

# AFM Fund Review

## QATO Capital Market Equity Long/Short Fund

Nov-16 **+0.79 %**  
Latest 12 Months **-9.51 %**



### Key Points:

- Melbourne-based boutique fund manager backed by single family office, Larkfield Funds Management. Qato has a systematic, market-neutral strategy which invests exclusively in S&P/ASX 100 stocks.
- Portfolio Manager and CIO Ben Silluzio has 21 years' financial markets' experience working for global financial institutions servicing institutional and ultra-high net worth (UHNW) investors.
- Silluzio developed QATO Capital's Q-score process which captures and quantifies six broad fundamental factors, which assess multiple underlying sub-categories. Those companies with the top score (quality companies) are included in the "long" portfolio, those with the lowest score are sold short.
- The portfolio targets a smart beta philosophy, with the Q-Score being run at the beginning of each month with positions adjusted, removed, or added as required.
- A strict risk regime and hard stop loss limits is employed intra-month to limit the portfolio's potential downside.
- The Manager has invested significantly in structure and staffing, with operations the responsibility of Brett Dawson and with a dedicated Legal, Compliance and Risk Manager reporting to the Board and total staffing of seven people.

### Management Company Overview:

QATO Capital was established in 2014 by Ben Silluzio, who along with the senior management consisting of Brett Dawson (COO/CCO) and Greg Hargrave (Executive Chairman) holds 100% of the management company.

Silluzio holds a Graduate Diploma of Applied Finance and has 21 years' experience in financial markets, servicing hedge fund managers and ultra-high net worth (UHNW) clients. He has also worked for global financial institutions including Colonial, Commonwealth Bank, Credit Suisse First Boston, Citi Group Smith Barney and UBS Wealth Management. In 2011 Silluzio established and became managing partner of RBS Morgans' UHNW division prior to founding Qato in 2014.

COO/CCO Brett Dawson has over 11 years' financial industry experience in both buy-side (Institutional funds management and hedge fund-of-funds) and sell-side (Private client wealth management) investing. Dawson's previous experience includes Warakiri Funds Management, UBS Wealth Management AG, and with Silluzio established RBS Morgans' UHNW Division. He holds a Bachelor of Commerce in Banking and Finance and a Bachelor of Applied Economics, and is primarily responsible for managing the Fund's operations.

In 2016, Dante Truda joined Qato as Senior Portfolio Manager, bringing over 15 years' financial markets experience including previously working for Royal Bank of Scotland as Head of Investor Products & Equity Derivatives in Australia, and Desk Head Emerging Market Trading - Equity Derivatives in the UK. Truda is primarily responsible for Portfolio Management,

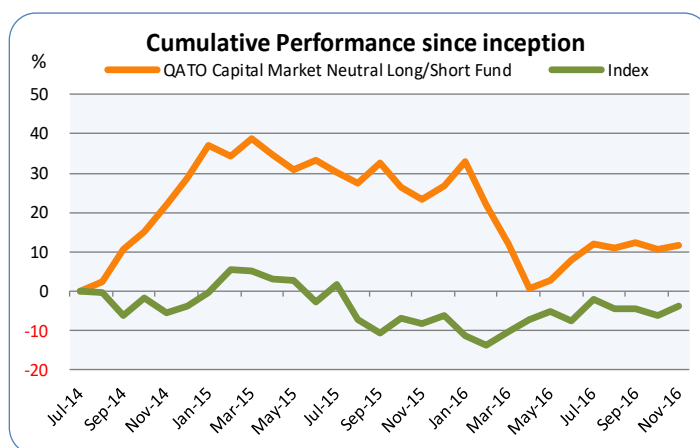
| Key Performance Statistics           | QATO   | Index* |
|--------------------------------------|--------|--------|
| Nov-16                               | 0.79   | 2.53   |
| Annualised Return                    | 4.80   | -1.62  |
| Latest 3 Months                      | 0.57   | 0.60   |
| Latest 6 Months                      | 8.52   | 1.31   |
| Latest 12 Months                     | -9.51  | 5.00   |
| Latest 24 Months p.a.                | -4.31  | 0.94   |
| Latest 36 Months p.a.                | NA     | NA     |
| Latest 60 Months p.a.                | NA     | NA     |
| % Positive Months                    | 57.14  | 46.43  |
| Best Month                           | 8.19   | 6.12   |
| Worst Month                          | -10.14 | -8.81  |
| Largest Drawdown                     | -27.45 | -18.25 |
| Average +ve Return                   | 3.89   | 3.51   |
| Average -ve Return                   | -4.02  | -3.16  |
| Annualised Standard Deviation        | 15.99  | 13.49  |
| Downside Deviation (Since Inception) | 11.62  | 10.27  |
| Sharpe Ratio (Since Inception)       | 0.25   | -0.20  |
| Sortino Ratio                        | 0.23   | -0.35  |

\*Index is ASX100 Price adjusted since Fund's Inception

specifically focusing on execution and ongoing development of Qato's risk management framework, and implementation of the portfolio's risk models.

