Ironbark Karara Australian Small Companies Fund

Monthly Investment Report as at 31 January 2019

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

$621.5m

Exit price

$3.5339

Number of holdings

56

Market review

Global markets recovered some of their December quarter losses in January with a mix of sectors leading the bounce back, including resources, real estate and technology. Global bonds had a volatile month and rallied after a cautious update from the US Federal Reserve. Amongst commodities, oil prices rallied and the iron ore price jumped due to supply disruptions. The S&P/ASX 300 Accumulation Index rose 3.87% while the S&P/ASX Small Ordinaries Accumulation Index gained 5.56%.

Australian dwelling prices fell again in January to record a year-on-year decline of 5.6% according to CoreLogic, the worst since March 2009. November employment was marginally better, adding 22,000 jobs, and the unemployment rate ticked down to 5.0% on lower participation. NAB business conditions fell to 2 in December, from November's 11, the biggest monthly drop since October 2008, while Westpac Melbourne Institute consumer sentiment retraced a sharp 4.7%.

Oil prices rebounded in January after three consecutive months of decline. The WTI and Brent rose 18% and 13%, respectively, amid Venezuelan sanctions and a drop in US stockpiles. Iron ore rose 16% after Vale, the world's largest producer, reported a dam failure that could take 40 million tonnes per annum out of the global market.

Metals rose with the LME Metals Index up 5.2%. Nickel (up 17%), recorded the largest monthly increase followed by zinc (up 8%), tin (up 7%), and lead (up 5%). Copper (up 3%), and aluminium (up 2%), rounded out the gains. Gold prices also continued their rise, up 3% for the month.

Performance review

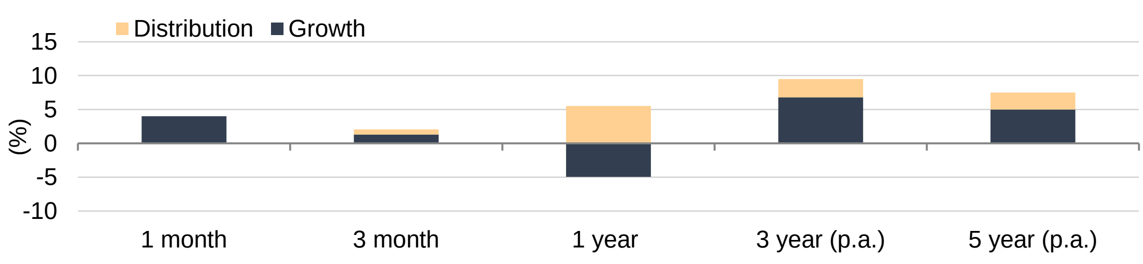
The Ironbark Karara Australian Small Companies Fund (the 'Fund') returned 4.01% (net) for the month, underperforming the benchmark's return of 5.56% by 1.55%.

The strongest contributors to Fund performance at a sector level were overweight positions in metals & mining and information technology, while an underweight position in real estate also contributed. Overweight positions in consumer staples and utilities were the main detractors from relative performance.

At a stock level, positive contributors to monthly performance included overweight positions in Saracen Minerals, Healius, Altium and Senex Energy.

Shares in Saracen rose 15% on a stronger gold price and December quarterly results that produced more ounces than market expectations at a lower cost. The company lifted group production guidance to 345-365,000 ounces (previously 325-345,000 ounces) on the back of higher volumes with cost guidance unchanged at $1,050-$1,100 per ounce on an all-in-sustaining-basis. Healius (formerly Primary Healthcare) shares gained 30% after the company's largest shareholder, the Jangho Ggroup, made an unsolicited, conditional approach at $3.25 per share, or about 33% above the prevailing share price. The Healius board rejected the bid on January 7, saying it undervalued the business. Altium shares rose 15% amidst a broad market re-bound in technology companies and Senex gained 25% on more favourable energy market conditions.

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	4.01	2.04	0.58	9.52	7.49	9.01	14.02	12.61
Benchmark Return[1]	5.56	0.78	-3.06	11.34	7.37	4.51	7.97	4.05
Active return	-1.55	1.26	3.64	-1.82	0.12	4.50	6.05	8.56

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.

Contact details

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Ironbark ASSET MANAGEMENT

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Performance review (continued)

The largest detractors to monthly performance included overweight positions in Costa Group, Elders and Northern Star Resources. Costa shares fell 25% after the company provided a disappointing trading update for the 2018 calander year and for the 2019 financial year. Management attributed the earnings downgrade to a number of factors. Firstly, a combination of strong industry supply combined with subdued consumer demand during December impacted pricing across a number of product lines (berries, tomatoes, avocados). Secondly, late season citrus volumes came in below expectations. Lastly, there were higher costs associated with the drought across the eastern seaboard (water and straw costs). The investment manager continues to assess whether the issues identified are short term in nature, as contended by management, or whether there are longer term structural issues that could see further price deflation in the future. Elders shares fell 11% on no company-specific news, most likely reflecting an absence of any easing in drought conditions in eastern Australia. Northern Star Resources shares lost 5% despite the firmer gold price, after the company produced less gold than expected during the December quarter at a higher cost. The company has maintained full year guidance and the investment manager has maintained their position as it is not unusual for the company's production to be second-half weighted.

