



Portfolio Update

September 2018

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From the Directors

September 2018 Review

The last date for a federal election to be held under the overly complicated Australian Federal election rules is 18 May 2019. If you would like to understand the calculation process you should take some time to read Anthony Green's election blog. With the vacant seat of Wentworth due to be contested on the 20th of October perhaps we don't even get to May. While the election is probably still a while away it is worth highlighting the key policy differences of the Australian Labour Party. While new policies would have to pass the upper house before becoming law it is likely that the ALP would gain the support of the Greens to force changes through.

The policy differences are:

- Personal Income tax - Reintroduce the 2% levy on the top tax bracket (lifting it to 49% from 47%). The Turnbull government had proposed to abolish the 37% tax bracket and lift thresholds over a 7 year period.
- Negative Gearing - Limit negative gearing to only new housing (and existing assets) rather than all housing.
- Capital gains tax - Halve the discount applied on capital gains for assets held for more than a year to 25%.
- Excess franking credits - Restrict access to excess franking credits to charities and not for profit organisations.
- Taxation of trusts - Apply a minimum tax rate of 30% on discretionary trust distributions to adult beneficiaries from mid 2019.

Clearly a big issue for most Australian retirees is the proposed change to franking credits with a significant amount of SMSF trustees facing significant losses to real income under the proposed changes. This is likely to cause a change in behaviour and cause a shift in focus towards assets with a higher yield, quite possibly further up the risk curve, to make-up for these losses. We continue to watch with interest but we are also preparing for the likely change.

Globally the economic cycle continues to move closer to the conclusion of a strong expansionary period. We still believe that it makes sense to remain long risk but as risks appear and/or magnify we believe we need to continue to diversify portfolios, remain more liquid and be ready to act. We believe a shock could come from excess wage and inflationary pressure which would cause excessive central bank tightening (not on the horizon as yet) or an external shock to the system such as the trade wars, although we are still undecided on how far we believe the Trump administration will push this. The US economy, as mentioned last month, is booming with consumer confidence at its highest level since 2000, jobless claims at the lowest level since 1969 and wage growth at the highest level since 2009. US GDP Growth for the year to the end of the second quarter is 4.2% and this is the strongest level experienced in 4 years. The strong economy has helped drive US equities in September which in turn has driven developed market equities, represented by the MSCI World Index, up +7.1% in 2018 after a strong 3rd quarter (+5.4%).

Australia

A weak Australian equity market in September (-1.2%) resulted in the quarter looking weaker relative to the developed market result we saw above with the ASX200 up only 1.5% in the quarter. Despite this, most of the TAMIM Australian managers were able to deliver a positive result in September with the Small Cap strategy being the stand out at approximately 8% in the quarter. Over this time the equity market was driven by strong telecoms, healthcare, industrial and technology sectors while the financial and materials sectors proved to be big detractors. The Royal Commission (and the probable increase in regulation to come) coupled with a weakening housing market has seen pressure on the local market increase. The earnings outlook in Australia has started to weaken as a result. A bright spot does still remain though, tightness in the supply of oil on global markets is likely to support energy and oil shares. The energy sector has remained a consistent performer but is still the only sector trading below its 15 year average forward price to earnings ratio.

US rate hikes and the inability of the Reserve Bank of Australia to follow suit has resulted in the ongoing weakness of the AUD versus the greenback. Thankfully the weaker AUD does provide some relief to the economy. The economy expanded by 3.4% in the year to the end of the second quarter which was more than the marketplace expected. Household consumption was weak which is a concern but growth was still experienced in this segment as well as government spending. With savings rates low, low wage growth and high household debt to income the Australian household remains vulnerable. It is likely that growth through the balance of the year and for 2019 will be more muted than the current pace.

Global Markets

As stated above, we are still not sure of how far Trump will push the trade war as we remember the Mexican wall (put this in the context of the modernised NAFTA agreement with Mexico) and the threat of Nuclear Armageddon with Kim Jong Un. Having said this, the most obvious near term risk to global markets and the economy as a whole is the potential for further escalation in the US China trade war. The US has imposed tariffs on \$250bn worth of Chinese imports. The retaliation from China has been to impose tariffs on approximately \$110bn of US imports. As of January 2019 the current 10% US tariff is set to increase to 25%

should a trade deal not be reached. A further threat of imposing tariffs on all Chinese imports has been threatened if China imposes any further retaliation. What does all of this mean? Well in a worst case scenario this creates a large drag on global growth and results in inflationary pressures. Our view is that calm will still prevail but the impact on business and consumer confidence is already being felt. On the positive side, an easing of trade worries will almost certainly result in upside for developed equity markets.

The other key risk to global markets, the Fed raising rates too far too fast, seems to be under control. The Fed raised rates in September once again. The rising yields have created volatility in the market but we need to remember rates are increasing in response to growth and not inflation and this should be seen as a positive signal for risk assets. Yield curve inversions precede recessions they do not cause them, you need to look at more comprehensive economic data to assess the risk of a recession.

