Atlantic Pacific Australian Equity Fund

ARSN 158 861 155

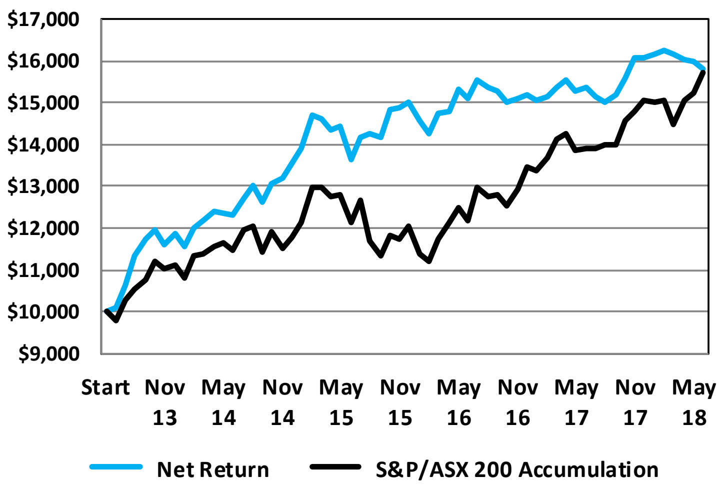
Fund Monthly June 2018

Return Summary

Period	1 mth	3 mth	6 mth	1 yr	3 yr (pa)	Cumulative	Per Annum
Fund Return	-0.86%	-2.0%	-1.6%	3.0%	5.1%	58.3%	9.5%
S&P/ASX200 Acc.	3.27%	8.5%	4.3%	13.0%	9.0%	57.2%	9.3%
Excess return	-4.13%	-10.5%	-5.9%	-10.0%	-4.0%	1.2%	0.2%

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 its Quadruple Alpha Investment Strategy which focuses on outperforming over all market cycles by capturing upside returns while minimising downside risk.

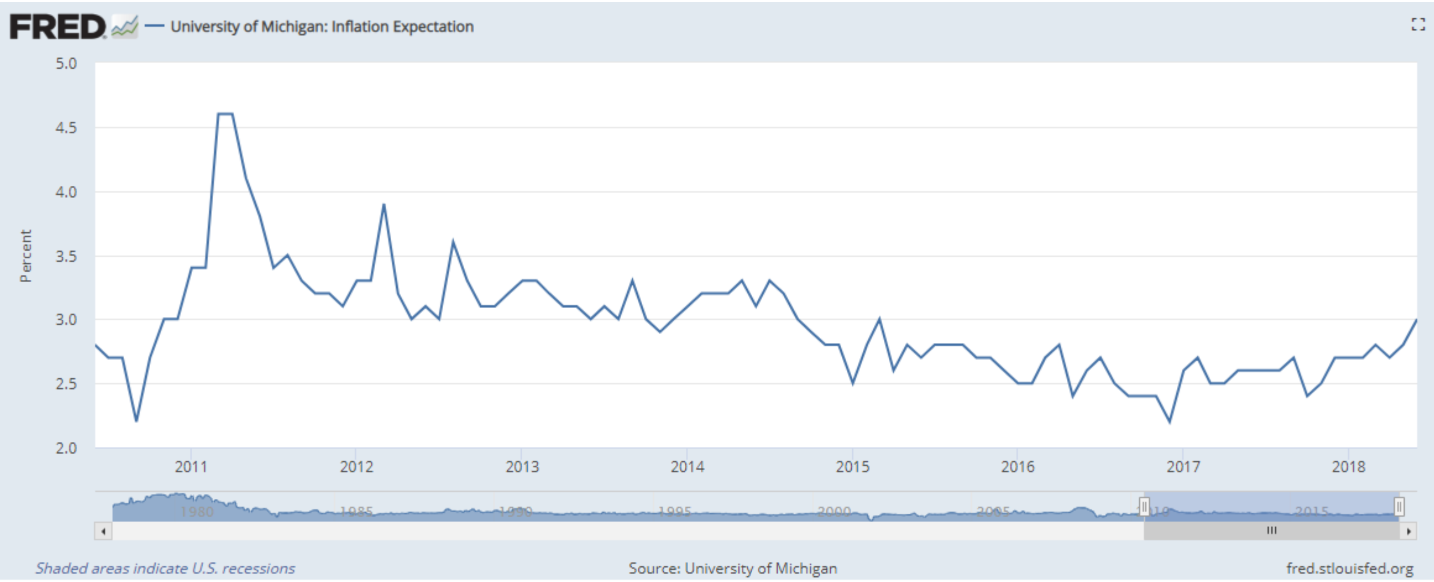
The objective of the Fund is to outperform the benchmark by greater than 5% pa after fees over a 5-7 year time frame.

