



Auscap Long Short Australian Equities Fund Newsletter – March 2016

© Auscap Asset Management Limited

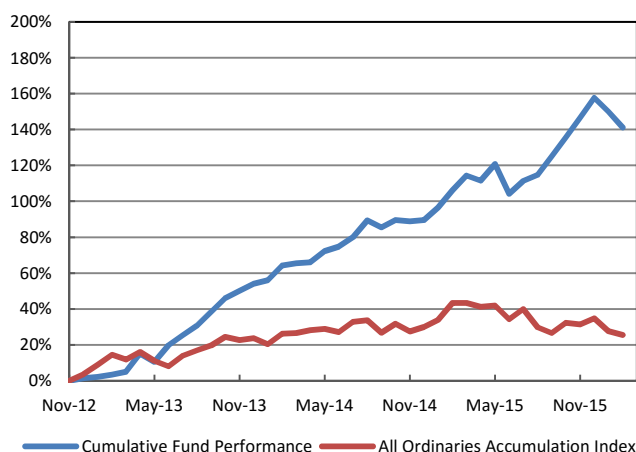
Disclaimer: This newsletter contains performance figures and information in relation to the Auscap Long Short Australian Equities Fund from inception of the Fund. The actual performance for your account will be provided in your monthly statement. Actual performance may differ for investments made in different classes or at different times throughout the year. This newsletter is intended to provide general background information only. It is not a Product Disclosure Statement under the Corporations Act 2001 (Cth), nor does it constitute investment, tax, legal or any other form of advice or recommendation to be relied upon when making an investment or other decision. Past performance is not a reliable indicator of future performance. While all reasonable care has been taken to ensure that the information in this document is complete and correct, no representation or warranty is given as to the accuracy of any of the information provided, including any forecasts. To the maximum extent permitted by law, Auscap Asset Management Limited ACN 158 929 143 AFSL 428014, its related bodies corporate, directors, employees and representatives are not liable and take no responsibility for the accuracy or completeness of this document. No investment in the Fund should be made without fully reviewing the information, the disclosures and the disclaimers contained in the Information Memorandum or any supplement to that document and obtaining investment, legal, tax and accounting advice appropriate to your circumstances.

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 analyse and reflect on the recent movements in the surprisingly strong Australian employment data.

Fund Performance

The Fund returned negative 3.54% net of fees during February 2016. This compares with the All Ordinaries Accumulation Index return of negative 1.47%. Average gross capital employed by the Fund was 53.5% long and 20.6% short. Average net exposure over the month was 32.9%. At the end of the month the Fund had 20 long positions and 5 short positions. The Fund’s biggest stock exposures at month end were spread across the financials, consumer discretionary, consumer staples, healthcare, energy and materials sectors.



Fund Returns

Period	Auscap	All Ords
February 2016	[3.54%]	[1.47%]
Financial Year to date	18.13%	[6.39%]
Calendar Year to date	[6.44%]	[6.77%]
Since inception	141.21%	25.71%

