

# K2 Global High Alpha Fund

## 31 December 2018



	1 Month	3 Months	1 Year	3 Years (%pa)	5 Years (%pa)	Inception (%pa)	Inception Date
Performance (Net of Fees)	1.6%	-8.5%	-9.4%	1.2%	7.2%	15.5%	1-Dec-2009
Average Net Exposure	24.3%	49.9%	76.7%	78.6%	82.7%	82.3%	

### Growth of \$10,000



Top 5 Stock Holdings	Current	Monthly Move
Metlifecare Ltd	3.4%	0.0%
Pioneer Credit Ltd	3.4%	0.0%
Cedar Woods Properties Ltd	3.2%	-0.1%
Elanor Investor Group	2.9%	-0.1%
Axesstoday Ltd	1.6%	-0.3%

Month End Exposures	Current	Monthly Move
Communication Services	0.9%	0.0%
Consumer	6.2%	-0.2%
Energy	0.7%	0.0%
Financials	10.9%	-2.7%
Health Care	7.6%	-1.7%
Industrials	1.5%	+0.2%
Information Technology	3.3%	+0.3%
Materials	0.0%	-0.8%
Real Estate	3.7%	-0.4%
SHORTS	-12.3%	-3.1%
Number of Positions	52	+4
Gross Equity Exposure	47.0%	-2.3%
Cash Weighting	77.6%	+8.4%
Net Equity Exposure	22.4%	-8.4%
Currency Exposure Hedged of AUD	1.4%	-41.3%

### Commentary

The K2 Global High Alpha Fund returned 1.6% for the month of December while global equity markets returned -3.6%.

Our underlying investment philosophy of capital preservation saw the Fund reduce net equity exposure through increased cash holdings and short positions as the risk of a shock to global growth gained momentum. This ability to protect capital when market conditions change provided significant benefit to investors in December.

Positive contributors to performance were dominated by short positions in consumer discretionary names such as Malibu Boats, L Brands, H&M, Carnival and Harley Davidson as rising US interest rates impact spending capacity amid a generally downbeat retail environment. With markets falling, it was tough to make money from long positions, however the Fund's position in Rio Tinto managed to post a positive return and global mining stocks edged higher.

Large detractors for the month included small cap companies Metlifecare, the New Zealand operator of retirement villages and nursing homes, Medical Developments as buyers became shy in a tough market environment. Globally, positions in China Taiping Insurance and US healthcare provider Anthem also detracted.

Holding significant levels of cash also aided the Fund's performance. The Fund's net equity exposure was reduced further early in the month to sit near 22% as we continue to watch economic and earnings events with trepidation. Our current base case entering 2019 is one of extreme caution. The new year looks as if it will throw up numerous challenges for equity markets. The change in rhetoric from the Federal Reserve and the recent fall in US 10-year yields below 2.8% point to lower growth expectations for the US economy, supporting our position that the Fed

(commentary continued next page)

Fund Characteristics	
FUM	AUD \$32m
Portfolio Managers	Campbell Neal, David Poppenbeek, Josh Kitchen, Nicholas Leilt, James Soutter and Tony Sutton
Strategy	International 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 120 stocks
Cash	Up to 100% of portfolio
Distributions	Annually
Management Fee	2.05%
Buy/Sell	Monthly Application/Redemption
Performance Fee	20.5% of the amount by which the NAV per unit exceeds the High Water Mark

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## **K2 Global High Alpha Fund**

### **Commentary – continued from page 1**

would have to step away from its overly hawkish stance. Cost inflation is also eating into corporate margins, which has been evident through US and European earnings seasons of late. We are cautious on the global consumer and currently the Fund's positioning stands "net short" Consumer Cyclical. The cost of rolling corporate debt is becoming more onerous with the BBB spread over treasuries hovering around 1.75%, up from 1.3% at the beginning of 2018, further highlighting credit implications for highly indebted corporates. The risk spreads on European high-yield debt are even more substantial. Moves in the credit markets have historically been a precursor to recession and although they can provide false indications, it is another data point that raises concern.

Australia is facing a number of problems that have accumulated from a twenty-seven year economic expansion. Households are struggling with their budgets as the impact of higher power prices, rising health costs, higher education costs, falling property prices and stagnant wage growth, combined to subdue consumer confidence. The Banking Royal Commission has seen the major banks restrict the supply of credit, impacting what is the greatest store of wealth for Australians - housing. The credit-crunch may place the Australian economy close to recession in 2019, which does not bode well for equities. The Australian Federal election likely scheduled for May 2019 and a number of foreshadowed capital/investor unfriendly policies proposed by the Labor Party, will also prompt investor, business and consumer caution over the next five months. Australia is also exposed to an economic deceleration of the Chinese economy. China is Australia's largest export client and may also be at risk from the consequences of a US-China trade deal, to the extent that China must buy more US exports that could partially be funded from Australia.

The Fund returned to a fully unhedged position in December noting in particular a worsening Australian economic environment and the recent 25bps rise in the US base rate. We expect the US to maintain a 1.0-1.5% margin over Australia short term interest rates in 2019 which will keep the Australian dollar under pressure. This interest rate differential combined with a worsening outlook for the Australian economy as house prices fall amidst a credit-crunch justify the unhedged position.