ISSUE DATE: 3-12-2015

We strongly recommend that potential investors read the product disclosure statement or investment statement. Lonsec Research Pty Ltd • ABN 11 151 658 561 • AFSL No. 421 445 • This information must be read in conjunction with the warning, disclaimer, and disclosure at the end of this document. This report supersedes all prior reports.

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**Company Review**

**Absolute Equity Performance Fund Limited**

**About this Company**

<table>
<thead>
<tr>
<th>LIC REVIEWED</th>
<th>ABSOLUTE EQUITY PERFORMANCE FUND LIMITED</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASX CODE</td>
<td>AEG</td>
</tr>
<tr>
<td>PROSPECTUS OBJECTIVE</td>
<td>DELIVER ABSOLUTE RETURNS VIA CAPITAL GROWTH AND INCOME REGARDLESS OF MARKET MOVEMENTS</td>
</tr>
<tr>
<td>EXPECTED COMPANY SIZE</td>
<td>$25M-$100M</td>
</tr>
<tr>
<td>BOARD OF DIRECTORS</td>
<td>MARC FISHER, GRAHAM HAND, ANDREW REEVE-PARKER</td>
</tr>
<tr>
<td>INDEPENDENT DIRECTORS</td>
<td>2</td>
</tr>
<tr>
<td>IPO PRICE</td>
<td>$1.10 INITIAL NET ASSET VALUE</td>
</tr>
<tr>
<td>(POST IPO)</td>
<td>$0.1074 - $1.079 (DEPENDENT ON MONIES RAISED)</td>
</tr>
<tr>
<td>STRUCTURE</td>
<td>FREE LISTED OPTION ON A 1-FOR-1 BASIS (EXERCISE PRICE $1.10, EXPIRY ON OR BEFORE 16 NOVEMBER 2017, 6 MONTH VESTING PERIOD)</td>
</tr>
<tr>
<td>MANAGEMENT FEE (P.A.)</td>
<td>1.5% OF NET ASSET VALUE (NAV)</td>
</tr>
<tr>
<td>PERFORMANCE FEE</td>
<td>20% OF OUTPERFORMANCE OVER THE CALCULATION PERIOD (SUBJECT TO 'HIGH WATER MARK')</td>
</tr>
</tbody>
</table>

**About the Investment Manager**

| INVESTMENT MANAGER | BENNELONG LONG SHORT EQUITY MANAGEMENT LIMITED |
| OWNER'SHIP | INVESTMENT STAFF 58%, BENNELONG FUNDS MANAGEMENT 42% |
| ASSETS MANAGED IN THIS SECTOR | $376M |
| YEARS MANAGING THIS ASSET CLASS | 13 |

**Investment team**

| TEAM SIZE | 4 |
| PORTFOLIO MANAGER | RICHARD FISH, SAM SHEPHERD |
| STRUCTURE / LOCATION | MELBOURNE, AUSTRALIA |

**Investment process**

| STYLE | ABSOLUTE RETURN, MARKET NEUTRAL |
| STRATEGY | PAIRS TRADING (25-40 PAIRS) |
| RISK OBJECTIVE (INTERNAL) | TARGET PORTFOLIO VOLATILITY OF 12-15% P.A. |
| TYPICAL STOCK NUMBERS | 50-80 |
| TYPICAL CAPITALISATION BIAS | TOP 100’ STOCKS |
| MAXIMUM STOCK WEIGHT | MAX 10% OF GROSS ASSET VALUE (GAV) |
| MAXIMUM WEIGHT PER PAIR | 5% OF GROSS ASSET VALUE |
| LEVERAGE LIMIT | UP TO 5X NAV |
| SMALL CAPS/INTERNATIONAL LIMIT | 20% GAV / 10% GAV |

**Fund rating history**

| DECEMBER 2015 | RECOMMENDED |

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**What this Rating Means**

The ‘Recommended’ rating indicates that Lonsec has strong conviction the financial product can generate risk adjusted returns in line with the relevant objectives. The financial product is considered an appropriate entry point to the asset class or strategy.

