Atlantic Pacific Australian Equity Fund

ARSN 158 861 155

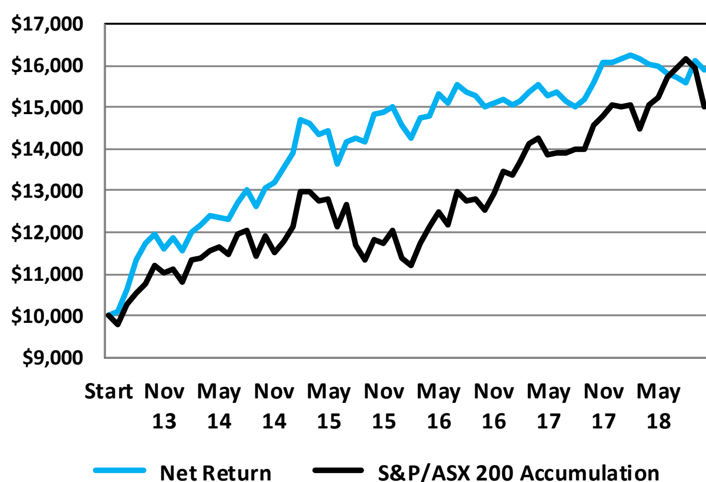
Fund Monthly October 2018

Return Summary (To October 2018)

Period	1 mth	3 mth	6 mth	1 yr	3 yr (pa)	5 yr (pa)	Cumulative	Per Annum
Fund Return	-1.54%	1.1%	-0.9%	1.7%	2.3%	6.2%	58.8%	8.8%
S&P/ASX200 Acc.	-6.05%	-5.9%	-0.4%	2.9%	8.2%	5.2%	49.9%	7.6%
Excess return	4.51%	7.0%	-0.5%	-1.2%	-6.0%	1.0%	8.9%	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 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

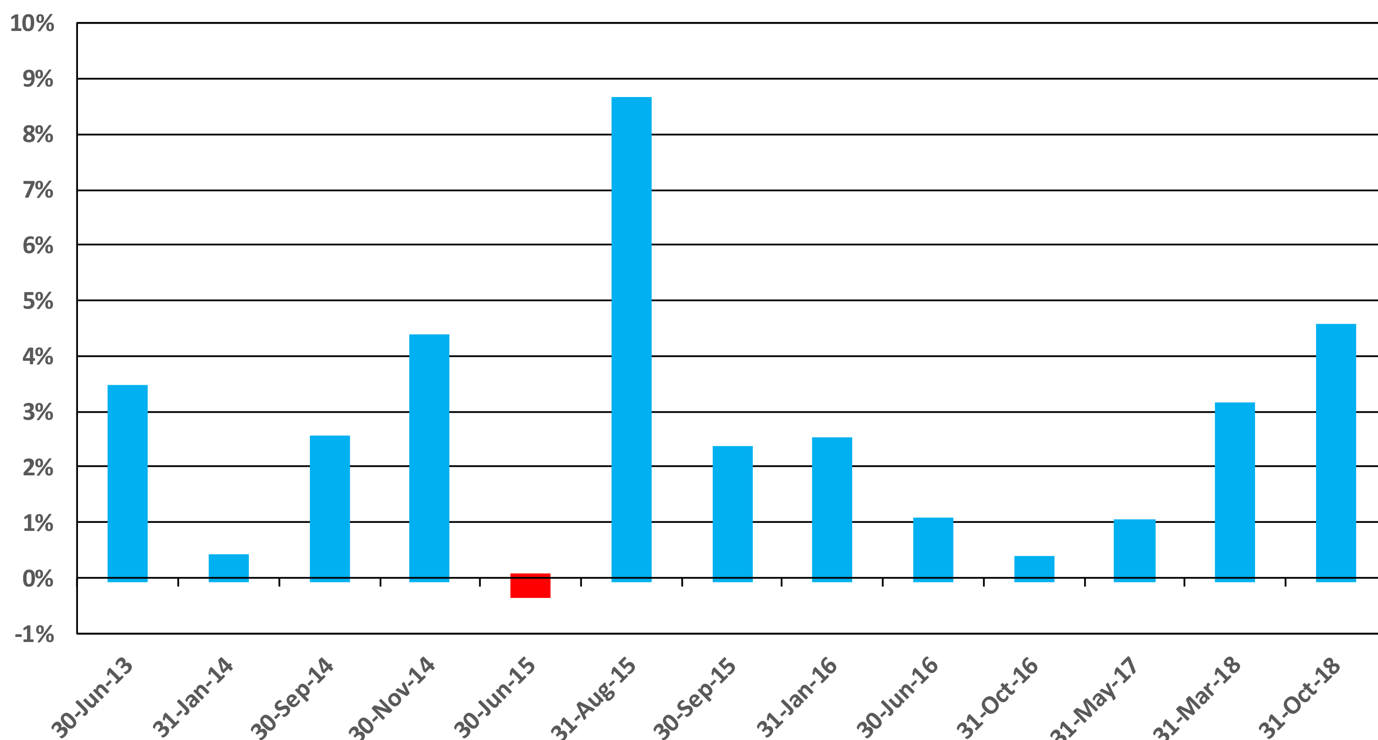
The Australian equity market continued to fall from its August 2018 peak, resting down over 6%. This in our view is not surprising given the weakest reporting season for many years as well as elevated valuations that had been the mainstay for most of this year. In terms of macroeconomic events that have impacted on markets there is a smorgasbord of reasons which have appeared to compress market consensus of late:

