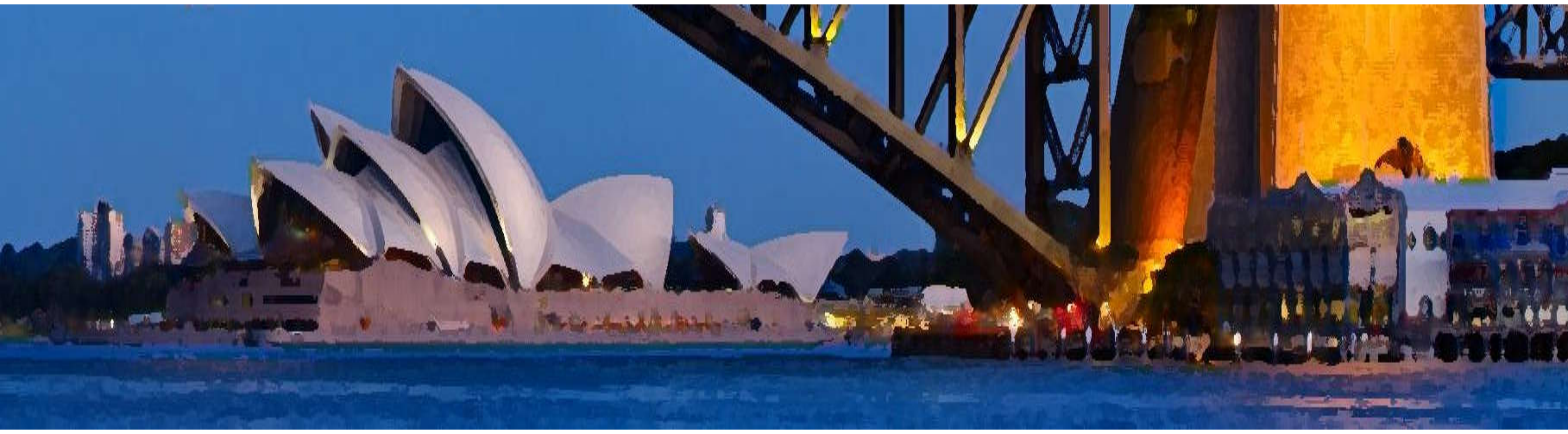

# Auscap Long Short Australian Equities Fund Newsletter – March 2017

**The Auscap Long Short Australian Equities Fund is now available on select leading platforms.** Interested investors can download a copy of the Product Disclosure Statement (PDS) from the Auscap website www.auscapam.com. If you wish to invest via a platform or an Investor Directed Portfolio Service (IDPS), please contact your financial adviser or platform operator.

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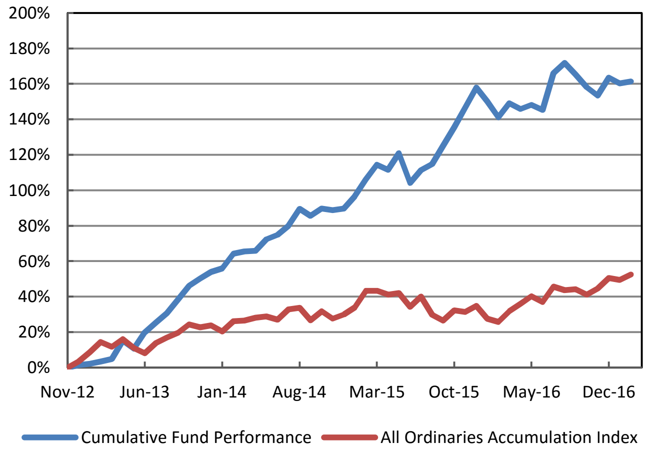
## Welcome

Welcome to the Auscap newsletter, an opportunity for us to report the performance of the Auscap Long Short Australian Equities Fund (Fund) to current and prospective investors. In each publication we will also discuss a subject that we have found interesting in our research and analysis of the market. We hope that you enjoy reading these snippets and encourage any feedback. In this edition we discuss active management in the context of a highly concentrated domestic equities market.

## Fund Performance

The Fund returned 0.42% net of fees during February 2017. This compares with the All Ordinaries Accumulation Index return of 2.09%. Average gross capital employed by the Fund was 125.3% long and 17.5% short. Average net exposure over the month was 107.8%. At the end of the month the Fund had 34 long positions and 10 short positions. The Fund's biggest stock exposures at month end were spread across the real estate, financials, consumer discretionary and telecommunications sectors.




