Ironbark Karara Australian Share Fund

Monthly Investment Report as at 31 December 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]

Distribution Frequency

Semi-Annually

Minimum Investment

$20,000

Fund Size

$78.8m

Exit Price

$1.6329

Market Review

Strong equity performance throughout 2017 has been underpinned by a broad-based acceleration in global economic growth. Goldman Sachs current activity indicator during December indicated global growth was running at approximately 5% year-on-year growth with developed markets having accelerated recently to approximately 3.9% year-on-year with all key economies (Europe, Japan and the US) contributing. Emerging market growth was approximately 6.5% year-on-year with China also around that level.

Unsurprisingly, strong economic growth has been a key contributor to stronger commodity prices. The strength in commodity prices assisted the Australian equity markets in outperforming global benchmarks with the S&P/ASX 300 Accumulation Index providing a total return of 1.86% during December.

Iron ore finished December at $74 per tonne (in US dollar ('USD') terms) (62% FE, CFR China), which was an 8% increase over the month. The high discounts for lower grade iron ore have continued, which means higher benchmark prices are not translating into a signal for lower grade marginal suppliers to increase production. The clear beneficiaries of this dynamic are the major iron ore producers (BHP and Rio) contributing to the metals & mining sector delivering a 7.5% return in the month.

Higher oil prices propelled the energy sector up 8%, which made it the top performing sector. Oil finished at $67 per barrel for Brent crude marking the sixth-straight monthly increase. Data continues to demonstrate that inventories are well on their way to normalising. The combination of tighter inventories and ongoing OPEC discipline provides the space for US shale to maintain its growth through 2018, however the risk that the call on the US exceeds its growth capacity is increasing.

Australian government 10 year bond yields rose 13 basis points, broadly in line with the 10 basis point increase in US government bond yields of the same maturity. The increase in bond yields acted as a drag on a number of the defensive growth stocks that have being particularly strong over the last six months.

Ongoing evidence of a cooling property market resulted in the banks underperforming (up 0.4%). Whilst the overflow is clearly coming out of the market, strong population growth (particularly from immigration) is assisting the absorption of the significant new supply of apartments.

The strong run of employment data continued with the release of November employment data. Over the last three months (Sep to Nov) growth hours worked has been 3.1% year-on-year, which is the fastest pace since 2008.

The improvement in terms of trade, oil and commodity prices strengthened, assisted by the Australian dollar closing at 0.78 USD, a gain of 3% in the month. The gains were also mirrored against the Euro (a 2% gain) and the British pound (a 3% increase).

Performance

	Net Fund Return (%)	Benchmark Return (%)	Active Return (%)
1 month	1.63	1.86	-0.23
3 months	8.67	7.74	0.93
1 year	11.23	11.94	-0.71
3 years (p.a.)	7.49	8.76	-1.27
5 years (p.a.)	9.50	10.15	-0.65
7 years (p.a.)	7.68	8.13	-0.45
10 years (p.a.)	3.12[3]	3.93[1]	-0.81[3]
Since inception[2] (p.a.)	6.87[3]	7.48[1]	0.61[3]
Since Karara as Investment Manager[4] (p.a.)	6.91	7.67	-0.76

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]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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Performance Review & Fund Activity

The Ironbark Karara Australian Share Fund (the 'Fund') returned 1.63% (net) for December, underperforming the benchmark return of 1.86% by 0.23%

Energy positions, Oil Search (up 11%), Santos (up 7%) and Origin (up 5%), were the strongest contributors for December. Oil Search held an investor day where management better articulated the strategy and the attractiveness of their recently acquired Alaskan development assets. It certainly appears, on first impressions, they have secured a good deal with significant upside in the acreage. Albeit pursuing the development of these assets simultaneously with expansion in Papua New Guinea will put some pressure on the strength of their balance sheet, however, the extent of this is heavily dependent upon the prevailing oil price over the next two to three years.

In a repeat of November, the gains from energy producers were partially offset by Qantas (-11%). Whilst fuel is a major expense for Qantas, the much-improved domestic market structure will reduce sensitivity and the investment manager believes that current earnings will be broadly sustained or rise if current demand conditions are maintained. This is still not reflected in the price. The position, which had been reduced, has been partially rebuilt following weakness.

James Hardie (up 6%) continued to outperform on the back of strong new home sales in the US, which surged 17.5% in November. The position was trimmed late in the month.

Other contributors included underweight positions in APA (-9%) and Aurizon (-6%) where there was increasing recongiation that changing regulatory settings will impact future returns for their assets.

AGL (-3%) held its investor day where management clearly outlined their organic growth pipeline, albeit with big caveats around future capital expenditure being dependent upon prevailing market conditions.

The stronger Australian dollar acted as a drag on offshore earners with Brambles (-1%), Ansell (-1%) and Resmed (-2%). The impact partially mitigate by the underweight position in CSL (-1%).

Underweight positions in Telstra (up 6%) and Westfield (up 21%) were amongst the top detractors. Westfield agreed to a takeover by European mall operator, Unibail-Rodamco, with the merged entity to remain listed on the ASX post completion of the transaction. The transaction somewhat signals that the Lowy Family views the long-term outlook for a retail landlord, even premium ones, as challenged.

