Firetrail INVESTMENTS

Firetrail Absolute Return Fund

AUGUST 2019

PERFORMANCE (AFTER FEES)

	Month	Quarter	6 mnth	1 yr	Fund incept[2]	3 yrs (pa)	Strategy incept[4]
Fund[1]	3.45%	4.95%	0.41%	-1.67%	-1.68%	-	-
Strategy composite[3]	3.45%	4.95%	0.41%	-1.67%	-	2.44%	12.13%
Benchmark	0.08%	0.28%	0.65%	1.40%	1.43%	1.45%	1.58%
Out/Underperformance	3.36%	4.67%	-0.25%	-3.07%	-3.11%	0.99%	10.55%

ABOUT FIRETRAIL

Firetrail is an investment management boutique which is majority owned by the Firetrail investment team. Additionally, the investment team is invested alongside clients in the investment strategies.

ABSOLUTE RETURN FUND

The Absolute Return Fund ("Fund") is a market neutral strategy with minimal correlation to equity market direction. It aims to generate positive returns in all market environments. The strategy is built on fundamental, deep dive research guided by the philosophy that 'every company has a price'.

INVESTMENT OBJECTIVE

The Fund aims to outperform the RBA cash rate over the medium to long term.

PORTFOLIO POSITIONING 31 AUGUST 2019

Top 3 Overweight Holdings (Alphabetical)
Qantas Airways Ltd
Telstra Corp Ltd
Transurban Group

FUND DETAILS

Unit prices	31 August 2019
Application price	$0.9792
Redemption price	$0.9694
NAV price	$0.9743

Fund Details	
APIR Code	WHT5134AU
Benchmark	RBA Cash Rate
Inception date	14 March 2018
Fund size	$223m
Management fee*	1.50% p.a.
Performance fee*	20% of outperformance

*Please read the Product Disclosure Statement for more details

FUND EXPOSURE 31 AUGUST 2019

	Portfolio Exposure
Long Equity	148%
Short Equity	(148%)
Net Equity Exposure	0.0%

Past performance is not a reliable indicator of future performance.

1. Firetrail Absolute Return Fund ('Fund'). Net Fund returns are calculated based on exit price with distributions reinvested, after ongoing fees and expenses but excluding taxation. **2.** Fund inception is 14 March 2018. **3.** The Fund has been operating since 14 March 2018. To give a longer-term view of our performance for this asset class, we have also shown returns for the Firetrail Absolute Return Strategy Composite ('Strategy') which has been operating since 30 June 2015. Strategy performance has been calculated using the monthly returns (after fees) of the Fund from 14 March 2018 to current date, as well as the monthly returns of the Macquarie Pure Alpha Fund (after fees) between 30 June 2015 to 23 November 2017. The Fund employs the same strategy as was used by the same investment team that managed the Macquarie Pure Alpha Fund as at 23 November 2017. Firetrail has records that document and support the performance achieved as the Macquarie Pure Alpha Fund. The composite returns for the Strategy and the RBA Cash Rate (Benchmark) exclude returns between 24 November 2017 and 13 March 2018. During this period the investment team did not manage the Strategy. As such, the annualised performance periods stated are inclusive of the combined composite monthly returns, and do not include the period when the team were not managing the Strategy. For example, the annualised return over 3 years for the Strategy and benchmark are inclusive of 36 monthly performance periods available in the composite return period, excluding the period between 23 November 2017 and 13 March 2018. For additional information regarding the performance please contact us through the link on our website. Net Fund returns are in AUD terms. Net Fund returns are calculated based on exit price with distributions reinvested, after ongoing fees and expenses but excluding taxation. Past performance is for illustrative purposes only and is not indicative of future performance. **4.** Strategy inception 30 June 2015.

