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 December 2023

Class A - Return Summary (To December 2023)

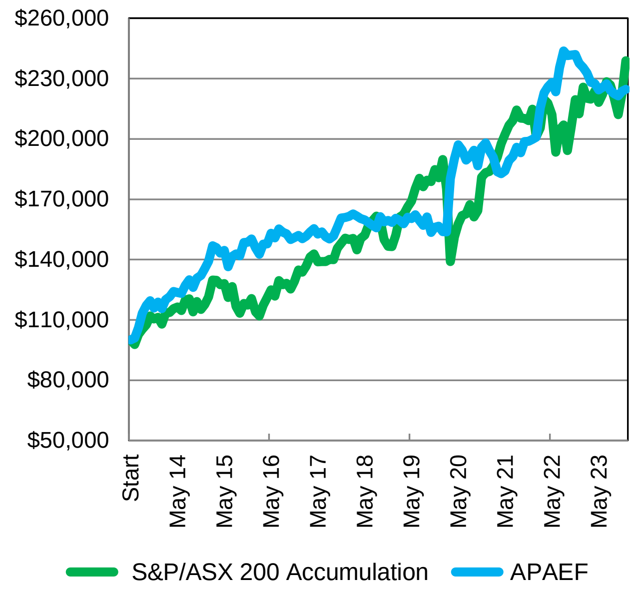
Period	1 mth	3 mth	6 mth	1 yr	3 yr (pa)	5 yr (pa)	Cumulative	Per Annum
Fund Return	0.45%	1.0%	-0.4%	-5.4%	4.3%	7.2%	124.7%	8.0%
S&P/ASX 200Acc.	7.26%	8.4%	7.6%	12.4%	9.2%	10.3%	138.9%	8.6%
Excess Return	-6.81%	-7.4%	-8.0%	-17.9%	-4.9%	-3.0%	-14.1%	-0.6%

Class B - Return Summary (To December 2023)

Period	1 mth	3 mth	6 mth	1 yr	3 yr (pa)	5 yr (pa)	Cumulative	Per Annum
Fund Return	0.57%	1.4%	0.3%	-5.9%	n/a	n/a	-5.9%	N/A
S&P/ASX 200Acc.	7.26%	8.4%	7.6%	8.2%	n/a	n/a	8.2%	N/A
Excess Return	-6.69%	-7.0%	-7.3%	-14.1%	n/a	n/a	-14.1%	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 melt up during December 2023. The extent of this certainly surprised us with valuations now recovering to pre-COVID levels despite bond rates normalising.
- The Fund has initiated a tactical short position due to overbought states across Australian large cap companies.
- The Fund's position in many stocks went sideways due to various issues including acquisition indigestion. A recovery in Fund returns is occurring in January 2024 against the tide of the market.
- Norwood Systems (NOR:ASX) confirm their recent Proof of Concept with Optus Australia has been completed successfully.

