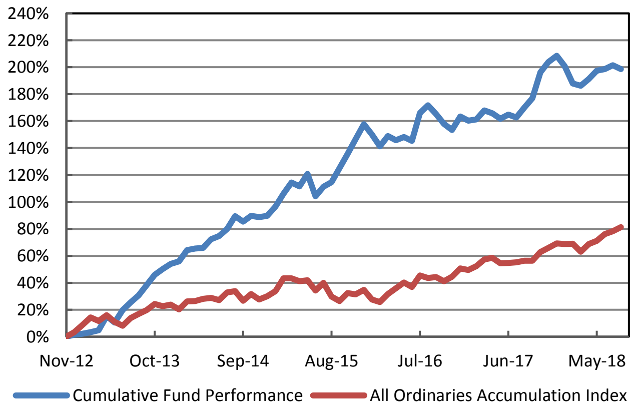
Auscap Long Short Australian Equities Fund Newsletter – September 2018

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 the importance of environmental, social and governance factors in investment decision-making.

Fund Performance

The Fund returned negative 0.99% net of fees during August 2018. This compares with the All Ordinaries Accumulation Index return of 1.71%. Average gross capital employed by the Fund was 87.8% long and 18.7% short. Average net exposure over the month was 69.1%. Over the month the Fund had on average 27 long positions and 8 short positions. The Fund's biggest stock exposures at month end were spread across the consumer, financials and real estate sectors.



Fund Returns

Period	Auscap	All Ords
August 2018	(0.99%)	1.71%
Financial Year to date	0.02%	2.95%
Calendar Year to date	(3.22%)	7.11%
Since inception	198.58%	81.28%

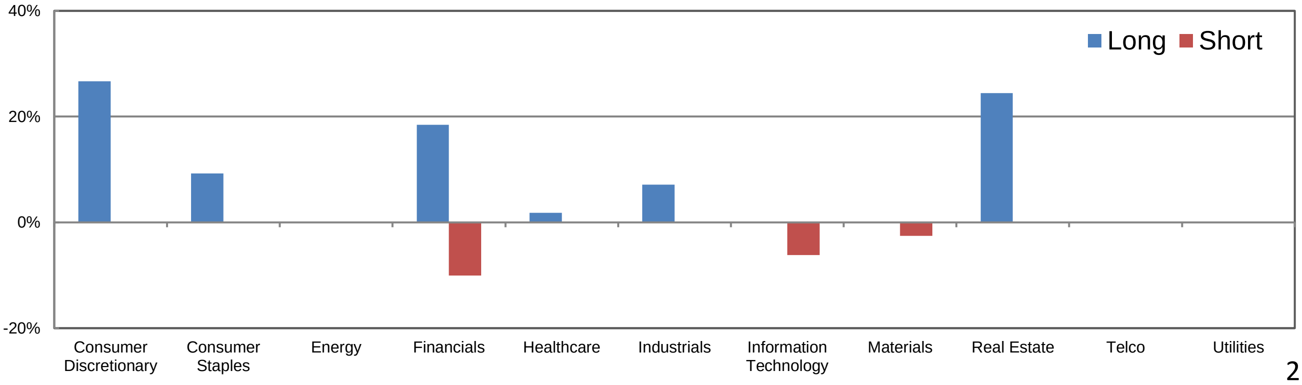
Fund Exposure

August 2018 Average	% NAV	Positions
Gross Long	87.8%	27
Gross Short	18.7%	8
Gross Total	106.5%	35
Net / Beta Adjusted Net	69.1%	46.6%

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	2.52	(0.81)	(1.53)	1.18	7.97
FY18	(0.77)	2.75	2.53	6.96	2.58	1.56	(2.50)	(4.31)	(0.56)	1.75	2.11	0.39	12.71
FY19	1.02	(0.99)											0.02

Sector Exposure - August 2018



Why Considering ESG Factors Makes Good Investment Sense

Scandals are plaguing corporate Australia. As the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry continues, another Royal Commission into the aged care sector is set to be established with a focus on the quality of care. The impact on the value of companies that have demonstrated misconduct is real, and in many instances long-lasting. As details of misconduct have become known, the investment community has responded to these events by sending share prices plummeting, and with good reason. Companies require a social licence to operate in the community, and if they breach this trust, it can become very difficult for a company to continue to operate. At the very least, the way in which the company operates is often restricted.