Greg Hargrave, Qato's Executive Chairman, has extensive entrepreneurial and management experience ranging from publicly listed companies and successful private start-ups. He was CEO for ASX-listed Skilled Group and Chairman and director of the Larkfield Family Office for over a decade.

James Skerrett who was Qato's in-house Legal, Compliance and Operations Manager has now left the firm but remains the secretary of the Board and Risk Committee.



| Performance - Net of Fees (%) |      | QATO Capital Market Neutral Long/Short Fund |       |        |       |      |       |       |      |       |       |      |         |
|-------------------------------|------|---|-------|--------|-------|------|-------|-------|------|-------|-------|------|---------|
| Year                          | Jan  | Feb   | Mar   | Apr    | May   | Jun  | Jul   | Aug   | Sep  | Oct   | Nov   | Dec  | YTD     |
| 2016                          | 4.90 | -8.09                                       | -8.29 | -10.14 | 2.19  | 5.05 | 3.71  | -0.96 | 1.23 | -1.43 | 0.79  | -    | -11.89% |
| 2015                          | 6.36 | -1.87                                       | 3.12  | -2.96  | -2.84 | 1.89 | -2.26 | -2.22 | 4.25 | -4.76 | -2.46 | 2.70 | -1.72%  |
| 2014                          | -    | -   | -     | -      | -     | -    | -     | 2.40  | 8.19 | 3.87  | 5.87  | 5.75 | 28.83%  |

Qato has established an impressive Advisory Board to provide management with strategic input regarding general business matters, and to ensure good corporate governance processes. Chairman of the Advisory Board is the Hon. Richard Alston AO., who is a global advisory board member of the \$USD14bn London based hedge fund manager CQS. Alston was formerly Australia's Ambassador to the UK, and prior to that a senior Federal Cabinet Minister. Other members of the Advisory Board include Ian Jeffrey, formerly Head Tax Partner of PwC, Luke McConnel, formerly CFO of the Royal Bank of Scotland (Nordics) and currently Financial Controller ANZ Institutional Bank, and Adrian Giles, the Co-founder of Hitwise and a Director of AdSlot, who has experience in global start-ups.

### Investment Strategy

The Qato Equity Market Neutral Fund (the "Fund") invests exclusively in S&P/ASX 100 Index stocks. The Fund may also invest outside of the S&P/ASX-100 Index, but only if companies within the S&P/ASX-100 Index dispose of a business and/or due to changes in the Index. The Fund may also hold cash and cash equivalents.

A systematic approach is used to build the portfolio which is based on a quantitative ranking system known as the Q-Score, a proprietary stock selection and risk management system which ranks companies based on fundamental bottom-up improvements or deteriorations. The system has been used as a long-only process since inception in 2002 and in 2010 underwent extensive research and development to include shares on both the long and short side. The resulting system has been operating live since August 2014.