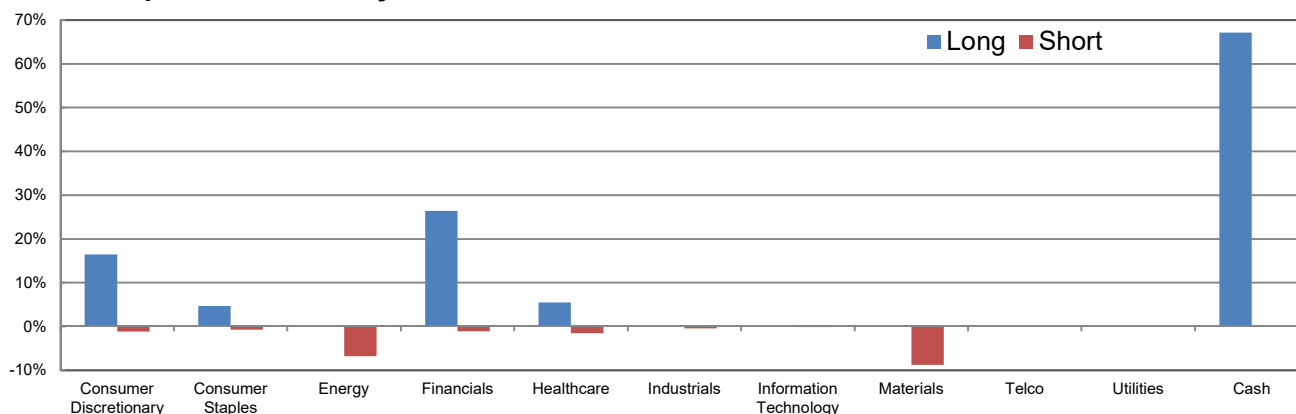
Fund Exposure

February 2016 Average	% NAV	Positions
Gross Long	53.5%	20
Gross Short	20.6%	12
Gross Total	74.1%	32
Net / Beta Adjusted Net	32.9%	13.2%

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)					18.13

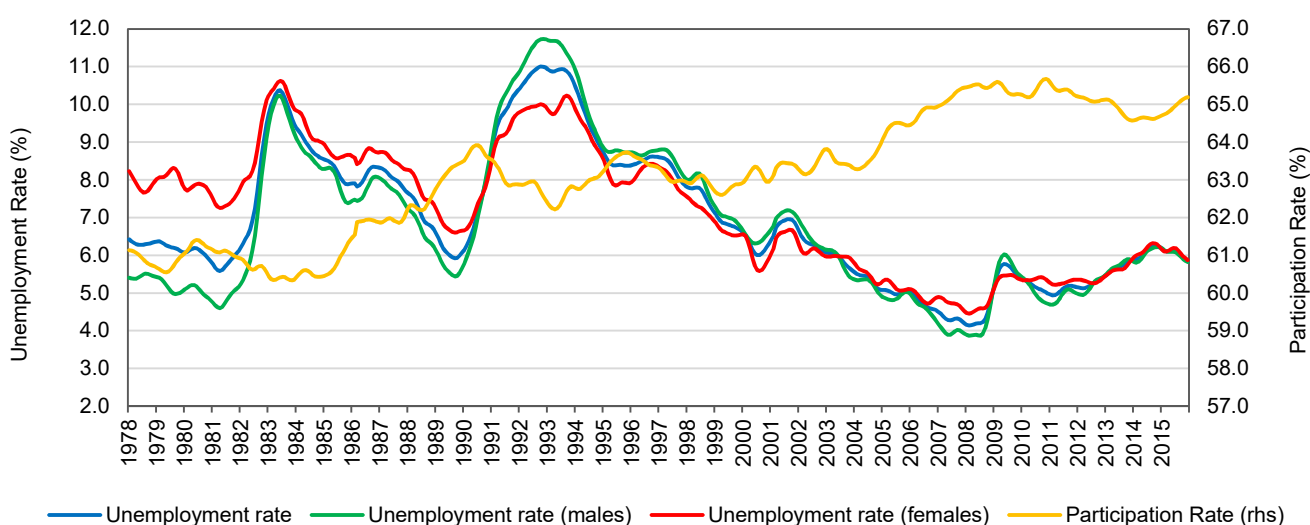
Sector Exposure - February 2016



Employing the jobs data: what conclusions can be drawn?

In the middle of the biggest decline in Australia's terms of trade in decades, the unemployment rate has actually dropped from 6.2% a year ago to 5.8% in January 2016. What's more, the participation rate has been holding steady at around 65.2%, slightly above the 65.1% average of the last ten years and well above the 40 year average of 63.1%. 11.90 million Australians currently benefit from employment out of a workforce of 12.65 million people, 53.7% of whom do so in a full time capacity. To many, the resilience of Australia's employment statistics has been a considerable surprise given declining commodity prices and a retracement in business capital expenditure on major new projects, both of which have had a considerable impact on Australia's gross domestic product (GDP).