## Fund Returns

| Period | Auscap | All Ords |
|---|---:|---:|
| February 2017 | 0.42% | 2.09% |
| Financial Year to date | 6.57% | 11.33% |
| Calendar Year to date | [0.78%] | 1.23% |
| Since inception | 161.40% | 52.45% |

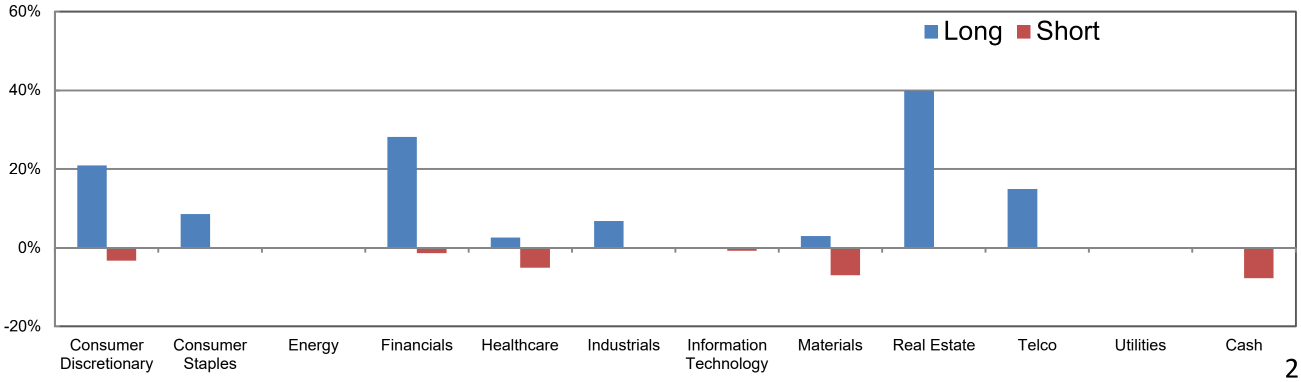
## Fund Exposure

| February 2017 Average | % NAV | Positions |
|---|---:|---:|
| Gross Long | 125.3% | 34 |
| Gross Short | 17.5% | 9 |
| Gross Total | 142.8% | 43 |
| Net / Beta Adjusted Net | 107.8% | 64.7% |

## Fund Monthly Returns

| Year | Jul % | Aug % | Sep % | Oct % | Nov % | Dec % | Jan % | Feb % | Mar % | Apr % | May % | Jun % | YTD |
|---|---:|---:|---:|---:|---:|---:|---:|---:|---:|---:|---:|---:|---:|
| FY13 | | | | | | 1.35 | 0.74 | 1.23 | 1.46 | 9.83 | (4.05) | 8.32 | 19.72 |
| FY14 | 4.70 | 4.28 | 5.84 | 5.46 | 2.86 | 2.57 | 1.32 | 5.32 | 0.70 | 0.29 | 3.82 | 1.48 | 46.01 |
| FY15 | 2.95 | 5.24 | (2.09) | 2.25 | (0.43) | 0.44 | 3.65 | 4.90 | 3.98 | (1.36) | 4.43 | (7.55) | 16.81 |
| FY16 | 3.46 | 1.64 | 4.82 | 4.65 | 4.69 | 4.56 | (3.01) | (3.54) | 3.22 | (1.24) | 0.96 | (1.19) | 20.13 |
| FY17 | 8.48 | 2.13 | (2.37) | (2.72) | (1.83) | 4.00 | (1.20) | 0.42 | | | | | 6.57 |

