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Atlantic Pacific Australian Equity Fund

ARSN 158 861 155

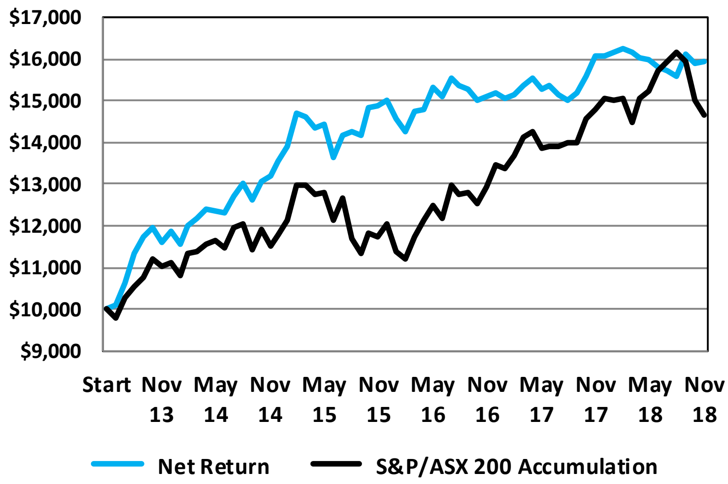
Fund Monthly November 2018

Return Summary (To November 2018)

Period	1 mth	3 mth	6 mth	1 yr	3 yr (pa)	5 yr (pa)	Cumulative	Per Annum
Fund Return	0.44%	2.4%	-0.1%	-0.7%	2.4%	6.9%	59.5%	8.7%
S&P/ASX200 Acc.	-2.21%	-9.3%	-3.7%	-1.0%	7.7%	4.9%	46.6%	7.1%
Excess return	2.65%	11.7%	3.6%	0.2%	-5.3%	2.1%	12.9%	1.6%

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.

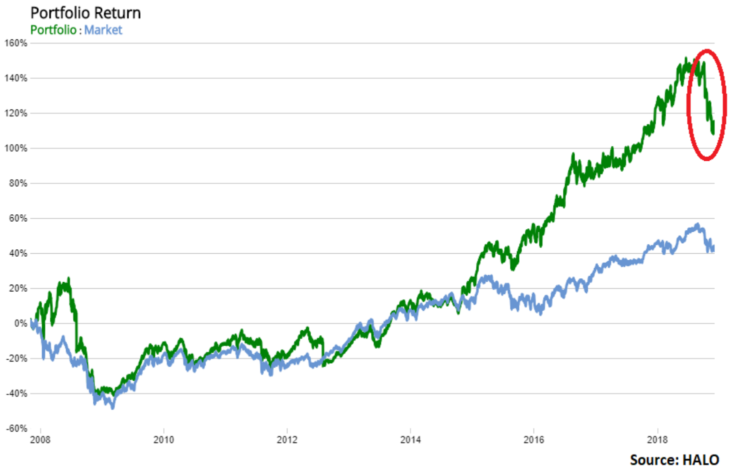
The Investment manager employs its Quadruple Alpha Investment Strategy which focuses on outperforming over all market cycles by capturing upside returns while minimising downside risk.

