QUARTERLY REPORT

SEPTEMBER 2018

# Racheting up

## Markets in a world of rising rates

p.1 Video insight

PM Capital Global Opportunities Fund Limited

ACN 166 064 875 (ASX Code: PGF)

PM Capital Asian Opportunities Fund Limited

ACN 168 666 171 (ASX Code: PAF)

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# Quarterly video update

In this in-depth video update, Paul Moore, Chief Investment Officer and Portfolio Manager, Global Strategies, discusses:

- 'Late cycle' market conditions and why we may not be there just yet
- The impact of a 'mini-TMT' rush
- Where the long term opportunities lie in a volatile period

Access the video **here.**

"... the opportunities are ... in those value and cyclical types of companies that can see earnings growth."

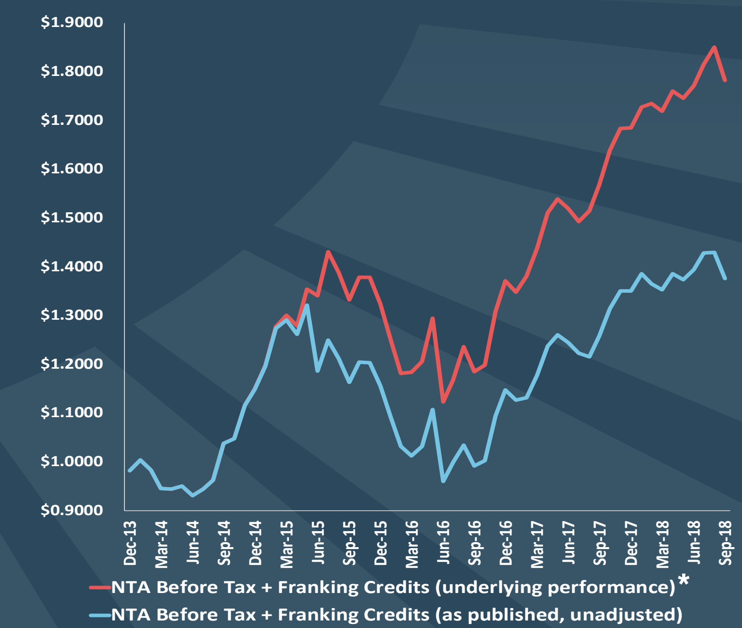
# Listed Company Overview

| | PM Capital Global Opportunities Fund Limited | PM Capital Asian Opportunities Fund Limited |
|---|---|---|
| Asset Class | Global equities | Asian (ex-Japan) equities |
| Listing Date | 11 December 2013 | 21 May 2014 |
| Suggested Time Frame | Seven years plus | Seven years plus |
| Shares on Issue | 351,161,024 | 56,313,902 |
| Share Price[1] | $1.30 | $1.16 |
| Market Capitalisation | $ 454.8 million | $ 65.3 million |
| NTA before tax accruals + franking credits (per share, ex-dividend) | $1.2698 | $1.1884 |
| Company Net Assets before tax accruals + franking credits | $ 445.9 million | $66.9 million |

# PM Capital Global Opportunities Fund Limited

- **The Company** aims to create long term wealth through a concentrated portfolio of 25-45 global companies that we believe are trading at prices different to their intrinsic values.
- **The Company's investment objective** is to provide long-term capital growth over seven-year plus investment horizon through investment in a concentrated portfolio of undervalued global (including Australian) equities and other investment securities.

NTA performance since inception[2]




| | |
|---|---|
| ASX Code | PGF |
| Category | Global equities (long/short) |
| Investment style | Fundamental, bottom-up research intensive approach |
| Number of stocks | As a guide, 25-45 stocks |
| Shares on issue | 351,161,024 |
| Suggested investment time | 7 years + |
| Listing date | 11 December 2013 |

* Excludes the impact of: Changes in ordinary share capital (i.e., option exercise, DRP); Dividends; and Tax paid. After all costs and expenses, including (but, not limited to): management fees; listing fees; registry costs; audit costs; and directors' fees.