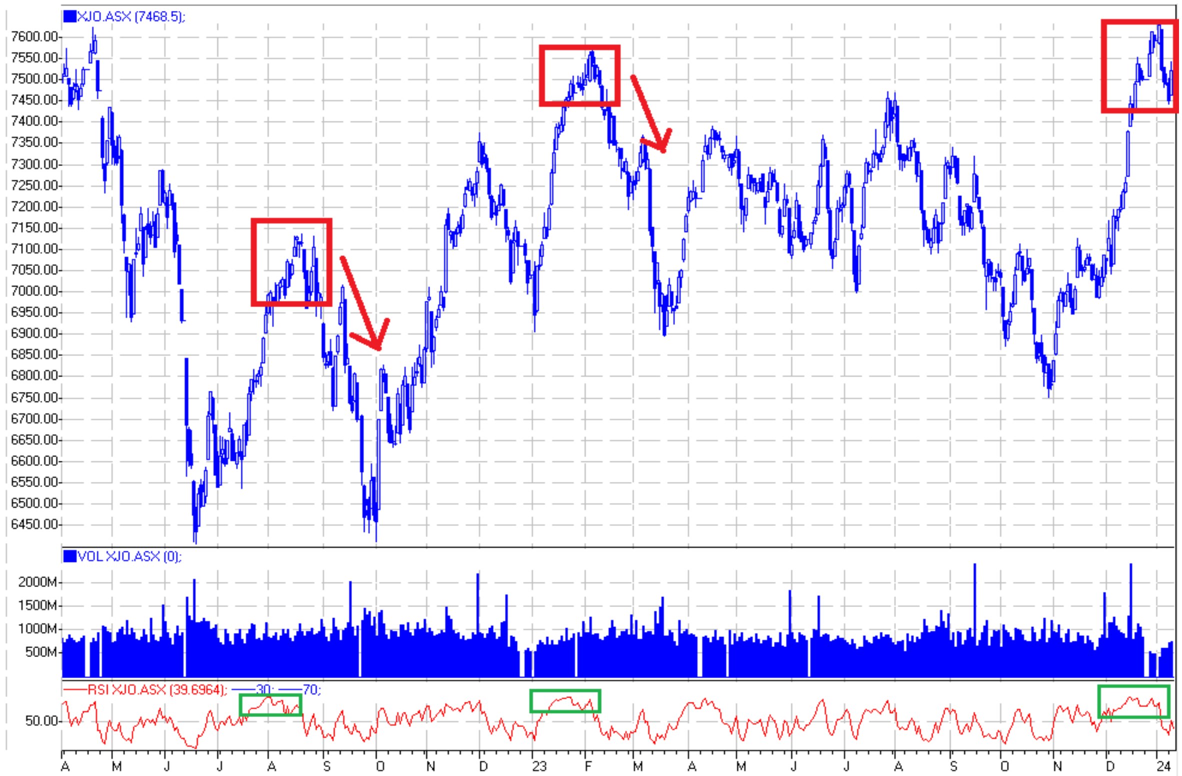
APSEC FUNDS MANAGEMENT

Portfolio Activity

Shorts Tactical

The market presented quite a few opportunities in the latter stages of the month as investors ramped stocks into year end. In many cases, the flat to negative outlook has not changed and hence extreme price formation is a natural environment for us to start to short.

We initiated a SPI short during the month and despite the low volume "heave-ho" post Christmas 2023, the position is now sitting in profit as prices generally have re-traced. In some cases, the retracement at the stock level has been dramatic with many now down 10% or more. But more importantly, time does repeat itself in uncanny ways in markets. Take the examples as shown in the chart below where we highlight periods where, at the index level (S&P/ASX200), the market has moved into an extreme overbought state over the past 20 months. We are quite precise in the way we look at price formation and will not move until the conditions are properly defined when in a tactical mode. In other words, it is a systematic signal for us and is a key environment to short. We are not saying it is 100% perfect but it does improve our odds if we are looking for it, as it works most of the time. The rationale we use is that it took so much effort (ie buying pressure) to get it up there in the first place, that the inertia once it reverses leads to a faster retracement (ie selling pressure) than one would expect. In essence, this is not normal volatliity and whether you can explain via Newtons third law (every action has an equal and opposite reaction) or the old saying of "The bigger they are, the harder they fall", it stands to reason the faster markets rise, the faster they must fall as well! In terms of stocks, we apply the same argument. Given the index has moved into an extreme overbought state, so too there must be opportuntities in large cap stocks. We initiated sells in Cochlear (COH:ASX) and CSL (CSL:ASX) in addition to returning to our old favourite, Breville Group (BRG:ASX), all from a tactical point of view, combined with valuation overreach.



Uranium | Long

Continuing from last month, Uranium stocks remain front of mind in terms of exposure. We added to this sector further during late November 2023 and through December 2023 into Boss Energy (BOE:ASX), the other billion-dollar company in the Australian equity uranium space. Performance in this sector was lackluster during December 2023 despite the general frothiness seen in large caps and uranium prices going near vertical. Nonetheless, some performance catchup is occurring during January 2024 at the time of writing with break-ups in prices looming.

In the case of BOE, the shares underperformed due to a capital raising in the early part of the month which caused some indigestion in the share price. This is as expected due to the capital raising being completed at a near 5% discount to the prevailing share price. We also saw various changes to the company's register with a substantial shareholder selling down, new substantial shareholders appearing as well as an increase in shorts. Plenty is going on in the share register, in other words! The capital raising was initiated to support their working capital as they head into full production which we believe is prudent, but also an acquisition and strategic joint venture.

