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 February 2024

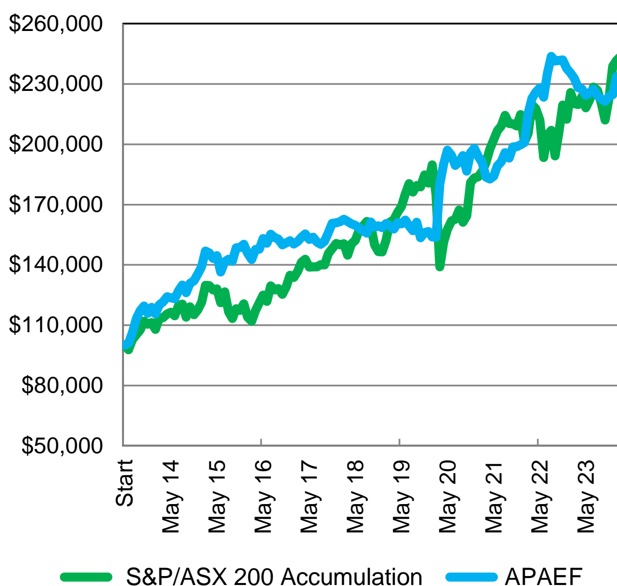
Class A - Return Summary (To 29th February 2024)

Period	1 mth	3 mth	6 mth	1 yr	3 yr (pa)	5 yr (pa)	Cumulative	Per Annum
Fund Return	0.01%	4.5%	4.3%	0.4%	7.0%	7.9%	133.7%	8.3%
S&P/ASX 200Acc.	0.79%	9.4%	7.4%	10.6%	9.3%	8.6%	143.6%	8.7%
Excess Return	-0.78%	-4.9%	-3.2%	-10.2%	-2.3%	-0.7%	-9.9%	-0.4%

Class B - Return Summary (To 29th February 2024)

Period	1 mth	3 mth	6 mth	1 yr	3 yr (pa)	5 yr (pa)	Cumulative	Per Annum
Fund Return	0.12%	4.8%	5.0%	0.9%	n/a	n/a	-2.0%	-1.6%
S&P/ASX 200Acc.	0.79%	9.4%	7.4%	10.6%	n/a	n/a	10.3%	8.3%
Excess Return	-0.67%	-4.6%	-2.4%	-9.7%	n/a	n/a	-12.3%	-9.9%

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.



Recent Highlights

- Markets take a breather somewhat over January 2024 after a ritzy December 2023 "Santa rally". On review of valuations, we are now back to "Growth-at-any-Price" territory. The Fund has started the year with strong performance of near 4%. February was muted.
- Performance laggards from prior months have started to mature including Uranium and high quality Asset Managers.
- The Fund initiated a position in Megaport (MP1:ASX) seeing outsized returns post their Second Quarter update towards the end of January 2024. This was an asymmetric setup which is what we are always looking for as we head through Reporting Season.