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

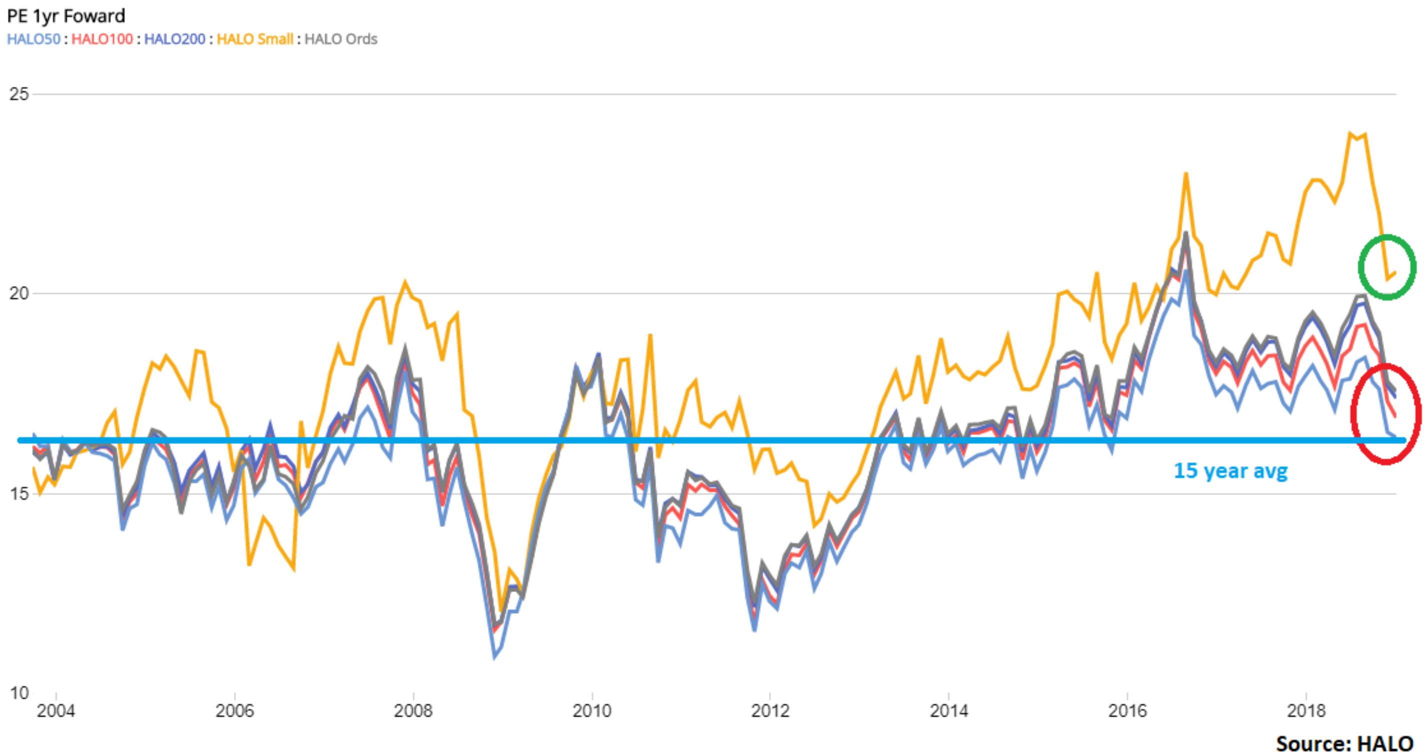
The Australian equity market continued to track downwards through November 2018, falling 2.21%, another significant down month. The Australian equity market since the recent reporting season i.e. the last 3 months, is down 9.3%. This is quite extraordinary considering the low volatility environment we have seen for quite some time. Pleasingly, we are able to report another strong month for your consideration with our performance diametrically opposed, returning 2.4% over the last 3 months and 0.44% for November 2018. Once again, we will make the point that investment managers who had done well earlier in the year have continued to report very poor results. We too have had a period during the year with a series of small consecutive negative months but the size of the downdrafts over the last quarter for many is breathtaking to say the least. Surprisingly, even the absolute return funds are continuing to show very poor performance which is out of step with how they should be performing in these environments. In many cases, they are "wolves in sheep's clothing", masquerading with an absolute return focus, but are actually long-only managers without any downside risk management expertise.

One very interesting dynamic that we have noticed with the use of the HALO Investment Research Platform (HALO), is that quantitative funds who utilise momentum, quality and value screens, are having one of the worst relative and absolute times in their many decade history. HALO provides composite factor model portfolios (eg HALO MQV) which essentially mirror the vast industry of traditional quantitative investment strategies. These strategies are a significant contribution to the natural flow of money into equity strategies across the globe. Their underperformance is born from the fact that the companies they have typically been exposed to are at the cheaper end of the spectrum which have significantly underperformed other parts of the market ie it would appear the cheaper, higher quality stocks have re-rated downwards on average faster than say the expensive stocks which would appear incongruous to logical thinking. We liken this to the fact that the typical company they have been exposed to are owned incrementally by more active investment managers than not ie active investors are increasingly exposed to "crowded trades". The historical significance of this for those with long enough memories is that this is exactly what happened in the GFC i.e. crowded trades underperformed and led to forced liquidation when markets fell quickly. A pictorial view of the recent underperformance of these strategies is shown to the left with the red circle highlighting the recent downdraft.



On review of sectoral returns over the month, cyclicals were clearly under the pump including Energy (down 10%+) due to oil prices falling circa 20%, Materials (down 5%) and consumer discretionary (down 5%) – the cheap end of town. We have spoken about Healthcare in the past, having been ramped dramatically over the past year, they too were down 4%. Surprisingly, Banks continued to rally off lows made in October 2018 post further interrogation from the Financial Services Royal Commission. We are generally neutral banks for the time being until we have more information on how the credit cycle is evolving domestically as equity prices probably reflect the downgraded state of their earnings.

