



ASX ANNOUNCEMENT

Sydney, 13th September 2018: Fat Prophets Global Contrarian Fund (FPC) announces a Disclosure pursuant to ASX Listing Rule 4.12

Dear Shareholders,

The month of August was again a pivotal one for the Fund with a number of significant changes made to the portfolio's composition. We took the opportunity to eliminate all leverage from the Fund, while at the same time substantially increase our cash holdings and weighting to gold. **This year has proven difficult for contrarian investors such as the Fund, especially with the US markets, led by the super-cap tech sector, outperforming on the upside, and the super strong US dollar draining liquidity from emerging markets such as China and Hong Kong.**

While we continue to hold conviction on markets such as China and Japan, **we reduced our overall exposure after the US dollar and trade tensions drained liquidity. We also reduced the Fund's weighting to the US and European markets, raising cash balances.** While the US markets continued to surge ahead, China's market was down around 5% in August, with ongoing trade fears and fallout from the Trump Administration's trade tariffs impacting performance. While the super-cap tech sector has delivered alpha to investors, **this is now quite a "crowded trade" with nose bleed valuations priced almost beyond perfection.**

During the month, **we continued to pivot the portfolio and placed the Fund in a much more defensive position, building up our cash position.** We believe this is appropriate given the prospects for excessive volatility in US markets at some point this year or in 2019.

Pre-tax and post-tax net tangible asset backing per share in the Global Contrarian Fund as at 31 August 2018 **decreased by 1.61% and 1.12% respectively to \$1.0872 and \$1.0945** on the previous month's net tangible asset backing.

	31-Aug-18	31-Jul-18	Change
Pre-Tax NTA	1.0872	1.1048	(1.61%)
Post Tax NTA	1.0945	1.1068	(1.12%)

At some point markets will begin to question extremely high valuations in certain sectors, and particularly, within the super-cap technology sector. After a bull market advance that has spanned a decade, the belief in the US super-cap techs is not going to wane easily, but then again "the believers" from here on in, are going to have to deal with valuations which have become stratospheric. The valuations are even higher today in some instances than what has been seen in previous bubbles.

