Ironbark LHP Global Long/Short Fund (Retail)

Quarterly Investment Report as at 30 June 2019

Asset class

Alternatives

Investment strategy

Multi-Manager Long/Short

Investment objective

To achieve global equity-like returns with lower volatility than traditional global equity investments

APIR code

HFL0106AU

ARSN

093 497 600

Fund inception date

31 March 2001

Benchmark

Benchmark unaware

Distribution frequency[2]

Annually

Minimum investment

$5,000

Number of underlying managers

25

Fund size

$136.1m (represents wholesale and retail share classes)

Exit price

$1.6954

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	1.18	1.67	-4.07	2.33	3.19	6.10	5.96	5.82

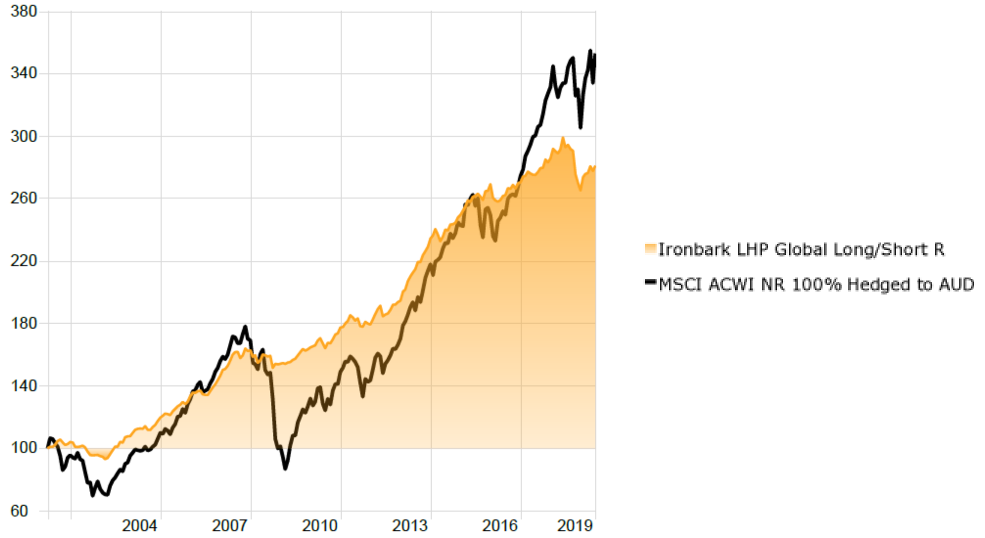
Past performance is not an indicator of future performance. Net performance figures are calculated using exit prices, net of fees and reflect the annual reinvestment of distribution. Retail investors should refer to net returns.

[1] This figure represents the annualised performance of the Fund from the first full month of operation.

[2] This is not an income focused fund and the Fund does not generally distribute, however we review the Fund for income earned annually and where a distribution is made, it will be made at the end of June. Investors should not rely on distributions from the Fund to service other obligations.