Market Overview

The Australian equity market ended the month up 3.27% as market participants bought into the end of the financial year. This very strong performance was in stark contrast to other major regions of the world with most relatively anaemic else materially down of a similar magnitude. It is quite astounding to see such contrarian performance particularly against the backdrop of recent sentiment suggesting Australia is somewhat removed from some of the global geo-political issues and therefore being viewed as a safe-haven. We don't agree and would caution investors not to get too caught up with this noise particularly as valuations continue to rise without a commensurate increase in earnings expectations. The performance of the Australian market was generally broad with the Financials component providing the lift to the index. This component alone reverted almost 4% after having been sold down over the prior 6 months, with some underperformance associated with the remarks emanating from the Financial Services Royal Commission. Our market should behave differently compared to other markets but the size and speed of the adjustment (it took essentially 6 trading days to recover almost 2 months of selling pressure!) particularly in the Banks where fundamentals remain poor was unusual. During the month, the oil price bounced back after selling off late in May 2018 rising 10%. This lead to similar gains in the underlying equities as well as the Resource heavyweight, BHP Billiton (BHP) which has a sizeable exposure to oil. It would seem of late the performance of BHP has solely been driven by oil price correlation despite its much higher earnings sensitivity to Iron Ore and Copper - both would explain an opposite price outcome for the underlying equity.

APSEC FUNDS MANAGEMENT

In any case, BHP looks set to be trapped in a channel for some time with a lack of clear direction from commodity prices. The "Tech" space in Australia also ripped into the end of year. Appen (APX), which rose over 30%, moved up in a straight-line for most of the month. Given the general illiquidity of the name in the lead up to this month and given the company's inclusion into the S&P/ASX200 index it is our view that passive investors (ie index investors) have swarmed on the company's shares in order to get filled prior to month end. This buying behaviour has been further amplified over recent years with the acceleration of inflows moving into products managed by passive investors. We have seen this herd like behaviour before. It still surprises us given where valuations have moved even compared to pre-GFC levels that markets continue to ratchet up aggressively. One thing is for sure, the recent flows on the passive side driving markets up, will show up just the same by the same late investors exiting when stress becomes evident in markets. Global financial markets have yet to see the impact of how ETF style vehicles will cope with a large exodus of money from these types of vehicles, well at least not in the equity space. We suspect it will be worse than any other period in the history of financial markets. While we remain bearish on markets due to valuation (we have written about this phenomenon for many months now), the last piece to the puzzle will be when global activity starts to slow due to an increase in global bond rates via the US Federal Reserve. The rise in bond prices moves in waves and the current cycle has had two re-pricing episodes. The next phase of re-pricing will take place over the coming 6 months as inflation accelerates globally coupled with follow through on normalisation by the US Federal Reserve. Inflation expectations in the US (as per the University of Michigan - see below), have been slowly rising. We expect