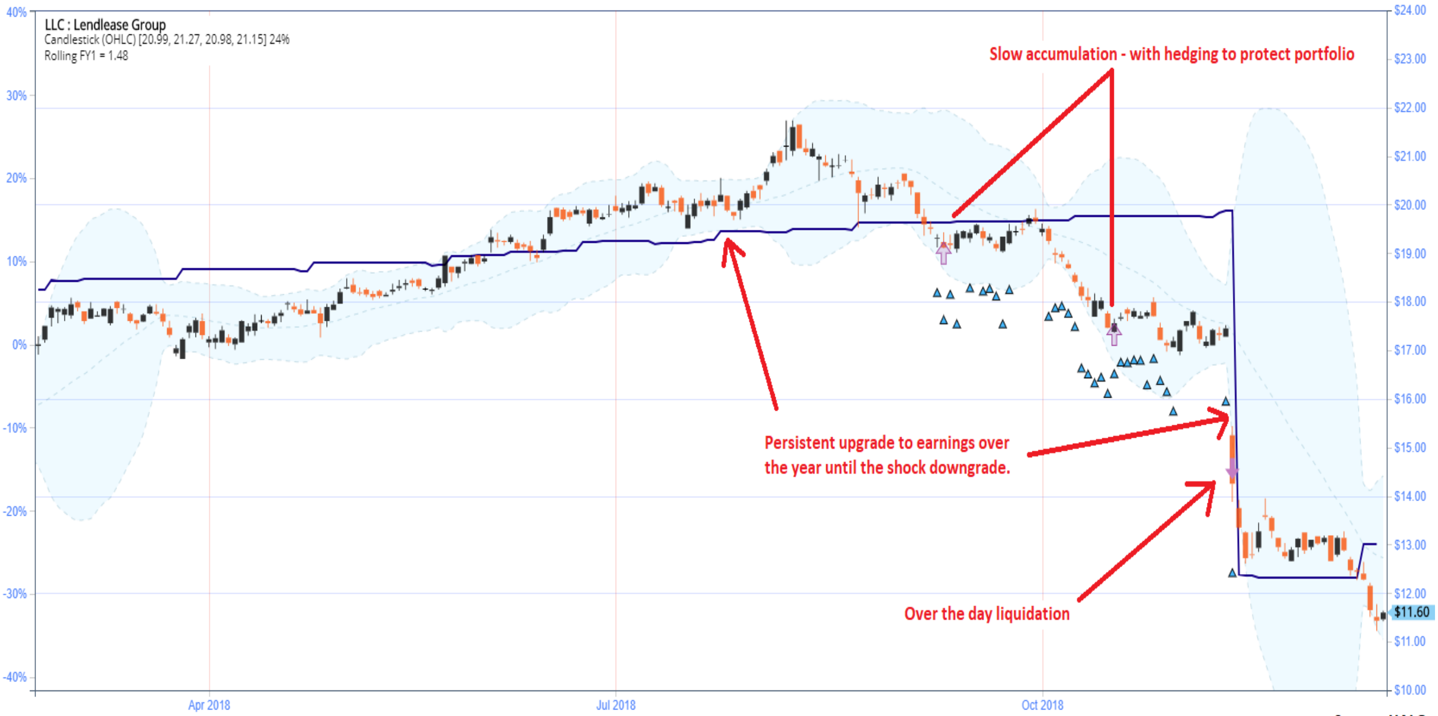
Now that we have witnessed such a retracement in the market and analysts have had time to roll forward their earnings estimates, it's probably a good time to re-visit market valuations to see whether there is now relative safety. On review of aggregate Forward PEs in the chart below, it would appear the very large capitalisation companies in aggregate (eg HALO 50, HALO 100) have now re-priced themselves back to the middle of the pack. This really is a good outcome subject to the expectation that earnings may need to be downgraded again. However, small caps remain in an elevated valuation state (green circle in chart below) which is where they shouldn't be if the market keeps falling…an unfortunate volatile cocktail mix of excessive valuations and a lack of liquidity.



