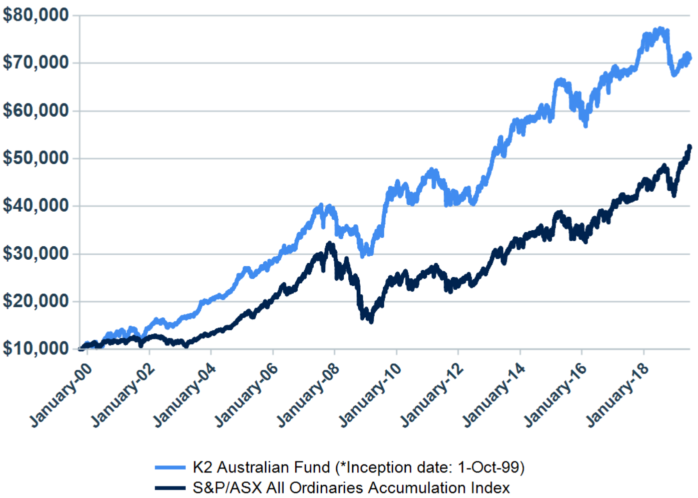
K2 Australian Fund
30 June 2019

The K2 Australian Fund is an Absolute Return equities fund. The fund is index-unaware, aiming to produce positive absolute returns over the long term with a capital preservation mindset. The Fund's mandate allows it to actively manage its net market exposure – utilising both cash and shorts to help protect clients' capital.

	1 Month	3 Months	1 Year	3 Years (%pa)	5 Years (%pa)	10 Years (%pa)	15 Years (%pa)	Inception (%pa)	Inception Date
Performance (Net of Fees)	-0.3%	1.5%	-7.6%	4.4%	4.1%	7.3%	8.3%	10.4%	1-Oct-1999
Average Net Exposure	66.6%	66.6%	60.7%	74.1%	76.8%	81.7%	75.5%	72.0%	

Growth of $10,000



Commentary

The K2 Australian Fund returned -0.3% for the month of June.

During the month, the Reserve Bank of Australia (RBA) reduced the official cash rate to 1.25%; a reduction of 0.25%, with the RBA sighting the disruptive impact that trade disputes were having on global economic activity. In addition, the RBA has seemingly found religion regarding spare capacity in the labour market. The RBA has ratchetted down its estimate of the unemployment rate that would be feasible for an inflation target of 2%; it was previously 5% but has now been revised down to 4.5%. Australia's 2-year bond yield subsequently dropped below 1% on the expectation that more rate cuts were imminent. The ASX All Ordinaries Accumulation Index rose 3.4% for the month as market participants speculated that the convergence in the yield differential between equities and bonds would continue.

The Fund's holdings in BHP, Rio Tinto, and Coronado Global Resources rose on average 9% for the month, as investors continued to embrace supply-constrained resource companies. News Corporation rose 15% for the month and was also one of the Fund's best performers. News Corporation looks compelling on a sum-of-the-parts basis and valuation upside will increasingly be evident as the group optimises its portfolio. During the month, a number of Australian industrial companies revised earnings lower; domestic activity was subdued in the lead up to the election. The Fund's holding in Star Entertainment was a detractor to performance; profits were guided lower following a softening in domestic revenue and a marked decline in turnover within the International VIP operations. The Fund's holdings in Nine Entertainment and JB Hi-Fi gave back most of last month's gains, as investor sentiment swung from post-election optimism back towards pessimism around the vulnerability of near term earnings.

(commentary continued on page 2)

Top 5 Stock Holdings	Current	Monthly Move
Macquarie Group Ltd	7.4%	+1.2%
Westpac Banking Corp	6.6%	+0.5%
Nine Entertainment Co Holdin	4.5%	-0.3%
BHP Group Ltd	3.7%	-1.1%
RIO Tinto Ltd	3.2%	-1.6%

Month End Exposures	Current	Monthly Move
Communication Services	6.7%	-2.1%
Consumer	9.4%	-4.3%
Financials	27.2%	+2.0%
Health Care	2.8%	-2.4%
Industrials	3.8%	+0.1%
Materials	11.8%	-3.4%
Real Estate	3.2%	+1.8%
SHORTS	-3.0%	-1.7%
Number of Positions	**40**	**-2**
Gross Equity Exposure	**68.1%**	**-8.7%**
Cash Weighting	**38.0%**	**+12.1%**
Net Equity Exposure	**62.0%**	**-12.1%**