Europe has weakened materially in exports since the start of the year. Most of this can be attributed to a slowdown in exports to China. This could lift as the Chinese continue to ease domestic lending policies to support domestic demand. The concern is that the weaker exports alongside higher oil prices will result in lower domestic consumption levels. Consumer confidence is off which coupled with the Italian political developments will cause greater volatility in both fixed interest and European equity markets.

In Japan, employment has risen to the highest level since 1974 and Japanese banks continue to expand credit. The weakening Yen (resulting from interest rate differentials to the US) has also helped Japanese equities with the Topix up 5.9% through the quarter. Interestingly the new TAMIM Asia Small Companies fund has approximately a 60% weighting to Japanese equities. A slowdown of Chinese credit growth has weighed (along with the trade war) on the Chinese market. Chinese authorities are now easing policy to support domestic growth. They are still however retaining regulatory pressure on the shadow lending sector.

Conclusion

US equities remain the standout sector but risks are now elevated with a hawkish Fed and a President that is difficult to read. The greater risk to the global economy is that the current US expansion comes to an end. They all do at some point. We believe there is a long overdue swing back to value from growth as an investment style. There has been a noticeable differential between growth and value style valuations as well as a weak set of second quarter numbers from the FAANG constituents. It is not a matter of if, rather a matter of when.

TAMIM Australian Equity All Cap Value IMA

The Australian equity market ended its five month winning streak in September. The worst performing sector was Healthcare (-7.3%) with CSL (-11.5%) and Cochlear (-7.0%) pulling back from all-time highs. We wrote last month about the overvaluation in the sector and were not surprised to see the pullback. In addition to high valuations the sector was hit with an announcement by the Prime Minister of an inquiry into the Aged Care sector. As a result Estia Health fell 22.3%, Japara Healthcare fell 22.0% and Regis Healthcare fell 17.4%. Whilst the index snapped a winning streak, our portfolio snapped a 3 month losing streak returning 0.6% for the month. Whilst we are currently sitting on an elevated level of cash, we are for the first time in around 18 months genuinely excited about the potential of our portfolio.

Portfolio News

As mentioned above there are currently a number of positions that we are excited about. We see them as medium term ideas that could be materially higher in

3 years time.

MSL Solutions (+2.3% in September) is one we wrote about last month and in our opinion remains the cheapest software company listed on the ASX. After disappointing the market by missing prospectus forecasts we believe the company has a chance to wipe the slate clean. With a clean slate we believe the market will soon start to focus on the fundamentals of the business and to us they are impressive.

In the recent result, revenue grew by 44% in FY18 with 20% coming via organic growth and 24% via acquisitions. The company completed two further acquisitions during the year and has indicated they have several advanced opportunities in late stage discussions currently. Importantly, during FY18 recurring revenue grew 31% and now equates to 47% of total revenue.

The below breakdown of the company's revenue growth over its short listed history tells an impressive story.

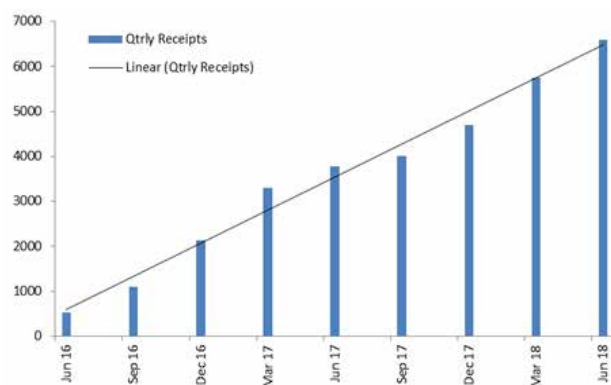
AUD \$m's	FY16	FY17	FY18	Description
Revenue Growth	30%	110%	44%	Total Revenue including Recurring Annuities (customer support & SaaS Subscriptions) and Non-Recurring Revenue (upfront licence fees, services, hardware & advertising)
- Organic Growth	14%	17%	20%	
- Acquisition Growth	16%	93%	24%	
Recurring Revenue	5.7	12.1	15.8 (31%)	Recurring annuity contracts – note customer churn rates annually are less than 5%
- Support Annuity	4.8	7.4	9.2 (25%)	
- SaaS / Subscriptions	0.9	4.7	6.6 (40%)	
Annual Recurring Revenue (ARR)			16.8	ARR is the forward looking annuity value contracted at a point in time.
- Support ARR			9.2	
- SaaS / Subscriptions ARR			7.6	
Customer Venues		2,066	2,406 (16%)	Customer venues using MSL software modules from the MPower Connect technology stack at period end.
- Organic Growth			4%	
- Acquisition Growth			12%	

Source: Company filings

The opportunities in front of the company are large. They operate in over 25 countries but have less than 5% of their addressable market with no clear number one player. They have a net cash balance sheet and are spending heavily on research and development to improve their products (currently 17% of revenue, entirely expensed). 50% of the revenue comes from offshore and this is only likely to increase as we move forward. The company has a strong base and the chance to be a global leader in a niche field.

