Atlantic Pacific Australian Equity Fund

ARSN 158 861 155

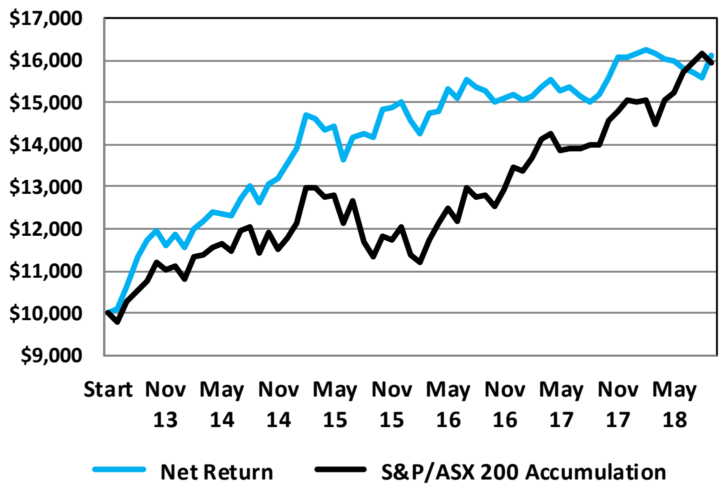
Fund Monthly September 2018

Return Summary

Period	1 mth	3 mth	6 mth	1 yr	3 yr (pa)	Cumulative	Per Annum
Fund Return	3.54%	1.9%	-0.2%	6.3%	4.4%	61.3%	9.4%
S&P/ASX200 Acc.	-1.26%	1.5%	10.1%	14.0%	12.1%	59.6%	9.2%
Excess return	4.80%	0.4%	-10.3%	-7.7%	-7.7%	1.7%	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.

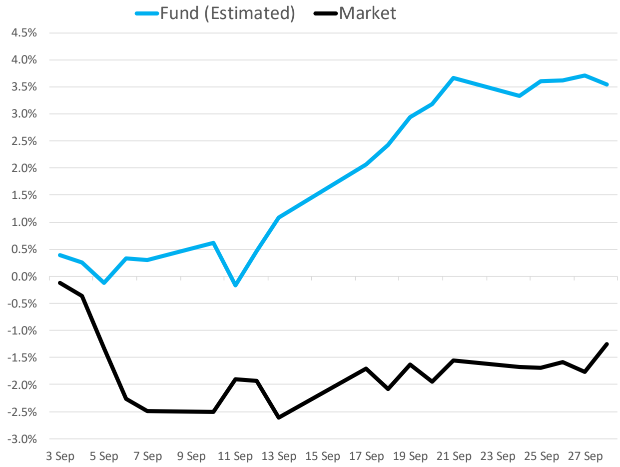
The objective of the Fund is to outperform the benchmark by greater than 5% pa after fees over a 5-7 year time frame.

Market Overview

The Australian equity market finally broke its winning streak of positive months falling 1.26%. More importantly for fund investors, we broke our streak of negative months. While certainly a positive outcome, we have, like many investors, not been happy with recent performance but green shoots are emerging. Across the globe, equity markets were generally ho-hum throughout the month apart from Japan which was up 5%. The story of the month however related to bond yields and expectations for a more hawkish Fed tone. At the time of writing, US bonds yields have continued to ratchet up dragging other global bonds with them. The negative implication of rising bond yields is that lofty equity valuations should come under pressure. Similarly, bond proxies (Utilities, Property Trusts, and Infrastructure) should underperform as they typically are the most leveraged sector of the market. We leave out Australian Banks from this analysis as they appear not to have any sensitivity to bond rate levels (as many other global banks do) but rather the spread of funding given a heavy reliance on offshore markets. Rising bonds did in fact hit the Australian Equity market over the month of September 2018 as sectors that have been identified in the past by us (in addition to above) came under significant pressure. The sectors that were hit the most included Healthcare, down 8%. We have lamented the excessive valuations of this sector (and its components) for many months now and it is no wonder they severely underperformed. Utilities, Property Trusts and Infrastructure also materially underperformed. On the contrary, Telecommunications companies outperformed with noise of pending consolidation after TPG Telecom (TPM) initiated a tie-up with Vodafone Hutchison. We suspect this is merely noise and will not show up in earnings in the near term nor likely over the medium term with various disruptive technologies in the sector afoot. Notwithstanding, the Materials and Energy sectors rallied supported by rising oil prices as well as an announcement by Rio Tinto of a jumbo off-market buy-back.

Fund Activity

As we noted in last month's report, we entered this month with a fully hedged position. This enabled us through the first week alone to provide coverage for the Fund through the down period. As you can see in the chart to the right, we essentially had flat performance through this period. This was quite a large draw in the market of around 2.5% and as we have stated in the past, during market moves like this we either react decisively or are prepared in advance. We are committed to providing downside protection in markets that no other Fund that we know of can provide. In the [March 2018 report], we were able to state that our downside protection in very weak markets (greater than 2% fall) is almost impeccable (11 out of 12). This early performance in the month once again highlights how we can adapt quickly when markets turn sour. The overall settings of the portfolio did not change materially over the month as once this performance had manifested we started to see the acceleration in rising bond yields. This essentially provided a signal to stay with very conservative portfolio settings as in our view it would likely lead to either a soft, re-assessing market or further downside to high valuation companies. As it turns out, markets moved sideways for the rest of the month.



Underlying the results of the month include some of the green shoots that we alluded to earlier. In particular, the standout performance for the month was driven by two companies we have spoken about quite often in past.