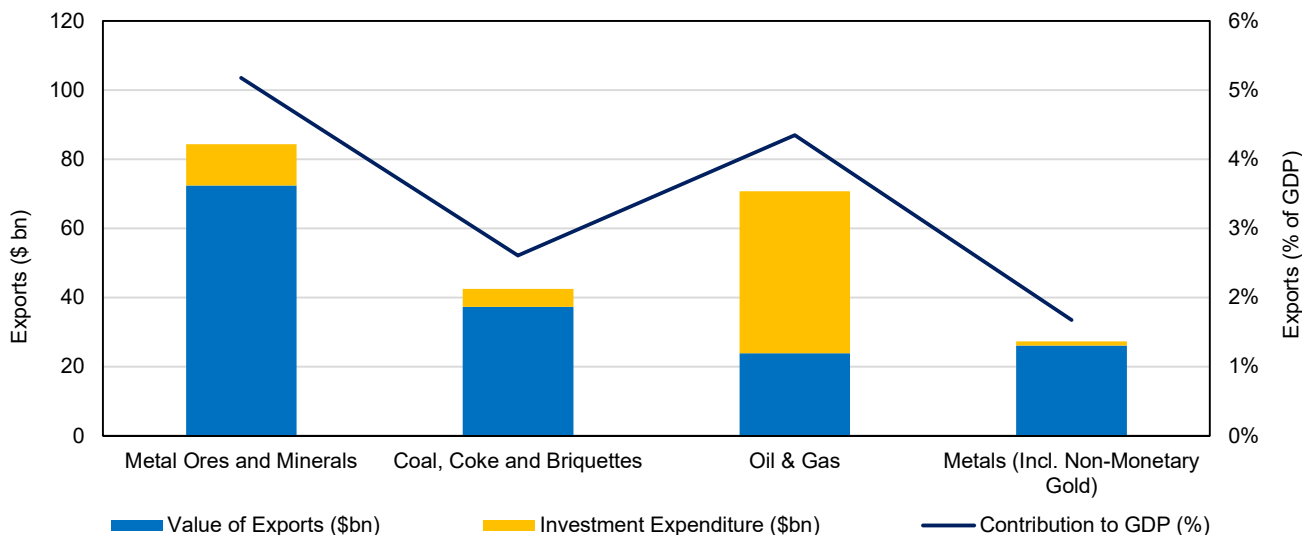
Australian unemployment (1978 - current)



Source: Auscap, Australian Bureau of Statistics

In 2015, mining and energy investment and exports constituted nearly 14% of Australia's GDP. While down from their peak contribution, these industries are still seen as considerable bellwethers for the health of the Australian economy.

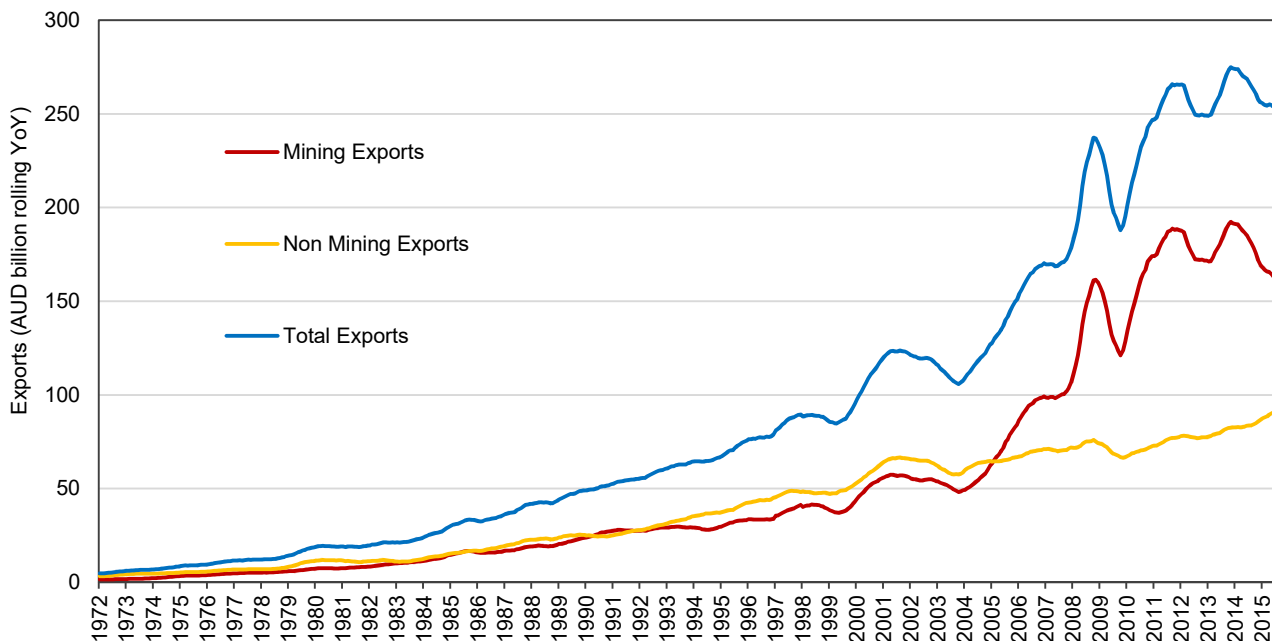
Australian commodity GDP contribution CY2015



