Ironbark Karara Australian Share Fund

Monthly Investment Report as at 28 February 2018

Asset Class

Australian Equities

Investment Objective

To outperform the benchmark (before fees) over rolling 4 year periods

APIR Code

PAT0001AU

ARSN

114 291 299

Fund Inception Date

30 June 2005

Manager Appointed

1 May 2010

Benchmark

S&P/ASX 300 Accumulation Index[1]

Distribution Frequency

Semi-Annually

Minimum Investment

$20,000

Fund Size

$76.7m

Exit Price

$1.6277

Market Review

Volatility returned in February, belying the ASX 300 Accumulation Index's small 0.34% gain. Sharp declines early in the month were triggered by a step up in US wage growth. This weakened the consensus view that rising inflationary pressures are not an immediate concern. The influence of exchange traded funds and other structured products on markets was evident as the initial declines induced technical selling that overwhelmed buyers for several days straight.

Local shares fared far better than global equities, which had their worst month in two years. Major global benchmarks lost between 3.5% and 6% although the tech thematic remained exceptional (NASDAQ -1.9%). Australian returns were insulated by a weaker currency (-3.6%) and a solid series of domestic profit releases.

International economic data toward month end turned less overtly growth supportive with Chinese leading indicators softening and mixed purchasing manager index readings in Europe. Australian releases were similarly choppy. Employment data and business confidence remaining well above trend, as there is some tentative improvement in wage growth but consumer confidence, retail sales and housing finance has weakened.

Commodity returns were variable with weakness in oil (-6%) and gold (-2%), iron ore (up 9%), wheat (up 7%) and corn (up 4%) were higher. Gold's fall was unusual given the equity market sell off and appetite for inflationary hedges. US oil inventories rose in line with seasonal patterns ending the steep downward trend that commenced mid last year. Declines in risk markets, large managed money long positioning and renewed debate around accelerating shale production also hurt oil sentiment.

Australian reporting season was more consistent than in recent years, with few significant disappointments and generally more constructive outlook commentary.

Input cost pressures, where well anticipated, such as oil and electricity, were generally managed well. But there were more instances of unanticipated cost increases such as from production shortfall (South32, BHP), skills scarcity (Brambles, Healthscope, Fletcher Building), or franchise model pressures (Domino's, Retail Food Group, Caltex).

With reasonable demand conditions and tightening capacity corporate pricing power is broadening somewhat. The margin conditions are improving in oil and gas, agriculture, steel, mining and mining services, travel, education, health care (ex hospitals), chemicals, supermarkets and general insurance. Conditions remain favourable in building materials, technology, infrastructure contracting and electricity generation. Telecommunications, apparel retail, retail property, hospitals, property development, wealth management, and banking are seeing moderating demand growth or structural pressures and with heightened focus on cost reduction.

Forward looking estimates were stable to slightly higher, also better than usual. High single digit prospective earnings per share growth is a little ahead of recent history.

Performance

	Net Fund Return (%)	Benchmark Return (%)	Active Return (%)
1 month	0.07	0.34	-0.27
3 months	1.31	1.80	-0.49
1 year	9.80	10.34	-0.54
3 years (p.a.)	3.93	5.22	-1.29
5 years (p.a.)	7.00	7.95	-0.95
7 years (p.a.)	7.20	7.75	-0.55
10 years (p.a.)	4.93[3]	5.15[1]	-0.22[3]
Since inception[2] (p.a.)	6.75[3]	7.38[1]	-0.63[3]
Since Karara as Investment Manager (p.a.)	6.72	7.50	-0.78

Past performance is not an indicator of future performance. Net performance figures are calculated using exit prices, net of fees and reflect the annual reinvestment of distribution.

[1]The S&P/ASX 300 Accumulation Index was adopted as the Fund's performance benchmark on 1 July 2010. Benchmark calculations prior to this date are based on the S&P/ASX All Ordinaries Index.

[2]This figure represents the annualised performance of the Fund since inception.

[3]Karara Capital appointed investment manager on 1 May 2010, Fund performance prior to this date is not attributable to Karara Capital but the prior manager.

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Ironbark ASSET MANAGEMENT

Ironbark Karara Australian Share Fund

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Performance Review & Fund Activity

The Ironbark Karara Australian Share Fund (the 'Fund') returned 0.07% (net) for February, underperforming the benchmark's return of 0.34% by 0.27%.

At a high level the Fund benefit from low exposure to interest rates sensitive stocks was offset by limited holdings of very highly priced growth stocks which (generalising somewhat) continue to re-rate ahead of earnings delivery.

Market movements continue, in the investment manager's view, to over-exaggerate the strength of results of the high price-earnings cohort and remain excessively cautious on the lower tier. The low failure rate of this group as a whole through reporting season (with the obvious exceptions of fading darlings Dominos (-17%) and Ramsey Healthcare (-7%)), and generally downbeat commentary from REITs, banks and consumer facing sectors made this the continuing line of least resistance, discouraging valuation based references despite the hurdle of rising interest rates.