1. Rising bond yields dampening equity market valuations together with signalling by Central Banks to take out liquidity
2. "Trade Wars" across the globe precipitated by myopic American policy which will lead to increased supply chain capacity against a backdrop of remnants of excess capacity post GFC
3. Weakening housing markets not only driven by price but also the end of the construction cycle precipitating the likelihood of a cyclical downturn in employment
4. Pro-cyclical expansionary US Fiscal policy at a time when it is not needed
5. Doubts about the longevity of the current global business cycle expansion

All appear to be legitimate concerns. However, we would pinpoint the first reason above for likely underperformance for asset classes in general ie market participant expectations for a reduction in credit is now apparent. As with any credit cycle which tends to pump-prime asset prices, when the music stops so does the positive trajectory of asset prices. Given that the

credit cycle is well telegraphed, investors should be very careful in making sure they are positioned for choppy waters. This is not a market for the faint-hearted and one should be diligent and process-orientated such that losses are minimised. In this respect, many investment managers had been able to capture the swing in equity market prices up until August 2018 but when the market reverted violently, many of these managers are now down significantly in absolute terms. The greed that was endemic in the market over this calendar year has been extraordinary and, in many ways, the weak company reporting performance was the straw that broke the camel's back. On top of this, most managers that you would hear in the press are long only managers, most of which will not be able to withstand a downward trending market without significant losses.

We are agnostic as to whether markets go up or down. We are more concerned about capital preservation when the alarm bells are ringing and to providing superior risk-adjusted returns over the long run. These market environments are our forte. Our experience in these types of markets is deep. From preserving capital through the GFC (as a Fund Manager who worked for another company) to now how we manage the Fund is critical to the success of our clients over the long term. Markets will always rise and fall, and it is how one adapts in down markets that matters because no one likes losing money. We present the following chart which looks at the material down months (more than 2% for a month) since inception of the Fund. This in our view is a good yardstick for performance when the going gets tough. In 12 instances out of 13 of the market falling more than 2%, we have outperformed and, in some cases, materially. While we would have liked to have had a perfect record, it nonetheless highlights our abilities and way of thinking.



Source: APSECFM

Fund Activity

As is always the case, when uncertainty is high we essentially move into risk management mode. For most of the month, we had virtually very little exposure. This was represented in a number of ways. First of all, our preferred method of hedging is the utilisation of the Australian SPI futures contract. This is a fantastically liquid and cheap instrument which enables typically an instantaneous implementation of a hedge. As is always the case, we have a book of longs which fall in a market like October 2018 but with the overlay of the SPI hedge, capital is able to be protected. For example, over the month of October 2018, our longs fell around 6% but with the SPI hedge, this was ameliorated by a 3% positive contribution.

