30 June 2019

ATRIUM INVESTMENT MANAGEMENT

ATRIUM EVOLUTION SERIES - DIVERSIFIED FUND AEF 5

INVESTMENT OBJECTIVE

To maximise returns within the constraint of ensuring that portfolio risk, or volatility, does not exceed 5% over the investment time horizon.

PERFORMANCE	Since Inception	5 Yrs p.a.	3 Yrs p.a.	1 Yr	6 Mths	1 Mth	Vol Since Inception p.a.	Sharpe Ratio
Atrium Evolution Series - Diversified Fund AEF 5	5.4 %	4.4 %	3.3 %	3.3 %	4.9 %	1.0 %	2.9 %	1.0
RBA Cash Plus 2.5%	4.8 %	4.3 %	4.0 %					

KEY HIGHLIGHTS

Central banks are acting on fears of slower global growth by cutting cash rates or indicating they may do so in the near term.

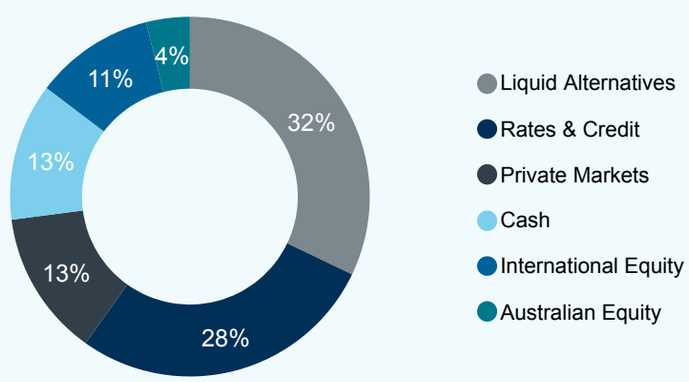
Bond markets are pricing risks to economic growth and subdued inflation.

Expectations of easier monetary policy have fuelled higher equity prices.

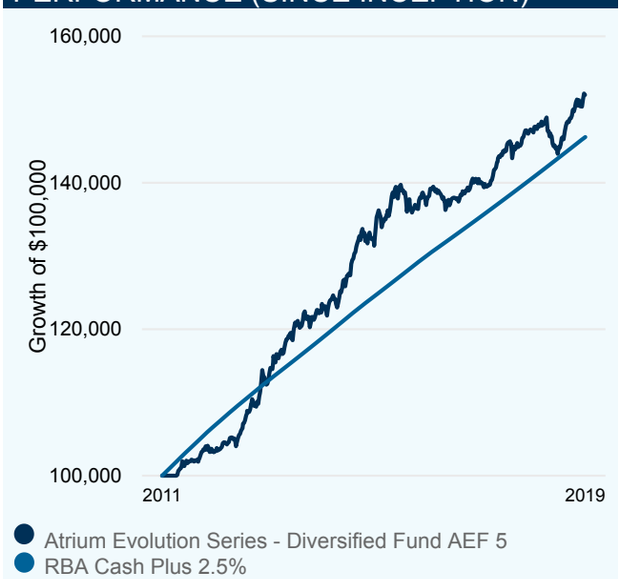
Our portfolios remain cautiously invested in risk assets while being diversified to smooth downside risks.

The Fund produced a solid return for the six-month period and continues to outperform its objective over the suggested investment timeframe.

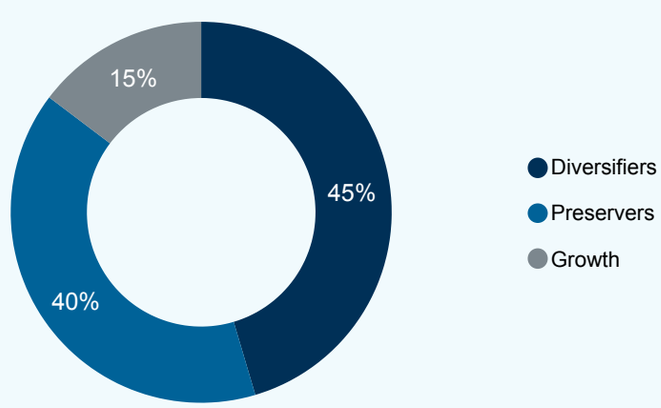
ASSET CLASS EXPOSURE



PERFORMANCE (SINCE INCEPTION)



RISK EXPOSURE



Source: Atrium, Iress. Allocations shown in the 'Asset Class Exposure' and 'Risk Exposure' charts as at the date of this report. Excludes derivatives.