Source: Auscap, Australian Bureau of Statistics

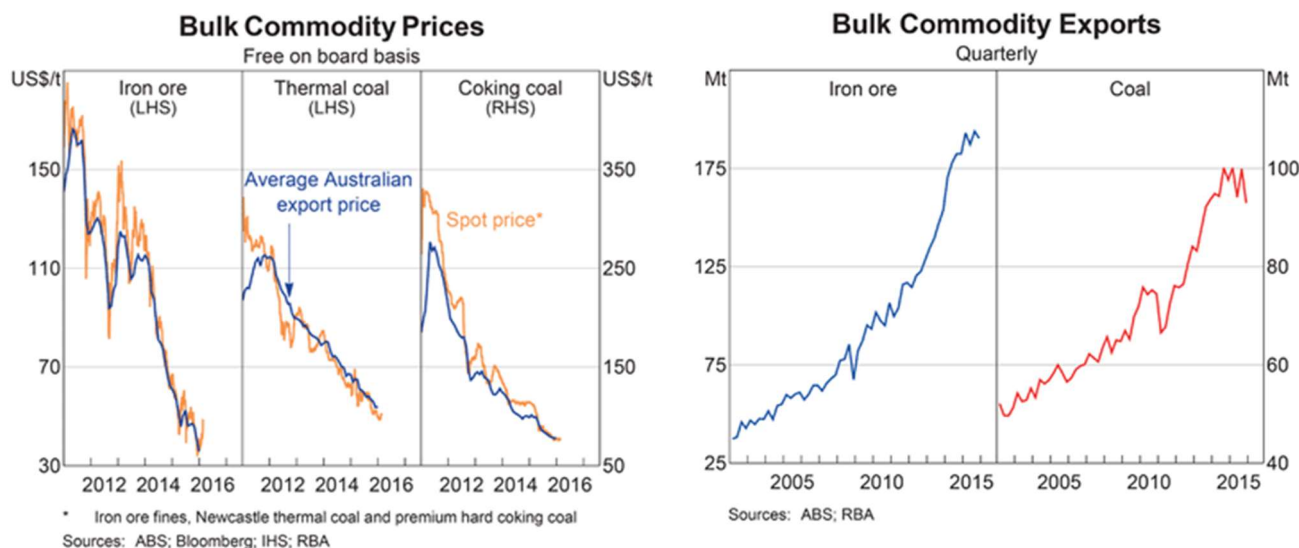
The natural extrapolation is to assume that mining and energy sector employment is both considerable and should be under substantial pressure with the recent decline in the value of commodity exports.