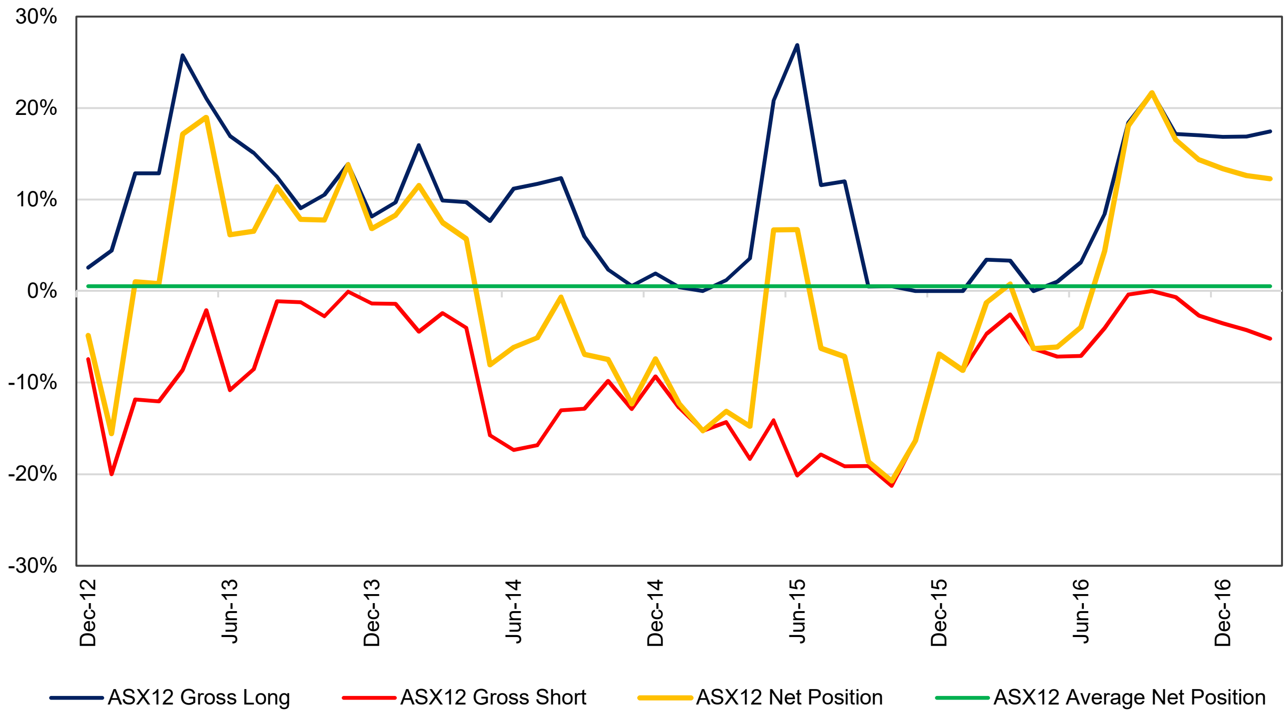
## Sector Exposure - February 2017



## Is active management complementary in a concentrated market?

The Australian sharemarket is a highly concentrated one. As outlined in the Auscap November 2015 newsletter, just twelve stocks constitute approximately half of the market capitalisation of the ASX200 (Index). In fact, as at the time of publication, these stocks represent 48.7% of the Index, with a combined market capitalisation that is almost the same as the next 188 companies that make up Australia's most recognised index. When we consider an investment opportunity, a company's proportion of any index plays no part in our decision. We are a completely index unaware fund. We recently analysed the Fund's historical exposure to the twelve largest ASX listed securities, which comprise Commonwealth Bank of Australia, Westpac Banking Corporation, Australia and New Zealand Banking Group, National Australia Bank, BHP Billiton, CSL, Telstra, Wesfarmers, Woolworths, Macquarie Group, Woodside Petroleum and Rio Tinto (hereafter the ASX12).