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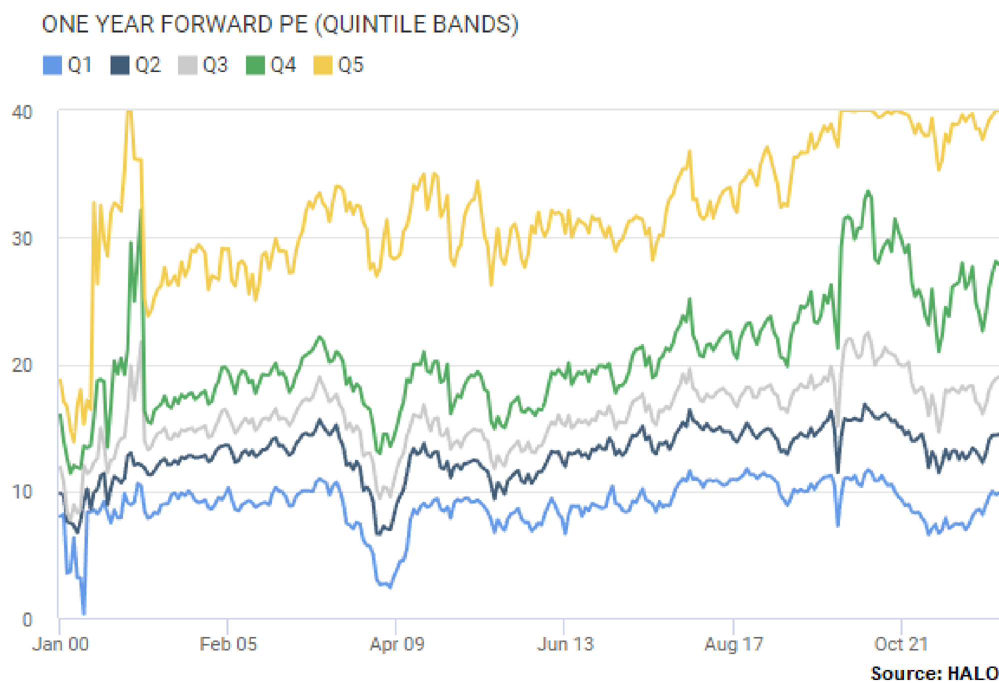
Portfolio Activity

GAAP — A Musing

We have used the phrase "Growth At Any Price" ("GAAP") in the past to describe extreme valuations where growth outlooks have been contrary to what one would expect. Essentially, there is no longer compensation for risk. This is pervasive across many sectors as we will show and while expectations may have been met in Australia during the recent reporting season, the prices that need to be paid for some equities is mind-boggling. Unlike the US, which has many companies growing at a break-neck pace due to the adoption of Artificial Intelligence (in particular Generative AI applications and related hardware uplift, among other new industries like Electric Vehicles), Australia at the big end of town doesn't have any of this. So while the US is rallying on true growth dynamics against a backdrop of normalised interest rates which are here to stay, Australia appears to be rallying unnecessarily against a muted growth outlook on a relative basis. If one were to compare the underbelly of the US market, those companies that have muted growth outlooks are underperforming or falling which one would expect. And yet the opposite is true in Australia.

The graphic below shows an equal weighted basket of stocks at various valuation bands (which adjust upwards or downwards depending on the trajectory of the underlying earnings and prices) where Q1 represents the cheapest 40 stocks and Q5 represents the most expensive 40 stocks. This is quite a dense sample in each quintile (Q) and from a statistical point of view is a good yardstick over time. With over 20 years of data, its quite clear that the expensive stocks (Q5 and Q4) remain the most overvalued and have become ***more*** overvalued. Is there a quality premium or is it simply that long only insitutional investors have no better use for the cash that is coming into their coffers?



Interestingly, companies remain hell-bent on maintaining buy-backs in this environment which shows a sense of hubris, rather than validation on whether this capital management is in the best interests of shareholders in the long run.

