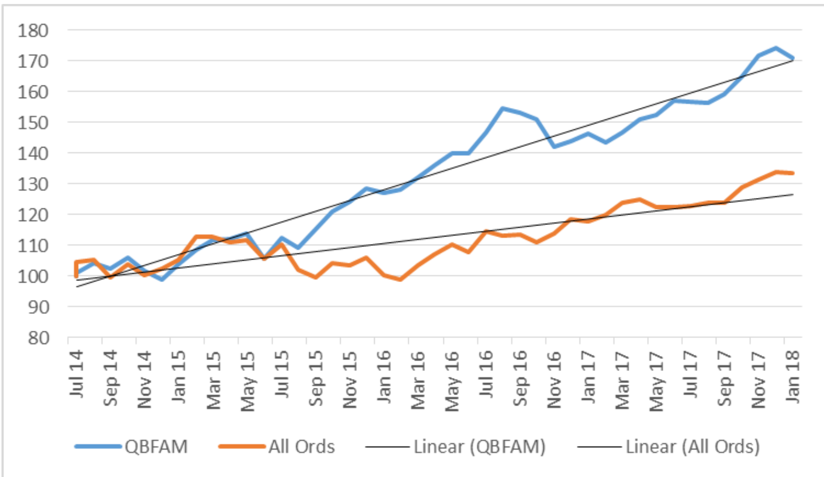
Quick Brown Fox Asset Management

Monthly Report – January 2018

The Australian Equity lagged global peers in January. Whilst US markets appeared to hit all-time highs virtually every session, the ASX 200 traded sideways and finished the month slightly in negative territory. Retail was the best performing subsector on the market (+5.0%) whilst REITs and Utilities were amongst the worst performers, down 3.3% and 4.5% respectively. The fund underperformed the broader market, retracing 1.8% after having four strong months in a row. The main detractors were in the IT space (Melbourne IT -12.4%, Data #3 -10.8% and Gentrack -10.7%). This is an area that has done very well for us over the course of the last year. Recently we have moved to reduce our IT weight and lock in profits. This has built up our cash level. One of the top performers for the portfolio over the last month was Resmed (+13.5%) on the back of a strong quarterly result.

	1 month	3 months	6 months	1 year	2 year (annualised)	Since Inception (annualised)
						1-Jul-14
QBFAM	-1.8%	3.7%	9.3%	16.9%	16.1%	16.2%
All Ords	-0.3%	3.6%	8.8%	13.0%	15.0%	8.2%
Small Ords	-0.5%	6.6%	17.7%	21.7%	19.0%	10.8%

Over the longer term, the fund maintains a strong lead over the market.



Note: All returns are pre fees and unaudited. The fund is not currently available for external investment. To access our investment strategy please contact [Tamim Asset Management](#).

Portfolio News

Our cash levels rose over the course of January as we reduced a number of existing positions. These positions had either become too expensive for our liking or something had changed. Ultimately though we are concerned around the prospect of a correction in equity markets and we believe the most likely source will be rising global interest rates.

The most important number to watch in the world currently is the US 10 year bond rate. The reason is that it is effectively known as the global risk free rate and in the world of finance all other assets are effectively priced off of it. Since September last year this rate has had a dramatic increase, going from a low of around 2.05% to above 2.80% now. The rise has come on the back of global GDP upgrades and the rising expectation that the Federal Reserve will raise interest rates at least three times this year.

Rising interest rates mean different things for different sectors. With higher yields available in the fixed income universe, yield sectors such as Utilities, Infrastructure and Real Estate sell off. Unsurprisingly, Utilities (-4.5%) and Real Estate (-3.3%) were the worst performers domestically last month. Since mid-December we have seen dramatic moves in the Infrastructure space with Transurban and Sydney Airport down over 7%, APA Group down 14% and Spark Infrastructure down over 15%. Whilst there may be further falls to come, it is an area that we are starting to get interested in. In particular companies with regulated earnings which now offer yields close to 7% in some cases. We have had no Utilities exposure over the last few years given the compressed yields on offer, however we have started initiate a small position in this sector and will potentially add on further weakness.

Outside of the yielding sectors, there are likely to be some other sectors that will be impacted. To understand what could happen, it’s important to look back at the past. Thankfully we don’t have to go back too far to find a similar period. Back in the second half of 2016, the US 10 year rate went from below 1.40% to over 2.60% as the Federal Reserve started to talk about further tightening. In the initial stages of this rise in bond yields, the sectors mentioned above started to fall, but what happened after that is interesting. Stocks with high price to earnings multiples started to fall dramatically. These stocks are typically ones with high levels of expected growth and are known as high duration assets. What that means is the payback from earnings typically falls further into the future. With rising interest rates the value of future cashflows begins to fall. The further out the cashflow, the longer the duration of the asset and the greater impact rising interest rates will have on the valuation.

Back in 2016, the healthcare sector was the second worst performing on the ASX. This is despite it arguably having the best long-term growth stories in the market. After a stellar run, the share prices of companies such as CSL, Resmed, Cochlear and Ramsay all fell over 15% from peak to trough. At the time, we used the weakness to establish positions in CSL and Resmed.

So what sectors are at risk this time? One of the best performing sectors in the last year has been Information Technology. Whilst we believe in the long term future of this sector (and it is our largest exposure), we do note that valuations across parts of it are feeling very frothy. Early stage companies such as GetSwift and Big Un have seen significant rises. It’s fair to say that speculation at the smaller end of town has been well and truly alive, however more often than not these fast paced gains in early stage companies reverse. Raising interest rates could very well be a catalyst.
In our portfolio we have moved to reduce some of our positions in higher multiple stocks within the Technology in recent months. Within our top five holdings at the start of last year were Gentrack which returned 85% for the year, Altium which returned 67% and Integrated Research which

returned 42%. We have locked in profits most notably in Altium and Integrated Research (we still hold positions in both but in a greatly reduced size). We have rotated into lower multiple stocks in sectors such as Industrials and Energy and have also built up our cash position. We feel this cash position will allow us to take advantage of what will be a more volatile market in 2018. In particular quality high growth companies which may become significantly cheaper and provide good long term opportunities for patient investors.

The Portfolio

The fund is currently invested in 21 companies. The cash level is currently 38.6% (up from 33.3%). We added one new position, exited our position in SDI, whilst trimming our positions in Axsess Today, Data #3, Beach Energy and Integrated Research.

GTK	8.2%
AXL	5.4%
DDR	4.3%
HSN	4.0%
CSL	3.7%
Other Positions	35.9%
Cash	38.6%

Sector Positioning

The fund maintains a strong overweight to the IT sector with other exposures in Healthcare, Financials, Industrials, Energy, Consumer Discretionary, Utilities and REITs.