Investment growth of $100 since inception

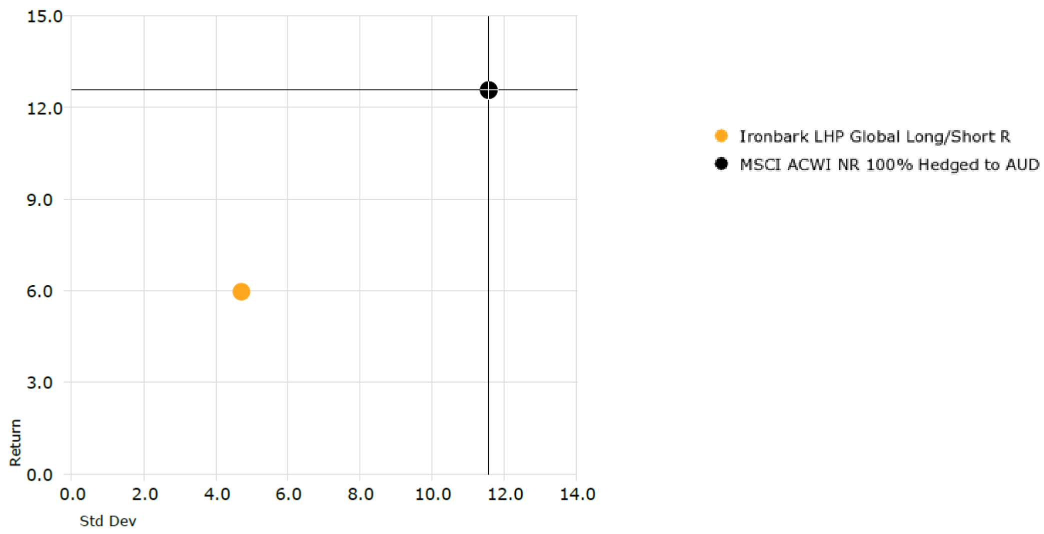
Time period: 01/04/2001 to 30/06/2019



Source: Morningstar Direct. Data in AUD

Risk vs return over 10 years

Time period: 01/07/2009 to 30/06/2019



Source: Morningstar Direct. Data in AUD

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Ironbark ASSET MANAGEMENT

Ironbark LHP Global Long/Short Fund (Retail)

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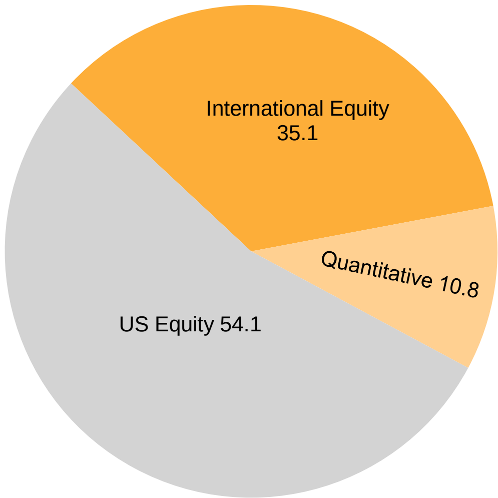
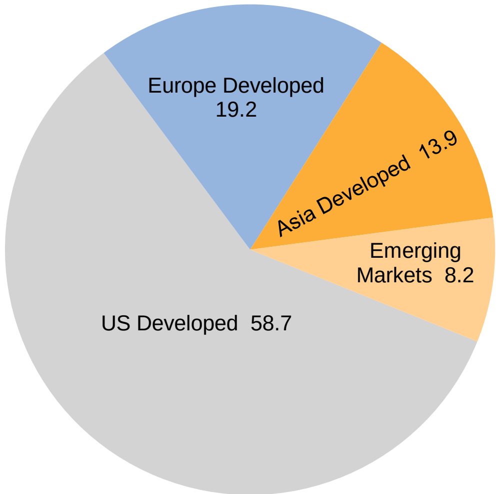
Asset allocation[1]

Strategy allocation (%)



Geographic allocation (%)



[1] Weights are at the strategy level, including an allocation to cash. The strategy is the Ironbark GLS Investments (Cayman) Fund Ltd.

Market review

Risk assets, in general, continued to move broadly higher in the second quarter, however at a more moderate pace and with a few more short-lived bouts of uncertainty than were observed in the first quarter of 2019. While equity markets (depending on market and region) reached or approached all-time highs, other markets indicated investor caution. In particular, the US 10-year Treasury bond interest rate dropped below 2.0% for the first time since 2018 while gold prices hit multi-year highs.

US inflation has started to recover from the lows of late 2018/early 2019 however remains below the Federal Reserve target. Manufacturing activity and business spending appear to be slowing on a global scale, while consumer sentiment readings are mixed. Heading into the end of the second quarter, the second highest number of S&P 500 companies issuing negative earnings guidance for the second quarter since 2006 was observed. It remains to be seen how guidance and earnings will play out over time as the peaks and valleys in trade conflict and central bank policy impact economic growth and corporate earnings.

Central bank behaviour in June seemed to have cut through the fears of slowing global growth and trade conflict that surfaced in May. The Federal Reserve's pause and indication that it may cut interest rates in the near future, as well as the European Central Bank's indication that it would too cut interest rates and pursue asset purchases, led to a rebound in equity markets in June after a sharp decline in May. The result was the best first half of the year for stock market returns over the previous 20 years, although in an environment where fundamental and macro-economic questions persist.

