SHAREHOLDER QUARTERLY REPORT
QUARTER ENDED 31 MARCH 2015

AAVOF
Arowana Australasian Value Opportunities Fund

ASX Code - shares:	AWQ
ASX Code - options:	AWQO
Listed:	January 2015
Share price:	$0.94
Shares on issue:	48,114,002
Market cap:	$45.2 million
Gross portfolio value as at 31 March 2015:	$47.0 million
NTA/share (pre-tax):	$0.97
Options on issue:	48,114,000
Option exercise price:	$0.98
Option expiry:	1 July 2016

All price data in A$ as at 31 March 2015

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Dear Shareholders

Welcome to this our first quarterly newsletter following the ASX listing of the Arowana Australasian Value Opportunities Fund Limited ("AAVOF") on 5th January 2015. We envisage that the format of this letter will change over time given our nascent stage of capital deployment and the fuller disclosure that will come with a mature portfolio.

INVESTMENT PHILOSOPHY AND MANDATE RECAP

This is an opportune time to recap on our investment philosophy (elaborated on towards the end of this letter):

- Value based
- Fundamental
- Data driven
- Concentrated
- Proprietary
- Absolute return focused

Our mandate has been stated as:

- Australian and New Zealand listed securities
- Single security limit of 15% of portfolio value
- Mandate excludes Metals and Mining GICS industry classification
- Market capitalisation agnostic
- Borrowing not permitted
- No cash limits

PORTFOLIO DISPOSITION AND PERFORMANCE

As at 31 March 2015:

- We had deployed approximately $3.1m or 6.6% of gross portfolio value, in a single security. This is a concentrated position in a single security we know very well and in a specific situation where we have had success historically. We like this position a lot and will fully elaborate on why that is so in due course.
- We held the balance of the portfolio in cash.

As at the date of writing (22 April 2015):

- We had deployed $4.8m or 10.2% of gross portfolio value[1] across three securities and as at the time of writing we are continuing to buy these three securities.
- The balance of the portfolio remains in cash.

[1] Defined as the market value of our securities portfolio including cash and cash equivalents as at 31 March 2015

Disclosure of largest positions:

Here is our conundrum. Best practice disclosure would see us reveal say, our top ten holdings. However we are continuing to build positions in the three securities we own. Thus premature disclosure of our holdings may well be prejudicial to the best interests of our shareholders and this is the position your board has taken.

With respect to market practice, most (but not all) listed investment companies (LICs) publish a list of their top 10 or 20 positions. However most LICs also have highly diversified portfolios comprised of 50 plus liquid securities. AAVOF given its mandate, is likely to never have more than 15-20 securities in its portfolio.

At this juncture, our policy is that we will not disclose a position until we have completed our buying program. We envisage disclosing several holdings and the rationale behind them in our next quarterly newsletter.

Since inception Returns	AAVOF[1]	S&P/ASX 200	S&P/ASX 200 Accum
January 2015	0.12%	3.28%	3.28%
February 2015	0.14%	9.57%	10.39%
March 2015	0.30%	8.88%	10.33%

[1] Measured as gross returns on portfolio value for index comparability

NAV per share	After tax	Before tax
January 2015	$0.98	$0.97
February 2015	$0.97	$0.97
March 2015	$0.97	$0.97

SOLID FOUNDATIONS

Since IPO we have appointed a Custodian. Whilst not required of a listed investment company under Australian law, we believe separation of custody and management is best practice. Custody is in our view an underappreciated risk management facet of establishing and running an investment undertaking, highlighted by the leverage in various broker dealer entities causing loss of capital for some fund clients during the financial crisis. We believe the custody arrangements entered into by AAVOF all but preclude the very small but significant risk of a similar event befalling our shareholders.

MARKET PERSPECTIVE

Macro. The sheer complexity of macro makes it fascinating. It can be very helpful in deciding which sectors to avoid. That said our focus is on finding cheap stocks. No matter what the macro outlook is, we focus on finding underappreciated or neglected stocks with underappreciated earnings upside. If we do this, then even if our stocks multiples contract during some macro gyration, provided the earnings deliver, the stocks will in time as well.

