Newgate

REAL ESTATE AND INFRASTRUCTURE FUND NEWSLETTER

SEPTEMBER QUARTER 2018

The Newgate Real Estate and Infrastructure Fund takes long and short positions in listed securities exposed to assets such as office and industrial real estate, residential development, retail shopping centres, healthcare, airports, ports, toll roads, rail and utilities.

QUARTERLY PERFORMANCE - FINANCIAL YEAR 2019					
	SEPTEMBER QTR	DECEMBER QTR	MARCH QTR	JUNE QTR	TOTAL FY RETURN
FY19	-2.1%	-	-	-	-2.1%

Fund Performance

"Humans are pattern seeking, storytelling animals. We look for and find patterns in our world and in our lives, then weave narratives around those patterns to bring them to life and give them meaning"

Michael Shermer, "Why People Believe Weird Things" and Sceptic Magazine

The **Newgate Real Estate and Infrastructure Fund** delivered a -2.1% return over the September quarter 2018, taking the rolling twelve month return to 9.8%.

The Fund's objective is to generate 10-12% per annum returns over the medium to long term. Over the past five years the fund has delivered 10.9% per annum return. The observed volatility of returns has been approximately 9%, well below that of the equities market.

What is volatility?

Volatility is a rate at which the price of a security increases or decreases. Volatility is measured by calculating the standard deviation of returns over a given period. It shows the range to which the price of a security increases or decreases.

Volatility is **just a proxy for risk**, an attempt to measure it. Risk is ever changing, covert, and **immeasurable**. Our best attempt to measure risk is the maxim that **the more variable an asset's return, the riskier is the asset**. Therefore, we use volatility to measure risk.

For perspective, over the past century, the volatility of global equities markets has averaged approximately 20% with bonds coming in at 10% . This volatility has come down over past decades to around 15%.

"Investing requires both generating returns and controlling risk. And recognising risk is an absolute perquisite for controlling it"

Howard Marks, The Most Important Thing: Uncommon Sense for the Thoughtful Investor, 2011

FUND PERFORMANCE AS AT 30 SEPTEMBER 2018

TIME PERIOD	RETURN
3 month return	-2.1%
12 Month return	9.8%
3 Year return	9.4% p.a
5 year return	10.9% p.a
Since Inception*	11.9% p.a
Observed Volatility	9.0%

*Inception 1 July 2013. Past performance is not necessarily indicative of future performance. Investments can go up and down.

AVERAGE FUND STATISTICS

STATUS	MOVEMENT
Number of Positions:	22
Net Position:	20.1% (longs less shorts)
Total Long Positions:	76.4%
Total Short Positions:	56.5%
Gross Exposure:	132.8% (longs plus shorts)

NOTABLE STOCK CONTRIBUTIONS

POSITIVE CONTRIBUTORS	NEGATIVE CONTRIBUTORS
Japara Healthcare (JHC)	Charter Hall Group (CHC)
Centuria Industrial REIT (CIP)	Mirvac Group (MGR)
Sydney Airport (SYD)	Data Exchange (DXN)
Updater (UPD)	

Source: Newgate Investment Management

QUARTERLY SUMMARY

Market performance

Over the quarter, the Fund has been impacted by the market's concerns over the escalation of trade conflict between the USA and China. These concerns created a 'flight to safety' – with capital leaving emerging markets in the Asian region and moving to the relative safety of the Australian market.

This capital has been willing to buy companies with relatively less perceived risk, and with less regard than we would normally expect to the weakening fundamentals of individual companies and sectors. For example, it caused strong performance in companies exposed to the struggling residential sector (Mirvac Group, Stockland Group) and retail shopping landlords feeling the early negative impact from Amazon's growth in Australia (for example Vicinity Centres). We have been short both the residential and retail sectors causing the strong performance of these companies to negatively impact fund performance.

We expect these influences to unwind as the underlying fundamentals of these companies reassert themselves.

