Atlantic Pacific Australian Equity Fund

ARSN 158 861 155

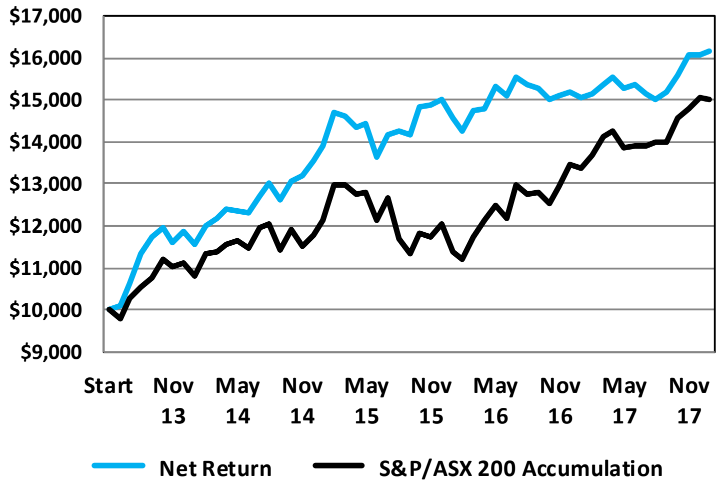
Fund Monthly January 2018

Return Summary

Period	1 mth	3 mth	6 mth	1 yr	3 yr (pa)	Cumulative	Per Annum
Fund Return	0.4%	3.5%	6.7%	7.4%	5.1%	61.5%	10.8%
S&P/ASX200 Acc.	-0.4%	3.0%	7.9%	12.2%	7.3%	50.0%	9.1%
Excess return	0.8%	0.4%	-1.2%	-4.8%	-2.2%	11.5%	1.7%

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.

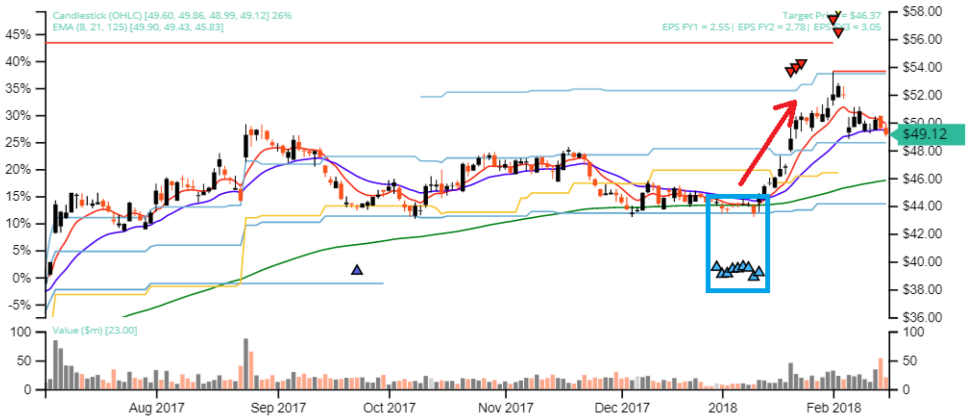
The objective of the Fund is to outperform the benchmark by greater than 5% pa after fees over a 5-7 year time frame.

Market Overview

- The Australian equity market ended the month down 0.45% after ratcheting higher in the early part of the month, up 1.3%, coinciding with the frothy US market. After the 9th of January 2018, the Australian market decoupled and exhibited extremely choppy behaviour. This eventual under-performance was broadly based with Australian banks, materials and energy sectors leading the way down. We are not entirely sure why Australian banks did not follow their global peers up as bonds started to sell-off. This positively correlated movement with offshore peers has been typical in years gone by but not this time. Perhaps market participants are finally waking up to the fact that rising US bonds are not a great outcome for Australian banks as we have mentioned many times in the past. Nonetheless, the US market stole the show rising 7.45% at its peak on none other than Australia Day…no such exuberance on our shores. If we were to translate US returns (5.6% in USD) to our market with Australian dollars, the return for the month would have been closer to 2.4%, much less impressive. Curiously, oil prices (as per WTI spot) rose almost 8% with our energy sector down for the month. Clearly, a substantive sell program hit Australia with potential flows moving back to the US and other parts of Asia.

In terms of company specific news, Sirtex Medical (SRX) which the Fund did not own, achieved a return of 66% for the month after receiving a very generous takeover offer. This company has been one of the more colourful over the past 18 months with a high around $35, lows around $11 and finally seeing an end to Australian listed equity status @ $28. On the other end of the spectrum, we saw Retail Food Group (RFG) (previously a fund holding in years gone by but no longer) continued its slide to lower prices after their disastrous profit downgrade during the early part of January 2018. They say it's a timing issue, but the market couldn't care less with a further 20% downdraft…such a good business if managed right but appears to have not kept up with the times with various retail formats failing.

Fund activity was dominated by selling down a number of super-hot share prices in the early part of the month. As we noted last month, we sold down our BHP Billiton (BHP) holding as it had powered to what we considered fair value. Similarly, we liquidated part of the Fund's Universal Coal (UNV) position into strength as the company upgraded guidance. It is quite extraordinary how a lower margin entity can upgrade earnings once their main commodity price ascends with attributable EBITDA upgraded by almost 50%. Full year guidance has also been upgraded by 35% and we believe this is being conservative. In the context of the company paying out their maiden dividend of 1c per share recently (around AUD$5m was paid out), one can surmise what the likely payout will be over coming years if they are able to maintain their full year guidance of almost $38m EBITDA. Even if they were able to pay out 3c (or AUD$15m out of $38m) such that they have enough cash to support growth options, the company will still be on a yield of over 10%. We have no idea how much they intend to payout but it would seem reasonable they would pay out at least 2c (1c per half) with an additional 1c from the upgrade. We have watched the evolution of this company for a long time and the company remains too cheap in our view. Time will tell but whichever way we look at the fundamentals of the company, we have a sense we are on the right side.



