Fund Update - 31 December 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	-0.53	3.50	19.39	8.17
Mid Cap Composite Benchmark	-1.11	1.82	21.70	9.89
Excess Return	**0.58**	**1.68**	**-2.31**	**-1.72**

* Inception date - 15 May 2017

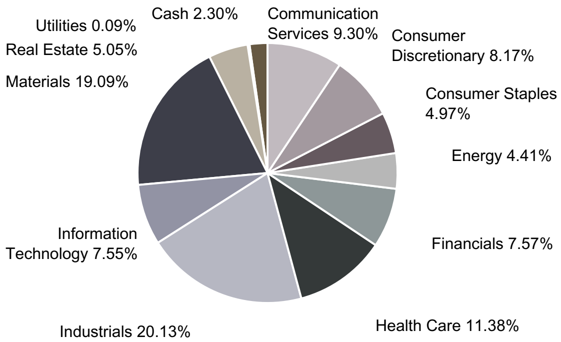
Fund Details

APIR Code	ETL8772AU
Fund Size (AUD m)	$79
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	55
Portfolio Dividend Yield	2.64%
Stock Range	Typically 40-60
Industry Range	Unconstrained
Cash Range	0-10%

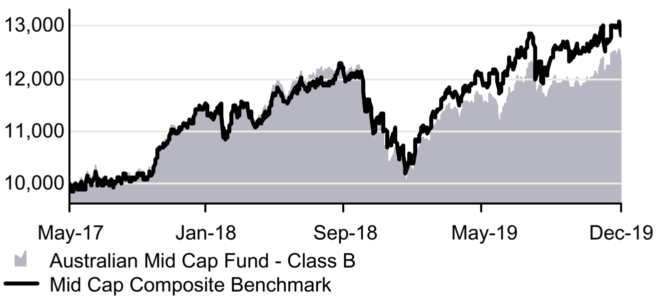
Sector Allocation



Top 10 Positions

	Weight %
Resmed Inc	5.64
Atlas Arteria	4.11
Downer EDI Ltd.	3.92
Cleanaway Waste Management Ltd.	3.68
Northern Star Resources Ltd.	3.40
Magellan Financial Group Ltd.	3.32
Charter Hall Group	3.19
Tabcorp Holdings Ltd.	2.73
Coca-Cola Amatil Ltd.	2.63
Orora Ltd.	2.62

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 December 2019 quarter extended the calendar year's gains, with the S&P/ASX Mid Cap 50 Total Return Index returning 2.3% for the period. This performance was slightly behind the broad-based indices, which were lifted through strong performances in the Healthcare and Energy sectors in particular. Global equity markets finished the year strongly with technology names lifting the USA indices and the Chinese market attracting investors as prospects of a trade deal again swung sentiment. In the USA and Australia, there was steepening in the yield curves with 10 year bonds rising to 1.21% (+18.8bps) in AU and 1.87% (+20.5bps) in the USA.

The roller coaster of news flow largely continued and there were a few potential positives. In the UK a sweeping election victory for Boris Johnson has seemingly paved the way for Brexit by 31 January 2020 which should provide some clarity and help markets to move forward. There are still a number of unknowns to determine how "hard" this exit from the EU will be and the impact it will have on the economy until further details of Brexit are available. Phase One of a trade deal between the USA and China is reportedly "done" with signing planned to take place in January 2020. There was also plenty of news flow during the quarter to make investors hesitant, including simmering tensions across the Middle East and Asia (particularly Hong Kong). A few days post the end of the December Quarter, the USA struck a key Iranian figure with drone attacks and this will create further geopolitical risks. In Australia the bush fires have torn across the East coast of the country and continue to burn unabated. The impact on humans, flora, fauna and the economy is colossal and tragic.

