Atlantic Pacific Australian Equity Fund

ARSN 158 861 155

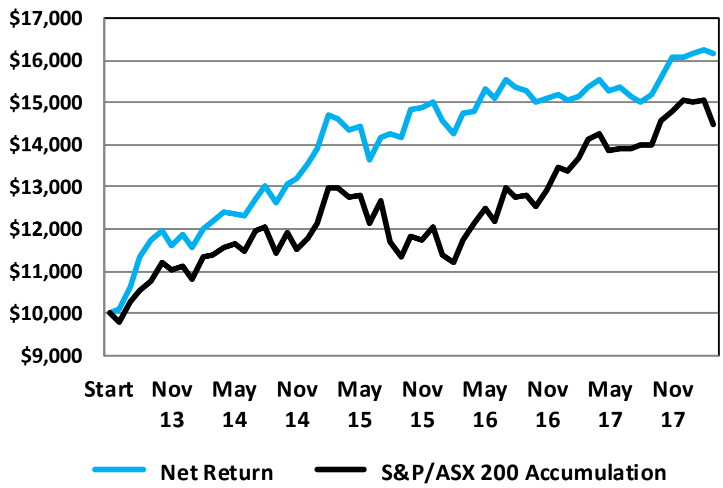
Fund Monthly March 2018

Return Summary

Period	1 mth	3 mth	6 mth	1 yr	3 yr (pa)	Cumulative	Per Annum
Fund Return	-0.69%	0.4%	6.5%	5.1%	3.5%	61.6%	10.4%
S&P/ASX200 Acc.	-3.77%	-3.9%	3.5%	2.5%	3.8%	44.9%	8.0%
Excess return	3.08%	4.3%	3.0%	2.5%	-0.3%	16.7%	2.5%

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

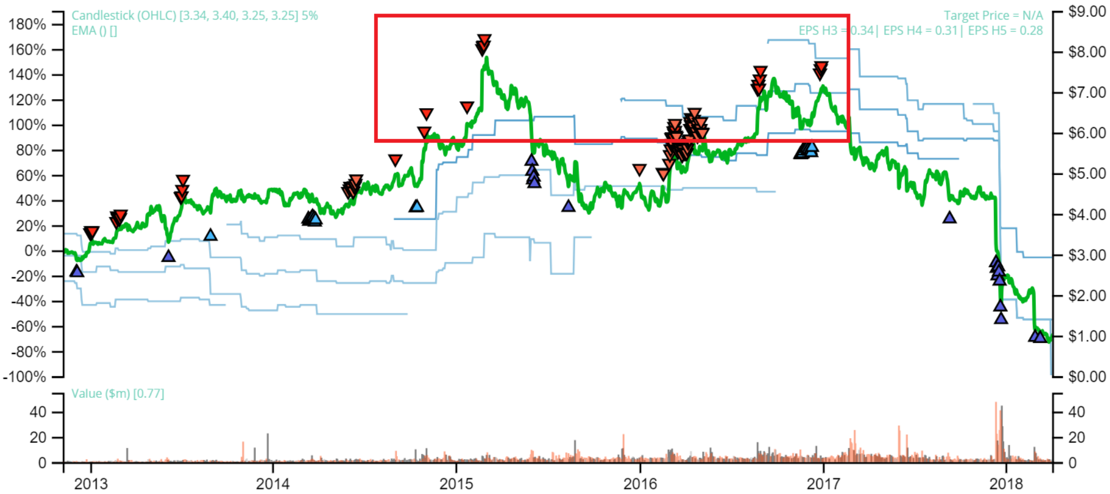
The Fund is a long-bias equity market product which typically buys or short sells Australian listed securities and derivatives. Net and Gross market exposure is maintained within a range of 0-100% and 0-200%, respectively.

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.