Because we get asked a lot, here is our very crude take on the macro at this juncture:

- The *Australian equity market is expensive* when viewed on an historical basis. The same applies to most (but not all) equity markets globally. Earnings multiples for most stocks are elevated relative to their historical trading ranges. Recent Australian market performance has more to do with the expansion of valuation multiples than the delivery of earnings growth, in aggregate.
- This is despite Australia experiencing something of a *nominal income shock*. A commodity price bubble is in the process of correction (it is not over yet). Commodity price declines are driving declines in investment and a softening of employment conditions, such that nominal wage growth is weak.
- *Unconventional monetary policy* in Japan, Europe and the USA has driven a shortage of high quality collateral and a compression of sovereign yields. As central banks buy bonds from bond mandated investors, those investors tend to use their cash to buy…more bonds, which drives the price of the bonds up and the yields down. When central banks buying of sovereign debt is greater than their host governments issuance of that same debt, there is a shrinkage in available supply – a squeeze.
- The US Federal Reserve has actually experienced a small shrinkage of its balance sheet of late, and the topic of *rate rises* is firmly on the agenda in the world's largest economy. Australia and the US currently traverse highly asynchronous paths. This is relevant for the Australian equity market because over any meaningful time period Australian equity indices are most correlated to US equity indices and its worth bearing in mind that equities don't always behave when rates rise, even if they can't rise too far given the high levels of system leverage in developed markets.
- The RBA is providing accommodative but conventional monetary policy to cushion soggy domestic demand. A deleterious consequence of this is *housing valuation*; some home buyers appear to be plugging all time low interest rates into their home loan affordability calculus and borrowing heavily. Given supply of houses changes very slowly yet the value of housing stock in some regions has been rising strongly for some time, there is a self-reinforcing circular reference at work; as the value of collateral rises, banks can lend more, home buyers can pay more, and thus the value of collateral rises again and the feedback loop continues. One famous investor would call this reflexive.
- The market is not expensive when viewed *relative* to bond yields. However, for perspective, the 10 year Australian Commonwealth Government bond's yield to maturity is ~2.5%, an all-time low and a thoroughly miserable return unless you're counting on deflation.
- We believe *commodity prices have only experienced their initial phase of correction*. This is why we excluded companies in the GICS metals and mining index from our mandate in late 2014 when we were drafting our IPO prospectus. Commodities can be a highly profitable area in which to invest, it just comes down to cycle timing and cycles in this sector are long. If we look at iron ore as the poster child of the commodity boom:
    - In the year to 31 March 2015, China produced approximately 812 million tonnes of crude steel[2]. This was an increase of only 8mt over the prior year.
    - Net exports from China of crude steel over the same time period increased 35 million tonnes[3]. That is, ex net exports and inventory adjustments, apparent Chinese steel consumption *declined* 27 million tonnes, or approximately 3.7%. The driver here is the Chinese property market and specifically pricing trends and their effect on raw materials demand.

[2] International Steel and Iron Institute data

[3] Customs General Administration, People's Republic of China

- Historically, perhaps the best analogue for Chinese steel is Japan. Japanese steel production peaked in 1973 at approximately 119 million tonnes and then declined, with the production level of 119 million tonnes not seen again until 2007; Japan produced 110 million tonnes of steel in the year to 31 March 2015. The USA produces approximately 87 million tonnes of steel a year and behind China and Japan is the world's third largest steel producer. China cannot export away its surplus. We think it very likely Chinese steel production has peaked and that a long adjustment has begun (we also wonder what someone looking down on Port Hedland from space must think, seeing three duplicate rail systems for transporting iron ore).

- Where are we bullish?
  - AUD depreciation winners (in the near term given extreme positioning, we may well see the AUD bounce; but our currency view mirrors our commodity view).
  - Under appreciated business models.
  - Out of favour businesses that aren't directly exposed to mining or housing.

PEOPLE

Ben Wolrige joins the AAVOF from 4th May as an investment analyst, based in our Sydney office. Ben has a passion which is investing. In November of 2014 he attended a respected value investing course at the Columbia Business School in New York whilst on annual leave, which is where we first met him. Attending an investment course whilst on vacation firmly puts Ben in the "keen" camp. Welcome Ben!

INVESTMENT PHILOSOPHY (CONTINUED)

The bullets listed out above are worth expanding on. Ultimately, all that matters is our performance, but we believe if we follow a relatively simple and logical, yet sometimes difficult path, the returns will follow.

Value based	Ultimately value is only definable in retrospect; but we actively seek situations where we believe the market is missing something or overly negative. Examples to follow in our next quarterly newsletter.
Fundamental	We generally spend a lot of time researching a company. Often we will extend our work to both the local and international industry.
Data driven	We don't like views or statements made without reference to data. Anecdotal observation is interesting but a dangerous base for extrapolation.
Concentrated	We want to make money for our shareholders, and we, the investment team, are the largest shareholder group. We aren't smart enough to have 50 great ideas, so we concentrate the portfolio around the better ones. The corollary is we have to live with volatility, but the only volatility that matters is the point to point kind; the straight line from buy price to sell price (easier said than done).
Proprietary	It is hard to make money reading someone else's research; our own desktop and field research is important.
Absolute return focus	We are looking for positive risk asymmetry in general. I.e. limited downside for attractive upside. We are able to hold cash if that is the most attractive asset class at the time.

We thank all our shareholders for their trust and patience and look forward to reporting our progress in coming quarters.