



ASX ANNOUNCEMENT

Sydney, 14th August, 2018: Fat Prophets Global Contrarian Fund (FPC) announces a Disclosure pursuant to ASX Listing Rule 4.12

Dear Shareholders,

The month of July proved to be a frustrating time for the Fund with initial strong gains in the first half of the month eroded in the last few weeks with downward pressure on rising trade tensions coming through in China and Hong Kong stocks markets. Despite one of the best quarterly reporting seasons in the US, the S&P 500 also failed to push above the January highs, as investors rotated out of the technology sector. With the benefit of hindsight, we should have been much quicker to lock in the large unrealised profits that accrued earlier this year.

During the month, **we continued to place the Fund into a much more defensive position and eliminated leverage.** We believe this is appropriate given the volatility. We are of the view that the second half of 2018 could produce further volatility, but this could also be a time of great “trading opportunities” around core holdings. The Fund is now in a position to capitalise on this.

Pre-tax and post-tax net tangible asset backing per share in the Global Contrarian Fund as at 31 July 2018 **decreased by 1.6% and 0.91% respectively to \$1.1048 and \$1.1068** on the previous month's net tangible asset backing.

Markets which we continue to hold a high conviction on, Japan and China, underperformed as the trade rhetoric heated up. The last six months has been unpredictable with the Chinese market alone losing close to 30%. Some of our positions proved not immune to the broader selloff.

| | 31-Jul-18 | 30-Jun-18 | Change |
|--------------|-----------|-----------|---------|
| Pre-Tax NTA | 1.1048 | 1.1228 | (1.60%) |
| Post Tax NTA | 1.1068 | 1.1170 | (0.91%) |

Shareholders will be equally frustrated, **but the markets have been challenging offshore, particularly in Asia and Europe, while Australia has been relatively insulated by the lower A\$.** The US was helped by the ongoing upward momentum in the quarterly reporting season.

According to Reuters, 85% of the S&P 500 companies that have reported on quarterly performance, have beaten bottom line expectations. The S&P 500 has struggled to push above the all-time high in January, although July concludes the best month in terms of performance since then. **We think the critical issue is that if one of the best quarterly reporting seasons cannot be the catalyst for a renewed push to the upside – what can? Is this as good as it gets?** The next few months are going to be critical for the US markets in terms of price action.

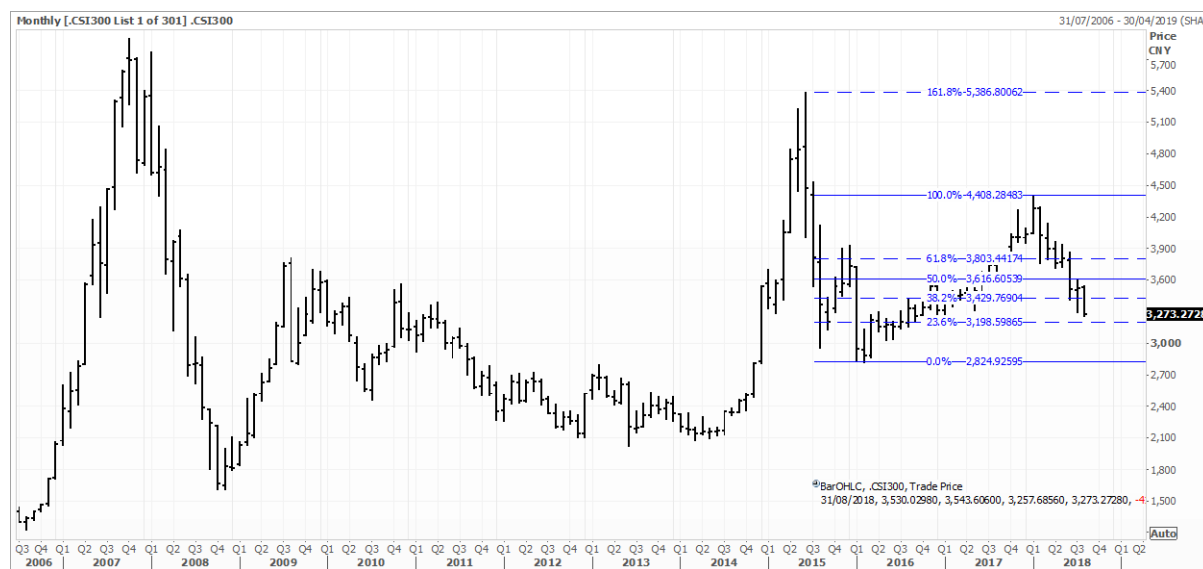
China's CSI 300 has had tumultuous 2008, buffeted by trade tensions in recent months which has taken its toll on the stock market. **The CSI 300 has fallen close to 30% this year, which has eroded close to 80% of the gains of the bull run during 2017.** However, the index has yet to fall below the low of 2015.