Universal Coal (UNV) rose almost 15% over the month, driven by new takeover activity. We actually don't quite know what to make of this offer, other than we are happy with the boost to Fund performance, as once again we are in belief that the deal significantly undervalues the company. The management team at UNV are certainly hitting their straps and similar to in the past this deal noise is unlikely to affect them from a production management perspective. Even so, once we move through this period of offer (and in some ways we hope it doesn't proceed), we will either know the outcome and exit the position or watch the company grow into a significant multi-mine producer.

We wrote briefly regarding Mesoblast (MSB) in last month's report. As we had indicated, we were expecting to see an update on their 180-day survival data for their aGvHD Phase 3 Trial. While the report came out later than expected, the results confirmed their ability to apply for a Fast Track through the US Food & Drug Administration. We are not sure when this will take place however this is likely to be completed over coming quarters. Once completed, this live saving treatment will be available to the largest Bone marrow transplant market in the world. Post this announcement, MSB rallied to finish up 31% for the month. In our view, given results for other block buster drugs by the end of the year, the likely trajectory of the price of the company's shares is positive where results confirm a path of success.

Rio Tinto also provided a boost to the Fund's returns after announcing a significant off-market buy-back. We had bought RIO initially as a hedge against our short in BHP Billiton (BHP-which we covered). A further reason we bought RIO was due to seeing divergence between the RIO share price and some of the commodities they are exposed to. This has shown up in a lot of resource companies ranging from Fortescue (Iron Ore) and Western Areas (Nickel) to name a few. We show this divergence in the chart to the left. The blue and white candle chart is the Rio share price and the orange line represents Dalian Iron Ore Futures. Iron Ore prices firmed over the 3rd quarter of 2018 with most iron ore companies falling against this backdrop. Given the seasonality of iron ore prices, we expected that this continued firming would support, at some point in time, the prices of iron ore producers.

Source: Bloomberg

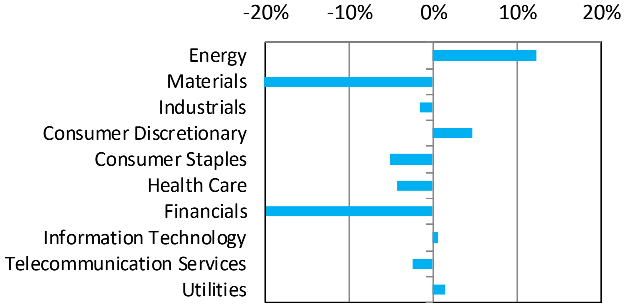
The other company that contributed to performance was Cochlear (COH). As we have mentioned in the past, the company has exhibited extreme valuation for quite some time now. At some point it needs to break and reflect fundamentals. We expect a re-pricing to occur when earnings are downgraded materially against the run of play or when markets dislocate of their own volition. This is what happens in most cases and logically makes sense. Further, it is almost impossible to short sell on valuation factors alone in our experience and while we short sell on a short term tactical basis we respect that other investors have different views and do not want to push against the tide too long. Post their recent earnings update though, the company downgraded earnings materially. We expected that we had missed the short sell (as we weren't prepared to short sell in anticipation of their report) and that the share price would continue to fall. We would very rarely chase the first day of selling pressure in any case as the decay of underperformance only lasts for so long. However, we now had a reason to have a short bias and would wait for an opportunity to implement our fundamental view. What we didn't expect was for the company to move through two near extreme overbought states. In the first instance in late August 2018 we started our short sell accumulation. But the extent of the price strength was extraordinary. We again waited until we saw the extreme of the buying and continued to short on the two highest days through September 2018 and the rest is history…after one day of washout (precipitated by a washout on the NASDAQ the night before), the very frothy buying pattern had come to an end. We are likely to remain short sellers of the company until valuations and general volatility subside.

Source: HALO

Risk Statistics

	Fund		Index	
	3 Year	Inception	3 Year	Inception
Alpha (%pa)	-7.7%	0.2%		
Downside Capture	44%	49%		
Standard Deviation	6.3%	8.2%	9.3%	10.7%
Sharp ratio	0.5	0.9	1.1	0.7
Sortino		1.3		1.3
Largest Drawdown	-7.1%	-7.1%	-13.7%	-13.7%

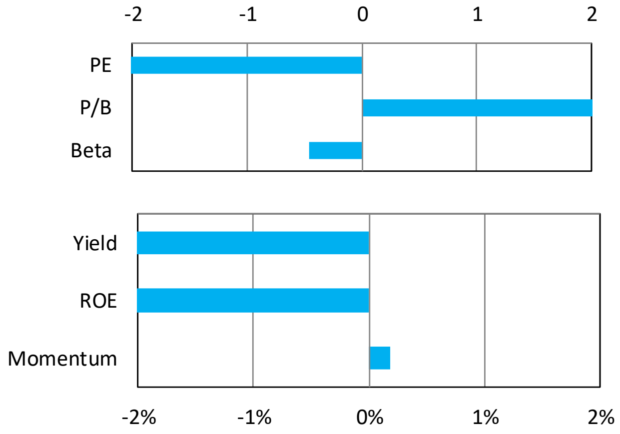
Sector Exposure



Exposure

	Long	Short	Net	Gross
Equity	56%	-21%	35%	78%
Index Futures	33%	0%	33%	33%
Net	89%	-21%	68%	111%
Cash			32%	

Factor Exposure



Contribution

Positive	Negative
Cochlear (Short)	Flight Centre (Long)
MesoBlast (Long)	ANZ Banking (Long)
Rio Tinto (Long)	Bluescope (Long)
Universal Coal (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)	1.2581	Application Price (ex Dist)	1.2594
		Redemption Price (ex Dist)	1.2568

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Important information

APSEC FUNDS MANAGEMENT