We also had a number of short sold companies which contributed materially to performance further dampening the impact of a market which fell over 6%. Cochlear (COH), continued to revert post downgrades and stupendously high valuations. We had been quite perplexed at how this company's shares had performed so well this year. We had short-sold their securities at their all-time highs and continued to hold through October 2018 until the end where we covered the entire position. This was almost a perfect short sell trade combining fundamentals, valuations and technical analysis. By end of month, the position contributed 0.33%.

Source: APSECFM, HALO

We also shorted Premier Investments (PMV) during September 2018 cum their financial report. We show the trade setup in the chart below. For those of you with long enough memories, PMV had been a major contributor to the Fund's returns during the first 3-4 years of life. The investment thesis at the time was the emergence and long-term growth platform provided by Smiggles and Peter Alexander. Their other businesses were never going to be the reason to hold PMV but with clinical execution of their optimisation program led by Mark McInnes, these mature businesses were no reason to sell the company either. However, there comes a time when every company goes through a hiccup, typically, not due to their own efforts but the industry conditions that are presented and they miss the market's expectations. Leading into the result, we took the view that analyst expectations were way too high coupled with EV/EBITDA valuations of over 16x. The market had effectively priced the company for perfection and any downgrade would lead to a falling share price. We remain concerned on their domestic business and the likely trajectory of sales over coming months and remain short. We don't believe there is anything in the short term to shake us from this tree. The company contributed 16bps to Fund returns.

Source: APSECFM, HALO

We have also maintained our short in Challenger Financial (CGF). This is a company which has undergone significant change over time and has grown significantly across retail platform distribution for their annuity product and more recently into Japan given the moribund Japanese bond market not offering any real-yield. However, this has all come at a cost to per share metrics. In particular, the company's capital raising in February 2018, led to a presumption that in order to grow they were effectively short capital. This event alone has proceeded to lead to a downgrade to earnings expectations. In relation to the short positioning into their report in August 2018, we took the view that in order to meet their own expectations, the company would need to perform even more strongly than they had. After various channel checks, observance of hiring intentions within the company or lack thereof and slowing sales into year end, we took the view that the company could miss expectations. This has indeed occurred with the added bonus (for a short seller) that their once lofty expectations of achieving a Return on Equity (ROE) of 18% by FY19, which they had heralded for many a year, would no longer be possible. And now post their AGM in October 2018, the current CEO has decided to pack his bag and run. This is certainly good timing for the Fund but not a great outcome for CGF shareholders who were relying on the former CEOs vision to drive the group fortunes over many years to come. The equity contributed 0.23% to Fund returns. We remain short their equity into November 2018.

Source: APSECFM, HALO

Risk Statistics (As at October 2018)

	Fund		Index	
	3 Year	Inception	3 Year	Inception
Alpha (%pa)	-6.0%	1.1%		
Downside Capture	41%	48%		
Standard Deviation	6.4%	8.2%	9.9%	11.0%
Sharpe ratio	0.1	0.9	0.7	0.6
Sortino		1.5		1.3
Largest Drawdown	-7.1%	-7.1%	-13.7%	-13.7%

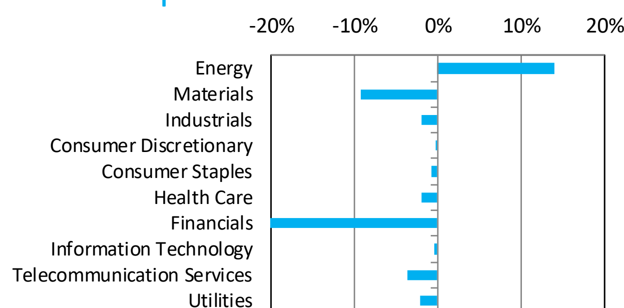
Exposure

	Long	Short	Net	Gross
Equity	76%	-4%	72%	80%
Index Futures	0%	0%	0%	0%
Net	76%	-4%	72%	80%
Cash			28%	

