Fund Update - 30 September 2018

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 Accumulation Index and 30% of the S&P/ASX Small Ordinaries Accumulation Index by 3% pa over a three to five year period (after management costs and before tax).

Performance Net (%) p.a.	1 Month	3 Months	1 Year	Since Inception*
Mid Cap Fund - Class B	-0.51	2.77	19.84	15.76
Mid Cap Composite Benchmark	-0.63	2.83	19.64	15.13
Excess Return	**0.12**	**-0.06**	**0.20**	**0.63**

* Inception date - 15/05/17

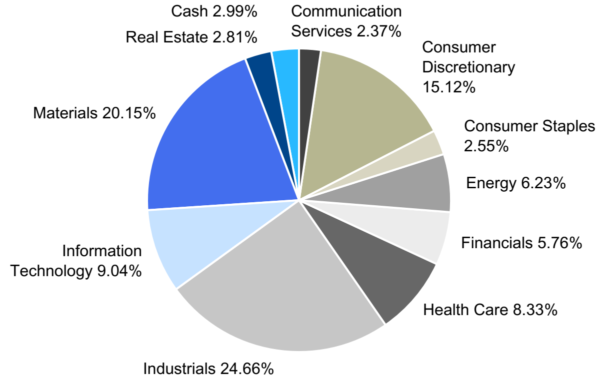
Fund Details

APIR Code	ETL8772AU
Fund Size (AUD m)	$85
Application Price	$1.1102
Redemption Price	$1.1036
Distribution Frequency	Semi-Annually
Management Fee	1.10% p.a.
Performance Fee	15% p.a.
Buy Sell Spread	+/-0.30%
Minimum Investment (AUD)	$20,000

Characteristics

Number of Stocks	55
Portfolio Dividend Yield	2.81%
Stock Range	Typically 40-60
Industry Range	Unconstrained
Cash Range	0-10%

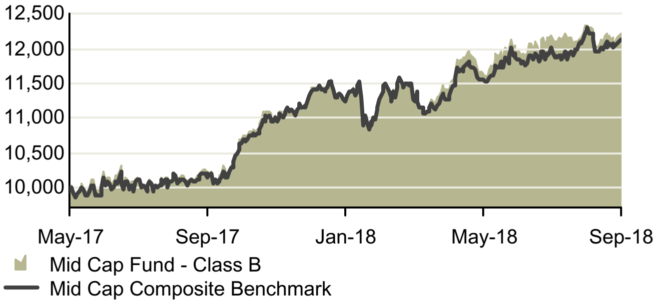
Sector Allocation (%)



Top 10 Positions (%)

	Fund
Resmed Inc	4.16
Downer EDI Ltd.	3.63
Atlas Arteria	3.46
Bluescope Steel Ltd.	3.20
Cleanaway Waste Management Ltd.	3.14
CYBG PLC Shs	3.11
Tabcorp Holdings Ltd.	3.08
CIMIC Group Ltd.	2.92
Charter Hall Group	2.81
Seek Ltd.	2.76

Growth of AUD 10,000



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Commentary

MARKET REVIEW

For the purpose of comparison, commentary is quoted in AUD terms and Australian sector returns refers to the S&P/ASX 200 Total Return Index except where stated otherwise.

The Australian equity market produced a reasonable return during the September quarter, with the S&P/ASX 200 TR Index delivering 1.5% for the period. It outperformed European and Asian markets but significantly underperformed the US market, with the S&P500 NTR Index up 7.6% in US dollar terms. The S&P/ASX Small Ordinaries TR Index largely kept pace with the broader market, adding 1.1% for the quarter, whilst the S&P/ASX Mid Cap 50 TR Index was the outperformer, generating 3.6% driven by a 4.8% return in Mid Cap Industrials. The portfolio performed well over the quarter outperforming the benchmark. Relative outperformance was largely generated by stocks held within in the portfolio.