PERFORMANCE COMMENTARY

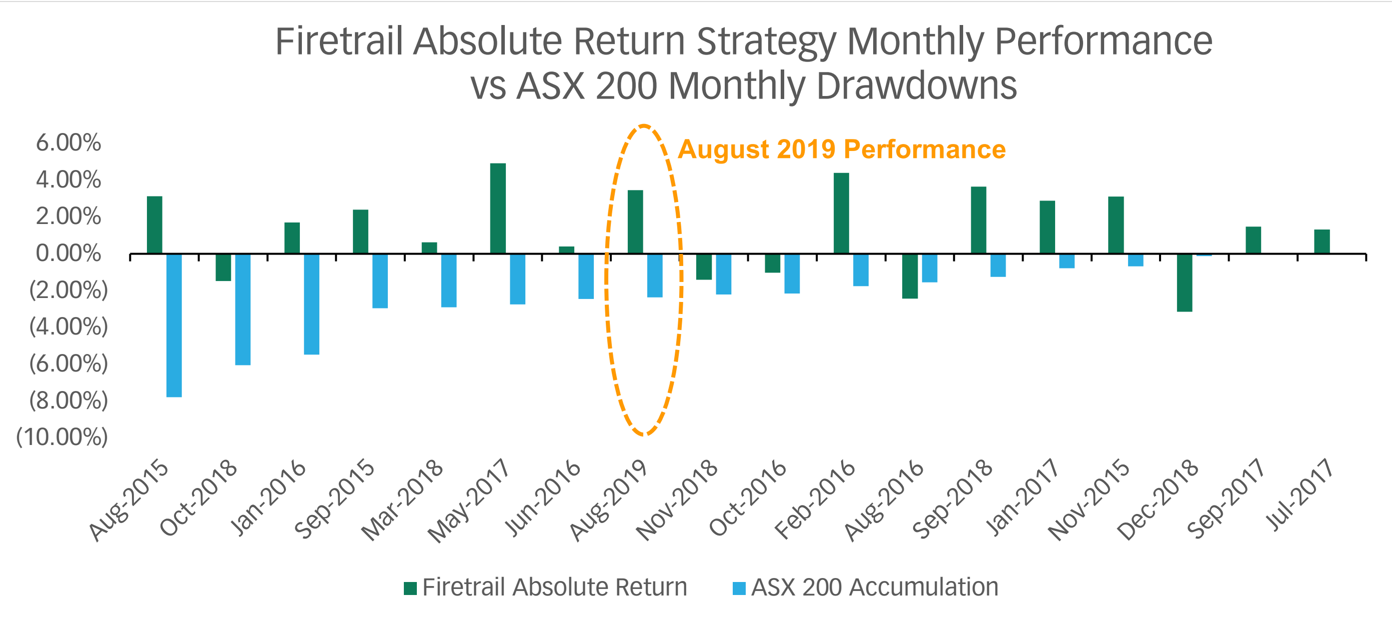
The Fund returned 3.45% during August, outperforming the RBA cash rate by 3.36%. The outperformance during the month was due to both small/mid cap long positions and fundamental shorts, whilst being partly offset from the underperformance of the large cap long positions.

Volatility remained present in equity markets during August, with the ASX200 down 3.1% for the month. Investors are dealing with the complexity of Trade Wars, Brexit, and rapidly declining interest rates. The US 10-year government bond yield fell a staggering 0.52% during the month as interest rate and inflation expectations reduced. Messaging from central banks on alternative stimulatory policies (quantitative easing and monetary/fiscal stimulus) has been increasing. Showing the current challenge of driving inflation as traditional monetary policy reaches its limits. As a fundamental equity investor, we very much keep abreast of these developments, and as we research companies keep these in our mind as we construct your investment portfolio.

PORTFOLIO COMMENTARY

Whipsawing markets in August reminds us of the value of uncorrelated, alternative investment strategies as part of a diversified portfolio. In August, a period where most developed equity markets delivered a negative return, the portfolio behaved completely independently from equity markets, delivering a positive return for our clients.

In the chart below, we highlight the historical performance profile of the Firetrail Absolute Return Strategy in months where the equity market has declined. Importantly, of the 18 monthly market declines since we launched the market neutral strategy in 2015, we have experienced a negative return in only 5 corresponding periods.



Source: Firetrail

Whilst returns will not always be positive during negative equity market periods, the chart above illustrates the uncorrelated nature of the portfolio which is designed to be market neutral. That is, long positions are equal in value to short positions. This ensures that portfolio returns are driven by individual stock picking of both long and short positions; as opposed to positive or negative equity market movements.

TOP CONTRIBUTORS FOR THE MONTH

In Australia, it was the annual reporting season for most companies. Reporting season is a time which we have found historically fruitful for returns. This month was no exception, with strong returns from both long and short positions that reported during the month. We took the opportunity to close out several of our fundamental short positions post company announcements, which we will rebuild as we start to see earnings and event catalysts appear over the rest of the year.

