- Coalition $ 1.08 ALP $ 8.00

November 8: USA Presidential election

- Democrats/Clinton: $ 1.30
- Republicans/Trump: $ 3.75

Mid 2017: German elections

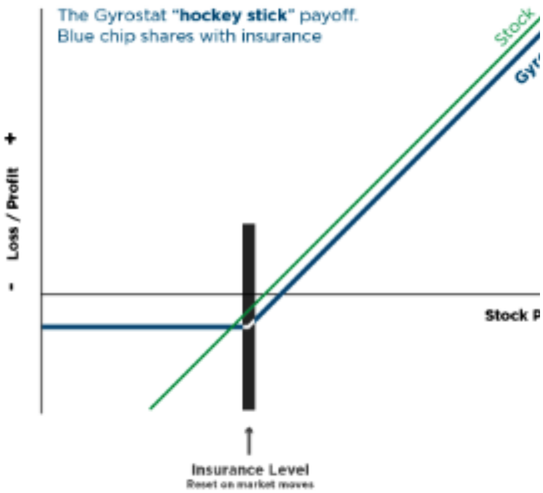
* Pricing based on online betting odds

The Gyrostat 3 step investment approach

1. **Buy and hold blue chip shares with insurance** on the Australian Stock Exchange

2. Technology enables our software systems to choose the lowest cost insurance from the many alternatives. The amount of **insurance is set to always participate in the upside with minimal capital at risk**.

3. **On market moves we re-set the insurance level.** If the share price rises, we buy more to 'lock in' the gains, on falls we sell some that is no longer required.



In contrast, traditional approaches have a 'straight line' payoff with no protection in place.

Retirement planning **Craig Racine**

End of seven-year rule brings a new ball game

For the first time in the history of the ASX, the All Ordinaries Index is lower than it was seven years ago. The seven-year rule used to be a persuasive sales pitch for financial planners. Now it is gone.

Times have changed. Global debt has increased by $57 trillion since 2007 and interest rates are at record low levels. Rental yields are heading in the same direction. Sharemarket volatility around the world adds to the uncertainties facing retirees.

Australia escaped the worst of the global financial crisis, but the record 25-year run of prosperity and growth seems set to end soon. The economic tremors in China and Europe add more uncertainty. This all spells trouble for retirement planning as the peak of the baby boom bulge moves past 65. In Paris last month, OECD secretary-general Angel Gurria warned about the risks created by current conditions.

He said: "Increasingly pension funds and life insurers are feeling the pressure to chase yield themselves, and to pursue higher risk investment strategies that could ultimately undermine their solvency. This not only poses financial sector risks, but potentially jeopardises the secure retirement of our citizens."

Reserve Bank of Australia governor Glenn Stevens recently questioned how an adequate flow of income could be generated for the retired "in a world where nominal returns on low-risk assets are so low".

David Murray, the chairman of the Financial System Inquiry, added more doubt when he said recently that "the retirement phase of superannuation is undeveloped and provides limited choice for managing risk in retirement". Put simply, the traditional approaches of buying high yielding stocks or buying stocks and selling call options are fragile and exposed.

Most attention on the financial planning industry recently has been, quite rightly, on the graft and corruption exposed by Fairfax Media in some of our biggest institutions. But the wider, long-term question is how the industry will produce income for its clients and manage the new risks. One answer is to deploy two other great movements of the past 25 years – technology and deregulation.

Deregulation allows fund managers and individuals to make unlimited numbers of transactions at low cost without the requirement to use a full service broker or other third party. And sophisticated software allows instant monitoring of large numbers of price movements simultaneously.

The deployment of these two weapons allows a form of insurance with downside protection always in place through the use of put and call options to lock in the sale price of the shares, no matter how low the share price may go.

The theoretical knowledge for this approach has been around since 1973 when Fisher Black and Myron Scholes published a paper that was the basis for a Nobel prize in economics awarded 14 years later. Their work created one of the most important concepts in modern financial theory, the mathematical model for pricing derivative investment instruments, including options. Recent software developments have opened the way for new ways to apply the model with deeper levels of sophistication and speed.

