

Bennelong Kardinia Absolute Return Fund

Monthly performance report

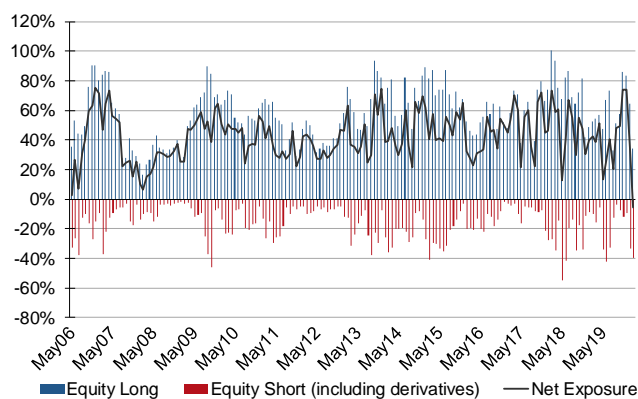
As at 29 February 2020

Fund at a glance

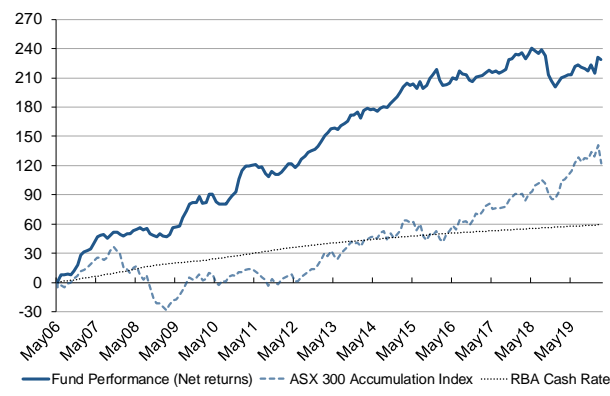
Fund facts	
Strategy	Long-short Australian equity
Process	Fundamental stock selection based on analysis of the macroeconomic environment, company and operating environment, quality of management and valuation
Objective	To achieve consistent positive returns through an investment cycle, with an overarching philosophy of capital protection
Strategy FUM	AUD 124.7 million
Inception date	1 May 2006
Unit price: daily series	1.1369
Unit price: monthly series	1.3381
Fund managers	Mark Burgess, CFA® Kristiaan Rehder, CFA® Stuart Larke, CFA®
Annualised return	8.98%
Total return since inception	228.63%
Annualised standard deviation	7.14%
Sharpe ratio (RFR=RBA cash)	0.78
Percentage of positive months since inception	68.07%

Fund in review

Portfolio exposure analysis



Fund performance



Source: Kardinia Capital

Timeframe	Fund return	RBA Cash Rate + 2% (Perf Fee hurdle)*
1 month	(0.86%)	0.22%
6 months	2.48%	0.89%
1 year	5.96%	1.55%
3 years p.a.	1.75%	1.52%
5 years p.a.	1.80%	1.66%
Since inception p.a.	8.98%	3.44%

Note: Performance results are presented net of all transaction costs, investment management and performance fees and all other costs incurred by the Fund. Performance is the total return of the fund (assuming re-investment of distributions) and is quoted based on hard-close unit prices, without including the impact of buy/sell spreads. The inception date of the Fund is 1 May 2006.

*The Performance Fee Hurdle is the RBA cash rate plus 2%. Prior to 2 December 2019 it was the RBA Cash Rate.

Largest holdings	Sector	%
CSL	Health Care	6.0%
Commonwealth Bank	Financials	5.6%
Resmed	Health Care	3.1%
Charter Hall	Real Estate	1.9%
Evolution	Materials	1.8%
Aristocrat Leisure	Cons. Discretionary	1.8%
Atlas Arteria	Industrials	1.7%
Retail Food Group	Cons. Discretionary	1.4%
James Hardie	Materials	1.3%
Primewest	Financials	1.0%

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Market and fund commentary

The Bennelong Kardinia Absolute Return Fund fell 0.86% in February, with the short book and low net market exposure protecting the portfolio from the significant market decline during the month (S&P/ASX300 Accumulation Index -7.76%). Key contributors and detractors for the month were as follows:

Positive Contributors	Basis Points	Negative Contributors	Basis Points
Short Book	+400	James Hardie	-47
West African Resources	+16	BHP	-38
Imdex	+14	Aristocrat	-29
Goodman Group	+8	Rio Tinto	-26
National Australia Bank	+3	Coles	-24

There were 3 key drivers of Kardinia's outperformance of the index during the month: 1) Low net exposure (including Short Book), 2) Stop loss policy and 3) Strong reporting season for Kardinia.

