Atlantic Pacific Australian Equity Fund

ARSN 158 861 155

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WINNER
HFM Asian Performance Awards 2022
Emerging Manager / Smaller Fund - Equity

Fund Monthly November 2023

Class A - Return Summary (To November 2023)

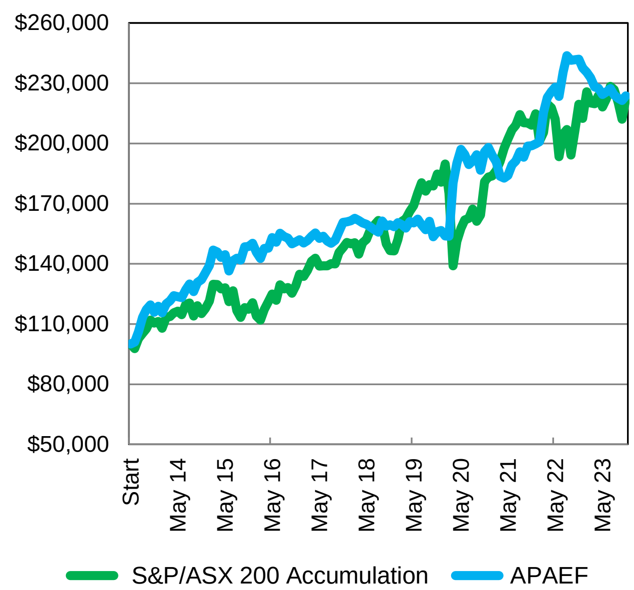
Period	1 mth	3 mth	6 mth	1 yr	3 yr (pa)	5 yr (pa)	Cumulative	Per Annum
Fund Return	1.01%	-0.2%	-0.3%	-7.6%	4.5%	7.0%	123.7%	8.0%
S&P/ASX 200Acc.	5.03%	-1.8%	2.0%	1.5%	7.1%	8.7%	122.7%	8.0%
Excess Return	-4.02%	1.6%	-2.4%	-9.0%	-2.6%	-1.7%	1.0%	0.0%

Class B - Return Summary (To November 2023)

Period	1 mth	3 mth	6 mth	1 yr	3 yr (pa)	5 yr (pa)	Cumulative	Per Annum
Fund Return	1.12%	0.1%	0.5%	n/a	n/a	n/a	-6.5%	n/a
S&P/ASX 200Acc.	5.03%	-1.8%	2.0%	n/a	n/a	n/a	0.9%	n/a
Excess Return	-3.90%	2.0%	-1.5%	n/a	n/a	n/a	-7.3%	n/a

Past performance is not indicative of future performance. Fund returns presented in this document are for both Class A Units and Class B Units. Fund Returns are prepared on a redemption unit price basis after management and performance fees inclusive of GST. Distributions are assumed to be re-invested at the mid unit price. Individual tax is not taken into account in deriving Fund Returns. In calculating the NTA, the Atlantic Pacific Australian Equity Fund ("Fund") asset values have been calculated using unaudited price and income estimates for the month being reported. Returns greater than one year are annualised.

Cumulative Returns of $100k



Recent Highlights

- Markets down 2.84% and 3.78% over the months of September and October 2023 respectively, with our long term strategy of downside protection being maintained.
- The Fund has moved to a more substantial long position heading into December 2023, after hedging through September and October 2023.
- The Fund's position in Perpetual (PPT:ASX) has recovered over the month with a cheeky takeover into December 2023.
- Key contract catalysts in our long term position in Norwood Systems (NOR:ASX) are nigh. We expect strong performance from this equity over the coming year.