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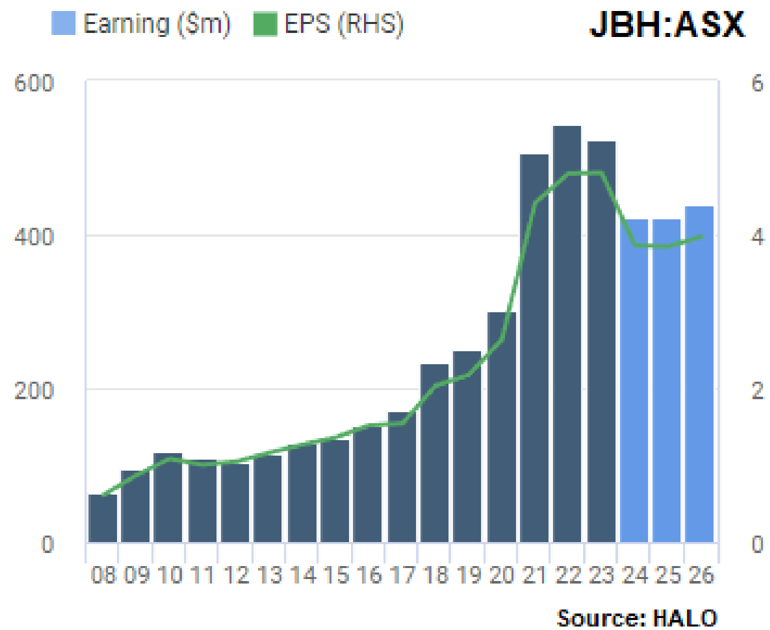
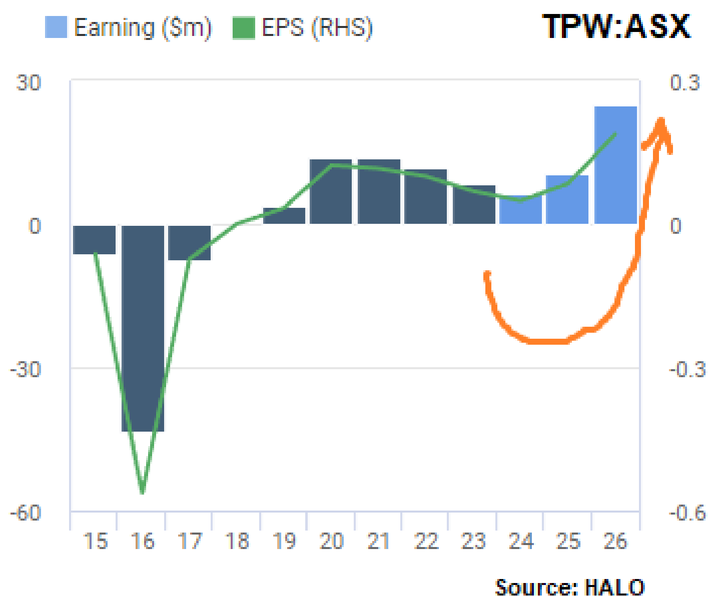
For example, the retail sector has been a major beneficiary during COVID-19 times driven by a re-adjustment of household budgets away from leisure activities. This led to outsized earnings for a couple of years by bringing forward consumption. The example we provide is JB-Hifi (JBH:ASX). Their earnings, historical and forecast, are shown to the right. While the company is excellent at what they do, we believe prices have shot up for no reason. The graphic shows forward expectations for earnings have fallen away and are now trending flat despite the share price magically hitting all time highs post their earnings update. On any reasonable valuation metric (PEs, PEGs, DCF, etc), one would have to be bonkers to chase these prices and yet that is exaclty what investors are doing.