Fund Characteristics	
FUM	AUD $138m
Portfolio Managers	Campbell Neal, David Poppenbeek, Josh Kitchen and Nicholas Leitl
Strategy	Australian and New Zealand Equities
Objectives	To deliver consistent absolute returns over the investment cycle with a focus on capital protection during periods of market declines
Return Target	+10% pa over the long term
Number of Stocks	Up to 80
Cash	Up to 100% of portfolio
Distributions	Annually
Management Fee	1.31%
Buy/Sell	Daily Application/Redemption
Performance Fee	15.38% pa of the amount by which the NAV per unit exceeds the High Water Mark once the fund achieves its hurdle

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Commentary – continued from page 1

K2's investment process requires discipline and conviction. We look to invest actively when growth opportunities are available. However we are also extremely conscious that wealth truly compounds when long term investment gains are preserved. Having the discipline to recognise when the probability of capital losses rises is one of the more difficult tasks of investing in equity markets. During FY19, we were presented with that unenviable prospect.

You may recall, back in October 2018 most asset markets were dislocating, global markets were contending with the escalation in trade tensions between the US and China, economic activity was suffering and profit projection looked overly optimistic. In Australia, the residential property market was on a downward spiral. The national auction clearance rate was just 50% and property prices had declined for 12 consecutive months. The Banking Royal Commission was in full swing, the Australian Liberal Party had suffered a resounding loss in the Wentworth by-election and the Australian Labor Party (ALP) had shot ahead in the national polls. Households were having to confront the prospect that ALP's policies to reform negative gearing and franking credit refunds would become a reality. Unsurprisingly the Australian equity market declined 7% that month. It was becoming very evident that household wealth was disappearing as rapidly as during the GFC. Equity market liquidity was drying up and volatility was steadily rising. We judged that it was prudent to reduce our net equity exposure and preserve some of the 148% gain the Fund had delivered since February 2009. In addition we made the decision to improve the liquidity of the portfolio. We removed 10 illiquid holdings from the Fund and in doing so we recognised that the basis for the next crisis would be liquidity driven. There was simply too much conformity in equity markets. Momentum was drawing passive money towards companies with ever rising valuations however this strategy was always vulnerable to exogenous shocks; the phrase "it works till it doesn't" comes to mind. Any eventual rotation away from "buying the winners" would have a dramatic impact on share prices. The investing world was becoming increasingly complicated.

Fast forward to January 2019 and the introduction of the word "patient" within the FOMC Monetary Policy Statement excited a number of pension funds. Trade frictions were sufficiently eroding economic prospects such that monetary stimulus needed to be resuscitated. The average 10-year government bond yield for the US, Japan and Eurozone declined 50 basis points over the subsequent 5 months. A handful of words from the FOMC did the equivalent of USD 3 trillion of Central Bank Quantitative Easing (QE). Despite the erosion in company fundamentals, equity market valuations expanded; that is true Central Banking productivity. We were happy to ride the "actual" QE wave between 2011 and 2017. However we believe that front running "potential" QE today is like picking up pennies in front of a steam roller. Regulatory guidelines continue to force insurance companies to buy bonds however it is hard to see why rational investors, even if Central Bankers are on the bid, would be seduced by sub 1% bond yields.

We lifted our net equity market exposure during the second half of FY19, but it was not associated with a lowering of our valuation discount rate. We were encouraged that the final report from the Banking Royal Commission was less prescriptive than first expected. This was followed by the surprising re-election of the Australian Liberal Party; government policy would most likely tilt towards capital efficiency and as a result wealth accumulation would not be discouraged.

Australia should now be entering a period of relative stability. Political leadership should be assured for the next three years and policy consistency should follow. We believe it is increasingly likely that Australia's "animal spirits" will re-surface towards the end of 2019 and as a result 2020 could be a year of growth. We would expect to see a revival in the level of business leader and household confidence. This should lead to a lift in business investment along with an improvement in household consumption. Ultimately, we feel that boards of Australian listed companies should now prioritise the re-investment of profits in the pursuit of growth. In our view, dividend payout levels should decline and return on equity needs to ultimately rise. Should signs of improvement begin to emerge on the horizon, the Consumer and Industrial sectors will provide substantial upside for investors. This space has been a value trap over the current cycle, as valuations have tracked earnings expectations down. If the operating environment does improve, then a positive earnings outlook combined with valuation support is a recipe for strong shareholder returns.

Over the course of the past two months, we have increased our overall exposure and in light of the relative stability, remain cautiously optimistic for equity markets. We remain cognisant of valuations and will continue to hunt for companies that show strong growth characteristics at valuations we believe are more appropriate.

