

Atlantic Pacific Australian Equity Fund

ARSN 158 861 155

Fund Monthly December 2017

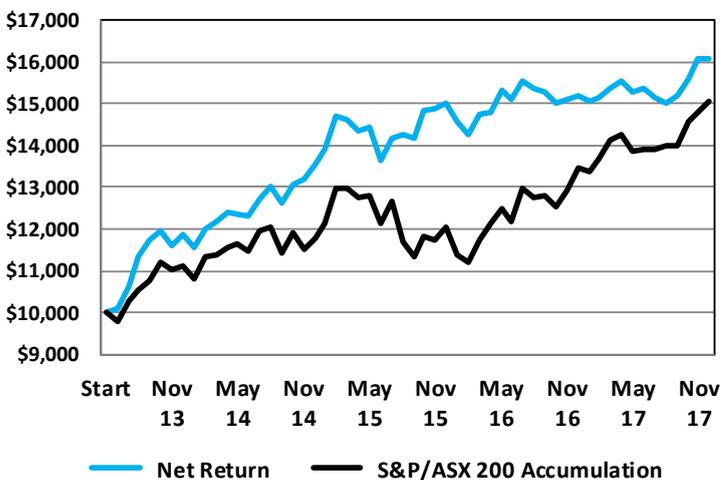
Return Summary

Period	1 mth	3 mth	6 mth	1 yr	3 yr (pa)	Cumulative	Per Annum
Fund Return	0.1%	6.0%	4.7%	5.9%	5.9%	60.9%	10.9%
S&P/ASX200 Acc.	1.8%	7.6%	8.4%	11.8%	8.6%	50.7%	9.4%
Excess return	-1.7%	-1.6%	-3.7%	-5.9%	-2.8%	10.2%	1.6%

Fund Returns are prepared on a redemption 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.

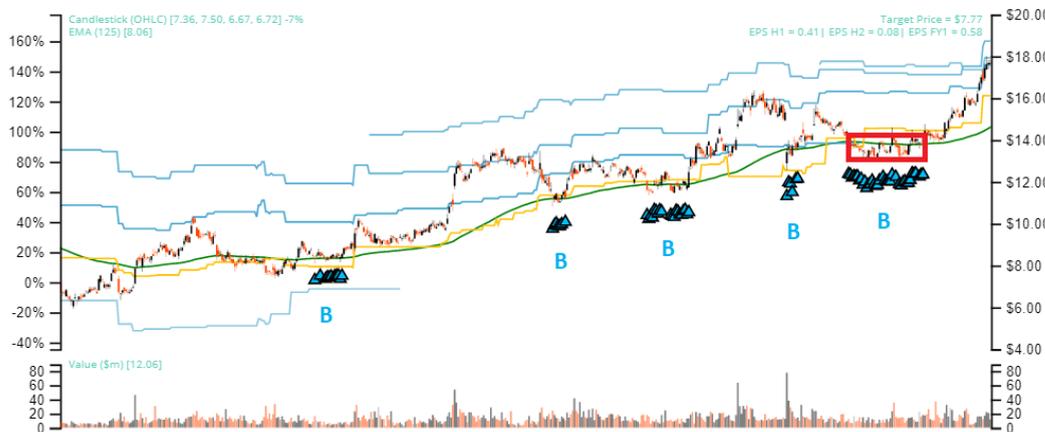
The objective of the Fund is to outperform the benchmark by greater than 5% pa after fees over a 5-7 year time frame.

Market Overview - The Australian equity market ended the year on a high rallying 1.8%. The traditional Santa-rally, coinciding with the payment of bank dividends in late December, was anaemic this year. This is not surprising as it is a phenomenon which is spoken about each year but does not always materialise. Dominating performance in the Australian market was the energy sector (+6.4%) driven by strong gains in crude oil where WTI spot rose 4.7%. Similarly, the materials sector performed strongly up 6.2%. The performance in materials was a little circumspect with BHP Billiton (BHP) essentially rising in a straight line. This price behaviour we generally avoid as in our view it looks too good to be true (see chart to the left



