Atlantic Pacific Australian Equity Fund

ARSN 158 861 155

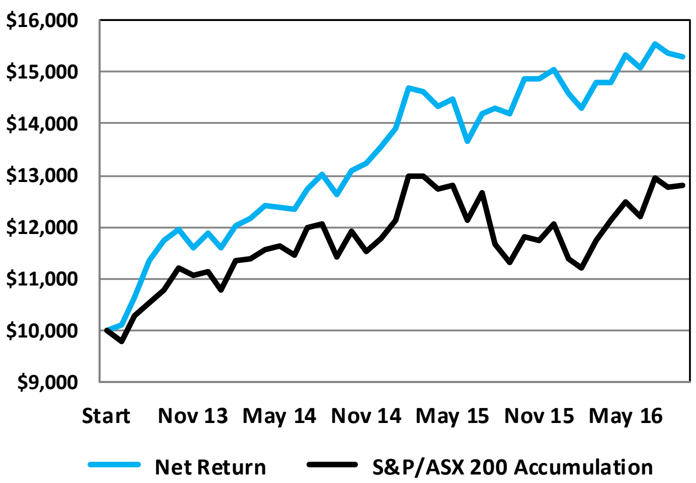
Fund Monthly September 2016

Return Summary

Period	1 mth	3 mth	6 mth	1 yr	3 yr (pa)	Cumulative	Per Annum
Fund Return	-0.5%	1.3%	3.5%	7.7%	9.2%	52.9%	13.6%
S&P/ASX200 Acc.	0.5%	5.1%	9.3%	13.2%	6.0%	28.2%	7.7%
Excess return	-1.0%	-3.8%	-5.8%	-5.5%	3.2%	24.8%	5.9%

Fund Returns are prepared on a mid unit price basis after management and performance fees inclusive of GST. Distributions are assumed to be re-invested at the mid unit price. Individual tax is not taken into account in deriving Fund Returns. In calculating the NTA, the Atlantic Pacific Australian Equity Fund ("Fund") asset values have been calculated using unaudited price and income estimates for the month being reported. Past performance is not indicative of future performance.

Cumulative Returns of $10,000



Fund Strategy

The Fund is a long-bias equity market product which typically buys or short sells Australian listed securities and derivatives. Net and Gross market exposure is maintained within a range of 0-100% and 0-200%, respectively.

The Investment manager employs their Quadruple Alpha Investment Strategy which focuses on outperforming over all market cycles by capturing upside returns while minimising downside risk.

The objective of the Fund is to outperform the benchmark by greater than 5% pa after fees over a 5-7 year time frame.

Market Overview and Fund Activity

The Australian equity market made a 0.5% gain much to our surprise after being down 3.8% at one point during the month. Performance across sectors was driven by expectations of rising long bond yields globally as well as some recovery in industrial related commodity prices. In the case of bond yields, sentiment was driven in part due to various central banks supporting the notion that the efficacy of their quantitative easing programs were waning. Further, strength in the US economy driven by employment markets and industrial production is supporting the odds of rising interest rates in the US. This was a major turning point in equity markets with performance dominated by interest rate sensitive companies underperforming, with Property and Telecoms falling over 4%. Utilities also fell 3% tying directly to this bond dynamic. We have also witnessed a number of the high expected growth companies underperform which is as much a second derivative outcome of higher bond rates as higher discount rates have a disproportionate effect on their future earnings. We had been quite skeptical of performance in all of the dominant online companies (REA: REA Group, SEK: Seek, CAR: Carsales.com and TME: Trade Me) with price performance over the past couple of years solely driven by PE expansion.