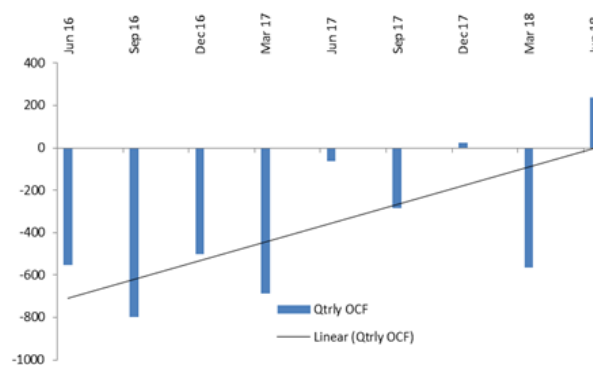
SRG Global (+1.4% in September) is another company we are excited about. It is a product of a recent merger between SRG and Global Construction Services. We owned both companies for different reasons before the merger and believe the combined entity is a stronger more scalable vehicle. The company has exposure to the coming infrastructure boom and the upside of the potential replacement of flammable cladding in a large number of recently built apartments across Australia. The stock in our opinion is currently one of the cheapest listed on the ASX as investors to date have questioned the merger. We believe with a little bit patience, earnings could push the shares higher.

Locality Planning Energy (-5.3% in September) is a Queensland based operator of embedded electricity networks. Essentially they provide energy services to strata communities. When they take on a new strata community, they install a “parent meter” in front of all the existing individual meters. As a result, a single metering and network charge now applies. In total, the company estimates they can save the residents around 20% on their electricity bills. For their trouble, Locality Planning make a gross margin of around 20%.



On the back of this growth, the company has reached breakeven at its operating cashflow line. Two of the last three quarters have been positive. The company is making significant strides and with a long growth pipeline ahead of it, we feel it is significantly

undervalued with a 2-3 year view.



Typically we don't invest in companies that don't make a profit but in the case of Locality Planning a few things give us some comfort in the future. Firstly, the company has experienced significant take up and growth over recent years (as evidenced above), and secondly (and probably most importantly) the average contract length they have is 7.2 years. In other words, their current run rate of revenue is locked in for the next 7.2 years and all additional strata communities they add will lead to growth. It's rare to see such a stable revenue base for a company with a market cap of \$45m.

With the company more or less at breakeven and still growing, we expect that additional growth over the coming years will lead to profitability and a rerating of the shares.

The Portfolio

The portfolio is currently invested in 19 companies. The cash level is currently 40.8% (down from 46.3%). During the month we sold out or commenced selling out of four smaller positions. We added two new positions; one in the financial sector and one in the industrial sector. We exited our last remaining position in the Energy space.

GCS	8.1%
MPW	6.8%
SKI	5.9%
GTK	5.0%
TME	4.5%

Other Positions	28.9%
Cash	40.8%

The portfolio maintains a strong overweight to the IT sector with other exposures in Industrials, Utilities, Healthcare, Consumer Discretionary and Financials. Our IT weight has been falling in recent times whilst we have been adding to Industrials (with an Infrastructure focus) and Utilities.

TAMIM Australian Equity Small Cap IMA



Portfolio Review

The underlying portfolio returned +1.60% after all accrued fees and expenses for September 2018. The ASX All Ordinaries Index was weaker, declining -1.58% during the month. For the first three months of the 2019 financial year, the underlying portfolio has increased +6.86%.

Following the August reporting season, and with AGM's scheduled for the next two months, there was limited company news announced during September. Highlights from portfolio company announcements included:

Legend Corporation (ASX:LGD, +35%) reported an encouraging start to the financial year with EBITDA up c. 70% on the same two months last year (up 60% excluding acquisitions). This result was driven by increased revenue of 28% and slightly higher gross margins. LGD also announced the acquisition of PCWI International - a manufacturer, distributor and exporter of specialised test and measurement equipment used in gas, oil & medical applications, which is expected to contribute an additional \$0.75m on an annualised basis.

Janison Education (ASX:JAN, +12%) updated the market on a number of recent customer wins that will result in implementation fees in FY19 and recurring platform revenue in future years. New contracts include NSW Department of Education, UNSW Global, Roads & Maritime Services NSW, a big 4 Australian bank and a leading Australian utility services company. Towards the end of the month, JAN undertook a \$5m capital raise to accelerate the growth of its higher education assessment offering, which we participated in.

Easton Investments (ASX: EAS, -16%) acquired a small business that provides dealer services (compliance, training, technical support and para planning) to more than 80 accountants on a subscription basis. In a post Royal Commission environment, it is likely that accountants will play an increasing role in the delivery of financial advice, and as the 2nd largest provider of authorisations (to provide advice) to the accountant market in Australia, Easton is well placed to benefit from this convergence of accounting and wealth channels.

Sector Exposure

The portfolio provides exposure to a genuinely differentiated portfolio of profitable smaller companies, with bright prospects, and at attractive valuations. Correlation with the broader market remains low, and thus an investment is expected to bring diversification benefits to our investors' broader portfolios. As set out below, the portfolio is exposed to sectors with some encouraging tailwinds, including above average weightings to healthcare, diversified financials, education and tourism.



