YEARLY FUND REPORT

2015

Atlantic Pacific Australian Equity Fund

ARSN 158 861 155

Fund Return vs the S&P/ASX 200 Accumulation Index after All Fees before Tax

Period	1 mth	3 mth	6 mth	1 yr	Inception (June 2013) Cumulative	Inception (June 2013) Per Annum
Fund Return[1]	0.88%	-1.61%	9.35%	17.0%	44.7%	20.3%
Index	0.40%	-1.37%	11.12%	9.9%	28.0%	13.1%
Outperformance	0.48%	-0.24%	-1.77%	7.0%	16.7%	7.1%

Key Fund Data

Unit Price (Mid)	1.3188	$10,000	Min. Investment
MER	2.2%	$5,000	Add. Investment
Performance Fee[2]	15%	1 Jun 13	Fund Commenced
Buy/Sell Spread	0.20%	30 Jun	Income Distribution

Fund Return by Month after All Fees before Tax

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Ytd
2013	n/a	n/a	n/a	n/a	n/a	1.09%	5.08%	6.72%	3.51%	1.92%	-3.03%	2.58%	18.97%
2014	-2.67%	3.83%	1.25%	2.04%	-0.42%	-0.28%	3.15%	2.27%	-2.89%	3.63%	1.05%	2.56%	14.06%
2015	2.62%	5.60%	-0.66%	-1.82%	0.88%								6.62%

1. Fund Returns are prepared on a mid 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.
2. Performance Fees are charged where the Fund's gross performance (before fees and expenses) exceeds the performance of the S&P/ASX 200 Accumulation Index by 3%pa and the Fund's High water mark.

Overview

Another year has passed and we present the second Yearly Fund Report for the Atlantic Pacific Australian Equity Fund (the "Fund"). The past year has certainly been a harder year to make money with market returns of only 9.9%, near half of the prior year's returns. Notwithstanding, we were able to create 7% of extra alpha after fees before tax through active management of the portfolio, near doubling the return of the market over the year. This is in line with what we set out to do over the year, and each and every year moving forward i.e. beat the market by 5-10% after fees before tax. This is an important target for the Fund's long term investors but nonetheless does not suggest this will necessarily occur in the future. Hypothetically, over ten years, if we as the investment managers of the Fund are able to achieve a 7% excess return in each year (assuming the market provides a long run return of 10%pa over those ten years) unitholders will double their money relative to the market return. This shows the power of compounding capital and income growth and is what we aspire to deliver. Time will tell as to whether we achieve this. Not many investment practitioners are able to deliver these types of returns given their aversion to concentrated risk and to some extent a misunderstanding of risk per se, which has tended to lead to sub-optimal returns within the industry.

We were able to create 7% of extra alpha after fees before tax through active management of the portfolio.

The market over the past year can be decomposed into two halves. The first six months (June 2014 to Nov 2014) may be characterised by a sideways market with the market printing down 1.1%. This was not totally unexpected given the poor performance of resource companies which weighed on the market, driven by the dramatic falls in the iron ore and copper price. The Fund had very little exposure to resource companies over the year. The Australian market was also exposed to the turgid Federal Budget of 2014 which resulted in significant underperformance across a number of sectors and companies that the Fund was exposed to. In particular the Consumer Discretionary sector was hit by a subsequent significant weakening in consumer sentiment. Despite these major negative thematics weighing on performance, the Fund achieved a return of 7% for the first 6 months, driven in part by an overweight to companies with overseas earnings exposure to take advantage of our expectation that the AUD would weaken significantly, which turned out to be correct, generating strong

