Ironbark Karara Australian Small Companies Fund

Monthly Investment Report as at 31 July 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

$640.6m

Exit Price

$3.7219

Number of Holdings

61

Market Review

Global emerging markets rebounded in July following June's sharp drop-off, aided by a moderation in the rise of the US dollar ('USD'). However, developed markets still outperformed, led by Europe and the S&P 500 with a strong start to reporting season. Domestic markets underperformed as a rise in telecommunication services, industrials, and consumer discretionary failed to offset falls in utilities, consumer staples and materials. The S&P/ASX 300 Accumulation Index rose 1.31% to a ten-year high in July, while the S&P/ASX Small Ordinaries Accumulation Index fell 1.01%.

Domestically, second quarter consumer price indices were below expectations for the seventh consecutive quarter, rising 0.4% versus the consensus 0.5%. The year-on-year rate lifted to 2.1%, marking the first time it has fallen within the Reserve Bank's 2-3% band since the first quarter of 2017. CoreLogic's national house prices fell 0.2% in June, and the year-on-year rate has now declined to -0.8%, the weakest since 2012. Elsewhere May retail sales rose a higher than expected 0.4%, June employment rose 51,000 for a 2.8% gain over the prior year, and NAB's business conditions index rose to 15.

The Reserve Bank of Australia left the cash rate on hold at 1.5%. Global trade policy and emerging markets were described as the main risks, although the latter was largely downplayed as being "country-specific".

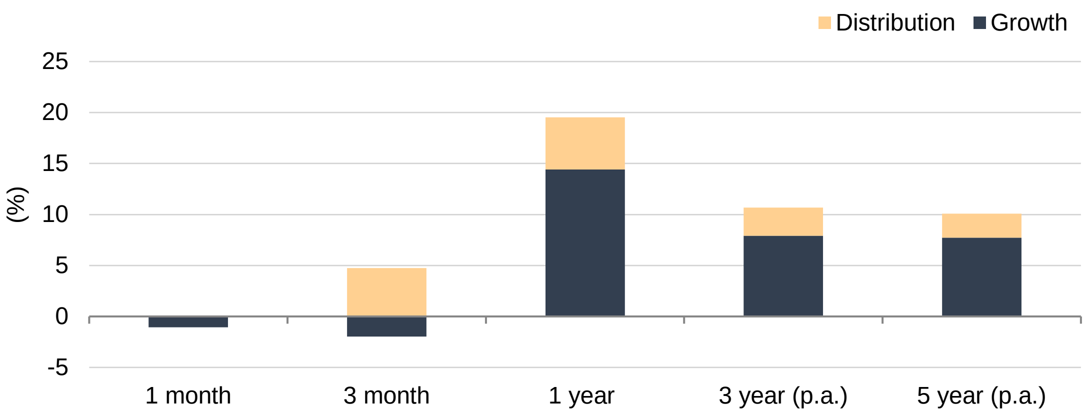
Commodity prices were mainly weaker in July as all base metals, with the exception of tin, fell with the LME metals index down 5.0%. Lead (down 11%), zinc (down 8%), and nickel (down 6%) were the main drivers. Coking coal finished the month down 13.2% after a strong run between May and June. Iron ore rose 4.9% as Chinese rebar prices surged 5.3%. Oil prices fell 6% as OPEC boosted production. Gold fell 2.3% (in USD terms) as bond yields rose.

Performance Review

The Ironbark Karara Australian Small Companies Fund (the 'Fund') returned -1.06% (net) for the month, underperforming the benchmark's return of -1.01% by 0.05%.

During the month, the strongest contributors to Fund performance at a sector level were overweight positions in energy, information technology, and utilities in conjunction with an underweight position in consumer discretionary. An overweight position in metals & mining detracted.

Performance



	Net Fund Return (%)	Benchmark Return (%)	Active Return (%)
1 month	-1.06	-1.01	-0.05
3 month	2.76	3.74	-0.98
1 year	19.53	22.58	-3.05
3 year (p.a.)	10.69	14.03	-3.34
5 year (p.a.)	10.07	9.27	0.80
7 year (p.a.)	9.47	4.53	4.94
10 year (p.a.)	11.40	3.07	8.33
Since inception[1] (p.a.)	13.51	4.78	8.73

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 Cooper Energy, LiveTiles, Technology One, and Bapcor. A nil holding in Nufarm also added to relative performance. Shares in Cooper rose 23% after development drilling at Sole-3 delivered gas flow rates sufficient to support the project on a stand-alone basis and the company confirmed the project as running in-line with both timetable and budget. The investment manager expects development of the Sole-4 well in August will end the riskiest phase of the project and should further support re-rating of the stock. LiveTiles gained 35% after the company's June quarter report confirmed annualised recurring revenue of $15 million in the period, driven by a tripling in average revenue per customer during the year associated with a larger proportion of high revenue customers coming on board. Cash receipts of $3.4 million during the quarter were also stronger than expected. Technology One shares rose 16% after the company confirmed that implementation of new accounting standard, IFRS 15, would have negligible impact on profits and free cash flow, alleviating some of the market's concerns towards the stock. Shares in Bapcor rose 7% on little news.

The largest detractors to monthly performance included overweight positions in Altium, Saracen Minerals, Evolution Mining, and Elders. Altium fell 9%, not on company-specific news, but more in-line with a broader sell-off of highly rated technology names in the US and domestically. Saracen and Evolution fell 15% and 21% respectively after recent outperformance in the face of a weaker gold price gave way to some mean reversion. Elder's share price fell 11% during the month after the company downgraded its 2018 financial year earnings to be relatively flat on the prior year, citing the impact of east coast drought conditions and lower cattle prices. The company did however, re-affirm its confidence in achieving earnings growth of between 5-10% through the agricultural cycle to 2020.