**Strengths**

- Very experienced Investment Manager (‘Bennelong Long Short Equity Management’, ‘BLSEM’ or the ‘IM’) and portfolio manager in Richard Fish.
- Differentiated equity product with a low expected correlation to traditional asset classes.
- The IM has an attractive boutique culture with strong alignment of interest with end investors.
- Strong commitment to capacity management at both the Listed Investment Company (LIC) and IM level to preserve the efficacy of the pair trading process.

**Weaknesses**

- Related-party Chairman in Marc Fisher.
- IM has very high key person risk in Fish.
- High fee load and performance fee with a high hurdle rate.
- High leverage (expected 4-5x NAV).
- IM’s track record for this capability while independently calculated has not been externally audited.

**Scope of this Rating**

- Lonsec has used its Managed Funds research process in forming a ‘point-in-time’ opinion on this Listed Investment Company’s (‘LIC’) ability to meet its investment objectives as outlined in the Prospectus. This research process, however, does not include any assessment of the Company’s ability to minimise any divergence between the share price and the NAV per share beyond acknowledging that the Company is committed to doing so via capital management measures. Lonsec considers an investment in the LIC sector to be suitable for investors with a long-term (5+ years) investment horizon.
- The Lonsec rating will expire upon the listing of Absolute Equity Performance Fund Limited (AEG) on the Australian Stock Exchange (ASX).

**Suggested Lonsec risk profile suitability**

| HIGH |
| Secure | Defensive | Conservative | Balanced | Growth |

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**Recommended**
Absolute Equity Performance Fund Limited

Company risk characteristics

<table>
<thead>
<tr>
<th>Risk Category</th>
<th>Low</th>
<th>Moderate</th>
<th>High</th>
</tr>
</thead>
<tbody>
<tr>
<td>CAPITAL VOLATILITY</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LEVERAGE RISK</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>SECURITY LIQUIDITY RISK</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LIC LIQUIDITY RISK</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SECURITY CONCENTRATION RISK</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>RELATED-PARTY RISK</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

Risk categories are based on Lonsec’s qualitative opinion of the risks inherent in the product’s asset class and the risks relative to other products in the relevant Lonsec sector universe.

What is this Company?