No REIT holdings added 18 basis points with a further 35 basis points coming nil interest in Telstra (-6%), Transurban (-4%), Sydney Airport (-3%) and Tabcorp (-8%). Revenues at Telstra and Tabcorp were impacted by increasingly formidable competition. Offsetting this were underweights to CSL (up 11%), Cochlear (up 6%), and a2 Milk (up 48%) which collectively impacted 50 basis points.

Performance of stocks that the investment manager regards as highly attractive on absolute and price to growth measures, which the Fund is overweight in, was patchy, with strong stock selection in a number sectors (energy, industrials, IT, materials ex mining) offset by some minor stock specific disappointment, some of which the market seems anchored around low probability scenarios. Positions in AGL (-4%), JB Hifi (-8%) and Star Entertainment (-11%) detracted.

Positive contributions came from positions in Qantas (up 12%), Rio Tinto (up 6%), Ansell (up 6%), Downer EDI (up 3%). Qantas posted growth of 19% in earnings per share which was well above expectations. Tight fleet management is enabling higher ticket prices which are more than mitigating higher fuel costs. The outlook for resources, corporate, loyalty, and international segments are improving. Qantas' 15% return on invested capital puts Virgin's 3% return on invested capital in stark relief and demonstrates a competitive advantage which belies a single digit earnings multiple.

Small cap positions in Altium (up 33%) and Costa (up 19%) captured some of the small cap growth enthusiasm.

Stock selection in insurance sector detracted. Early cycle leverage was evident in IAG's (up 15%) but costs pushed Suncorp (up 1%) and QBE's (-5%) underlying margins lower. IAG has lowered short term earnings volatility with quota sharing agreements but its core franchise is far more like Suncorp's than it is different. Looking forward, rising premium rates, Suncorp's new commitment to hard cost targets and asset sales should lift earnings and shareholder returns.

Over the month the Fund added to its positions in Qantas, Suncorp, BHP (up 1%) and Wesfarmers (-3%) while holdings in Woolworths (up 2%), James Hardie (up 5%) and Ansell (up 6%) were trimmed. The small position in Vocus was sold following disappointing result disclosure.

Market Cap Distribution

Market Cap	Fund (%)	Bench (%)
1- 50	71.57	76.60
51-100	15.71	12.77
101-200	7.57	8.01
201-300	1.83	2.62
Ex 300[1]	1.54	0.00
Cash	1.78	0.00

[1]Including Placement Securities

Top 5 Active Weights

Security Name	Active Weight (%)
CSL	-4.47
AGL Energy	3.20
Origin Energy	2.82
Brambles	2.69
Telstra	-2.39

Key Contributors & Detractors for the Month

Top 5 Contributors	Active Position
Qantas Airways	Overweight
Altium	Overweight
Woodside Petroleum	Underweight
South32	Underweight
Telstra Corporation	Underweight

Top 5 Detractors	Active Position
CSL	Underweight
Star Entertainment Group	Overweight
AGL Energy	Overweight
JB Hi-Fi	Overweight
Insurance Australia Group	Underweight

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Market Outlook

The global economy entered 2018 with strong momentum. Global growth indicators remain robust albeit inflationary expectations currently remain modest. The investment manager anticipates above-trend global growth to continue for some time and for slack in the global economy to decline resulting in higher rates of inflation in due course. With the durability of this period of growth still doubted by many market participants, large pools of global capital remain defensively positioned in assets with negative real yields.

Slack in the US economy and labour market is now relatively low and rapidly decreasing in Europe and Japan. Given this, the significant expansionary monetary policy pursued by the three key central banks is increasingly less appropriate and risks are rising that the market is underestimating the pace of tightening that may be required. However, the investment manager anticipates that the key central banks will have some tolerance around inflation exceeding their targets as wage inflation picks up.

With the global earnings outlook improving and a decent gap between earnings and bonds yields, there is scope for the stock market to weather somewhat higher interest rates. The key macro risks remain twofold:

- The sustainability of debt driven Chinese growth. Given the success of 2016's stimulatory efforts, the Chinese Government's focus has moved judiciously towards containing risks, controlling credit growth and advancing reform. The investment manager expects policy to be more modulated going forward and overall less supportive for steel making materials.

- The structural challenges in Europe remain unresolved. Better growth and recent electoral outcomes are encouraging however adverse political risks remain.

Whilst the global growth improvement is relatively synchronised, Australia is lagging. The investment manager anticipates that Australian gross domestic product ('GDP') growth will remain modest at around 2-3%. Strong population growth is assisting headline growth numbers with per-capita growth quite low in a historical context.

The modest uptrend in domestic economic data is encouraging, particularly the employmentgrowth. Overall, the investment manager expects aggregate consumer spending to be broadly in line with household income growth (3-4%), which is still low in a historical context. Further strength in the Australian dollar could jeopardise this.

House prices are high by any measure and conditions in the housing market vary considerably outside of Melbourne and Sydney. The tightening of credit to the investor segment of the market has had a cooling impact on the housing market with a reasonable likelihood of small real price declines over the next couple of years. As a small open economy, the key risk to house prices remains external macro shocks which have, if anything, diminished of late.