Performance shown as at the date of this report. Inception date is 24 June 2011. Past performance is not a reliable indicator of future performance. Future performance and return of capital is not guaranteed. Performance is after fees and costs and assumes re-investment of all distributions.

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MARKET COMMENTARY

Markets extended their strong run from the first quarter into the second quarter of 2019 as the prospect of easier monetary policy eased concerns around global trade and slowing global growth. The rally in bonds was particularly impressive given the extremely low starting yields. Credit markets were firm, and the Australian dollar remained under pressure before a recovery into the end of June.

Equity markets were stronger in the second quarter of 2019, although rising at a slower rate than the first quarter. A key theme for equity markets has been global monetary policy, in particular the US Federal Reserve (Fed) making it clear that policy tightening (rising rates) is complete, encouraging expectations of easier policy (lower rates) in the coming months. US financials rose 8.0% for the quarter as the yield curve steepened, a tailwind for earnings. Technology, the largest sector in the US market, returned 6.1%. The S&P 500 index returned 4.3%, leaving it up almost 20% since the start of 2019. The European benchmark lagged slightly, rising 3.0%, although the German DAX index and French CAC index outperformed sharply (up 7.6%, and 6.2%, respectively). Emerging markets also lagged, with a slightly weaker US dollar and lower US bond yields (usually a positive for EM) being offset by tensions over trade policies, with China a notable laggard market.

Australian equities outperformed many global markets for the quarter, returning 8.0%. The banks continued to drive the market, returning 13.5%, partly as lower yields have driven a search for higher yielding stocks, and helped somewhat by the election result taking away some downside risk for the banks and for the housing market to which they are heavily exposed. Resources lagged, returning 5.2% for the quarter, as commodity prices struggled on weak global growth, although they have led the 12 month returns in the Australian market (+16.0%).

Bond markets remained very firm with yields falling sharply (and prices rising) as markets moved to incorporate central bank rate cuts. The Fed altered course early January to adopt a 'patient' stance, however markets have now priced in interest rate cuts in the near term as the Fed acknowledges weaker growth, subdued inflation expectations and risk skewed to the downside for the global economy. US 10-year bond yields closed the month at 2.0% after starting the quarter at 2.4% and commencing 2019 at 2.7%. The US 10-year bond yield traded well below the overnight cash rate (2.4% approx.), anticipating further interest rate cuts in the US. This has allowed the yield curve to steepen slightly. As Mario Draghi (European Central Bank Governor) faces his last four months of his non-renewable term, he has given signs that he feels more stimulus is needed in Europe (taking cash rates further negative and potentially more quantitative easing), pushing German yields negative out beyond 10 years. The Reserve Bank of Australia cut rates in June by 25 basis points (bps) and again after quarter-end with market expectations of more cuts before year end as inflation continues to disappoint and the labour market cools. Australian Government bond yields fell to record lows, 10-year yields closing the quarter at 1.3%.

The Australian dollar (AUD) fell slightly against the US dollar, closing at 0.70, down 1.1%. The strong upward move in iron ore provided some support for the AUD, although interest rate differentials remain a distinct headwind with US interest rates having appreciated. Over the quarter, the US dollar fell very slightly. The Japanese yen was 2.8% stronger as concerns lingered around low global bond rates.

We remain cautiously invested in risk assets and view central bank influence, rather than an improvement in fundamentals, as pivotal to this extension of the economic cycle. We are closely watching earnings, macroeconomic indicators and market sentiment for a signal to de-risk portfolios given the low future returns implied by extended valuations.