On balance, we think China's stock market has to be close to forming a significant bottom with the forward PE ratio now below 10 times earnings. In 2009 and 2015, China's stock market

bottomed out on a similar if not slightly higher multiple. Valuation support should now begin to provide a foundation for the broader market, as sentiment begins to diverge from underlying price action.

The Dow Jones bottomed out at 8 times earnings in the 1930s following the Great Crash of 29. So, a 10 times price earnings multiple for both China and Hong Kong must be relatively “cheap,” especially considering the above average growth rates in the Chinese economy.

CSI 300



The Hong Kong stock market has been caught up in the broader selloff in China this year, losing close to 18%, which represents a Fibonacci retracement of 31.2%. Similarly, to the CSI 300, the Hang Seng is now valued at a price earnings multiple of around 10 times earnings. And like China, this represents a depressed bear market valuation, caused in part by the ongoing trade spat with the US. **Sentiment is resolutely bearish but any sign of the trade dispute being settled could be the catalyst for an explosive rally.**

Bear market cycles tend to be sharper but much shorter than bull market cycles. The last major bear market cycle in Hong Kong began in late 2007 when the Hang Seng topped out above 32,000 and a 70% decline then ensued for around 15 months. The Index bottomed out at around 11 to 12 times earnings.

We are currently 6 months into the latest bear market cycle in Hong Kong and Chinese equities, and while further falls cannot be ruled out, this cycle may prove to be shorter in duration than 2009. Consequently, **the Hang Seng may well be very close to a bottom, particularly with valuation support now becoming very prominent.**

We have warned on the high valuations of the super-IT stocks, and following Netflix, and Facebook, we have seen another share spill in the form of Twitter. Despite being President Trump’s favourite communication tool, the stock slumped 20.5% after reporting that its number of monthly users dropped in the latest quarter and could continue to slide as it strives to shut down fake accounts. ‘Fake news’ is important news it seems.

According to Bloomberg, **since Facebook has reported, around \$240 billion has been erased from the market capitalization of the S&P 500 Information Technology Index,** which now stands at \$6.3 trillion. While **the FAANGS have clearly ‘lost some of their bite,’** they have not been alone, with weaker sentiment spilling over to the broader tech sector.

We have expressed caution about the valuation of the large tech darlings in the US, and particularly several constituents of the FAANG fraternity. Valuations for the collective in our view have become stretched and opened up the prospect of a broader market fallout given how ‘over-owned’ the segment has become.

Nasdaq 100 is struggling to maintain upward momentum



Bloomberg reported that **US Treasury Secretary Steven Mnuchin and Chinese Vice Premier Liu He had been speaking** privately as *“both sides sought to restart negotiations and avoid a full-scale trade war.”* We think that as the US moves closer to the mid-term primaries in November - a crucial test for the Government - the Trump Administration **will look to tone down rhetoric and “consolidate its narrative” before the elections.**

The strategy of *“rocking the boat and shaking things up”* has boosted support for Trump, which is near a post electorate high, **but it would now make more sense to ‘consolidate’ ahead of the elections.**

The US corporate sector has delivered one of the strongest quarterlies in terms of earnings, but the rhetoric from CEOs has been very cautious on trade. **And the US corporate sector is perhaps the one voice that is something Donald Trump will finally listen to.** Killing the goose that lays the golden eggs can only have negative political consequences for the Republicans.