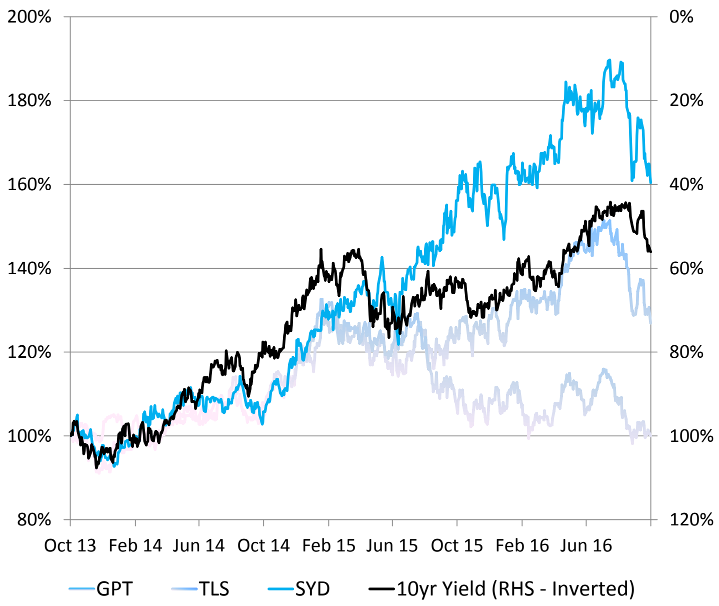
Curiously, Banks and Insurers which are positively disposed to rising long bond yields, failed to make much ground to offset the losses in the market elsewhere. In the case of QBE Insurance, it was clear there was a quarter-end sell program which we accumulated into over most of the month of September. While the company's recent reporting was weak and in hindsight we started too early in accumulating the position, the extent to which the company was continually sold off into quarter-end provides price asymmetry in our view over the medium term.

APSEC FUNDS MANAGEMENT

Fund activity during the middle of the month was also associated with buying heavily oversold company shares. To put this in perspective, the Australian market exited July 2016 in an extreme overbought state driven by the reduction in the cash rate by the RBA. This was completely reversed just over a month later with the market moving into an extreme oversold state. These are manic market gyrations which are not normal. Examples of company shares that were accumulated which moved into an extreme oversold state included Sonic Healthcare (SHL), Brambles (BXB), Dulux Group (DLX), Tatts Group (TTS) and GPT Group (GPT). In neither case does the Fund own any of these shares but overall the rebound in share prices provided positive performance. Other highlights included Challenger (CGF), Rio Tinto (RIO), Banking exposure (NAB: National Australia, CBA: Commonwealth Bank) and Universal Coal (UNV). Offsetting the positive attributes of performance were individual company exposures. Santos (STO) fell over 18% through the month against the overall tide of rising energy prices. Our position in Magellan Financial Group (MFG) also materially detracted from performance despite accelerating flows into their products. We also reduced market exposure when markets fell precipitously which led to a slower grind higher into the end of the month.

Outlook

We have written many times over the past year on the eventual increase in US interest rates. It has been a slow process but now and then it takes the world's attention. This has significant global implications across all asset markets and in particular various sectors that have been the mainstay of many equity portfolios. Unfortunately, the Fund has had little exposure to this thematic since inception and very little of late. In the attached chart, we provide a graphical view on the Australian 10 year yield (black highlight and inverted) and how it has performed over the past three years. What is clear from this chart is that yields have sold off (rising line on chart) in line with general easing in global interest rates or expectations of a slower upward trajectory in the major markets of the US and Europe. From an Australian context, while the short term (not shown) has been dominated by domestic issues, the long end (eg 10 year) is affected by global dynamics with any sense of changing expectations likely to impact long bond yields quite quickly and en-masse. The recent increase in long end yields has been a global phenomenon and one which central banks can do little to control except for "twist" operations (ie buying the long end) which appear to be waning in their use. We have provided examples of three companies which have natural leverage from falling yields. A Property Trust, (GPT: GPT Group), a Telecom (TLS: Telstra) and an infrastructure company (SYD: Sydney Airports). Each has their own idiosyncratic business drivers but one has to view the input of long bond yields in the same way as one would consider commodity prices for a mining company. When bond prices go up (yields fall) we would expect companies exposed to yield arbitrage or where there is high leverage to rise as well. This is clearly represented in the case of the three companies presented. At each point when yields rallied (bond prices fell) there was a slowing or a reduction in the price growth of the company's share prices. This has become even more exaggerated for the likes of SYD more recently as the company's valuation had become stretched relative to the stable but slowly growing revenues ie yield alone has caused the significant underperformance in their share price recently as yields have rallied. Therefore, if we take the view that global rates will rise with a faster trajectory across the curve (curve steepening), then we must position for companies that are likely to benefit/lose from such dynamics. Companies like those above are likely to continue to lose.