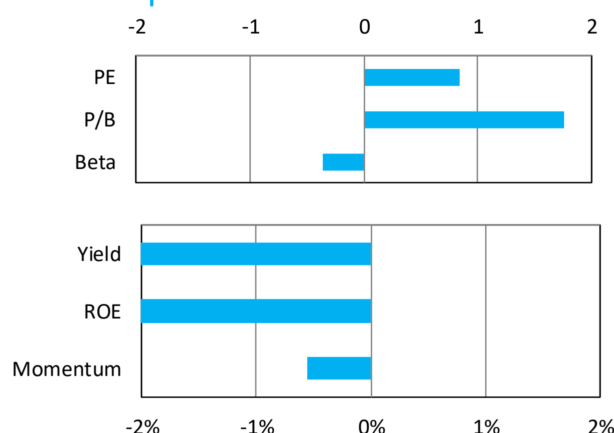
Contribution

Positive	Negative
Cochlear (Short)	Bingo Industries (Long)
Challenger Financial (Short)	Corporate Travel (Long)
Fortescue Metals (Long)	Norwood Systems (Long)
Universal Coal (Long)	Woodside Petroleum (Long)

Sector Exposure



Factor Exposure



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)	1.2386	Application Price (ex Dist)	1.2398
		Redemption Price (ex Dist)	1.2374

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

APSEC
FUNDS MANAGEMENT

Important information

APSEC Funds Management Pty Ltd ACN 152 440 723 (APSECFM) is a corporate authorised representative (CAR: 411859) of APSEC Compliance and Administration Pty Limited (AFSL 345 443 ACN 142 148 409). APSECFM is the investment manager of the Atlantic Pacific Australian Equity Fund (ARSN 158 861 155) (Fund). This document has been prepared and issued by APSECFM. Equity Trustees Limited ("Equity Trustees") (ABN 46 004 031 298), AFSL 240975, is the Responsible Entity of the Fund. Equity Trustees is a subsidiary of EQT Holdings Limited (ABN 22 607 797 615), a publicly listed company on the Australian Securities Exchange (ASX:EQT). A Product Disclosure Statement (PDS) for the Fund is available at www.eqt.com.au/insto and can be obtained by calling APSEC on +612 8356 9356. The PDS should be considered in deciding whether to acquire, or to continue to hold, an investment in the Fund. This material is for general information purposes only. It is not an offer or a recommendation to purchase or sell any security and is not intended to substitute for the Fund's PDS which will outline the risks involved and other relevant information. It is not intended to take the place of professional advice and you should not take action on specific issues in reliance on this information. Please note that past investment performance is not a reliable indicator of future investment performance. Equity Trustees do not express any view about the accuracy or completeness of information that is not prepared by Equity Trustees and no liability is accepted for any errors it may contain. The performance of the Fund or the repayment of any investor's capital is not guaranteed. This information has not been prepared taking into account your objectives, financial situation or particular needs. This document may contain information provided directly by third parties. To the maximum extent permitted by law, APSECFM excludes liability for material provided by third parties. APSECFM does not warrant that such information is accurate, reliable, complete or up-to-date, and to the fullest extent permitted by law, disclaims all liability of APSECFM and its associates. APSECFM believes that the information contained in this document is accurate when issued. To the maximum extent permitted by law, APSECFM excludes liability for any loss or damage arising as a result of reliance placed on the contents of this document.

HALO is an analytical tool developed and owned by HALO Technologies Pty Ltd (ABN: 54 623 830 866) (HALO Tech) a Corporate Authorised Representative (CAR: 1261916) of Amalgamated Australian Investment Solutions Pty Ltd (ABN: 61 123 680 106. AFSL: 314 614) (AAIS) and a related party to ASPEC FM. HALO only contains factual and forecast information. Information presented or extracted from HALO should not be considered advice or a recommendation. Any forecast information relates to the intent, belief and current expectations of various analysts via Factset with respect to the performance of the respective stocks based on historical and projected performance data. You should not place undue reliance on these forward-looking statements. While all due care has been used in the preparation of the forecast information, actual results may vary in a materially positive or negative manner. Forecasts and hypothetical examples are subject to uncertainty and contingencies outside of HALO Tech's or AAIS's control. If you would like more detail in relation to HALO please contact APSEC FM / or your Adviser.