In terms of our recent disclosure regarding the use of HALO to provide investment ideas, we used this to great effect over the month. Once again, the "Fakey Shakey" signal was used judiciously. In particular, we accumulated Flight Centre (FLT) during the month around $44.10. As per the chart to the left, the FLT share price went below the 6-month trend in prices against a backdrop of rising earnings, resulting in the signal being triggered. The subsequent performance witnessed over the remaining part of the month was pleasing as it had been on our radar for the reporting season through February 2018. We believe after many horror years of persistent downgrades the company is on the cusp of continuing its trajectory that was typical of earlier phases in their growth. We rate the company very highly and will hold through their report subject to asymmetry in price remaining. We also re-entered Treasury Wine Estate (TWE) but this was a classic mean-reversion trade (as per the chart below). We unfortunately did not hold on long enough to accrue the return that transpired. We rate the company highly (especially their premium wine products) except we don't like the valuation. Therefore, in instances like these we will typically allocate much lower capital. In the case of TWE, we are not sure why the share price was sold down aggressively for almost 3 weeks starting prior to Christmas 2017, however, the resulting capitulation at the end (as per the blue box) presented a strong chance of outperformance. Inexplicably, the short-term oversold state moved into a short-term overbought state (as per the green box) within a matter of days. That is very rare and is not something that one should expect. However, what is clear from our use of HALO, there are various forms of price movements which can be modelled and tactically implemented for both short-term and long-term gain. We hope as investors in the fund these simple expositions provide more information and enable a better understanding of our process as it will only become more streamlined using HALO.

Outlook – At the time of writing, we are now in the heart of reporting season. The resources sector has been able to show strong production records in late January/early February which has supported the notion that top line revenues will be strong. However, the insight from the updates of South32 (S32) and Whitehaven Coal (WHC) suggest that costs are a large swing variable for many of the cyclicals and has resulted in sizeable downgrades. This is of paramount importance as the resource sector has seen enormous revisions (20%!) leading into the reporting season. If these revisions are an artefact of analyst reasoning rather than reality then from the perspective of the market being able to continue to rally due to these revisions is most likely a mirage. As we noted last month, if it were not for the resource sector, the Australian market would be unlikely to rally in line with other global equity markets simply due to the fact that our domestic companies are not rising in line with global economic aggregates, which other regions are seeing more broadly. This is most likely due to other regions being more generally sensitive to global economic activity. When the dust finally settles across the market post reporting season, we will re-assess our portfolio positioning which has tended to be quite conservative.

As we noted last month, US interest rates and hence global long bonds are on the rise. Unfunded Fiscal deficits are the main risk factor outside of cyclical inflation. Wage inflation is a mirage and does not look to be making much progress anywhere. Consequently, there appears to be uncertainty with respect to the rise in the price of global credit and how it is transmitted to economies. But to be frank, it is quite simple. Long duration assets will underperform in that environment. With debt ratios globally at all-time highs, from governments and consumers alike, any re-pricing of credit will lead to the other side of the business cycle contrary to what we have witnessed over the past 10 years. Be ready because it is coming. Now is the time to be vigilant on high valuations.

Risk Statistics

	Fund		Index	
	3 Year	Inception	3 Year	Inception
Alpha (%pa)	-2.2%	1.7%		
Downside Capture	60%	58%		
Standard Deviation	7.9%	8.5%	11.4%	11.1%
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%

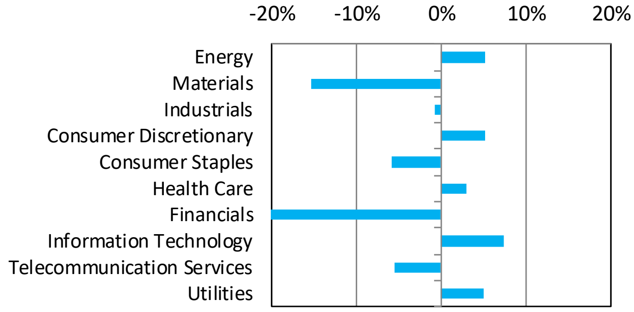
Exposure

	Long	Short	Net	Gross
Equity	74%	0%	74%	74%
Index Futures		0%	0%	0%
Net	74%	0%	74%	74%
Cash			26%	

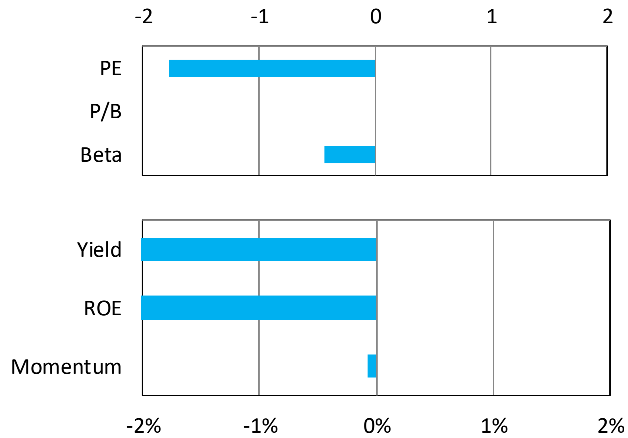
Contribution

Positive	Negative
Flight Centre	Mesoblast
Fortescue Metals	Norwood Systems
Sims Metal	
Universal coal	

Sector Exposure



Factor Exposure



APSEC FUNDS MANAGEMENT

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		
Mid Unit Price	1.2706	Application Price	1.2719
		Redemption Price	1.2693

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