The Australian Reserve Bank (RBA) cut the Cash target Rate to 75bps in early October, the third cut in 2019. Philip Lowe, the RBA Governor, indicated in a November speech that although unlikely, he would not discard considering Quantitative Easing measures if conditions required as much. We would question the merits of such actions should they eventuate and there has been much debate about QE and negative interest rates and the true impact on economic growth. It was interesting to read commentary from the World's oldest central bank, Sweden's Riksbank, regrading returning interest rates from negative to zero as a start to try and "normalise" the rate environment. Given the muted impact of the aggressive monetary policy measures seen to date, fiscal stimulus as a driver of growth has increasingly been suggested by a number of market and political commentators.

Post the FY19 August reporting season, there have been net downgrades to earnings expectations. Included in this mix was Boral downgrading on accounting irregularities in parts of its USA business and Flight Centre downgrading on the back of weak retail travel performance. Post the royal commission into the banking sector, the shocks keep coming. Westpac suffered after allegations by AUSTRAC on anti money laundering (AML) breaches, NAB was sued by ASIC over fees for no service and Bank of Queensland raised capital to support its balance sheet with no clarity on how growth is to be reinvigorated. Highlighting the vulnerability of over-inflated momentum names, the once $12b+ market cap Wisetech has been sold down by 38% over the quarter after a short report was released questioning the efficacy of its acquisition strategy. M&A activity has continued with some notable announcements being: 1) the Canadian Couche-Tard $8.9b bid for Caltex (which is changing its brand name to Ampol after Chevron took its brand back), 2) the successful acquisitions of Barrick and Newmont's respective 50% holdings in the Super Pit gold mine in Kalgoorlie by Saracen and Northern Star, bringing the asset back into Australian hands.

PERFORMANCE

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

Wisetech (WST) – Underweight Stock got sold off after a report was published questioning the efficacy of its acquisition strategy over the past few years. This highlights how vulnerable these momentum stocks can be to any news shock.

Fisher & Paykel Healthcare (FPH) – Overweight FPH upgraded guidance in October before the release of a very good result for the half year to September. The release of new sleep apnea masks and ongoing penetration in the ventilation market was received positively.

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.

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

Virgin Money (VUK) – Underweight VUK (used to be called Clydesdale Bank) got caught up in the post Boris Johnson emphatic UK election win and the view that at last we will see action regarding Brexit and the market can then hopefully get on with business as usual.

Contact Energy (CEN) – Overweight After a very strong run CEN got sold off mainly due to concerns about South Island power prices should the Tiwai smelter close down (NZ's largest single consumer of power) and the capital costs associated with new geothermal generation.

Bapcor (BAP) – Overweight BAP's primary business is the supply of after market parts to the auto sector. At the AGM management signalled that margins were under some pressure from competition and this led to a sell off post a strong run. We continue to like BAP as they are a consolidator in a fragmented sector and the business is well run.

OUTLOOK

With global economic data looking to have found a bottom, the question is to what extent it recovers to support ongoing strength in equity markets. Given the uncertainty that still exists in the broader global economy we continue to not make overly bold assumptions regarding growth and continue to structure the portfolio around sound businesses that have some resilience.

The outlook for the February 1HFY20 reporting season is relatively muted and we expect it to be fairly volatile given lofty expectations reflected in some multiples. As mentioned in the summary above, Wisetech was the victim of not a downgrade, but a report questioning their strategy. This highlights the nervousness around where some of these stocks trade. Outside of the tech names, areas we will be watching with interest are the consumer sector, financials and building related stocks given we are underweight these areas. With Black Friday pulling forward sales pre Christmas, key will be to see if the consumer still has much spending left coming into 2020. Whilst house prices have shown signs of a nice rebound, the completion of past approvals should be evident over the next few quarters as activity “lulls” until any pick up in approvals comes through in building activity towards the end of the year.

Against this backdrop of pockets of extreme valuation and uncertain 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.

Lastly our hearts and thoughts go out to all those affected by the bush fires in Australia. It is truly remarkable to see the strength and resilience of Australians under times of immense pressure such as this.