Ironbark Karara Investment Funds

Quarterly Investment Report as at 31 March 2018

Market Review

Volatility returned during the March quarter and global equity markets fell for the first time in several quarters with the MSCI World Index delivering a total return of negative 1.8%. The apathy towards the ASX seen in 2017 continued with the S&P/ASX 300 underperforming by 2% providing a negative 3.8% total return during the quarter.

Global economic data indicated that growth momentum had most likely peaked, albeit, growth remains above trend. The risk of a trade war impacting on long-term growth rose as the US applied tariffs against steel, aluminium and a range of products from China.

Commodity prices were generally softer during the quarter as activity levels in China slightly disappointed and a broadening expectation that Xi Jinping might pursue additional reforms that would impact on near-term commodity demand now that he has successfully removed his 10-year tenure limit. Iron ore retraced during the quarter falling back to $64 per tonne (in US dollar 'USD' terms) (62% CFR China), which represented a 14% fall. Oil bucked the trend with Brent up 5.1% to $70.30 per barrel (in USD terms) as inventories failed to rise per seasonal norms.

The Australian dollar ('AUD') weakened during the quarter, depreciating by 4% on a trade-weighted basis and 1.7% against the US dollar as local ten-year government bond yields closed at 2.6%, below US levels for the first time since 2000.

Central banks remain market-friendly, however unease is rising over how monetary policy is to be normalised. Rising inflationary expectations hit US Treasuries (US 10-year yields up 33 basis points to 2.74%) although after sharp losses in January global bond markets were generally stable.

Surveys of business conditions in Australia remained strong and non-mining business investment is increasing with higher levels of public infrastructure investment assisting the economy. The labour market's forward-looking indicators continue to point to solid growth in employment in the period ahead. Whilst wage growth remains anaemic, there is emerging evidence that wages have troughed with some reports that some employers are finding it more difficult to hire workers with the necessary skills.

The domestic property market continued to cool with volume data highlighting a sharp retracement in volumes during the last three months in 2017. The weakness appears to be concentrated in Melbourne and Sydney at the upper end of the market where credit availability has been tightened. The new supply coming on continues to be absorbed with minimal changes in vacancy rates of late.

Australian reporting season in February was more consistent than recent years, with few significant disappointments and a more constructive tone surrounding outlook commentary. Signs of input cost pressures rising were common. Where anticipated they were generally managed well although there were some instances of unanticipated cost increases emanating from production shortfall (South32, BHP), skill scarcity (Brambles, Healthscope, Fletcher Building), or franchise model pressures (Domino's, Retail Food Group, Caltex).

Performance

Ironbark Karara Australian Share Fund

Fund size: $72.5 million **Exit Price: $1.5755** **Inception date: 30 June 2005**

	1 month (%)	3 months (%)	1 year (%)	3 years (pa) (%)	5 years (pa) (%)	7 years (pa) (%)	Since inception[3] (pa) (%)
Net Fund Return[1]	-3.21	-3.52	3.57	2.66	6.70	6.57	6.43
Benchmark[2]	-3.73	-3.78	2.86	3.92	7.62	7.06	7.01
Excess Return	0.52	0.26	0.71	-1.26	-0.92	-0.49	-0.58

Ironbark Karara Australian Small Companies Fund

Fund size: $652.4 million **Exit Price: $3.7210** **Inception date: 30 June 2005**

	1 month (%)	3 months (%)	1 year (%)	3 years (pa) (%)	5 years (pa) (%)	7 years (pa) (%)	Since inception[3] (pa) (%)
Net Fund Return[1]	-0.99	-0.18	14.12	7.48	9.02	7.83	13.46
Benchmark	-2.29	-2.79	14.99	10.67	6.45	2.35	4.38
Excess Return	1.30	2.61	-0.87	-3.19	2.57	5.48	9.08

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]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.

[2]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.

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

Market Review (cont'd)

With reasonable demand conditions and tightening capacity, pricing power appears to be broadening somewhat. At the margin, conditions are improving in oil and gas, agriculture, steel, mining and mining services, travel, education, health care (excluding hospitals), chemicals, supermarkets and general insurance. Conditions remain favourable in building materials, technology, infrastructure contracting, and electricity generation. Telecommunications, apparel retail, retail property, property development, wealth management, and banking are seeing moderating demand growth or structural pressures and a greater 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.