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returns for a number of our holdings including Amcor (AMC including the spin-off security Orora (ORA)), CSL (CSL), Magellan Financial Group (MFG) and Westfield Group (WDC/ WFD including the spin-off security Scentre Group (SCG)). The Fund also had exposure to individual company risk which contributed significantly to returns including M2 Group (MTU), Premier Investments (PMV) and Retail Food Group (RFG). Throughout the second half of the year market returns can be explained through an understanding of the volume of excess liquidity that entered markets during this time. Flows into equities were driven by European quantitative easing, expansion of the Japanese quantitative easing program, coordinated interest rate cuts across most major economies in early 2015 and more recently, China's reduction of borrowing costs in order to stave off their weakening investment environment. This led to interest rate sensitives globally outperforming and in the Australian market context, Banks, Telecoms, Utilities, and Property trusts. The Fund generally did not invest in these sectors (apart from Telecoms), tending to rely more upon expected volume increases and corresponding margin expansion in companies undergoing positive dynamics i.e. fundamentals. This led to underperformance of the Fund of 1.6% relative to the benchmark but a healthy 9.3% absolute return over the last 6 months of the year as asset revaluations, driven by lower nominal interest rates, became the dominant share price driver. Notwithstanding, the Fund had little exposure to Banks as they went into freefall over the last two months of the year driven by heightened capital raising risk and a global selloff in bonds driving yields higher. Interestingly, the major banks underperformed the market over the year, quite unexpectedly. The Fund has had little exposure to Banks since inception and given forward indications of their potential earnings, the Fund is unlikely to build significant exposure in Australian banks in the future. Of course, there will always be calls from market analysts which may result in improved price outcomes for the banks either due to an upgrade of recommendation in the short term or simply a reversion on the basis of relative valuation, but like the underperformance of resource companies over the past year, we believe Australian banks, with their declining return on equity profile likely to deteriorate further, will also lead to underperformance over the medium term.

Investments

Table 1: Return Contribution by Size

Market Segment	Share
S&P/ASX50	52%
S&P/ASX100	62%
S&P/ASX200	89%
ex S&P/ASX200	11%

Table 1 provides a breakdown of the returns the Fund has achieved as depicted by a proxy for liquidity i.e. size. As we have stated in the past, we tend to focus on the Top 50 companies and selectively choose companies outside of this universe to add specific company risk. The table shows over 60% of the returns came from the most liquid companies (Top 100) in Australia. Beyond this, approximately 90% of returns came from within the Top 200 companies. Our investment strategy will always be dominated by the most liquid companies with the ability to add further value through selective mid to small cap company selections. We recognise that small caps are often a place where one can earn super-normal profits when the market environment is positive but conversely when markets are falling, the likelihood of significant downward price gaps increases. The potential for significant loss results in very minimal allocation to micro and less liquid small caps, to the extent that these types of companies will very rarely feature highly as a contributor. A further interesting point, though not shown, is that we don't generally participate in capital deals (IPOs, Placements, etc) or where we do very minimal capital is allocated. There are always great stories being spruiked by the many broking houses but over the many years we have participated in equity markets we haven't necessarily found a sure fire way of making consistent money from these activities. In other words, we stick to our disciplined process of focussing on companies with a listed history. Beyond these less than obvious "new company" deals, we also have not been fortunate to be exposed to a takeover over the life of the Fund. These events can contribute significantly to excess returns but it would seem we are always left at the altar. The most probable reason for this dynamic is that we very rarely have the wherewithal to predict when it is most likely a company will be taken-over as what typically precedes a take-over is underperformance which we don't necessarily want our unitholders to be exposed to. Notwithstanding, given the number of stocks in which the fund invests through any given period, it is likely that unitholders will at some stage be exposed to the excess returns generated by the announcement of a takeover.

Our investment strategy will always be dominated by the most liquid companies with the ability to add further value through selective mid to small cap company selections.

Table 2 provides a breakdown of the major contributors to the Fund's returns over the year. This reflects in some ways our intellectual property, a snapshot of which we are happy to

Table 2: Return Contribution by Security

Significant Contributors (>0.50%)

Company	Name	Main Index	Thematic	Sector
AIO	Asciano	ASX50	Cost-out plus De-leveraging	Industrial
AMC	Amcor	ASX50	USD Strength	Materials
BXB	Brambles	ASX50	USD Strength	Industrial
FXJ	Fairfax Media	ASX100	Cost-out plus De-leveraging	Consumer Discretionary
ICQ	iCar Asia	Micro	Early Stage	Consumer Discretionary
JBH	JB Hi-Fi	ASX100	Organic Growth	Consumer Discretionary
MFG	Magellan Financial	ASX100	USD Strength + Organic Growth	Financials
MQG	Macquarie	ASX50	USD Strength	Financials
MTU	M2 Group	ASX200	Acquisition led growth	Telecoms
NXT	NextDC	Small	Cash-flow positive state	Telecoms
PMV	Premier Investments	ASX200	Organic Growth	Consumer Discretionary
RFG	Retail Food	ASX200	Acquisition led growth	Consumer Discretionary
SHL	Sonic Healthcare	ASX50	USD Strength	Healthcare
SHV	Select Harvests	Small	Almond Price	Materials
TLS	Telstra	ASX50	Stable Yield	Telecoms
WFD	Westfield	ASX50	USD Strength	Property
	Featured Last Year			