Who knows what the Trump Administration will be capable of if political support does not run their way in the mid-term primaries in November, which is just three months away. Donald Trump does not see himself as being a “one termer”, so an adverse result in the polls could intensify political uncertainty over the last two years of his term. He wants to be able to go to the Mid-Term Primaries and hold China up as a *“trade trophy”* so we could see tensions on this front begin to settle down as we move closer towards November.

The Federal Reserve concluded its latest FOMC and said that economic growth has been rising strongly and the job market has continued to strengthen while inflation has remained near the central bank's 2% target since its last policy meeting in June.

The FOMC statement went on to say that *"job gains have been strong, on average, in recent months, and the unemployment rate has stayed low. Household spending and business fixed investment have grown strongly."* It was "notable" that the policy statement made no mention of the administration's protectionist trade policies and maintained that the risks to the outlook were "roughly balanced." **Market reaction to the Fed decision was muted.**

The US 10-Year T Bond yield nudged above 3% for the first time since early June and the concern is that a recession is looming for the US and global economy. We think that call is premature, but there can be no question, investors are flocking to bonds as a flight to safety. Our view is that the US yield curve will steepen and normalise once the trade rhetoric dies down.

US 10-Year T Bond



We have commenced **placing our portfolios on a defensive footing and will further take advantage of any strength in the US and Global stock markets over the coming months** to make additional adjustments ahead of what could be a volatile fourth quarter.

The Nikkei 225 continues to consolidate above the breakout level of 21,000. What is supportive of the Japanese equities apart from low valuations and improving economy, is a changing mindset amongst the Japanese themselves, **most generations have been subdued by decades of deflation.**

Nikkei 225



The BOJ maintained key features of its current monetary policy framework but made some significant tweaks. The central bank kept its interest rate targets steady but for the first time adopted a forward guidance on future policy, saying it will keep rates "very low" for an "extended period of time." **The central bank also said it would "allow yields to rise more naturally and could slow asset buying" if market conditions allowed. This should be supportive of the banking sector where we hold multiple names.**

Turning to the portfolio, the most significant change made was a reduction in leverage at the beginning of the month. We sold down the portfolio across the board to achieve this objective and exited some specific names.

The Fund is currently carrying minimal levels of gearing after further sell downs in the first week of August. We subsequently narrowed the portfolio reducing the overall number of companies.

Changes made in the month of **July** included reducing our precious metal exposure in the face of US dollar strength and selling **out** US silver and gold miner **Coeur Mining**. We also reduced holdings in **Walt Disney**, **Van Eck Junior gold miner's ETF**, **Telepizza**, **Caixabank**, **Baidu Inc** and **Powerhouse Energy Group**. We added to our **Reliance Industries** position and traded around one of our core holdings, **Sony Corp**.

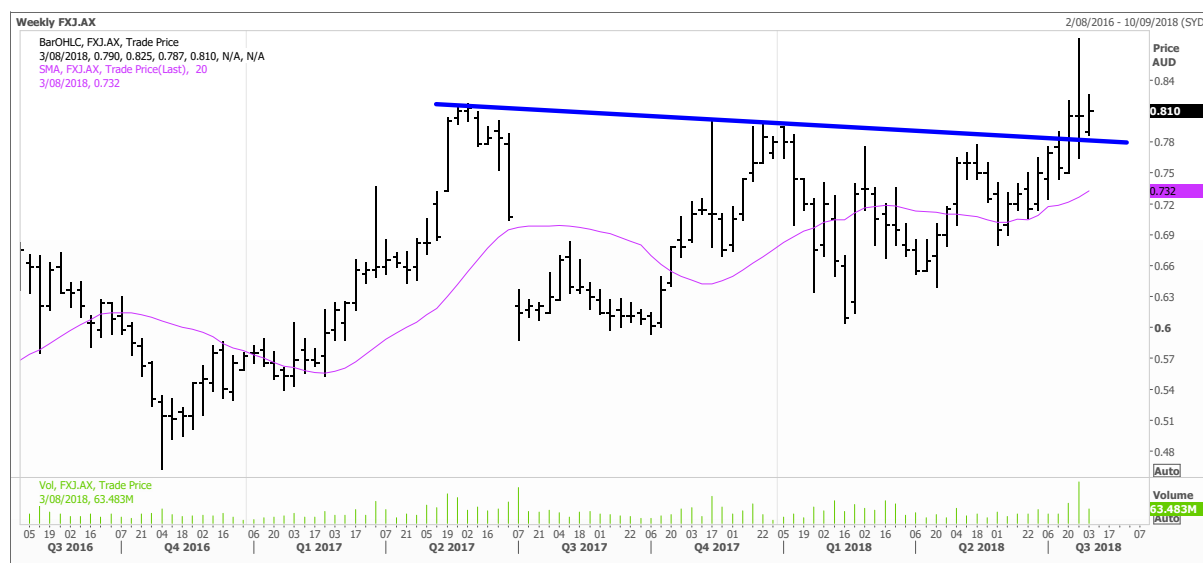
Top performers for the Fund during the month came from **Reliance Industries (+21.7%)**, **Fukuoka Financial Group (+9.69%)**, **Mitsubishi UFJ (+9.24%)** and **Walt Disney (+8.35%)**. Stocks that weighed on the portfolio were the casino stocks **Wynn Macau**, **MGM China** and Australian gold miner **Evolution Mining**.