Performance review

The Ironbark LHP Global Long/Short Fund (Retail) (the 'Fund') returned 1.67% (net) for the quarter.

Long/short equity strategies have shown strong alpha generation year-to-date, which was also evident in the second quarter, particularly from the short side of the Fund. May's market selloff allowed the Fund's portfolio managers to shine as stock selection allowed the Fund to protect capital well. The investment manager was unable to navigate the June rebound with as much ease, as macroeconomic factors became more pronounced, namely the Federal Reserve actions to ease market conditions.

Performance review (continued)

Gross and net exposure remained reasonably stable over the quarter. Gross exposure ranged from approximately 295% to 315% during the quarter with an average of approximately 305%. Net exposure ranged from the mid-teens to the low thirties with an average of roughly 25%. Net exposure dipped in mid-June, when some of the Fund's managers made tactical shifts in response to macroeconomic news, however gradually rose to end the quarter in the mid-twenties. North American exposure drove profits within the Fund, with European exposure also quite profitable. By contrast, Asia proved to be a more difficult region, as trade conflict news weighed on market returns in China, and stock selection in Japan was challenging due to themes driving prices rather than fundamentals. From a sector perspective, financials, technology, real estate, health care and consumer staples produced material gains, while consumer discretionary was the only sector to generate meaningful losses. The Fund's managers produced the strongest alpha in the technology sector followed by the real estate, consumer staples, health care and financial sectors. Not surprisingly, the consumer discretionary sector was also a challenge from an alpha perspective, particularly on the long side, as certain segments (namely retail) started to show disappointing results in early June.

Manager review

Three quarters of the Fund's underlying managers generated positive returns for the period, which is not surprising given rising equity markets and the positive alpha environment so far in 2019. The investment manager was also pleased to see well over half of the managers generate positive returns in May when global equity markets sold off materially and quite broadly.

The top contributors included two financials sector specialists and a European focused portfolio manager. The most substantial contributor, a financial sector specialist with over a decade of portfolio management experience in the sector, was able to capture excellent returns when financials were up in April and June, as well as protect capital in May when the sector sold off even though the manager runs with a moderately net long profile. Asset management stocks were particularly fruitful for this manager. The investment manager was pleased to see the manager navigate a difficult interest rate environment, which can be an important driver for financial stocks.

A second financials sector portfolio manager was the next largest contributor and generated positive results across financials and related companies in technology (electronic payment companies) and real estate (REITs). This portfolio manager has expertise in small caps, which was a particularly profitable area over the quarter. Nimble shorting in large capitalisation companies also generated positive results for the manager. The third largest contributor, a European specialist, generated positive returns from both long and short positions. This manager tends to move their exposure opportunistically as market conditions change, which they did quite adroitly during the quarter. In addition, both longs and shorts in consumer discretionary and health care companies were profitable over the quarter.

The three largest detractors to the Fund included a China focused manager, a health care sector portfolio manager, and a consumer sector specialist. The China focused manager suffered mostly in May when trade tensions between the US and China took a turn for the worse. Subsequently, in June when markets rebounded in the region, this manager's bias towards mid-capitalisation stocks worked against the Fund, as larger companies outperformed. The manager has built out short exposures and is currently running with a lower net exposure than in the past due to concerns about volatility created by the trade conflict and rhetoric surrounding it.

The second largest detractor, a European based manager who takes a global approach to the health care sector, was not able to make up for losses in their pharmaceutical positions with strong health care equipment results. A generic pharmaceutical long holding was particularly painful as a weak earnings report was followed by news of litigation and negative sentiment generally in the subsector. The manager, with whom the investment manager has held for well over a decade, decided to trim but maintain the position. They believe the current environment of elevated uncertainty (i.e., macroeconomic, regulatory) and robust merger and acquisition activity, will prove to be an attractive environment for stock selection within their sector.

The consumer specialist, the third largest detractor, was hurt by longs in retail companies that announced weak earnings during the quarter. Sentiment towards bricks and mortar retail has significantly deteriorated once again, after a rebound in the second half of 2018, and the manager suffered losses in this subsector. The investment manager decided to move on from this manager to contain losses, after concluding that the current environment was proving too difficult for the manager to navigate despite a long track record of success in the sector.