Top 5 Active Weights

Security Name	Sector	Active Weight (%)
Costa Group Holdings	Consumer Staples	3.92
Altium	Information Technology	3.69
Bega Cheese	Consumer Staples	3.46
Cooper Energy	Energy	2.24
Bapcor	Consumer Discretionary	2.13

Key Contributors & Detractors over the month

Top 5 Contributors	Active Position
Cooper Energy	Overweight
LiveTiles	Overweight
Nufarm	Underweight
Bellamy's Australia	Underweight
Sigma Healthcare	Underweight

Top 5 Detractors	Active Position
Altium	Overweight
Saracen Mineral Holdings	Overweight
Evolution Mining	Overweight
Elders	Overweight
Afterpay Touch Group	Underweight

Market Outlook

Global growth remains strong after the modest slowdown in the first quarter. The investment manager believes this economic cycle has some room to run and is more likely to end from rising inflation in response to tight labour and commodity markets than from 'old age'. This contrasts with the weight of money that, in general, remains defensively positioned in assets offering low real returns due to concerns over the durability of the current expansion.

Risk appetite remains fragile as demonstasted by the recent plunge in emerging markets. In the real economy there are relatively few signs of excess, and where there is, they seem to be deflating in a relatively benign manner (e.g. local property and Chinese state-owned-enterprise lending).

Central banks are likely to continue to tighten incrementally, yet prefer to remain slightly behind the curve rather than risk facing a re-run of structural stagnation fears. As a result, there is rising risk that the market is ultimately challenged by the emergence of higher inflation.

The outlook for equities appears reasonable with earnings growth at long-term trend levels across a broad range of sectors. Earnings are being capitalised at rates which, in aggregate, are marginally above long term averages. While this does not shout great value, fixed income and other asset classes seem relatively less attractive given they are more reliant on subdued inflation, very low real interest rates and low credit spreads.

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Market Outlook

Lately, equity markets have been driven by a narrow cohort of stocks resulting in significant valuation dispersion near historic extremes. Yet there have been a number of recent examples of ‘market darlings’ failing to deliver to the often-lofty embedded expectations, particularly in small caps. The investment manager believes that more variability in relative prices and ultimately a higher cost of money will eventually correct this. Even if this doesn’t eventuate, these stocks would be seen as being exposed to falling investor confidence of any form.

A number of risks to the growth outlook are present. While there is the absence of a sizable policy error, these are unlikely to materially impair the current cycle. The Chinese have signalled strongly that they will balance reforms with near-term growth. Even with an irrational escalation of the US-Sino trade war, the direct economic impact remains manageable to China and can be adressed by some re-acceleration in infrastructure investment by China. The second order impacts on corporate confidence are harder to gauge. For now, the market seems to have been quite measured in how it has treated the escalating tariffs impact. As the fiscal stimulus continues to work its way through the US economy the willingness of markets to fund the widening twin deficits of the US poses another significant risk for markets.

With evidence of ongoing house price declines, investor concerns around the Australian economy are generally cautious. The investment manager’s view is that the modest declines in house prices currently being observed are likely to curtail housing investment, but are unlikely to have significant flow on effect to the broader economy. However, the current situation does increase susceptibility to an external macroeconomic shock during the adjustment period.

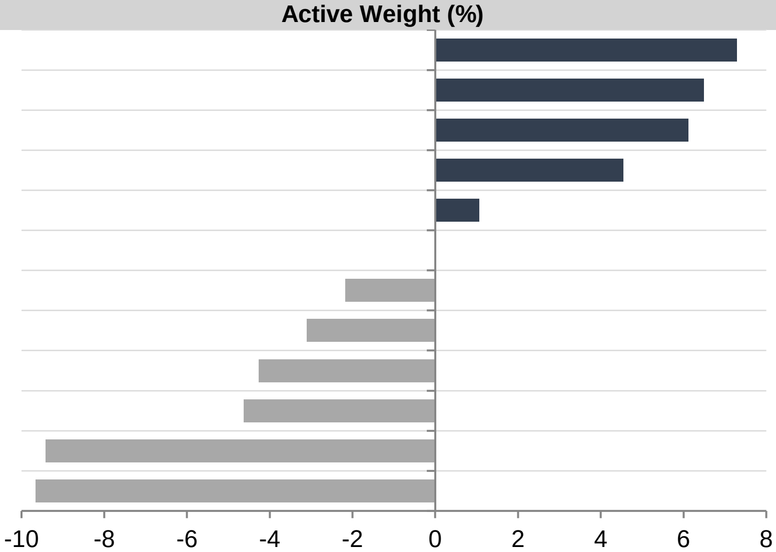
Technology, along with increased regulatory scrutiny and intervention are threatening longer term growth of most sectors and in some cases dominates investor sentiment. Capital is flowing to the perceived winners and legacy companies are being sent a clear message not to re-invest. The investment manager continues to seek opportunities on both sides of this ledger.

Overall, the Fund is positioned for a more reflationary environment than what is currently priced by the market and believe that there are 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 (%)
Information Technology	16.46	9.17
Consumer Staples	15.37	8.89
Metals & Mining	21.44	15.32
Utilities	5.03	0.49
Energy	7.88	6.82
Financial ex Property Trusts	7.33	7.32
Telecommunications Services	0.62	2.79
Materials ex Metals & Mining	0.00	3.10
Industrials	4.90	9.16
Health Care	2.29	6.92
Property Trusts	1.53	10.95
Consumer Discretionary	9.41	19.07
Cash	7.74	0.00

Active Weight (%)



Important Information

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