- **Absolute Equity Performance Fund Limited** (AEG or ‘the LIC’) will seek to provide investors with a positive absolute return irrespective of market conditions. This will be implemented via a fundamentally-based pairs trading strategy that will target 25-40 high conviction pairs primarily among the S&P/ASX 100 Index.
- The LIC will be market neutral and is expected to have a net market exposure of +/- 2% pre-leverage at any one time. This should ensure that investors are only exposed to the net idiosyncratic stock risk inherent in each pair as the systemic market risk will be neutralised. It is this feature that should ensure that the LIC’s expected returns will be lowly correlated with traditional asset classes over an investment cycle.
- The LIC will be managed to a volatility target of 12-15% p.a. on a leveraged basis and leverage will be capped at 5x of portfolio NAV. In effect, given the aim of market neutrality, for most pairs this mean a maximum of 2.5x long and 2.5x short or 250/250 at a gross portfolio level. There are no stop-losses at the pair level as the IM does not believe having such arbitrary limits to be in investors’ best interests.
- Lonsec notes that the size of the LIC upon listing will fall in the range of $25m-100m depending on investor demand. Lonsec makes the general observation that newly listed LICs that are towards the lower end of the market cap spectrum ($100m or less) are likely to be less liquid than larger, more established LICs in the market place especially if these have been consistent dividend payers. This relative illiquidity may make it more difficult for larger investors to exit their holdings in timely and orderly fashion. Less liquid securities may also be prone to periods of enhanced share price volatility.
- Subscribers to the IPO will be issued with a ‘free’ option on a 1-for-1 basis that will be listed (ASX code – AEGO). The attached option is initially subject to a six month non-exercisable escrow period and thereafter will be exercisable at $1.10 within 18 months of the listing date. Such in-built options have been a feature of recent LIC IPOs rated by Lonsec and are designed to address the issue that all new LICs have a starting NAV below the issue price due to the impact of transaction costs.
- BLSEM has been appointed as the IM of AEG for an initial 10-year term (‘5+5’). Founded by Richard Fish in 2002, BLSEM is a specialist provider of market neutral and absolute return capabilities in the market. BLSEM’s investment philosophy is that it is possible to identify instances when stock prices are not reflecting fundamental value and that these should mean revert over the longer term.
- Lonsec notes that the LIC’s investment objectives and the IM’s skill-set should mean that the LIC demonstrates strong defensive characteristics over time. In particular, given the market neutrality and pairs trading strategy, the LIC could deliver solid and repeatable absolute returns in volatile market conditions. Alternatively, relative to traditional equity benchmarks, LIC performance is expected to lag in markets characterised by strong beta rallies or the latter stages of bull markets.
- Investors in the LIC will incur a management fee of 1.5% p.a. of NAV. Lonsec considers this fee to be high but relatively in line with similar strategies across its hedge fund universe. Lonsec notes that the trade-off for the higher fee is the IM’s strong capacity discipline that it has demonstrated over time and that the strategy (including the LIC) will be ‘hard closed’ at $500m.
- Lonsec notes that the IM will also be entitled to a performance fee of 20% of the increase in NAV of the LIC where the NAV on the last day of the Performance Calculation Period (PCP) exceeds the LIC’s ‘high watermark’ (HWM). The PCP is six-months since the previous performance fee anniversary and the HWM is the highest NAV since the LIC’s inception.
- Lonsec supports the concept of performance fees as long as these are appropriately structured. Lonsec considers an appropriate structure to be one where the performance fee is in line with industry standards, where the fee is subject to an appropriate hurdle rate of return, and where the fee is subject to a prior ‘high water mark’ with no reset period.
- With respect to the LIC, Lonsec considers most of the structural aspects of the performance fee to be in line with Lonsec’s expectations. However, Lonsec notes that the performance fee will be earned simply if a positive absolute return has been generated over the preceding six-month period. While acknowledging the alignment this provides with the LIC’s absolute return objectives, Lonsec observes that hurdle rate is not particularly onerous.
- Lonsec notes that the quantum of the management fee will be shared between the IM and the outsourced related-party service provider, Perma Capital (PC). PC will in turn outsource some additional marketing and back and middle office services to ZG Advisors and Seed Partners at its own expense. The performance fee will only be received by the IM.
**Absolute Equity Performance Fund Limited**

**Using this LIC**

This is General Advice only and should be read in conjunction with the Disclaimer, Disclosure and Warning on the final page.

- The LIC is an active market neutral Australian equities product that aims to earn a positive total return irrespective of market conditions. Lonsec typically expects the LIC to have a net market exposure close to 0% (within small band). Despite this, potential investors should be aware of, and comfortable with, the potential for the LIC to experience periods of negative returns which may result in capital losses being incurred. This is especially so as a LIC pre-tax return in an investors pocket is both a function of the movement in NAV, the dividend received and the LIC’s share price movement.

- Lonsec recommends advisors consult the Lonsec Risk Profile Review and / or the Lonsec Risk Profile Definitions document(s) for guidance on appropriate asset allocations to Australian equities within a diversified investment portfolio. Lonsec recommends that both equity and LIC investments are suitable for investors with an investment time horizon of at least five years.

- Lonsec notes that as the LIC is designed to be market neutral, it is expected to display a low correlation to other asset classes. Despite this design, Lonsec highlights that at various points in a market cycle, the LIC may display a higher correlation with traditional equity benchmarks.

- The LIC will utilise short selling, leverage and derivatives in an attempt to enhance its risk / return profile. Lonsec recommends that investors consider all the additional risks associated with short and levered investing (including the potential for substantial capital losses) prior to investing.