Outlook

We continue to remain wholly focused upon what is within our control: executing on a well-considered, time-tested, value-conscious investment philosophy.

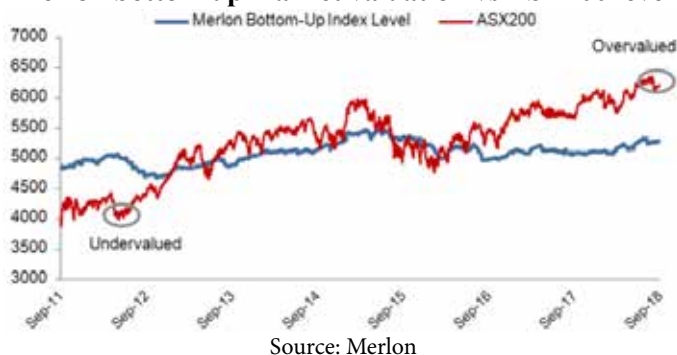
We are enthused by the medium to long-term prospects across our current portfolio holdings. These are high quality businesses with great management teams with whom we've built strong relationships. Importantly, valuations remain attractive and ultimately will drive returns over time. We continue to add new holdings to the portfolio that have significant medium to long term upside.

TAMIM Australian Equity Income IMA

Market Outlook & Portfolio Positioning

As has been our historic practice, we continue provide an aggregate assessment the ASX200 valuation based on the individual company valuations for the 156 stocks we actively cover. On this basis the market appears approximately 15% overvalued.

Merlon bottom up market valuation vs ASX200 level



Our individual company valuations have been established utilising our estimates of sustainable free-cash-flows and franking credits discounted at consistent mid-cycle interest rates and risk premiums.

In truth, we don't really know whether our approach of utilising "mid-cycle" interest rates and risk premiums to "value the market" is the right one. We are not macro investors and don't think we have any special insights that would justify speculating with our own or our clients' money on the imminent direction of the global economy or financial markets. We can observe however, as others have done, that the current aggregate market valuation would appear to reflect a fairly complacent attitude towards risk and an expectation that interest rates will remain low for an extended period of time.

One example at the extreme end of investor apathy towards risk within an Australian context is the emergence of what one stockbroker recently coined the WAAAX stocks (Wisetech Global, Altium Limited, Afterpay Touch Group, Appen Limited and Xero Limited). These five companies in aggregate generated gross operating cash flow during their most

recently reported 12 month periods of around \$100 million and a pre-tax free cash flow loss of around \$40 million. Against this financial performance, the WAAAX stocks have a combined market capitalisation (based on the average share counts during the period) of over \$20 billion.

For context, this market valuation approximates estimates for the Coles Group soon to be spun out of Wesfarmers, a company that generated gross operating cash flow of approximately \$2.2 billion and free cash flow before tax of \$1.7 billion during the year to June 2018.

As this example illustrates, there remains dispersion across stocks and sectors. We have flagged for some time that we believe the resources, healthcare, property and infrastructure sectors to be overvalued relative to other parts of the market. We can safely add the WAAAX stocks to this list.

Our portfolio comprises our best research ideas, based on our long-term valuations and analyst conviction. As seen below, the portfolio offers 20% absolute upside and is looking increasingly attractive relative to the index.

Expected return based on Merlon valuations



The United States continued on its journey towards higher interest rates during the quarter. Cost pressure in the United States is evident in the data (wage pressures and inflation) and has been a clear theme of our recent trips to the US (we visited in May and September). The Federal Reserve remains likely to

continue increasing interest rates over the next 12 to 18 months.

The divergent path of US and Australian interest rates coupled with our cautious outlook for commodities lead us to expect depreciation in the Australian dollar. Our positions in Magellan Financial, News Corporation, QBE Insurance and Platinum Asset Management should benefit against this backdrop.

The state of the Australian housing market remains a major area of focus and concern for investors. The Royal Commission and the associated “credit crunch” has added fuel to the fire driving bank stock and consumer discretionary stock valuations to historically low levels. While our non-benchmark approach means we are content holding no major banks at times where investors are too complacent, we have added some exposure to the sector as these legitimate concerns have become more adequately reflected in market expectations and stock prices.

Portfolio Aligned to Value Philosophy and Fundamental Research

The portfolio reflects our best bottom-up fundamental views rather than macro or sector-specific themes. These are usually companies that are under-earning on a three year view, or where cash generation and franking are being under-appreciated by the market.

While we are not macro investors, as discussed above there are clearly some macro themes built into the portfolio. We need to be aware of these themes and ensure they do not expose us or our clients to unintended risks. In the first instance, any such risks are mitigated by our strategy of investing in companies that are under-valued relative to the sustainable free cash flows and the franking credits they generate for their owners. Attractive valuations strongly imply that market concerns are – at least to some extent – already reflected in expectations and provide a “margin of safety” in the event conditions adversely deteriorate.