1. Low Net Exposure (including Short Book)

Kardinia's ability to vary our net exposure to the market and short sell stocks and Share Price Index Futures contracts (SPI) enables the Fund to protect capital in periods of market downturn. The Fund has the flexibility to vary the net exposure to the market between -25% and +75%. We used this flexibility during the month to reduce our net exposure from 30.9% to -5.6%. We reduced the size of our Long Book but also increased the number of individual short positions from 9 to 16 such that the Short Book weight increased from -33.5% to -39.8%. The SPI is a particularly effective tool in risk mitigation as we can deploy a short SPI position quickly and decisively given the enormous liquidity of that market. During the month the Short Book added 400bp to performance.

2. Stop Loss Policy

The other risk management tool that protected the portfolio during the month was our stop loss policy. We have two stop loss triggers, one based on the trade price and the other based on the end of month price. We have a soft stop where the position moves against us by 10% (such that we reassess the position and begin reducing the position size) and a hard stop at 15% (such that we exit the position entirely). During the month a number of stops were triggered. Within the ASX300 Index, 82 stocks fell more than 15% during the month. We have analyzed the share price performance of our positions post being stopped out and the stop loss policy saved the portfolio 99 basis points of performance for the month.

3. Strong Reporting Season for Kardinia

The Australian profit reporting season was generally disappointing with more misses than beats and material downgrades to FY20 earnings expectations. Consensus now expects market EPS growth of only 1.7% in FY20. The two positives were dividends and costs performance. REITs were the best sector in reporting season, delivering solid results and modest EPS upgrades.

The Kardinia portfolio had a good success rate in the reporting season with 38 out of 43 stocks owned by the Fund either beating or meeting expectations. The best results for the Kardinia portfolio included Charter Hall, CBA, ResMed, CSL, Coles and Atlas Arteria whilst the weakest were Altium, Beach Energy, EML Payments and James Hardie.

The Australian equity market fell heavily in February with the S&P/ASX300 Accumulation Index down 7.76% driven by fears over the impact of the coronavirus (COVID-19) on global supply chains. All sectors were negative. The Australian market did a little better than global markets (S&P500 -8.2%, Euro Stoxx 50 -8.4%, FTSE 100 -9.0%, MSCI Asia ex Japan -2.1%). Global bond yields again fell significantly during the month (US 10yr -35bp to 1.15%, Australia 10yr -13bp to 0.82%).

Newsflow during the month was dominated by fears of a global spread of COVID-19 with the number of confirmed cases rising from 9,927 on 31 January to 86,013 by 29 February. The heightened risk of a pandemic saw countries enforce border controls including bans on travel from people who had travelled through China. Kardinia's thoughts on the coronavirus are overleaf.

US economic data was mixed, European data was better than expected, while Chinese economic data was delayed (post month end it was reported that China's manufacturing PMI plunged from 50 in January to 35.7 in February). Australian house prices continued to rise in February (+6.0% year on year) driven again by gains in Sydney and Melbourne. The unemployment rate increased from 5.1% to 5.3%, increasing the chance of a cut in rates by the RBA (with a 25bp cut subsequently delivered post month end). Gold rose 3.4% to US\$1643/oz, copper rose 2% to US\$2.57/lb and Brent oil fell 12% to US\$50/bbl.

The best sectors were Utilities (-3.6%), Health Care (-3.7%) and REITs (-4.9%), while Information Technology (-17.3%), Energy (-17.2%) and Materials (-11.7%) lagged.

We reduced the Fund's net equity market exposure from 30.9% to -5.6% (34.2% long and 39.8% short), with the key changes being lower weightings across the board in our Long Book (particularly James Hardie, Commonwealth Bank, National Australia Bank, Goodman Group, Coles and Macquarie), 7 new short positions and the sale of Santos, Woodside Petroleum, EML Payments, Independence Group, Altium and Bravura Solutions.