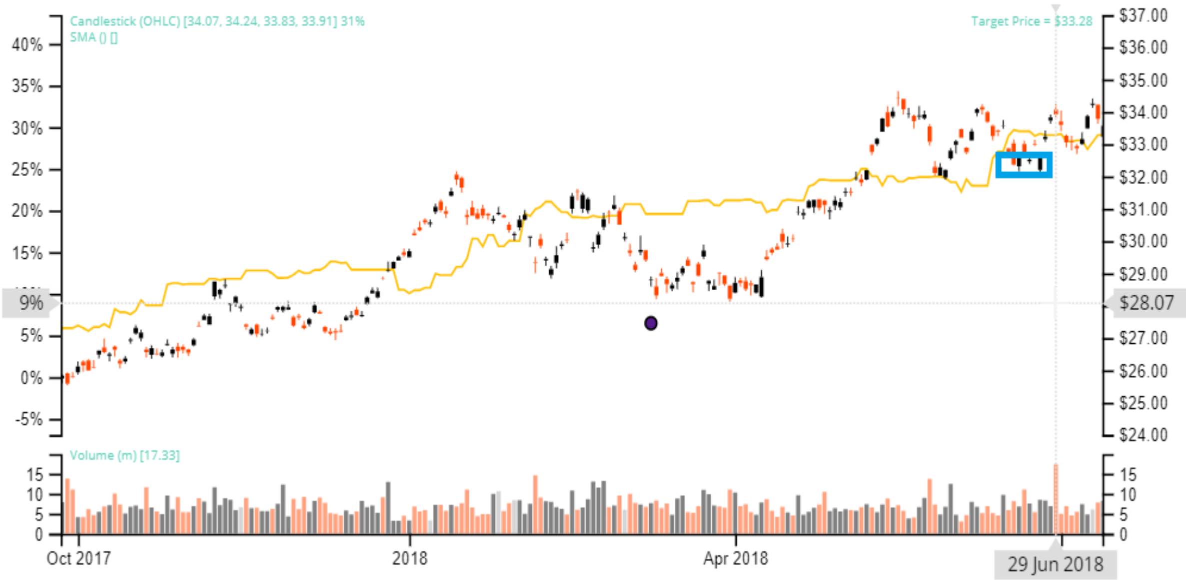


inflation expectations to continue to rise and feed through to goods, services and labour prices. From an international perspective, given the relative strength of the USD (~10% depreciation for the AUD since January 2018 peak), we would expect inflation to accelerate somewhat from current levels due to the transmission of import prices as well. As we noted last month, the Trump tax-cuts have also brought forward demand in our view and activity on the other side of the current peak will not be welcomed by markets once this transpires. This is probably an calendar 2019 story but its certainly something to look out for as we lead into the end of this calendar year.

Fund Activity

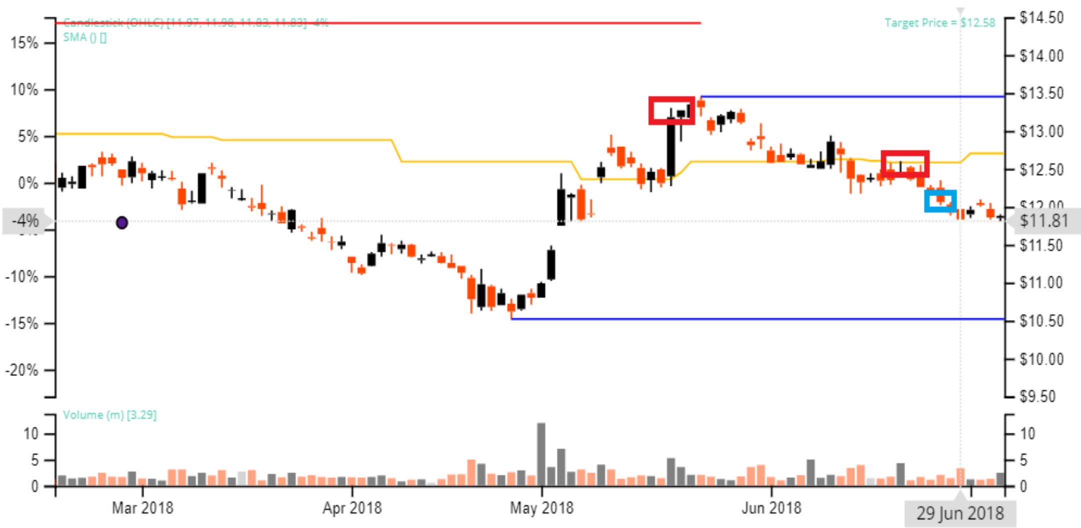
Given it was the end of financial year, Fund activity was dominated by liquidation of tax-losses to improve the tax status of the Fund for Fiscal Year 2018 (FY2018). The Fund paid a distribution of 1.07c for FY2018 which was materially lower than prior years. We never have indicated that the Fund is focussed on distributions, but as a normal course, inevitably, the Fund will pay something while it continues to grow the wealth of investors. The Fund's position in Altura Mining (AJM) was liquidated having not really performed for many months. There was some talk of a takeover but together with weakening sentiment towards the sector, prices for the equities in the sector have come off somewhat. Our position in Mineral Resources (MIN) was also liquidated by month end having reversed relative to our initial price accumulated during April 2018. We had much higher hopes for the name but the price pressure over the past couple of months has been ridiculous in our view. One week up 10-15% then the following week down 10-15%. This price behaviour makes no sense to us. Similarly, the Fund's position in Bellamy's (BAL) was liquidated. There has been some negative sentiment towards the stock of late in relation to the certification of various products into China. But the re-pricing has been way too aggressive in our view. Nonetheless, we liquidated the position into month end with the anticipation of picking up the stock again at a later date. Similar aggressive selling pressure occurred in CSR (CSR) over the month which we had bought with the anticipation that we would see some sort of mean reversion into month end. Considering CSR's exposure relative to other companies in the Australian building space, the share price moves have been very surprising suggesting that a number of institutions have been liquidating into month end. We also liquidated by month end.