Our larger investments are typically in companies where investors have become overly pessimistic about long term prospects on account of weaker short term performance. This tendency to extrapolate short-term conditions too far into the future and investors’ focus on nonsensical measures of corporate financial performance instead of cash flow continue to present us with opportunities. The WAAAX stocks are an

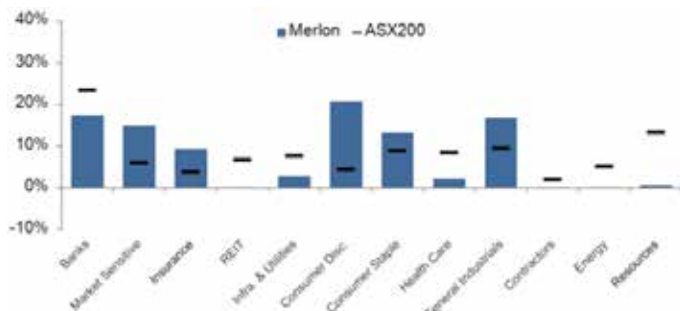
example of this type of behaviour with little “margin of safety” should their performance deteriorate.

Conversely, a company like Magellan Financial is trading at a discount to the ASX200 on a simplistic price-earnings ratio notwithstanding the company’s exceptional cash conversion (as evidenced by the recent dividend increase), debt free balance sheet, low operating leverage, strong distribution and the defensive positioning of its underlying funds (high cash holdings, short Australian dollar). This company has a market capitalisation that is less than a quarter of the WAAAX stocks, will generate gross operating cash flow approaching five times the WAAAX stocks and has virtually no capital expenditure so can actually return the vast majority of this cash flow to shareholders.

QBE Insurance Group is also a stock we like against the current macroeconomic backdrop. This company holds approximately US\$23 billion of investments and cash, the majority of which is in floating rate fixed income investments and the majority of which is held outside Australia. Higher global interest rates will improve the running yield on this portfolio and increase the rate at which liabilities are discounted, the latter of which will strengthen the company’s capital position and free up cash that can be returned to shareholders. QBE has struggled since the GFC partly due to mismanagement but also as a result of reducing global interest rates and a tough insurance pricing backdrop. Management is more focused, interest rates are turning from a headwind into a tailwind and the insurance pricing cycle appears to be stabilising.

News Corporation included Foxtel in its consolidated accounts for the June quarter, significantly lifting its consolidated revenues and highlighting the company’s increased skew towards recurring subscription revenues and away from more cyclical and macroeconomic exposed advertising income. While Foxtel and the legacy print businesses face significant structural challenges, these assets are not really being valued by the market to any material extent once we take into account the value of the company’s online real estate classified businesses.

Portfolio Exposures by Sector (gross weights)



Source: Merlon

Some of our best research ideas do not appear in the top 10 in terms of size as they are constrained by liquidity. These include, among others Southern Cross Media, Asaleo Care and Sky TV New Zealand.

September Quarter Portfolio Activity

During the quarter we added to two existing investments in Aurizon and Asaleo Care, with both having underperformed relative to our long-term fundamental valuation. We initiated an investment in Aurizon Rail last quarter, with long-term fundamental value upside emerging after a poor regulatory decision on its monopoly rail business that we believe will improve over time. We similarly initiated a small investment in Asaleo Care, a manufacturer of personal hygiene and tissue products, with some strong brands and margins now more realistic after rebasing from unsustainable levels at the time of the IPO. On our estimates, the market is currently ascribing no value to the tissue business despite higher pulp prices being an industry issue, and we already assume personal care margins revert to be more in line with global peers.

We funded these investments and ended the quarter with a higher level of cash after exiting our investments in Fairfax, following the takeover offer from Nine Entertainment Group, Super Retail Group, after it outperformed in the lead up to its result, and Clydesdale Bank, following the acquisition of Virgin Money UK at a high multiple of sustainable earnings in our view. We also reduced but continued to retain an investment in Suncorp Group, after it outperformed following a result in-line with our expectations but ahead of the market's.

September Quarter Market Review

Notwithstanding a down month in September, the market posted another strong quarter, advancing 2.0% (including franking). US 10 year bonds climbed 8bp (+53bp since December) although the yield curve continued to flatten with 2 year bonds rising by more. Interestingly, the US 10 year bond yield extended its record spread over its Australian equivalent that marginally declined in the quarter. The diverging outlook for short-term rates led to a depreciation in the AUD. Commodities were mixed, with oil continuing to rise on Iran sanctions and iron ore advancing 7% but base metals retreated on trade war fears and precious metals on tightening global liquidity.

Telecomms was the best performing sector, on the view the TPG/Vodafone merger will improve industry structure. Energy performed strongly in-line with the oil price and Health Care continued to enjoy expanding multiples. Materials had a negative quarter on the back of trade war concerns but bounced back strongly in September. Rising regulatory risk impacted Utilities, the Royal Commission continued to weigh on non-bank Financials, Consumer Staples edged lower, and Banks de-rated further on concerns tightening lending standards will put further pressure on house prices and credit growth.

Portfolio Performance Review

The strategy performed broadly in-line with the ASX200 for the quarter. The non-benchmark approach was a tailwind, with the structural underweight to mega large-cap stocks contributing to relative performance.