- The LIC as a ‘long / short’ Australian equity product will predominately be fully invested in the market. As such the LIC will generally sit within the growth component of a diversified investment portfolio. As a market neutral product, Lonsec considers it suitable for blending with other Australian equity strategies including benchmark aware, small cap or style-biased products.

- Lonsec notes that a feature of similar levered strategies delivered via a fund structure is the ability to pass on a high level of franking credits. Lonsec notes that the company structure of the LIC will not allow such a high level of franking credits to be passed on to investors.

**Lonsec Opinion of this LIC**

**Board of Directors**

- As a company, AEG will have its own Board of Directors (BOD) consisting of three constituents, with two of these being independent. The BOD is chaired by Marc Fisher and the two independent directors are Graham Hand (Non-executive) and Andrew Reeve-Parker (Non-executive). The LIC will also have its own Company Secretary.

- Lonsec is pleased that remuneration for the BOD is not excessive and has been capped at $95,000 p.a. for the pool of three. Each director will receive between $30,000-$35,000 p.a. for their services and will be reimbursed for reasonable expenses. The quantum of fees is below that which Lonsec has observed for other LIC IPOs brought to market over the last 1-2 years that Lonsec has provided a research rating for.

- Lonsec is mildly concerned that Chairman Fisher is a related-party. Fisher, as well as being the Managing Director of Gottex Fund Management, is a director of both Perma Capital and ZG Advisory which will be providing various outsourced services to the LIC. Lonsec notes that Fisher will excuse himself from any Board discussions on any of these related party entities and that the LIC has a detailed related-party charter.

- In Lonsec’s view, the BOD is comprised of a mix of individuals with both the experience and skills in financial services, funds management and long/short and levered strategies to allow AEG to meet its investment objectives.

- Being ASX-listed, AEG will also need to comply with the listing rules of the ASX.

**People and resources — Investment Manager (IM)**

- Richard Fish is both the founder of the IM (in 2002) and the lead Portfolio Manager (PM) for the LIC and he will have ultimate responsibility for its performance. Fish has over 30 years’ experience in Australian equities, both as an investors and specialist manager of pairs trading and levered strategies. Prior to the IM, Fish held portfolio management roles at National Asset Management Limited as well as serving for a number of investment banks. Lonsec considers Fish to be a decorated veteran of the market neutral and long/short investment space and has a high regard for his portfolio management and investment skills. His significant tenure at BLSEM is also a strong positive as is his substantial equity stake and co-investment in the strategy.

- Fish is supported by an investment team of three seasoned investors. Including Fish, the team has an average of 15 years of relevant experience and are proven performers in managing long/short, pair trading and levered capabilities. Fish’s primary support is provided by Senior Portfolio Manager, Sam Shepherd. Shepherd, who joined BLSEM in May 2012, has 22 years of experience. The team is rounded out by Senior Investment Analysts Sam Taylor (joined in 2008) and more recent hire Steven Lambeth (joined in 2014). Lonsec is impressed by the investment pedigree of the team. However, a detracting feature is its small size given the extended universe covered and the relatively lower tenure in Shepherd and Taylor.
Lonsec considers the alignment of interest of the team with end investors to be strong. Investment staff own 58% of the equity in BLSEM with only Lambeth not holding equity. This means that staff directly share in an enhanced level of dividends when performance fees are paid. Staff are also significant investors in the strategy. Lonsec considers that such strong alignment could be a contributing factor to the low level of staff turnover since BLESM’s inception.

Lonsec considers there to be a very high level of key person risk (KPR) associated with Fish and to a lesser degree Shepherd. The risk in Fish is particularly high given his key role in setting up the capability in 2002, long tenure at the IM and the complexity inherent in the strategy itself. As well as the investment risk, the loss of Fish would also potentially lead to heightened business risk as his departure could well lead to a period of large withdrawals. Lonsec notes some mitigating circumstances such as the boutique structure, experienced investment team and low turnover at the IM.

