Ironbark LHP Global Long/Short Fund (Wholesale)

Quarterly Investment Report as at 31 December 2018

Asset class

Alternatives

Investment strategy

Multi-Manager Long/Short

Investment objective

To achieve equity-like returns with lower volatility than traditional global equity investments

APIR code

HFL0108AU

ARSN

093 497 600

Fund inception date

31 March 2001

Benchmark

Benchmark unaware

Distribution frequency

Annually

Minimum investment

$5,000

Number of underlying managers

30

Fund size

$171.6m (represents wholesale and retail share classes)

Exit price

$1.6810

Markets review

During the first half of 2018, US gross domestic product ('GDP') growth accelerated at least partially due to tax cuts and increased fiscal spending while economic growth stagnated elsewhere. A focus on rising US interest rates, the end of quantitative easing by the US Federal Reserve, and forecasts of more pedestrian US GDP growth are marked for the back half of the year. Investor confidence seemed to falter in the fourth quarter, as concerns about the damage inflicted on the global economy by the escalating US and China trade conflict and potential Federal Reserve policy missteps moved to the forefront. According to Barron's, the week of November 26 provided S&P 500 investors the best returns in seven years for a single week. The week of December 17, by contrast, exhibited the worst weekly returns in over seven years. As risk aversion roared to life during the quarter, inflation expectations and interest rates reversed course and most equity markets entered a correction. Global stocks as measured by the MSCI All Country World Index erased the modest gains of the prior three quarters in the fourth quarter to end 2018 down close to 9%. Emerging markets reversed some of their prior relative underperformance as the MSCI Emerging Markets Index lost approximately 8%, while US markets began to follow the global pattern as the S&P 500 dropped over 13% for the quarter.

Performance review

The Ironbark LHP Global Long/Short Fund (Wholesale) (the 'Fund') returned -8.72% (net) for the December quarter.

While alpha generation was strong during the initial wave of volatility in 2018 (second-half of January into February), the fourth quarter proved much more challenging as investor uncertainty led to broad de-risking across both traditional long only mutual funds and hedge funds. This dynamic created one of the most challenging alpha environments we have seen since 2008.

Gross and net exposure exhibited a downward trajectory for most of the quarter, a result of market corrections and active de-risking on the part of portfolio managers. Gross exposure ranged from approximately 250% to 340% during the quarter, with an average of approximately 300%. Net exposure ranged from the low teens to the mid-thirties with an average of roughly 25%. Net exposures stabilised in the mid 20% range moving into and through December and gross exposure rebounded off quarter lows in the back half of December to end in the mid 270% range. The investment manager expects gross exposure to ramp up modestly as managers rebuild their positions and take advantage of valuation dispersions moving into 2019, while it is expected net exposure to remain between 20-30%, which is the investment manager's long-term target.

All regions, other than developed Asia, contributed to negative returns for the quarter as alpha on the long side was difficult to generate. From a sector perspective, financials, communication services, consumer discretionary, materials and health care generated negative returns while consumer staples, industrials and information technology sectors provided gains.

It was a challenging year for the Fund. This was partially due to the Fund's portfolio managers giving back the alpha they created early in the year in the increasingly difficult environment of the back half of the year. Secondarily, geographies or sectors where the Fund's set of managers have taken on market or beta exposure corrected to a much greater degree than overall global markets, with specific areas of pain including exposure to China and the financials and industrials sectors. The investment manager does not expect these alpha and performance trends to persist and have seen them start to reverse in late December and the beginning of the New Year.

Performance

Net returns (%)	1 month	3 month	1 year	3 years p.a.	5 years p.a.	7 years p.a.	10 years p.a.	Since inception p.a.[1]
Fund returns	-1.74	-8.72	-6.98	-0.26	2.77	6.01	5.96	5.78

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. Retail investors should refer to net returns.

[1] This figure represents the annualised performance of the Fund from the first full month of operation.