**Auscap ASX12 Exposure**



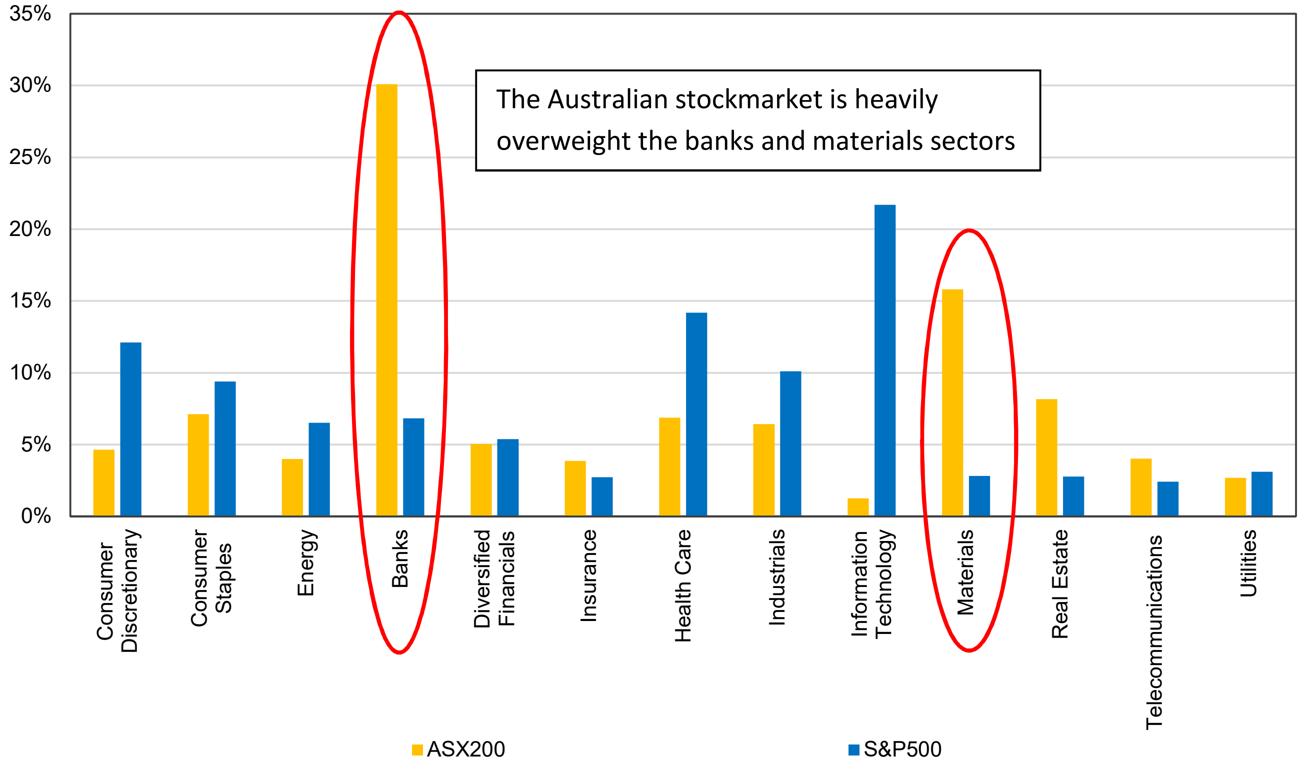

Since its inception in 2012, the Fund has averaged only 0.5% net exposure to the ASX12. That is an average of practically zero net exposure to half of the ASX200 Index. It might lead an observer to ask a number of questions. Firstly, does that mean that our performance will look very little like the Index's performance? And secondly, given the importance of the top twelve securities to the overall performance of the market, should we be making decisions with the size of companies relative to the Index in mind?

The answer to the first question, whether our performance will deviate frequently from the performance of the broader indices, is a most definitive yes. Much of the time our performance has not mirrored or even resembled the performance of the major indices given we have had, on average, no material exposure to half of the Australian market by "index weight". Further, we are a long short fund, which means that not only do we not share the major exposures of the market, sometimes we may be net short a particular sector. Our performance over time will be determined far more by our ability to select stocks that have compelling reward and risk metrics than it will be a function of what happens to the broader stockmarket. This is borne out in Auscap's low correlation with markets, which is running at 52.3% against the All Ordinaries Accumulation Index since the Fund's inception.

Our answer to the second question, whether index weight should be a major determinant in our investment making decision, is for us a most definitive no. The fact that a company has a very large market capitalisation, in and of itself, tells us very little about whether the company is a compelling investment proposition. The Auscap portfolio's investments are sized by investment merit, old fashioned value based investing and an evaluation of risk and reward.

The fact that the Australian equities market is very concentrated in a few sectors actually means that the average domestic investor is considerably overweight the major Australian sectors. Consider, for example, the Australian market's exposure to various sectors compared to the broader and more representative S&P500 index.