with short term channel highlighted) and has the hall mark of manipulation. Either way, the price moved into an extreme overbought state and above analyst target prices and we exited our position in early January 2018 on the first break of the trend around \$30. In the case, of the oil sector, we maintained our position in Oilsearch (OSH) which rose over 10% for the month. For those who have had the opportunity to road-test HALO, we present a practical example of one of the key monitors we use for assessing the

attractiveness of a company. We have devised a screen which encapsulates a “double-blessing” – we call this screen the “Fakey-Shakey”. While the hit rate of the signal has not been provided, logically it makes a lot of sense. The signal focuses on the twin-pillars on how we view asymmetry. The first pillar is the presence of rising EPS revisions (EPS = Earnings per share). There is an abundance of evidence that supports the notion that positive EPS revisions are supportive of positive share price performance. The persistency and consistency of this signal is so powerful that an entire industry is built upon it! Quantitative strategies, which account for a significant chunk of active equity-based strategies, explicitly use this information to construct their portfolios. The second component to the “Fakey-Shakey” signal, where upon the name is derived (“The Fake Shakedown” by short term institutional sellers) is the mean reversion price component which compares the current price to the 6-month exponential moving average. Where the price of the security falls below the 6-month trend and the rising EPS revisions are telling us that the price is likely to continue, then buying at the bottom of the trend is essentially an optimal time to buy. To put this in context, we initiated a position in Sims Metals Group (SGM) during the accumulation phase as per the



red box (with blue triangles underneath representing the timing of the signal) highlighted in the chart to the left. SGM rose 12.5% during the month and was our largest contributor to returns. Looking at the chart, the “Fakey-Shakey” signal has identified pretty much every buy-trough signal, highlighted by the symbol, B. And this in our

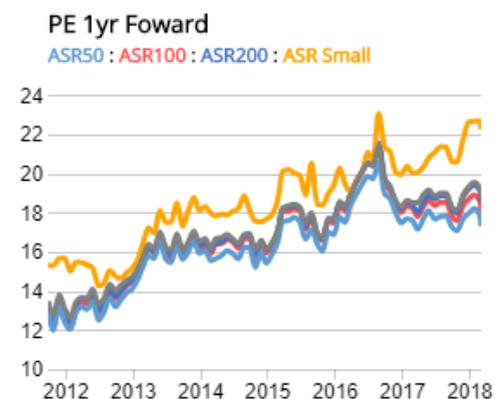
view is no coincidence. You will see more and more of an explanation and usage of this signal as times goes by. Other opportunities that were used to target investment using the “Fakey-Shakey” signal over the month include OZ Minerals (OZL) where we accumulated further stock around \$8, Alumina (AWC) was initiated based on two spike-down days during the month and CSR provided a weaker signal as well. Similarly, we accumulated BT Investment Management (BTT) based on the signal but it didn’t amount to much over the month. We also took the opportunity to purchase Fortescue Metals Group (FMG) during the month around \$4.59. This is in part due to the belief that negative sentiment regarding the discount the company accrues on their low-grade ore had reached hysterical levels and the company prints money on a very large scale with pricing too cheap. We will re-assess our position leading into the company’s quarterly as they will release an update on the discounting that has occurred over the quarter – we will look for a basing of this discount with any positive guidance seen as “rocket fuel” for the share price.

As the tone of the message above shows, the resource sector was very much in vogue over the month. However, our position in Universal Coal (UNV) which to some extent has been a very deep value opportunity that we have pursued for many years (4-5x Price to earnings with generally stable pricing for their product with growing international coal price exposure offset by Rand risk) bucked the trend, underperforming the materials index by almost 10%.

Other detractors from performance included our Banking positions with both National Australia Bank (NAB, -0.1%) and Westpac Banking (WBC, -0.4%) underperforming the overall market. The Australian banks offer mid-range valuations with generally anaemic earnings projections. In light of rising bond yields, and generally positive correlation therein (albeit not from a fundamental perspective given their reliance on more expensive offshore funding) we had expected better performance particularly as dividends were re-invested. But to no avail. We await their updates in coming weeks as to whether they remain of interest to us. Norward Systems (NOR), an evolving technology company which we have owned for quite some time, also detracted from returns. Unlike the prior month where the share price rose 61%, the company’s share price fell 27%. We are not entirely sure why we are seeing such volatility in their share price but is to be expected given this is typical price behaviour for a smaller company. We remain hopeful that contracts within the global compliance space (driven by global regulations) will bear fruit over coming months.