K2 Australian Fund Net Monthly Returns in AUD

Year	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Fin YTD	Fin YTD Index (1)	Average Cash	Average Short
1999/00				1.9	2.0	9.5	-3.9	-2.6	5.6	-4.0	-1.9	2.4	**8.5**	16.0	*52.0%*	*-12.8%*
2000/01	13.1	6.8	-3.1	0.1	4.5	0.9	4.5	-2.9	-11.9	13.0	5.2	0.5	**32.2**	8.8	*27.7%*	*-16.7%*
2001/02	-7.9	-4.8	-5.4	8.7	11.5	1.8	3.9	3.5	-0.2	-0.4	2.7	-2.7	**9.5**	-4.5	*32.1%*	*-14.6%*
2002/03	-6.3	3.6	-0.9	1.7	1.6	4.3	1.8	1.2	-0.2	2.2	0.7	1.5	**11.2**	-1.1	*51.6%*	*-14.4%*
2003/04	3.7	7.0	1.6	2.5	-1.2	2.9	0.4	1.4	0.5	-0.1	0.3	2.2	**23.2**	22.4	*36.0%*	*-3.7%*
2004/05	3.1	1.4	4.2	4.5	3.7	1.4	3.8	0.3	-2.0	-3.4	0.8	3.2	**22.6**	24.7	*26.9%*	*-5.2%*
2005/06	1.3	0.7	3.9	-3.2	3.7	1.4	1.7	0.5	3.5	1.9	-0.4	2.0	**18.3**	24.2	*27.6%*	*-3.9%*
2006/07	-0.9	2.3	1.5	5.8	0.4	3.0	1.0	0.5	3.0	2.7	3.5	0.2	**25.3**	30.3	*32.2%*	*-4.9%*
2007/08	-0.6	-1.5	2.6	0.9	-1.9	-0.3	-9.3	-0.4	-1.5	1.6	0.9	-2.3	**-11.6**	-12.1	*51.1%*	*-8.2%*
2008/09	0.3	2.8	-5.8	-5.6	-3.8	3.4	-1.6	-1.2	5.7	4.7	0.9	2.9	**1.9**	-22.1	*46.6%*	*-3.4%*
2009/10	7.2	7.4	5.1	-1.0	1.8	3.5	-4.0	-0.2	3.5	-0.6	-5.7	-0.9	**16.3**	13.8	*10.3%*	*-2.6%*
2010/11	2.1	-1.1	4.7	3.3	0.1	3.4	-0.5	1.9	0.0	-1.6	-1.7	-0.8	**10.0**	12.2	*14.1%*	*-4.0%*
2011/12	-3.4	-0.6	-4.8	3.7	-2.8	-2.1	3.1	1.9	1.9	-0.2	-5.5	-0.4	**-9.2**	-7.0	*23.3%*	*-3.5%*
2012/13	3.3	2.9	1.2	3.6	0.1	3.1	4.5	4.5	0.3	4.5	-2.8	-1.4	**26.1**	20.7	*7.2%*	*-0.2%*
2013/14	3.3	1.3	4.6	2.5	-0.3	0.1	-2.3	2.2	1.7	-0.1	0.0	-0.9	**12.5**	17.6	*11.7%*	*0.0%*
2014/15	2.8	1.6	-2.0	2.0	-0.8	-0.7	3.5	6.2	0.4	-0.3	1.2	-3.0	**11.0**	5.7	*18.5%*	*-0.3%*
2015/16	1.6	-4.1	-2.7	3.4	-0.6	-1.7	-3.8	-1.4	4.4	3.1	2.2	-3.1	**-3.2**	2.0	*19.8%*	*-0.3%*
2016/17	5.1	1.3	1.3	-1.4	0.0	2.9	0.2	-1.6	1.0	-0.1	0.1	0.0	**9.0**	13.1	*16.7%*	*-1.5%*
2017/18	1.0	0.3	0.5	2.9	1.8	3.2	0.8	0.7	-2.7	1.7	0.7	1.6	**13.1**	13.7	*21.6%*	*-3.7%*
2018/19	0.4	-1.4	0.1	-7.2	-2.4	-1.2	0.1	2.4	0.2	1.4	0.3	-0.3	**-7.6**	11.0	*39.3%*	*-3.3%*
												Incept	**611.0**	422.6		
												Incept	**10.4%pa**	8.7%pa	***28.3%***	***-5.4%***

(1) S&P/ASX All Ordinaries Accumulation Index