Ironbark Karara Australian Share Fund

Monthly Investment Report as at 31 October 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

$50.4m

Exit Price

$1.5687

Market Review

Global equity returns were crushed in October. The ASX 300 Accumulation Index fell 6.2%, taking the market's year-to-date returns to 0.5%. This was marginally better than the S&P 500 (down 6.9%) and the MSCI World (down 7.4%), however, the ASX 300 Accumulation Index underperformed relative to these indices, if adjusted for a 2.1% decline in the Australian dollar.

Market moves were driven by some macro and geo-political developments. These were not significantly different to trends observed in recent months with the slowing in China, prospects of trade war escalation, and the impact of the Federal Reserve tightening on the longevity of the US cycle and market valuations. However, pent up concerns over these factors released a wave of sustained selling. Lack of progress on Italian budget resolution, Brexit negotiations, as well as the destabilisation of Saudi/US relations only added to fear levels.

The revelation of the Saudi government's role in the murder of a dissident journalist weakened their position to resist US calls for increased OPEC production. Brent oil dropped 9% to $75 per barrel (in US dollar 'USD' terms) as speculative positions in oil were completely unwound as traders correctly anticipated that exemptions may be granted to Iranian sanctions and some weaker data on inventories.

Despite aggressive selling in domestic consumer exposures, annual general meeting updates did not support the prevailing bearish view that lower house prices and rising fuel bills are materially impacting consumer spending. Slightly weaker growth was evident in some housing related and budget retailers, and new car sales are falling from historically high levels. However Qantas, Virgin, JB HiFi, Wesfarmers and several retail property trusts reported strong or improving recent sales trends. Housing credit moderated slightly in September (up 0.3%) but is 5.2% higher year-on-year. The slowdown still seems consistent with a normalisation in demand rather than a disorderly supply side credit crunch.

In corporate activity, AMP (down 23%) and Worley Parsons (down 25%) mimicked Amcor's August move by crossing the bid-ask spread to make aggressive but dilutive acquisitions (divestment in AMP's case) to materially remix their business exposures. This dilution of existing assets is confronting for investors as, on first impressions, the deals imply management's view of the pre-existing position is weaker than investors had previously believed. MYOB (up 14%) shareholders were a beneficiary of the private equity industry's cost of capital arbitrage after KKR lobbed a bid while Healthscope (down 7%) also had an earlier unsuccessful approach reinstated.

Performance

	Net Fund Return (%)[2]	Benchmark Return (%)[1]	Active Return (%)
1 month	-7.12	-6.16	-0.96
3 months	-7.51	-5.98	-1.53
1 year	0.73	2.88	-2.15
3 years (p.a.)	6.59	8.24	-1.65
5 years (p.a.)	3.86	6.00	-2.14
7 years (p.a.)	8.22	9.06	-0.84
10 years (p.a.)	7.50	8.55	-1.05
Since inception[3] (p.a.)	6.20	6.94	-0.74
Since Karara as Investment Manager (p.a.)	5.86	6.81	-0.95

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. Returns are rounded to two decimal places. Slight variations to actual calculations may occur.

[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] 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.

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

Contact Details

T: 1800 034 402 | **E:** client.services@ironbarkam.com | **W:** www.ironbarkam.com

Ironbark ASSET MANAGEMENT

Ironbark Karara Australian Share Fund

Monthly Investment Report as at 31 October 2018

Performance Review

The Ironbark Karara Australian Share Fund (the 'Fund') returned -7.12% (net) for the month, underperforming the benchmark's return of -6.16% by 0.96%.

Low holdings of high price-earnings ratio momentum stocks were beneficial to performance (TWE down 14%, Corporate Travel down 34%, Seek down 14%, Xero down 18% and REA down 17%). However, these were insufficient to offset the sharp de-rating of positions within the more cyclical energy, industrial and consumer sectors.

No exposure to the real estate trusts (down 4%) or large yield names such as Telstra (down 3%), Sydney Airport (down 7%) or Transurban (down 1%) detracted 0.25% relative to benchmark. While defensive in such periods, the investment manager sees the maturity of Telstra's earnings and duration risks intrinsic to the infrastructure sector as greater long term risks.

Declines in the energy sector (down 11%) holdings, detracted 0.30% from the Fund's returns. Origin (down 12%) and Oil Search (down 14%) were the largest individual detractors. Investor favourite Santos (down 9%) weakened later in the month, yet performed relatively well. The investment manager continued to reduce Santos in favour of Oil Search and Origin. Oil Search has significantly underperformed the sector over the past year despite good progress of its projects in Papua New Guinea and Alaska which are steadily building shareholder value.

Other commodity exposures performed quite well. Iron ore was unfazed by the turmoil, supported by expectations of further Chinese spending measures. This helped Rio (down 3%). Small gold holdings performed nicely. Incitec Pivot (down 2%) continued to benefit from tightening nitrogen fertilizer conditions.