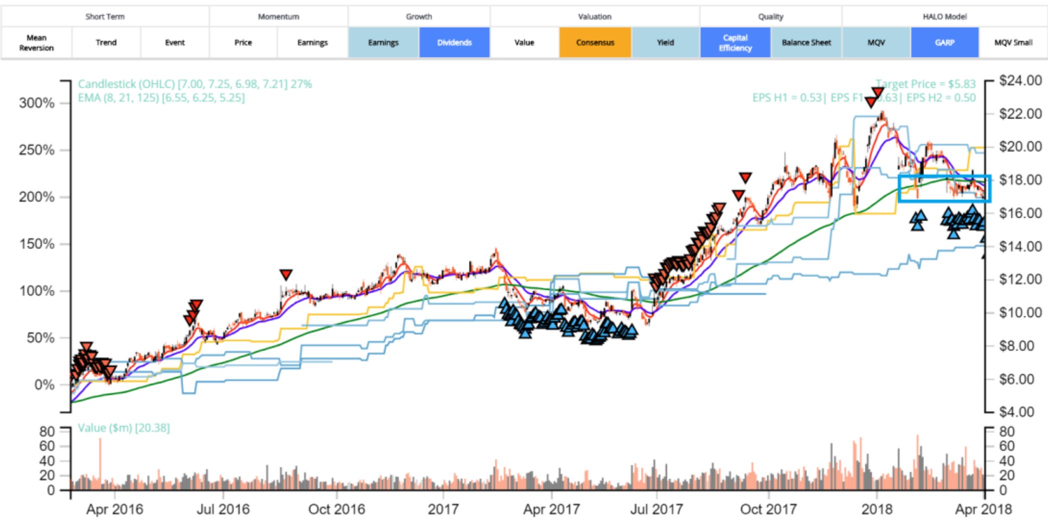
Market Overview

The Australian equity market ended the month down 3.8% after falling essentially from the get-go to finish on lows. Negative performance of this magnitude was felt across the globe albeit Australia fared the worst. The main driver of the late month falls was an indication from the Trump Administration of tariffs to apply to various commodities. This has initially led to a sell-off in China demand related names (eg Resources) and in some respects, would explain the outsized impact Down Under. The one point to note is that broadly the actions that Trump indicated during his election campaign are now becoming a reality. Global trade related noise was always a risk for markets and was certainly the initial fear on the day of his election as e-minis fell limit down in Asian time zones. How the emerging policies transpire over the coming year will require some very adaptive process to protect capital. Once again, we have been able to implement our adaptive process over the month in order to minimise capital loss. When looking at negative months in the market of over 2% since inception of the Fund, the Fund has had an almost perfect track-record of outperformance with 11 months out of 12 months where the performance of the Fund has beaten the market and in some cases quite materially. This is an attractive attribute of the Fund’s return profile and one that is very rare. In terms of sector performance over the month, it was the heavy-weight sectors of Banks and Materials which underperformed. This is not surprising given the extent of passive long only strategy formation nowadays (ETFs, Smart Beta, etc) and their inability to protect capital. Defensive and/or interest sensitive sectors (except Telcos) outperformed correlating well with a rally in bond prices as investors chased certainty (10 year bond yields fell ~20bps)...all up a classic rotation in times of perceived stress. At a company level, there was one standout outcome in the market. Retail Food Group (RFG) was punished severely, down over 50% on its first trading day in March. This would have been a terrible result those investors who held during this period. Luckily, the Fund's involvement in this company ended about a year ago but we do wonder whether the company knew of current issues but decided not to report accordingly. We are sure a class-action will be forthcoming over coming months. Interestingly, as shown below in the price chart of RFG over the past 5 years, our framework for analysis (as presented in HALO), has strongly been to sell the company's share price at the highs they achieved. Unfortunately, no such persistent signals have presented in the last 6 months and is a case of the "fish that got away" and Happy Hunting for next time! We are always searching for longer duration short ideas and we are sure many opportunities will present over coming years.



