Atlantic Pacific Australian Equity Fund

ARSN 158 861 155

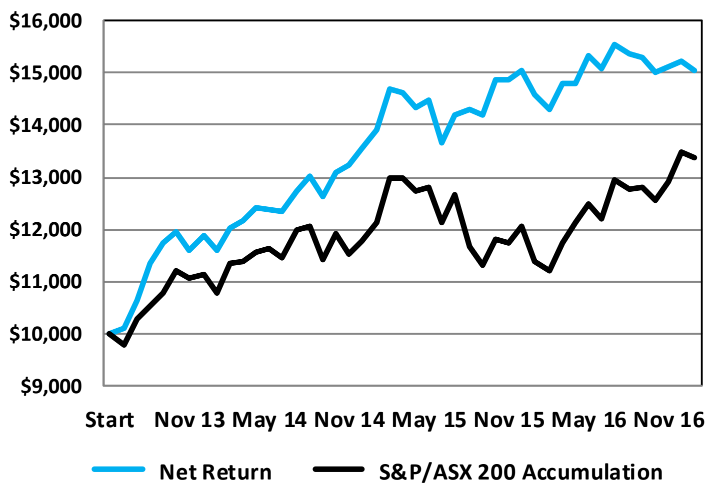
Fund Monthly January 2017

Return Summary

Period	1 mth	3 mth	6 mth	1 yr	3 yr (pa)	Cumulative	Per Annum
Fund Return	-1.0%	0.3%	-3.2%	3.2%	9.1%	50.6%	11.8%
S&P/ASX200 Acc.	-0.8%	6.6%	3.2%	17.3%	7.4%	33.7%	8.3%
Excess return	-0.2%	-6.3%	-6.4%	-14.1%	1.7%	16.8%	3.6%

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 - **The Australian equity market fell 0.8%** over the month of January 2017, underperforming the US market which rose 1.79%. Partly to blame for local performance was the Financials sector (down 2%) after the very fast appreciation in prices over November and December 2016. It is a good outcome to see some of the heat come out of Australian Banks as the bottoming in Net Interest Margins (NIMs) has not occurred which would ordinarily be associated with the fundamental reason for positive performance of our local banks. **Expansion in NIMs is a significant determinant of the value proposition for any bank** as the long end of the yield curve rises faster than the short end. This in turn should lead to higher pricing of a bank's assets (lent money) while at the same time a bank's liabilities (deposits) are kept lower on a relative basis. Looking across all of the results at the time of writing (National Australia Bank, Suncorp Group and Bendigo & Adelaide Bank), there appears to be little evidence of better margins for the banks much to our surprise. From what we can gather so far the coordinated rally in Australian banks with their global peers appears to **be driven by flows** with valuations rising from mid-range to now at the top of their historical ranges. It is certainly the case that passive money has made the most of the illiquidity of markets over the Christmas period and now into January. Peculiar to the Australian market, **the Santa rally appears to be a phenomenon of the Australian market with ~45% of full year returns over the past 3 years attributable to the month of December**. Growth companies have come under increasing pressure with earnings misses on high valuation companies being met with significant underperformance. Aconex (ACX), which the fund had no exposure to, fell over 40%.

Bellamy's (BAL) (the Fund had exposure in December 2016 but the position was liquidated on the first day post their December 2016 profit shock), fell another 37% after being in a trading halt for many weeks. Virtus Health (VRT) also downgraded profits leading to an 18% fall. On the positive side, resource and related companies led the way with commodities generally buoyant over the month. BlueScope Steel (BSL) had another profit upgrade and so far for the larger Contractors (Cimic Group, Downer EDI) have shown better results than expectations.

