Atlantic Pacific Australian Equity Fund

ARSN 158 861 155

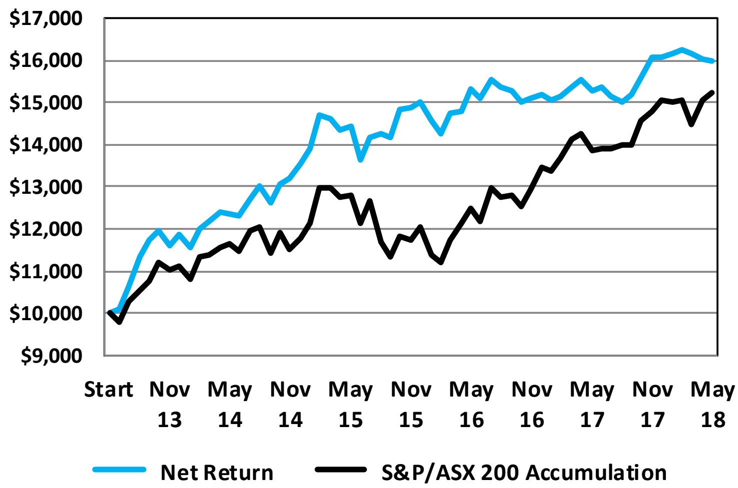
Fund Monthly May 2018

Return Summary

Period	1 mth	3 mth	6 mth	1 yr	3 yr (pa)	Cumulative	Per Annum
Fund Return	-0.40%	-1.8%	-0.6%	4.6%	3.4%	59.7%	9.8%
S&P/ASX200 Acc.	1.09%	1.1%	2.8%	9.6%	5.9%	52.2%	8.8%
Excess return	-1.49%	-2.9%	-3.4%	-5.0%	-2.6%	7.5%	1.1%

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

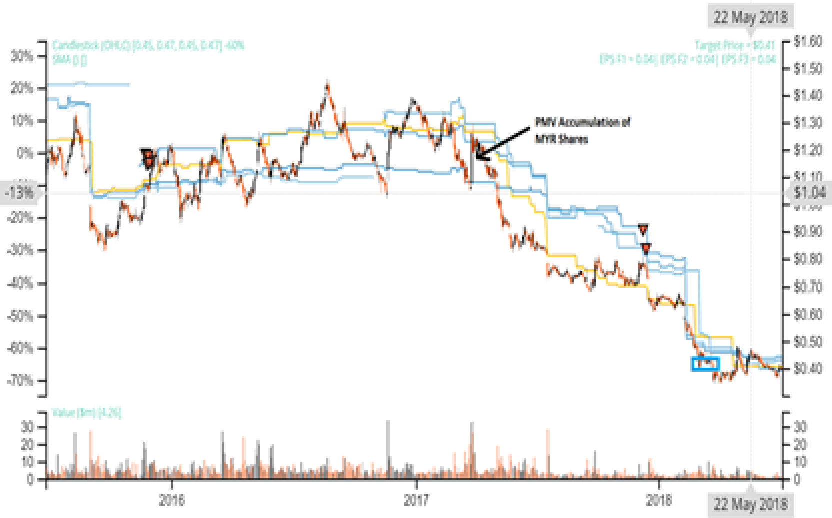
The Australian Market finished the month up 1.1%, with strong performance early in the month ultimately fading following falling resource prices and trade war rhetoric in the middle of May. The strong beginning of month performance was driven predominantly by Resource names with both RIO and BHP rising around 10% into the middle of the month. Underlying resource prices were broadly stronger at the front portion of the month, which drove the broader resources sector up by over 7% by mid-May. We then saw commodity prices roll off, with Oil and Iron Ore both reverting into the back end of the month. This commodity sell-off was driven in part by the heightened trade war rhetoric led by President Trump. A trade war is undoubtedly bad for global economic activity, and in particular, Chinese manufacturing and the knock-on effect into Europe given the high correlation with European machinery orders into China and certainly implies weakening forward demand for underlying industrial commodities. By month end the United States had announced the timing (15th June) of tariff imposition on certain Chinese goods, as well as the intention to restrict the investment and export options for Chinese persons and entities related to “industrially significant technology”. We are not too sure what economic model the Trump administration is using to support the reason for tariff-based protection. We don’t think it matters at it is merely a representation of his mantra of “Make America Great Again”. Like their tax policy which has brought forward demand while at the same time weakening their fiscal position, we don’t believe the tariff policy front will create nirvana for all. It is clear certain industries are favoured over others while others are punished unnecessarily. It certain seems to us the Trump administration has chosen winners and losers which inevitably will lead to excess capacity across the world as prior long-term investment is replaced geographically.