In the case of the acquisition, they vended into the US Alta Mesa high grade uranium mine by purchasing a 30% interest. Ordinarily, we don't like these sorts of deals as they don't control the assets but at least with production looming during the current calendar half, there should be some value attributable as uranium prices firm. Like Paladin Energy's and BOE's assets, this asset is a re-start post-Fukushima, which as we mentioned last month, for those companies with production coming on now should benefit disproportionately versus a producer to come on stream in a couple of years. As part of the purchase, they have also entered into a joint venture relationship with enCore Energy who were the previous operators of the Alta Mesa mine. This sort of deal is about buying operating capability which is quite clever in our view given the movement by western governments to accelerate primary electricity production via nuclear energy. We have yet to assess the merits of the collaboration agreement to use enCore Energy's Prompt Fission Neutron (PFN) technology as we don't think it matters so much as having production now. Technologies like theirs have been around for quite a while and assists with the identification of uranium in a borehole i.e. assists with exploration. Time will tell whether it is meaningful or not.

BOE also announced a supply deal with a major US power utility during the month. This is a seven-year deal, effectively underwriting the company with minimum pricing above their cost of production.

Norwood Systems (NOR) Long

As per the last update, the initial work to substantiate their ability to integrate with Optus has been confirmed by the company at their recent AGM. We didn't think this was ever something they would fail at as its not reinventing the wheel, and certainly a nice revenue kicker for 2 months of intensive work albeit at the mercy of Optus payment terms!

The company now has flexibility to offer any of its solutions with the Visual Voicemail (VV) as a base case EDLP ("Every Day Low Price") option to replace old, end of life technology and/or the higher value generative AI-related agentic services, both integrated into the one platform. In the case of VV, one would suspect the options for delivery could be as a standalone application similar to Spark NZ (SPK:ASX) or an integration with the Optus App. Either way, if they are able to consummate the VV deal, given the relative size of the customer base of Optus (~10m) vs SPK (~2.7m) and assuming the same penetration rate of usage, this could lead to a ~3x increase in subscription revenue plus relevant maintenance income. There may be some element of discount for volume but ultimately this is a high margin contract which in of itself could lead to a closer-to cashflow breakeven state. From our understanding from industry sources, as a potential replacement service, revenue should be turned on soon after integration, subject to being awarded a contract. If one of the agentic services are consummated, then they are well on their way to profitability. We are still unsure how quickly adoption by a telecommunications customer will be for these services. We will wait and see. Clearly, it's been a long wait for this company!

As one would expect, telecommunications companies are an obvious choice to implant various AI/ML agentic services given telcos are all about communication. And given their huge marketing reach they can turn a great idea into a very profitable one for the supplier of that idea. It comes up from time to time when we speak with investors, but what about the smart phone manufacturers? Aren't they doing the same? While smart phone manufacturers have a bevy of software apps which mirror in some respect, they don't own the customer nor the infrastructure for telecommunications services as they are a device manufacturer. They certainly don't think like a Telco! On the surface as a consumer, a telco business may seem quite simple, but business telco services are completely different. Similarly, not many large businesses would rely on "freeware" to drive their telecommunications. Abstracting further, even the concept of X (the old "Twitter") being a ubiquitous consumer app that will take over everything, we just don't see it. The world of commerce has always been defined by the specialisation of labour, concepts and the like. The global behemoths (like Apple, Microsoft, etc) have been formed by specialising their focus on large markets (computers, smart phones, operating systems, AI, etc) and if they look back, and not forward, they will most likely fail. You only have to look at how Apple almost became a thing of the past many decades ago. Therefore, this notion of a company being all things to all consumers, business or individual, in our view is ridiculous i.e. Apple is not a competitor in the telecommunications space. The corollary to this is the reason why Apple aren't a competitor in the credit card space, an equally large market, other than a highly regarded re-seller of someone else's balance sheet ie not every "red ocean" can be attacked simply because you have a "me-too" product.