Shares in **Fairfax Media** sprung further into life last week, hitting a nine year high, after the announcement of one of the biggest media deals ever seen in Australia. Nine Entertainment is effectively buying Fairfax for \$2.16 billion. Under a Scheme of Implementation Agreement, Fairfax shareholders will receive 0.3627 Nine shares and \$0.025 in cash for each Fairfax share. Nine shareholders will own 51.1% of the combined entity, while Fairfax shareholders would own the remaining 48.9%.

The offer translates to around \$0.94 per Fairfax share, representing a premium of 22.1% to Fairfax's last closing price. The shares have been running in recent weeks, with the 'smart money' clearly aware that something big was brewing. We see the deal as a 'sign of the times' and a good

outcome for shareholders. The transaction also has positive implications for **Domain Holdings Australia**.

Fairfax Media



Video game developers and publishers reported solid numbers for the second quarter. **Nintendo's** operating profit hit ¥30.5 billion, up 88% from a year earlier and exceeding expectations as revenues increased 9%. The company reported after the closing bell and the shares slipped 2.1% in trading on news a US hedge fund has built up a short-selling stake.

Sony also beat profit forecasts, with operating profit of ¥195 billion for the quarter. Net income also surpassed expectations at ¥226.5 billion and the conglomerate lifted its net income guidance for the full year by ¥20 billion to ¥500 billion. Sony's numbers benefitted from share sales of part of its stake in Spotify and solid software sales from the PlayStation segment.

Stocks that weighed on the portfolio during the month included our exposure to the casino sector in Macau. Gambling revenues rose 10.3% in July that were bolstered by demand from China betters keen to play in the country's only legal casino hub. July marked 24 straight months of year-on-year revenue increases. Year-to-date cumulative revenue growth in Macau for the sector is still impressive, reaching another 25.3 billion patacas (US\$3.14 billion) in July. The Macau gaming stocks typically underperform for a few months at this time of year, with momentum likely to return in the second half.

The Funds three largest positions at the end of July were **Sony Corp, Praemium** and **Baidu Inc.** Praemium bounced back from the recent strong pullback in the shares from their highs, with the market softening (given the company's earnings leverage thereto), and after BT cut fees on its super platform. It's not always about price however, and we are not sure that the likes of Praemium will follow suit and erode margins. The company has built a reputation on innovation, and that is also a key differentiator.

Chinese online search giant **Baidu** reported quarterly earnings last week. The company beat Wall Street's estimates on both the top and bottom line as its core online advertising business turned in a strong performance. **We have lightened holdings in Baidu in recent months, which is in line with our view that the FAANG complex will correct sharply in the coming months.** Over the longer term however, the outlook for the company is robust and we would look to add to Baidu when the right window of opportunity presents itself.