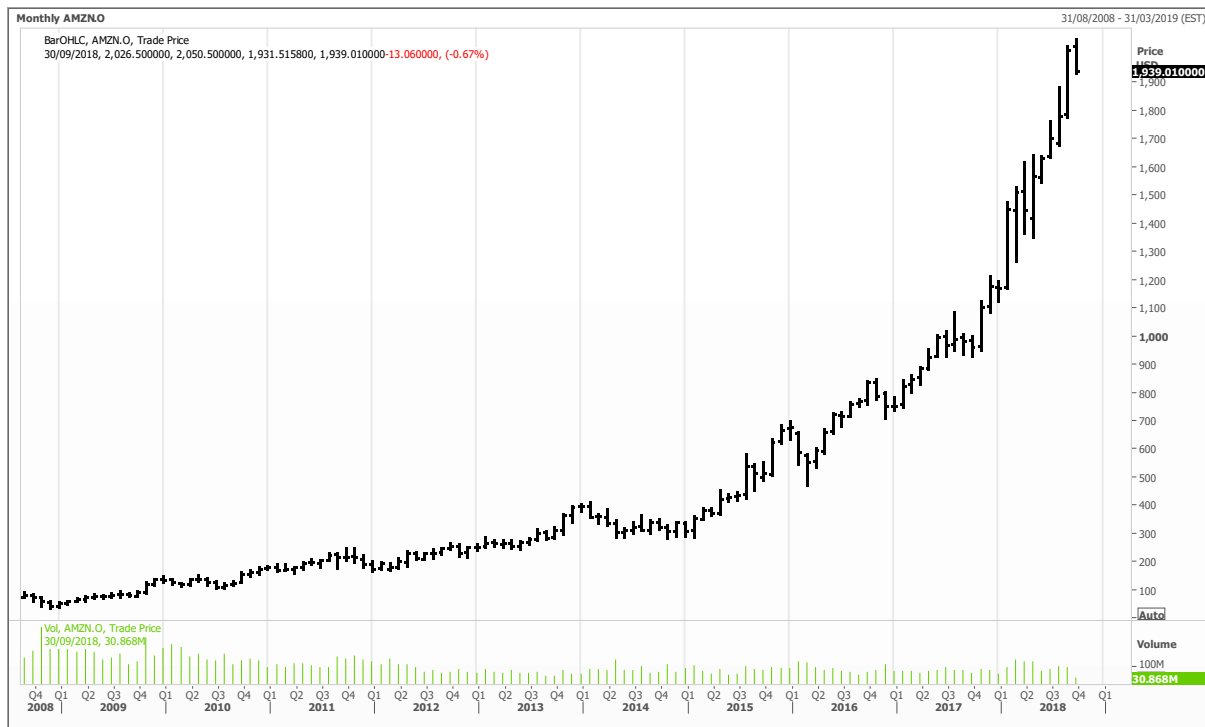
Nasdaq Composite



Even if the likes of Amazon and other FAANG companies were not to put a foot wrong, it is highly probable that the markets will awaken **to the fact that a company such as Amazon, valued on a PE of 160X**, raises the bar to the point where it will be very difficult for market expectations to be met - and for future growth to be sustained at current rates.

It is inevitable that the Nasdaq, and the super-cap tech sector in particular, will incur a significant adjustment at some point, and this could hold broader repercussions for the US market. Whilst nobody really knows the precise timing of a reality check in the space, the level of overvaluation probably means we are close to the top of the cycle. There is also a risk that **the US super-cap sector could experience a “melt-up scenario” triggered by a large short covering rally, before the onset of a serious correction.**

Amazon



We are not alone in adopting a cautious and defensive approach to present day markets, electing to build the Fund's weighting in cash and physical gold (via ETFs). FAANG stocks have accounted for nearly half of the Nasdaq Composite's rally in the past year. However, many hedge funds have since shorted the FAANG complex, which is now a "crowded trade". Short positions against the FAANG group of the largest US technology stocks have surged by more than 40% in the past year which is close to a record.

However, while playing the long side, an investor can potentially only ever lose 100%, for the "shorts" the "sky is the limit". In a short squeeze, losses can potentially be multiples of 100%. It is this polarizing dynamic that concerns us with the FAANG short positioning today. Some funds will be in a lot of pain if the Nasdaq rally renews on the upside forcing those shorts to capitulate. As John Maynard Keynes once said, "the market can stay irrational a lot longer than you can stay solvent".

The narrowness of leadership in the US market has raised the overall risk profile considerably for US investors. **Morgan Stanley joined this school of thought recently, citing growing concerns about the concentration of ownership within the technology sector.**