Most fund managers will be searching for ways to adapt to the new market paradigms to deliver better returns in a sluggish investment environment. This introduces another risk for investors who may be at the mercy of unintended consequences of new investment products.

Some exotic products will be exposed as fatally flawed. A recent example is bank hybrids, which were supposed to be a cross between the safety of cash and the risk of shares, with a yield somewhere in between. Unfortunately, some investors have found that hybrids are capable not only of producing the best of both worlds, but also the worst.

Investors and trustees of self-managed superannuation funds need to get used to the marketing by financial planners of more novel products aimed at producing higher returns than the old formulas. Investors should look for strategies with a proven track record. Those asked to participate in novel approaches should check for safeguards, including a straightforward business model with minimal capital at risk at all times and a financially strong counterparty such as the ASX for hedging activities, be cautious about leverage within a fund, ensure instruments are traded on an exchange which provides transparency and ask questions about whether the offering is robust in all market conditions.

Craig Racine is managing director of Gyrostat Capital Management.

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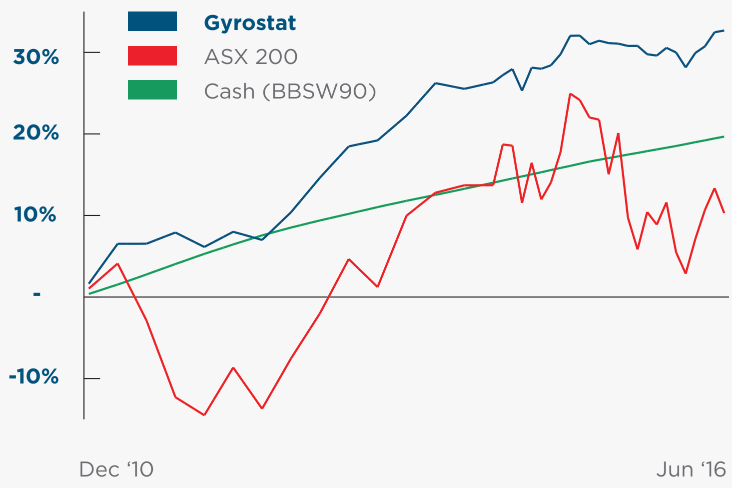
RISK MANAGED EQUITY FUNDS

If your objective is to generate a higher level of income than cash and term deposits, whilst always protecting and growing your capital investment...

...OUR FUND CAN HELP.

Risk managed equity income fund

- Minimum distribution cash rate plus 3% (currently 5.3%)
- Growing your investment on market rises or large 'one off' falls
- Protecting your investment when markets fall
- Compounded returns of 33% since inception
- 21 consecutive quarters of no losses exceeding 2%



WE BUY AND HOLD BLUE CHIP STOCKS AND PASS ON THE FRANKED DIVIDEND.

We simultaneously enter the Australian Securities Exchange ("ASX") options market to hedge risk.

We are always fully invested with minimal capital at risk.

Our Track Record of Returns:

Period	Gyrostat	ASX 200	BBSW 3M
31 Mar 2012	6.1%	-6.7%	4.9%
31 Mar 2013	7.6%	2.0%	4.3%
31 Mar 2014	7.1%	4.0%	3.8%
31 Mar 2015	6.7%	5.2%	3.6%
31 Mar 2016	5.1%	1.3%	3.3%

* compunded annualised returns since inception

Business Model - "How we invest"

Unit Trust

Investors purchase units in "Gyrostat Capital Stability Income Fund".

The fund net income is dividends and franking credits less expenses and the cost of protection.

Stock Market ASX

The fund simultaneously buys stock and enters ASX options market

Stocks are "buy and hold" to generate dividends and franking credits

Options Market ASX

For hedging risk only we use calls and put options to grow your investment when markets rise, and protect your investment when markets fall.

Daily management to restore risk-return profile from market movements

Technology & Deregulation

Software continuously monitors price movements to identify "least cost" alternatives to restore risk-return pay-off from market moves.

Deregulation enables low cost transactions

Further details available at:
www.gyrostat.com.au
info@gyrostat.com.au

Call: (03) 9041 0970

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