Market Cap Distribution

Market Cap	Fund (%)	Bench (%)
1- 50	71.35	76.71
51-100	15.69	12.65
101-200	7.68	8.07
201-300	1.86	2.57
Ex 300[1]	1.51	0.00
Cash	1.91	0.00

[1]Including Placement Securities

Top 5 Active Weights

Security Name	Active Weight (%)
CSL	-3.85
AGL Energy	3.45
Origin Energy	2.95
Brambles	2.67
Telstra Corporation	-2.60

Key Contributors & Detractors for the Month

Top 5 Contributors	Active Position
Oil Search	Overweight
CSL	Underweight
Santos	Overweight
Rio Tinto	Overweight
Origin Energy	Overweight

Top 5 Detractors	Active Position
Qantas Airways	Overweight
AGL Energy	Overweight
Westfield Corporation	Underweight
Telstra Corporation	Underweight
Brambles	Overweight

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Performance Review & Fund Activity (cont'd)

The position in Clydesdale (up 3%) was increased post their result in late November. The investment manager views it as a cost and capital self-help story coupled with leverage to UK base rate increases underpinned by reasonable valuation parameters and strong forecast earnings per share growth.

Other portfolio activity included Navitas (up 4%) being trimmed following recent strong.

Portfolio Characteristics

No of large cap stocks
35

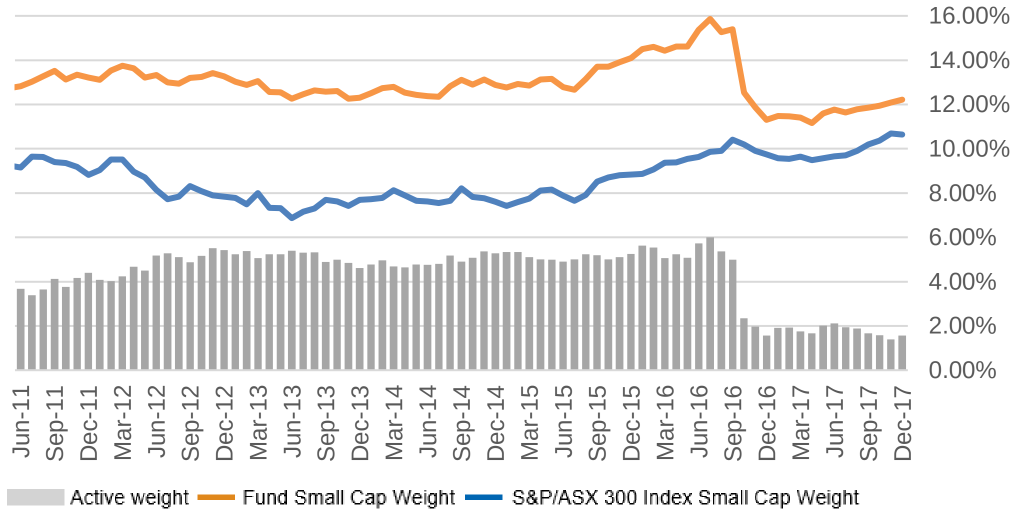
No of small cap stocks
57

Cash
1.91%

Portfolio Turnover (1yr)
49.63%

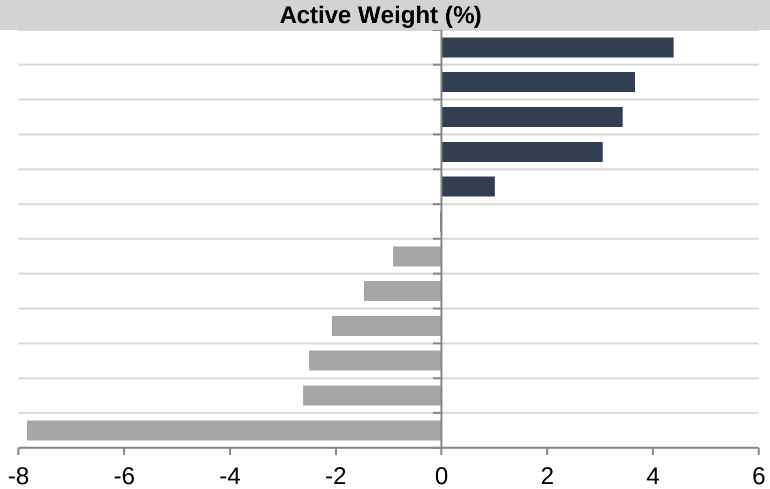
Sharpe Ratio (1yr)
1.41

Standard Deviation (5yrs)
11.79%



Asset Allocation

Sector Weights	Fund (%)	Bench (%)
Energy	9.58	5.19
Materials ex Metals & Mining	7.76	4.09
Consumer Discretionary	8.28	4.86
Utilities	5.07	2.02
Industrials	8.38	7.37
Information Technology	2.04	2.07
Health Care	6.16	7.07
Consumer Staples	5.99	7.47
Financial ex Property Trusts	32.89	34.97
Telecommunications Services	0.54	3.04
Metals & Mining	11.03	13.64
Property Trusts	0.37	8.21
Cash	1.91	0.00



Market Outlook

Global growth indicators remain robust, although 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 doubted by many market participants, large pools of global capital remain defensively positioned.

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.

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Market Outlook (cont'd)

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 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 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.

The high-levels of valuation dispersion that were observed last year have returned, and exceeded, driven by ongoing increases in the valuations of stocks with defensive growth characteristics. This group of stocks now trades at historically high valuation 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.

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Ironbark ASSET MANAGEMENT