AGL (down 8%) underperformed the relatively resilient utility sector (down 3.8%) which in total cost 0.14%. AGL's poor performance remains a source of frustration. Although wholesale power prices have recovered strongly, in line with fundamentals and the investment manager's expectations, AGL has de-coupled as the new energy minister has desperately tried to muscle down retail prices by characterising the industry as bandits and threatening a break up. The latest efforts appear to be a desperate attempt to get a 'win' on this issue with cherry picking of facts and ACCC recommendations to justify the extreme rhetoric and threats. However, this anti-market behaviour is driving up the cost of equity to the sector, which could contribute to higher prices over the long term.

JB HiFi (down 9%) and Star Entertainment (down 9%) fell with other consumer exposures. Qantas (down 7%) fared little better ignoring presumptive fuel price relief. There appeared to be some disconnect here as Qantas and JB HiFi both reported trading updates with improved demand in key divisions. Star Entertainment has subsequently reported similarly.

On the plus side, QBE (up 1.8%) performed strongly as international peers reported improving premium rate growth and Lloyds announced capacity rationalisation. Industry conditions are improving as higher interest rates and elevated disaster claims lead to more cautious underwriting. Brambles (down 2.5%) was another relatively strong portfolio contributor. Its third quarter update showed improving cost recovery in CHEP US and continuing strong growth in Europe. Competitor feedback is consistent with smaller competitors feeling greater input cost pressures and are lifting prices. The Fund's Suncorp holding also held up well (down 3%).

Avoiding Worley Parsons or AMP was beneficial. As implied by comments above, neither transaction much improves the investment manager's view of management's stewardship of shareholder capital or the long term investment prospects.

Holdings in Resmed (down 7%) and Macquarie Bank (down 7%) were reduced further before they are dragged down by the sell-off. Resmed's result was strong with little slowing evident despite a strong comparableperiod. However expectations are such that this was not enough to revise expectations higher. The investment manager believes it will be hard for the company to sustain these elevated rates of growth into the medium term.

Market Cap Distribution

Market Cap	Fund (%)	Bench (%)
1- 50	73.43	76.50
51-100	14.62	12.70
101-200	6.62	8.33
201-300	1.94	2.47
Ex 300[1]	1.21	0.00
Cash	2.18	0.00

[1]Including Placement Securities

Top 5 Active Weights

Security Name	Active Weight (%)
CSL	-5.28
Brambles	3.26
AGL Energy	3.20
Rio Tinto	2.62
Oil Search	2.53

Contact Details
T: 1800 034 402 | **E:** client.services@ironbarkam.com | **W:** www.ironbarkam.com

Ironbark ASSET MANAGEMENT

Ironbark Karara Australian Share Fund

Monthly Investment Report as at 31 October 2018

Market Outlook

Despite market fear, the outlook for global growth remains solid despite the re-emergence of some slowing in China and parts of Europe. The US economic cycle has some room to run and still seems more likely to end from rising inflation in response to tight labour and commodity markets than from 'old age'. This has become more of a non-consensus view of late as the weight of money has migrated towards defensive assets offering low real returns due to concerns over the durability of the expansion.

Central banks are likely to continue to tighten incrementally, however conditions remain loose and the investment manager expects policymakers will prefer to remain slightly behind the curve to minimise the risk of a re-run of structural stagnation fears. As a result, there is a rising risk that the market is ultimately challenged by the emergence of somewhat higher inflation.

This suggests a more volatile outlook for equities, however one where earnings can still grow at around long-term trend levels. In an environment of rising price pressures this provide better prospects than fixed income and other asset classes reliant on subdued inflation, low real interest rates and low credit spreads. The investment manager is cautious that excesses appear to be occurring in credit markets as investors search for higher returns by taking more risk, which is resulting in record lower quality credit issuances and higher corporate leverage in some areas.

Even after recent declines there remains a narrow cohort of stocks that have driven valuation dispersion to near historic extremes. After the recent reset of sentiment, and as the cost of money increases, the investment manager expects 'market darlings' that do not deliver to lofty growth and margin expectations will become much more sensitive to disappointment.

As always numerous risks to the growth outlook are present, however, it seems to the investment manager that the sum of the fears exceeds the fundamentals. The Chinese have signaled strongly that they will balance reforms with near-term growth. Despite the irrational escalation of the US-Sino trade war, the direct economic impact is manageable to China. Second order impacts through corporate confidence are harder to gauge, however are still thought to unlikely materially change the outlook. Market reaction to escalating tariff increases the pressure on the US to seek resolution.

The US fiscal expansion will support activity for some quarters though the investment manager is concerned by the size of the US twin deficits at this stage in the cycle. The investment manager sees the need for the US to maintain and attract larger amounts of foreign capital in the future is generating a significant risk for global markets in the longer-term.

With evidence of ongoing house price declines, investors' concerns around the Australian economy are cautious. The investment manager's view is that the modest falls in house prices currently being observed is likely to modestly curtail housing investment, yet is unlikely to have significant flow-on effects to the broader economy. However, the current situation does increase the susceptibility to an external macro shock during this adjustment period.