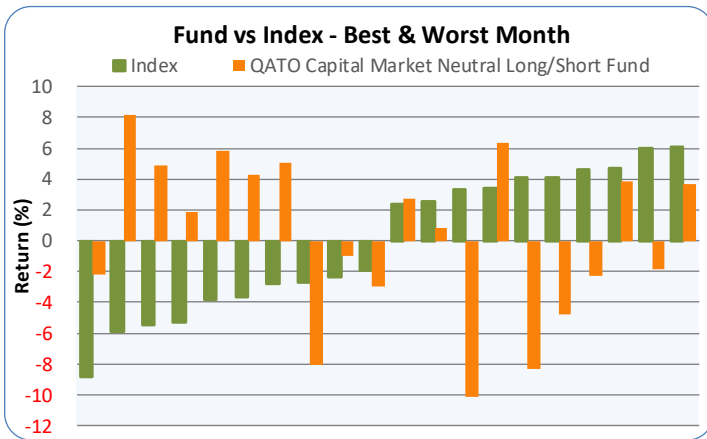
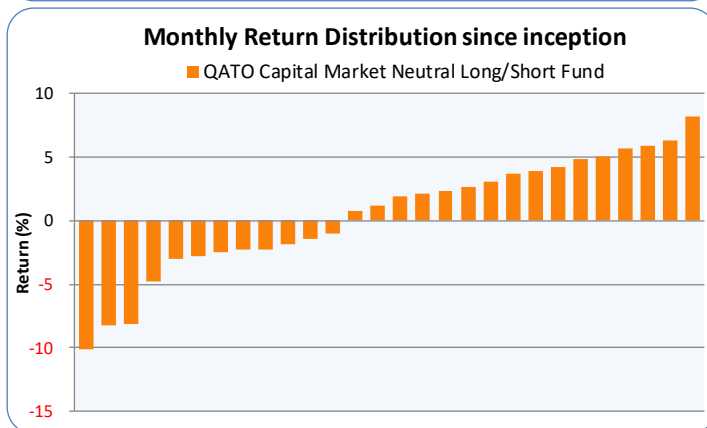
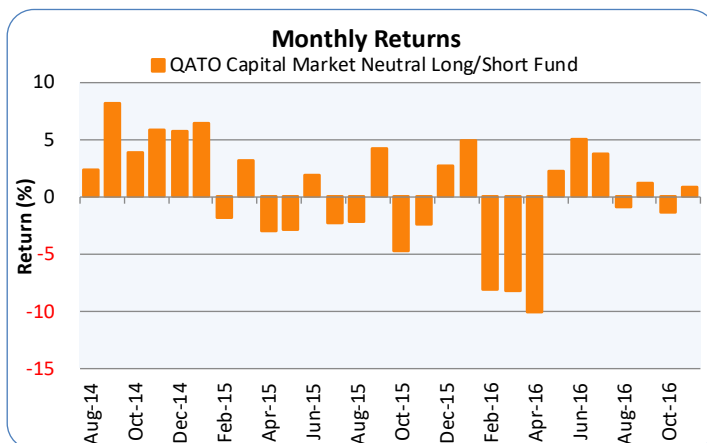
In a typical environment the Fund targets 25 long and 25 short positions with the resulting portfolio broadly market neutral on a cost basis. The stocks representing the highest Q-Score are purchased for the long book, whilst those with the lowest Q-Score are sold short. The Q-score is recalculated monthly, with the short and long book reset and re-balanced each month.

The Q-score process is entirely objective, consistent and replicable, and apart from the logic involved, has no subjective inputs. The system incorporates a prescriptive risk overlay, and given the methodology is intended to produce results independent of market movements, and is likely to have a negative beta.

The Q-Score methodology is a proprietary system, tested and developed by Silluzio and his team. Being a dynamic process, all ongoing testing and development is conducted in-house at Qato, with the underlying models continually evolving to adjust to market conditions.

For instance, originally all positions were equally weighted in the portfolio. As a result of the ongoing evolution the process now adjusts position sizes depending conviction – high, medium or low, while intra-month positions can now be cut on a change in fundamentals, or company management.

The essence of the Q-Score is to capture the changing financial factors affecting a company and its valuation, then using this data to generate a list of those with improving fundamentals.



**Performance Review**

- ❑ The Fund has just over two-year track record and therefore it is difficult to draw conclusions around performance in the full range of market conditions.
- ❑ Since inception, the Fund has an annualised return of 4.80%, which has been achieved with higher volatility of 15.99%. compared to the ASX-100 Price Index's -1.62% with a volatility of 13.49%.
- ❑ The Fund's correlation (beta) to the S&P/ASX 100 Index is -0.24.

Those which score well are regarded as quality companies and vice-versa. The six major attributes that are captured and measured are valuation, growth, risk, quality, earnings and price, although there are multiple inputs to each of these. Effectively the system is looking to systematically capture the

most important fundamental factors and catalysts that investors focus on, and which therefore drive prices over a market cycle.

After evaluating the Q-Score outputs the resulting portfolio will have a low beta “long” exposure typically composed of relatively high-quality, safe, growing, value companies.

Meanwhile the short exposures are typically high beta, lower-quality, riskier companies generally exhibiting higher volatility. In addition, the portfolio will have a cash holding derived from the short sales, earning the prevailing interest rate.