In terms of sector performance this month Health Care and Consumer Discretionary were the standout sectors, adding 5.6% and 5.1% respectively. Healthcare remains in bubble-territory for valuations in our view. While they have historically been expensive, the divide and height of valuations have never been higher or larger. You can see this in the graphic to the right, highlighted by the red line. In our view this is not justified as earnings in most cases have not been revised up enough. Suffice to say that these valuations will not last forever and remains a reason why we have very rarely invested in this sector over the past couple of years but at the same time are astonished how far valuations have expanded. It is certainly the case over the past year or so, that the more expensive companies have continued to become more expensive. Resources, despite the strong start to the month, ended up ahead by just under 2%. The notable underperforming sector in the month was the Telco sector which ended the month down over 10%, driven primarily by Telstra (TLS) which fell by almost 12% throughout the month. TLS' announcement to the market on the 14th May that they were reaffirming their FY18 guidance, with EBITDA expected to be at the bottom end of their range, resulted in analysts cutting their expectations regarding future EPS and thus dividend payments. One unusual aspect of the TLS share price move is that most of this repricing of TLS occurred during market hours. Normally TLS is well priced on the open and tends to trade in a relatively tight range intraday. Instead during the 14th and 15th of May, there was significant intraday selling that was not well represented on the open, and thus we had two intraday moves of approximately 5%. Despite the aggressive selling that we saw in TLS, we do not as of yet see a compelling reason to own the stock, despite it now trading on a Forward P/E of sub-double digits. The company has always traded as a bond (yield proxy) but unfortunately for those who did not keep abreast of the downgrades, they have seen a near halving in the share price. As shown to the left, our proprietary indicators, as contained in HALO, have been suggesting liquidation for many years as per the highlighted areas.

Fund Activity

The single largest contributor to fund performance this month was the Fund's position in Universal Coal (UNV), the South African coal miner that we have mentioned in our investor communications several times previously. Both Coking Coal and Thermal Coal prices rose throughout May, and this, coupled with the initiation of coverage by a new broking firm on the stock, led to UNV performing extremely well throughout the month. UNV rose from AUD 0.235 to AUD 0.25 (up 6.4%) at month end, albeit whilst touching AUD$0.27 intra-month. The Fund has held a position in this stock for a number of years, which we accumulated at much lower levels and continue to hold at the time of writing. The position has grown to be a sizeable one, which is certainly positive given that it has been driven by an expanding share price, but now subjects the fund performance to the swings impacted by such a small cap holding. We remain in frequent contact with the management of UNV, who generally come in for a face to face when they are in town, and we are pleased that they remain as focused as ever upon continuing to build the business and grow value for shareholders.

Another stock that contributed strongly to the performance of the Fund in May was Myer Holdings (MYR), rebounding from soggy performance in the prior month. We built a position in the embattled retailer in the First Quarter of CY18 (see blue highlight in chart below), in the belief that the selling was beginning to look overdone, and that at some point the share price would stabilise and may present as a likely takeover candidate. With 2017 expected to mark the bottom in terms of EPS, and consensus expectations of a reinstated dividend in FY19 it appears that we may be at an inflection point for the stock and at the end of the earnings downgrade cycle. With major shareholder Premier Investments (PMV) continuing to agitate for change, we recognise that they certainly know what it takes to drive value in Australian retail despite the timing of their own investment in MYR. We expect that without positive change coming from within it will be forced from the outside, perhaps in the form of a takeover (David Jones remains ever rumoured), or a reorganisation of the board and management by Premier Investment executives.