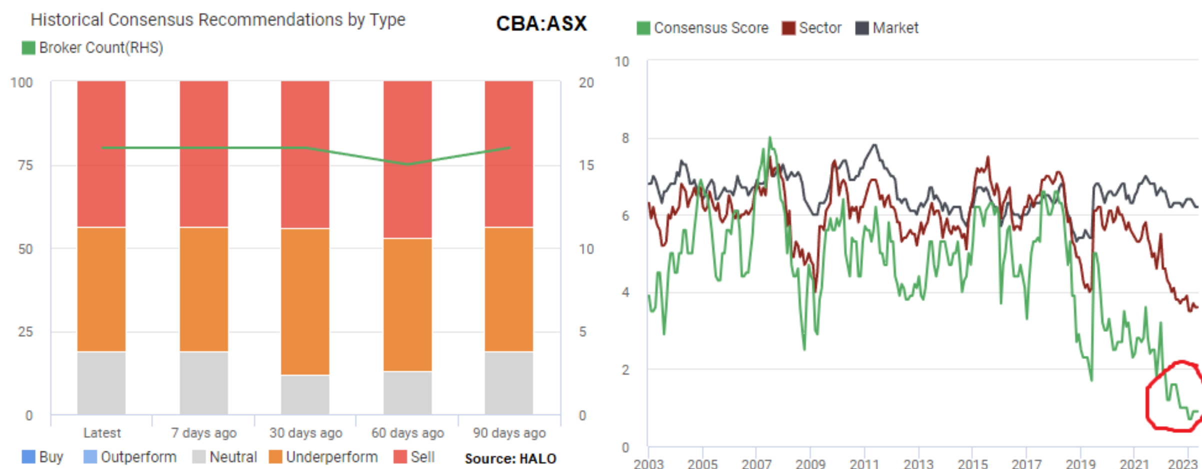


A similar example would be Temple and Webster (TPW:ASX), shown to the left, who operate on the skinniest of margins. If ever we have seen a “hockey-stick” forecast, the forward earnings profile provided by a consensus of analysts shows potentially a misunderstanding of consumer demand. In the online segment, while the company may be taking market share, the comparables to prior years at an industry level are falling similar to most other consumer discretionary items. They would need to take significant market share in order to meet the lofty revenue expectaions.

In each case, we started shorting post earnings result to catch the froth and both short positions are now in profit at the time of writing.

Another curious case is Commonwealth Bank (CBA:ASX). The company's share price now sits on the most expensive valuations (20x+ 1 year forward PE) the company has seen in 20 years and is at a PE premium of over 5-7pts to their large bank brethren. This is against a backdrop of

1. Falling earnings expectations
2. Flat dividend expectations which is important as they generally should behave like a bond as very rarely have they grown earnings over the past 10 years and aren't expected to in the future
3. Target prices by the consensus of analysts is over 20% below the current share price
4. Spread of analyst sentiment is the most bearish it has been in over 20 years as per the graphic below (refer to red circle)



There is only one answer to this conumdrum that seems remotely plausible. Passive ETFs have become such a dominant force in our investing landscape, they are forced to bid the shares up. How long that will last is anyone's guess. Hopefully Blackrock's (Blackrock is the world's largest passive and active manager) recent table-thumping statement that investors should move into actively managed investments now does not fall on deaf-ears. (https://www.bloomberg.com/news/articles/2024-02-27/blackrock-says-new-regime-calls-for-more-active-management)

And now to the really expensive stocks. We have highlighted various dominant growth stocks in the past like Cochlear (COH:ASX), REA Group (REA:ASX) and CSL (CSL:ASX – The Fund has a short position on this as well). Valuations aside, all of these companies are high quality and is why they are able to survive economic cycles easier than most. However, one new segment that is now appearing expensive are the "new-breed" platform providers, HUB24 (HUB:ASX) and Netwealth Group (NWL:ASX). We had been positively disposed to HUB over 2023 but now looking at the equity, seems too hard from a valuation perspective. Both companies trade on 50x 1 year forward PEs with a growth profile that just doesn't seem achievable without significant underlying asset market re-ratings. This is why we remain exposed to the cheap end of town with exposure to quality Fund Managers like GQG Partners (GQG:ASX) which trade on 12x against a 10%+ growth outlook.

Norwood Systems (NOR) Long

The company released their Quarterly Activities and Interim Half Yearly report over the last 2 months. The most significant information or change in language of note were the following declarations in their Half Yearly report (**emphasis added**):

1. "Commenced further commercial discussions for the implementation of Norwood's platform and applications across Singtel **and the entirety of its operating companies** (OpCos)."
2. "Global Master Services Agreement with Singtel: A landmark achievement of the half-year period was the signing of a GMSA with Singtel, a leading Tier-1 CSP, with **700 million subscribers in their operating company (OpCo) network**."