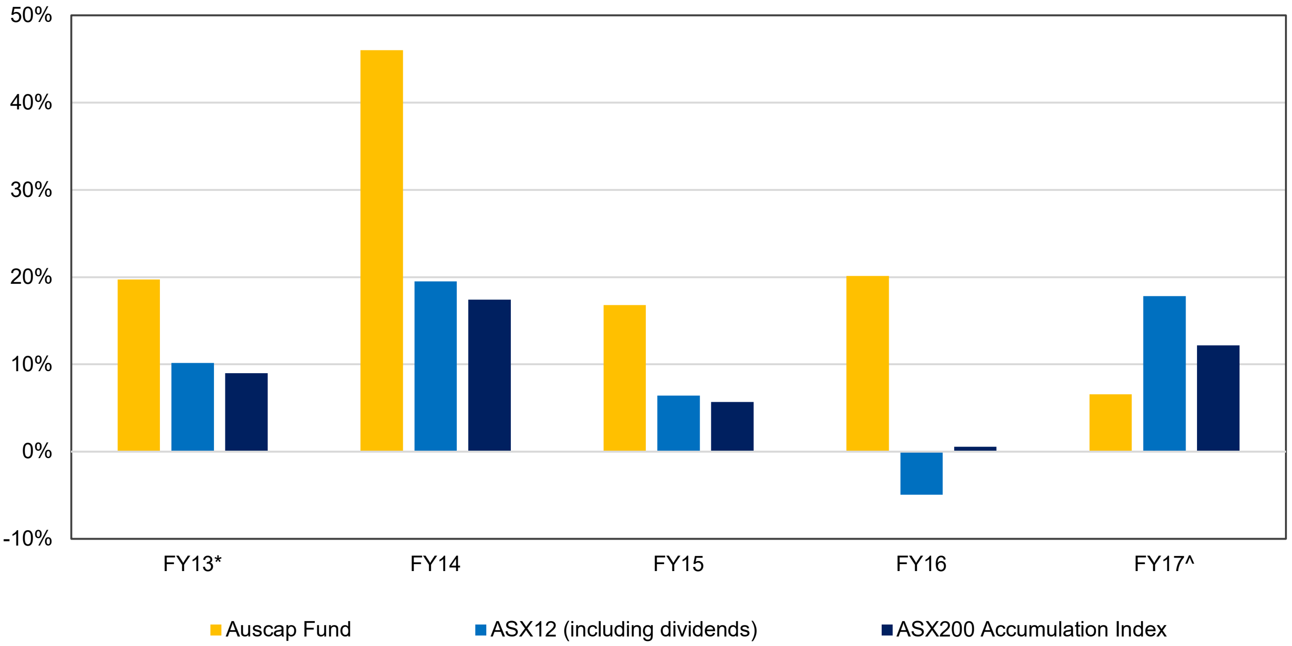
**Sector Weightings: ASX200 vs S&P500**




The Australian market is heavily overweight banks and resource companies compared to the S&P500 or most other international indices. Should we naturally lean towards being overweight these sectors simply because they contain some of the largest domestically listed companies? We prefer to evaluate opportunities on a stock specific basis, sticking to our strict investment criteria and disciplined, patient approach to managing our investors' capital. This will mean regular divergence in the Fund's performance compared with the domestic indices. Whether actively managed funds have the ability to complement the typical Australian investor's portfolio is potentially worthy of some consideration, especially if the firm's investment philosophy, approach and stock selection process appeal to the particular investor.

While passive portfolio management is gaining in popularity around the world, in Australia this means having a close to 50% exposure in just twelve stocks without a consideration of the merits of these investments. Many of these securities are already owned in some capacity by the average investor, which might make an investment in a genuine active manager a complementary exposure. As shown below, Auscap outperformed in FY16 when the ASX12 detracted from the market's overall performance. The converse has been true thus far in FY17, with the biggest companies driving the market's performance. We continue to see better investment opportunities outside of these mega-cap stocks.

**Auscap Fund Performance vs ASX12 and ASX200 Accumulation Index#**




# Past performance is not an indicator of future performance.
* FY13 returns from 1 December 2012 (Auscap Fund's inception date) to 30 June 2013
^ FY17 returns from 30 June 2016 to 28 February 2017

By all means, careful manager evaluation and selection is critical when choosing active managers. Our belief is that investors should search for managers with whom they have a shared investment philosophy as well as those managers who have a demonstrated track record of performance. It is possible for a managed fund's portfolio to be highly complementary to the average investor's portfolio. Given most domestic investors' exposure to the largest twelve Australian listed companies, funds that have lower exposure to these stocks are not adding to already overweight positions. While some funds go to the other end of the spectrum, and are concentrated in small and micro cap stocks, this is not true of the Auscap Fund. Approximately 80% of the Fund's returns in FY16 came from stocks within the ASX100. Our preference is to invest in large and mid cap securities. These are companies that have the characteristics we are looking for, including: significant cash flow generation; a track record of strong returns on invested capital; sensibly geared balance sheets; simple and proven business models and significant sustainable competitive advantages to ensure continued profitability.

***If you do not currently receive the Auscap Newsletter automatically, we invite you to register.*** To register please go to the website http://www.auscapam.com and follow the registration link on the home page. Interested investors can download a copy of the PDS at www.auscapam.com/auscap-fund/pds. We welcome any feedback, comments or enquiries. Please direct them to info@auscapam.com.

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