Sestante Global Macro Fund

Monthly Investment Report as at 28 February 2018

Asset Class

Alternatives

Investment Objective

To outperform the RBA Cash Rate +2% p.a. before fees with volatility of less than 4% and low correlation to traditional financial markets over rolling 1 year periods.

APIR Code

PAT5878AU

ARSN

619 981 752

Fund Inception Date

6 September 2017

Benchmark

Unaware

Buy/Sell Spread

Nil

Management Costs

1.89% p.a.[1]

Distribution Frequency

Annually

Minimum Investment

$20,000

Fund Size

$2.7m

Exit Price

$1.0191

Market Review

US interest rates continued their sharp move higher in February, with both the front end and the back end selling off, as US wages accelerated at their fastest pace in 9 years. As a result, global fixed income (hedged back to the Australian dollar ('AUD')) (-0.23%) was down for the second month in a row, extending its decline since the beginning of the year to -0.91%. Conversely, Australian fixed income (up 0.29%) closed positive, fully recovering the ground lost in January, as the 2, 5 and 10 years bonds moved 3 basis points, 4 basis points and 1 basis point lower at 2.00%, 2.37% and 2.81%, respectively.

The US dollar ('USD') finally caught a bid after touching its lowest level since December 2014 and was up versus all major developed currencies. Conversely, the Australian dollar was weaker across the board, down 3.25% against the US dollar, 1.63% against the Euro and 5.58% against the Japanese yen, however it was up against Emerging Market foreign exchanges. The softening of the domestic currency greatly reduced the losses generated by international equities, as the MSCI AC World Daily TR was down 4.20% (in USD terms) and 0.98% (in AUD terms). Not surprisingly, US outperformed Europe and emerging markets, as it mostly does during "risk-off" periods of time. Japan was the best performing market as investors sold the Australian dollar and bought back the yen to close their carry trades. The domestic equity market outperformed its global peers, as the S&P/ASX 300 TR (up 0.34%) bucked the trend, led higher by the top 20.

Financials (in particular banks), industrials, consumer staples and health care were the key performing sectors. Materials closed positive while resources were down, together with energy, consumer discretionary, telecommunication services and utilities. Smaller companies were flat. The AREITs came under severe pressure, as real assets around the world tumbled. Property and infrastructure were down 6.26% and 5.32%. At the end of February, performance for the former was negative on a 12 months horizon, while the latter had almost given back all the returns accumulated in the same period of time. Finally, alternatives were down 2.54% as managed futures strategies posted their worst monthly return on record and short volatility strategies were crushed by a 120% surge in the VIX index.

Performance Review

The Sestante Global Macro Fund (the 'Fund') returned -0.33% (net) for the month.

February was a turning point as the Goldilocks market defined by low volatility and risk-on ended, mostly due to exogenous economics risks, however this was having an important impact on the market. The investment manager increased the Fund's protection during December and January by buying Volatility index ('VIX') and this trade helped to navigate the risk-off movement. The Fund was at the epicentre of the risk-off trade as the volatility spiked more than 100%. The Fund took profit on all volatility trades. Unfortunately, the Fund's long position in equity suffered a stiff sell off and did not manage to recover over the remainder of the month. Asian equities and European equities were the laggards on the equity market. Another area of underperformance was exposure to Emerging Markets bonds. This position suffered due to the increase of the 10 Year US Treasury and the general widening of bid offer spreads. The investment manager believes over the next few months the fund will recover the performance as they believe bid offer spreads will tighten.

Performance

	Growth Return (net) (%)	Income Return (net) (%)	Total Return (net) (%)
1 month	-0.33	0.00	-0.33
3 months	0.70	0.00	0.70
1 year	N/a	N/a	N/a
3 years (p.a.)	N/a	N/a	N/a
Since inception[2] (p.a.)	1.91	0.00	1.91

Past performance is not an indication of future performance. Net performance figures are calculated using exit prices, net of fees and reflect the annual reinvestment of distribution.

[1] Estimated management cost as at 30 June 2017. Refer to PDS for full breakdown of management costs.

A Performance Fee of 10% may be payable. Refer to PDS for further details.

[2] This figure represents the annualised performance of the Fund since inception.