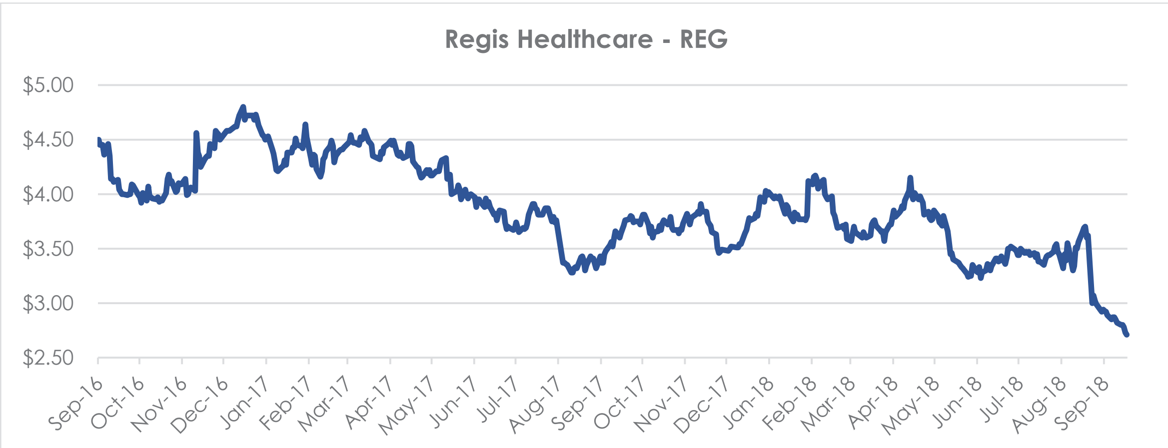
Positive Contributors

Over the past 12 months, the Fund has had an exposure to select **aged care** real estate owners and operators in Australia. The investment case was premised on our analysis that the stocks were trading well below the replacement cost of the assets. We expected at some stage this value would be realised by better management or corporate activity.

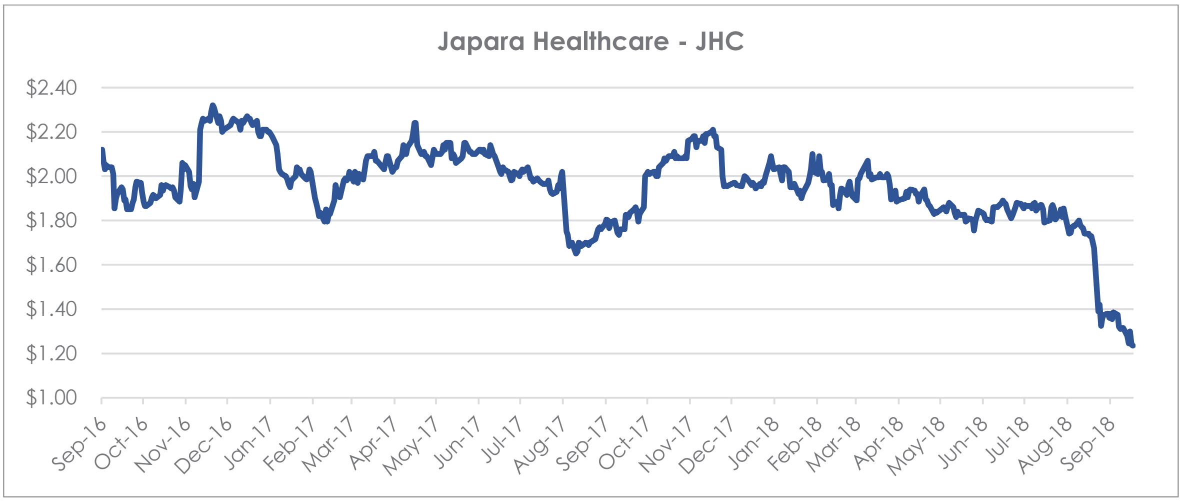
Our positive view eroded over time due to our research creating concerns that the aged care industry was not investing sufficiently in labour to provide an appropriate level of care for the residents of aged care facilities. This situation was a function of lower government funding to the aged care sector as well as a conscious lack of investment in staff by some aged care operators.

