

Ironbark Karara Australian Share Fund

Monthly Investment Report as at 31 May 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 Index¹

Buy/Sell Spread

+0.25%/-0.25%

Management Costs

0.9925% p.a.²

Distribution Frequency

Semi-Annually

Minimum Investment

\$20,000

Fund Size

\$83.8m

Exit Price

\$1.5157

Market Review

Latent worries around house prices were crystallised by the Government's surprise budget revenue measure to tax the 'riskier' liabilities of the large banks. Squeezing bank profitability adds to the regulatory pressures that are pushing retail mortgage rates up and tightening credit availability. The fallout radiated from the banks, through retail and other consumer discretionary exposures, which had already been roughed up by concerns about the impact of new online competition.

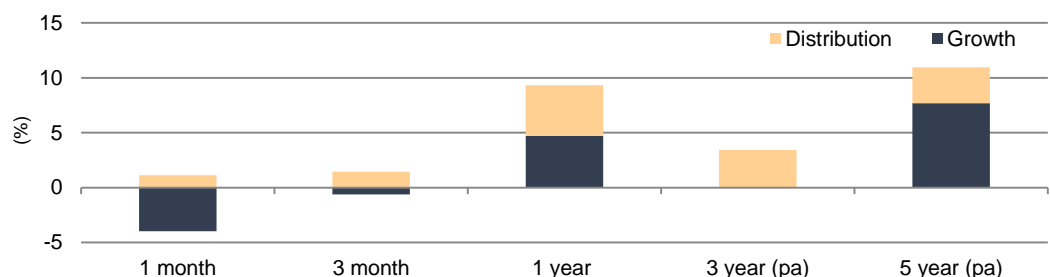
The Australian dollar fell 0.8% against the US dollar and 3.8% versus the resurgent Euro. Domestic bond yields continued their recent decline, with the premium to the US ten year Treasury yield tightening to a mere 18 basis points.

Looking through the lens of elevated household debt, Australian data releases supported rising anxiety. Building approvals declined sharply, wage growth slowed and March retail sales printed a nominal decline. Offsets including stronger employment data and rising business confidence did little to stem weakening sentiment.

Developed and emerging market equities continued to make new highs despite global data softening somewhat and bond yields rallying. The election of Emmanuel Macron as French President was a rallying point and peripheral European markets performed particularly strongly.

The rolling over of China's manufacturing Purchasing Managers' Index ('PMI') and slowing house prices growth contributed to weakness commodities prices, notably iron ore which fell 17% over the month to \$57 per tonne and is down 38% over three months. Oil slipped another 3% as speculative positioning continued to shorten driven by the macro momentum and incremental US production growth. Nevertheless, OPEC confirmed the extension of production cuts and North American inventories continued to decline at an accelerating rate.

Performance



	Net Fund Return (%)	Benchmark Return (%)	Active Return (%)
1 month	-2.87	-2.74	-0.13
3 months	0.84	1.43	-0.59
1 year	9.32	10.80	-1.48
3 years (pa)	3.40	6.04	-2.64
5 years (pa)	10.97	11.70	-0.73
7 years (pa)	7.52	8.35 ¹	-0.83
10 years (pa)	2.55 ⁴	3.42 ¹	-0.87 ⁴
Since inception ³ (pa)	6.43 ⁴	7.10 ¹	-0.67 ⁴
Since Karara as Investment Manager ⁴ (pa)	6.17	7.04	-0.87

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.

¹The 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.

²As at 31 December 2016. Refer to PDS and website for full breakdown of management costs.

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

⁴Karara 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 Fund returned -2.87% (net) over the month, underperforming the benchmark's return of -2.74% by 0.13%.

Financials did most of the damage, down 7.7% for the month and was the only sector to underperform the benchmark. The prices of the big four banks fell between 9% (CBA) and 12% (ANZ), giving up their 2017 gains. The Fund had squared off its overweight to the bank sector in previous months but the underperformance of ANZ relative to CBA and the regional banks saw the sector detract modestly.

Bond market strength and rotation from financials and banks continued to push bond proxies higher as capital sought sanctuary in areas less correlated to house prices and consumer spending. It is to this side of the rotation that the portfolio was more exposed. REITs (which would clearly not be immune to a downturn in residential prices and household spending) outperformed albeit modestly (-1%). Combined with infrastructure (Transurban up 1%, Sydney Airport up 8%, APA up 5% and Aurizon up 7%), and a rebound in Telstra (+4%) these collectively impacted 0.46%. After their rallies in 2017 most of these companies now look more expensive relative to interest rates than they did at their peak during June quarter last year. Yet fundamentals, at least for most of the REITs, Telstra, Sydney Airport, Aurizon and APA, have deteriorated.

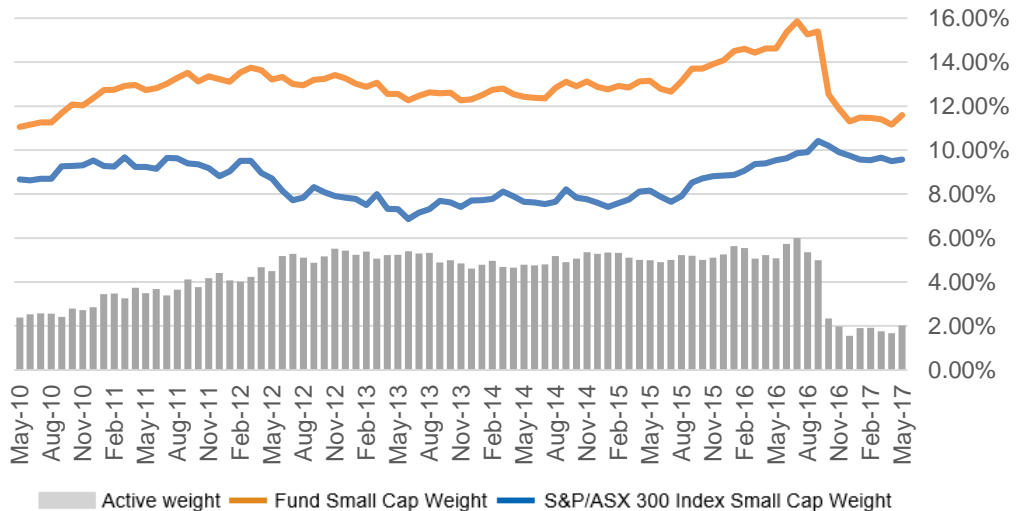
Qantas was the Fund's best performer, rising 18% as the sustainability of current returns became more generally accepted following its annual investor day. Also supportive was the continuing re-rating of global airlines to which Qantas still trades at a steep discount.

