Ironbark LHP Global Long/Short Fund (Wholesale)

Quarterly Investment Report as at 30 September 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

Number of underlying managers

31

Fund Size

$193.9m (represents wholesale and retail unit classes)

Exit Price

$1.8416

Market Review

The persistent and rather isolated strength of the US equity market has surprised many investors, coming on the back of a period of synchronous global growth. Asia and Europe have demonstrated some issues that threaten their growth stories, while emerging markets have been challenged by idiosyncratic events specific to certain markets and more broadly by the strength of the US dollar, the headwinds of trade wars and a slowing Chinese economy.

Global equity markets, as measured by the MSCI All Country World Index ('ACWI') rose more than 4% for the quarter, while the ACWI ex-US Index gained less than 1%. Emerging market equities continued their underperformance in the third quarter, as the MSCI Emerging Markets Index lost just over 1%. Japan proved to be a bright spot within Asia, partially due to a weakened yen, as markets reached levels not seen since 1991. Global growth is expected to decelerate into 2019 due to emerging market stresses and China's focus on deleveraging, while the US economy is marked both by continued corporate profitability and government fiscal stimulus. During the third quarter, health care, industrials, and technology sectors outperformed the overall market, while materials, energy and real estate stocks underperformed and were barely positive.

Performance Review

The Ironbark LHP Global Long/Short Fund (Wholesale) (the 'Fund') returned -0.73% (net) in the September quarter.

Following good results in the first half of the year, alpha production was weaker this quarter, particularly on the long side of the Fund as sentiment changes and global macroeconomics tended to dominate equity markets. Gross exposure ranged from approximately 320% to 345% during the quarter with an average of approximately 330%. Net exposure ranged from approximately 30% to 40% with an average of roughly 35%. These exposures fluctuated within a fairly tight range as managers generally harvested gains and responded actively to market trends. The investment manager is happy with the moderately higher levels of exposure and volatility the Fund is producing, even as near-term results came in below long-term expectations.

Exposure to the Americas and Europe contributed positively to results. Alpha production was particularly strong in Europe from both long and short positions. Negative alpha in the Americas and Asia was driven by long exposure. Financials, health care and communication services sectors drove positive contributions, while consumer discretionary, consumer staples and industrials were sectors that generated negative returns. Alpha production was particularly strong in financials but weak in consumer discretionary.

Performance

	Net Fund Return (%)
1 month	-0.37
3 months	-0.73
1 year	4.20
3 years (p.a.)	4.15
5 years (p.a.)	5.65
7 years (p.a.)	7.54
10 years (p.a.)	7.11
Since inception[1] (p.a.)	6.42

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.

Contact Details

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Manager Review

Despite negative performance overall for the quarter, approximately two thirds of the underlying managers contributed positively to returns, which was true for both US and internationally focused portfolio managers.

The three largest detractors to the Fund included a portfolio manager who invests across technology and consumer sectors, a China specialist and a pan-Asian manager. The technology and consumer focused manager suffered significant losses on the long side within consumer discretionary companies and on the short side in technology and consumer-related health care positions. A large position in the gaming industry sold off due to negative sentiment in the casino industry. This manager has historically generated dynamic returns from shorting "hyped" companies but was unable to do so in the third quarter, and instead added further to losses with these types of positions.

The China specialist, the second largest detractor, gave back their gains from the first half of the year alongside the significant decline in local equity markets. This manager was hurt by their net long bias, particularly in consumer discretionary and industrial companies. While Chinese equity markets are impacted by a slowing economy due to deleveraging and issues related to the trade conflict, this manager is focused on companies that can grow earnings and are trading at attractive valuations despite the macroeconomic backdrop. The pan-Asian manager who was the third-largest detractor suffered losses primarily in Hong Kong based longs and Japan based shorts. This experienced portfolio manager tends to run with a contrarian style, however, has reduced their Hong Kong net long bias and Japan net short bias going into the fourth quarter to take advantage of company specific opportunities.

The top contributors included a Japan specialist, a financials manager, and a global capital markets specialist. The most substantial contributor, a long-tenured Japan specialist, was able to generate alpha in both long and short names in an upwardly moving Japanese market while running with a slightly net short exposure. Consumer discretionary, financials and materials proved to be fruitful sectors for the manager.

A financials specialist, the second largest contributor, was able to generate positive returns each month of the quarter. They had success in the asset management & custody subsector, both on the long and short side. Contribution was fairly even between longs and shorts overall, but alpha was driven primarily by shorting. This manager believes that a less stringent regulatory environment combined with rising interest rates will create a favourable environment for stock selection within the banking sector. The Fund's capital markets specialist was able to extract value from the considerable activity in primary and secondary issuance that took place over the quarter. This manager was able to generate positive results across the globe, with particularly strong performance in Asia.

During the quarter, the investment manager added two new managers who specialise in technology, media and communication services stocks. One of these portfolio managers is exclusive to Lighthouse and takes an intermediate term (12-18 months) time horizon with moderate net exposure while the other manager approaches these sectors with a much shorter time horizon (3-9 months) and more neutral net exposures. The investment manager has found that blending a group of managers who focus on different parts of a sector using different time frames and with varying biases (i.e. growth versus value) offers the best approach.