This left us with the view that aged care companies had to materially increase their labour levels, which would negatively impact profitability and share prices. On the back of this view we positioned the Fund in the expectation that aged care companies would ultimately experience margin erosion.

Over September, an ABC "Four Corners" report was released that highlighted the concerns we harboured for the sector. At the same time, we also saw Prime Minister Scott Morrison announce a Royal Commission into the aged care sector. These two events saw a material decline in the share price of aged care stocks. The Fund profited from these share price declines.



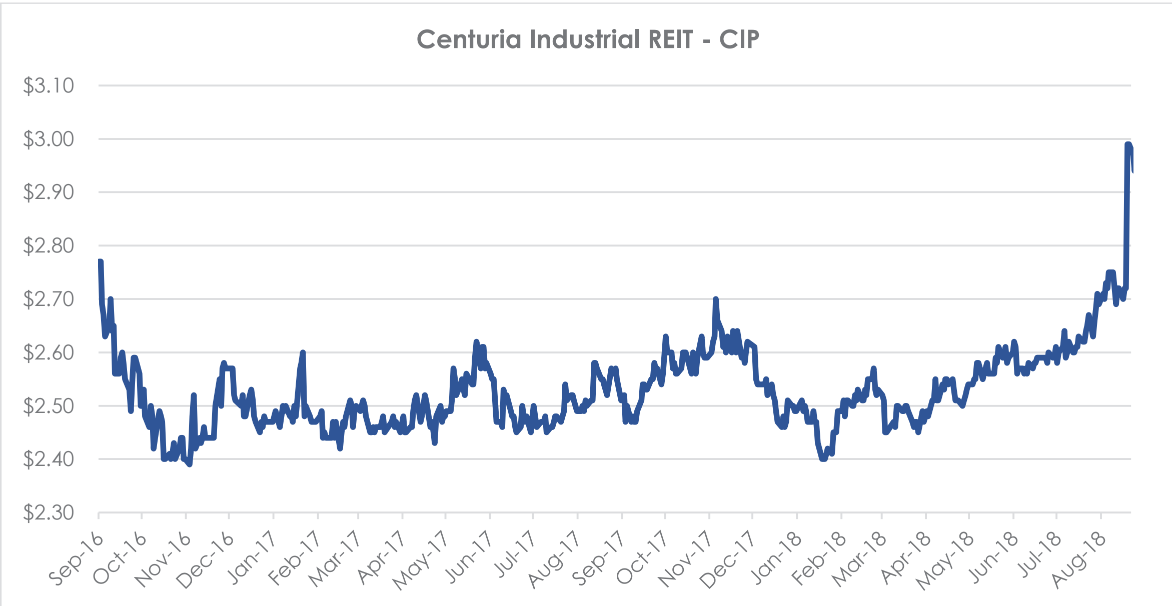
QUARTERLY SUMMARY



Centuria Industrial REIT (CIP) contributed positively to returns over the September quarter. CIP is an owner of 37 industrial assets across Australia valued at approximately $1 billion.

On 13th September 2018, real estate company **Propertylink (PLG)** proposed a cash and scrip bid for CIP[1], which saw the share price spike to $3.00 and values CIP at $3.21.

Currently CIP trades on a 7% distribution yield, with distribution growth at least at inflation. Net tangible asset backing is $2.58.



[1] Please note, post the September quarter, a company called ESR has lodged a bid for PLG, and it is unlikely that the PLG bid for CIP will go ahead.