Significant Detractors (<-0.50%)

Company	Name	Main Index	Thematic	Sector
SGN	STW Communications	ASX200	Idiosyncratic underpeformance	Consumer Discretionary
BSL	BlueScope	ASX100	Steel Prices	Materials

share. The main ideas represented in the returns of the Fund include a number of overall thematics that enabled outperformance over the year and in particular the first six months. The dominant contribution to returns is attributable to the Fund's overweight to overseas earnings streams (AMC, BXB, MFG, MQG, SHL & WFD). There is a very simple analytical framework to explain this. By far and away the fall in the Australian dollar (AUD) or expectations therein was the dominant macroeconomic thesis in the market over the past year. As the AUD fell, the value of overseas earnings streams became more valuable in the "hands" of Australian investors, irrespective of reporting currency and at times whether a business was performing or not. This led to consistent bidding up of prices for these assets until February/March 2015. In hindsight, we probably exited most of these positions 2-3 months too early. However, as was evident at the time of liquidation, company share prices were bid up indiscriminately over the January/February 2015 period which in most cases led to prices significantly above our target prices. We must remain disciplined on not only entry but also exit where valuations move to levels that represent poor risk-reward dynamics in our opinion. Individual company specific risk arose characterised by a number of familiar descriptions and themes. Acquisition led growth companies are defined as companies expected to improve earnings based on the notion that the whole is worth more than the sum of the parts. In particular, companies may be able to arbitrage their own valuation by buying cheap assets, improving the scale of acquired businesses, or alternatively, there may be an opportunity to vertically integrate thereby capturing margin they would ordinarily pay away to others either above or below them in the supply chain.

The dominant contribution to returns is attributable to the Fund's overweight to overseas earnings streams.

In the case of M2 Group (MTU), the company has been in acquisition mode for the past couple of years with the fruits of these acquisitions now performing well, value uplift has been delivered to investors through a combination of valuation arbitrage and scale efficiencies. It is often the case that investors are unwilling to pay upfront for the uncertain benefits of an acquisition; rather they require the company to report on their success for a company's share price to be re-rated. This was the case with Retail Food Group (RFG) which had been discounted on a relative value basis until the company was able to confirm the trajectory of their earnings to the market. The other major company specific risk we focus upon is finding companies which have the opportunity to reduce costs (operational or sell-downs) and de-lever their balance sheet. Asciano (AIO) and Fairfax Media (FXJ) fall into this category. AIO has provided very low beta exposure for the portfolio over the past year and has behaved remarkably well relative to the up and downs of the market. It remains one of the Fund's preferred investments with further upside expected if they are able to de-lever their balance sheet (driven either by cost-out or asset sell-downs) to improve payout ratios. As one can see from the table, only a few companies have been represented over both years of the Fund's history. The statement "Past performance is no indicator of future performance" necessarily applies at the company level! As is always the case, we had our fair share of underperformers over the year however the number was quite small. This is partly because we generally cut our losing positions quickly when it becomes apparent that our original investment rationale was incorrect. Further, the market did produce an almost "average" return of 9.9% over the past year, versus a historical average of 10.5% over the past 20 years, which necessarily results in a skew towards positive returns across the market.