Magellan Financial was the best performing holding, benefitting from stronger markets, a weaker currency, improved retail flows and excellent cost control. TradeMe outperformed with a strong result highlighting market leading classified verticals in real estate, motor and jobs are less exposed to online competition than perceived. QBE Insurance outperformed with a clean result, favourable industry pricing environment and leverage to rising US interest rates. Seven West Media continued its recovery as the rate of TV advertising decline moderated and ratings share stabilised. JB Hi Fi rounded out the top performers with The Good Guys acquisition showing signs of improvement.

News Corporation was the worst performing holding in the quarter, with the market focusing on Foxtel's

deterioration while overlooking the shift from print advertising to subscriptions revenue, the value of realestate.com and net cash balance. Asaleo Care underperformed with share loss in the branded personal care segment, higher pulp prices impacting margins in the tissue segment and concerns around high debt levels. AMP continued to underperform on concerns of permanently higher compliance and remediation costs, as well as accelerating fee pressure as customers migrate to lower fee products. We continue to hold the view AMP is more diversified and the Advice franchise more resilient than the market currently perceives. Caltex underperformed with the market disappointed by the lack of progress divesting retail sites and risks around the retail convenience strategy, despite the latter being partly mitigated by the new Woolworths contract.

At a sector level, not owning Telecomms detracted while several Consumer exposures benefitted performance given attractive starting valuations and low market expectations.

Over the past 12 months, the strategy has lagged the market's strong return. The benchmark unaware portfolio construction was a slight positive as the banks weighed on the market index. Some of the underperformance was also a result of the market paying expanding multiples for stocks with low perceived earnings risk and growth stocks, as referenced in the Market Outlook section of this

report. Key stock specific detractors held in the portfolio included AMP, Fletcher Building, Caltex, Amaysim and Asaleo Care. On the other side of the ledger, Origin Energy, Seven West Media, Wesfarmers, Super Retail and Metcash contributed most positively to relative returns.

Longer-term, the strategy has outperformed over the past 7 years, with positive underlying stock selection enhanced by being structurally underweight the mega large capitalisation stocks. We continue to hold the view there should not be any material deviation between the cap weighted and equal weighted index performance over longer time periods.

Performance contributors over the long term have been broad-based, with Macquarie Bank, National Australia Bank, Tabcorp, Pacific Brands and Fairfax the key contributors. Key detractors over this time frame include AMP, QBE Insurance, Seven West Media, Worley Parsons, as well as not owning Aristocrat. At a sector level, being underweight banks and owning minimal mining and energy stocks were the most notable contributors.

TAMIM Global Equity High Conviction IMA

Going forward the Global High Conviction Strategy will be reporting quarterly.

September 2018 Quarterly Review

The Global High Conviction Strategy saw returns of 5.4% in AUD terms for the quarter ended 28 September 2018. This lagged the developed market World Value oriented benchmark a little and the capitalisation weighted World index by over 1.5%.

The latter index is now over 62% weighted to USA stocks which is a function of very strong relative price performance of the USA equity market relative to the rest of the world over the last several years.

The preferred World value weighted benchmark index we use (as value biased managers) is weighted approximately 50% to the USA which reflects the cheaper valuations elsewhere. We currently have about 60% of the portfolio in USA listed companies. Our exposure based on revenue would be less, since we own a lot of companies doing business in Asia – a region about which we are very constructive.

The second quarter was another quarter in which growth stocks outperformed value stocks. The difference in performance between them is unusually high. We understand the dangers of being ‘in denial’ about regime changes, however we are happy with the portfolio which has a P/E multiple of 11; a dividend yield of 3.3% and Return on Equity of 24%

In an eventful quarter our best performers were Anthem, a recently acquired USA based health care provider, (up 15%) Caterpillar (up 13% for quarter),

Singapore Tech Engineering (up 10%), Cisco (up 14%) and Apple (22%). Our underperformers were Randstad which was down after a competitor’s poor results; Hitachi High Tech, which was sold down as investors took fright at statements by Micron, a DRAM competitor, and Lear Corporation, which as a supplier to the global car industry, was affected by the poor BMW results and guidance. Lear Corporation has actually been refusing to re-tender for business from BMW recently.

We sold BNP, a French bank, after the Italian election results, which installed a government aggressively seeking to change the narrative with the EU on budgets and the Euro. BNP, like many European banks, owns a fair amount of Italian debt and any redenomination or reprofiling of this debt will hurt their capital base considerably. The European banking system was also hit by the rapid decline in the Turkish lira which also affected the collateral value held by many European banks. Our positive stance on European financials, on the basis of higher margins, has proven incorrect.

After such underperformance it is tempting to reduce our underweight to Europe but with the ECB intending to reduce its bond buying programme at the end of the year, we think the Euro zone will be tested further.

We purchased a small position in Celanese corporation a USA based speciality materials business. The company has pushed through price rises successfully recently and should benefit from rising economic activity in the USA. We still hold the view that a large increase in private sector capital investment is long overdue in the USA.

