

Long-Short Quarterly Report – September 2016

Portfolio Performance

As at 30 Sep 2016	3mth	Since Inception
Alleron Long-Short*	10.41%	10.41%
S&P/ASX 100 Acc**	4.90%	4.90%
RBA Cash Rate	1.50%	1.75%

Performance figures are net of fees and expenses

*Inception date is 1 July 2016

** Performance benchmark

Simulated Portfolio Performance

As at 30 Jun 2016	1 Year	3 Yrs ***	5 Yrs ***
Alleron Long-Short*	7.13%	19.24%	23.84%
S&P/ASX 100 Acc**	-0.35%	7.53%	7.73%

*** Annualised, Simulated Portfolio returns are before fees and expenses

Portfolio Commentary

The Alleron Long Short Portfolio performed strongly during the September Quarter returning +11.8% before fees. The strong returns throughout the quarter were the result of significant outperformance of the long side of the portfolio.

The September quarter is always a key period for the market as majority of ASX listed companies report either their financial year end or half year end results. Strong contributions in the quarter came from companies such as Nanosonics, Fortescue Metals and Treasury Wine Estates. The confirmation of growth drivers for all three companies gives Alleron confidence in their longer term prospects.

Given the positive market performance, it was as expected that the largest detractors from the portfolio came from the short portfolio. Stocks rebounding from lows such as Ansell and Woolworths contributed negatively to portfolio performance. While the end of year company reports for certain companies within the short portfolio may not have been as poor as initially expected, operating earnings outlooks for each of the companies remain weak for all short positions.

Market Overview

The Australian market rose as resources outperformed income stocks. The market was concerned that the US Federal Reserve would begin a series of interest rate increases. The Port of Melbourne was sold for \$9.7bn, an Australian record 25 times forecast earnings for an infrastructure asset. Sydney Airport announced strong passenger growth both domestically and internationally. Cochlear reported continued double digit growth with an increasing emphasis on customer engagement. Treasury Wine Estates' new branding strategy is delivering ahead of schedule. The market got excited by Woolworth's imminent exit from Masters despite few signs of a turnaround in store sales and margins. Woodside Petroleum announced a sector low cash breakeven of US\$9 per barrel for the half year.

Portfolio Highlights

Positives:

Nanosonics Ltd (Long) - The Company reported its maiden full year profit in August and has forecast continued growth in its installed unit base at 1,000 units per quarter for FY17. The company has also announced further R&D spend to develop new infection prevention technologies.

Fortescue Metals Group Ltd (Long) - The Company continued to cut C1 costs to US\$13 per tonne as at the end of FY16 through a combination of reduced capital expenditure and efficiency initiatives. This has enabled management to proactively pay down a total of \$3.6bn of debt since the beginning of FY16, strengthening the balance sheet and increasing free cash flow.

Downer EDI Ltd (Long) - The Company was awarded several infrastructure contracts in Australia and New Zealand in the quarter, validating the company's strategy to invest heavily in infrastructure expertise to offset the reliance on mining services income.

Negatives:

S32 Ltd (Short) – The share price rebounded on the back of the spike in coal prices. The Company mines some of the most abundant commodities and thus has significant earnings volatility. S32 was spun out of BHP due to the commodities being non-core and in difficult jurisdictions.

Ansell Ltd (Short) – While the potential disposal of its sexual wellness business to focus on industrial and medical protection was viewed favourably by the market, the company's growth profile is lacking and recent business purchases have not been integrated well.

Medibank Private Ltd (Long) – The Company has experienced slowing revenue growth and expects continued market share loss following a weak 2H16. Management has announced a change in focus in corporate strategy with increased investment for customer value and experience.



Portfolio Changes

Stocks purchased:

Navitas Ltd (+1.50%; New Long): An Australian education provider. University partnership segment has shown strong organic growth in both US and Australian markets.

Commonwealth Bank Ltd (+1.50%; New Long): An Australian bank. Retail banking, the company's largest segment, has been growing strongly at a double digit pace.

Primary Healthcare Ltd (+5.10%; closed short): A medical centre operating company. The Company has divested non-core assets to reduce debt and developed off balance sheet funding for new medical centres.

Stocks sold:

TPG Telecom Ltd (-1.00%; New short): An internet service provider. The company has forecast shrinking margins due to future increased NBN access costs.

Bank of Queensland Ltd (-4.10%; New short): An Australian bank. Niche lending segments are struggling to deliver growth.

Computershare Ltd (-1.40%; New short): A data management and transaction processing company. The company's core share registry business is mature and facing increasing competition.

Quarter-End Position & Portfolio Exposures

As at 30 September 2016, the fund had a net exposure of 95.81% and gross exposure of 192.67% to equities. Cash was 4.19%.

Major portfolio exposures were to medical devices & services and resource stocks with less portfolio weight in major banks and retailers.

Stock Highlight

Fortescue Metals Group Limited – Long Position

Energy Argument: Alleron's view of Fortescue had changed dramatically from its entrepreneurial roots to becoming a world class asset with a reducing risk profile. The Company had successfully completed the construction of one of the world's largest iron ore mining operations. The reduction of debt would result in the market removing its high risk discount and valuing the company based upon the value of its world class asset.

Trigger: Release of the December 2015 quarterly operational results showed cost reductions compensating for falls in commodity prices and repayment of further US\$750m in debt.

Since that time, management at Fortescue have continued to drive cash costs of production down to be broadly in line with those of both Rio Tinto and BHP. They have continued to de-risk the company by focussing on debt repayment with over \$1.7bn in debt repaid since the beginning of 2016. This has been recognised by major debt rating agencies who have upgraded their respective ratings on Fortescue's debt.

About the Australian Eagle Trust Long-Short Fund

Alleron is an Australian boutique wholesale fund manager specialising in Australian equities. Alleron's investment process seeks to deliver significant outperformance by identifying mispriced stocks with changing growth profiles and building concentrated portfolios of those stocks.

The Australian Eagle Trust Long-Short Fund aims to achieve strong double digit returns by allowing clients to access Alleron's demonstrated historical strength in constructing Australian share portfolios applied to a long-short product.

Modelling a combination of Alleron's actual long investment performance since 2005 in conjunction with a short selling discipline, suggests that this product can provide strong investment returns along with an alpha performance that is negatively correlated to the broader Australian equity market.

Disclaimer: This communication is issued by Alleron Investment Management Limited ABN 71 109 874 160 AFSL 278856 Suite 402, Level 4, 71 Walker Street, North Sydney NSW 2060. This information does not constitute a recommendation, offer or solicitation to buy or sell any securities. It reflects Alleron's Portfolio at the end of the month stated and Alleron's views at the date of preparation. Both the Portfolio and Alleron's views are subject to change without notice. Past performance figures are no guarantee of future returns. Date of preparation: 14 October 2016.