Fund Activity

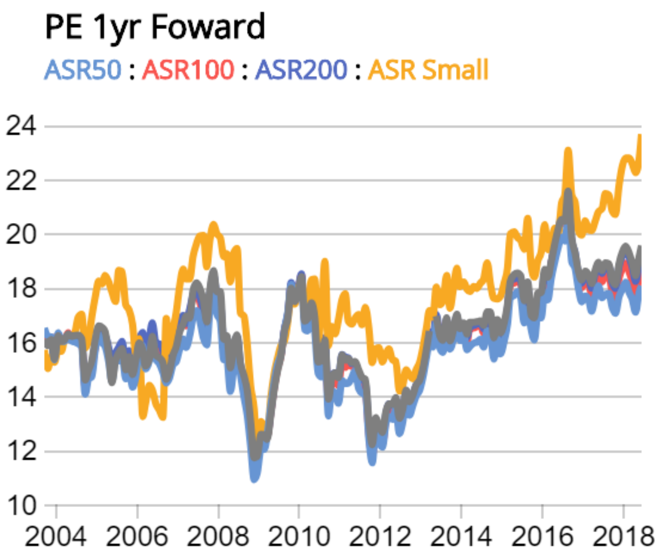
Given the prelude of calamity from February and the reporting updates from various resource companies, we were generally looking for short opportunities in this space during the month as well as running much lower exposure than normal due to Trump related trade war noise. In the context of our overall short book our SPI hedging program accrued a positive portfolio outcome of near 2%. The basic premise of the short position bias was to shield the portfolio from broad market falls. This dynamic hedging provided a good ballast to the rest of the portfolio positions as the market fell offsetting the losses on the Funds long positions. This is a strategy we have pursued since inception of the Fund and will remain a key feature moving forward. In terms of short term opportunities in the Resource space which we knew would be negatively impacted from any news related to a disruption in global trade, Fortescue Metals Group (FMG) had been one we have focussed on. There is certainly a clear broker bias in terms of positivity and the relative valuation argument is ordinarily quite convincing. But when the company's revenues are deteriorating faster than broker updates the cheap companies continue to get cheaper. This is the case for FMG with another downgrade to their price realisation outcomes only a month post their prior downgraded update. Outcomes like this do not generally re-surface so quickly as it would have been expected the company, after a number of downgrades, would have attempted to be conservative. FMG was our largest contributor to our short security book leading to around 50bps of gain. We also implemented a short position in BHP Billiton (BHP) which also contributed marginally positively. Offsetting to some extent the Funds Short position in resources we implemented a long position in Alumina (AWC) which also provided positive portfolio outcomes over the month. We have also started to accumulate in Mineral Resources (MIN) shown in the chart to the right. While this is a partial hedge against FMG given their Iron Ore exposure,



we also are taking the view they offer a cheap entry point into Lithium as well as having an exceptional Balance Sheet. As with other recent reports and our usage of HALO to identify ideas, we highlight the accumulation phase for MIN in the chart during the early part of 2018. We are certain the company will perform over the coming years and remain positively disposed especially compared to their much larger and more expensive diversified counterparts in BHP and Rio Tinto (RIO). Underperformance in the portfolio came from most other long positions with some of the smaller companies the Fund owns exhibiting downward bias. In the case of Mesoblast (MSB), which in our view has the potential to move forward significantly over the coming year in terms of commercialisation, succumbed to significant volatility. After providing positive results through February 2018 with the consequent rally in the share price from $1.34 to $1.78, through March 2018 it fell to $1.49 by month end. Clearly, market volatility led to in part to a fall in the share price but nonetheless was disappointing. The shareholder register of this company is like the who's who and it's not as if they are small investors either. We do wonder however why the volatility is so high given the likelihood of commercialisation has become more certain. In any case, the basis for holding the company's shares is based on a long-term thesis with upside potentially multiples of the current share price.