Lonsec notes that the non-investment related management for the LIC will be outsourced to Perma Capital (PC). PC has in turned engaged Seed Partnerships (SP) and ZG Advisors (ZGA) to assist in the provision of these services. In terms of fees for service, Lonsec notes that PC will receive an undisclosed portion of the LIC’s annual management fee. The services provided by the other two entities will be paid for by PC and not the LIC.

Lonsec notes some concern with the added complexity this outsourcing structure brings, noting that such cascading structures can potentially dampen accountability and impede investor visibility. Lonsec also again highlights that the LIC’s Chairman, Fisher, is also a director and shareholder of both PC and ZGA. Nonetheless, Lonsec notes that an outsourced model keeps the LIC’s fixed cost stable and also ensures that the IM can focus exclusively on investing.

Research approach and portfolio construction

Lonsec considers AEG’s research process which it will adopt from the IM to be logical, repeatable and in-line with its investment objectives. AEG will adopt a vanilla pairs trading strategy designed to maintain its market neutrality and thereby provide pure net exposure to idiosyncratic stock risk in a controlled pair. The cornerstone of the research process is the fundamental analysis that the IM performs on mostly ‘top 100’ stocks over a 1-2 year basis.

The initial step of the process is to identify individual stock opportunities on either the long or the short side. For a long position, the IM typically seeks quality companies that have strong business franchises, strong balance sheets and solid management teams with an identifiable track record. On the short side, the targets are companies that screen as being inferior on these metrics. Valuation is also considered on an absolute basis; however Lonsec considers that quality is the primary determinant of stock conviction.

Risk management

AEG will have a separate Board that will provide it with an additional overlay of risk management and independent scrutiny of compliance. AEG will also be required to meet the stringent listing rules of the ASX.

Lonsec is pleased to note that the LIC will be fully invested within seven business days of listing. This is important as were the LIC not to be fully invested for a number of reasons and therefore remain substantially in cash, then it is less likely that it would be able to meet its investment objectives in the shorter term. All trading profits are also re-balanced immediately to ensure that individual pairs continue to line up both with investment team conviction and the portfolio rules (discussed below).
Absolute Equity Performance Fund Limited

- Lonsec considers risk management to be largely embedded in the IM’s fundamental research process which will adopted by the LIC, with the typical ‘long’ in a pair being the stock assessed as being of a higher quality versus the short. Pairs are typically sector neutral which ensures that investors are not exposed to systemic risk.
- The LIC has a number of upfront portfolio rules designed to ensure that it meets its risk and return metrics. The first is that the LIC cannot exceed a gearing level of 5x of NAV. Typically gearing is expected to be 4x NAV. This rule is a covenant in the prime broking agreement with UBS. The LIC is also managed to a relatively tight volatility target (as measured by standard deviation) of 12-15% p.a. on a levered basis. Finally there are ‘hard’ limits in terms individual stocks and pairs as well as caps on the number of uncorrelated pairs and exposure to small capitalisation and international stocks. Lonsec considers these portfolio rules to be broad ranging and focused on the risk that matters.

Funds Under Management (FUM)
- The IM currently manages FUM of $376m in this capability, a number which does not include this capital raising. Assuming that both AEG is fully subscribed and the options are 100% exercised in 18 months’ time, then all else being equal the total capacity of the capability will be over $500m.
- In Lonsec’s view, at $500m the strategy would be at the very upper end of its capacity limit especially given the importance of shorting to the strategy. Lonsec is pleased to observe that the IM has a track record of closing the capability to preserve the efficacy of its investment process.