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Manager review

Less than one third of underlying managers generated positive returns for the quarter, considering the significant market correction and difficult trading environment. The five largest detractors to the Fund included two financials specialists, a China focused portfolio manager, an industrials sector specialist, and a European based manager. The financials specialists both suffered significant losses in their long biased regional bank portfolios. Regional banks corrected more severely than the overall equity market for the quarter and the year due to concerns about shrinking net interest margins. In the case of the largest detractor, the manager also took losses in the short portfolio of commercial real estate-oriented REITs, which were intended to be a hedge to the regional bank long positions, with the thesis that they are fundamentally related to the nature of credit risk taken on by banks. Unfortunately, the REITs rallied as they were viewed as a potential safe haven among growing global macro-economic risks. The second largest detractor, also a financials specialist, rotated from regional banking companies into consumer finance companies over the quarter, and experienced losses as that subsector was negatively impacted by growing negative sentiment around economic growth and how that would impact the consumer. The Fund's managers view the current market as rich with both absolute and relative value opportunities within financials.

The China specialist, the third largest detractor, was hurt by their net long bias, particularly in communication services and consumer discretionary companies which sold off with additional negative economic data and resultant market sentiment. While Chinese equity markets have been severely impacted by a slowing economy due to central government forced deleveraging and issues related to the trade conflict, this manager retains conviction in their portfolio as they are focused on companies that are fundamentally healthy and are trading at increasingly attractive valuations despite the macroeconomic backdrop.

The fourth negative contributor to returns was an industrials and related sector specialist who runs a combined portfolio of a hedged relative value book and a long biased absolute value book. The long portfolio was impacted by greater than 10% corrections in both October and December in the industrials sector. The manager saw significant losses within the energy sector in the oil and gas exploration and production subsector, within the materials sector across a range of subsectors, and within the industrials sectpr in aerospace and defence.

The fifth largest detractor, a European manager who runs a global portfolio, experienced losses in Europe and the Americas. Industrials was the most difficult sector within their exposure to the Americas, while individual company losses were most significant in health care, consumer discretionary and industrials companies in Europe. This portfolio manager is running with lower than average gross exposure, as they await a clearer global macro-economic outlook. While experiencing a difficult fourth quarter, this manager has traded more nimbly earlier in the 2018 market selloff and, as a result, suffered only modest losses on the year.

The top contributors included a Japan specialist, a European portfolio manager, and an energy sector specialist. The most substantial contributor, a long-tenured Japan specialist, was able to generate significant alpha on the short side of their hedged portfolio, which drove positive results for the quarter. Consumer discretionary and industrials shorts proved to be particularly successful for this manager over the quarter. Japanese markets sold off and rotated particularly hard in December, potentially related to heavy selling on behalf of foreign equity holders. The Fund's manager believes this has created an interesting environment to further build out the portfolio. This manager had a strong 2018, which supports their belief in their ability to generate gains in a variety of market environments.

The pan European mid-capitalisation manager, the second largest contributor, was able to generate positive returns through alpha generated in specific short positions and by ramping up their short portfolio in the middle of the quarter. In the investment manager's opinion, this tactical trading skill is rare, but this is one of the few portfolio managers observed that demonstrates this skill over a prolonged period. Short exposure in consumer discretionary, industrials, information technology and health care drove the positive results. The Fund's energy sector specialist produced gains that came close to covering their losses from earlier in the year. They were able to extract value from their short portfolio primarily as the exploration and production subsector dropped well over 30% in the final quarter of the year due to a selloff in the price of oil.

During the quarter, the investment manager terminated a quantitative equity manager with a long track record of success in statistical arbitrage strategies. This manager has struggled with the challenging environment for quantitative strategies, one of the more difficult environments that the investment manager has observed. While certain quantitative managers are included in the in the Fund's portfolio for diversification benefits, the investment manager decided to move on from this manager once they were convinced they were unlikely to generate significantly positive results over the medium to long-term, regardless of their correlations to other managers or markets.

Given the heightened volatility, the investment manager has proactively maintained an ongoing dialogue with the Fund's underlying managers over the course of the quarter. As the information is at their fingertips through their managed accounts platform, the investment manager does not need to call about performance, exposures or trading activity; however, they use these regular interactions to assess the trading environment for the manager's sector or geographical focus and how they are responding to it.

A volatile equity market concurrent with a difficult hedge fund trading environment provided meaningful data to assess the portfolio and risk management skills of the managers which the investment manager partners with. The investment manager continues to find talented equity portfolio managers across all regions. In fact, they believe the difficulties experienced in 2018 by certain larger multi-strategy hedge funds and the overall industry generally may accrue to the Fund's benefit as more talented portfolio managers look for stable platforms and new sources of capital. As such, the investment manager will seek to upgrade the Fund's roster of long/short equity managers over the course of 2019, both in the US and abroad.