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Fund out-performance in periods of market correction¹

Kardinia has a strong track record of protecting capital in market downturns over its 14-year history.

Year		Kardinia	ASX 300AI Drawdown	Kardinia Outperformance
Nov '07 - Feb '09	Global Financial Crisis	-6.02%	-47.55%	41.53%
Jan '10		-3.82%	-6.17%	2.34%
Apr '10 - Jun '10	Greece IMF bailout #1 & Austerity package	-5.32%	-11.20%	5.88%
Apr '11 - Sep '11	US Credit rating downgrade, Euro crisis	-4.97%	-15.41%	10.44%
May '12	Euro debt contagion, French bank fears	-1.79%	-6.74%	4.95%
May '13 - Jun '13	China slowdown fears, QE unwind	-0.06%	-6.83%	6.77%
Sep-14	Euro area credit stress	-0.31%	-5.37%	5.06%
Jun-15	Euro fears, China crash, Renminbi reval	-1.49%	-5.32%	3.83%
Aug '15 - Sep '15		-1.16%	-10.34%	9.18%
Jan '16 - Feb '16		-5.13%	-7.08%	1.95%
Sep '18 - Dec '18	Euro fears, China crashes 13%	-11.37%	-9.50%	-1.87%
Jul '19 - Aug '19	US China trade concerns, Inversion of US yield curve	-1.27%	-6.03%	4.76%
Feb-20	Coronavirus (COVID-19)	-0.86%	-7.76%	6.91%

Source: Iress

Coronavirus

The novel coronavirus (COVID-19) is continuing to spread across the globe. In the US, it is 'when' and not 'if' a virus outbreak occurs. Economically, the key question is whether the virus represents permanent loss of growth, or a temporary loss of growth followed by a V-shaped recovery. In this regard, it is the policy response which is the most damaging to global growth – not necessarily the virus itself. The longer travel restrictions, production shutdowns and barriers to free-flowing trade are in place, the more costly this will be to global growth.

We believe the key issue facing markets is the impact of COVID-19 on global supply chains and global demand. The Chinese government took the decisive action of shutting down an industrial precinct of 11 million people and preventing hundreds of millions of people from travelling. In Hong Kong, inbound tourism has fallen 99% from 200,000 visitors per day to 3,000. In the LNG market, cargoes remain stranded in North America following an evaporation of demand.

China, the world's factory, is having an economic heart attack. Many people may not have realised the true extent of how much global production is based in China until now. One of our preferred retailers has 100% of its production in China and will not have stock to sell if the shutdowns continue for another three months. China has now commenced the process of re-starting its enormous manufacturing base, which is an important signal we are watching closely.

We believe the credit markets are leading equity markets once again, with the bond market rallying significantly over recent weeks (US 10-year bond yield has fallen from 1.92% on 1 January 2020 to 1.15% at month end). Only in the last week or so has the equity market truly woken up to the economy-killing threat that this coronavirus could prove to be.

We started the month of February with a relatively low net exposure of 30% and progressively reduced this over the course of the month as the impact of COVID-19 became apparent. This has enabled the Kardinia Absolute Return Fund to protect investors' capital during this period. To raise the net again, we are looking for signs of significant resumption of Chinese manufacturing activity, immediate monetary and fiscal stimulus, potential cures or vaccines, extreme volatility indicators and capitulation in markets (driven by passive exchange traded funds). There are early signs that some of these catalysts are starting to play out, and our toolkit allows us to act quickly in response to any of these indicators.

The Fund has maintained a low to neutral net exposure position since mid-February and has returned +4.5% calendar year to date (to the end of February 2020).

