Ironbark Karara Australian Share Fund

Monthly Investment Report as at 30 September 2017

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]

Buy/Sell Spread

+0.25%/-0.25%

Management Costs

0.99% p.a.[2]

Distribution Frequency

Semi-Annually

Minimum Investment

$20,000

Fund Size

$77.2m

Exit Price

$1.5236

Market Review

The S&P/ASX300 Accumulation returned 0.04% in September, adding another month to its string of near-zero returns. Calendar year to date it also remained practically flat (up 0.3%).

Australian performance was notable as there were no shortage of positive stimuli. Global economic data strengthened further, suggesting that synchronised growth has continued to gain momentum. Fiscal stimulus was put back on the table in the US and hurricane damage was interpreted as providing a further boost to activity. UK and US central banks signaled some greater conviction to lift rates this year which pushed their bond yields and currencies higher. Investor sentiment responded, evidenced by rising global stock markets, subdued volatility and outperformance of high yield credit. US benchmarks hit record levels (S&P/500 up 1.9%) and Europe (DJ STOXX600 up 3.9%) benefitted from a softening in the Euro.

Domestic gross domestic product ('GDP') and employment data was also encouraging, and business survey data remained at very high levels. The Reserve Bank of Australia was also upbeat noting 'the outlook of non-mining investment has improved recently'. Domestic bond markets paid some heed, pricing rising cash rates in 2018 with more conviction, although not enough to prevent the Australian dollar ('AUD') falling 1.4% against the US dollar ('USD').

The price of Brent oil rose 9% as data showed US and other OECD inventories continue to draw. Oil futures moved more convincingly into backwardation. This incentivises inventory release which suggests market participants now believe the supply-demand balance has moved into deficit. Doubts about the strength of US shale oil recovery increased as the US Department of Energy revised down production estimates. Metal prices softened somewhat however remained close to cycle highs.

Despite some large moves in yield curves, a reversal in the AUD and commodity price volatility, sector returns were surprisingly muted. The only sectors that rose or fell more than 2% were telecommunication services (-4.5%), utilities (-3.6%) and health care (up 2.2%).

So what explains the ASX's lethargy?

Firstly, confidence around domestic earnings was damaged by reporting season. In addition, a number of factors are keeping a lid on forward expectations: 1) there is no evidence, yet, of any improvement in household income growth, 2) concerns of the impact of flattening house prices, 3) heightening competition (for example Amazon, a new entrant into mobile telephony), 4) new regulatory risks (bank taxes, electricity), 5) limited listed exposure to parts of the economy showing improvement, and 6), a benchmark with large exposure to relatively low growth or interest rate sensitive sectors.

Performance

	Net Fund Return (%)	Benchmark Return (%)	Active Return (%)
1 month	0.30	0.04	0.26
3 months	0.30	0.80	-0.50
1 year	8.33	9.02	-0.69
3 years (pa)	4.59	7.12	-2.53
5 years (pa)	9.12	9.94	-0.82
7 years (pa)	7.16	7.68	-0.52
10 years (pa)	2.18[4]	2.98[1]	-0.80[4]
Since inception[3] (pa)	6.29[4]	6.99[1]	-0.70[4]
Since Karara as Investment Manager[4] (pa)	5.96	6.86	-0.90

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. Retail investors should refer to net returns. If investing through an IDPS Provider, the total after fees performance return of your investment in the Fund may be different from the information in this report.

[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] For a full breakdown of management costs, refer to the PDS dated 30 September 2017.

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

[4]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 0.30% (net) over the month, outperforming the benchmark's return of 0.04% by 0.26%.

Over the month, underweight positions in telecommunication services, consumer staples (-1.9%) and mining (-1.9%) sectors added value. Overweight positions in energy (up 1.1%) and financials (up 1.1%) also helped. Detracting were a modest recovery in property trusts (up 1.2%) and health care, which was mainly driven by CSL (up 5.0%) and is not held by the Fund.

Key stock contributions came from positions in Santos (up 6.9%), Oil Search (up 5.1%) and Incitec Pivot (up 8.1%) which were supported by firming output prices. Bank stock selection also assisted as NAB (up 4.3%) solidly outperformed CBA (-0.7%). Telstra (-4.9%), Fortescue (-10.9%) and Newcrest (-7.6%) were key contributing underweights.