Valuation dispersion continued to widen with the key driver being an insatiable appetite for health care and information technology stocks. The top quintile of the largest industrial companies (which has a median one year forward price-earnings ratio ('PE') of 31.4) has rallied 12% over the last three months. By contrast, the lowest quintile (with a forward of PE 12.2x) fell 7% during the quarter. Despite the approximate 20% total return differential, the difference in earnings revisions was only approximately 5%.

Portfolio Performance & Portfolio Activity

Ironbark Karara Australian Share Fund

The Ironbark Karara Australian Share Fund (the 'Fund') detracted 3.52% (net) during the March quarter. This constituted an outperformance of 0.26% when compared with the S&P/ASX 300 Accumulation Index return of -3.78% (net) for the quarter.

Qantas (up 17%) delivered a stand out result with tight capacity management supporting higher domestic yields as the domestic duopoly more than mitigates higher fuel costs. The outlook for resources, corporate, loyalty, and international segments is improving. Qantas' 15% return on invested capital ('ROIC') puts its domestic competitor's 3% ROIC in stark relief and demonstrates a competitive advantage which contradicts a single-digit earnings multiple. The Fund increased its position on the expectation that the market will ultimately recognise the strength of the domestic duopoly enabling a material further re-rating.

Small-cap positions Altium (up 33%) and Costa (up 19%) captured some of the enthusiasm towards small caps currently being demonstrated by the market.

Despite the ongoing strength in the oil price, energy holdings collectively detracted 30 basis points with the sector seeing some profit taking after strong performance in 2017. There appears to be an increasing disconnect between long-term price expectations between equity investors and commodity speculators. Whilst the underlying oil market is expected to be quite tight over the coming 12 months, equity investors are still generally of the view that US shale will comfortably meet demand over the coming years limiting medium-term pricing to $60 per barrel (in USD terms). The investment manager is increasingly of the view that with strong demand, strong OPEC cooperation and risks around Iran, that US shale is no longer the near term marginal barrel and that prices will need to increase to either bring additional OPEC barrels back or constrain demand growth. Both suggest pricing in the $70-80 per barrel (in USD terms) range is likely to be sustained over the coming 12 months.

Nil REIT holdings added 40 basis points with a further 57 basis points coming from not holding Telstra (down 11%), Transurban (-8%), Sydney Airport (-5%) or Tabcorp (-19%). Both Telstra and Tabcorp saw competition weaken revenue growth. Offsetting this were underweights to CSL (up 7%), Cochlear (up 6%), a2 Milk (up 55%) which collectively impacted 56 basis points.

Stock selection in the insurance sector with IAG's gains (up 5%) compounding Suncorp (-1%) and QBE's (-9%) disappointment given the premium cycle has turned upwards. Despite IAG's better current cost performance and lower earnings volatility due to quota sharing deals its and Suncorp's two franchises are more alike than not. The Fund increased its position in Suncorp on the expectation that cost outs will be delivered.

The Fund increased its position in Wesfarmers (-4%) following their announcement to pursue a demerger of Coles. The investment manager views this move as strong action by the new CEO to close the valuation gap that exists between it and Woolworths. The action also supports rationality within the supermarket industry. The increase was partially funded by increasing the underweight position in Woolworths (-2%).

The Banking Royal Commission began with a vengeance putting poor sales practices and poor internal bank processes front and center. The concern for the banks is that a strong set of recommendations around responsible lending results in increased costs and slower volumes. These concerns resulted in the major banks underperforming with Commonwealth Bank (-8%), Westpac (-9%), ANZ (-7%) and National Australia Bank (-4%). Whilst ultimately any recommendations will go through a more rigorous regulatory process that assesses the costs and benefits, the combination of this uncertainty and minimal earnings growth means sentiment towards the banks is likely to continue to be lackluster despite improving relative valuation.

AGL (-9%) was impacted by market concerns around a step change in competition in the retail segment. Whilst there has been enhanced competition from Alinta, the materiality of the impact versus the substantial increase in wholesale earnings that is taking place is small and the impact appears concentrated in the Queensland market. Despite the noise around Lidell, the investment manager continues to see government intervention that impacts on wholesale electricity prices as unlikely. At its core the debate around the National Electricity Grid is about removing subsidies for renewable and ensuring reliability, both are long-term benefits to AGL.

Ironbark Karara Investment Funds

Quarterly Investment Report as at 31 March 2018

Portfolio Performance & Portfolio Activity (cont'd)

Star Entertainment (-12%) had a slightly disappointing result with some softening in the top end of its mass market business and higher costs. Additionally, Star surprised the market by announcing a significant investment to improve and enhance the capacity in its premium mass market business. Late in the quarter, Star announced a strategic alliance with Chow Tai Fook and the Far East Consortium, which included a placement of equity to these two parties. Although this deal seem dilutive for little tangible benefit valuation is reasonable and medium-term growth prospects seem sound.