Moderate global growth and the return of pricing power in some sectors suggest a reasonable backdrop for many stocks. Although, after the expansion in valuations in recent years, sustained gains will require continuing profit delivery.

Portfolio Characteristics

No of large cap stocks
35

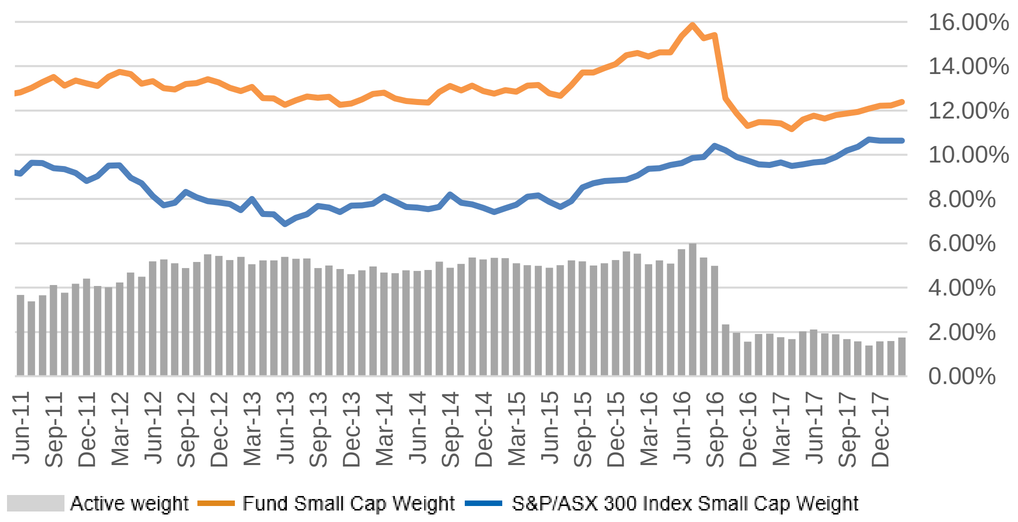
No of small cap stocks
59

Cash
1.78%

Portfolio Turnover (1yr)
49.60%

Sharpe Ratio (1yr)
1.25

Standard Deviation (5yrs)
11.35%



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Market Outlook (cont'd)

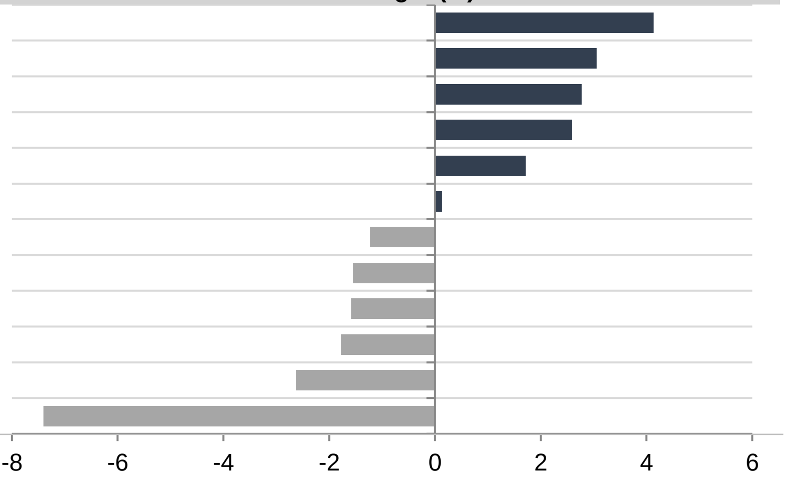
Aggregate valuation metrics are reasonable in a historic context, however high valuation dispersion exists. Valuation metrics appear stretched for stocks with defensive growth characteristics. The investment manager expects this starting point, along with the prospect of higher nominal and real bond yields and broadening growth, is increasing the opportunity cost of holding these stocks. Failure by individual companies to meet or exceed expectations, which is quite common and possibly likely to become more so in an environment of tighter input markets, can be expected to have bigger consequences than has been the case over the past couple of years. The Fund remains underweight to this area.

The Fund remains generally positioned for a more reflationary environment than is currently priced by the market and the investment manager continues to believe there are good risk adjusted returns available in many sectors. Within this, the emphasis is on attractive quality companies whose prospects are unappreciated by the market.

Asset Allocation

Sector Weights	Fund (%)	Bench (%)
Energy	9.25	5.12
Consumer Discretionary	7.85	4.79
Utilities	4.70	1.92
Materials ex Metals & Mining	6.60	4.01
Industrials	8.95	7.24
Information Technology	2.29	2.16
Health Care	6.61	7.83
Metals & Mining	12.39	13.95
Consumer Staples	6.02	7.60
Financial ex Property Trusts	33.04	34.82
Telecommunications Services	0.15	2.79
Property Trusts	0.37	7.77
Cash	1.78	0.00

Active Weight (%)



Important Information

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ASSET MANAGEMENT