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Outlook

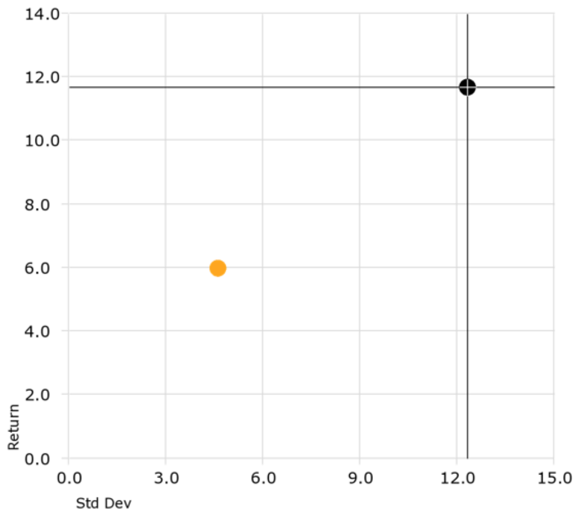
Despite a challenging quarter and year for long/short equity, the investment manager believes that alpha, while cyclical and varying, is available to investors when executed with discipline over long time frames. In particular, they maintain their conviction in low net exposure approaches run by sector and geographic specialists. Recent research in the Financial Analysts Journal by Cao, Chen, Goetzmann and Liang indicates that hedge funds are the sole type of institutional investor that display skill in the selection of mispriced stocks over extended periods of time, however that the resultant correction in mispricing is not instantaneous.

The past decade has not been conducive to actively managed, hedged strategies. Central bankers have successfully suppressed interest rates and volatility globally in their efforts to move beyond the 2008 financial crisis, creating elevated demand for risk assets and a lack of dispersion in fundamental results and prices. It appears that the markets have begun to move out of that environment. This transition is likely to be messy and difficult for both traditional asset classes and hedge funds at times, such as the fourth quarter of 2018. The investment manager believes, however, that the security selection strategies that long/short equity hedge funds employ will benefit from a normalisation in volatility, higher cost of capital, and dispersion in growth trajectories.

The investment manager remains convinced that their approach will continue to add value to client portfolios over longer periods of time. This is due to a focus on specialist managers with a history of excellence in security selection and risk management, combined with an ability to evaluate and quickly adjust the Fund's portfolio as risks and opportunities present themselves.

Risk vs return over 10 years

Time period: 01/01/2009 to 31/12/2018



Ironbark LHP Global Long/Short (W)

Investment growth of $100 since inception

Time period: 01/04/2001 to 31/12/2018

MSCI ACWI NR 100% Hedged to AUD

Source: Morningstar Direct. Data in AUD

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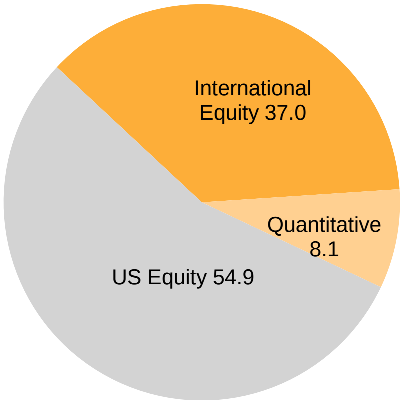
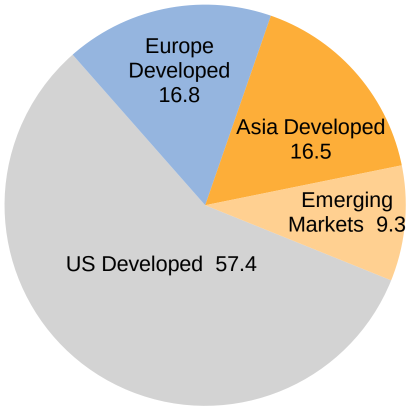
Asset allocation[1]

Strategy allocation (%)



Geographic allocation (%)



[1] Weights at the Underlying Fund level, including an allocation to cash. The Underlying Fund is the Lighthouse Global Long/Short Fund Limited, Class C.

Important information

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Ironbark ASSET MANAGEMENT