

K2 Australian Small Cap Fund (Hedge Fund)

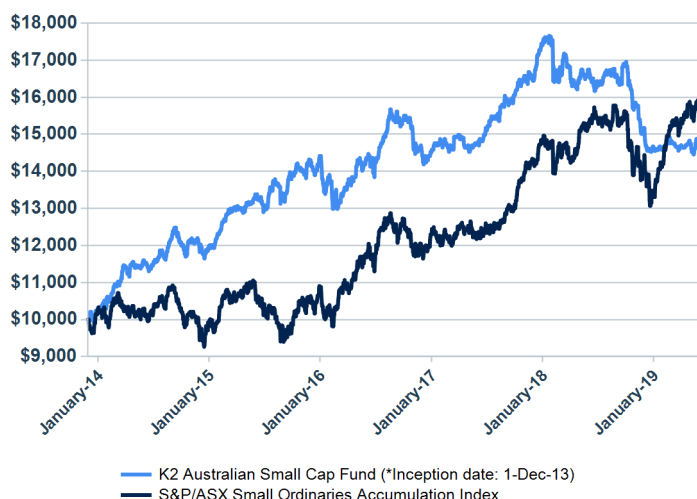
31 May 2019



The K2 Australian Small Cap 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 Funds' 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)	Inception (%pa)	Inception Date
Performance (Net of Fees)	0.3%	0.3%	-11.2%	1.3%	5.1%	7.5%	1-Dec-2013
Average Net Exposure	56.9%	50.5%	56.9%	73.5%	76.5%	74.8%	

Growth of \$10,000



Commentary

The K2 Australian Small Cap Fund returned 0.3% for the month of May.

The ASX Small Ordinaries Accumulation Index fell -1.3% in May, underperforming the ASX 100 Accumulation Index by -3.4%. Defensive sectors, led by Utilities (+7.5%) and Telco (+4.5%) performed best, while Consumer Staples (-8.2%) and Energy (-7.5%) lagged.

The Small Ordinaries Index currently trades on a one-year forward PE of 16.4x, with Small Industrials Index trading on 19.8x, a 14% premium to its 5-year average. Despite tough operating conditions and stagnant earnings over the past 2 years, strong earnings growth (+12.3%) is expected for small industrial companies in FY20.

The Fund benefitted from a short position in Costa Group in May. Late in the month, Costa provided a trading update in which NPAT was downgraded by 16% at the mid-point of present guidance. The company pointed to a range of factors that impacted their trading in May, which caused profits to fall short of expectations. While we positively rate Costa management and the business they operate, we felt that the valuation did not fully reflect the potential volatility in earnings.

The Fund's net equity exposure increased to 65% in May. Two key events have unfolded in 2019 which show cause for optimism on the domestic economy; a more benign outcome of the Banking Royal Commission and a Coalition victory. These outcomes, along with cuts to the RBA cash rate and APRA's easing of interest servicing buffers, should see a stabilisation of clearance rates and house prices. While this will not provide an immediate domestic economic uplift in data, we should see an improvement through the back half of the year. Plummeting bond yields across the world have continued to push valuations higher, particularly for long duration assets and high growth companies. However, with signs of economic tailwinds on the horizon, the focus may shift back to 'traditional' business models with attractive valuations.

Top 5 Stock Holdings	Current	Monthly Move
Cedar Woods Properties Ltd	4.5%	+0.9%
Elanor Investor Group	4.5%	+0.8%
Ooh!Media Ltd	4.0%	+1.9%
Seven Group Holdings Ltd	3.3%	+0.4%
Coronado Global Resource-Cdi	3.2%	+0.8%

Month End Exposures	Current	Monthly Move
Communication Services	4.0%	+1.9%
Consumer	13.5%	+2.7%
Financials	15.2%	+2.1%
Health Care	8.8%	+0.6%
Industrials	13.1%	+3.8%
Information Technology	0.9%	-0.8%
Materials	7.1%	+1.3%
Real Estate	4.7%	+0.5%
Utilities	1.1%	+0.4%
SHORTS	-3.3%	-1.2%
Number of Positions	39	+2
Gross Equity Exposure	71.7%	+13.7%
Cash Weighting	34.8%	-11.4%
Net Equity Exposure	65.2%	+11.4%

Fund Characteristics

FUM	AUD \$20m
Portfolio Managers	Campbell Neal, David Poppenbeek, Josh Kitchen and Nicholas Leitl
Strategy	Australian and New Zealand Small Cap 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 100
Cash	Up to 100% of portfolio
Distributions	Annually
Management Fee	1.31%
Buy/Sell	Bought and Sold on the ASX market (ASX: KSM)
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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K2 Australian Small Cap 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
2013/14						2.9	3.2	3.1	4.4	0.4	1.2	-1.3	14.5	1.1	41.9%	0.0%
2014/15	3.6	2.6	-0.7	0.5	-1.0	-0.4	2.6	4.5	1.4	-0.2	2.2	-2.1	13.5	0.4	22.5%	0.0%
2015/16	5.7	-2.8	3.6	1.6	1.3	1.2	-4.0	-5.8	4.8	3.3	1.2	-0.4	9.6	14.4	12.5%	-0.2%
2016/17	4.8	3.1	0.0	-1.5	-3.8	-0.4	1.6	-1.5	3.1	-2.3	0.8	2.8	6.5	7.0	15.9%	-0.5%
2017/18	2.1	3.6	0.1	2.9	-0.2	5.9	-0.3	-3.4	0.0	-2.1	1.7	-1.9	8.3	24.2	21.3%	-2.0%
2018/19	1.8	-1.0	2.1	-6.3	-4.2	-3.3	-0.4	1.5	-1.1	1.0	0.3		-9.5	1.0	45.4%	-4.0%
												Incept	48.7	56.0		
												Incept	7.5%pa	8.4%pa	26.6%	-1.1%

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

DISCLAIMER: Returns are shown after fees (including performance fees) and expenses have been deducted and assume the reinvestment of income distributions. Please note that past performance is not a reliable indicator of future performance. The information contained in this document is produced by K2 Asset Management Ltd ("K2") in good faith, but does not constitute any representation or offer by K2. It is subject to change without notice, and is intended as general information only and is not complete or definitive. K2 does not accept any responsibility, and disclaims any liability whatsoever for loss caused to any party by reliance on the information in this document. A product disclosure statement or information memorandum for general information on any Fund referred to in this document can be obtained at www.k2am.com.au or by contacting K2. You should read the product disclosure statement and consider whether the product is appropriate for you before making a decision to acquire or continue to hold an interest in a Fund. Fees referred to in this document are inclusive of GST and RITC and do not include expense recoveries.