Ironbark Karara Australian Small Companies 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

PAT0002AU

ARSN

114 291 486

Fund Inception Date

30 June 2005

Manager Appointed

1 May 2010

Benchmark

S&P/ASX Small Ordinaries Accumulation Index

Distribution Frequency

Semi-Annually

Minimum Investment

$20,000

Fund Size

$606.5m

Exit Price

$3.4901

Number of Holdings

59

Market Review

Global risk appetite collapsed in October on multiple headwinds led by the US Federal Reserve's ongoing stance on tightening monetary policy, while other risk factors such as continued trade war concerns and emerging market weakness added to the bearish tone. Relatively expensive growth sensitive sectors, such as information technology, were the worst performers, while real estate, consumer staples and utilities fared better. Safe haven assets rallied, with gold moving higher. Australia's fall was in-line with the global selloff in the S&P/ASX 300 Accumulation Index (down 6.2%), while the small company index lost 9.6%.

In Australia, the Reserve Bank of Australia left the policy rate unchanged at 1.5% in October, although the labour market commentary was upgraded such that the Reserve Bank now sees the unemployment rate "trending lower". Both headline and core inflation printed at 0.4% in the third quarter, and annual headline inflation came in at 1.9%. Fuel prices rose, while the housing group was weak, reflecting softness in rents.

Domestic house prices fell again in October with CoreLogic's dwelling prices down 0.5%, taking the year-on-year fall to 3.5%, the worst since February 2012. Sydney led falls (down 7.4%), followed by Melbourne (down 4.7%). Retail sales rose 0.3% month-on-month in August, modestly higher than consensus. However, sales at department stores and household goods retailers declined in trend terms, weighed down by lower house prices.

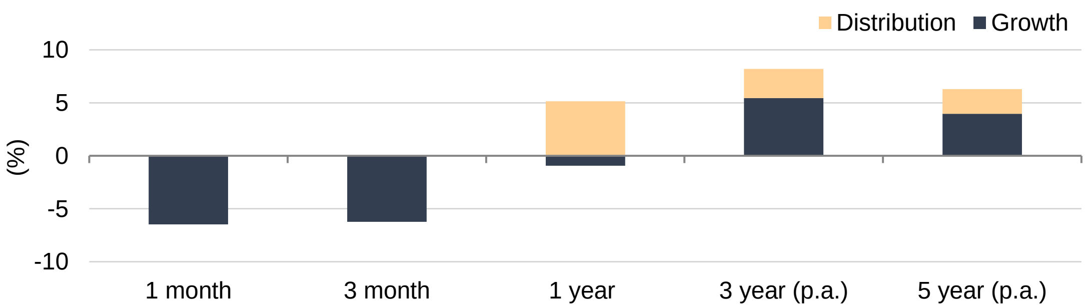
Amongst commodities, base metals ended lower, weighed down by global growth concerns. Copper (down 5.2%) and nickel (down 8.6%) were the worst affected while tin (up 1.5%) was the only metal to gain. Crude oil was weaker and the WTI was down 0.8%, as the US government directed OPEC to lift its collective production rate to reduce prices. Iron ore continued to break higher, crossing $75 per ton (in US dollar terms) amid tight fundamentals and record high Chinese steel production. Gold rose 1.9% to $1,215 given risk-off sentiment.

Performance Review

The Ironbark Karara Australian Small Companies Fund (the 'Fund') returned -6.46% (net) for the month, outperforming the benchmark's return of -9.60% by 3.14%.

For October, the strongest contributors to Fund performance at a sector level were overweight positions in metals & mining and utilities, as well as an underweight position in financial ex property trusts. An underweight position in real estate was the main detractor from a sector perspective.

Performance



	Net Fund Return (%)	Benchmark Return (%)	Active Return (%)
1 month	-6.46	-9.60	3.14
3 month	-6.23	-7.67	1.44
1 year	4.18	2.59	1.59
3 year (p.a.)	8.22	10.54	-2.32
5 year (p.a.)	6.29	6.00	0.29
7 year (p.a.)	9.05	4.29	4.76
10 year (p.a.)	13.31	6.73	6.58
Since inception[1] (p.a.)	12.69	4.06	8.63

Past performance is not an indication 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]This figure represents the annualised performance of the Fund since inception.

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Performance Review (cont'd)

At a stock level, positive contributors to monthly performance included overweight positions in Saracen Minerals, Steadfast Group and Cooper Energy. A nil holding in WorleyParsons also added to relative performance. Shares in Saracen rose 31% on the general risk-off sentiment and firmer gold price. The company's September quarter report confirmed a strong foundation for the 2019 financial year with record quarterly production of 89 thousand ounces at an all-in sustaining cost of $993 per ounce. Steadfast shares gained 4% after the company upgraded their 2019 financial year earnings guidance by a similar amount to take year-on-year growth to approximately 20%, driven by a combination of organic and inorganic growth. Cooper Energy added 2% after the company confirmed that construction on the Sole gas project is 74% complete and scheduled for completion late 2019, with remaining works to be completed under fixed price arrangements. The company's balance sheet has net cash of $50 million and is well placed to fund growth projects in both the Otway and Gippsland Basins.