Fund Activity

The month of November 2018 was a trading month for us with the remnants of uncertainty filtering through to markets. We generally kept a trailing hedge position relative to market movements with our ability to instantaneously hedge a key feature of the month. Like last month, our capability in Australian SPI Futures hedging came to the fore with this instrument contributing 2.3% to overall returns. Once again, our natural long positions fell but were covered easily by our risk management and timing skills. Over the month however, we had been exposed to two company reporting events, one foreseen the other unforeseen, which hit Fund returns on two consecutive days…we certainly wondered early in the month how we were going to dig ourselves out of two very big holes, but we did!

In the first instance, the Fund was hit by an unexpected profit downgrade by Lend Lease (LLC). We had viewed the company positively for a long time as they moved from having a developmental income bias into a cash harvesting phase…the company's management had flagged this for many years with a consequent buy-back announced in March 2018 to use up excess cash. However, on the 9th of November 2018, the company announced an unexpected downgrade of earnings due to a deterioration in several development projects. This downgrade has effectively led to a breakeven profitability state over the coming half. More importantly though is how we react to events like this which is determined by a large extent on how we expect market analysts to react as they will determine the sentiment towards the company's shares over the short term. With profit downgrades we always consider the "Day 1 Rule", a key part of our risk management strategy. This rule essentially tells us "if in doubt, liquidate…if we know there is further downside, then liquidate as well". Time and time again over years, this rule has served us well. After considering the impact of how we expected sentiment on the stock to change we took the view that analysts would not only downgrade earnings (company led) but also downgrade their recommendations. In each case, we were right, earnings and recommendations were downgraded. At the time of writing after liquidating the position around $14.33 on Day 1, the share price is currently trading around $11.50, 20% below our sell price.



Source: HALO

The second company that impaired the returns of the Fund was Mesoblast (MSB). This company tends to trade on news flow and we have had mixed success over the past three years, albeit we have made money overall on the name. However, it certainly was the case this time around the extent of the downdraft was unexpected with the price impact on Day 1 falling almost 30%. We have reduced the Fund's position as there are a number of material events over coming months and years which we believe will more than make up for current year losses.

We also went on the hunt for more stocks to short sell over the month with a number of setups providing small incremental returns. For example, we were able to latch onto Soul Pattinson (SOL) on the short side. This was more about the fact the company's shares had shown significant dispersion to the rest of the market with no real catalyst or reason together with a reverse hammer setup failing against recent highs. As you can see from the chart our timing was once again quite optimal selling at effectively the company's all-time high.

Source: HALO

Similarly, we shorted Incitec Pivot (IPL) into their financial report in early November. The company rallied into their result with very little likelihood of a material current half upgrade due to the overcapacity issues in their explosives business, which is the company's largest exposure. We do wonder why people get so excited by pushing stocks into results when the fundamentals tell the opposite story. The company missed current half forecasts by around 5%. In any case, their smaller fertiliser business could provide upside surprise, but this too appears now to be fully priced in. Perhaps when we have greater visibility on fertiliser prices (eg ammonia prices) and the price has not rallied, we may take the other side as a value investment, but we would need to be convinced of a much higher price relative to consensus to make that decision. At this point, we don't particularly against the backdrop of further misses on the explosives side. The trade setup is provided below.

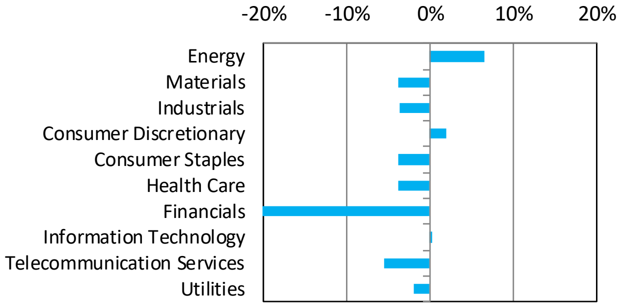
Source: HALO/APSECFM

APSEC FUNDS MANAGEMENT

Risk Statistics (As at November 2018)

	Fund		Index	
	5 Year	Inception	5 Year	Inception
Alpha (%pa)	2.1%	1.6%		
Downside Capture	45%	46%		
Standard Deviation	5.9%	8.1%	9.8%	11.0%
Sharpe ratio	0.7	0.9	0.4	0.5
Sortino		1.5		1.1
Largest Drawdown	-7.1%	-7.1%	-13.7%	-13.7%