# PM Capital Global Opportunities Fund

Paul Moore
Global Portfolio Manager

| Net Tangible Asset (NTA) backing per ordinary share (all figures are unaudited)[1] | June 2018 | June 2018 (ex) | September 2018 (ex) | Change[4] | Perf. since inception p.a.[5] | Perf. since inception total[5] |
|---|---|---|---|---|---|---|
| NTA before tax accruals plus franking credits[2] | $1.3938 | $1.3680 | $1.3764 | +0.61% | + 12.8% | + 78.2% |
| NTA after tax[3] | $1.2812 | $1.2632 | $1.2698 | +0.52% | | |

1. Past performance is not a reliable indicator of future performance. 2. 30 September 2018 includes $0.015 of franking credits. 3. Net Tangible Assets (NTA) refers to the net assets of the Company after the accruals for net current and deferred tax liabilities/assets. 4. Change calculated on an ex-dividend basis. 5. Performance adjusted for capital flows associated with the payment of dividends, share issuance as a result of the dividend reinvestment plan, and including the value of franking credits.

## KEY POINTS

- Portfolio performance broadly flat for the quarter
- Blackstone's investor day illustrates the strength of its global franchise
- The US Dollar continues to rise against the Australian Dollar as the Federal Reserve raises rates

## PERFORMANCE

Portfolio returns were broadly flat over the quarter. A strong performance by the alternative managers, Pfizer and the payment companies Visa and Mastercard assisted performance. The Australian Dollar continued on its downward trajectory against the US Dollar, also assisting portfolio performance.

These gains were offset by weakness in the US homebuilders, European banks and the Macau gaming companies.

Portfolio performance relative to the MSCI World Net Total Return index (AUD) reflects the concentration of the market's gains over the past 6 months. It is a little bit like the old economy/ new economy disparities in valuation that we witnessed at the turn of the century - the "TMT" mania. In 2018 a handful of stocks like Amazon, Apple, Google, Microsoft and Netflix have seen a significant increase in their valuation as investors worry if interest rate increases will see an end to the positive global economic cycle.

In contrast, the so called "late cycle" businesses have been de-rated to record dispersions versus their "growth" compatriots. This is despite earnings expectations continuing to be met. With Toll Brothers (US homebuilder), ING (European bank) and Bank of America selling at 6, 8 and 9.5 times forward 12 month earnings respectively, the risk of an earnings decline has been severely discounted and we suspect will unwind significantly at some point in the next 6 months. We also suspect that the growth sector of the market has seen peak valuations and is vulnerable to de-rating, the beginnings of which may have been witnessed with the recent market adjustment.

## PORTFOLIO ACTIVITY

We have completed our exit from European hotel positions, selling our holding in NH Hotels just after the end of the quarter. NH Hotels is a pan-European company owning and operating hotels throughout Spain, Italy, Germany and the Benelux countries. We entered the position in 2016 through buying its convertible bonds when the stock was trading well below its conversion price. The convertible bond paid us a 4% coupon per annum and in addition, due to the very strong performance of NH Hotels equity, the bond allowed us to convert into the NH stock substantially below its trading price.

The NH Hotels sell-down comes subsequent to the exit of our position in Hispania, which received a takeover offer from Alzette Investments (a vehicle owned by firms advised by affiliates of Blackstone).

During the quarter we added to our Macau gaming exposure. Given its reliance on mainland Chinese patronage, Macau has been at the epicentre of concerns around a slowing Chinese economy and trade fears. A further escalation in geopolitical tensions coupled with the impact of Typhoon Mangkhut in September impacted negatively. Our long term thesis for Macau has not changed and thus we used this weakness as an opportunity to increase our exposure.