The largest detractors to monthly performance included overweight positions in Altium, LiveTiles and Seven Group. Shares in Altium fell 20% on little news, largely reflecting heightened risk-off sentiment towards higher growth technology stocks. LiveTiles (down 33%) encountered similar sentiment issues despite issuing an annualised recurring revenue update confirming the company's expectation of "significant" growth in customer receipts in the second quarter of 2019, as well as distribution partner, N3, generating rapid sales pipeline growth. Seven Group shares fell 22% after US-based Caterpillar fell heavily following the release of its third quarter 2018 results. On the earnings call Caterpillar management confirmed Asia-Pacific sales were up 38% on a 12-month basis, a data point likely insightful for WesTrac, the Caterpillar dealer in Western Australia, New South Wales and Australian Capital Territory. Caterpillar noted it saw higher mining equipment sales in the third quarter of 2018 and flagged that strong mining sector rebuild, overhaul and maintenance activity was driving higher aftermarket parts sales. These dynamics are positive for WesTrac and the investment manager remains constructive on Seven Group's exposure to normalisation in Australian mining equipment maintenance following several years of under-investment, as well as the company's exposure to growth in east coast infrastructure investment.

Top 5 Active Weights

Security Name	Sector	Active Weight (%)
Bega Cheese	Consumer Staples	3.42
Costa Group Holdings	Consumer Staples	3.20
Saracen Mineral Holdings	Metals and Mining	2.82
Worleyparsons	Energy	-2.62
Cooper Energy	Energy	2.39

Key Contributors & Detractors over the month

Top 5 Contributors	Active Position
Saracen Mineral Holdings	Overweight
Worleyparsons	Underweight
Corporate Travel Management	Underweight
Steadfast Group	Overweight
Cooper Energy	Overweight

Top 5 Detractors	Active Position
Washington H. Soul Pattinson and Co	Underweight
Altium	Overweight
LiveTiles	Overweight
Lynas Corporation	Underweight
Regis Resources	Underweight

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.

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Market Outlook (cont'd)

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.

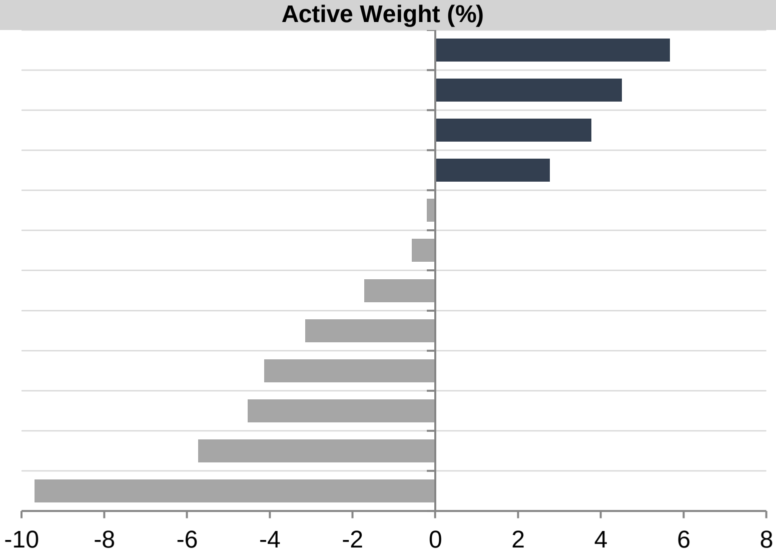
There is potential for future fiscal easing as government revenues have showed a marked improvement on the back of better commodity prices and stronger labour markets. The likely prospect of tax giveaways or higher spending will reverse the negative drag seen over the last couple of years where deficit 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.

Asset Allocation

Sector Weights	Fund (%)	Bench (%)
Consumer Staples	14.20	8.53
Utilities	4.96	0.45
Information Technology	13.49	9.72
Metals & Mining	17.67	14.90
Industrials	7.14	7.34
Financial ex Property Trusts	7.84	8.41
Energy	7.59	9.30
Materials ex Metals & Mining	0.00	3.14
Health Care	2.31	6.44
Communication Services	3.27	7.80
Consumer Discretionary	7.33	13.06
Real Estate	1.23	10.91
Cash	12.97	0.00

Active Weight (%)



Important Information

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