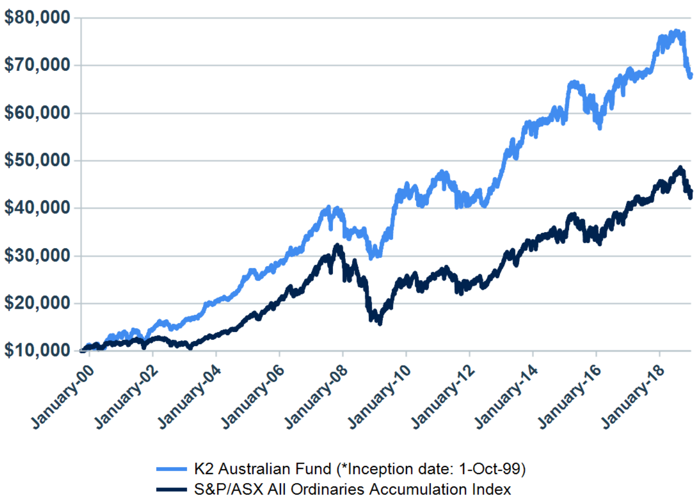
K2 Australian Fund
31 December 2018

	1 Month	3 Months	1 Year	3 Years (%pa)	5 Years (%pa)	10 Years (%pa)	15 Years (%pa)	Inception (%pa)	Inception Date
Performance (Net of Fees)	-1.2%	-10.5%	-8.9%	3.4%	3.4%	8.0%	8.3%	10.5%	1-Oct-1999
Average Net Exposure	27.4%	50.3%	75.4%	77.5%	79.1%	82.1%	75.7%	72.4%	

Growth of $10,000



Commentary

The K2 Australian Absolute Return Fund returned -1.2% for the month of December while the All Ordinaries Accumulation Index returned -0.4%.

The Australian equity market posted its fourth consecutive negative month in December. By the morning of Christmas Eve the All Ordinaries Index was down 5% for the month but recovered during the last 3 trading days of the year. The Australian equity market also exhibited more volatility than usual; the A-VIX averaged 17.6 during December and was 25% higher than the post QE2 seasonal trend. BHP Group was the Fund’s largest positive contributor for the month. BHP rose 11.5% following the completion of its USD5.2 billion off-market buy-back and announcement of a USD1.02 per share special dividend. Short positions in Domino’s Pizza Enterprises and Genworth Mortgage Insurance were also positive contributors for the month falling on average 9.4%.

The Fund’s exposure to smaller domestic cyclical companies were the largest detractors to performance; holdings in Seven Group, Villa World and Southern Cross Electrical Engineering all declined by more than 10% for the month. The weakness in these holdings reflected market participants' wariness about corporate profitability connected to domestic housing activity or global trade. Selective short exposure to the A-REIT sector was also a detractor to performance.

The Fund has been raising significant levels of cash over the past three months with net exposure averaging 27.4% in December; the lowest since February 2008. While the process has been difficult and resulted in some negative short term performance, we feel this is the most prudent approach. We expect the investment climate to remain turbulent over the coming months and we believe that significant levels of cash will allow the Fund to take advantage of opportunities which may be presented.

(commentary continued on next page)

Top 5 Stock Holdings	Current	Monthly Move
Cedar Woods Properties Ltd	2.9%	0.0%
Metlifecare Ltd	2.8%	+0.0%
Medical Developments International	2.8%	-0.1%
RIO Tinto Ltd	2.0%	-0.4%
National Australia Bank Ltd	1.8%	+0.3%

Month End Exposures	Current	Monthly Move
Consumer	2.4%	-1.6%
Energy	0.5%	-1.3%
Financials	8.4%	-3.7%
Health Care	5.9%	-1.1%
Industrials	0.8%	-3.3%
Information Technology	1.3%	0.0%
Materials	6.5%	-1.4%
Real Estate	2.9%	-0.8%
SHORTS	-4.0%	-1.1%
Number of Positions	**32**	**-4**
Gross Equity Exposure	**32.6%**	**-12.2%**
Cash Weighting	**75.5%**	**+14.5%**
Net Equity Exposure	**24.5%**	**-14.5%**

Fund Characteristics	
FUM	AUD $198m
Portfolio Managers	Campbell Neal, David Poppenbeek, Josh Kitchen and Nicholas Leitl
Strategy	Australian and New Zealand Equities
Objectives	To deliver consistent absolute returns over the investment cycle with a focus on capital protection during periods of market declines.
Return Target	+10% pa over the long term
Number of Stocks	Up to 80 stocks
Cash	Up to 100% of portfolio
Distributions	Annually
Management Fee	1.31%
Buy/Sell	Daily Application/Redemption
Performance Fee	15.38% p.a. of the amount by which the NAV exceeds the High Water Mark once the fund achieves its hurdle.

Nicholas Allen
Head of Distribution
03 9691 6119
nallen@k2am.com.au

Sophie Gibbons
Head of Distribution
03 9691 6117
sgibbons@k2am.com.au

K2 Asset Management
Level 32, 101 Collins Street Melbourne Victoria 3000 Australia
Telephone 61 3 9691 6111 **Facsimile** 61 3 9691 6170
Website k2am.com

K2 Australian Fund

Commentary – continued from page 1

The Fund on average held short exposure of 4.2% in December 2018. We are being quite selective with our short exposure; we are looking for absolute returns based on business risks, earnings vulnerabilities, valuation excesses and balance-sheet weaknesses. We are concerned about the trajectory of Australian corporate earnings but are mindful that equity yields are more prospective than other asset classes. We continue to look for long and short opportunities on a stock specific basis as market volatility continues to play out.

The current yield premium that Australian shares offer relative to term deposits might prompt us to invest actively in equities. However we are concerned that the Australian economy will materially contract in 2019. The weakness in equity and property markets for the December quarter will most likely lead to a $300 billion decline in Australian household net-worth. This “wealth effect” is already impacting consumer activity; national passenger car sales for the December quarter were 23.7% lower than last year. Housing activity was also subdued; national auction clearance rates for the December quarter averaged just 47% and national property prices fell 6.2% for the year.

We feel that the first half of 2019 will see a continuation of restricted consumer activity particularly given the near term policy uncertainty associated with the forthcoming Federal election and the release of the Royal Commission’s final report into the Misconduct in the Banking, Superannuation and Financial Services Industry. As a result we would expect business confidence to move lower over the coming months and subsequently we consider it probable that Australia’s unemployment rate will rise in 2019. Ultimately we believe that a contracting domestic economy will lead to lower earnings projections, dividends could be at risk and the dividend yield of Australian equities may be a “value trap”. As a result we have been gradually reducing the Fund’s number of long holdings; today the Fund has just 25 long positions versus 46 at this time six months ago. The Fund will remain conservatively positioned for the short to medium term until such time that we feel that share prices appropriately reflect the earnings risk.