AGL (-2.6%) and Origin (-2.2%) continued to be weighed down by intense media and government scrutiny around energy policy. Unfortunately, there is no silver bullet for lower power prices. Efforts by the government to intervene are only likely to result in higher longer-term prices as the regulatory uncertainty substantially increases the cost of capital to the sector. Over the month AGL provided a robust defence against the Federal Government's push to commit to keeping the Lidell coal power station open.

During September the Fund continued to reduce its position in Woolworths in favour of Wesfarmers.

Market Cap Distribution

Market Cap	Fund (%)	Bench (%)
1- 50	71.89	77.87
51-100	14.36	11.94
101-200	7.86	7.58
201-300	1.61	2.61
Ex 300[1]	1.46	--
Cash	2.82	--

[1]Including Placement Securities

Top 5 Active Weights

Security Name	Active Weight (%)
CSL	-3.93
AGL Energy	3.21
Telstra Corporation	-2.69
Origin Energy	2.53
Brambles	2.35

US Housing Trip

The investment manager recently visited the US and met with a number of companies and associations relating to the US housing industry across four states and also attended investor site visits for James Hardie and Boral.

The most consistent theme across all meetings was confirmation that skilled labour shortages are constraining the building trade. There are clear signs that labour costs are on the rise, although at this stage are still region and skill specific.

This tightness is impacting the growth of housing starts, along with still relatively constrained credit conditions for first home buyers. Millennials are a growing force in the housing market and will be a key driver of housing formation in coming years. The meetings point to a large degree of pent up demand for housing which should support sustained long-term growth in annual housing starts at around 20% above current levels (1.5 million houses) and potentially beyond.

James Hardie Site Visit

Fallout from the production issues experienced by James Hardie over the past 18 months have forced an honest reappraisal of planning and execution. The company is implementing changes and appears to be making solid progress to this end. In the investment manager's opinion, the issues are fixable.

Competition has increased in recent periods, as the economy and housing cycle improves more participants are pursuing a share of that improvement. James Hardie is responding to this change through wider targeting of specific competitors and market segments.

The investment manager returned with the view that there has been no significant change to the company's competitive positioning or market opportunity and with confidence in their ability to sustain the category share growth over the longer term. As housing construction levels gradually improves and James Hardie's market share increases then earnings should rise significantly.

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US Housing Trip (cont'd)

Boral Site Visit

The investment manager was impressed with the depth and experience of the Headwaters management team who are now running the combined Boral and Headwaters business in the US. Management were convincing on how they will successfully integration Headwaters and realise cost savings. The fly ash business in particular has good prospects through higher pricing and contract volumes. The investment manager returned more confident that Boral should show solid earnings delivery as US housing cycle improves, underpinned by stronger market positions across key products.

Market Outlook

Global growth leading indicators remain robust and above-trend global growth is expected to continue. This is at odds with the market's inflationary expectations which still remain quite modest. Large pools of global capital remain sidelined in low or negative yielding assets and will take time to re-position as confidence over the durability of growth continues to build.

Slack in the US labour market is now relatively low and the investment manager expects that the Federal Reserve will slowly raise rates given overall financial conditions are still easing further through a weaker currency and strong equity market. Structural limits on US growth mean that they will likely have some tolerance around inflation exceeding their targets as wage inflation picks up.

Commodity prices and bond yields are responding, however yields still seem overly depressed given the underlying economic momentum that is currently being observed. Strengthening earnings and a decent gap between earnings and bonds yields means there is scope for the stock markets 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 towards containing risks, controlling credit growth and advancing reform. The investment manager expects Chinese policy to become less supportive for steel making materials.
- The structural challenges in Europe remain unresolved. Better growth and recent electoral outcomes are encouraging, despite adverse political risks remaining omnipresent.