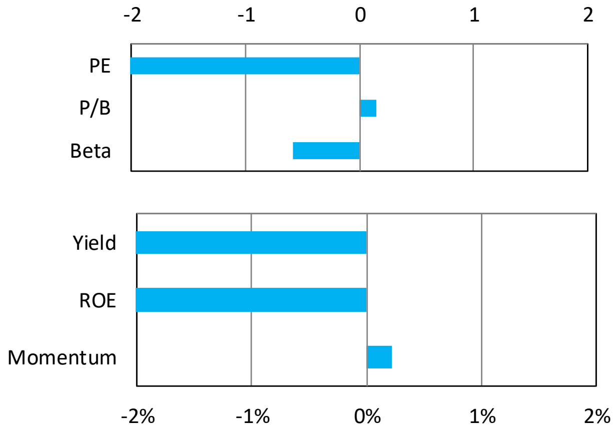
Sector Exposure



Exposure

	Long	Short	Net	Gross
Equity	40%	-16%	25%	56%
Index Futures	14%	0%	14%	14%
Net	54%	-16%	39%	70%
Cash			62%	

Factor Exposure

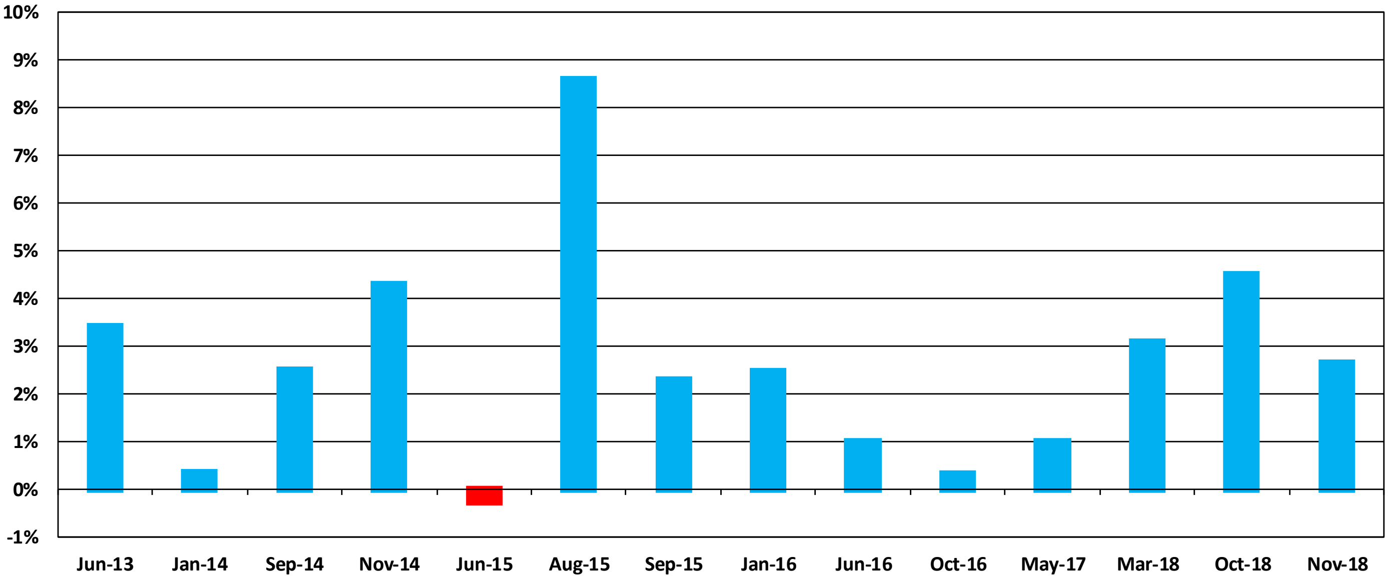


Source: APSEC Funds Management

Contribution

Positive	Negative
Corporate Travel (Long)	Alumina (Long)
Incitec Pivot (Short)	Lend Lease (Long)
Norwood Systems (Long)	Mesoblast (Long)
TheGO2People (Long)	Woodside Petroleum (Long)

APAEF Relative Returns (From Inception to November 2018)
When the market is down more than -2%



Source: APSEC Funds Management

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)	1.2440	Application Price (ex Dist)	1.2452
		Redemption Price (ex Dist)	1.2428

Contact Information

Nicolas Bryon	n.bryon@apsec.com.au	Investment Manager	+ 612 8356 9356
George Paxton	g.paxton@apsec.com.au	Responsible Entity	1300 555 378
Website	www.apsecfm.com.au	Unit Registry	1300 133 451

Important information

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