Having sound standards and practices in relation to environmental, social and governance ("ESG") issues is not just imperative from a moral perspective, it is critical in creating long term value for the shareholders of any business. We are increasingly focusing on ESG issues because of the material impact on the value of equity investments where poor practices exist.

Consider in the last couple of years how many ESG issues have plagued corporate Australia and the associated cost to investors. The media has identified a considerable list of ESG issues amongst some of Australia's largest listed companies, including:

- Irresponsible lending within the financial services industry;
- Financial services firms receiving fees for services that were never provided;
- Insurers charging customers for policies that were of limited or no benefit;
- BBSW rate rigging amongst major financial organisations to generate short term profits;
- Breaches of AUSTRAC enforced anti-money laundering and counter-terrorism financing laws;
- Enforceable undertakings being imposed by ASIC on numerous organisations to ensure compliance with regulatory standards;
- Mining companies facing remediation payments and other penalties due to practices that led to significant and deadly environmental incidents;
- Unconscionable conduct and breaches of Australian Consumer Law within the supermarket industry in relation to conduct towards suppliers resulting in fines and enforceable undertakings to redress past practices;
- Deliberate underpayment of wages to employees across large franchise networks;
- Illegal promotion of gambling in international jurisdictions;
- Aggressive accounting practices leading to the reporting of significantly inflated short term earnings;
- Misleading customer communication regarding replacing existing broadband connections with the National Broadband Network; and
- Market manipulation by energy utilities designed to maximise profits at the expense of consumers.

In most instances the cost of penalties and remedial action for organisations that have breached their ESG responsibilities is more significant than the extra profits that were generated as a result of the improper conduct. This is the way it should be. The financial cost must ultimately act as a deterrent to other companies to prevent them from behaving in a similar way. This invariably leads us to one logical conclusion. The need for investors to encourage boards and management teams to carefully consider ESG issues is not a separate consideration from maximising firm value, the two are clearly intertwined. Adoption of acceptable ESG principles will also maximise long term shareholder value.

In October 2017 Auscap became a signatory to the United Nations supported Principles for Responsible Investment (UNPRI or PRI). The PRI's mission is straight forward. "*We believe that an economically efficient, sustainable global financial system is a necessity for long term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.*" Once we were made aware of the initiative, it was not a difficult decision to become a signatory.

As a signatory we must abide by a commitment that "*As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objective of society.*" Signatories must, where consistent with their fiduciary responsibilities, commit to the six key Principles for Responsible Investment.

It is undoubtedly important for the owners of businesses who are concerned about long term value to carefully consider and abide by their environmental, social and governance responsibilities. Being a good corporate citizen might not maximise the next annual result, but it will increase the long term value of the organisation, even if it comes at a short term cost. Encouragingly there *are* examples of Australian companies acting as model corporate citizens in their day-to-day operations, and even going above and beyond in times of community or social need by using corporate resources to the benefit of broader society. While the immediate cost of such actions is relatively small, the value-add to business sustainability and the improvement in the company's social licence to operate should not, in our view, be underestimated.

One challenge investors face is how to assess the true importance attached to ESG issues by boards and senior management. While paying attention to management reporting of these issues is important, we focus on trying to ascertain whether ESG considerations extend beyond formulaic compliance reporting. In our investment research we spend considerable time focused on the culture within an organisation as a lead indicator of how important ESG issues are to the directors, management and employees. A positive culture encourages and reinforces good behaviour. As Warren Buffett has stated, "*if you have good culture, you can make the rules pretty simple*". Corporate culture is heavily influenced by management and the board. Setting the right tone at the top is imperative.

We welcome the increasing focus on ESG issues within the Australian corporate landscape. In our view, the more that good behaviour and sound ESG practices become expected for all companies operating in society, the less likely it will be that companies will shirk these responsibilities in pursuit of short-term gains.

If you do not currently receive the Auscap Newsletter automatically, we invite you to register. To register please go to the website 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.

Auscap Asset Management Limited

ACN 158 929 143 AFSL 428014
Lvl 30, 9 Castlereagh St, Sydney

Email: info@auscapam.com
Web: www.auscapam.com

Service Providers

Prime Brokerage: Citi Global Markets
Administration: Link Fund Solutions

Tax & Audit: Ernst & Young
Legal: Norton Rose Fulbright