Portfolio Characteristics

No of large cap stocks
35

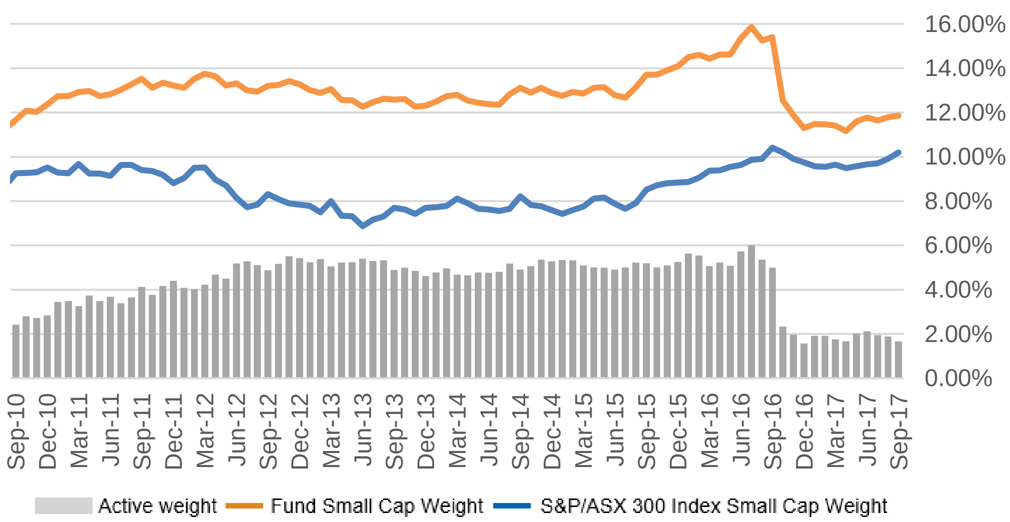
No of small cap stocks
58

Cash
2.82%

Portfolio Turnover (1yr)
53.12%

Sharpe Ratio (1yr)
0.92

Standard Deviation (5yrs)
11.76%



Key Contributors & Detractors for the Month

Top 5 Contributors	Active Position	Top 5 Detractors	Active Position
Telstra Corporation	Underweight	CSL	Underweight
Incitec Pivot	Overweight	South32	Underweight
Santos	Overweight	AGL Energy	Overweight
Newcrest Mining	Underweight	Downer EDI	Overweight
Oil Search	Overweight	Lendlease Group	Underweight

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Market Outlook (cont'd)

Whilst the global growth is now quite synchronised, Australia is still lagging. The investment manager anticipates that Australian GDP growth will remain modest at around 2-3%. As strong population growth is assisting headline numbers the implied per-capita level is quite low.

The recent pickup in domestic economic data is encouraging, particularly the recent employment data. Overall, the investment manager expects aggregate consumer spending to be broadly in line with household income growth (3-4%), which is still soft 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 recent tightening of credit to the investor segment of the market appears to be having a cooling impact with a reasonable likelihood of small real price declines over the next couple of years. However, 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. Yet, after the expansion in valuations in recent years, sustained gains will require continuing profit delivery.

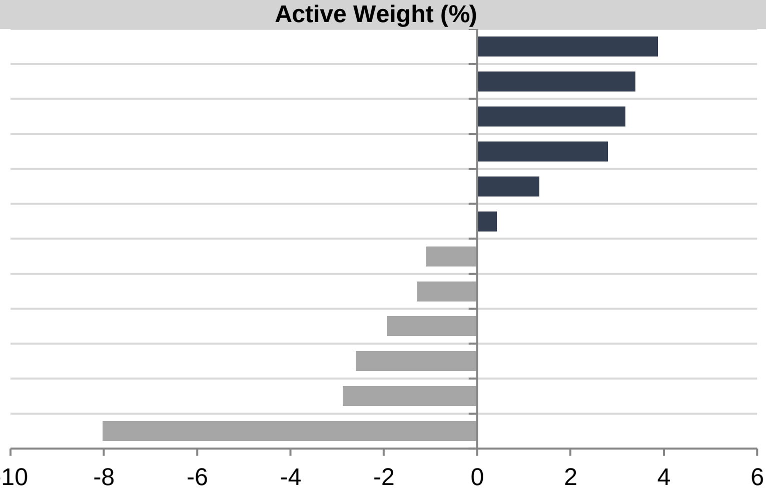
The high-levels of valuation dispersion that were observed last year have returned driven by expanding valuations of stocks with defensive growth characteristics. This group of stocks is now back to historically levels and the Fund remains underweight to this area.

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 (%)
Materials ex Metals & Mining	7.95	4.08
Energy	7.79	4.40
Consumer Discretionary	8.16	4.98
Utilities	4.93	2.13
Industrials	8.82	7.49
Information Technology	2.03	1.61
Health Care	5.99	7.08
Consumer Staples	5.96	7.25
Financial ex Property Trusts	34.73	36.65
Telecommunications Services	0.48	3.08
Metals & Mining	9.96	12.84
Property Trusts	0.38	8.41
Cash	2.82	0.00

Active Weight (%)



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