Top contributors for the month included long positions in Qantas and Afterpay. Qantas outperformed for the month after announcing a strong FY19 result, providing the building blocks for us to infer a similar level of profitability in FY20. Given the weaker domestic economic environment, investors had been apprehensive ahead of the company results. The highlight for us was the increase in the earnings growth for their Loyalty division (Qantas Frequent Flyer), with growth of 12% y/y over the past 6 months. As Australians know frequent flyer points earning can be done in many aspects of our lives – from credit cards to health insurance to superannuation. Our valuation for the Loyalty business is well north of half of today's current share price, providing a significant "sum of the parts" valuation upside to Qantas. It remains a core holding.

Buy now, pay later provider Afterpay was up 17% for the month after demonstrating continued strong customer additions. This is in face of an apparent increasing competitive landscape. The number of providers of buy now, pay later services continues to increase (Klarna, Sezzle, Affirm, Humm …the list goes on!), thus we are now at a point where the credit provision is no longer a unique proposition. What attracts us to Afterpay is instead their focus on the proposition for the retailer. The analysis we have done suggests the uplift in sales a retailer gets from bringing Afterpay onboard is the strongest of all propositions. Retailers can think of Afterpay as more of a marketing expense rather than a payment processing fee. More retailers = more customers and their ecosystem is continuing to grow, as was demonstrated with the 2.1 million US customers now on the platform.

A long position in ERM Power also contributed positively, after receiving a takeover bid from energy giant Shell during the month. We sold our position post the announcement, with the shares trading close to the bid price.

Fundamental shorts added value during the month, with winners of note in the industrial and packaging segments.

TOP DETRACTORS FOR THE MONTH

A long holding in outdoor advertiser oOH! Media was one of the largest detractors in August, falling during the month after reducing its calendar year 2019 earnings guidance range from $152 to $162m down to $125-$135m. Two factors are contributing to the fall:

1. Firstly, a poor advertising market, particularly in July and August;
2. Secondly, growing pains from the integration of a recently acquired business (Adshel).

Industry data suggests that the overall spend in the advertising market fell 9.3% in July, with the outdoor segment falling 15.2%. Channel checks with media agencies and companies suggest that there has been a pick-up since then. In particular, it appears that banks and auto companies have started to increase their spend, giving us confidence into a stronger Q4 for the ad market and Ooh Media.

We took the significant fall in the share price as an opportunity to increase our position in oOH! Media, which contributed positively to performance intra-month as the share price regained some of its losses toward the month-end.

Another detractor was a long position in waste management provider Cleanaway, which disappointed investors with a weaker than anticipated FY20 outlook. Cleanaway has been a great performer for the fund, having risen +25% CYTD. The global waste industry is undergoing an adjustment as the flow of waste products is changing. Three years ago, companies in Australia were paying to collect waste material, as they could then sell that material for a profit on the global market. However, one of Australia's largest waste customers China is no longer willing to accept other countries waste, thus newer recycling methodologies are being required.

Cleanaway, as the largest player in the industry is best placed to take advantage of this adjustment. Unprofitable business models are going under (for example, large Melbourne processor SKM), and councils are adjusting the rates they pay collectors to account for higher processing costs. Newer technologies such as converting waste to energy are also being explored by providers. We believe Cleanaway will benefit materially from these changes over the medium term, and it remains a key holding in the fund.

ONE INTERESTING THING THAT HAPPENED THIS MONTH…

Is the divergence we are seeing across seemingly similar areas of the economy. Take new car sales for example:

- In July, there was a decline in the number of new cars sold for the 16th month in a row – falling 2.8%.
- But commentary from listed luxury vehicle retailer Autosports, showed that the luxury part of the market actually grew 1.9% in the month.

Similar commentary from the airlines, Qantas and Virgin Australia, indicated that the weakest part of the market is the discount leisure market – think Jetstar and Tiger. Premium leisure is holding up both domestically and internationally for both airlines, as is the corporate market.

To us, this suggests that recent cuts in interest rates are benefitting the higher wealth households in the Australian economy. Ie. Those that can borrow, spend and take advantage of lower rates. Much of the economy is yet to see the "trickle down" impacts of recent cuts. This divergence re-emphasises the need to fundamentally research each company's specific investment opportunity. In the current environment, it will be hard to find returns simply by picking a sector. Significant gaps are emerging between the winners and losers in each segment across the market.

MORE INFORMATION

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