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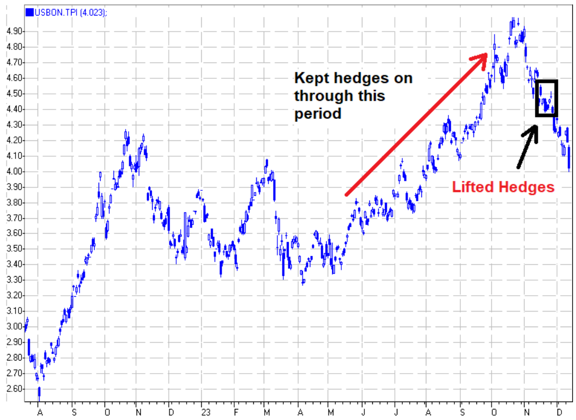
Portfolio Activity

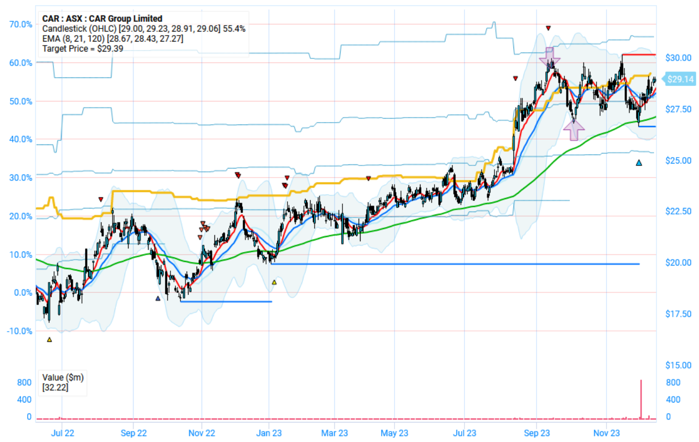
Shorts | Buy Cover

After a persistent fall in local markets over August 2023 to October 2023 (down 6.5% across September and October 2023) brought about by geopolitical uncertainty in Israel as well as a lack of conviction on the trajectory of global interest rates, we covered all shorts (index only as we had no stock shorts in November until later in the month) in and around what appeared to be indications from the Fed that bond rates are likely to peak for now. As you can see from the chart, bonds have sold off dramitically but are reversing course quite aggressively. We took around 7 to 10 days in coming to this conclusion which would seem to be a long time in markets, in some respect it certainly appears that way given we didn't capture any of the updside in the first week of November 2023 which accounted for most of the month's return. Nonetheless, it is a reversal of what we had been thinking for a long period of time. Our structural thesis on hedging has always been clear.



Given valuations have been elevated since the post covid rally, we expected long duration assets (ie equities) to de-rate because as discount rates rise, valuations should fall. However, it seems that while cash is now moving into bonds as a opportunity to move into safer assets, there appears to remain substantial cash balances on the sideline to be deployed in equities. Notwithstanding, while we have moved away from a structural hedge program, we will always be willing to tactically remove equity exposure when conidtions arise, particularly when markets move into extreme overbought states.

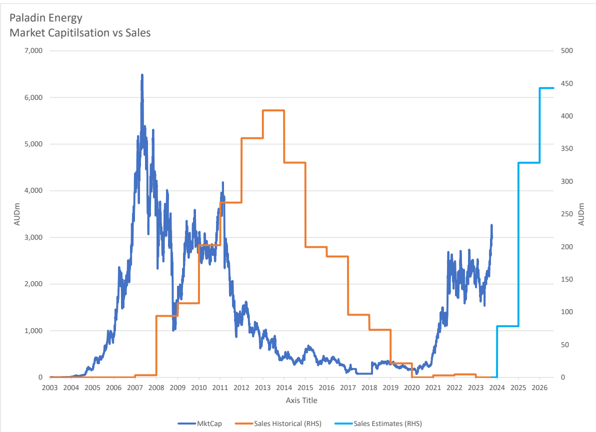
During the period since we last wrote, we have also taken on various tactical short positions at the equity level. In the example of CAR Group (CAR:ASX, formerly known as CarSales.com)), you can see pristine levels captured to create trading income for the Fund, if only all short trades could look like this! We are now seeing similar opportunities emerge in December 2023 which we will discuss in the New Year. During November 2023 we have started to accumulate a short position in Commonwealth Bank (CBA:ASX) as a hedge against our long position in ANZ Group (ANZ:ASX). At the time of writing, CBA is now moving very close to an extreme overbought state in line with the general market ie the Santa rally is underway! The hedge is a classic relative valuation arbitrage AND dispersion trade where the performance of CBA is expected to underperform ANZ.