Moving on to the general question of where these technologies could be placed, there are other industries that require fully trained agents to interact with a customer whether in a call centre for a retail product (eg General Insurance, Bank, and yes, a Telecommunications company) or indeed more important services related to life and death outcomes as provided by emergency services where connection to someone on the end of the phone needs to be done expeditiously. In some large markets, the pick-up rate in emergency call centres is atrocious with 5min waits for near on 1% of calls.

In the case of retail call centres today, the quality of the customer experience is based on key criteria including the time that someone is in queue (often long duration for high use consumer products), language/accent of responder matching caller, the experience and knowledge base of the agent you are talking to and the delivery platform (over the phone or via a messaging system).

In our view, call centres, message bots or emergency centre triaging (there are plenty more!) could be something immediately applicable to a Norwood-style agentic model. For example, a low-cost, near flawless language and intent detecting neural "agent" (this is an important description as many AI/ML models are, at best, a really bad bot!), could solve many of the issues of the past that annoy customers the world around. A client no longer needs to sit in a queue and is answered immediately by an "agent" who can detect what language/accent is being used while at the same time being fully trained based on the knowledge base of the organisation. And the "agent" can have a meaningful conversation, while attempting to optimise the triaging of the client. Like in the SME business case we spoke about last month, simply improving outcomes by 5-10%, if not more, is a substantial revenue opportunity. To conceptualise the size of the market, one can apply simple metrics to volumes and price per activity/month. However, at the end of the day, we don't know how large these markets will be ultimately, just as no analyst would have known Apple would become a multi-trillion-dollar company 10 years ago. Similarly, the novel re-invention of "lay-by" financing and the valuation explosion that eventuated, has always fascinated us. But at least, from an analytical perspective, we must have some sort of yardstick…ergo…simplicity is the key.

As we alluded to last month, the Fund has an asymmetric option position (NOROD:ASX) in the company which is currently deep out of the money (50% below the strike). These options, were the company to secure long duration contracts with large telecommunications companies, will reprice to being very valuable with the current time (just under a year) and volatility (around 80-90% annualised for years!) value being dwarfed by the delta moving to near 1 once deep in the money. In effect, these options will almost double the notional value of the Fund's position to any share price movement once the share price is in-the-money. We are not aware of any other individual nor entity that has this leverage. We hope the ride over 2024 will be rewarding for investors in the Fund.

Portfolio Positioning

Portfolio positioning remains dynamic. Given the pace of change over the last 2 months, we have been compelled, based on market pricing formation signals, to take exposure off. We are now starting in earnest to position for the next reporting season and will attempt to time entry in companies that appear asymmetric from a risk-reward perspective. We will update investors on our deliberations in the next instalment.

Having said that, our longer-term holdings in Insurance brokers (Steadfast Group [SDF:ASX] and AUB Group [AUB:ASX]) we believe will continue to perform with insurance premiums continuing to rise leading to outsized margin expansion and EPS revisions. Similarly, the Fund's exposure to Uranium we believe will continue to perform with equity prices, completing the arbitrage to the underlying commodity, rising forthwith. This is not rocket-science, as most commodity companies move with the underlying commodity price eventually. The Fund's position in Corporate Travel Management (CTD:ASX) has improved of late but not to the same extent as other global travel stocks have performed (for example, Expedia Group (EXPE:NAS)). We expect the contracts that have been consummated during last year together with a general strength in corporate travel bodes well for the company's shares. And of course, as we have noted earlier, we expect a significant re-rating in Norwood Systems over the coming year.

Overall, 2023 was a disappointing year for investors in the Fund, our worst yet, after exiting 2022 on a high and we apologise for this. The Fund Managers are aligned with every investor with significant investments in the Fund. We plan to make amends. Thanks for your continued support as we believe exciting times are ahead of us.