Performance
- As the LIC is yet to list, there is no performance data available.
- Lonsec notes that BLSEM has built a 13-year track record for this capability, first as a Managed Account structure and then, from 2008, as a wholesale fund. As disclosed in the Prospectus, Lonsec notes that this track record has not been externally audited; however it has been independently calculated by a third-party fund administrator, TMF. Lonsec hence has placed less reliance on this track record than had it been independently audited.
- The track record as disclosed in the Prospectus is strong. For the period 1 February 2002 to 30 September 2015, the investment strategy has provided a total return of 18.1% p.a. (post fees). The recent experience is still strong, with the strategy returning 13.4% p.a. over three years and 16.4% p.a. over five years. All returns have been delivered with a low level of correlation versus traditional asset classes. The strategy has also not had a negative annual return on a 12-month calendar basis.
- Given the specific volatility targets for the LIC, Lonsec also draws comfort that the investment strategy has consistently delivered higher returns than equity benchmarks with a similar level of volatility. The strategy also has a superior drawdown profile since inception, recording a worst drawdown of 12.2% (during the GFC) which took six months to recover. This is as opposed to the S&P/ASX 200 Accumulation Index which recorded a worst drawdown of 47.5% that took 71 months to recover.
- Lonsec again emphasises that past performance is not an indication of future expected performance.

Overall
- Lonsec has assigned AEG with a rating of ‘Recommended’ at IPO. Lonsec believes the Investment Manager, Bennelong Long Short Equity Management, to be well placed to run the LIC. In particular, senior portfolio manager Richard Fish has a long-term track record in running similar pair trading and levered strategies and is an impressive investor. Lonsec also takes comfort from the logical and repeatable fundamental research process and the robust risk management practices.
- Detracting from the rating is the LIC’s lack of track record, the small size of the investment team and the onerous fee structure. Lonsec also notes the very high key person risk in Fish and the tight capacity limits. Finally Lonsec highlights the enhanced liquidity and related party risks.

People and Resources

Board of Directors
AEG has its own Board of Directors (BOD), with the majority of the directors being independent. The Board has the responsibility for ensuring that the Company is properly managed so as to protect shareholder interests in a manner that is consistent with the LIC’s obligations to all stakeholders. This includes meeting its Prospectus investment objectives. Lonsec considers the following two directors to be independent as defined by the corporate governance policies and practices of the ASX.

Graham Hand, Non-executive Director. Hand has a 38-year track record in financial markets. He has held a number of prominent positions in the industry including the roles of General Manager of Funding and Alliances at Colonial First State, General Manager of Capital Markets at Commonwealth Bank of Australia (CBA), Deputy Treasurer of the State Bank of New South Wales and Managing Director of Treasury at NatWest Markets Australia. At Colonial, Hand managed the funding for $10b in geared funds and established seven boutique asset management alliances. Hand is currently a member of the compliance committee of Lazard Asset Management Pacific Co.

Andrew Reeve-Parker, Non-executive Director. Reeve-Parker is an experienced financial advice professional and is currently a director and responsible manager of NW Advice Pty Ltd, Wealth Focus Pty Ltd and Personal Choice Management Pty Ltd (all three hold current AFSLs). Reeve-Parker is also a current Non-executive
Absolute Equity Performance Fund Limited

Director of Datacenter Limited and the PM Capital Asian Opportunities Fund.
Lonsec notes that the LIC’s Chairman is the related-party Marc Fisher. Fisher is based in Hong Kong where he acts as the Senior Managing Director and Executive Committee member of Gottex Funds Management, a global alternative investment specialist. Before Gottex, Fisher held senior investment positions for FRM, including being Chairman of its Asia Pacific business. He has also held senior roles at Citigroup in London.

Board remuneration
The LIC will pay each director an annual fee of $30,000 – $35,000. All reasonable expenses will also be recovered.

Investment Manager
Bennelong Long Short Equity Management (‘BLSEM’) has been appointed as the Investment Manager for the LIC. BLSEM is a boutique market neutral and pairs trading specialist manager that was first founded in 2002 by principal Richard Fish. BLSEM is owned 58% by staff and 42% by Bennelong Funds Management. It currently has funds under management of $321m which it runs for mostly institutional and high net worth clients. BLSEM is domiciled in Melbourne Australia.