While the company had previously announced Point 2 late last year, putting both together provides a curious update and extension of language to not solely focus on Optus Australia, a 100% operating subsidiary of SingTel (Z74:SES). Based on public updates by the company, their involvement with Optus Australia (10m+ mobile subscribers) had been **our** understanding (as per various company releases) and not a much broader reference to Singtel's mobile footprint (700m+ mobile subscribers). Or perhaps the other combination that seems plausible is that they are referring to their 100% owned OpCos ie SingTel and Optus. We really don't know what this means and whether this change in language was as intended. But suffice to say, if the company does achieve a broader agreement to implant their technology within SingTel much sooner than expected as each of the OpCos move to the cloud (eg SingTel & Telkomsel (170m mobile subscribers) recently indicated a Joint Venture for an orchestration platform for 5G and the Edge), then the valuation of the company will no doubt re-price asymmetrically relative to Optus only, subject to any of the deals completing.

With mobile operators moving to the cloud for various service offerings, the ability to expand services will be enormous. A novel example is to think about Government services, say Healthcare, whereby siloed on-prem data becomes universally available via the cloud to all healthcare professionals, from your GP to your Specialists to the Emergency Room Registrar. The cloud alone means baseload software (mobile-centric) that can operate at an "every day low price" relative to prior generation technology will undergo a dramatic replacement cycle in lockstep with the move to the cloud. Further, an ability to layer various Generative AI applications, either developed in-house or open source, will drive Telecommunication innovation for years to come.

As we alluded to in the last Fund Report for December 2023, the company is now extending the Agentic services to be much broader (as per the statement below) and are now having positive re-enforcement to investigate the applicability of their technologies to Call Centres. We have always thought this was a valid use-case and are glad the company is moving forward on this. With the company's hyperbole aside, if they can secure a Proof-of-Concept and achieve the endpoints of engagement, then they will be well on their way to enormous profitability as its one of the foundational pieces GenAI is being used for to improve company productivity.

"Feedback from global engagements has underscored the potential for CogVoice in revolutionizing Customer Service Call Centres. Recognizing this opportunity, Norwood is engaged in in-depth discussions with several Tier 1 CSPs to tailor the platform for these specific use cases."

As has been the case for many years, it is a waiting game with this company, and we remain hopeful they will be able to provide updates on each of the above over the coming months.

Reporting Season | Longs

The Australian market progressed through the reporting season during February 2024. From a dispersion perspective, there were 94 companies out of the S&P/ASX200 that beat the market (>0.79%) over the month. This to us, is quite lacklustre. But of course, there was devil in the detail and the Fund had "fat-tails" on both sides of the spectrum.

On the downside, our position in Corporate Travel Management (CTD:ASX) was impaired ~20%. We liquidated Day-1 on such a shock outcome. In late October 2023, the company indicated their first half was to be stronger than initially guided in conjunction with a small buyback which led to a rally in the stock over ensuing months. Given they were 4 months into the half, one would have thought the company would have good visibility on the remaining 2 months. But alas, they concluded unforeseen macro issues facing the travel sector plus an underperforming UK contract would lead to material downgrades of circa 17% at least across forecast years. We suspect there is more to the downgrade story and do not believe the company's 5-year aspirational targets that seem to always get further into the distance. We will place this stock in the "too-hard-basket" for the time being even though industry consolidation will continue.

Given the rally in markets over November and December 2023, our classic asymmetric reporting season trade setups were few and far between. What we are looking for is where expectations have been downgraded which is represented in the price. To counter this, we are looking for an expectation of a beat in earnings to supercharge the buying and hopefully for short covering to fuel the fire. One particular example on the upside was Megaport (MP1:ASX). We entered at $9.076 in the lead up to their report. Post the Q2 trading update the near term numbers beat which was contrary to what the company had been expecting. Similarly, guidance on 3Q numbers looked better than expected with the company continuing to invest in Sales resources as products were turned on. Growth in the US was the standout with EBIT margins bouncing due to scale benefits, this essentially igniting the stock post report. Given the markets they are targeting, they will have significant revenue opportunities moving forward. But unlike other companies who portray a desire to do well in the US, we believe the company will succeed as already evidenced in the short run. The Fund is likely to continue holding the company's shares for the foreseeable future. As at the end of the February 2024, MP1 was the best performing stock over reporting season.