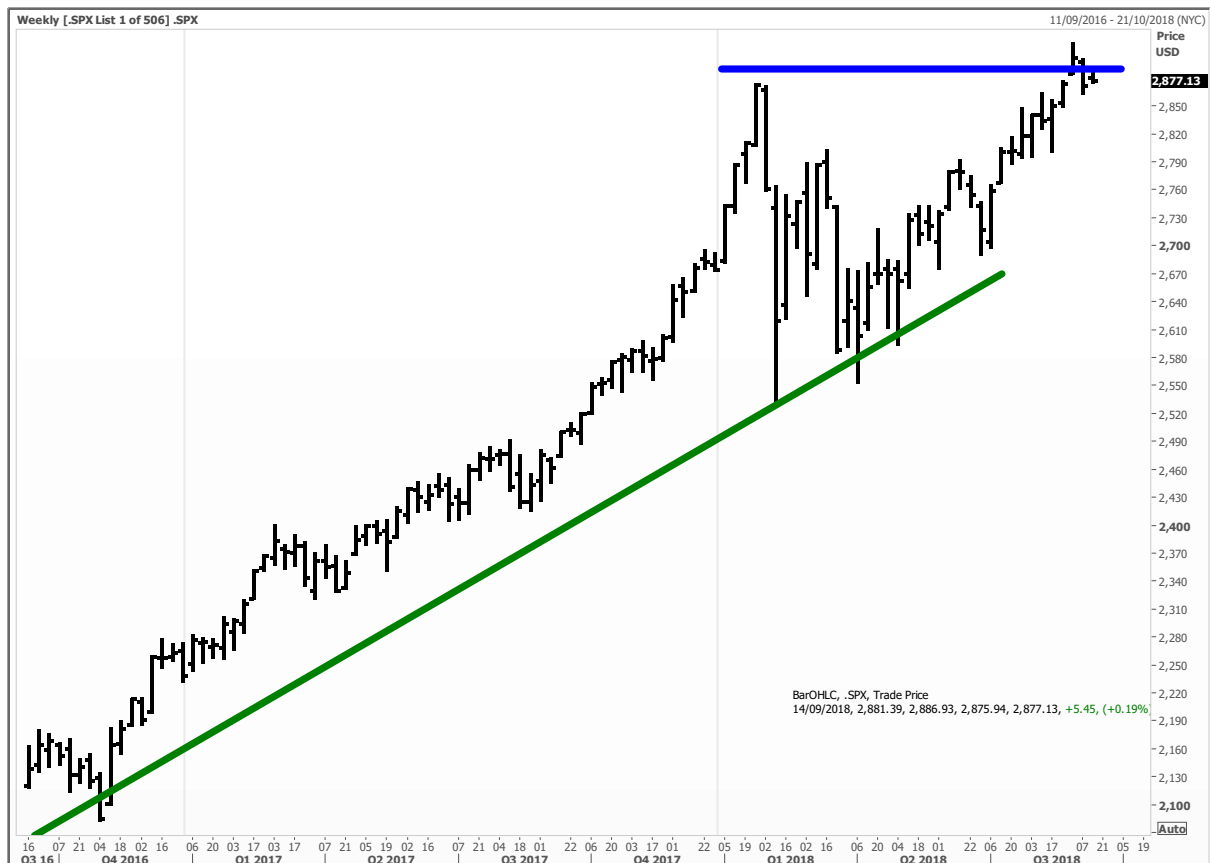
While valuation support mitigates some risk with the S&P500 (priced on a prospective forward PE of around 17X for 2019), **this probably also reflects "top of the cycle growth" in the US.** We think this is as good as it gets for the US economy in terms of growth outlook, and **from here on in the downside risks for the US economy are going to compound for investors.**

The trade outlook is also beginning to weigh with an increasingly unpredictable Trump Administration set to bring in some further \$200 billion tariffs on China and renewed threats to introduce another \$267 billion in levies. **We believe markets are in for more volatile times ahead** with the Nasdaq and super-cap tech stocks which have delivered so much alpha for investors over the past decade having to revert towards the historical mean at some point.

The Nasdaq 100 has surged ahead this year, and valuations no longer make much sense...



...while the S&P500 has struggled to break through and move beyond the January highs. Valuations are more sensible for the broader US stock market, but the leadership has narrowed in the market and has been confined to the super-cap tech sector.



Recently we increased our exposure to physical gold and also precious metal producers. We see gold as being a principal beneficiary of the coming weakness in US super-cap stocks and broader stock market weakness which could have contagion in other markets, and chiefly the US dollar.

US dollar strength could succumb to broader stock market weakness at some point.

