

Long-Short Quarterly Report – December 2018

Portfolio Performance

As at 31 Dec 2018	3mth	6mth	1yr	2yr p.a.	Net Return S/I p.a.	Total Net Return S/I
Alleron Long-Short*	-6.06%	-7.85%	3.32%	11.93%	15.54%	43.53%
S&P/ASX 100 Acc**	-7.73%	-6.31%	-2.35%	4.13%	7.68%	20.34%
Out/(under) performance	1.68%	-1.55%	5.67%	7.80%	7.86%	23.19%

Performance figures are net of fees and expenses

*Inception date is 1 July 2016

** Performance benchmark

Portfolio Commentary

The Portfolio outperformed a very weak Australian market in the December quarter after a relatively weaker performance in the September quarter. For calendar year 2018, the Fund has outperformed the ASX 100 index by over 5%, rewarding long term investors with +3.32% for the year vs ASX 100 performance of -2.35%.

The Australian market outperformed global markets in the December quarter as the US Fed hiked interest rates and the Chinese economy showed signs of slowing. Resources outperformed as the iron ore price stabilised while Financials and Fund Managers underperformed as continued net outflows and regulatory proceedings provided an increasingly uncertain future outlook.

The Long side of Alleron's portfolio recovered towards the end of the quarter after enduring volatility in September and October. Resmed rose after it announced 2 highly complementary and fast growing acquisitions of connected health solutions companies in the December quarter. Xero's 1H19 report showed that the US became the fastest growing territory with subscriber numbers growing at 62% in the last 6 months. Fortescue rose after it reported its maiden shipment of 60.1% grade iron ore to China.

The Short side of the portfolio added to performance as new positions in building materials stocks like Boral, CSR and James Hardie all fell on concerns with the slowing US economy and sluggish overseas and domestic property markets. Fund managers AMP, Perpetual and Janus Henderson all fell sharply due to net outflows from their core businesses. IOOF was confronted by ASIC alleging it had breached the Superannuation Industry (Supervision) Act, with the share price falling 37% on announcement day.

Portfolio Highlights

Positives:

IOOF Holdings Ltd (Short) – APRA proceedings have sought to impose licence conditions, address corporate governance issues as well as disqualify the majority of current senior executives. The Chairman and CEO have temporarily stepped aside pending further investigations.

AMP Ltd (Short) – The Company sold its troublesome Wealth Protection business at 0.8x embedded value in October while the core Wealth Management business continues to suffer from fund outflows after the Royal Commission.

Perpetual Ltd (Short) – The Company's flagship Perpetual Investments FUM endured its 6th consecutive quarter of fund outflows, highlighting the headwinds faced by the Company and the industry as a whole.

Negatives:

Carsales.com Ltd (Long) – The share price fell after an industry body reported 8 consecutive months of weakening new car sales in Australia. The Company also impaired its Stratton Financing Group despite previously showing signs of remediation of internal problems.

Ramsay Healthcare Ltd (Short) – The share price recovered after a period of underperformance. The Company's European acquisition was finally completed during the quarter, expanding its footprint to Scandinavia, Germany and increasing presence in France.

Treasury Wine Estates Ltd (Long) – The share price fell on growing concerns of the US-China trade war as the slowing economic conditions may dampen luxury good consumption in its 2 most profitable markets, the US and China.

Australian Eagle Trust Long Short Fund - Net Monthly Returns

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FY
2016/17	10.52%	0.99%	-1.08%	-4.14%	2.94%	5.16%	-0.25%	5.15%	-0.06%	1.94%	1.31%	0.36%	24.48%
2017/18	-1.70%	5.27%	0.20%	5.35%	1.05%	1.10%	2.41%	3.08%	-3.86%	4.18%	2.34%	3.60%	25.13%
2018/19	-1.09%	1.45%	-2.24%	-7.62%	-0.53%	2.23%							-7.85%



Market Overview

The Australian market had a volatile quarter as the US-China trade negotiations continued while multiple Chinese data points confirmed fears of a slowing economy. Resource stocks outperformed, Energy stocks fell with the oil price towards the end of the quarter while Financials continued to drift lower with the ongoing Royal Commission. Cochlear announced it has started its next phase of research for a totally implantable cochlear implant. Xero's 1H19 result showed significant improvement in operating cash flow. Wesfarmers successfully spun off Coles Group after shareholder approval.

Portfolio Changes

Increased Exposure:

Coles Group Ltd (+1.50%; New Long): An Australian consumer staples conglomerate. The core Coles supermarket division showed positive sales momentum as it entered the crucial Christmas trading period.