Source: HALO

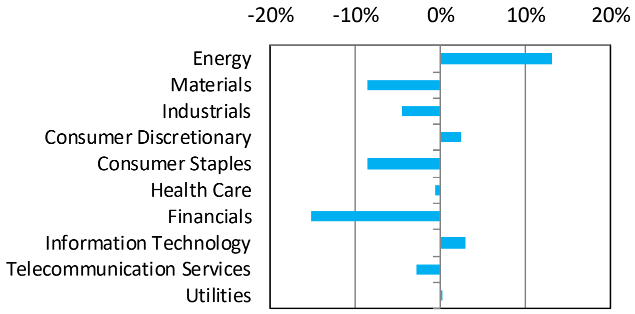
Major detractors from Fund performance this month included our position in Norwood Systems (NOR), which continues to perform poorly amid a lack of announced deal flow. The company has built some excellent technology, filling a couple of well-defined niches including a compliance solution well suited to the demands of running a financial services business and a Wi-Fi finding product assisting people to find free, but safe, Wi-Fi access points. We remain holders of the stock at the time of writing and believe that the strong products being developed by the company will ultimately find themselves with good uptake by users, both here and abroad. In many respects, we simply did not expect the time-to-deal to take as long as it has. Another detractor from the performance of the Fund this month was a short position in Aristocrat (ALL). We had short-sold the stock early in the month as it had entered an extremely overbought state (indicated by the upside down red triangles in the graph to the left), which in our experience generally reverts. Unfortunately, the share price took another leg higher, and maintained the overbought state for longer than we would had expected which led to us holding the stock at the time of the announcement of the ALL results on the 24th May. We had expected the very high expectations for growth to be met at-best, but the company once again convinced analysts that earnings were going to move higher for the foreseeable future. We cut the position immediately post the announcement, costing the Fund 20bps.

Source: HALO

Risk Statistics

	Fund		Index	
	3 Year	Inception	3 Year	Inception
Alpha (%pa)	-2.6%	1.1%		
Downside Capture	53%	56%		
Standard Deviation	7.1%	8.3%	11.1%	11.0%
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%

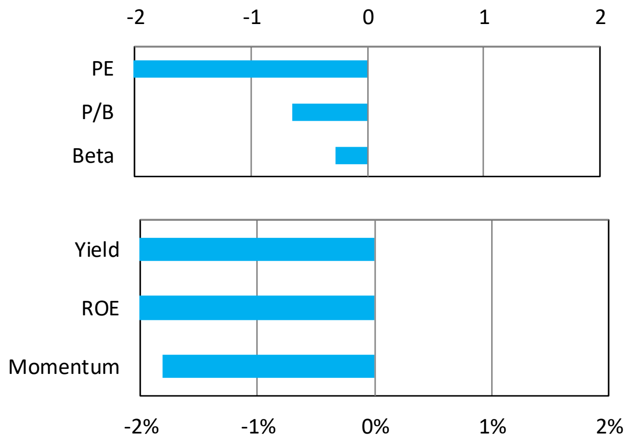
Sector Exposure



Exposure

	Long	Short	Net	Gross
Equity	64%	-7%	57%	72%
Index Futures		22%	22%	22%
Net	64%	14%	79%	93%
Cash			21%	

Factor Exposure



Contribution

Positive	Negative
Mesoblast (Long)	Aristrocrat (Short)
Myer Holdings (Long)	Link Administration (Long)
The Rejest Shop (Long)	Norwood Systems (Long)
Unversal Coal (Long)	Seven West Media (Short)

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	1.2564	Application Price	1.2577
		Redemption Price	1.2551

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Important information