The Australian market was heavily focused on reporting season. This largely occurred in August and covered the period ended 30 June 2018, which for the majority of companies was their financial year end. The season was generally quite solid and we saw a number of stocks that had struggled into reporting season rally on quite decent results. Examples held in the portfolio included Cimic and Downer and outside the portfolio included JB Hi-Fi. We also saw a number of stocks that had underperformed into reporting season that produced reasonably disappointing results but still had relief rallies. Examples held in the portfolio included Domino's Pizza and outside the portfolio included Myer Holdings. Reporting season also saw a continuation of the strong rally in expensive stocks, particularly in the IT sector (+10.5% led by the likes of Afterpay, Wisetech and other stocks such as Pro Medicus, Nearmap, all increased between 40% and 90%) and to a lesser extent the Health Care sector (+4.2%). The Communications sector was the strongest performer (+25.3%) over the quarter with all stocks outperforming and TPG Telecom leading the way with a 65.2% return (discussed below). This represented a strong bounce in the sector after a prolonged period of underperformance. The other theme to emerge from reporting season was expected capex increases in the resources sector after many years of frugality. In a lot of cases this has been forced upon the sector, e.g. all three major iron ore companies need to access new major orebodies in the next 2 to 3 years to replace their dwindling current sites. This dynamic bodes well for mining services companies.

From a thematic point of view the reporting season highlighted some of the extremities we are seeing in markets at the moment with the second highest divergence seen between the best performing (tech and telco) and worst performing (utilities) sectors in the last 5 years (source JP Morgan). This growth versus value extremity is just one of a number that we are seeing in the market and is discussed in further detail in the Outlook section.

Domestically economic news remained mixed with GDP growth in the June quarter above expectations (0.9%) and employment growth remaining strong. House prices fell 0.6% in the June quarter, representing the first negative period since mid-2012. This is a concerning trend given the extent to which the economy and consumer confidence are dependent on housing and has not been aided by the unfortunate, but necessary, Royal Commission into the banking sector and APRA's tightening of credit standards in recent years. At this stage the RBA remains unconcerned by these trends using the September meeting to hold rates steady at 1.5% for the 26th consecutive month.

Politically the revolving door of Prime Minister's continued with Malcolm Turnbull being replaced by Treasurer Scott Morrison, and the chance of an early election being called is now very real. Shortly after his appointment Morrison announced a Royal Commission (RC) into the aged care sector. With the Banking RC fresh in their minds, saw investors flee from listed operators.

Three recurring themes that we witnessed in the quarter included a continuation of the unprecedented levels of State Government infrastructure spending (a phenomenon that started in NSW and has well and truly spread to other states), the ravages of the drought continuing (seen in profit downgrades by Graincorp and Nufarm) and M & A and corporate activity sustaining at a moderate pace (bidding war for Investa Office, TPG's proposed merger with Vodafone Australia, SG Fleet's bid for Eclipx, a raising by Northern Star to acquire the Pogo asset in North America and the proposed listings of Pexa (property register) and Coronado Coal).

Global equities had a volatile quarter driven by political issues and posturing. Trade tensions are becoming increasingly front of mind for investors. At the time of writing the US has reached preliminary trade deals with both the EU and NAFTA (Mexico/Canada) although there are no guarantees that there will not be further hiccups along the way. The trade dispute with China has escalated with another $200bn of imports having a 10% tariff placed on them that is due to be ratcheted up to 25% in the New Year. China retaliated with tariffs on $60bn worth of US goods prompting the US to threaten effectively placing tariffs on all Chinese imports. The conflict is increasingly beginning to look more like being politically related than trade related with both parties looking determined in their position (although this can seemingly change on a daily basis). The outcome of this posturing was USD strength (AUD/USD down 2.4%), Emerging Markets chaos and selected resources weakness (base metals down 6.5%, gold down 4.8% but iron ore up 7.3%) which saw the materials sector perform poorly during the quarter (down 0.9%). Oil bucked the trend (up 5.9%) as global inventory drawdowns continued and US sanctions against Iran and Venezuela started to bite. This period of uncertainty also coincided with the Federal Reserve continuing to raise rates. All of these factors will have an ongoing impact on the Australian market. We discuss these dynamics further in the Outlook section.