Reliance Worldwide Corporation Ltd (+0.75%; New Long): A plumbing parts company. The Company's acquisition of John Guest in the UK has made it the leader in Push-To-Connect (PTC) plumbing supplies in developed markets.

Fortescue Metals Group Ltd (+1.75%; Long): An Australian iron ore miner. The Company's commitment to low operating costs and a gradual shift to higher grade iron ore will mitigate earnings volatility from the lower grade discount.

Decreased Exposure:

Lovisa Holdings Ltd (-2.25%; Exit Long): A global fast fashion jewelry and accessories retailer. The tough Australian retail conditions have resulted in consecutive sales warnings as the Company's Australian division has increased the overall risk to earnings for FY19.

Origin Energy Ltd (-2.25%; Short): An Australian electricity retailer and oil & gas producer. Government pressure and increased competition are depressing retail margins while the volatile oil price has also dampened the Company's outlook.

James Hardie Ltd (-2.25%; New Short): A building materials company. The core US market is slowing and margin pressure due to rising raw material costs is impacting on growth forecasts. Integration of the European acquisition poses a risk.

Quarter-End Position & Portfolio Exposures

As at 31 December 2018, the fund had a net exposure of 95.70% and gross exposure of 194.51% to equities. Cash was 4.30%.

Major portfolio exposures were to medical devices & services and technology stocks with less portfolio weight in major banks and income stocks.

Stock Highlight

Caltex Australia Limited (CTX) – Short Position

Energy Argument: Alleron previously owned Caltex between 2012 and 2016 when management changed the business focus to its marketing division by closing its Kurnell refinery. Alleron exited after the Company began optimising its balance sheet with its \$270m buyback. The stability in retail earnings was previously underwritten by a lucrative Woolworths fuel agreement which has subsequently suffered a fundamental change in nature after the contract renewal. Management also decided on an expensive and slow roll out to enter its retail network into the fast food and convenience segment. Alleron believes the deterioration of earnings quality and increased capital expenditure have created substantial headwinds for the Company.

Trigger: The short position in Caltex was initiated in late 2016, when Woolworths put its fuel business up for sale and was sold to BP, pending ACCC approval. Despite being blocked by the ACCC, Caltex renewed the Woolworths contract but on significantly worse commercial terms, meaning an ongoing \$80m hit to existing earnings. The contract renegotiation highlighted the risk to earnings this single contract had as well as the increased exposure the company had to a cyclically high earning refining asset.

Outlook: Since Alleron initiated its short position, the Company has doubled its net debt to \$1bn and begun buying back franchises after prolonged negative media attention, costing \$100m-\$120m and eliminating a steady source of franchisee fee income. The Company's convenience retail division has been enduring lower fuel volumes while the Fuels & Infrastructure segment has had increasing exposure to volatile refining margins. The recent acquisitions and capital expenditure programs since 2016 have failed to provide any uplift or stability to earnings and Alleron sees limited upside for the Company in the medium term future.





About the Australian Eagle Trust Long-Short Fund

Alleron is an Australian boutique wholesale fund manager specialising in Australian equities. Alleron's investment process seeks to deliver significant outperformance by identifying mispriced stocks with changing growth profiles and building concentrated portfolios of those stocks.

The Australian Eagle Trust Long-Short Fund aims to achieve strong double digit returns by allowing clients to access Alleron's demonstrated historical strength in constructing Australian share portfolios applied to a long-short product.

Modelling a combination of Alleron's actual long investment performance since 2005 in conjunction with a short selling discipline, suggests that this product can provide strong investment returns along with an alpha performance that is negatively correlated to the broader Australian equity market.

How to Invest

The Australian Eagle Trust Long-Short Fund is only available to investors via the Australian Eagle Trust Information Memorandum that is available on www.alleron.com.au/how-to-invest/. The Information Memorandum offers investors the opportunity to invest a minimum of \$500,000 in the Australian Eagle Trust (the Fund). Alleron has the discretion to waive or vary this minimum requirement.

The offer of units in the Fund are available to investors both resident in Australia and elsewhere receiving this document (including electronically) in Australia or elsewhere who qualify as "wholesale" clients as that term is defined in section 761G and 761GA of the Corporations Act. The Trustee may also accept applications from investors who are otherwise permitted to invest as permitted by the Corporations Act. Investors who are not resident in Australia can invest in the Fund where they are permitted by law to do so. The Trustee and Investment Manager of the Fund is Alleron.

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