Value of Australian exports 1972 - present



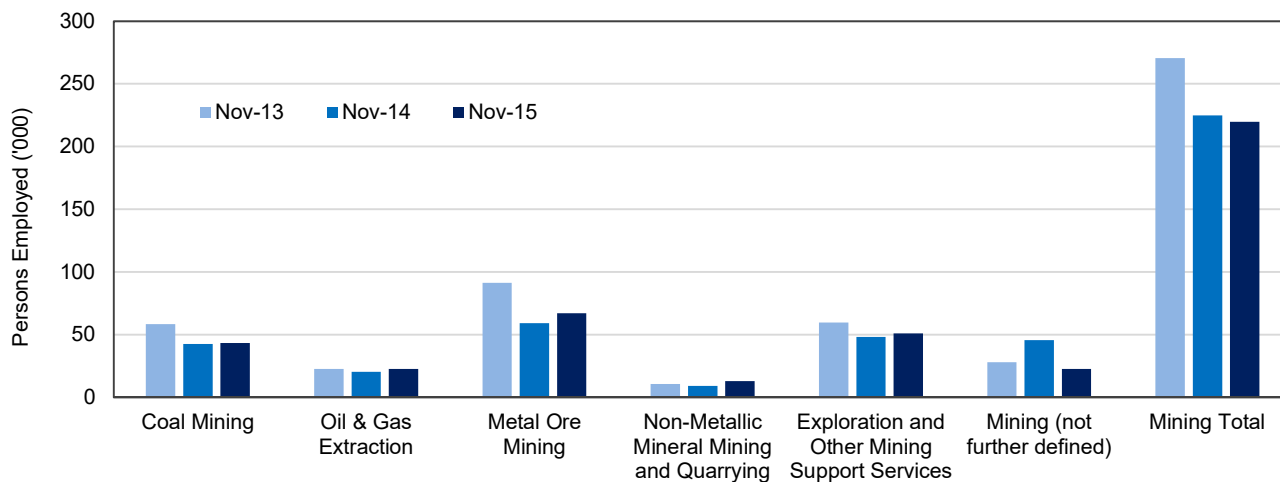
Source: Auscap, Australian Bureau of Statistics

However, the export data above doesn't quite tell the whole story. In 2015, falling commodity prices led to an overall decline in the *value* of exports despite the *volume* of exports remaining at close to record levels, as seen below.



With volumes remaining at elevated levels, mining employment has not been affected as significantly as would have been the case if demand and prices were both falling. As a result, after a substantial decline in employment numbers in 2014, the data suggests that mining employment remained reasonably stable through 2015.