Size and experience – BLSEM’s investment team

<table>
<thead>
<tr>
<th>Name</th>
<th>Position</th>
<th>Years in industry/ firm</th>
</tr>
</thead>
<tbody>
<tr>
<td>RICHARD FISH</td>
<td>PRINCIPAL / SENIOR PORTFOLIO MANAGER</td>
<td>30/13</td>
</tr>
<tr>
<td>SAM SHEPHERD</td>
<td>PRINCIPAL / SENIOR PORTFOLIO MANAGER</td>
<td>22/3</td>
</tr>
<tr>
<td>SAM TAYLOR</td>
<td>SENIOR ANALYST</td>
<td>15/9</td>
</tr>
<tr>
<td>STEVEN LAMBETH</td>
<td>SENIOR ANALYST</td>
<td>10/1</td>
</tr>
</tbody>
</table>

Remuneration / alignment of interests
The investment team holds a combined 58% of the equity in BLSEM. This ensures that should performance fees be earned, staff would share in these via enhanced dividend payments. Investment staff are also investors in the wholesale fund.

Research Approach

Overview

<table>
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<tr>
<th>INVESTMENT STYLE</th>
<th>MARKET NEUTRAL, ABSOLUTE RETURN</th>
</tr>
</thead>
<tbody>
<tr>
<td>STRATEGY</td>
<td>PAIRS TRADING</td>
</tr>
<tr>
<td>STOCK UNIVERSE</td>
<td>ASX 100</td>
</tr>
<tr>
<td>RESEARCH INPUTS</td>
<td>‘SELL SIDE’ RESEARCH, INTERNAL FUNDAMENTAL RESEARCH, INDUSTRY CONTACTS</td>
</tr>
<tr>
<td>USE OF ‘SELL SIDE’ RESEARCH</td>
<td>EXTENSIVE</td>
</tr>
<tr>
<td>VALUATION</td>
<td>UNCONSTRAINED, CONSIDERS RELATIVE VALUATION</td>
</tr>
</tbody>
</table>

The LIC will adopt the IMs well established fundamental research process.

The first stage of the process is to identify stock ideas predominantly in the ASX 100. The key techniques utilised include performing:
- Fundamental analysis;
- Qualitative assessments;
- Relative valuations; and
- Absolute valuations.

The extent of the research performed depends on the both the opportunity and the need to do so and can range from a ‘deep dive’ to more of a high level assessment. While the research undertaken is relatively conventional, the focus on relative valuation opens up a different return configuration.

Once stock opportunities of interest have been identified (both on the long and the short side), the next step is to generate a pair. The following factors are considered:
- Suitability;
- Concentration; and
- Beta or risks.

The latter two are more portfolio construction considerations. In terms of the ‘suitability’, this involves a review of the industry commonality and correlation of an intended pair.

Existing pairs, be they immature and mature, are subjected to continuous review by the investment team. The key criteria under consideration are:
- Maturity;
- Success or failure;
- New information; and
- Timing.

Depending on the research findings, this is then fed through to the portfolio construction stage to ensure that the pair is still viable and/or the weights reflect the investment teams conviction levels.

Portfolio Construction

Overview

<table>
<thead>
<tr>
<th>COMPANY OBJECTIVE</th>
<th>DELIVER ABSOLUTE RETURNS VIA CAPITAL GROWTH AND INCOME REGARDLESS OF MARKET MOVEMENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>RISK OBJECTIVE</td>
<td>VOLATILITY OF 12-15% P.A. ON A LEVERED BASIS</td>
</tr>
<tr>
<td>PORTFOLIO DECISIONS</td>
<td>ULTIMATE RESPONSIBILITY WITH THE PORTFOLIO MANAGER</td>
</tr>
<tr>
<td>STOCK SELECTION</td>
<td>FUNDAMENTALLY-BASED, FOCUS ON INDUSTRY PAIRS</td>
</tr>
<tr>
<td>TOP-DOWN INFLUENCE</td>
<td>LIMITED</td>
</tr>
<tr>
<td>MARKET CAPITALISATION BIAS</td>
<td>LARGE CAP</td>
</tr>
<tr>
<td>EXPECTED PORTFOLIO TURNOVER</td>
<td>LOW ON AN UNLEVERED BASIS DUE TO LONG-DATED NATURE OF PAIRS (1-2 YEAR VIEW)</td>
</tr>
</tbody>
</table>
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- Portfolio construction is largely an outcome of the fundamental research process, with the typical pair (pre-leverage) having a weight in the range of 2-4% of GAV (or 1-2% of GAV for each stock). The final weight arrived at is a function of the following factors:
  - Mandate rules;
  - Investment team conviction;
  - Timing assessment; and
  - Technical.