The small position in Amcor (-7%) was exited. The business is well positioned and managed howeverthe investment manager sees the medium-term outlook as increasingly challenged on several fronts, including customer volume and margin pressures and rising community sensitivity to plastic packaging, which places at risk market expectations for continuing margin expansion. The company's fully geared balance sheet provides less opportunity for meaningful expansion.

The small position in Vocus (-23%) was sold following disappointing result disclosure. Other activity during the quarter included reductions in James Hardie (up 1%), Ansell (up 5%), Resmed (up 13%) and Navitas (-7%) and an increase in BHP (-2%).

Ironbark Karara Australian Small Companies Fund

The Ironbark Karara Australian Small Companies Fund (the 'Fund') detracted 0.18% (net) during the March quarter. This constituted an outperformance of 2.61% when compared with the S&P/ASX Small Ordinaries Accumulation Index return of -2.79% (net) for the quarter.

The strongest contributors to Fund performance at a sector level were overweight positions in information technology, metals & mining and financials ex property trusts, as well as an underweight position in property trusts. Underweight positions in consumer discretionary and industrials detracted.

At a stock level, positive contributors to quarterly performance included overweight positions in Altium, a2 Milk, Evolution Mining and Pantoro. A nil holding in Wisetech Global also contributed. Shares in Evolution and Pantoro rose 16% and 38% respectively on gold price strength and general risk-off sentiment. Altium (up 51%) and a2 Milk (up 56%) were two of the market's strongest performers during February's interim results period. Altium reported strong sales volumes and margin improvements suggesting the company's 2020 revenue guidance could be achieved ahead of time. Whilea2 Milk exhibited continued strong operational momentum and new news included an agreement with Fonterra to help accelerate new products and markets.

The largest detractors to monthly performance included overweight positions in Metals X (-31%), Qube Holdings (-15%), and IRESS (-16%). Metals X shares have been weak in recent months due to commodity price weakness and mining-related issues at the company's Nifty copper mine in Western Australia. The investment manager remains confident that the production recovery at the mine remains on-track after a site visit by the team during the month. Qube's interim result highlighted margin weakness in Logistics and competitive pressures facing the Patrick stevedoring business.

Meanwhile IRESS reported a full year 2017 result in line with revised expectations however, the company's outlook for 2018 disappointed the market with meaningful UK growth remaining elusive in the near term.

Top 5 Active Weights

Ironbark Karara Australian Share Fund

Security Name	Sector	% of Fund
CSL	Health Care	-4.42
AGL Energy	Utilities	3.27
Brambles	Industrials	2.87
Origin Energy	Energy	2.79
Telstra	Telecommunication Services	-2.35

Ironbark Karara Australian Small Companies Fund

Security Name	Sector	% of Fund
Altium	Information Technology	5.74
Costa Group Holdings	Consumer Staples	3.61
Bega Cheese	Consumer Staples	3.36
Saracen Mineral Holdings	Materials	2.58
Technology One	Information Technology	2.46

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 highly 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 ultimately be required. However, the investment manager anticipates that the key central banks will tolerate inflation modestly exceeding their targets as wage inflation picks up.

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 willingness of the market to fund the growing Twin Deficits of the US following the implementation of their significant tax cuts.
- The structural challenges in Europe remain unresolved. Better growth and recent electoral outcomes are encouraging but adverse political risks remain.
- A material escalation of trade tariffs. The tariffs imposed today are likely to have minimal real economic impact, however, an unlikely widespread escalation would have both inflationary and long-term growth implications.

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 employment growth. Overall, the investment manager expects aggregate consumer spending to be broadly in line with household income growth (approximately 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.

Overall valuation metrics now appear quite reasonable in a historical context, however high valuation dispersion exists with valuations 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.

