Atlantic Pacific Australian Equity Fund

ARSN 158 861 155

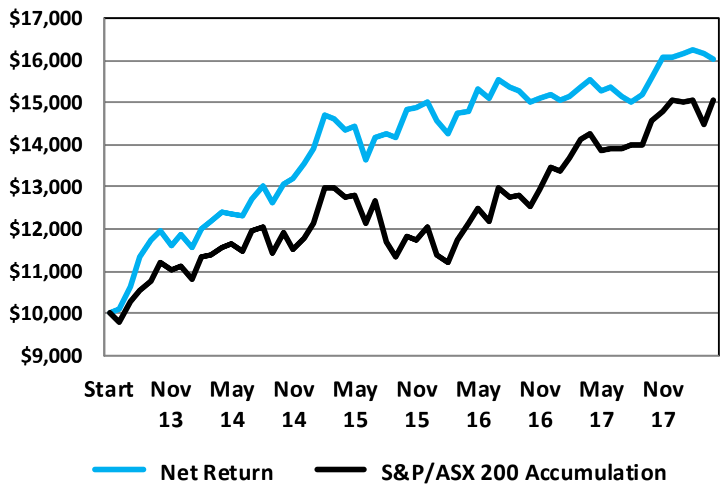
Fund Monthly April 2018

Return Summary

Period	1 mth	3 mth	6 mth	1 yr	3 yr (pa)	Cumulative	Per Annum
Fund Return	-0.77%	-0.7%	2.7%	3.2%	3.8%	60.3%	10.1%
S&P/ASX200 Acc.	3.91%	0.3%	3.4%	5.5%	5.7%	50.6%	8.7%
Excess return	-4.68%	-1.1%	-0.7%	-2.3%	-1.9%	9.8%	1.4%

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 up 3.9% after rising essentially from the get-go to finish on highs. The market accelerated into highs leaving the month ready to launch into a parabolic state. This is quite the opposite to what happened in the US which was generally in a comatose state returning 0.3%. Europe also rallied strongly with most European markets up over 4%. These rallies are directly linked to recent indications of a waning ability for the Trump Administration to enact tariffs which led to support of highly correlated markets to Chinese end markets. The volatility created by changes in stance and overnight tweets is here to say but for us very frustrating. This was further amplified in early April 2018 with the release of what appeared concrete evidence of sanctions on a Russian company, RUSAL. This company is one of the major producers of aluminium globally and to announce that potentially their output could be excluded from global markets caused aluminium prices to rise over 20% in the space of 10 trading days. This in turn led to a general ramp in resource prices with South32 (S32) the main beneficiary over the month, up 15.5%. S32 operate both Alumina and Aluminium assets in generally cheap resource-rich locations but have had some issue with leveraging their assets to rising prices given the cost of energy has dramatically increased over the same time – Alumina refining and Aluminium smelting are some of the most energy intensive processes known to man. Alumina (AWC) also rallied strongly, rising 11.9%, however their assets are tied to the fortunes of the production and refinement of Bauxite into Alumina, the primary stages prior to the smelting into Aluminium. While the price of Alumina is tied to Aluminium prices one should expect that their pricing will be somewhat more less exposed