Outside of the above fat-tails (MP1: excellent and CTD: sub-par), the Fund had positive contributions from

1. GQG Partners (GQG:ASX) with a continuation of performance following the US market.
2. AGL Energy (AGL:ASX) – Another asymmetric trade leading to a 10% pop on the day of reporting.

Seven West Media (SWM:ASX), was the only other major detractor from performance. Given relative valuations of similar companies as well as a general industry slowdown post various major events, we don't believe the company is a value-trap despite being on near 4x 1 year forward PEs and trading on sub-book. While there will be some underperformance in the short run as Small-Cap managers liquidate as it moves out of the S&P/ASX300 on the 18th of March, after this point we believe this will be a rewarding longer term investment. The Fund has made a lot of money in this name over the years, and we believe not much has changed other than the price is way too cheap.

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 February 2024

	Fund		S&P/ASX 200 AI	
	5 Year	Inception	5 Year	Inception
Alpha (%pa)	-0.7%	-0.4%		
Downside Capture	-7%	26%		
Standard Deviation	10.9%	9.5%	16.3%	13.7%
Sharpe ratio	0.6	0.7	0.5	0.6
Sortino		1.4		1.5
Largest Drawdown	-8.5%	-8.5%	-26.7%	-26.7%
Correlation	-17%	13%	100%	100%

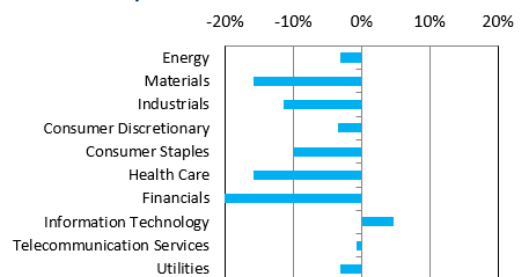
Exposure

	Long	Short	Net	Gross
Equity	51.5%	-7.5%	44.0%	59.0%
Index Futures	0.0%	-21.9%	-21.9%	21.9%
Net	51.5%	-29.4%	22.1%	80.9%
Implied Cash			77.9%	

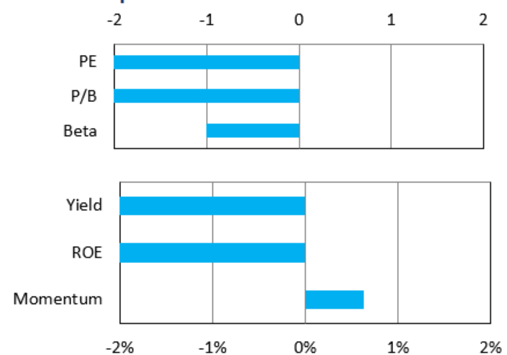
Largest Positions

Long	Short
Karoon Energy	Commonwealth Bank
Norwood Systems	CSL
SteadFast Group	JB Hifi
Telstra	SPI Futures