# PM Capital Global Opportunities Fund

## OUTLOOK

Our alternative asset managers positions had a very strong quarter, led by Blackstone which rose 18%. We see Blackstone as an excellent business, with its significant free cash anchored by recurring revenue streams, rising margins and a 'capital-light' business model. It is a global franchise with a loyal customer base and strong brand. Blackstone held an investor day in September which illustrated its near and long term growth plans for the business. Its model allows for very strong funds under management growth and improving margins as it scales its various investment platforms. This is expected to drive a targeted 50% increase in management fees over the next two years.

We continue to hold our position in Blackstone due to our view that it can substantially grow its earnings and expand its multiple given an increasing percentage of its revenue coming from locked-in management fees. In addition, we are receiving a 6% dividend yield on the stock - the highest dividend yield among the largest 150 US companies. Blackstone continue to monitor its corporate structure and is impressed by the stock market performance of peers after they have converted from a partnership to a corporation.

Our US homebuilder holdings had a weak quarter due to lower than expected demand. The softening has been attributed to recent house price rises, combined with borrowers' reluctance to give up their current lower locked in mortgage rates for more expensive financing when buying a new house. However, the overall affordability index remains well below prior peaks and homebuilders continue to under-build relative to long run demand, suggesting this slowdown is temporary. There remains a large supply deficit, a strengthening job market and improving demographics as millennials move into prime buying age, creating sufficient tightness in the market for homebuilders to grow earnings over the next few years.

Pfizer rose strongly over the quarter, up over 21%, following an increase in pipeline news-flow. While senior management have been consistent in articulating the long term future growth prospects driven by the internal pipeline, the investment community has often overlooked this narrative given near-term patent expiries. The largest remaining patent expiry, Lyrica, occurs in 2019, after which the business should start to see a reacceleration in revenue growth.

Pfizer's pipeline prospects remain sound with the potential approval of 15 blockbuster drugs ($1 billion revenue plus), half of which are due for approval prior to 2020. In the interim, management remains cognisant of returning excess cash to shareholders through dividends and buybacks. However, Pfizer is now trading on 14 times earnings which is probably fair value and thus we have sold.

Our payment providers, Visa and Mastercard, also had a strong quarter as they reached a settlement on the class action lawsuit by retailers initiated in 2005. As per the terms of the settlement, Visa and Mastercard will pay a combined $6.2 billion, only a $900 million increase on the previously agreed settlement amount with all of the increase covered by existing litigation reserves. As a result, the impact to their earnings is neutral. The removal of this litigation overhang had a positive impact on market sentiment towards the stocks.

The continued upward trajectory of the US Dollar was also a positive contributor to the portfolio over the quarter. With the US Federal Reserve increasing rates and the Reserve Bank of Australia on hold, the interest rate differential between Australia and the US continues to widen, lending strength to the US Dollar.

| Portfolio investments | Weighting^^ |
|---|---|
| Post GFC Housing Recovery - US | 11.9% |
| Post GFC Property Recovery - Europe | 10.3% |
| Global Domestic Banking | 34.3% |
| Service Monopolies | 20.9% |
| Pharmaceuticals | 3.2% |
| Gaming - Macau | 5.9% |
| Alternative Investment Managers | 17.4% |
| Other | 3.4% |
| **Long Equities Position** | 107.3% |
| Short Equities Position | -13.7% |
| Net Invested Equities | 93.6% |
| Total holdings | 36 |

| Current stock examples |
|---|
| Howard Hughes Corporation |
| Cairn Homes |
| Bank of America |
| Alphabet |
| Pfizer |
| MGM China Holdings |
| KKR & Co L.P. |

| Currency exposure* | |
|---|---|
| USD/ HKD | 71.0% |
| EUR | 16.7% |
| GBP | 6.3% |
| AUD | 6.0% |
| Total exposure | 100.0% |