On the buying side, as we mentioned earlier, BHP is likely to move sideways for the time being until there is a new driver of their earnings ie the prices of their main commodity exposures are moving one way or the other. So, in our view, the company has become a trading stock for the time being and we will move from long to short at various points in time where we believe the trading range has been preserved. We accumulated further exposure around the bottom of the month as per the chart to the right.



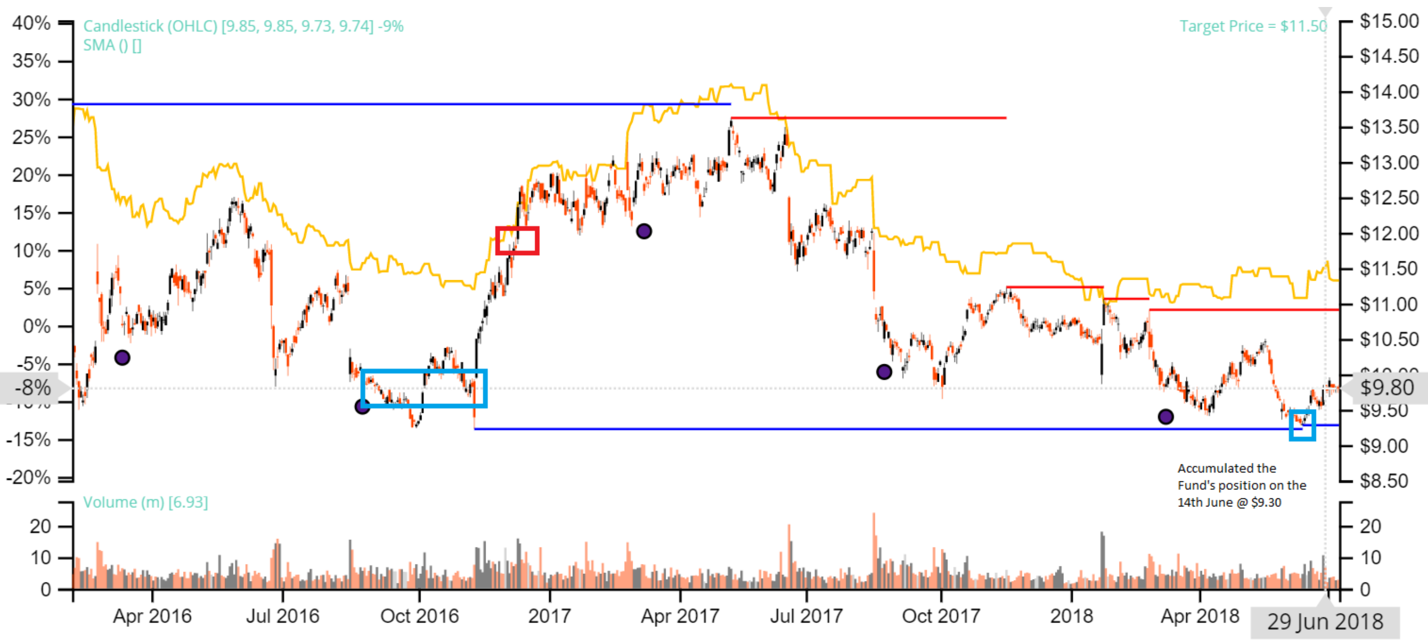
Source: Halo

We also took the opportunity to cover our short-sold position in Challenger (CGF) by month end (see below in the chart). We had originally short sold into the end of May 2018 as the company's shares ramped into news associated with longer term government policy related to Retirement savings. While this incremental news will always support the long-term structure of their main industry, we don't agree that the company's share price should have ramped so aggressively particularly as the company's more recent sales activity would suggest a slowing. We have taken a bearish view on the company's earnings into the upcoming reporting season but were happy to cover by month end to re-sell if the company's shares are re-ramped.