PORTFOLIO COMMENTARY

The Atrium Evolution Series 5 Fund posted another strong quarterly return of 1.9%, building on the solid prior quarter performance. The Fund's return drivers were broad based with our equities, alternatives and fixed income strategies all contributing positively as equity and bond markets moved higher on the prospect of central banks lowering interest rates to ward off threats of trade disputes and weaker sentiment to the pace of global growth.

During the quarter the Fund took advantage of the buoyant equity markets to lock in some gains in our US equity market exposure. This was achieved via an investment strategy which protects some downside while retaining upside participation if equity markets continue to perform. Currency exposures were also through a reduction in US dollar exposure in anticipation of near-term Australian dollar strength as strong iron ore exports push Australia's current account balance toward surplus.

The Fund has outperformed its cash plus return objective over the past five years while maintaining volatility within its 5% upper risk limit, limiting the overall impact of market drawdowns and delivering a more consistent return for investors.

Preservers

The Atrium Enhanced Fixed Income Fund (AEFI) continues to perform strongly as credit markets remain firm and bond yields declined further. The largest underlying holding, the Kapstream Absolute Return Income Fund, added 1.2%, a healthy return boosted by their decision to lengthen the portfolio duration (sensitivity to interest rates), reflecting their view that interest rates are more likely to fall in the near term, a view confirmed as central banks shifted to an easing bias throughout the quarter.

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PORTFOLIO COMMENTARY

The Daintree Core Income Trust continued to perform well, returning 1.2% for the quarter with the Trust generating income and benefitting from tightening credit (corporate bond) spreads and also a longer interest rate duration. The investment remains a small allocation within AEFI but is likely to grow over time.

The JP Morgan Global Strategic Bond Fund had a strong quarter returning 1.5% as US credit markets continued their recovery from the volatility of Q4 2019. The majority of the Fund's credit exposure is held in US dollar assets, reflecting the manager's view of relative value. Given a cautious stance towards tighter credit spreads as the market has continued to rally, the Fund has increased its exposure to securitised assets which typically see less price volatility. The securitised asset markets in general have seen a significant increase in demand for higher rated debt tranches in recent years.

AEFI's allocation to Australian Government bond futures reflected a view similar to our underlying managers that bond yields would continue to decline in the near term. This added substantial value over the quarter as 10-year Australian Government bond yields declined from 1.8% to 1.3%, driven lower along with global bond yields and the move by the Reserve Bank of Australia (RBA) to lower its cash rate target, a move which markets do not expect to be reversed for some time given subdued inflation expectations both locally and globally.

Growth Drivers

Australian equities had another strong quarter as markets priced in easier monetary conditions despite macroeconomic headwinds including a weaker labour market, high household debt levels and falling house prices which have been impacting consumer confidence. Australian Government 10-year bond yields have halved over the fiscal year making equities relatively more attractive given their higher earnings yield.

The Atrium Equity Opportunities Fund outperformed the benchmark over the quarter, returning 8.7% to be over 20% higher since the start of the calendar year. Key contributors to performance included, EML, Lovisa and Magellan while the only notable detractors for the quarter were Challenger and Speedcast. EML was a standout over the quarter driven by the earnings accretive acquisition of European gift card solutions provider Flex-e-Card, and salary packaging deal with Smartgroup.

During the quarter the Fund took some profits on Lovisa and EML, while redeploying some capital to building products company, James Hardie. The Fund remains diversified and well positioned in quality companies with structural earnings growth, while avoiding those areas of the market which are trading at expensive multiples and subject to structural and cyclical headwinds. The Fund retains a 10% cash holding, providing flexibility to exploit opportunities in the event of the return of market volatility.

The SG Hiscock ICE Fund returned 2.9% for the quarter led by positions in EML, local tech company Rhipe and Lifestyle Communities, while the detractors included GTN and Pendal. The Bennelong ex-20 Australian Equities Fund returned 5.1% led by its large position in gaming company Aristocrat Leisure, while the detractors included Reliance Worldwide and Costa Group.