QUARTERLY SUMMARY

Negative Contributors

The Fund's short position in diversified real estate company **Mirvac Group (MGR)** failed to deliver. We are short MGR primarily because of its exposure to the residential sector (approximately 30% of assets and earnings). The market is ignoring this risk, believing that its ability to develop office assets will be able to offset the declining returns from their residential division. MGR rallied 14% over the quarter over excitement towards the potential profits from this commercial development pipeline. Being one of our largest short positions, it negatively impacted Fund performance.

We are confident the position will deliver for the Fund over the coming 12 months as the residential real estate sector experiences falls in capital value and materially lower turnover. The correction in housing is being driven by ample evidence that banks are tightening credit. Housing prices are driven by the credit cycles, as credit contracts, house prices should decline.

The Fund has a position in data centre company **Data Exchange (DXN).** The data centre real estate sector has grown to be a significant component of the market in the USA. Companies such as Digital Realty (DLR US) with a market cap of $AUD 30 billion, and Equinix (UQIX US) with a market cap of $AUD 44 billion are two such examples.

The Australian data centre industry is also experiencing rapid growth and there are now over 200 data centres in Australia. DXN own and operate modular data centres in Australia. Their first two sites will be located at Port Melbourne, Victoria (4,000 square metres) and Homebush, New South Wales (4,600 square metres). Both centres come online over the coming months.

Whilst a higher risk proposition, we believe DXN will be able to create significant value through the development and ownership of their unique low-cost data centre offering. The DXN share price declined over the quarter on no news flow. We remain positive DXN, the company is delivering on its stated objectives and we expect the share price to start performing as the first two data centres are leased up over the coming 12 months.

QUARTERLY SUMMARY

Retail Real Estate

We remain negatively disposed towards **retail real estate**. We are starting to see the first signs of valuers considering the issues faced by this class of real estate. For example, Stockland Group (SGP) saw 15 of its retail assets, or 24% by value experience valuation declines at its full year result (August 24th, 2018). Overall SGP's retail portfolio **declined in value by 2.7%[2].** This is likely to be the beginning of a gradual decline in asset values. Based on our analysis we expect retail asset values to fall 15-20% over the coming three to five years.

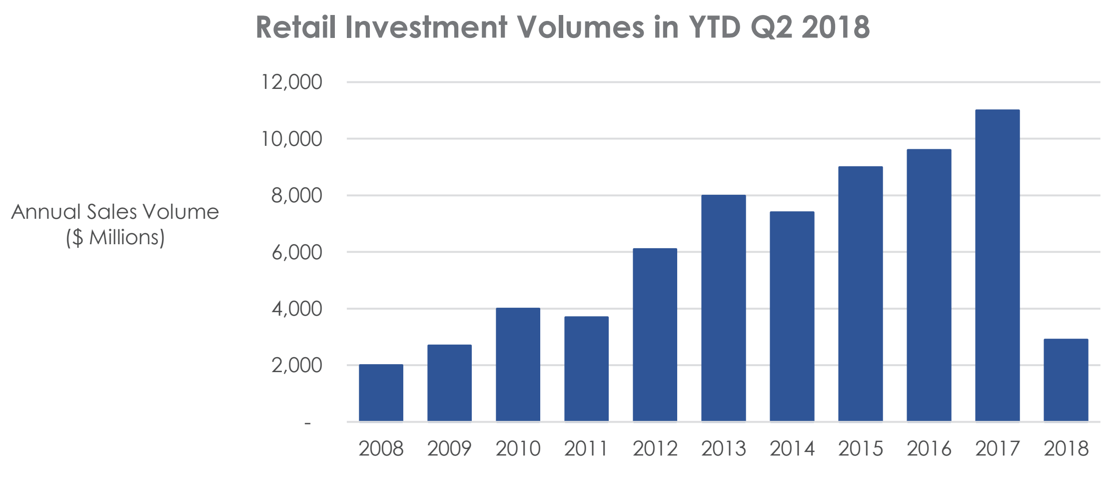
By way of background, retail landlords have enjoyed geographic based natural monopolies for decades. This has afforded them strong pricing power, the ability to grow rents at a multiple of inflation. This rental growth has seen Australian retail rents amongst the highest in the developed world and retail assets highly sought after, affording them the highest investment status in real estate.