Outlook – As is always the case, January is a particularly important month for us as we prepare for the upcoming reporting season where most companies will provide an update on their half yearly financial reports. While resource companies are expected to do well with very impressive earnings revisions of late (~20%!) leading into their reporting

dates, there will always be other companies through this period from which we will be able to re-assess once they report. But the difficulty of late has been rising valuations that are now appearing across the market coupled with weak to negative earnings revisions outside of the cyclicals (materials, construction, energy) - if it weren't for resource companies, we suspect the Australian market would continue to underperform global benchmarks (Europe and US) which have had rising trends over the past 6-12 months. The graph to the left shows how valuations have continued to ratchet up without any commensurate increase in earnings expectations. We are always mindful of this dynamic and believe all investors should too.



We are also mindful of rising interest rates which are now being driven by the US. While many commentators will point to the potential for rising inflation expectations (partially driven by rising commodity prices), this thesis will inevitably be proven wrong as the cyclical components of inflation will be temporary because there is a more powerful force at play here. As such, our focus is more attuned to the unfunded fiscal stimulus that is likely to take hold in the US. As the US fiscal deficit rises this will lead to rising long bonds due to higher risk premiums associated with owning US bonds. In effect, this interest rate signal could “kill the golden goose” that the Republicans hope will endure the economic cycle. But business cycles are business cycles. Excessive stimulation will eventually lead to a very steep downward trajectory from atop of the economic hill. In the short term though, rising bonds will have detrimental effects similar to what was witnessed early on in the cycle during mid 2016 i.e. high valuation and interest rate sensitive companies are likely to underperform.

Risk Statistics

	Fund		Index	
	3 Year	Inception	3 Year	Inception
Alpha (%pa)	-2.8%	1.6%		
Downside Capture	62%	59%		
Standard Deviation	8.0%	8.5%	11.4%	11.2%
Sharp ratio	1.0	0.1	0.7	0.1
Sortino		1.3		1.3
Largest Drawdown	-7.1%	-7.1%	-13.7%	-13.7%

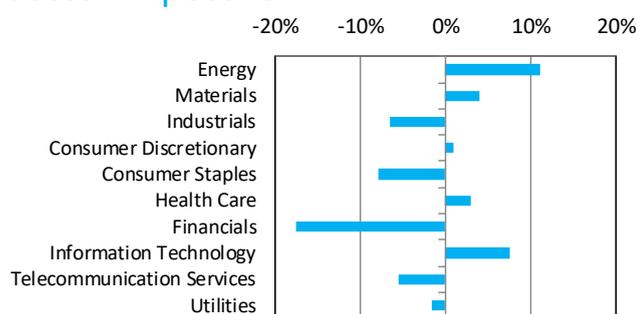
Exposure

	Long	Short	Net	Gross
Equity	88%	0%	88%	88%
Index Futures		0%	0%	0%
Net	88%	0%	88%	88%
Cash			12%	

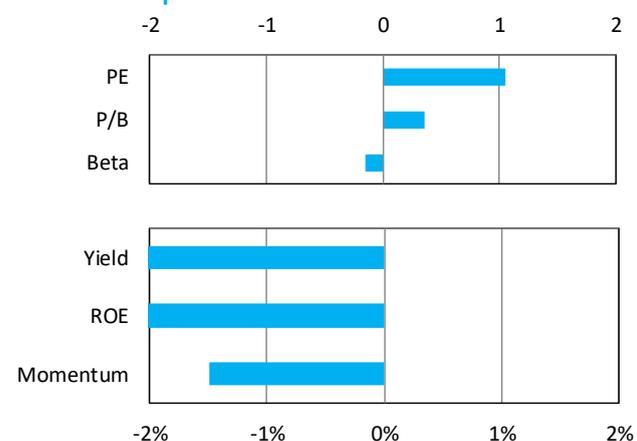
Contribution

Positive	Negative
BHP Billiton	Norwood Systems
Magellan Financial	Universal Coal
Oil Search	
Sims Metal	

Sector Exposure



Factor Exposure



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	1.2938
Mid Unit Price	1.2925	Redemption Price	1.2912

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