Our global equity managers all posted strong returns for the quarter with expectations of global central bank easing again providing added support for markets.

The Magellan Global Equities Mandate returned 7.6% for the quarter and continued its stellar outperformance of its global equity benchmark. The Mandate has delivered an impressive 20.8% return over the last 12 months. Key contributors to performance included Facebook and software companies, Microsoft and SAP, while detractors included Alphabet (Google) and Lowe's. During the quarter the manager added positions in American Express, LVMH, and Estee Lauder and maintains a bias to quality global multinationals.

The Antipodes Global Fund finished the quarter strongly returning 4.7%. Key contributors to outperformance included US telco and chip maker, Qualcomm and SAP. Its positions in the financials and consumer discretionary sectors also added value while utility stocks detracted. The manager maintains a bias to strongly growing markets in Asia.

Our fundamental active emerging markets manager Northcape returned 7.1% for the quarter, beating the emerging market index by over 5%, with strong performance amongst a number of its high-quality Asian companies.

Diversifiers

The trade-off between trade war concerns and the benefits of easier monetary policy saw volatility return to global asset prices over the quarter. The portfolio of alternatives managers navigated this volatile period well returning circa 1.6%. This was also under a backdrop of negative yields pervading much of the global bond landscape.

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PORTFOLIO COMMENTARY

With prospective returns in bond markets so low, our diversified alternatives allocation becomes key to achieving portfolio objectives and compound long-term returns for investors. It is this time in the cycle that portfolio diversification becomes critical. We employ managers such as GMO and Two Trees whose strategies seek to identify mispricing between bond markets and profit from this 'relative value'. Recently we re-shaped the managers within our Crown Diversified Macro Segregated Portfolio to add 3 world class systematic macro managers. These new managers made an immediate contribution to the portfolio with a return of 8.7% for the quarter and their return prospects remain attractive. Our managers are also seeing significant opportunities in the commodities space, trading both hard and soft commodities. WTI oil fell 16.5% in May while wheat rallied 18.6%, providing additional return opportunities for these managers.

We also saw a relatively wide dispersion across alternatives managers' returns for the quarter. The relative performance of equity and bond markets helped to explain the drivers of performance for these strategies. Bennelong navigated the quarter well returning 1.1% and Zebedee continued to be on the correct side of moves in European equity markets returning 3.3%. Regal Tasman found the mid-quarter equity market reversal challenging and detracted from portfolio returns giving back a portion of their strong year to date gains. The current environment represents a dilemma for managers with a value-based approach. Low interest rates potentially allow low quality companies to survive much longer than they would have in a higher interest rate regime. These 'value traps' continue to look unattractive in this environment. Interestingly trend following, the subject of similar question marks at the end of 2018, has been the best performing strategy year to date. This continued in the second quarter as our trend strategies were able to capture the bond market move despite yields looking unappealing, thus delivering strong positive returns.

The private markets portfolio of direct property and asset backed investments continued to deliver a stable mix of income and capital growth. Notably, the Evolution Fund's exposure to the Marshall Investments Caringbah Trust, a debt exposure to a series of apartment projects in Caringbah NSW, returned capital during the quarter achieving an 18.0% IRR over circa 2 years, which was in line with the original forecasts for the project.

Outlook

The strong rebound in global markets continued into the June quarter after a pullback in May. The sharp reversal in equity markets in early 2019 and increased volatility have allowed us to take advantage through tactical positioning while maintaining a neutral stance on risk assets overall. We retain a significant allocation to Preservers in the Atrium Evolution 5 Fund. The US Federal Reserve's 'pivot' towards easier monetary policy coupled with easing locally by the RBA has continued to support asset markets globally.

The investment team are currently considering a number of new investments for potential inclusion, which aim to allow the Fund to continue to participate in rising markets while limiting the impact of an equity market pullback on Fund performance (this will be discussed in greater detail in coming months).

At the overall Fund level, we maintain our focus on achieving our risk and return objectives over the Fund's investment horizon, with a strong emphasis on preserving and growing client capital.