Uranium Long

We remain positively disposed to equities exposed to the Uranium market. Uranium prices have continued to firm due to a movement from historical inventory supply to now a more earnest recovery in major nuclear utilities contracting for mine supply. In Australia, the Fund's primary position is in Paladin Energy (PDN:ASX) who are re-starting the Langer Henrich mine in Namibia which they previously operated for 10 years. The mine was mothballed almost 7 years after the Fukushima nuclear accident, which ultimately led to uneconomic prices for any Tier 2 mine. However, more recently prices for uranium equities have generally gone sideways even while underlying uranium prices have continued to elevate (see price chart above). This looks and feels very much like the thermal coal market which the Fund made substantial returns in over CY2022. In the case of PDN, once they confirm they are in production (company has guided to 2024Q1), we expect the equity to re-rate according to the underlying uranium price.

We have attempted to re-construct historically how PDN has been valued (Market Cap) in prior years as their Sales have changed or expectations of increased reactor rollouts have transpired. Pre-GFC versus now looks eerily the same in terms of required supply over multi-decades to come! Given the recent capital raisings, write-offs of capital and various other accounting tricks, we have settled on providing a market cap to sales chart as this is our most reliable dataset. We don't see this as a complete tool for analysing the company's valuation as we rely on the forecasts of analysts, but nonetheless it provides some context to what is on offer in these equities if prices do continue to rise above $100/lb. In our view, were prices to rise and remain elevated there will be a period where those who are supplying into the market earlier in the cycle will benefit disproportionately. As with studying any commodity over long periods, we are acutely aware that conditions could reverse with Tier 2 and 3 mines being restarted but we don't expect this to be front of mind for investors for at least 6 months. Similarly, global commodity analysts are generally behind the eight-ball in terms of upgrading their estimates for Uranium prices which will provide a tailwind to sales and earnings.



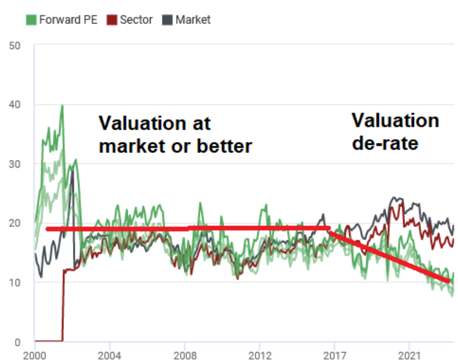
While we did not attend, the Annual World Nuclear Symposium in London gave us an insight into sector-held views. It's becoming clearer to us that uranium inventories are becoming increasingly tight and current supply is drawing down on previously built-up stockpiles. Those procuring or broking uranium in the enrichment and utilities spaces are confident of supply from a plethora of mines that don't have permits, let alone any construction activities going on nor forward orders on mining equipment. During September 2023, Cameco Corporation (CCJ.TSE, not held) announced challenges at their Cigar Lake & Key Lake uranium mines, citing issues with "availability of personnel with the necessary skills and experience" causing market uplift.