The investment manager also terminated two managers. The Fund moved on from one financials specialist, as the investment manager believes the two newer specialists that have been added in this sector over the past two years offer greater potential returns at more equitable fees. As Lighthouse hires more exclusive and/or niche managers, they have continued to drive down the fees that we pay managers, particularly the management fee. The investment manager will continue to focus sourcing efforts on what they believe are the best portfolio managers from a risk and return perspective. However, they will also seek to reduce fixed fees as appropriate. In addition, the Fund exited its position with an event-driven specialist, following several mergers that were either completed or terminated, as the Fund redeploys the capital into other strategies.

As the investment manager has done recently within financials and technology, they are always looking to improve the Fund's mix of approaches across sectors and geographies by adding complimentary managers, and they would expect to continue to be active in the portfolio through the first quarter of next year. The Fund's pipeline within long/short equity strategies is particularly robust due to the investment manager's focused sourcing effort and reputation. The ability to offer opportunities to managers on an exclusive basis opens the investment manager's sourcing process to a much larger set of portfolio managers than is available to a typical competitor.

Outlook

Recent analysis by Barclays and HFR indicate that since 2010, the hedge funds that have generated the most alpha tended to be those that exhibited the lowest equity betas. In the shorter term, Goldman Sachs analysis for June through September indicated a particularly difficult alpha environment for low beta stock selection strategies. This is consistent with the investment manager's long and short-term experience. The investment manager maintains their conviction in long/short equity as a strategy and their belief that specialist equity managers are the best way to approach the strategy.

Markets outside of the US have borne the brunt of a stronger US dollar, trade wars, and tariff fears. The Fund's exposure to Asian and European strategies has been quite beneficial over the longer term. Recent analysis by Barclays also indicate that since 2010, Europe and Asia hedge fund managers have produced higher levels of alpha than their US counterparts. The investment manager will continue to favour less crowded markets, which they believe is a major contributing factor to this higher level of alpha. Asia, and particularly China, fit that requirement. The market structure in China has meant that the Fund has needed to take on some market exposure alongside the stock selection alpha.

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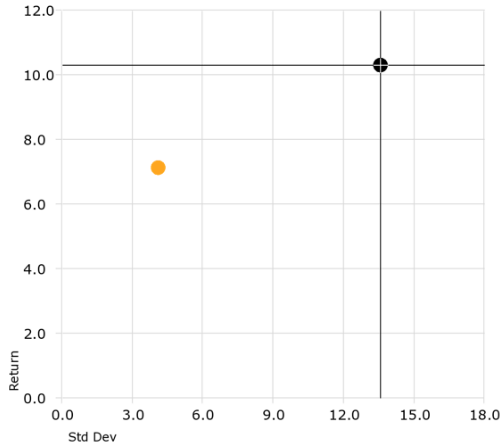
Outlook (cont'd)

The investment manager thinks this risk is worth the reward, particularly in light of the level of alpha the Fund has been able to access in these markets.

The investment manager believes long/short equity fund performance for the past ten years has come in below expectations. This has been particularly true of more liquid and hedged approaches. Looking back more carefully, it is not surprising that this has occurred during a decade of coordinated global quantitative easing by the world's central banks. This environment will not persist indefinitely, and the recent developments within US interest rates, at the very least, lead the investment manager to believe the market may be on the cusp of a decade that is likely to look very different than the last. The investment manager is focused on creating a Fund that will serve investors well across a broad range of potential market environments, including ones that have not been seen in some time. The investment manager's focus remains on sourcing talented managers globally and building efficient, lower cost portfolios utilising the Fund's managed account infrastructure, complimentary risk systems, and the operational skills and advantages their experience and scale offers.

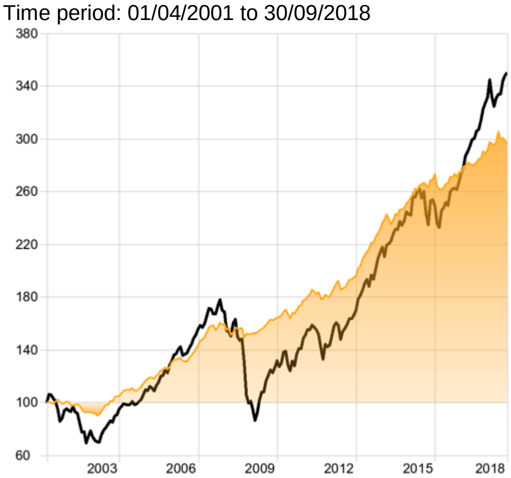
Risk vs Return over 10 years

Time period: 01/10/2008 to 30/09/2018



Investment growth of $100 since inception

Time period: 01/04/2001 to 30/09/2018



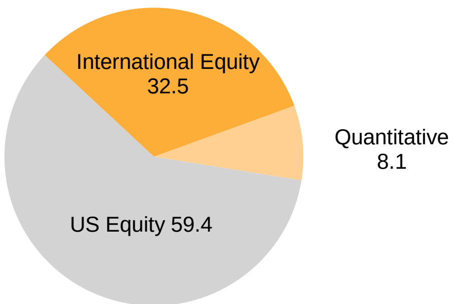
● Ironbark LHP Global Long/Short (W)

● MSCI ACWI NR 100% Hedged to AUD

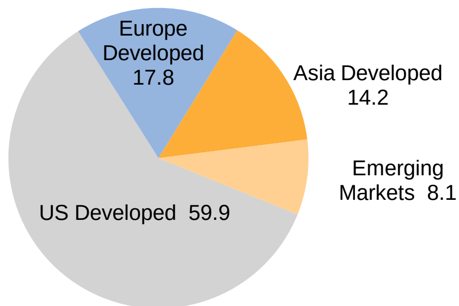
Source: Morningstar Direct. Data in AUD

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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