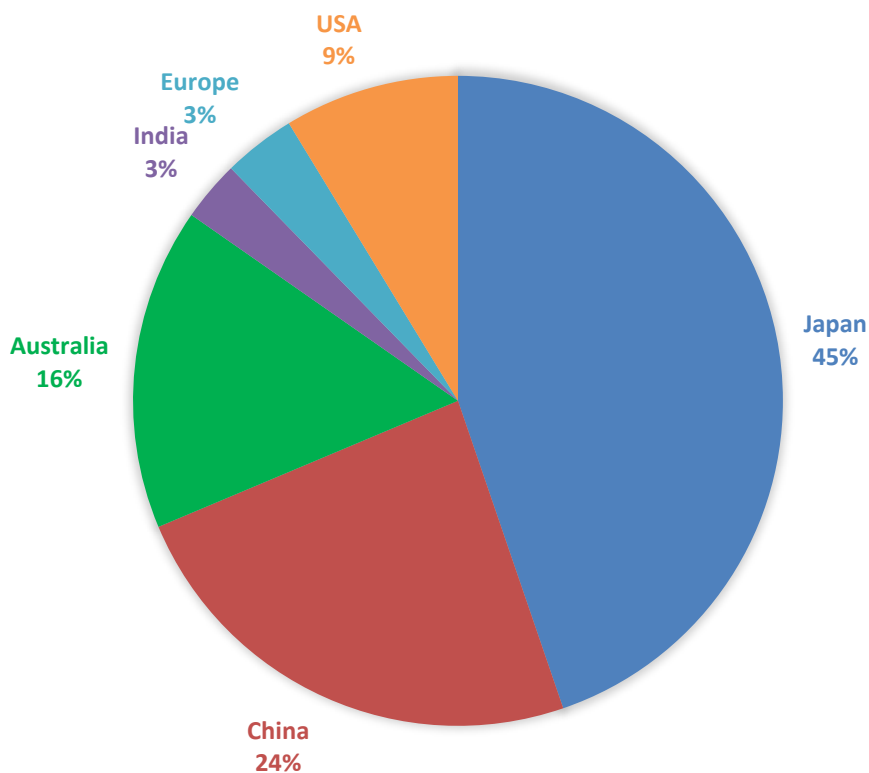
Disney and 21st Century Fox shareholders voted overwhelmingly in favour of Disney's \$71.3 billion buyout of most of Fox's media assets. The shareholder meetings were reportedly brief and only one shareholder spoke up at the Disney meeting to protest the deal, reportedly saying "*I think we are overpaying for Fox.*" At the Fox meeting, according to reports one shareholder got up to speak and praise Rupert Murdoch, saying "*Nobody does it like Rupert Murdoch*" and adding, "*I love Rupert Murdoch.*" Presumably the shareholder owns quite a few Fox shares...

Certainly, the combination of the two companies strengthens what we believe is already the best portfolio of creative IP in the industry, at Disney. It will make Disney's new consumer streaming offering even more attractive when it launches next year. Netflix, while spending massively on its content and doing a good job of adding subscribers (even after the recent miss on that front), has a hit and miss track record when it comes to quality.

As at the end of July the Fund had **leverage of 0.43%, which has subsequently been eliminated with the fund now carrying cash. We will be taking advantage of any further strength in global markets by increasing the cash position.**

| Top 10 Holdings | 31-July-18 | Country |
|---------------------------------|------------|-----------|
| SONY CORP | 7.06% | Japan |
| PRAEMIUM LTD | 5.60% | Australia |
| BAIDU INC | 5.35% | USA |
| THE WALT DISNEY COMPANY | 5.18% | USA |
| WYNN MACAU LTD | 5.00% | China |
| MGM CHINA HOLDINGS LTD | 4.20% | China |
| SUMITOMO MITSUI FINANCIAL GROUP | 4.11% | Japan |
| VANECK VECTORS JUNIOR GOLD ETF | 3.47% | USA |
| BHP BILLITON LTD | 3.41% | Australia |
| NINTENDO CO LTD | 3.20% | Japan |

GEOGRAPHIC EXPOSURE AS AT 31 JULY 2018



Angus Geddes
Chief Investment Officer
Fat Prophets Global Contrarian Fund