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 December 2023

	Fund		S&P/ASX 200 AI	
	5 Year	Inception	5 Year	Inception
Alpha (%pa)	-3.0%	-0.6%		
Downside Capture	-7%	26%		
Standard Deviation	10.8%	9.5%	16.4%	13.9%
Sharpe ratio	0.6	0.7	0.6	0.6
Sortino		1.3		1.5
Largest Drawdown	-8.5%	-8.5%	-26.7%	-26.7%
Correlation	-18%	13%	100%	100%

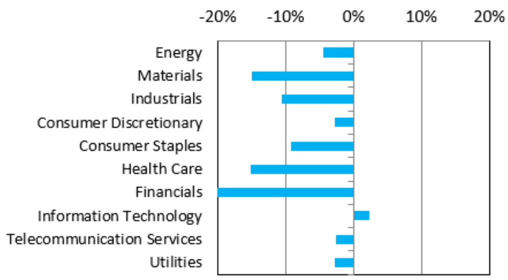
Exposure

	Long	Short	Net	Gross
Equity	46.7%	-7.6%	39.2%	54.3%
Index Futures	0.0%	-32.5%	-32.5%	32.5%
Net	46.7%	-40.0%	6.7%	86.8%
Implied Cash			93.3%	

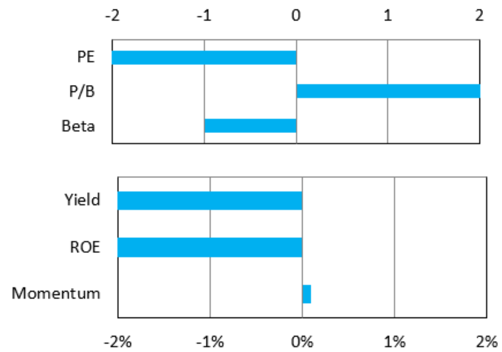
Largest Positions

Long	Short
Corporate Travel	Breville Group
Norwood Systems	Cochlear
Paladin Energy	Commonwealth Bank
Steadfast Group	CSL

Sector Exposure

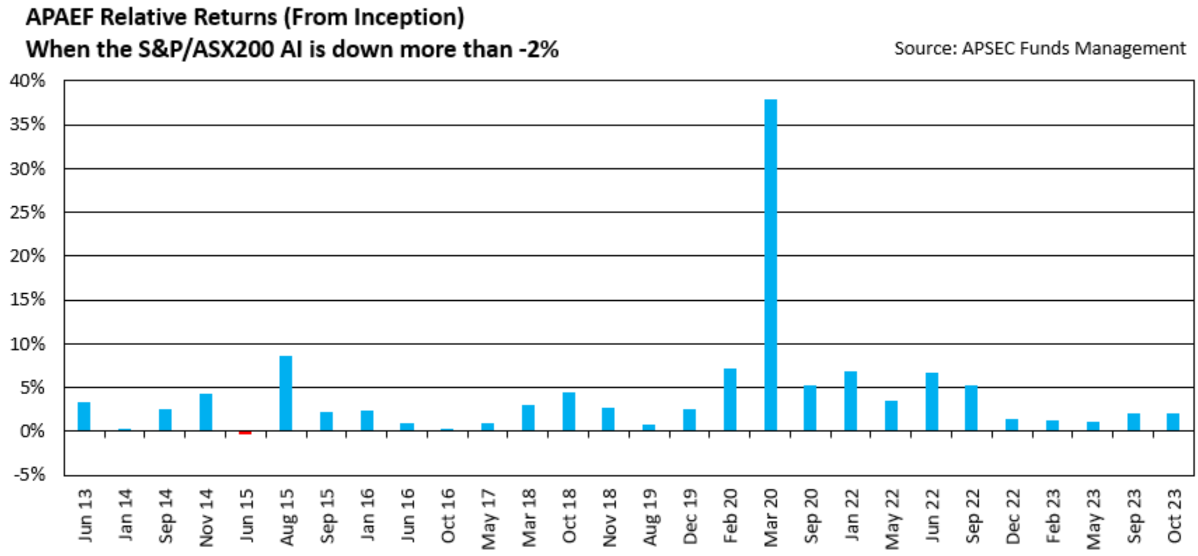


Factor Exposure



Source: APSEC Funds Management

Downside Performance



General Information

Class A - Fund Information (As at 30 December 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)	1.2020	Application Price (Class A)	1.2032
		Redemption Price (Class A)	1.2008

Class B - Fund Information (As at 30 December 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)	0.8869	Application Price (Class B)	0.8878
		Redemption Price (Class B)	0.8860

Contact Information

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Online Applications (Olivia123)	Click here	Unit Registry	1300 133 451

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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