If the Dollar Index (DXY) is soon to run its course on the upside – and it is encountering some headwinds at 96 – then **Asian equities having been sold down between 20% and 30% this year, are arguably a defensive place to be if and when the US dollar comes under renewed pressure.**

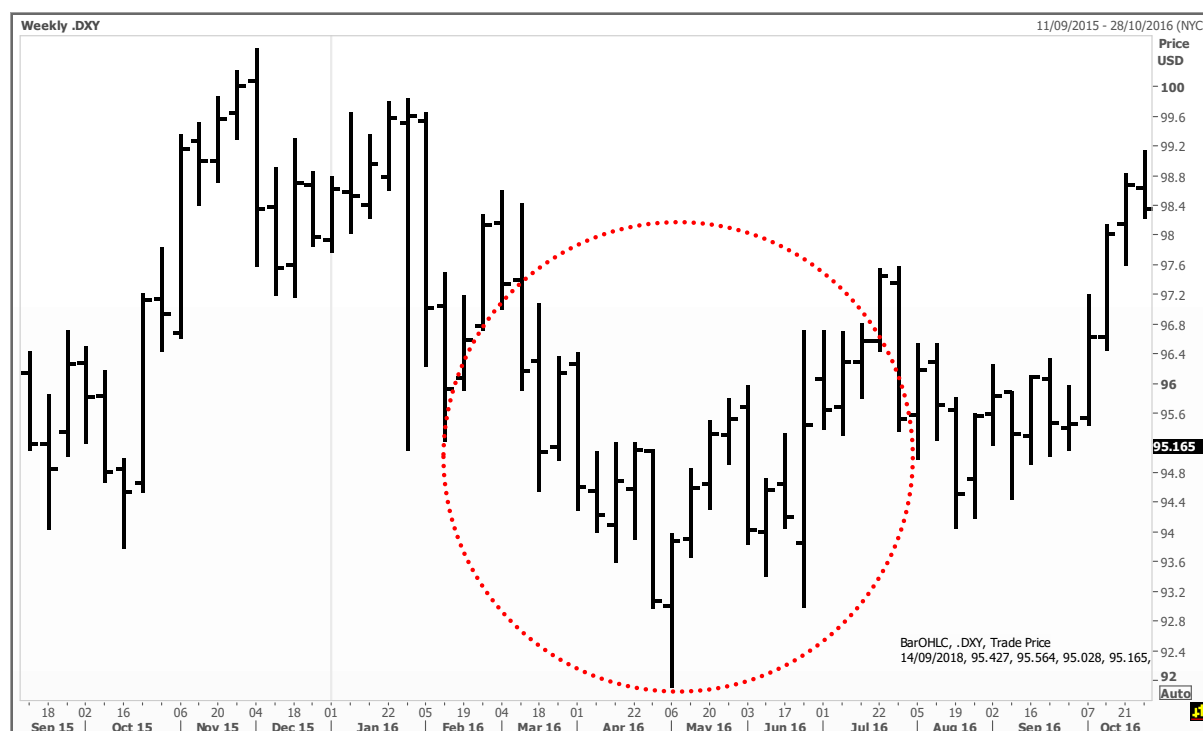
The strong US dollar is draining liquidity from emerging markets, not to mention lowering the earnings outlook for multinational US companies on translation. As a result, emerging markets including China and Hong Kong have sharply adjusted downwards **with a significant amount of risk currently priced in for implemented and threatened tariffs.**

China and Hong Kong markets **are now compellingly valued at around 10X 2019 earnings, arguably offering a more attractive risk/reward profile.** The key question is however, just how much higher can the DXY can go.

The US dollar is becoming overbought with significant long positions established amongst the hedge funds, and a corresponding large short position held by the commercial banks, which is often a precursor for a significant change in trend. It is notable that the commercials have recently been re-establishing long positions in the dollar (and reducing shorts in gold).

This is similar to the scenario in December 2015 when the DXY was near record highs at 100 – which preceded a 10% decline. We believe the stage is set for a similar selloff in the greenback and a corresponding advance in precious metals over coming months.

US Dollar Index – Sep 2015 to Oct 2016



According to the latest COT report from COMEX for August 21st, the net short position in gold was 90,000 contracts – **which is a record short position for hedge funds and a significant long position for the commercials - also close to record levels.** The last time the commercials were this short the US dollar (and this long gold) was back in December 2015, just before gold broke out on the upside.