PERFORMANCE

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

Afterpay Touch (APT) – Overweight The company's much anticipated launch into the US is gaining traction with leading retailers faster than anticipated, leading the market to begin to value the upside potential in this market. Also announced planned entry into the UK via acquisition of a small incumbent.

Downer EDI (DOW) – Overweight The company's 2018 result highlighted continued strength in the core business and the steps that they have taken to turnaround the Spotless acquisition. The company is also confident of finding a resolution to the problematic Royal Adelaide Hospital contract that they inherited with Spotless.

Beach Energy (BPT) – Overweight The stock has progressively re-rated post the Lattice acquisition, as investors begin to grasp the significant growth potential from the deal, and the strict cost discipline that management are adopting. The stronger oil price is adding a further tailwind. Post the end of the quarter the company held an Investor Day that elaborated on the significant potential for production growth over the next 5 years.

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

TPG Telecom (TPM) – Underweight Share price strength driven by a general recovery in the telco sector and the announcement of a proposed merger with Vodafone Australia. Such a merger makes strong commercial sense.

St Barbara (SBM) – Overweight Impacted by general weakness in the resources/gold sector on trade war concerns and a stronger USD. SBM has also been heavily impacted by gold ETF selling.

Sims Metal Management (SGM) – Overweight Weakness driven by trade war concerns, China policy changes around non-ferrous scrap (tariffs and environmental) and poor communication on behalf of the company.

OUTLOOK

This presents an opportunity to give our thoughts on a number of issues that were raised in the Market Review Section. Firstly, it has become seemingly apparent that the US/Sino trade war has moved beyond a trade matter to a political one. Both sides seem committed to their respective positions and it would seem to us that the US is likely underestimating China's resolve on this matter. The issue is further complicated by US mid-term elections and some early signs that corporates are increasingly concerned about what impact this will have on their businesses (recent announcements by Ford and Whirlpool on the costs to their businesses highlight this). From an Australian position the trade war is prima facie negative for resources. This analysis ignores any offsetting effects of China using domestic stimulus to offset weakness (not happening to a great extent currently) and the potential for a weaker USD (supportive for resources) as they face the ongoing prospect of twin fiscal and trade deficits. This also ignores the prospect that the US does a complete about face which is also a possibility. We have an overweight position in resources as we think they represent good value in a market with some very expensive sectors. We did, however, reduce the overweight as we felt the trade war was intensifying. We currently feel that the oil sector is reasonably exempt from the impacts given the current demand/supply equation in oil and we remain overweight. The team will be visiting China again (after visiting in September) for an update next month and also recently returned from the US where we gained further insights into these matters.

On the political front the twists and turns on Brexit continue with the potential for a number of stocks in our universe to be impacted. The team recently returned from the UK (as part of the US trip) and is sadly unable to provide any definitive views on what might happen, with the landscape shifting on an almost daily basis and political infighting making the position even more precarious.

As highlighted in the Market Review section we remain alert to the significant valuation differential that has developed between the higher and lower ends of the equity market. We actually saw this differential expand during reporting season. The valuation discrepancy is at an extreme that we have not seen since the tech boom that ended in 2000, with the market seemingly prepared to buy feel good stories without any reference to valuation. The trend is consistent with what has been experienced in offshore markets. Unusually, the rally of these "long duration" stories has continued despite rising bond yields suggesting the valuations of such assets should be peeling off. Amazingly, we have actually had a number of occasions where sell side analysts have told us that earnings and valuations are no longer relevant. We are not sure what will see this phenomenon unwind but our only certainties are that it is not different this time, it will end and that the decline will ultimately be led by offshore markets (particularly the US).

Given this backdrop, we remain favourably disposed to those corporates where earnings growth is not exposed to trade and political concerns, or where the impacts should trade tensions escalate would be positive vs. current market expectations. We are also focusing on companies with valuation support, strong management and good balance sheets. We continue to remain underweight long duration and bond proxy sectors that are likely to underperform in a rising interest rate environment. Should equity markets remain volatile, we expect more opportunities to present themselves.