Source: HALO

One very interesting name that we have been keeping on eye on is QBE Insurance (QBE). While the company is viewed as a perennial disappointer, from time-to-time, the share price is so heavily overdone that it is hard to resist not buying. The most recent time we entered the name based on a structural, non-trading view was in the second half of 2016 in anticipation of the sell-off in global bonds. Once the US Federal reserve indicated they would start to increase the US cash rate, the resulting re-pricing in QBE was swift. We liquidated into the end of the year in that case. Subsequently, to the macro rally described previously, the company's share price has stopped and started with disappointment coupled with statements suggesting the worst is behind them. They have never really cleaned up their books as many decades of acquisition activity takes time to reverse. However, when prices re-assert themselves at all time lows, we will often take another look at the company's shares as it is times like these that other investors are at their most bearish. We entered the company's shares on the 14th June 2018 @ $9.30 and remain invested into the end of the month as per the chart below. This price point is in recent history the lowest it has been which all seems remarkable that we coincidently picked the right day!

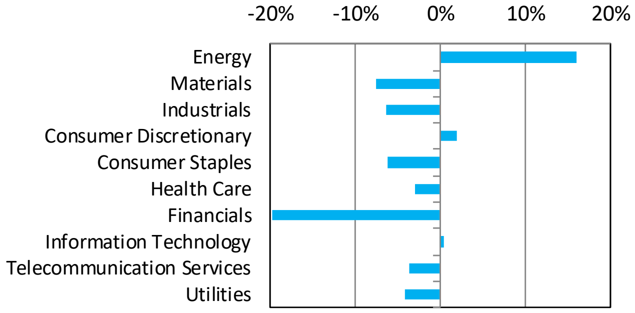


Source: HALO

Risk Statistics

	Fund		Index	
	3 Year	Inception	3 Year	Inception
Alpha (%pa)	-4.0%	0.2%		
Downside Capture	43%	56%		
Standard Deviation	7.2%	8.2%	11.2%	10.9%
Sharp ratio	0.6	0.9	0.7	0.7
Sortino		1.3		1.3
Largest Drawdown	-7.1%	-7.1%	-13.7%	-13.7%

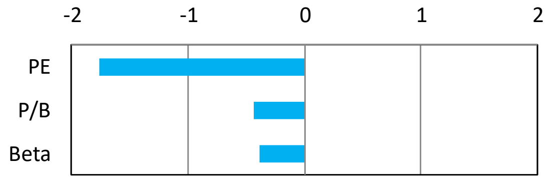
Sector Exposure

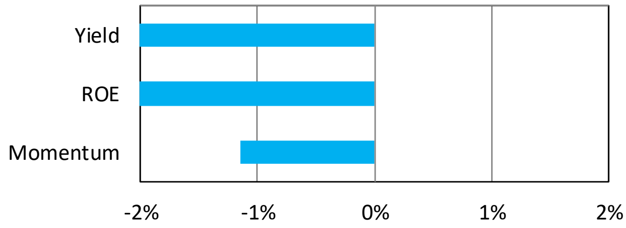


Exposure

	Long	Short	Net	Gross
Equity	75%	-4%	71%	79%
Index Futures		0%	0%	0%
Net	75%	-4%	71%	79%
Cash			29%	

Factor Exposure





Contribution

Positive	Negative
BHP Billiton (Long)	Altura Mining (Long)
Corporate Travel (Long)	Bellamy's (Long)
Unversal Coal (Long)	Mineral Resources (Long)
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 (ex Dist)	1.2348	Application Price (ex Dist)	1.2360
		Redemption Price (ex Dist)	1.2336

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Important information