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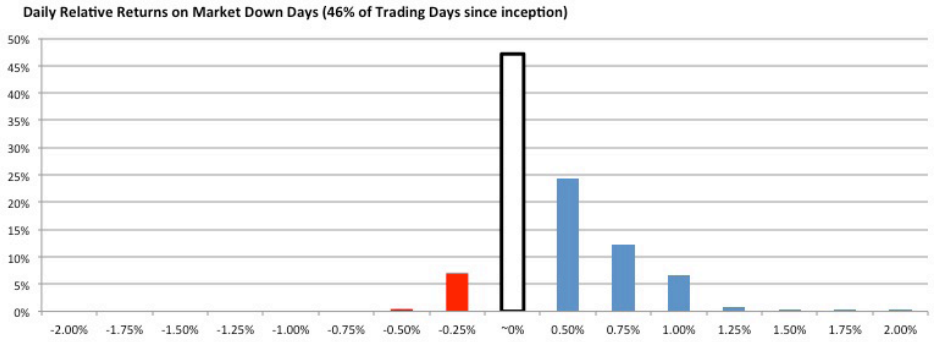

A Brief Discussion on Risk

There are many notions of risk used by the investment community, the majority of which to some degree focus upon volatility. These quantifiable measures include volatility of investment returns, tracking error relative to an index, Value at Risk (VAR) or a more simplistic measure like beta. We have our own opinion on whether these represent legitimate representations of risk and as we have witnessed over almost two decades of investment analysis (while working with various investment companies) they are only part of the story. By far and away our greatest fear or risk as investment managers is the fear of suffering a loss which is not recoverable (whether for a finite or for an extended period of time) i.e. permanent loss or downside risk. None of the "traditional" risk measures are able to adequately measure the risk of permanent loss or downside risk, with their focus too heavily upon volatility as a proxy for risk. Indeed, we have no answer to this either a priori. However, this highlights our aversion to focus on the traditional risk measures with bias as the industry typically does. Instead, we focus more about downside risk despite the Fund having a long bias. This statement may seem contradictory but we know each sits perfectly comfortable together.

In our first year of operation this idea was highlighted at the stock level with the permanent write-off of around 2% of unit holder funds as a result of our unfortunate investment in Forge Group (At this juncture we see very little hope of recovering any value from this administered company). While stock specific permanent losses will always be a feature of any Fund's investment returns (albeit hopefully no more than a one in twenty year event), at a portfolio level it is paramount to consider downside risk, as a fully invested equity portfolio can lead to downside returns of over 50% through certain macroeconomic and market conditions, as witnessed at one point during the last decade. As such, while not knowing a priori whether a particular day will present as "risky" and lead to substantial loss, we need to be prepared for such outcomes.

By far and away our greatest fear or risk as investment managers is the fear of suffering a loss which is not recoverable.

In the chart above we demonstrate the daily relative return performance of the Fund since inception on days where the market has produced a negative return. It shows a positive skew demonstrating that the Fund has tended to outperform on down days. This is a deliberate result of our investment strategy, and stems from our aversion to suffering significant drawdowns. In our opinion this is the simplest representation of our internal risk management controls that we can provide. Despite the market now having increased 28% since the inception of the Fund, over 45% of trading days have been negative averaging around -0.55%. Historically over the past 30 years for the All Ordinaries Accumulation index, the ratio is closer to 48% with an average of around -0.60%. This shows an extraordinary symmetry to the downside despite the fact markets have moved over 1200% in 30 years. This highlights that if one were to focus upon this, significant relative value could be captured. We focus on this and expect to create significant value from merely not investing to the extent to which we ordinarily would be compelled to. We of course continue to focus upon security selection to deliver most of the excess returns of the Fund in a normal year, and while this approach obviously has implications in terms of opportunity cost i.e. not being exposed while markets are running but, within the conceptual framework in which we consider portfolio risk we consider opportunity cost to be less significant than downside risk. Therefore, downside loss, and our attempts to minimise and avert it, is central to our thinking and our management thereof will be critical for the future performance of the Fund.

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In Summary

Once again, our focus on generating upside volatility while minimising downside volatility within the large and mid-capitalisation space has performed well over the past year. We are very happy to report another strong year relative to the market and will strive to maintain the momentum. As we alluded to earlier, we do have periods of underperformance, but our focus remains on the bigger picture, being the long run performance of the Fund, a journey that at this point in time we are only a couple of years into. As always, we need to be consistent with the way we approach equity markets and believe over the long term (5-7 years) our strategy will continue to generate significant excess returns for investors whilst displaying lower downside bias than the market. We would again like to thank all current investors for placing their trust in us by allowing us to manage a part of their investment portfolio and we look forward to continuing to serve you over the coming years. We would also like to take this opportunity to thank all of the service providers to the Fund who have assisted us in delivering a robust operational and compliant platform for unit holders.

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