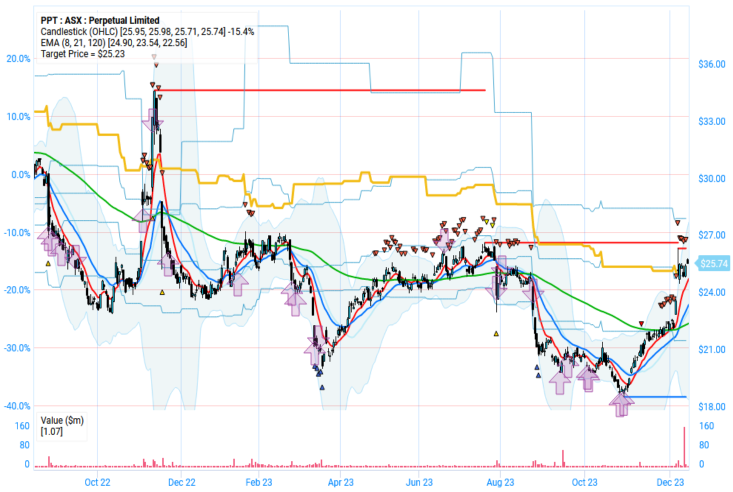
Post-September, our team had the opportunity to attend the Australian Nuclear Conference which left us with two key takeaways. Firstly, there is clearly momentum coming back into the uranium and nuclear energy spaces, highlighted by the attendee count being double that of the previous year. The other takeaway from conversations with uranium experts acknowledged the lack of skilled labour, coalescing into what Cameco are indicating. In essence, we are seeing a continual pickup on the demand side of uranium whilst the supply curve simply cannot keep up. If supply cannot be achieved, prices can only go one way!

Asset Managers Long

Over the past couple of years, we have witnessed many a fund manager come under pressure from poor performance, whether in the short run or over longer time periods based on their style or otherwise. This is also true of the Atlantic Pacific Australian Equity Fund at various times over the past 10 years though our yardstick being a long-short manager is not about “mirroring an index and then some” but more about smoothing volatility and achieving market returns over the long run. In relation to the share prices of listed asset managers in Australia, the falls seen have been quite dramatic of the order of 90% in some cases. It would not be unusual to consider that these asset managers will eventually go out of business or at least consolidated by other asset managers as we are seeing currently with overtures from Regal Partners (RPL:ASX) and Washington H Soul Pattinson & Company (SOL:ASX) across the sector of late. Underperformers of note include Magellan Financial Group (MFG:ASX) and Platinum Asset Management (PTM:ASX) who have had their own specific issues but ultimately has come down to personal issues within the company. Each of the examples is well broadcasted across print media. We believe manager concentration (i.e. being reliant on a single individual within a firm) should place a significant underweight bias and one has to be careful backing the equity of a “single manager” company as the potential volatility created when the wheels fall off is too perverse.

When looking at the sector from a top down perspective, the once double digit to >20x forward PE multiples paid from 5+ years ago are now no longer. We are quite perplexed by this as Asset Managers, once at scale, generally grow earnings faster than their asset accumulation and should trade at market or above. Take the example of Perpetual, while earnings have fallen due to mismanagement and fund outflows, they have not benefited from the general level of equity markets at all. Indeed, both earnings and valuation compression are now providing a substantial opportunity for a “deep value” operator to reinvigorate. And while the bid recently by SOL was cheeky i.e. not paying up relative to other prices offered previously, it makes sense on so many levels and is why we have been attracted to this space over the past few years. During the sell-off since September 2023, the Fund did suffer from the position but now we believe investors are realising these equities are way too cheap. As you can see from the trading activity, we have been consistently on the long side attempting to optimise the ultimate position for the benefit of unitholders. We remain positively exposed where forward multiples for an Asset manager are near single digit with plenty of runway for their strategies. To that end, the Fund is also exposed to GQG Partners (GQG:ASX), a collaborative multi-strategy global equities manager. In their case, they remain at a significant valuation discount to the market with substantial growth opportunities and a yield of near 10%. These financial properties are just too attractive to miss out on.





Norwood Systems (NOR) Long

Norwood Systems (NOR:ASX) has been a position in the Fund for over 8 years. That is a long time in anyone's book with various trials and tribulations determining our involvement. However, we believe the company is on the cusp of company-making deals with the company indicating more tangible evidence over the current year.