### Investment Risk & Processes

The Fund does not invest in derivatives and has no currency exposure. The only leverage in the Fund is via short selling. There are no hard stop loss limits, although positions can be adjusted intra month in the event of a significant change in the fundamentals which in turn impact the models or Q score for a company.

Risk models and monitoring also evaluate factors that might impact portfolio construction such as short borrow availability, gross exposure limits (generally between 160% and 200%), company up/downgrades, in addition to which there are ratcheting and rolling stop loss limits.

Any breaches of risk limits are corrected on market with the CCO acting independently if limits are breached, although requiring the sign off of at least one independent trustee. At the stock-level ‘long’ and ‘short’ positions are typically rebalanced monthly.

### Operational, Business Risk and Compliance

Operational and business risk is considerably reduced through the use of industry standard service providers such as PWC and Citco, and Morgan Stanley Intl PLC as prime broker. The Manager conducts thorough due diligence on each counterparty prior to their engagement, with COO/CCO Brett Dawson responsible for monitoring and managing counterparty risk and exposures on an ongoing basis. Dawson also monitors a range of credit and liquidity measures on a monthly basis to identify any stress in the broader financial system. The Manager’s compliance regime was established by, and is maintained by Compliance and Risk Services Pty Ltd, based in Melbourne.

The main operational risk is focused on key man risk regarding Ben Silluzio. While other members of the senior executive team can operate the proprietary software driving the Q-score process, Silluzio developed it and has the most thorough knowledge of the system and its dynamics. However, given that the Fund only invests in liquid ASX 100 stocks there are unlikely to be delays in the event the Fund’s assets need to be realised with the size and structure of the portfolio, thereby reducing the impact of the loss of a key person to investors.

### Investor Relations

Total funds under management (FUM) is over A\$180million, including US\$100 million on behalf of a US university endowment which is managed on a parri-passu basis but is structured as a separately managed account. The Australian unit trust has over 60 investors and totals A\$40 million. As of

November 2016 the three principles, their families and members of the advisory board have a combined \$A15million invested in the fund

Monthly reporting is detailed and includes exposures, major long and short contributors as well as risk analytics and correlations. The Manager also provides commentary on the Fund and markets.

### Structure, Terms & Conditions and Fees

Qato Capital Pty Ltd (ACN 601 673 107) is an Australian company and the Information Memorandum is issued under authority of the Trustee, Cyan Investment Pty Limited (AFS Licence number 453209). The Fund is open to wholesale investors only, and has monthly application terms requiring 3 business days’ notice and a minimum investment of \$250,000. Redemptions of a minimum amount of \$250,000 are monthly with 10 business days’ notice. There is no lock up or exit restrictions.

The Manager charges the fund a management fee of 1.65% p.a. of the Fund’s NAV, payable monthly, with an annual performance fee of 20% of the increase in NAV above the benchmark (RBA Cash Rate), subject to a high water mark. There is no entry fee, and a sell spread of 0.3% paid to the Fund.

### QATO Capital Market Neutral Long/Short Fund

|                       |                               |
|-----------------------|-------------------------------|
| Strategy              | Equity Market Neutral         |
| Geographic Mandate    | Australia                     |
| Domicile/Structure    | Australia                     |
| Investor Type         | Wholesale                     |
| Min. Investment       | AU\$250,000                   |
| Additional Investment | AU\$25,000                    |
| Management Fee        | 1.65% of NAV                  |
| Performance Fee       | 20%                           |
| Hurdle                | RBA Cash Rate                 |
| Min. Term             | 1 month                       |
| Investment/Redemption | Monthly, min. amount \$25,000 |
| Buy Spread            | 0.00%                         |
| Sell Spread           | 0.30%                         |
| Inception Date        | Aug-14                        |
| Fund Size             | AU\$180m+                     |
| Status                | Open                          |

The Fund is structured as an Australian Unit Trust and the Manager is in the process of establishing a Cayman based fund which will operate identically to the domestic fund, to cater for demand from offshore investors.

The Manager has recently achieved SEC registration in the USA.

### Service Providers

**Custodian & Prime Broker:** Morgan Stanley & Co. Intl PLC

**Administrator:** Citco Fund Services

**Auditors:** KPMG

**Legal:** Watson Mangioni (AU) & Maples & Calder (Cayman)

**OM/PMS/Risk:** Eze Castle/Tradar

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