¹ Market correction defined as market falls greater than 5%

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Fund performance

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2020	5.40%	-0.86%											4.50%
2019	1.66%	1.55%	0.46%	0.55%	-0.03%	2.82%	0.42%	-0.83%	-0.35%	-0.73%	2.04%	-2.84%	4.68%
2018	-0.16%	0.56%	-1.90%	1.56%	1.78%	-0.77%	-0.68%	1.08%	-1.93%	-5.71%	-2.18%	-2.02%	-10.12%
2017	0.12%	0.25%	1.04%	0.89%	-0.75%	0.48%	-0.65%	0.34%	0.66%	3.18%	0.35%	1.43%	7.53%
2016	-3.42%	-1.78%	0.30%	0.52%	1.60%	-0.47%	2.95%	-1.02%	-0.22%	-1.85%	-0.37%	1.45%	-2.44%
2015	1.44%	1.90%	1.24%	-0.59%	0.41%	-1.49%	2.20%	-2.27%	1.14%	2.45%	1.16%	1.74%	9.60%
2014	-2.12%	2.69%	0.87%	-0.63%	0.36%	-0.66%	1.07%	0.56%	-0.31%	1.22%	1.13%	1.53%	5.77%
2013	2.21%	2.36%	1.42%	1.34%	0.40%	-0.46%	1.31%	0.96%	0.93%	2.17%	0.15%	1.11%	14.76%
2012	1.08%	2.30%	1.82%	0.04%	-1.79%	1.38%	2.30%	1.38%	1.85%	0.68%	0.71%	1.07%	13.52%
2011	4.25%	2.13%	0.23%	0.37%	0.11%	-1.41%	0.31%	-3.23%	-1.19%	2.31%	-1.16%	-0.13%	2.42%
2010	-3.82%	0.66%	4.36%	0.36%	-4.38%	-1.33%	0.03%	0.09%	2.49%	2.19%	2.02%	6.84%	9.33%
2009	-1.46%	-0.68%	1.79%	4.56%	0.34%	0.54%	5.31%	4.41%	3.86%	1.21%	-0.28%	3.59%	25.47%
2008	-1.00%	1.12%	0.17%	1.93%	1.33%	0.87%	-1.72%	1.02%	-3.20%	-1.29%	-0.81%	2.04%	0.30%
2007	2.04%	1.28%	1.45%	3.74%	4.95%	1.21%	0.65%	-2.62%	1.76%	2.36%	-0.02%	-1.34%	16.36%
2006					1.53%	6.54%	-0.06%	0.32%	-0.22%	3.65%	5.50%	8.72%	28.67%

Contact details

For more information, contact Client Services on 1800 895 388 (AU) or 0800 442 304 (NZ), or visit kardiniacapital.com.au

How to invest

The Fund is open to investors directly via the PDS (available at kardiniacapital.com.au), or a range of platforms.

Platforms

AMP: Elements Investment, Elements Pension, My North, North, Portfolio Care, Portfolio Care eWrap, PPS, Weathview eWrap Inv

AON IOOF: Portfolio Services

Asgard: Master Trust, eWrap, Macquarie Wrap: IDPS, Employee Super, Infinity Super

BT: Wrap, Super Wrap, Netwealth: Super Service, Assemble Wrap Service, IDPS

CFS: FirstChoice, FirstWrap, IX Oasis: Dominion

Credit Suisse Powerwrap: Super, Pension, Smartwrap

Federation Spitfire (Wealthtrac)

Hub 24: Super, IDPS Wealth O2

Notes:

1. Kardinia Capital is an investment manager that invests solely in Australian and New Zealand securities.
2. The Bennelong Kardinia Absolute Return Fund (Fund) was launched on 1 May 2006 by another trustee, and the above performance data relates to this strategy. Bennelong Funds Management Ltd (Bennelong) assumed responsibility as replacement trustee on 16 August 2011 – for performance history relating to this date, please contact Client Services on 1800 895 388 (AU) or 0800 442 304 (NZ) or client.services@bennelongfunds.com. Mark Burgess and Kristiaan Rehder were employed by the previous trustee and became employees of Kardinia Capital Pty Limited (Kardinia), which has been engaged by Bennelong to manage the Fund, in August 2011. Kardinia has applied the same investment philosophy and strategy in respect of the Fund. Past performance is not a reliable indicator of future performance.
3. Valuations are computed and stated in Australian dollars and are provided by independent service provider Apex Fund Services (Sydney) Pty Limited (Apex).
4. Performance results are presented net of all transaction costs, investment management and performance fees and all other costs incurred by the Fund. Performance is the total return of the fund (assuming re-investment of distributions) and is quoted based on hard-close unit prices, without including the impact of buy/sell spreads.
5. A complete and detailed list of performance results including a presentation is available upon request.
6. Please note that performance data for the Fund is historical data based on the main series using a monthly unit pricing methodology. For those who are invested in the daily series please contact Client Services (1800 895 388 or client.services@bennelongfunds.com) to request your performance history.

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