Food for Thought

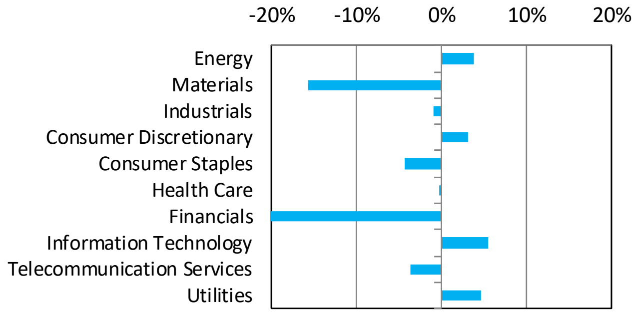
The Australian equity market over the past 12 months has returned near on 2.5%. This is quite an extraordinarily low number considering the overnight news that tends to determine our day-to-day psychology. As we noted last month the extent of earnings upgrades has been the strongest in a long time through the recent reporting season, certainly since the bounce from the lows post the GFC period. This in of itself makes us wonder why the performance has not been broader given the underlying economy has been relatively strong which incidentally has performed with upside relative to our thoughts a year ago. But like any phase in markets there is always an underlying story which can be told and one which you need to consider when investing in markets. We have from time to time discussed the elevated valuation levels in the Australian Market. We present a much longer time series for your perusal which essentially captures the have-nots and haves. In the chart to the right, we measure forward PE ratios across various market cap segments. What is clear from this chart is that valuations are elevated when compared to pre-GFC levels across all market cap segments. (This in of itself is a remarkable fact in our view). More decisive is the Small Capitalisation component (gold line) which is now on valuation levels akin to a bubble. If one were to look at peaks in valuations across the globe for many markets, anything above 20x starts to look very unappealing. And like many bubbles it is driven by excessive liquidity which in many cases does not discriminate on the quality of earnings. Further, the dispersion in valuation away from the most mature large companies has accelerated convincingly over the past year. This alone points to excessive liquidity moving into Small Cap companies driving returns. So, while the broader market has returned 2.5% over the past twelve months, the small capitalisation segment has returned near on 15%. However, when returns are dominated by valuation expansion (we estimate around 20% for valuation and -5% for earnings to explain the total return of 15%) one should start to think about what you are buying. Is it fear of missing out by moving into small caps right now or at these levels is it like buying at the top? We believe the odds are now looking in favour of a poor risk reward for small companies. Notwithstanding, it is certainly the case that new money is still chasing the small end of the market but when it ends it will likely end very badly. Food for thought for the time being but worthy of consideration.



Risk Statistics

	Fund		Index	
	3 Year	Inception	3 Year	Inception
Alpha (%pa)	-0.3%	2.5%		
Downside Capture	56%	56%		
Standard Deviation	7.2%	8.4%	11.0%	11.1%
Sharp ratio	0.3	1.0	0.2	0.6
Sortino		1.3		1.3
Largest Drawdown	-7.1%	-7.1%	-13.7%	-13.7%

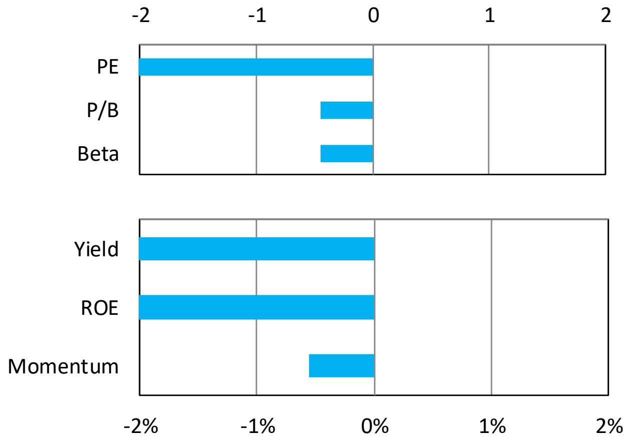
Sector Exposure



Exposure

	Long	Short	Net	Gross
Equity	74%	-8%	66%	82%
Index Futures		0%	0%	0%
Net	74%	-8%	66%	82%
Cash			34%	

Factor Exposure



Contribution

Positive	Negative
Alumina (Long)	Mesoblast (Long)
Commonwealth Bank (Short)	Myer (Long)
Fortescue Metals (Short)	Norwood Systems (Long)
Transurban (Short)	Universal Coal (Long)

Fund Information

APIR Code	OMF0003AU	Responsible Entity	Equity Trustees Limited
Inception	1 June 2013	Investment Manager	APSEC Funds Management
Minimum Investment	$10,000	Administrator	Mainstream Group Holdings Ltd
Application/Redemption	Monthly	Custodian	Mainstream Group Holdings Ltd
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	1.2712	Application Price	1.2725
		Redemption Price	1.2699

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Important information

APSEC FUNDS MANAGEMENT