Stock selection contributed in energy and mining sectors as Origin (up 7%), Rio Tinto (up 4%) and Saracen (up 12%) saw good gains. Boral (up 11%), Resmed (up 3%) and Sonic Healthcare (up 5%) took some benefit from their overseas earnings however each also saw some specific risks moderate. Crown (up 4%) continued to be re-rated after it exited its remaining holding in Melco.

The Fund's position in Medibank Private was sold. The price had rallied while the investment manager has less conviction that Medibank can differentiate itself from industry outcomes. Industry margins are very sensitive to growth in claims, prices and policyholder numbers, all of which the investment manager expects will deteriorate from today's favourable levels.

Portfolio Characteristics

No of large cap stocks	37
No of small cap stocks	57
Cash	4.69%
Portfolio Turnover (1yr)	38.80%
Sharpe Ratio (1yr)	0.79%
Standard Deviation (5yrs)	11.85%



Market Cap Distribution

Market Cap	Fund (%)	Bench (%)
1- 50	71.29	79.15
51-100	14.77	11.10
101-200	5.79	7.18
201-300	1.94	2.57
Ex 300 ¹	1.52	0.00
Cash	4.69	0.00

Top 5 Active Weights

Security Name	Active Weight (%)
CSL	-3.81
AGL Energy	3.66
Origin Energy	2.52
Brambles	2.28
Telstra Corporation	-2.27

¹Including Placement Securities

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Market Outlook

The broad based pickup in global growth indicators and inflationary expectations is moderating somewhat, albeit above-trend growth is occurring and this is expected to continue in most advanced economies. The outlook for emerging markets is also generally improving. China is supported by its increased spending on infrastructure and property with some improvement also observed in the non-investment side of the economy.

Large pools of global capital remain sidelined in low or negative yielding assets and will take time to re-position as confidence over the durability of recovery builds.

Slack in the US economy is now relatively low and the investment manager expects that the US Federal Reserve Bank can slowly raise rates given overall financial conditions have eased materially over the last 12 months. Structural limits on US growth mean that they will have some tolerance around inflation exceeding their targets.

With the 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. However, bond markets remain inflated and yields trending higher will generally be a headwind for developed market benchmarks.

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.
- Europe as the structural challenges in Europe remain unresolved. Better growth and recent electoral outcomes are encouraging however, adverse political risks remain omnipresent.

While global growth improvement is more synchronised, Australia is lagging. The investment manager anticipates that Australian gross domestic product ('GDP') growth will remain modest by historic standards at a sub-trend rate of around 2-3%. Population growth is assisting headline growth numbers with growth on a per capita basis quite low in a historical context.

Key Contributors & Detractors for the Month

Top 5 Contributors	Active Position	Top 5 Detractors	Active Position
Qantas Airways	Overweight	James Hardie Industries	Overweight
Origin Energy	Overweight	ANZ Bank	Overweight
Downer EDI	Overweight	Telstra Corporation	Underweight
Commonwealth Bank	Underweight	Aristocrat Leisure	Underweight
Sonic Healthcare	Overweight	Sydney Airport	Underweight

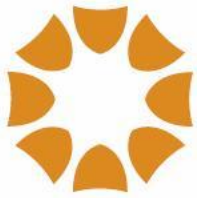
Asset Allocation

Sector Weights	Fund (%)	Bench (%)	Active Weight (%)
Materials ex Metals & Mining	7.48	4.12	3.36
Utilities	5.56	2.39	3.17
Energy	7.45	4.41	3.04
Consumer Discretionary	7.74	5.11	2.63
Industrials	8.47	7.51	0.96
Information Technology	1.58	1.31	0.27
Health Care	6.18	7.11	-0.93
Financial ex Property Trusts	35.29	36.35	-1.06
Telecommunications Services	1.67	3.82	-2.15
Consumer Staples	4.92	7.24	-2.32
Metals & Mining	8.50	11.85	-3.35
Property Trusts	0.47	8.77	-8.30
Cash	4.69	0.00	4.69

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Market Outlook (cont'd)

Indicators on the domestic consumer are mixed. There has been a fall in consumer confidence and some moderation in consumer spending has occurred. The ongoing modest decline in the savings rate continues given the strong increases in household wealth over the last few years in both housing and other financial assets. Overall, the investment manager expects consumer spending to be broadly in line with household income growth, which remains relatively low in a historical context.

House prices are high by any measure and conditions in the housing market vary considerably outside of Melbourne and Sydney. The recent tightening of credit to the investor segment of the market will have some 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.

Moderate global growth and the return of pricing power in some sectors suggest a reasonable backdrop for many stocks. However, after recent expansion in valuations, sustained gains will require continuing profit delivery.

The investment manager has observed a return of the high levels of valuation dispersion that were observed last year. Stocks with defensive growth characteristics are again trading at historically high valuation levels.

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.

Important Information

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