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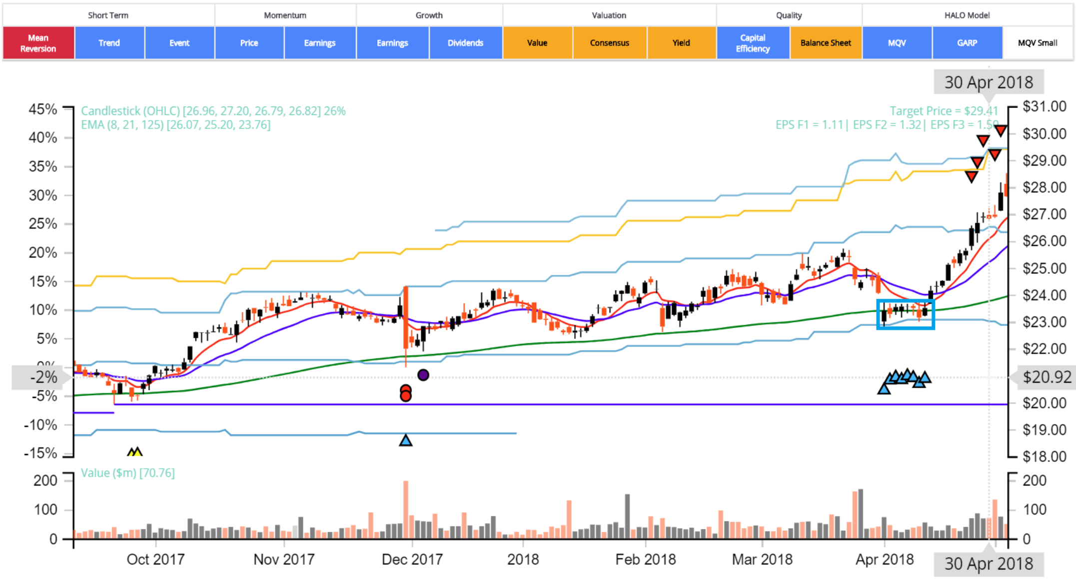
to the final product. Companies with offshore exposure also performed well with the AUDUSD falling close to 2%. Ordinarily, it wasn't a number we would have said would lead to parabolic moves but in the case of Aristocrat (ALL, +11.5%) it was one-way accelerating traffic once the AUD started to fall. We show the signal that was generated from our investment research platform, HALO below highlighted by the blue box. We hadn't had long exposure in this company for some time and after assessing the extent of a recent legal case against them to be nothing other than noise, we decided to move back into the name. As can be seen from the graphic, sell-downs of this nature (on some days over AUD$200m of turnover) are brought about by selling volume attributable to institutional investors which we were happy to accumulate into. The interesting point about Aristocrat apart from its very powerful earnings upgrade cycle, valuations are not all that aggressive when compared against the more likely potential for growth. In other words, the price you are paying for such growth (~20x Forward PEs), albeit acquisition led, is quite reasonable.



In contrast, we now discuss Treasury Wine Estates (TWE, +13%) which also performed well rising strongly into the end of the month. For TWE, we have generally avoided on the long side (but occasionally short) simply because of the opaque nature of their reporting documents as well as the hype associated with China imports which we have no comfort on i.e. the rate at which the Chinese have purchased wine could slow down materially which we have no visibility on. Coupled with valuations of over 20x Forward Enterprise Value to EBITDAs (this is extraordinary) and Forward PEs of near 40x, we know this company has now moved into bubble territory. As per last month's general discussion on valuations, it is exactly companies like this that are driving this elevated valuation phenomenon in the Australian market.

Energy prices also rallied over the month with Oil and Thermal Coal in AUD rising 8% and 5.5% respectively. This has supported our long-held position in Universal Coal (UNV, +17.5%) which has upgraded earnings twice in the last 4 months and are likely to surprise again given recent thermal price dynamics. In terms of length of holding, we have pretty much held since inception of the Fund with the Fund's first purchase in August 2013 @ 7.1c with an average accumulation of around 15c to date. As opposed to buying companies on 40x Forward PEs like TWE above, UNV is sitting on valuations of close to 5x next year with substantial growth in 2019 propelling valuations down to 3.3x. We would prefer to expose the Fund to such deeply discounted companies even at the expense of short term performance because when the realisation by other investors that this is a company that is now hitting its straps the Fund will be rewarded with significant price appreciation. Not to mention the company is now exposed to the best export thermal prices (denominated in AUD) in over a decade which will lead to much higher payouts from operations. Watch this space over coming months as they indicate payouts of 2c per half.

Fund Activity

It is fair to say we were caught short in terms of exposure given the extent of the speed of the market performance. We would liken this huge reversal as nothing short of frothy with many companies moving into parabolic states by month's end. Price formation like this is rarely sustainable and we will watch closely moving through the next couple of months for opportunities that present. Given the coincident events relating to resource markets which were a major

contributor to index returns over the month, we covered our shorts once the speed of the re-ratings was acknowledged. In particular, shorts in Fortescue Metals (FMG) and BHP Billiton (BHP) were covered. We will look to reset at higher prices subject to movements in underlying commodity prices. In terms of buying activity we were able to accumulate in one of our more favoured names, Corporate Travel (CTD), after selling part of the position a couple months earlier in an extreme overbought state. The optimality of the purchasing was once again impeccable as shown in the chart to the left where we accumulated through the blue rectangle. It's important to consider that no one signal will work all the time, but in our view, so long as the signals are consistently applied against companies whose earnings are more likely to continue growing we should be on the right side of ledger more often than not. Which brings us to discussing two significant detractors to performance over the month. As has been written in the popular press for weeks during the Royal commission, the fund