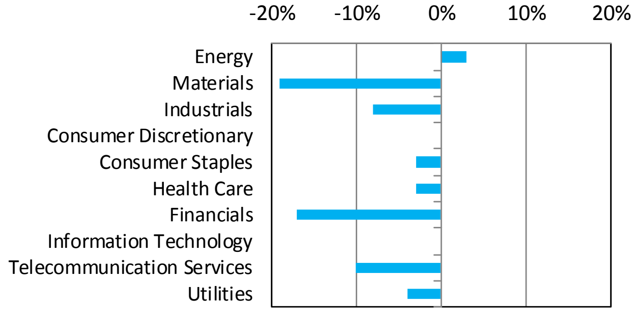
Fund Activity **has in the past been focused on gaining exposure to an improving US outlook.** The way in which we have typically implemented this view has been through companies exposed to US earnings. The Fund took a hit from one of the companies in this basket with Brambles (BXB) downgrading guidance by around 5% which resulted in a 16% hit to their share price. While input cost increases and inventory management in the short term have been viewed negatively, given the potential for improved activity in the US as well as for a reduction in corporate tax rates in the US, it is our view that the company's share price hit is overdone and we remain invested. There have been other companies that we have observed over the last 6 months which have been similarly impacted by cost increases without the commensurate impact to share prices - we made mention of James Hardie (JHX) in November 2016 to that effect. This same cost impost we also surmised for Ansell (ANN) which we liquidated during January 2017 around $24.20. Rubber prices (which are a major component of latex prices) have risen by over 100% from the lows around the middle of the year. At the time of writing, the company has indicated a significant impost from the rise in input prices which have yet to be offset by rising product prices. We suspect that input cost pressure for manufacturers operating in the US will be a continuing feature of the reporting season. **Premier Investments (PMV) were also an underperformer** over the month falling ~11% in unison with many other retail companies. This is in stark contrast to the underlying demand for apparel in the Australian market which over the past half has been one of the strongest components of retail trade. At the time of writing, PMV have guided to positive earnings growth with very little change in expectations which has led to a strong relief rally. On the short side, we have taken various short term trades either because they were overbought or where we thought prices had moved ahead of fundamentals. ARB Corporation (ARB) is an example where we took a short position around $17.90. The company was trading on multiples of over 26x forward earnings with high single digit earnings growth. This doesn't generally make sense compared to other companies with lower valuations and higher growth. We were able to trade out around $16.70 with the price subsequently falling another $1.20. **REA Group (REA) is another expensive company that we view unjustified** despite their ability to control revenue outcomes in an effective oligopoly with Domain. But when volumes fall dramatically as is the case currently with online listings of homes, it leaves very little room for a re-rating. We were also able to liquidate the Fund's position in Greencross (GXL) around $7.12 which we had thought was a little overpriced for the risk associated with the Western Australian business. **A few of the smaller companies we have held in the portfolio for some time were also liquidated partially** including Liquefied Natural Gas (LNG) around 88c and Mesoblast (MSB) around $1.70. The Fund's strongest large cap performer through the month was Treasury Wine Estates (TWE) which we accumulated further around the lows. After a period of underperformance relative to other large companies, the market has started to re-price the evolution of their value. Not only are volumes growing strongly into Asia and other parts of the developed world together with the removal of low value product, they are now starting to benefit from an uplift in pricing for their premium products driven by Asian consumers who are forcing higher prices globally. This should bode well for future earnings over coming years.

Outlook - **We are now at the start of the February reporting season.** As we have noted in the past, this is one of the most important periods in the share market outside of general macroeconomic dynamics which may move markets otherwise. **We are confident in the companies we have accumulated over the last couple of months** and are very sensitive to earnings downgrades which may lead to permanent loss of capital. The Fund has already had 2 negative pre-reporting events in the space of 2 months. As always we attempt to minimize these outcomes in line with our overall capital preservation philosophy. Downgrades are a normal outcome for most portfolios and sizing becomes paramount to minimize the impact. **We remain on the sidelines with respect to Australian banks** as there has been no noticeable improvement in earnings dynamics with the spectre of high valuations and a property retracement likely on the horizon which will lead to underperformance driven by global investor selling.

Risk Statistics

	Fund		Index	
	3 Year	Inception	3 Year	Inception
Alpha (%pa)	1.7%	3.6%		
Downside Capture	53%	57%		
Standard Deviation	8.6%	9.2%	12.6%	12.1%
Sharp ratio	0.8	1.0	0.5	0.5
Sortino		1.8		1.2
Largest Drawdown	-7.1%	-7.1%	-13.7%	-13.7%

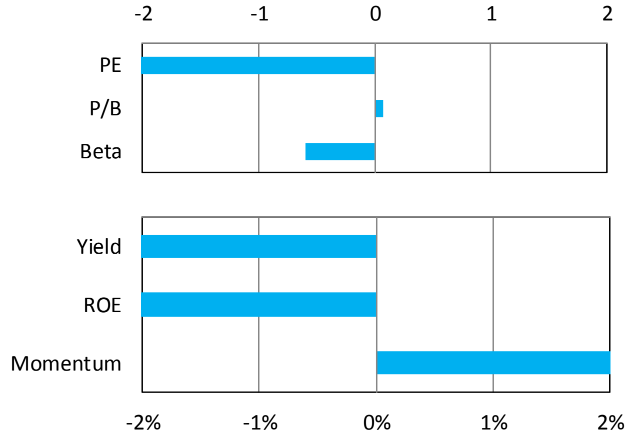
Sector Exposure



Exposure

	Long	Short	Net	Gross
Equity	88%	-8%	80%	97%
Index Futures			-41%	41%
Net	88%	-8%	39%	137%
Cash			19%	

Factor Exposure



Contribution

Positive	Negative
BHP Billiton	Brambles
Liquified Natural Gas	Newcrest Mining
Mesoblast	Norwood Systems
Treasury Wine Estates	Premier Investments

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