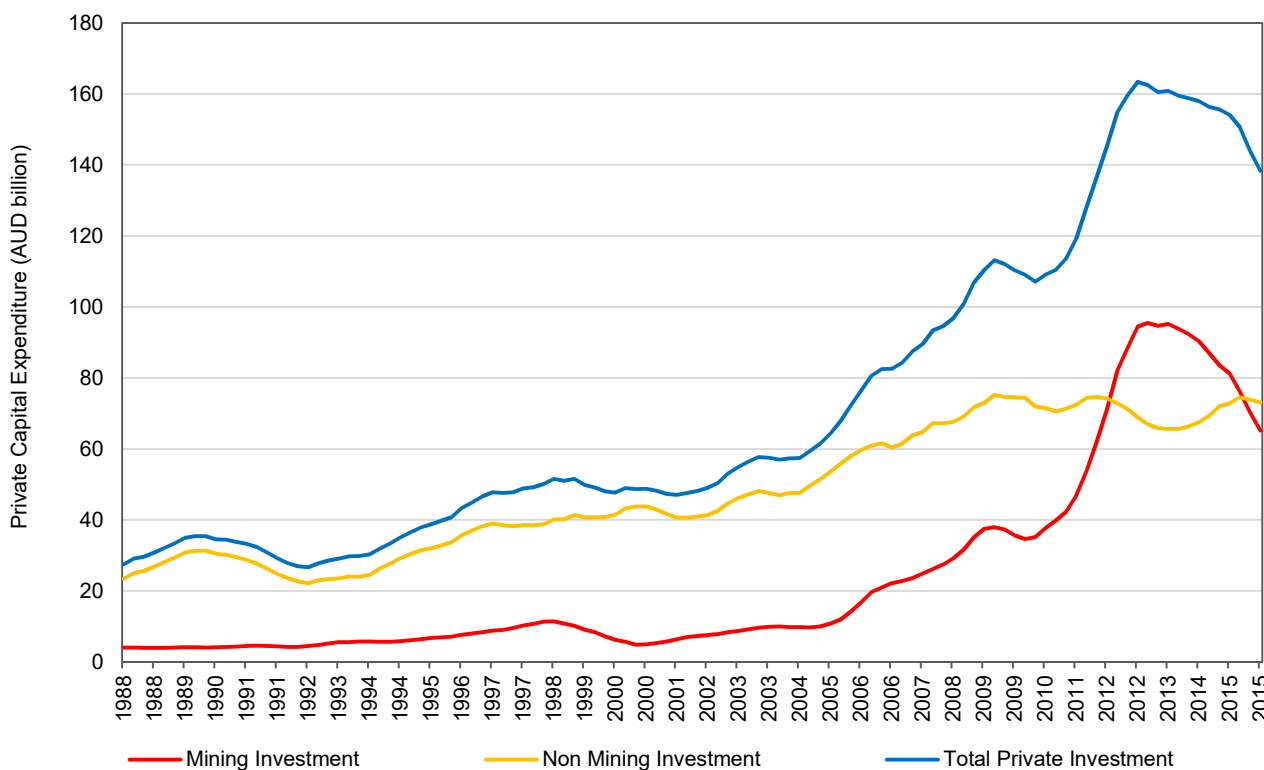
Mining sector employment



Source: Auscap, Australian Bureau of Statistics

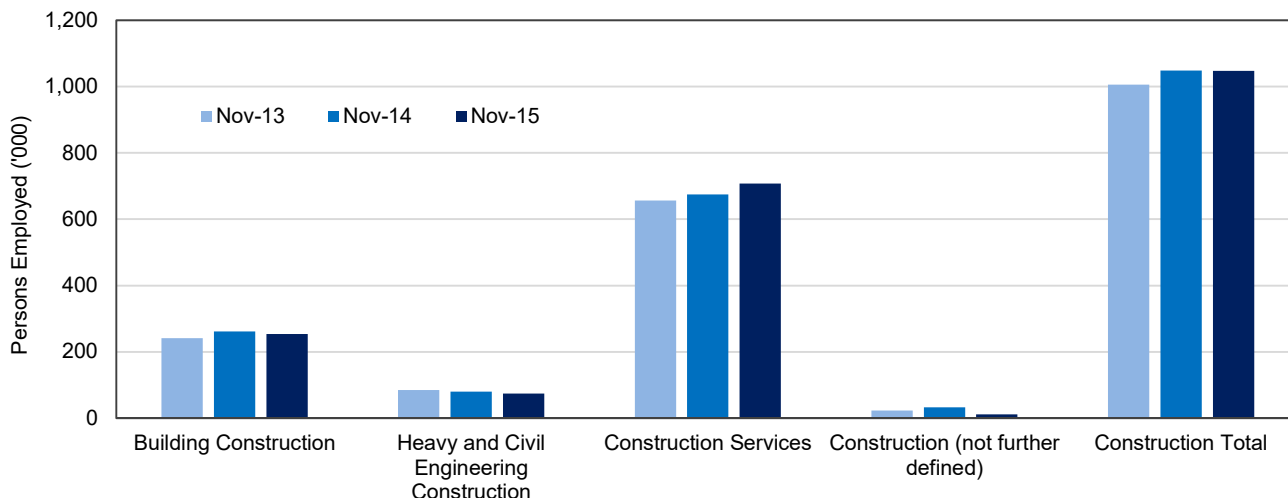
Declining business investment also dragged on economic growth, with a decline in mining and energy related capital expenditure the main reason for the \$20 billion fall in private investment in recent years.

Australian private capital expenditure



As a result of declining private investment, many expected the impact on employment in the construction industry to be significant. However, while the heavy and civil engineering construction sector is a significant employer, it pales in comparison to the broader building construction space. A boom in residential and commercial property construction has seen significant *net gains* in employment over the last few years in the construction industry.

