Fund Update - 30 September 2019

Australian Mid Cap Fund - Class B

PARADICE INVESTMENT MANAGEMENT

Fund Objective

The Fund aims to outperform the composite benchmark of 70% of the S&P/ASX Mid Cap 50 Total Return Index and 30% of the S&P/ASX Small Ordinaries Total Return Index over a three to five year period (after management costs and before tax).

Performance Net (%)	1 Month	3 Months	1 Year	Since Inception* p.a.
Australian Mid Cap Fund - Class B	-0.02	1.79	-2.93	7.51
Mid Cap Composite Benchmark	1.40	3.25	3.64	10.16
Excess Return	**-1.42**	**-1.46**	**-6.57**	**-2.65**

* Inception date - 15 May 2017

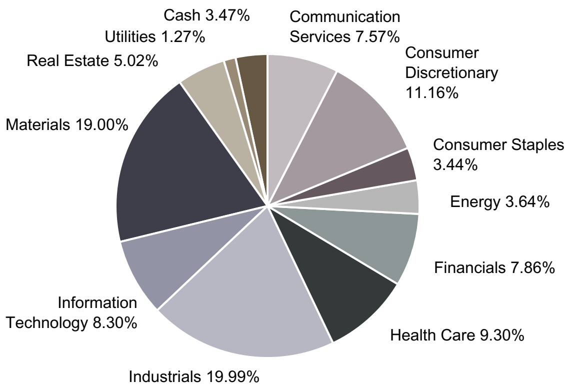
Fund Details

APIR Code	ETL8772AU
Fund Size (AUD m)	$77
Fund Currency	AUD
Distribution Frequency	Semi-Annually
Management Fee	1.10% p.a.
Performance Fee	15% p.a.
Buy Sell Spread	+/-0.25%
Minimum Investment (AUD)	$20,000

Characteristics

Number of Stocks	57
Portfolio Dividend Yield	2.90%
Stock Range	Typically 40-60
Industry Range	Unconstrained
Cash Range	0-10%

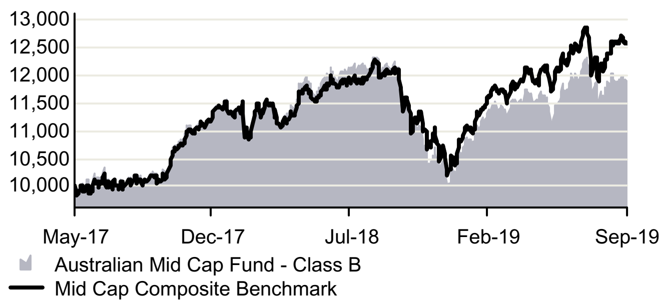
Sector Allocation



Top 10 Positions

	Weight %
Resmed Inc	5.28
Atlas Arteria	4.07
Downer EDI Ltd.	3.70
Cleanaway Waste Management Ltd.	3.59
Charter Hall Group	3.47
Tabcorp Holdings Ltd.	3.02
Northern Star Resources Ltd.	2.97
Xero Ltd.	2.54
Reliance Worldwide Corp. Ltd.	2.54
Orora Ltd.	2.38

Growth of AUD 10,000



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Commentary

MARKET REVIEW

For the purpose of comparison, commentary is quoted in AUD terms except where stated otherwise.

The September 2019 quarter extended the calendar year's gains further, with the S&P/ASX Mid Cap 50 Total Return Index returning 3.3% for the period. This performance was slightly ahead of the broad-based indices, led by continued strength across the information and technology, interest rate sensitive, and Australian domestic cyclical sectors. Globally, equity markets were also largely up, although there was some evidence that the strength in markets from earlier in the year is starting to wane; particularly late in the quarter where markets experienced a brief but aggressive rotation out of high multiple stocks into more value-oriented alternatives.

There was plenty of news flow during the quarter to make investors hesitant, most notably the continuing war of words between the US and China, an increasingly farcical Brexit situation, and simmering tensions across the Middle East and Asia (particularly Hong Kong); all of which seemed to take a turn for the worse during the quarter. Notwithstanding efforts by central banks to offset these pressures, economic data across the period appeared to indicate a slowing in growth across many major economies, leaving investors more sceptical that further interest rate cuts will be an effective panacea moving forward. Central bankers appeared to acknowledge as much, both indicating that QE and other unconventional policies are being considered, whilst also pressuring Governments to fill the void where monetary stimulus has become less effective. Whilst there was some tacit acknowledgement of this need from the likes of Germany, The Netherlands and even the US during the quarter, it remains to be seen how fast and sizeable such action will be.