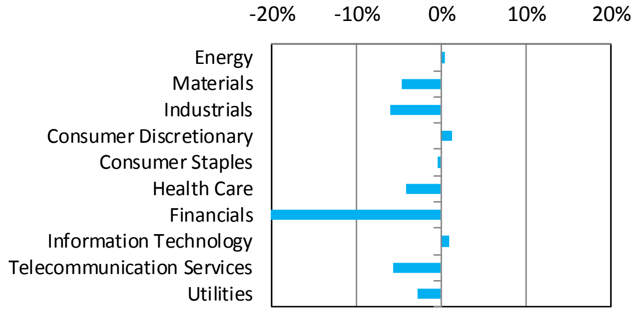


As at the time of writing, the Fund has transitioned to the new investing framework with the ability to short individual equity securities, albeit late to take advantage of the recent sell off in the interest-rate sensitive space. We will be looking to opportunistically implement the full coverage of our mandate (long and short) over time with interest rate sensitive companies a key component of our strategy. Like the Fund's underweight to Resources and Banks in the first couple of years of operation, this is a major macro distortion which we expect to provide major opportunities over coming months.

Risk Statistics

	Fund		Index	
	3 Year	Inception	3 Year	Inception
Alpha (%pa)	3.2%	5.9%		
Downside Capture	58%	53%		
Standard Deviation	9.0%	9.5%	12.4%	12.3%
Sharp ratio	0.8	1.2	0.4	0.5
Sortino		2.1		1.0
Largest Drawdown	-7.1%	-7.1%	-13.7%	-13.7%

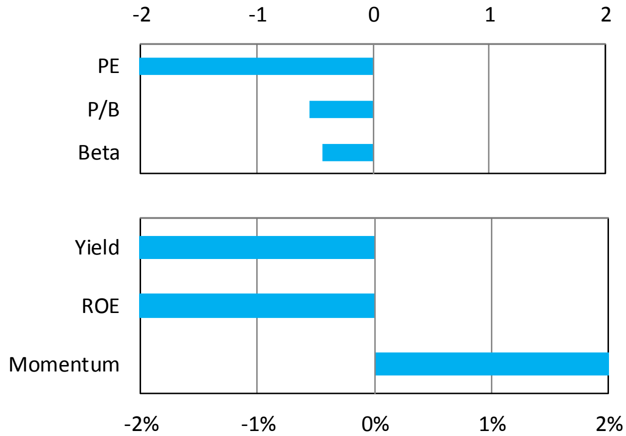
Sector Exposure



Exposure

	Long	Short	Net	Gross
Equity	58%	0%	58%	58%
Index Futures			0%	0%
Net	58%	0%	58%	58%
Cash			42%	

Factor Exposure



Contribution

Positive	Negative
Challenger	Magellan Financial
Rio Tinto	Mesoblast
Sonic Healthcare	QBE Insurance
Universal Coal	Santos

Fund Information

APIR Code	OMF0003AU	Responsible Entity	Equity Trustees Limited
Inception	1 June 2013	Investment Manager	APSEC Funds Management
Minimum Investment	$10,000	Administrator	FundBPO
Application/Redemption	Monthly	Custodian	FundBPO
Management Fee	2.0%	Prime Broker	Interactive Brokers LLC
Benchmark	S&P/ASX200 Accumulation	Auditor	PriceWaterhouseCoopers
Performance Fee	15% above S&P/ASX 200 Accumulation + 3%pa subject to a high water mark		
AUM of Fund	AUD$26.19m	Application Price	1.2948
Mid Unit Price	1.2935	Redemption Price	1.2922

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Important information