As the USA Federal Reserve continued to tighten monetary policy in Q3, we saw a significant sell-off in certain emerging market currencies. We have written about this and placed the article on our website. The vulnerable currencies are those of heavily indebted nations and the obvious suspects are the Turkish Lira, South African Rand, and even the Indian Rupee and Australian dollar. At the end of the quarter, a number of Indian financial companies defaulted causing a significant fall in the BSE which we believe expensive. The state-owned banking system is less than stellar, and the rising oil price will also put pressure on the Indian budget deficit, so we avoid this popular market.

The trade dispute between the USA and China deteriorated further. The real focus would appear to be technology theft by China. The escalation of this issue has bipartisan support in the USA government. We think that this produces more share price volatility for technology companies as news flow comes and goes, however it also provides a long-term opportunity for Asian hardware suppliers to increase their shipment volumes to China if there is a full-blown embargo on tech exports by the USA. We hope that after the USA mid-term elections, the conversation becomes less incendiary. We are currently underweight Technology.

We do not know where USA interest rates will eventually go; and nor does anyone else! Our expectation is that the Federal Reserve continues to reduce the size of its balance sheet even if cash rates remain where they are for the next few months. This is the first such tightening for many years and will catch some companies out. It is possible for equities to rise while interest rates are increasing; what seems to matter more is the shape of the yield curve which is still 'normal', but there is every possibility of a 'traffic accident'. Consequently, we favour companies with decent balance sheets, moderate P/E multiples and a catalyst for share price performance.

Ten Largest Holdings

Company Name	Country	Weighting
Verizon Communications Inc.	USA	5.4%
Legal & General Group PLC	UK	4.8%
Caterpillar Inc.	USA	4.7%
Gilead Services Inc.	USA	4.5%
Apple Inc.	UK	4.5%
Valero Energy Corporation	USA	4.0%
Macy's	USA	4.0%
Manulife Financial Corp.	Canada	3.9%
DowDuPont Inc.	USA	3.9%
AXA	France	3.8%
TOTAL		44.0%

TAMIM

Income Fund

The Tamim Income Fund generated the following returns in September:

Series 1	0.67%
Series 2	0.61%

The Series 1 portfolio was allocated as follows:

Platform	Allocation
RateSetter	71.6%
Society One	26.4%
Cash	2.0%

The Series 2 portfolio was allocated as follows:

Platform	Allocation
RateSetter	49.3%
Longreach	50.5%
Cash	0.2%

The SocietyOne loans comprise 26.4% of the overall portfolio of series 1 and this is split across over 318 loans as follows:

Category	Allocation	Yield (gross)
A	19.0%	8.95%
B	29.0%	10.92%
C	44.9%	14.40%

It is important to remember that the Ratesetter platform operates with a provision fund which protects the portfolio loans to approximately the first 6% loss. This does however operate at a portfolio level so is not a guarantee of capital.

The Ratesetter provision fund balance is currently \$11,418,598 which is 6.0% of the outstanding loan book. Key Ratesetter details are summarised below:

RateSetter Key Statistics

Claims on Provision Fund	100% of late payments and defaults
Claims paid by Provision Fund	100% of total claim value
Total amount lent	\$364,589,208
Total principal repaid by borrowers	\$174,635,066
Current funds on loan	\$189,954,142
Current estimated bad debt rate*	<3.8%
Current estimated bad debt*	\$7,193,118
Current estimated default coverage ratio*	1.6x

Source: RateSetter

The TAMIM Alpha monthly reports aim to provide our investors with a general review of the Israeli market and describe the key events that occurred in the fund through the month. We will be producing these reports on a monthly basis with a more in-depth report at the end of each quarter.

In our last quarterly report, we highlighted and explained our four different investment strategies: Value, Growth, Special situations and Hedging. As we write this report we are very pleased to see that this combination of strategies has proven to be beneficial. In line with global trends, the first six months of the year have witnessed growth companies outperform value companies. That trend reversed in the third quarter of the year and we saw value companies outperform growth companies, slowing the strong run of growth companies in the portfolio (mainly led by Israeli technology companies traded on the Nasdaq).

It is important to point out that our downside protection strategy is in place and 40% of our equity exposure is protected from a decline of greater than 10% in the market.

In our last report, we mentioned a significant development for the Israeli stock exchange. Four major foreign financial institutions (including two from Australia) are buying a stake (around 40% all up) in the Israeli stock exchange (TASE). As we stated, we are sure that this development will only help increase the level of interest of foreign investors in listed Israeli companies. We have already seen this occur through the increasing number of Israeli listed companies that were acquired by foreign companies since the beginning of 2018.

We are seeing exits not only in the venture capital

segment but also in mature and established public companies both in the technology (high tech) and industrial (low tech) sectors. We are pleased to see that Israeli publically listed companies are on the radar of foreign investors. In fact, Mobileye (develops vision technology for Advanced Driver Assistance Systems) is a great example. The company was private for almost 15 years, it went public in 2014 at a valuation of US\$5.3bn and three years later (2017) it was bought by Intel for an amazing US\$15bn.