With the growth of online retailing, this geographic monopoly enjoyed by 'bricks and mortar' retailers is being eroded. **Retail is facing the effects of 'globalisation'.** Physical real estate is no longer as valuable because its competitive advantage is being eroded by ecommerce.

To highlight one aspect of the impact of the valuation impact of ecommerce: In the past, large store networks have delivered consumers **convenience**. This competitive factor is being surpassed by online retailers – where consumers rate **convenience as the number one reason they use online retailers.** This is genuine disruption – where a large physical store network is faced with new competition that degrades their strong competitive advantage of convenience.

We are starting to see retailers react to this new reality with major retail store networks seeking to contract. Based on public disclosures we estimate Myer will be seeking to reduce its floorspace by 15-20%.

In response to likely declines in asset values, the owners of retail real estate are in the process of divesting their 'non-core' retail real estate. 'Non-core' is a euphemism for retail real estate that will find it difficult to compete in the online world.



Source: CBRE Research, Q2 2018

[2] Macquarie, August 24th, 2018

QUARTERLY SUMMARY

Over the past few years approximately $8-$10 billion of retail real estate has transacted each year[3]. So far this year we have seen $3 billion transact, but there is a lot more for sale. Based on public disclosures and anecdotal feedback, there is about another $10-$12 billion for sale. This is clear evidence that owners of physical real estate are aware of the competitive threat from online retail and are seeking to reposition their portfolios. We judge that they will have to accept materially lower values to move these assets, or they will be unable to sell them.

[3] CBRE Research, 2018

FUND PROFILE	
Fund Inception	1 July 2013
Trustee:	Equity Trustees Limited ABN 46 004 031 298, AFSL 240975
Fund Manager:	Newgate Investment Management ABN 63 613 481 968
Prime Broker:	Macquarie Bank
Administrator & Custodian:	Mainstream BPO
Auditors and Tax	PricewaterhouseCoopers
Legal:	DLA Piper, CNM Legal
Regulator:	Australian Securities and Investment Commission (ASIC)

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The individual fund performance figures are based on an investment in the Fund's June 2013 Series made on July 1st, 2013, the date of the Funds' inception. The performance numbers are based on the net asset value of the Fund and are calculated net of management fees, brokerage commissions, administrative expenses, and accrued performance allocation, if any, and include the reinvestment of all dividends, interest, new issue income or loss, and capital gains. Certain information provided herein is based on third-party sources, which information, although believed to be accurate, has not been independently verified. The Firm assumes no liability for errors and omissions in the information contained herein. This report is for informational purposes only and may not be reproduced or distributed without the prior consent of the Firm.

Volatility is calculated by using the annualised standard deviation of monthly returns since inception of Newgate Real Estate and Infrastructure Fund. Standard deviation measures the distribution of returns around the mean return. Low standard deviations reflect low variation in monthly results; higher variability is usually interpreted as higher risk. Standard deviations are based on monthly results, and then annualised. The Sharpe Ratio is the ratio of "excess return" to volatility. Excess return is defined as the annualised rate of return less the risk-free rate, using monthly returns since inception. The volatility measure is the annualised standard deviation of monthly excess returns since inception.

Any investment in the Funds is speculative and involves substantial risk, including the risk of losing all or substantially all such investment. No representation is made that the Funds will or are likely to achieve their objective, that any investor will or is likely to achieve results comparable to the estimated performance shown, will make any profit at all or will be able to avoid incurring substantial losses.

Past performance is not necessarily indicative of future results. Comparisons of the performance of actively managed accounts such as the Funds with passive securities indices involved material inherent limitations. Performance estimates are presented only as of the date referenced above and may have changed materially since such date.