NOR are a company which creates various telco-grade software, (network and/or consumer level) with one existing contract supporting the visual voicemail services of Spark New Zealand customers. This is a growing contract but, at this point, is unlikely to ever cover their cash outflows which is driven by significant Research & Development spend as well as general corporate purposes. In some respects, we have opined that they should have been housed in a Private Equity type structure. Curiously, the Fund has not bought on-market for many years and instead has provided primary capital from time to time. This has been a deliberate strategy in part due to the options offered when capital is raised. Indeed, the Fund has an enviable position in deep out of the money options, which, if the company is able to deliver on the telegraphed contracts, will re-price asymmetrically for the benefit of unitholders. A broad set of Directors of the company have recently ramped up their fiscal support of the company via a recent capital raising, in anticipation of deal flow presumably. This is generally viewed as a positive by market professionals and retail punters alike.

The company has gone through various re-inventions over time and now has, to a large extent, integrated technologies to support various telco solutions. Importantly, their movement into voice mail over the past 5+ years and now AI related applications over the past 3+ years forms a strong basis for future contract wins which wasn't evident with voice mail alone, in our view. What is not obvious from the above is that the voicemail services provide an "EDLP strategy" to convert old and expensive voicemail technology with the impressive visual voicemail component. While on the other hand, the AI-related applications provide new revenue for telcos. This is not something to be sneezed at and it would be naïve or wrong to assume that large telcos are not interested in this.

In terms of AI related applications, there are a number that the company has spoken of under the umbrella name, "CogVoice", including call screening and various agents (jobs agent or a simple personal assistant). There are global regulatory issues to resolve and problems to solve when it comes to the AI space. We are not of the view that sentient biological machine states are ever possible but there are plenty of issues to resolve based on the world's collective limited knowledge. On the regulation side, how "in-transit" call screening is used and deployed is of paramount concern to regulators. But on the other hand, as an example, the evolution of "cloned" voices using AI to scam is also requiring a new intervention. Essentially, AI needs to fight AI to minimise the disruption of consumers. It is only AI that will be able to separate the wheat from the chaff, so to speak. The simple perverse example, most interestingly portrayed in the "Terminator" movie series, would be where your son or daughter's voice has been cloned via an AI model. Your "child" then rings you to borrow money, pay for something or find out information and you unwittingly perform or provide what is asked of you! However, if you had an AI call screening agent monitoring the call in-transit and it intervenes when required, then consumers will benefit. Similarly, productivity tools (the "agents") are an evolving part of the AI landscape, and it is no surprise telcos are interested, as they present a new revenue source.

We provide some simple numbers on what this could look like for a large US telco with a very large cohort of Small Medium sized Enterprises (SMEs). If one were to do any analysis on the various job scheduling web-based software platform market, you would find there is a plethora, ranging from a couple of hundred to thousands of dollars in annual subscriptions for each SME. If there were an elegant mobile solution integrating voice calls to minimise lost revenue, evolving over time to cater for different industries and optimisation of geographical job placement to minimise petrol usage say, at a much lower cost to the existing plethora of platforms combined with the marketing clout of a large US telco, then this is certainly a market where a lot of money can be made. In the US there are about 30m SMEs based on government registrations. If an app (excluding the Telcos mark-up) were able to take 1% market share at US$5 per month, this translates to US$18m of high margin revenue. Linearly, moving to 3% market share supports US$54m of revenue. And if the app (excluding the Telcos mark-up) has a US$10 per month charge, then that equates to US$108m. Clearly, these are very large numbers. We are sure the Telcos mark-up will be greater than US$10 per month as well!

Since the early part of the year, the company has indicated a relationship with Singtel via Optus Australia has been forming with the culmination in October 2023 of a Group Master Supply Agreement which is generally a prelude to the awarding of a contract.

At this point in time, they are integrating their software (Voicemail and AI related variations) into the various Operational and Business support systems of Optus, which is a required integration prior to moving forward with any contract. Importantly, they are necessary hoops and provide an indication of how complicated and time consuming it is to move into the Telco space in general. The company has indicated this work is short in duration so the company is likely to provide an update on this work in the near future, perhaps before Christmas 2023. We will provide an update on this in due course.