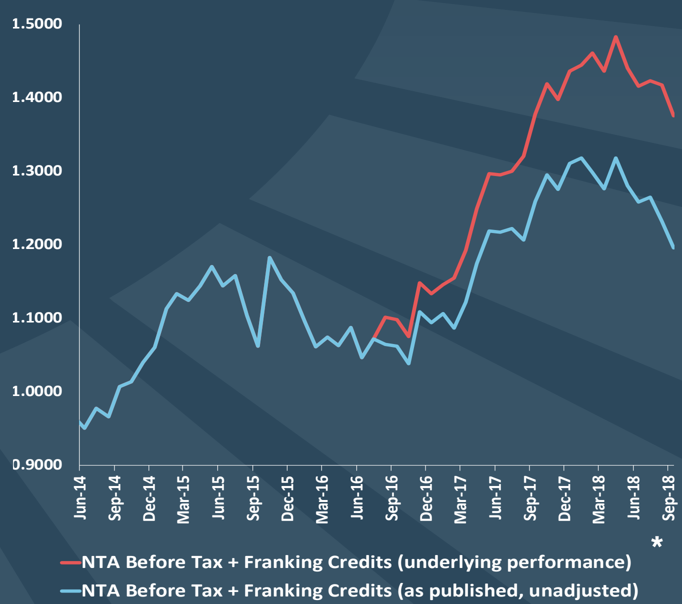
* Stated as effective exposure.

**Paul Moore -** Chief Investment Officer & Global Portfolio Manager
**John Whelan -** Contributing author

# PM Capital Asian Opportunities Fund Limited

- **The Company** aims to create long term wealth through a concentrated portfolio of typically 15-35 Asian centric companies that we believe are trading at prices different to their intrinsic values.
- **The objective of the Company** is to provide longterm capital growth over a seven-year plus investment horizon through investment in a concentrated portfolio of predominantly undervalued listed Asian equities and other investment securities in the Asian Region (ex-Japan).

NTA performance since inception[2]




| | |
|---|---|
| **ASX code** | PAF |
| **Category** | Asian (ex-Japan)[6] equities |
| **Investment style** | Fundamental, bottom-up research intensive approach |
| **Number of stocks** | As a guide, 15-35 stocks |
| **Shares on issue** | 56,313,902 |
| **Suggested investment time** | 7 years + |
| **Listing date** | 21 May 2014 |

*Excludes the impact of: Changes in ordinary share capital (i.e., option exercise, DRP); Dividends; and Tax paid. After all costs and expenses, including (but, not limited to): management fees; listing fees; registry costs; audit costs; and directors' fees.

# PM Capital Asian Opportunities Fund

Kevin Bertoli
Asian Portfolio Manager

| Net Tangible Asset (NTA) backing per ordinary share (all figures are unaudited)[1] | June 2018 | June 2018 (ex) | September 2018 (ex) | Change[4] | Perf. since inception p.a.[5] | Perf. since inception total[5] |
|---|---|---|---|---|---|---|
| NTA before tax accruals plus franking credits[2] | **1.2580** | **1.2304** | **1.1884** | **- 3.4%** | **7.6%** | **37.6%** |
| NTA after tax[3] | **1.1818** | **1.1618** | **1.1316** | **- 2.6%** | | |

1. Past performance is not a reliable indicator of future performance. 2. 30 September 2018 includes $0.032 of franking credits. 3. Net Tangible Assets (NTA) refers to the net assets of the Company after the accruals for net current and deferred tax liabilities/assets. 4. Change calculated on an ex-dividend basis. 5. Performance adjusted for capital flows associated with the payment of dividends, share issuance as a result of the dividend reinvestment plan, and including the value of franking credits.

## KEY POINTS

- Headline performance relatively subdued despite escalation of trade fears.
- Portfolio weighting to Macau increased after recent sell off in regional gaming companies.
- Continue to hold a positive view on Asia despite growing macro concerns.