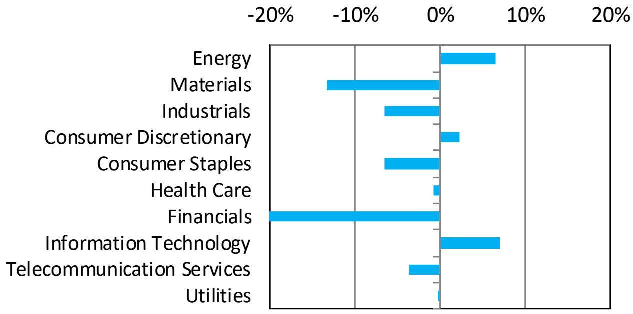
exhibited some impairment due to the underperformance in AMP (AMP). It is hard to imagine how poorly shareholders have been let down by Senior Management and the Board of a top 20 company in Australia. A class action is on the horizon as it would appear Senior Management and the Board of Directors have knowingly misled shareholders. What turned out to be the start of a classic mean reversion trade, which we implement regularly, turned into a case of "falling-knives" which immediately led to our liquidation of the position. These events happen from time to time and risk management, where you can act, is very important. Arguably, we should have liquidated the position on the prior day but didn't. In any case, the position cost the Fund around 35bps. Another position which we are not very happy about reporting on this month was our short position in Healthscope (HSO) which was implemented during the month. As always, the key risk to a short position is the risk of takeover or improved earnings expectations. In the case of HSO, valuations are high relative to expected growth and earnings were likely to weaken further. This simplistically

presents as a normal short thesis for us and with earnings likely to be downgraded further in the future, we expected a slow grind downwards in price. Instead, we were confronted with a takeover which on the basis of the company's current balance sheet (leverage already high and cashflow debt metrics very high) makes no sense at all despite the superior funding costs of private equity vehicles. Nonetheless, we chose on day 1 post the indication of a bid to exit the position, realising a loss of 54bps.

Risk Statistics

	Fund		Index	
	3 Year	Inception	3 Year	Inception
Alpha (%pa)	-1.9%	1.4%		
Downside Capture	53%	56%		
Standard Deviation	7.2%	8.3%	11.2%	11.1%
Sharp ratio	0.3	1.0	0.4	0.6
Sortino		1.3		1.3
Largest Drawdown	-7.1%	-7.1%	-13.7%	-13.7%

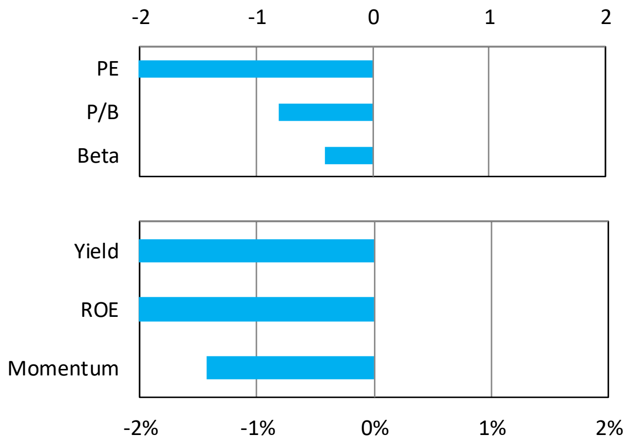
Sector Exposure



Exposure

	Long	Short	Net	Gross
Equity	74%	-9%	65%	82%
Index Futures		-1%	-1%	1%
Net	74%	-10%	64%	83%
Cash			36%	

Factor Exposure



Contribution

Positive	Negative
Aristocrat (Long)	AMP Capital (Long)
Corporate Travel (Long)	Fortescue Metals (Short)
Unversal Coal (Long)	Healthscope (Short)
Woodside (Long)	Norwood Systems (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	1.2614	Application Price	1.2627
		Redemption Price	1.2601

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Important information