Portfolio Positioning

As alluded to before, we have lifted our strategic hedge and are now starting to move to a more invested state. Given the market performance over August to October 2023, the hedge made perfect sense driven by very little positive news and a substantial sell off in bonds driving weaker equity prices. However, this appears to have all changed with expectations from the US Federal Reserve now in pause mode and potentially reduction mode. Unlike the US Fed though, in Australia we may have slightly different dynamics due to a slower increase in interest rates which may push out the positive inflation impulse domestically and hence the need to reduce interest rates. Under these circumstances, we will tactically deploy capital where an equity price for a particular company is attractive. Of course, tactically we will reduce capital where an acceleration in prices is not warranted. The current "Santa Rally" is certainly a case in point with prices reaching ever higher, not on fundamentals but on a lack of liquidity.

From a relative expectation point of view and based on general market commentators, 2024 is shaping up to be a good year for equities with liquidity remaining firm supported by general sentiment moving positive. Valuations won't matter as much under this scenario. But those maybe famous last words. Without valuation discipline, you limit your long term returns.

We wish all investors a Merry Christmas and a Happy New Year and thank you for your continued support. We will be working over the break and will update investors shortly after the New Year on how the month of December 2023 has transpired.

Fund Strategy

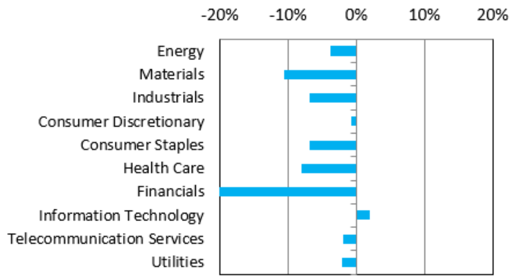
The Fund is a long-bias equity market product which typically buys or short sells Australian listed securities and derivatives. Net and Gross market exposure is maintained within a range of 0-100% and 0-200%, respectively. The Investment manager employs its Quadruple Alpha Investment Strategy which focuses on outperforming overall market cycles by capturing upside returns while minimising downside risk. The objective of the Fund is to outperform the benchmark after fees and expenses over a 5-7 year time frame.

Risk Statistics

As at November 2023

	Fund		S&P/ASX 200 AI	
	5 Year	Inception	5 Year	Inception
Alpha (%pa)	-1.7%	0.0%		
Downside Capture	-6%	26%		
Standard Deviation	10.9%	9.6%	16.4%	13.8%
Sharpe ratio	0.6	0.7	0.5	0.5
Sortino		1.3		1.3
Largest Drawdown	-8.5%	-8.5%	-26.7%	-26.7%
Correlation	-18%	13%	100%	100%

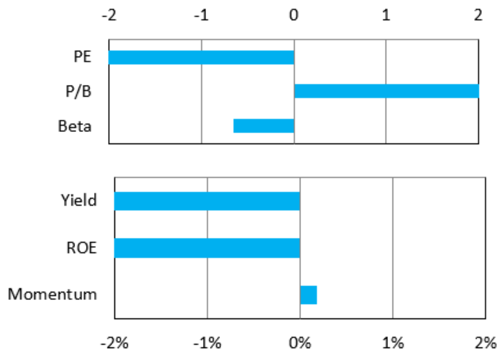
Sector Exposure



Exposure

	Long	Short	Net	Gross
Equity	51.8%	-4.1%	47.7%	55.9%
Index Futures	0.0%	0.0%	0.0%	0.0%
Net	51.8%	-4.1%	47.7%	55.9%
Implied Cash			52.3%	

Factor Exposure



Source: APSEC Funds Management

Largest Positions

Long	Short
Corporate Travel	Breville Group
Norwood Systems	Commonwealth Bank
Perpetual	
Steadfast Group	