## PERFORMANCE

Headline performance was relatively subdued for the quarter. While the underlying equities portfolio was impacted by the broad-based selling witnessed across Asian markets, currency positioning offset a large part of the negative impact.

Asian equity markets experienced some of their sharpest declines since the start of 2016, which was the height of 'China hard landing' and 'oil crisis' fears, as net capital outflows returned to the region. Ongoing US/ China trade tensions acted as a headwind as investors contemplated the economic impact if negotiations are unable to be resolved amicably. China's Shanghai Composite declined 10% while the Korean KOSPI, dominated by industries linked to global trade, fell 9%.

The impact of rising US interest rates and a strengthening US Dollar also had a negative impact, particularly on some peripheral Asian markets. Hardest hit were the Philippines' PSEi which declined 10% and Vietnam's Ho Chi Minh Index down 18%, albeit after recording very strong returns since the start of 2016. The performance of both the Philippines and Vietnam markets highlight the role foreign capital flows have on emerging market performance. A strong US Dollar, rising interest rates and commodities have put pressure on many emerging market economies. This phenomenon is not just being felt in Asia, with Argentina, Turkey and Brazil also in the spotlight in recent months.

## PORTFOLIO ACTIVITY

Pax Global, Baidu and Malaysian brewing holdings, Heineken Malaysia and Carlsberg Malaysia, provided positive contributions to performance. Baidu advanced 9% after first quarter earnings comfortably beat expectation and their US listed video stream subsidiary iQIYI performed strongly post-IPO. We expect the robust momentum being displayed in Baidu's core search and video stream businesses will continue in the foreseeable future, irrespective of China's macro conditions.

Heineken Malaysia rose 5%, buoyed by the surprise general election result that saw a change of government for the first time since the foundation of Malaysia in 1957. One of the first actions of the newly elected Pakatan Harapan ('Alliance of Hope') coalition was to eliminate the goods and services tax which, it is hoped, will boost consumption.

Positions sensitive to economic growth and regional trade were among those sold lower. Of note were KB Financial and Industrial and Commercial Bank of China which both fell 13% over the quarter despite confirmation of a rising interest rate environment globally, which will benefit our financial holdings initially through expanding net interest margins.

Investments in the gaming sector also detracted from performance. MGM China declined 10% while Nagacorp fell 12% over the quarter. Several factors have prompted investors to temper near-term growth expectations, most notably the prospects of a slowing Chinese economy and recent depreciation of the Chinese Yuan (lowering the purchasing power of the Chinese gambler). Macau's casino operators were also impacted by notably tighter monitoring of illegal UnionPay point-of-sale terminals (POS). The portfolio's gaming exposure, Macau in particular, was reduced materially at the beginning of 2018. During the latter stages of the June quarter we increased our exposure to Macau again initiating a position in Wynn Resorts.

# PM Capital Asian Opportunities Fund

## OUTLOOK

The factors impacting markets in the first six months of this year are likely to remain throughout 2018. These will act as near-term headwinds for regional markets as investors try to gauge the flow-on effects to economic activity.

Trade, and more accurately fair trade, is not a new topic, however investor reactions this time have been far more pronounced. There are several reasons for this, most obvious being that negotiations involve the world's two largest economies, but also because trade issues between the two countries have long been glossed over causing significant imbalances which need to be addressed. Overlay this with the fact that negotiations are seemingly being played out as much on Twitter, or in front of the camera, as they are at the negotiating table has investors on edge. Market participants are not used to the level of hyperbole President Trump brings to the table and this heightened rhetoric inevitably changes how we view the topic. The strong performance of markets over the last several years and high market valuations also means the margin for error is small.

Predicting the internal machinations of trade negotiations is the most difficult aspect of the current market and the reality is in the short term it is virtually impossible. From a portfolio perspective, decisions based solely on predicting the outcome of such events are similarly likely to result in error.