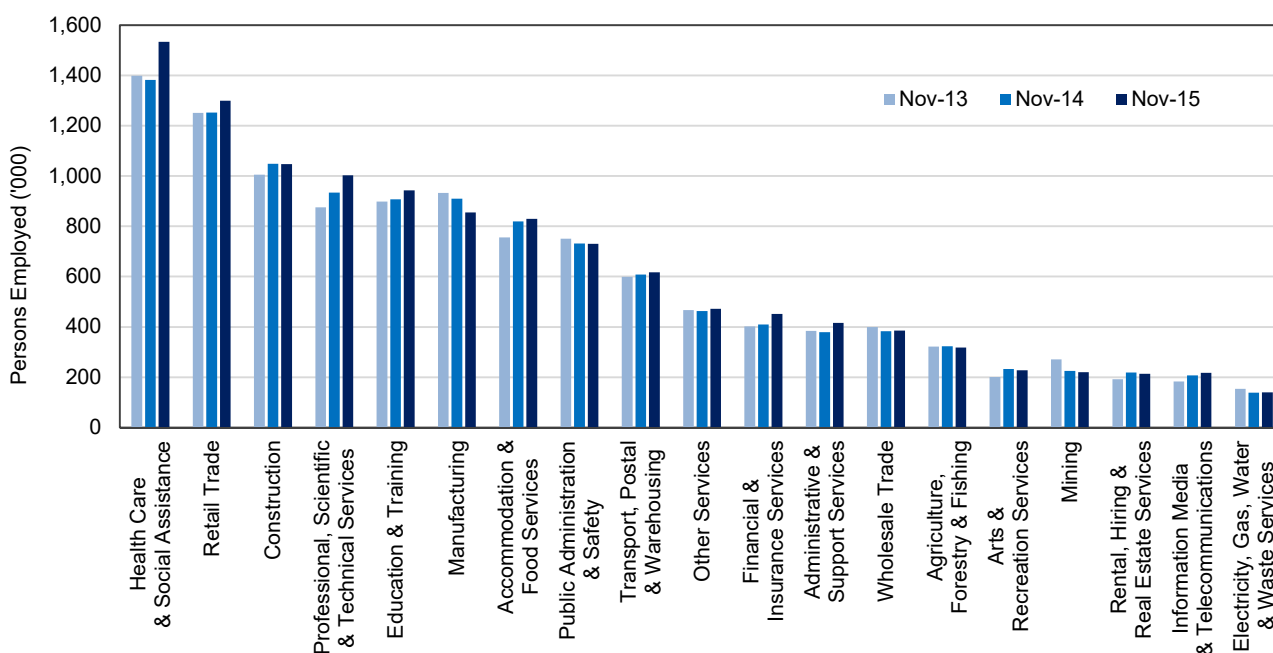
Construction sector employment



Source: Auscap, Australian Bureau of Statistics

Perhaps more significantly, the aggregate employment data reminds us that Australia’s economy, despite its exposure to mining and energy, is a service sector based economy. The service sector appears to be under little stress if the employment data is evidence of what is transpiring. Many of the major service sectors appear to be expanding. The healthcare and social assistance industry employs directly nearly seven times as many people as the mining industry. Almost 135,000 jobs have been added in healthcare in the last few years, over 60% of *total* current mining sector employment. Healthcare, along with the professional, scientific & technical services; accommodation & food services; financial & insurance services; retail; and education & training sectors have added over 478,000 jobs in the two years from November 2013 to November 2015, nearly four times the number of job losses seen in the two sectors hardest hit, manufacturing (predominantly in steel based goods) and mining.

Australian employment by sector



Source: Auscap, Australian Bureau of Statistics

The conclusions that we can draw from this analysis are not necessarily obvious. Where data is inconclusive we try hard *not* to draw any (potentially erroneous) conclusions. While any continued pressure on the mining, energy and related industries will continue to have a significant impact on Australia's GDP growth, the direct impact on broader employment and consumer spending is less obvious. It may explain why many consumer facing companies reported reasonable results in the recent half year despite the economy facing overall sluggish growth. Despite the perception to the contrary, employment in the service sector economy is probably more significant in determining the direction of household expenditure and the earnings of companies that are exposed to movements in its subcomponents. At Auscap, we look to capitalise on those unusual occasions when the data clearly provides supporting evidence for an investment thesis despite strongly contrasting market sentiment and opinion. The best investment opportunities often arise when extremes in sentiment contrast with fundamental data-driven valuation support.

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 wholesale investors can download a copy of the Auscap Long Short Australian Equities Fund Information Memorandum at www.auscapam.com/information-memorandum. We welcome any feedback, comments or enquiries. Please direct them to info@auscapam.com.

Auscap Asset Management

ACN 158 929 143 AFSL 428014
Lvl 24, 9 Castlereagh St, Sydney

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

Service Providers

Prime Brokerage: Citi Global Markets
Administration: White Outsourcing

Tax & Audit: Ernst & Young
Legal: Henry Davis York