



KSM - K2 Australian Small Cap Fund (Hedge Fund) Monthly Report - 31 December 2016

Australian Small Cap Market Review

The K2 Australian Small Cap Fund returned -0.39% for the month of December.

Global equity markets ended the year on a high as investors continued to price in a Donald Trump era of higher growth, higher interest rates, higher inflation and increased Fiscal spending. Macro-economic data released over the month was generally better than expected, propelling the US Dollar Index to levels not seen since 2002. Commodities continue to power ahead, despite the stronger USD, with WTI Oil +8.6% and Iron-Ore +10% for the month and +45% and +81% for the year respectively! Bond Yields across the world drifted higher, capping off an immensely volatile year, with the Australian 10 year yields ending -4% lower for the year, however this was after experiencing a +51% rally from August lows.

Over the past 4 months, Australian Small Caps have suffered a -15% relative underperformance versus their large cap counterpart, and -10% in absolute returns. Companies trading on high multiples have suffered from a repricing of growth, disappointing earnings updates during the AGM season were punished and fund outflows have been the contributing factors to the underperformance.

Despite higher bond yields, Utilities (+8.7%) were the best performing index within the Australian small cap space, while Energy (+6.1%) and Financials (+5.5%) also delivered strong returns. Telco Services (+0.5%) continue to underperform along with Healthcare (+0.9%) and Consumer Staples (+1.7%).

Portfolio Insight: Axesstoday

Axesstoday (AXL) is a new addition to the Fund, via our participation in the IPO. AXL is a rapidly growing equipment finance provider to small and medium enterprises across the hospitality and transport sector. The company has a strong track record of profitable growth driven by the successful strategy execution from a highly experienced management team. The key focus for the company has been market share gains via distribution channel growth and a conservative risk management framework. Vital to the product offering is the streamlined and automated end-to-end technology, which allows retailers to offer their customers a "Faster, Fairer & Easier" experience. Within a target market of 1,200 retailers and introducers, the company has secured 140 of these with a conversion rate of over 90%. At listing price, the company was trading on a 1 year forward PE 11.2x and offering a 4.5% fully franked dividend. Management are still significant shareholders in the business and are further incentivised via profit targets in future years, which if met, would deliver material profit growth. With a small but growing share in a large addressable market, the company is attractively priced and has a significant opportunity to deliver shareholders with strong returns.

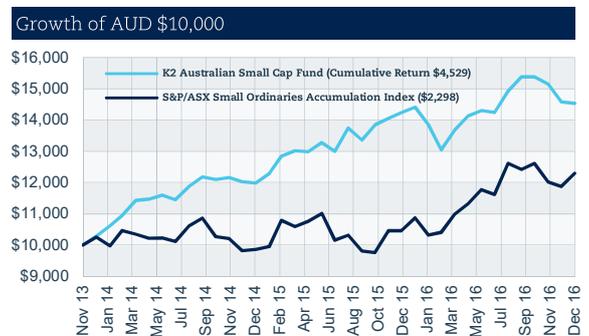
Outlook

Global markets enter 2017 with an optimistic tone, having navigated many of the downside risks that some were predicting at the start of 2016. The operating environment for Australian corporates still remains inconsistent, however looking forward there appears to be some tailwinds beginning to emerge. Commodity prices and grain volumes are now at levels which will provide a major boost to our terms of trade and government budget, the stimulus provided from the Australian Dollar trading near 7 year lows against the US Dollar, the bulk of bank recapitalisations completed and the business capital expenditure cycle appears to have bottomed. In this environment, we remain focused on companies that have quality management, the opportunity to grow and are trading at appropriate multiples. The median 1 year forward PE of our portfolio is 13.6x with earnings growth expected to exceed 13% and a dividend yield of 3.5%. The Fund ended the month with 89.7% net equity exposure and we feel our portfolio is well placed to deliver positive returns in the future.

Top 5 Stock Contributions - December

Largest	Axesstoday Ltd, Elanor Investor Group, Scottish Pacific Group Ltd, SmartGroup Corp Ltd, Yowie Group Ltd
Smallest	Catapult Group International, Ellex Medical Lasers Ltd, Tech Mpire Ltd, Updater Inc, Veris Ltd

Performance to 31 December 2016 (net of fees)	
1 Month	-0.39%
3 Months	-5.56%
6 Months	2.00%
1 Year	0.79%
3 Years (pa)	12.20%
Since Inception (pa)	12.88%



Returns are based on NAV per unit plus distributions reinvested net of management fee and performance fee accruals. The method for calculating the NAV is set out in the Fund's PDS.

Fund Details (Unaudited)	
NAV Per Unit:	A\$2.55
Fund Size:	A\$21.0m
Start Date:	1-Dec-13

Top 5 Holdings	Sector	%
Medical Developments International	Cons. Non-Cyc	4.4
Baby Bunting Group Ltd	Cons. Cyclical	3.8
Motorcycle Holdings Ltd	Cons. Cyclical	3.6
Think Childcare Ltd	Cons. Non-Cyc	3.5
Updater Inc	Technology	3.5

Sector Exposure %			
	Long	Short	Net Equity
Basic Materials	1.3	-	1.3
Communication	6.6	-	6.6
Cons. Cyclical	19.5	-	19.5
Cons. Non-Cyc	24.0	-	24.0
Energy	0.4	-	0.4
Financial	23.4	-	23.4
Industrial	5.8	-	5.8
Technology	8.7	-	8.7
Total Equity	89.7	-	89.7
Total Cash			10.3
Total Equity and Cash Exposure			100.0

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