We have been vocal over the past 12 months in calling out the dramatic shift in earnings expectations and markedly higher valuations which has made it more difficult to uncover genuine anomalies.

Perhaps unsurprisingly, at a Hong Kong conference I attended in March 'synchronised global growth' was the most repeated phrase, suggesting an overwhelmingly positive sentiment. In the space of three months these attitudes have been fundamentally tested. Any meaningful correction in markets driven by fluctuations in these short-term sentiments will give us a chance to put capital to work.

During the quarter Chinese equities were front and centre with the country being granted an increased weighting in MSCI's global indices. The announcement served to highlighted how underweight global investors are when it comes to not only China but Asia more broadly. Approximately 350 new stocks were added to the global MSCI index, over 300 of those additions were Chinese companies (a-shares, US listed ADRs and Hong Kong h-shares). It is rare to see significant changes to indices like this which suggests gatekeepers like MSCI have the mix wrong and are scrambling to catch up. Investors remain under allocated to the main source of global GDP growth – after the recent changes China still accounts for only 3.7% MSCI All Countries World Index compared to the US at 53%.

Our approach to Asia remains very much a long-term one. We continue to believe Asia will remain the epicentre for global growth into the foreseeable future, as it has been better part of the last two decades. While growth in the US and Europe has been largely a function of a recovery from severe cyclical corrections, Asia provides one of the best places with consistent structural growth underpinning GDP. Most of the growth drivers will remain regardless of current debates.

| Portfolio investments | Weighting |
|---|---|
| Consumer - Breweries | 9.8% |
| Consumer - Other | 11.3% |
| Financials | 18.3% |
| Gaming - Macau | 10.8% |
| Gaming - Other | 5.4% |
| Online Classifieds & Ecommerce | 14.0% |
| Capital Goods & Commodities | 10.4% |
| Oil & Gas Infrastructure | 8.9% |
| Technology Hardware | 6.4% |
| **Long Equities Position** | **95.3%** |
| Short Equities Position | -1.2% |
| **Net Invested Equities** | **94.1%** |

| Current stock examples | |
|---|---|
| Heineken Malaysia | |
| Dali Food Group | |
| DBS | |
| MGM China Holdings Ltd | |
| NagaCorp | |
| Baidu | |
| Turquoise Hill Resources | |
| Sinopec Kantons | |
| Total Holdings | 25 |

| Currency exposure* | |
|---|---|
| USD | 44.6% |
| HKD | 30.5% |
| AUD | 19.1% |
| INR | 3.2% |
| Other | 2.6% |
| Total exposure | 100.0% |

* Stated as Effective Exposure.

**Kevin Bertoli** - Asian Portfolio Manager

# Important information

**This Quarterly Report is issued by PM Capital Limited (ABN 69 083 644 731, AFSL No. 230222) as investment manager for the:**

PM CAPITAL Global Opportunities Fund Limited
ACN 166 064 875 (ASX Code: PGF)

PM CAPITAL Asian Opportunities Fund Limited
ACN 168 666 171 (ASX Code: PAF)

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The Index for the PM Capital Global Opportunities Fund Limited is the MSCI World Net Total Return Index in Australian dollars, net dividends reinvested. The Index for the PM Capital Asian Opportunities Fund Limited is the MSCI AC Asia ex Japan Net Total Return Index in Australian dollars, net dividends reinvested. See www.msci.com for further information on the MSCI indices.

See the company announcements platform at www.asx.com.au, and www.pmcapital.com.au, for further information.

1. As at close of market trading Friday 28th September 2018.

2. Past performance is not a reliable indicator of future performance.

6. The Asian region (ex-Japan) includes Hong Kong, China, Taiwan, Korea, Indonesia, India, Sri Lanka, Malaysia, Philippines, Thailand, Vietnam, Pakistan and Singapore, but excludes Japan. The Company may also obtain exposure to companies listed on other global exchanges where the predominant business of those companies is conducted in

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