During the quarter, the investment manager terminated three additional managers (besides the consumer manager noted above). A financials specialist decided to retire, despite profitable year-to-date returns, the macroeconomic drivers were making stock selection within this sector particularly stressful. The investment manager also moved on from an additional financials specialist that represented a smaller allocation, as the investment manager has decided to concentrate their financial efforts with two core positions noted earlier. In addition, the Fund exited a pan-Asian manager whose stock picking suffered during the quarter after also experiencing losses in broader overlay trades in the region. When the investment manager underwrote this manager, their strong preference was for the stock selection strategies however results over the past year have been dominated by the overlay trades.

In April, the investment manager added two health care specialists, both of whom have nearly 20 years of experience in the sector. One of the managers started their career as a consultant to the health care industry after earning law and medical degrees before transitioning to the asset management industry, while the other portfolio manager has spent their entire career analysing health care companies for investment purposes. The former is exclusive to Lighthouse and targets about half of their portfolio to be invested in therapeutics, while the latter is part of a larger hedge fund organisation and will invest more broadly in the health care sector. In addition, the investment manager hired a global technology, media and telecommunications manager with a focus on driving alpha through short research. This portfolio will include positions derived from both thematic and primary research.

Manager review (continued)

The investment manager continues to add talented portfolio managers in multiple sectors and geographies. These managers can bring skilful stock selection within a well-run portfolio and risk management process that is differentiated from their existing exposures in the Fund. The investment manager is also working on a number of potential new managers, notably in the industrials and financials sectors, as well as additional Japan specialists.

Market outlook

Global equity markets seem focused on, or even obsessed with, US and China trade relations and the easing and stimulative actions of central bankers, both real and projected. The investment manager would argue that it is probably better to pay more attention to broader phenomena such as business and credit cycles rather than headlines (or tweets). While the timing and scale of those can also prove difficult to predict, they are indeed regular parts of the investment landscape, a fact that should inform asset allocation and risk discipline for investors of all kinds.

The investors of which the investment manager have spoken to, are wrestling with the two, seemingly contradictory, paths that the equity and fixed income markets are taking. Fixed income markets appear to indicate fears of a global economic slowdown, while equity markets reach all-time highs. If central bankers are successful in promoting economic growth, bond market duration (let alone the trillions in negative yielding assets) it will prove problematic. If they are unsuccessful or only modestly successful, equity investors may find valuations troublesome. In this odd, late-cycle environment, diversification outside of traditional asset classes makes sense.

The investment manager believes that active stock selection strategies, which possess high active share (the Fund is formed through bottom up research and does not resemble long only indices) and focus on hedged approaches can serve as a liquid and valuable diversifier in more challenging environments. Recent research by Bank of America Merrill Lynch indicates that stocks have become less correlated to each other than sectors are, meaning that stock selection should start to matter more than sector selection.

The investment manager's approach remains consistent, as they seek to invest in differentiated strategies by partnering with specialised investment talent. They are focused on terms and structures that create alignment with investors' goals and allow for flexibility to both find new and interesting opportunities and to manage risk in times of crisis. They believe long/short equity hedge funds that are focused on idiosyncratic returns with discipline around hedging and liquidity are well positioned to serve investors ably over the intermediate to long term. The investment manager fully acknowledges that as global equity markets have continued to advance higher, it has created challenging conditions for hedged equity approaches. That said, they have seen this type of market environment before, and it is important that they continue to follow their investment process.

Material matters

In May 2019, a new structure was established where the Ironbark LHP Global Long/Short Fund invests in a wholly owned unlisted company, Ironbark GLS Investments Pty Ltd ('IGLIP'), which in turn invests into the Ironbark GLS Investments (Cayman) Fund Ltd, a Cayman Islands exempted company ('Lighthouse Fund'). Ironbark Asset Management Pty Ltd is the administrator of IGLIP. For more information refer to the Product Disclosure Statement dated 28 June 2019 on our website www.ironbarkam.com.

There have been no other material changes to the Fund in terms of the risk profile, investment strategy or changes to individuals in the investment team who play a key role in the investment decisions of the Fund.

Important information