Contact Details

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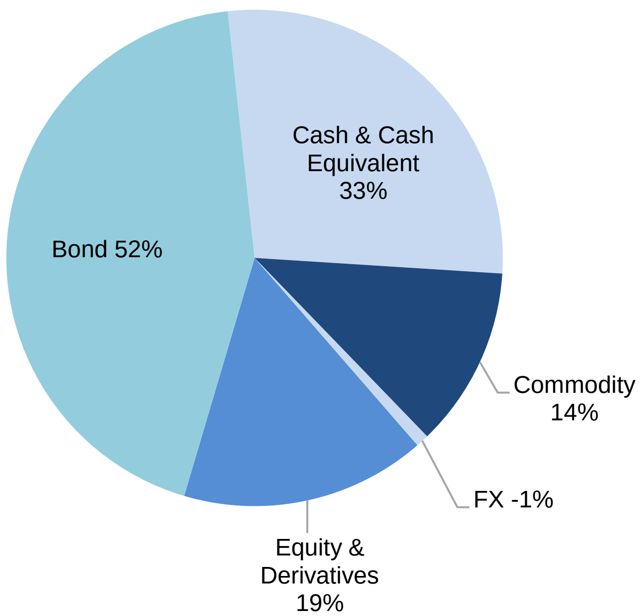
Outlook

The low recorded by the S&P 500 on the 8th of February has held so far. Divergences abound as the subsequent recovery has been uneven. US and Big Tech, the leadership of the previous rally, have rebounded sharply, while the rest of the market much less so. Interest rate sensitive sectors in particular have continued to move steadily lower, accumulating in the space of 6 months a record underperformance only seen at the height of the dot-com bubble. Conversely, emerging markets and global financials have maintained their good momentum through and after the correction.

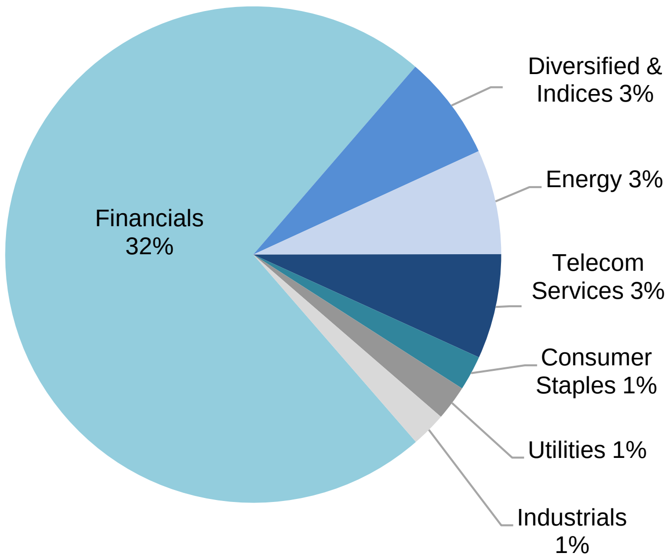
While the market continues to adjust to the new reality of higher rates, US dollar and US duration have emerged as the clear losers. Not surprisingly, if we consider that the US is at the epicentre of the current inflation scare. Both assets are over sold and they may rebound, as is often the case when the consensus is universally bearish on a specific asset class. Nonetheless, from a strategic point of view, their role in a diversified portfolio will come increasingly under scrutiny and their allocation may be diminished in the long term. Simply put, up until today these two asset classes have been largely considered a “hedge” in times of volatility, however as the latest correction has demonstrated, they may have ceased to perform that function. US rates were in fact higher as the market was lower, while the US dollar was unable to stage a significant rally. If that was not enough, in February the entire US interest rate curve up to 10 years traded at higher yields than its Australian counterpart, a condition which has no precedent in the last 30 years. In the investment managers it is not an anomaly, however the natural outcome of divergent economic performance and monetary policy between the two countries. Hence, for the Fund’s fixed income investments the investment manager will continue to source the duration risk primarily on the domestic market. Furthermore, as the gradual increase in US rates leads to sporadic explosions of volatility, the Fund will continue to steer clear of managed futures funds in alternatives. These strategies typically hedge their equity exposure with US fixed income, a dangerous combination in the current and foreseeable market environment.

Underlying Fund Portfolio Summary

Asset Exposure



Bond Exposure- Sector Allocation



Important Information

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