Key Contributors & Detractors over the Quarter

Ironbark Karara Australian Share Fund

Top 5 Contributors	Active Position
Qantas Airways	Overweight
Resmed	Overweight
Altium	Overweight
Telstra Corporation	Underweight
JB Hi-Fi	Overweight

Top 5 Detractors	Active Position
CSL	Underweight
Star Entertainment Group	Overweight
AGL Energy	Overweight
a2 Milk Company	Underweight
Origin Energy	Overweight

Ironbark Karara Australian Small Companies Fund

Top 5 Contributors	Active Position
Altium	Overweight
a2 Milk Company	Overweight
Wisetech Global	Underweight
Evolution Mining	Overweight
Pantoro	Overweight

Top 5 Detractors	Active Position
Bellamy's Australia	Underweight
Sirtex Medical	Underweight
Nine Entertainment Company	Underweight
Metals X	Overweight
Qube Holdings	Overweight

Ironbark Karara Investment Funds

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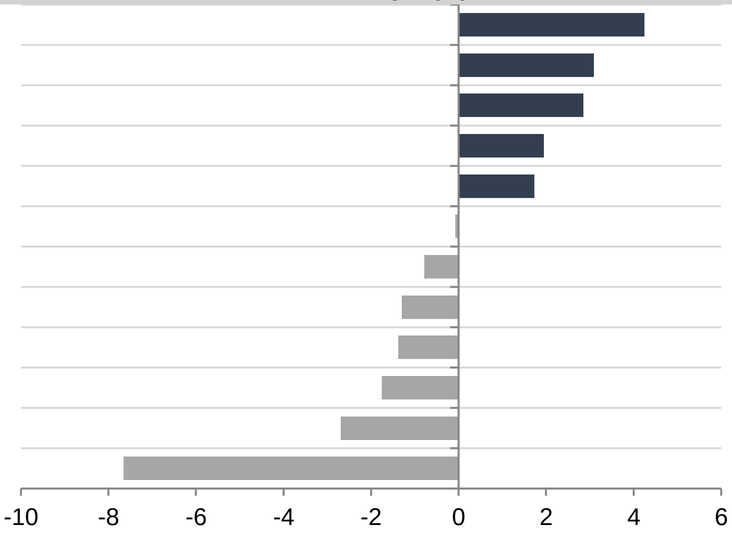
Asset Allocation

Ironbark Karara Australian Share Fund

Sector Weights	Fund (%)	Bench (%)
Energy	9.42	5.17
Consumer Discretionary	7.96	4.87
Utilities	4.83	1.98
Materials ex Metals & Mining	6.06	4.11
Industrials	9.17	7.44
Information Technology	2.29	2.37
Consumer Staples	6.98	7.75
Metals & Mining	12.34	13.65
Health Care	6.41	7.79
Financial ex Property Trusts	32.33	34.08
Telecommunications Services	0.06	2.76
Property Trusts	0.38	8.03
Cash	1.77	0.00

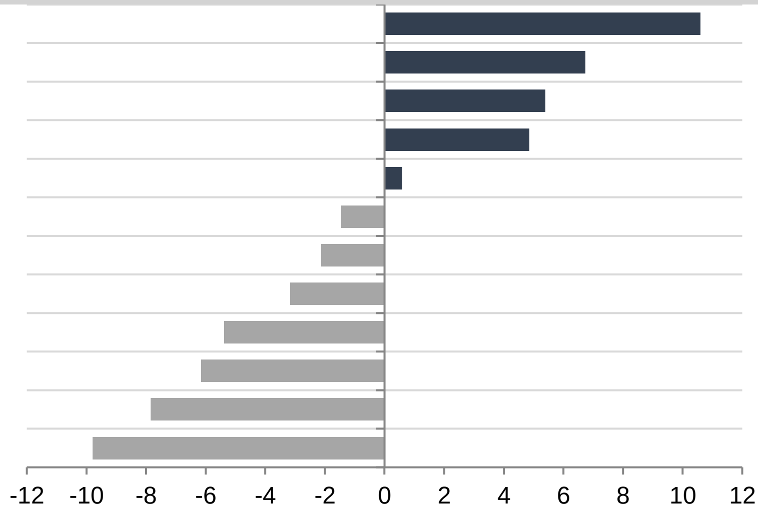
Active Weight (%)



Ironbark Karara Australian Small Companies Fund

Sector Weights	Fund (%)	Bench (%)
Information Technology	18.77	8.16
Consumer Staples	15.35	8.62
Metals & Mining	21.69	16.30
Utilities	5.38	0.52
Financial ex Property Trusts	8.27	7.68
Energy	5.97	7.43
Telecommunications Services	0.52	2.65
Materials ex Metals & Mining	0.00	3.16
Industrials	3.21	8.59
Health Care	0.83	6.99
Property Trusts	3.06	10.90
Consumer Discretionary	9.21	19.00
Cash	7.74	0.00

Active Weight (%)



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