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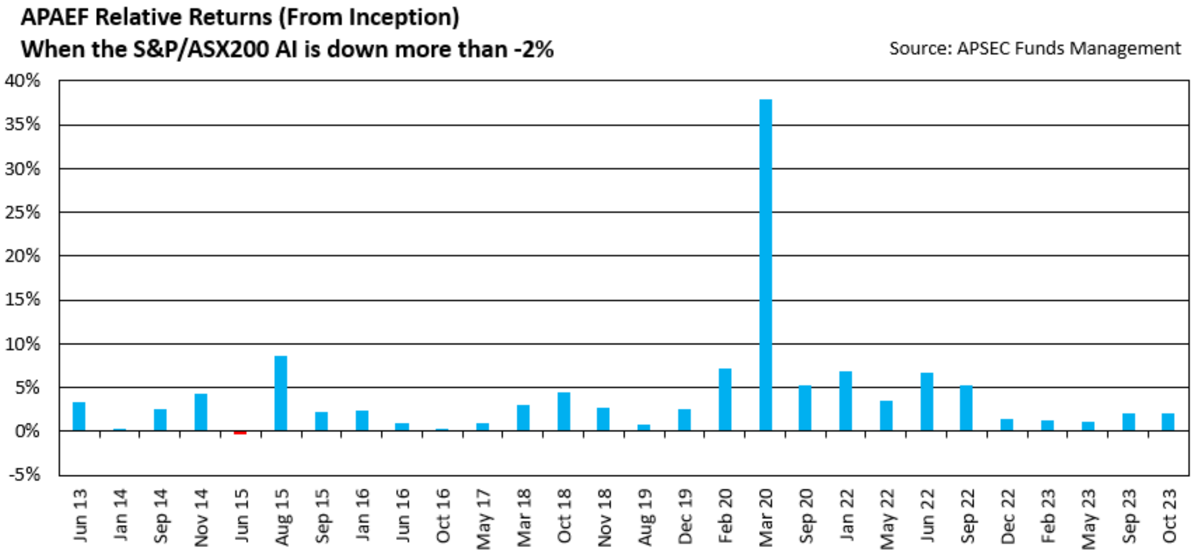
Downside Performance



General Information

Class A - Fund Information (As at 30 November 2023)

APIR Code	OMF0003AU	Responsible Entity	Equity Trustees Ltd
Inception	1 June 2013	Investment Manager	APSEC Funds Management
Minimum Investment	$20,000	Administrator	Apex Group Ltd
Application/Redemption	Daily	Custodian	Apex Group Ltd
Management Fee	2.2% pa	Prime Broker	Interactive Brokers LLC
Benchmark	S&P/ASX200 Accumulation	Auditor	PriceWaterhouseCoopers
Performance Fee	15% above S&P/ASX 200 Accumulation + 3%pa subject to a high water mark		
Mid Unit Price (Class A)	1.1966	Application Price (Class A)	1.1978
		Redemption Price (Class A)	1.1954

Class B - Fund Information (As at 30 November 2023)

APIR Code	ETL1038AU	Responsible Entity	Equity Trustees Ltd
Inception	5 December 2022	Investment Manager	APSEC Funds Management
Minimum Investment	$250,000	Administrator	Apex Group Ltd
Application/Redemption	Daily	Custodian	Apex Group Ltd
Management Fee	0.95% pa	Prime Broker	Interactive Brokers LLC
Benchmark	S&P/ASX200 Accumulation	Auditor	PriceWaterhouseCoopers
Performance Fee	Subject to a high water mark		
Mid Unit Price (Class B)	0.8819	Application Price (Class B)	0.8828
		Redemption Price (Class B)	0.8810

Contact Information

Habib Chebli	h.chebli@apsec.com.au	Investment Manager	1300 379 307
Website	www.apsec.com.au	Responsible Entity	1300 555 378
Online Applications (Olivia123)	Click here	Unit Registry	1300 133 451

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Important Information

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Atlantic Pacific Australian Equity Fund's Target Market Determination is available here – https://www.eqt.com.au/insto/. A Target Market Determination is a document which is required to be made available from 5 October 2021. It describes who this financial product is likely to be appropriate for (i.e. the target market), and any conditions around how the product can be distributed to investors. It also describes the events or circumstances where the Target Market Determination for this financial product may need to be reviewed.
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https://awards.withintelligence.com/hfmasianperformanceawards2023/en/page/2022-roll-of-honor

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