Top 5 active weights

Security name	Sector	Active weight (%)
Saracen Mineral Holdings	Metals & Mining	3.82
Bega Cheese	Consumer Staples	2.82
Costa Group Holdings	Consumer Staples	2.61
Cooper Energy	Energy	2.41
Meridian Energy	Utilities	2.32

Key contributors & detractors over the month

Top 5 contributors	Active position
Saracen Mineral Holdings	Overweight
Healius	Overweight
Altium	Overweight
Senex Energy	Overweight
Pantoro	Overweight

Top 5 detractors	Active position
Costa Group Holdings	Overweight
Elders	Overweight
Northern Star Resources	Overweight
Steadfast Group	Overweight
Wisetech Global	Underweight

Market outlook

Recent indicators suggest that global growth remains modestly above trend but momentum has weakened over the last several months led by China. Contrary to the investment manager's expectations, the uncertainty and second order impacts around Trump's trade war have damaged corporate confidence and investment. The magnification of this upon financial markets, and the feedback loop this has risked initiating, has escalated the pressure on both sides to resolve it. A timely deal is needed to help rebuild some lost confidence in the global economy. This demonstrates again that post Global Financial Crisis the sensitivity of investors to any moderation in growth still remains deeply entrenched.

As always, numerous risks to the growth outlook are present, however, it seems that the sum of the fears exceed the fundamentals. The Federal Reserve's significant step to (all but) announce they will remain solidly behind the curve has quickly reversed much of the tightening in financial conditions observed towards the end of 2018 that risked compounding the slowdown. By switching position so quickly, the Federal Reserve will hold down the US yield curve, and it is underwriting looser liquidity at a time when labor and commodity markets generally remain quite tight. This might support valuation expansion in the short run, yet increases the likelihood of inflationary pressures in the longer-term. The investment manager continues to see the eventual end game of this economic cycle as driven by rising inflation than by 'old age'.

In Australia, the investment manager expects some divergence between housing-linked and other sectors of the economy in 2019. The investment manager doesn't see a significant excess stock of housing, nor expect any further tightening in credit, nor the decline in employment needed to accelerate house price declines and trigger significant flow-on effects to the broader economy. However, the current situation raises the vulnerability to an external macro shock during this adjustment period. This looks less likely after recent developments.

With the precedent set by the Federal Reserve, it is possible that the Reserve Bank of Australia will also take the line of least resistance. With the Federal budget now in surplus running into the election and the continuing improvement in terms of trade supporting national income, fiscal easing is also firmly on the agenda. The pressure on state governments to improve infrastructure means spending is still expected to continue to increase notwithstanding lower stamp duty revenue.

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Market outlook (continued)

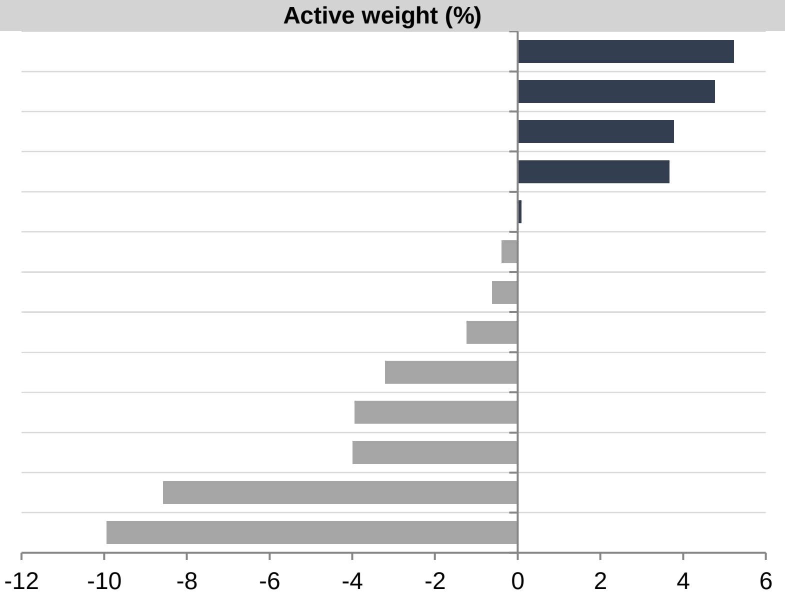
Heightened levels of risk aversion continues to drive many investors towards 'safe' assets offering low real returns. Despite this, the economic backdrop is one that should support earnings growth at or around long-term trend levels.In this context, equities continue to provide better prospects than fixed income where prospects are largely beholden on inflation remaining low and growth deteriorating.

Within equity markets there remains a cohort of stocks that have driven valuation dispersion to near historic extremes. Some renewed loosening global liquidity increases the risk that these valuation differentials continue to widen, the investment manager remains wary that many will struggle to deliver to high growth and margin expectations.

Overall, the Fund remains underweight to interest rate sensitive sectors and is positioned for a more reflationary environment than is currently envisaged by the market. The investment manager still sees good risk-adjusted returns available in a number of sectors. Within this, the emphasis is on quality companies whose prospects are unappreciated by the market.

Asset allocation

Sector weights	Fund (%)	Bench (%)
Utilities	5.64	0.41
Metals & Mining	20.37	15.60
Consumer Staples	12.28	8.49
Information Technology	15.03	11.35
Energy	6.82	6.73
Property Trusts	0.00	0.40
Financial ex Property Trusts	7.10	7.71
Industrials	6.23	7.47
Communication Services	2.55	5.76
Materials ex Metals & Mining	0.00	3.94
Health Care	2.27	6.27
Consumer Discretionary	6.04	14.62
Real Estate	1.30	11.25
Cash	14.37	0.00
Total	**100.00**	**100.00**



Important information

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