Another Israeli company was acquired just last week in the Medical device sector. The US company Medtronic (MDT:NYSE) bought the Israeli company Mazor Robotics (MZOR:TASE & NASDAQ) for US\$1.6bn. Mazor is a medical device company that engages in the development and marketing of innovative surgical guidance systems. They specialise in robotic, computerised and imaging-based systems, primarily in the field of spinal surgery.

This deal is the fifth deal since the beginning of the year which included:

Orbotech

- Tech company providing process solutions and equipment serving the global electronics manufacturing industry;
- Acquired by the U.S public company KLA Tencor for US\$3.4bn.

Frutarom

- Specialises in the production and distribution of extracts for flavour and fragrance;
- Acquired by the US public company IFF for US\$6.4bn (IFF will now be listed on the Israeli stock exchange).

SodaStream

- Industrial Manufacturing (Carbonated drinks);
- Acquired by the U.S public company PepsiCo for US\$3.4bn.

Impreva

- Leading cybersecurity company and provider of data and application security solutions that protects business-critical information;
- Acquired by a US private Equity fund Thoma Bravo for US\$2.1bn.

Market Review

Although economic growth slowed in the second quarter, data points to solid economic momentum in the third quarter. The Central Bank's State-of-the-Economy Index edged up in July and the PMI (Purchasing Managers Index) readings in the first two months of the quarter trended above the average for the previous quarter. Moreover, business confidence remained elevated in August.

The Composite State-of-the-Economy Index indicates acceleration in the rate of expansion of economic activity. In July-August the monthly indicators on economic activity (headed by the Composite State-of-the-Economy Index) indicate a continued expansion in activity. Since the beginning of the year (January-August) the composite index increased 2.3% while in the twelve months ending in August 2018 an increase of 3.6% was registered. In recent months, the growth rate of the composite index has stabilised at around a level similar to the growth rate of GDP in 2017 (3.5% in real terms), which matches the current potential growth rate of the economy.

The International Monetary Fund has recently indicated that it shared this outlook by revising upwards its 2018 growth forecast up from 3.3% to 3.6%, and maintained its 2019 growth forecast at 3.5%.

A moderation in inflation and strengthening of the shekel has led to a delay of an interest rate hike. The Monetary Committee of the Bank of Israel decided on October 8 to keep its interest rate unchanged at its current level of 0.1%. The central bank rate has remained unchanged since March 2015.

The Monetary Committee repeated and emphasized the importance of entrenching inflation within the

price stability target range (1%-3%) in its interest rate decisions. As explained in the past, the meaning of "entrenching the inflation environment within the target refers to inflation that is not close to the borders of the target range (in other words, above 1%).

Portfolio Review

As we enter the fourth quarter of 2018, we keenly await third quarter results of our portfolio.

In this report we would like to focus on another value position in our portfolio, a company by the name of Caesarstone. **Caesarstone (CSTE:NASDAQ)** engages in the production and marketing of quartz surfaces used for kitchen countertops, vanity tops, flooring, wall cladding and general interior design. The company, founded in 1987, is headquartered in Israel and has production facilities in Israel and the USA. Its products are sold in approximately fifty countries around the world (including Australia) through a network of six subsidiaries and numerous distributors.

Caesarstone is an established company with good products, technological advantage and is considered a premium brand based on innovation. Despite this, the company has been in crisis the past two years, during this period we have seen the share price drop from a record US\$70 (beginning of 2016) to a low of around US\$13 (May 2018) and back to US\$19 today.

The primary causes for the crisis were the following:

- Production problems at the plant (in our view this is solvable);
- Management problems - the company replaced its CEO twice and, on top of that, replaced its US plant operational manager;
- Inventory management – the company managed its inventory & shipping poorly and this significantly increased cost;
- Significant excess inventory in the US, which the company may need to erase.

With all that considered, the company has a solid financial balance sheet with approximately \$100m excess in financial assets. The company's 2017 sales were \$588m with an operational margin of \$65m (a significant reduction from 2016 where it sold \$538m with an operational margin of \$98.7m) - this is, in our opinion a crisis that presents an opportunity.

As it is still early, we do not want to write too much about the 2018 financial statements but the second-quarter results were a very pleasant surprise as we saw that the company was able to maintain its operating margin of 10% (in 2016 it was 18% and in 2017 it was 10%). In light of the figures we described, the company's market value today is \$580m and with the deduction of cash (\$100m) brings us a corporate value of \$480m. Operational profit based on 2017 sales was \$58m which means the company is trading at a multiple of 10x. Our estimate is that the company will be able to achieve operational margin of over 10% and increase its sales, we will know better when they come out with their 3rd quarter results.

The company is still in the crisis management process so we are currently at less than half of the position size we would like (currently 2.5%) but we prefer to wait and evaluate if the company is progressing according to our milestones. We are monitoring their progress closely and will make our final decision after reviewing third quarter results.

We would like to mention that one of Israel's biggest and well renowned Private Equity funds – Tene Capital - has just recently bought a significant (15%) stake in the company. Another good sign.

Sincerely,

Sagi Ben Yosef, Darren Katz
& the combined TAMIM Alpha Team

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