The potential for future fiscal easing as government revenues have showed a marked improvement on the back of better commodity prices and stronger labour markets. The likely prospect of tax giveaways or higher spending will reverse the negative drag seen over the last couple of years where deficit reduction has been prioritised. The significant spend by state governments on infrastructure continues unabated with the pipeline growing as Victoria and New South Wales head to the polls over the coming six months.

The oil market is expected to remain in deficit throughout 2019 due to Iran exports falling by 1-1.2 thousand barrels per day, infrastructure constraints in the Permian Basin and a disciplined OPEC that continues to be focused on maximising revenue. Going forward, spare supply capacity is very limited with any future supply disruptions poised to deliver a sharp increase in oil prices.

Key Contributors & Detractors for the Month

Top 5 Contributors	Active Position
QBE Insurance Group	Overweight
Brambles	Overweight
AMP	Underweight
Saracen Mineral Holdings	Overweight
Rio Tinto	Overweight

Top 5 Detractors	Active Position
Oil Search	Overweight
Origin Energy	Overweight
CYBG	Overweight
Boral	Overweight
Transurban Group	Underweight

Ironbark Karara Australian Share Fund

Monthly Investment Report as at 31 October 2018

Portfolio Characteristics

No of large cap stocks
33

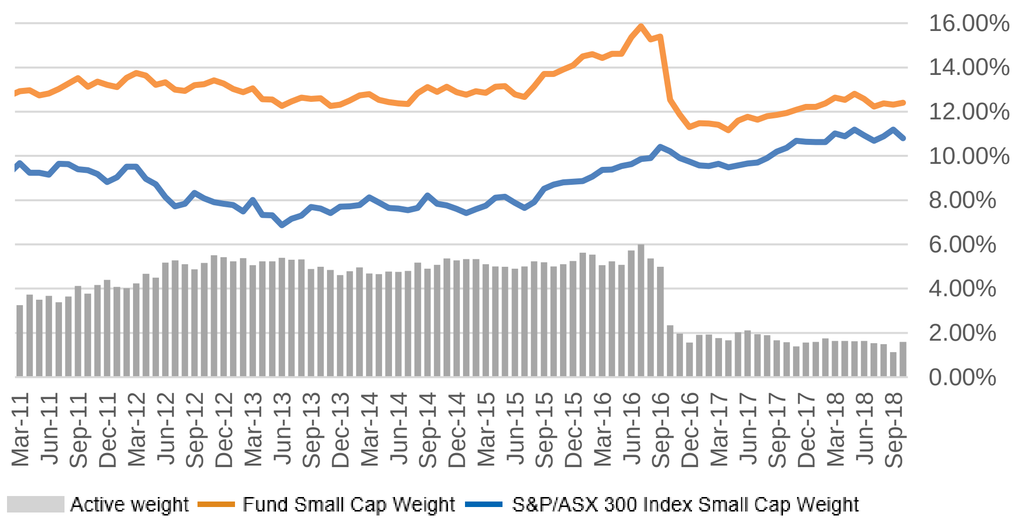
No of small cap stocks
55

Cash
2.18%

Portfolio Turnover (1yr)
39.22%

Sharpe Ratio (1yr)
-0.07

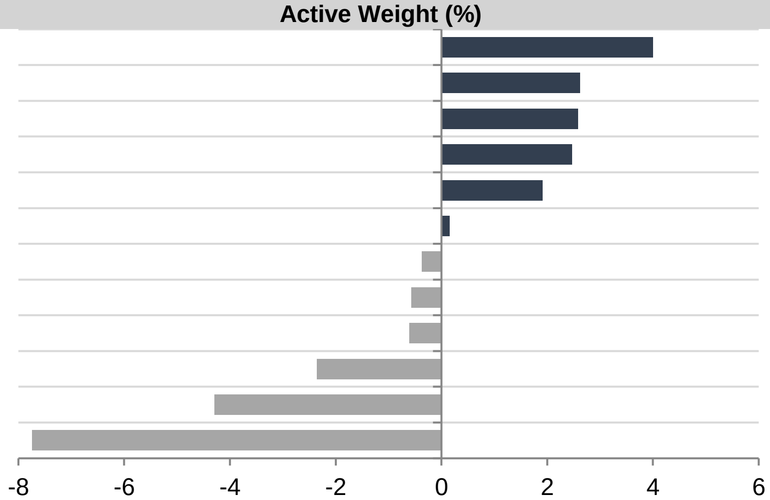
Standard Deviation (5yrs)
11.34%



Asset Allocation

Sector Weights	Fund (%)	Bench (%)
Energy	9.86	5.86
Utilities	4.53	1.91
Consumer Discretionary	6.80	4.22
Industrials	10.28	7.81
Materials ex Metals & Mining	5.63	3.71
Metals & Mining	14.56	14.40
Financial ex Property Trusts	31.54	31.91
Information Technology	1.61	2.18
Consumer Staples	7.34	7.95
Communication Services	1.32	3.67
Health Care	4.21	8.50
Real Estate	0.14	7.88
Cash	2.18	0.00

Active Weight (%)



Important Information

Contact Details
T: 1800 034 402 | **E:** client.services@ironbarkam.com | **W:** www.ironbarkam.com

Ironbark
ASSET MANAGEMENT