Sector Exposure

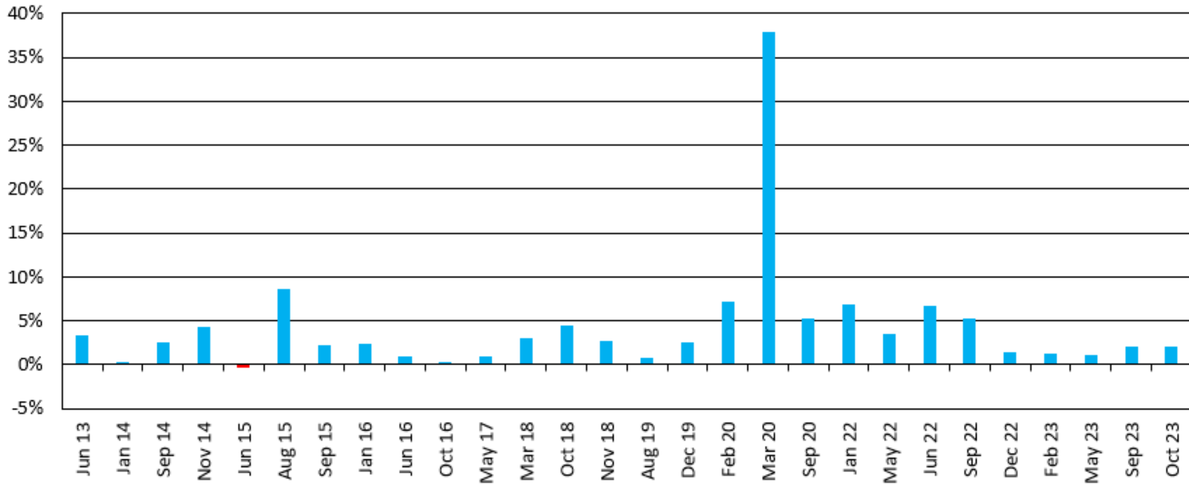


Factor Exposure



Source: APSEC Funds Management

Downside Performance



General Information

Class A - Fund Information (As at 29 February 2024)

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)	1.2500	Application Price (Class A)	1.2513
		Redemption Price (Class A)	1.2487

Class B - Fund Information (As at 29 February 2024)

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)	0.9243	Application Price (Class B)	0.9252
		Redemption Price (Class B)	0.9234

Contact Information

Account Enquiries	n.bryon@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

Equity Trustees Limited (Equity Trustees) ABN 46 004 031 298 | AFSL 240975 is the Trustee for the Atlantic Pacific Australian Equity Fund (ARSN 158 861 155) (Fund). Equity Trustees is a subsidiary of EQT Holdings Limited ABN 22 607 797 615, a publicly listed company on the Australian Securities Exchange (ASX: EQT). APSEC Funds Management Pty Ltd (APSECFM) ACN 152 440 723 is the Investment Manager of the Fund and a Corporate Authorised Representative (CAR: 411859) of APSEC Compliance and Administration Pty Limited (AFSL 345 443 ACN 142 148 409). This publication has been prepared by APSECFM to provide you with general information only. In preparing this information, we did not take into account the investment objectives, financial situation or particular needs of any particular person. It is not intended to take the place of professional advice and you should not take action on specific issues in reliance on this information. Neither Equity Trustees, APSECFM, nor any of their related parties, their employees or directors, provide any warranty of accuracy or reliability in relation to such information or accept any liability to any person who relies on it. Past performance should not be taken as an indicator of future performance. You should obtain a copy of the Product Disclosure Statement (PDS) before making a decision about whether to invest in this product. 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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The historical link to the WithIntelligence Hedge Fund Award can be found here.

https://awards.withintelligence.com/hfmasianperformanceawards2023/en/page/2022-roll-of-honor

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Class A - Return Summary (To 31st January 2024)								
Period	1 mth	3 mth	6 mth	1 yr	3 yr (pa)	5 yr (pa)	Cumulative	Per Annum
Fund Return	3.98%	5.5%	2.8%	-0.8%	6.4%	7.8%	133.7%	8.4%
S&P/ASX 200Acc.	1.19%	14.0%	5.8%	7.1%	9.6%	9.7%	141.7%	8.7%
Excess Return	2.79%	-8.5%	-3.0%	-7.9%	-3.2%	-1.9%	-8.0%	-0.3%

Class B - Return Summary (To 31st January 2024)								
Period	1 mth	3 mth	6 mth	1 yr	3 yr (pa)	5 yr (pa)	Cumulative	Per Annum
Fund Return	4.10%	5.9%	3.5%	0.0%	n/a	n/a	-2.1%	-1.8%
S&P/ASX 200Acc.	1.19%	14.0%	5.8%	13.8%	n/a	n/a	9.5%	8.1%
Excess Return	2.91%	-8.1%	-2.3%	-13.7%	n/a	n/a	-11.5%	-9.9%

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