The graphic below shows the net short position of non-commercials (managed money, other institutional pools of investment money and retail traders) in gold futures, 10yr Treasury futures and VIX futures



We continue to view Japan favourably from a risk/reward profile, particularly as the country recovers from several decades of deflation. Japanese manufacturing activity expanded in August at a slightly faster pace than the previous month as new orders accelerated. **The index remained above the 50 threshold that separates contraction from expansion for the 24th consecutive month.** The survey data indicated the upturn in demand was domestic led, which is encouraging and points to an ongoing support from the consumer in Japan's recovery.

The yield on 10 Year Japanese bonds has broken up decisively through 0.1% after the BOJ widened the ceiling on the trading range from 0.1% to 0.2%. As a result, yields on the 10 Year have consolidated above the breakout level and look appear to be headed higher towards the top of the range. **While this is relatively a small increment, this will boost sentiment towards the depressed banking sector (the Fund holds an overweight position) and which is reliant on higher longer term rates to boost net interest margins.**

10 Year Japanese Government Bond yields



Upward pressure is also building in the US Bond market. Federal Chair Jerome Powell said recently "my colleagues and I believe that this gradual process ... remains appropriate. The economy is strong. Inflation is near our 2% objective, and most people who want a job are finding one ... **If the strong growth in income and jobs continues, further gradual increases in the target range for the federal funds rate will likely be appropriate.**"

The strong wage growth and nonfarm payroll data out recently endorses our view that US rates are headed higher than current expectations.

Turning to the portfolio we added to our position in Evolution Mining following a strong trading update and three-year outlook. Particularly encouraging were cost forecasts, with all-in sustaining costs (AISC) expected to remain between A\$850 per ounce and A\$900 per ounce in 2019 and 2020 before edging up to between A\$870 and A\$920 in 2021. This bodes well for margins (and given our strong outlook on gold prices) with Evolution one of the lowest cost miners in the world. Management have done a great job at driving costs down, and considering ASIC was over A\$1200 five years ago.

One of our largest position Praemium made new record highs after reporting strong earnings and a number of broker upgrades. Praemium released results mid-August which showed another year of record performance marking continued growth across all regions and business units, proving our expectations for an impressive FY18 finish. We expect further growth in the bottom-line as international operations are reaching a critical mass and set to deliver significant operational leverage.

We established a position in the out-of-favour Australian telco sector, in Telstra after confirmation of a merger between TPG Telecom and Vodafone Hutchison. We believe the depressed Australian telco sector has reached a "significant inflexion" point. A concentration of the telco landscape in the hands of fewer players is clearly being viewed favourably by investors, with Telstra sustaining a rebound recently.

Telstra is about to have one less competitor, with the telco sector set to consolidate to just three players. This will have positive implications for all three companies should the merger complete. We think the Australian telco sector has been excessively discounted and that longer term growth prospects are robust with the introduction of 5G and a rising population.

Telstra CEO Andy Penn recently remarked that the TPG/Vodafone merger would bring Australia into line with most other developed economies where there are only three companies offering 80 to 90% of mobile and broadband services.

On the negative side the Funds exposure to Macau gaming and the broader Hong Kong market contributed heavily to the underperformance in August, but we continue to hold a favorable view towards the sector and our largest holding, Wynn Macau.

We believe investors have overreacted to a slowdown in gross gaming revenues. In the case of Wynn Macau (the Fund's largest Macau gaming exposure) the stock now yields close to 8%. **While Wynn does have higher exposure to VIP than other operators, investors have overly penalized the sector and are ignoring the fact that the lucrative premium mass segment is still growing at well above average.**

Wynn Macau has one of the best operating efficiency models in Macau with table utilization significantly above average in both the VIP and Mass market segments **and one of the best operating cost ratios**, which underpins strong margins. The newly opened Wynn Palace continues to successfully ramp up and this will underpin growth over the medium term, **despite near term concerns that VIP gaming revenues will flatten out**. The era of big CAPEX spending is also behind Wynn Macau and the other major operators MGM China and Sands, which should also see free cashflows increase significantly.