Australia is not immune to these pressures, albeit the significant fall in the AUD coupled with strong iron ore prices has served as somewhat of a cushion. The RBA has followed the lead of their overseas counterparts, reducing the Cash Target Rate to 100bps during the quarter (and further to 75bps post quarter-end), although recent data suggests this has only served to drive further asset inflation rather than renew investment. Consumer and business confidence indices showed further deterioration during the quarter, retail sales remained largely flat, credit growth too continues to be anaemic, and the unemployment rate ticked up marginally; all suggesting monetary policy has become largely ineffective. Governor Lowe was quite vocal during the quarter in advocating for fiscal stimulus, a policy that runs counter to the current Government's stated policy of maintaining a balanced budget.

The FY-19 August reporting season highlighted a lot of the issues above, noting the ratio of FY-20 EPS forecast downgrades to upgrades was the worst since the GFC. The ASX200 Industrials forecasts now sit at 4.5% EPS growth, seemingly in stark contrast to a P/E of ~20x which is, for now, being held up by low interest rates. As for the potential for a medium term improvement, dividend per share growth of 13% vs. EPS growth of 3% for FY-19 highlights the lack of reinvestment by corporate Australia, and until such times as the uncertainties clouding the global economic outlook look to being resolved, a recovery in corporate or consumer spending appears unlikely.

PERFORMANCE

The top relative contributors to performance for the quarter are as follows:

Resmed (RMD) – Overweight August result confirmed strong market growth and Resmed's leadership position in obstructive sleep apnoea (OSA), with material optionality in new products and businesses that underpin longer-term growth prospects.

Downer EDI (DOW) – Overweight Stock is beginning to re-rate as investors become more comfortable with the turnaround in the acquired Spotless division, and broader improved performance from existing Downer operations.

Alacer Gold (AQG) – Overweight Improved project performance coupled with a strong gold price drove meaningful share price outperformance.

The bottom relative contributors from performance for the quarter are as follows:

Cleanaway Waste Management (CWY) – Overweight Guidance issued for FY-20 highlighted lower growth than investors were expecting, though longer-term thesis remains intact.

Wisetech Global (WTC) – Underweight / not owned Wisetech performed strongly along with the broader tech sector for the quarter.

oOh! Media (OML) – Overweight Whilst the results for h1-19 (December y/e) were slightly ahead of expectations, media markets in the third quarter have been very weak leading to lower than expected full year guidance and some concerns from investors about the current level of gearing in the business.

OUTLOOK

The strength in equity markets runs somewhat counter to the challenges facing the world economy, though this performance – and the rate of broader asset inflation – has largely been a function of falling interest rates, and as highlighted in our Market Review; is showing early evidence of waning momentum.

Notwithstanding, there are still areas of the market that stand-out for overly optimistic implied expectations. Domestic cyclicals are the leader in this regard, where, during and post the August reporting season, a number of stocks re-rated as investors hoped for improved earnings performance as interest rates and tax cuts stimulated demand. To date, all evidence from both a corporate earnings and macro-economic data perspective suggests this is not coming through, and we view a lot of these stocks, particularly in the retail and housing exposed areas, as being very expensive.

The same can be said for the 'hyper-growth' stocks across the IT and biotech sectors, which have continued to attract capital searching for higher returns in a low interest rate world, paying little regard for whether these stocks have any demonstrable path to acceptable cashflow returns on capital – even on a very long-term view. We maintain constant coverage of these stocks, though most are incompatible with our valuation-based, cash flow focused investment style, and our memories of the previous tech boom where a significant number of these companies rapidly disappeared as the equity market elected to stop funding perpetual losses. As an example, recent coverage of the failed WeWork IPO highlights how fast valuations can deteriorate.

Against this backdrop of pockets of extreme valuation and weaker economic growth prospects, we remain positively disposed to companies that have displayed earnings resilience and a meaningful growth pipeline, that can be largely delivered upon without an improvement in the macro-economic backdrop. Our largest active positions, whilst across diverse industries, tend to share several factors in common: strong management teams, beneficial structural change at a company and/or industry level, and opportunity to reinvest capital at returns substantially above their current capital cost. More broadly, we also retain a significant exposure to companies with material offshore earnings that are operating in more attractive end markets.