In terms of importance, the key driver of the weight arrived at is conviction levels given the longer-dated nature of the pairs.

Risk Management

**Risk limits**

- **SEPARATE RISK MONITORING**: YES
- **INDIVIDUAL STOCK LIMITS**: MAX 10% OF GAV
- **ISSUED CAPITAL LIMITS**: MAX 5% OF ISSUED CAPITAL AT TIME OF PURCHASE
- **INDIVIDUAL PAIR TRADE LIMIT**: "SOFT" LIMIT OF 5% OF GAV
- **EXPOSURE UNCORRELATED PAIRS OR UNCOVERED LONGS / SHORTS**: MAX 40% OF GAV
- **LEVERAGE LIMIT**: MAX 5X PORTFOLIO NAV
- **EXPOSURE TO SMALL CAPS**: MAX 20% OF NAV
- **EXPOSURE TO INTERNATIONAL SECURITIES**: MAX 10% OF GAV
- **NET EFFECTIVE DERIVATIVES EXPOSURE RANGE**: 0-100%
- **LIC TIME TO IMPLEMENTATION**: 1 WEEK

The IM operates a pre and post trade compliance system for its trading strategies (FMO) to ensure all trades comply with a particular capabilities portfolio rules. These rules are fully integrated with the Bloomberg trading system. Compliance will also monitor for all other compliance breaches.

The IM has provided a range of risk management tools for the Portfolio Manager including Bloomberg, MSCI Barra and a range of proprietary models.

**Risks**

An investment in the LIC carries a number of standard investment risks associated with domestic and international investment markets. These include economic, political, legal, tax and regulatory risks. These and other risks are outlined in the Prospectus and should be read in full and understood by investors. Lonsec considers major risks to be:

**Equity market**

Investments in equity markets are subject to numerous factors which may have an impact on the performance of an investment (both positive and negative). Unexpected changes in economic, technological, structural, regulatory or political conditions can have an impact on the returns of all investments within a particular market.

**Market**

Being an LIC, its securities may trade on the ASX at a discount to its NAV for extended periods of time.

**Derivatives**

The IM has scope, via the Prospectus, to implement extensive derivative strategies for the LIC. Exchange traded derivatives and over-the-counter derivatives including but not limited to futures and options contracts may be used to enhance portfolio returns and cushion the impact of falls in the market. Gains or losses can result from this process. Derivatives cannot be used to lever the LIC.
Absolute Equity Performance Fund Limited

Glossary

Absolute Return ‘Top line’ actual return, after fees
Excess Return Return in excess of the benchmark return (Alpha)
Standard Deviation Volatility of monthly Absolute Returns
Tracking Error Volatility of monthly Excess Returns against the benchmark (the Standard Deviation of monthly Excess Returns)
Sharpe Ratio Absolute reward for absolute risk taken (outperformance of the risk free return (Bank Bills) / Standard Deviation)
Information Ratio Relative reward for relative risk taken (Excess Returns / Tracking Error)
Worst Drawdown The worst cumulative loss (‘peak to trough’) experienced over the period assessed
Time to Recovery The number of months taken to recover the Worst Drawdown
Absolute Equity Performance Fund Limited

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Date prepared
December 2015

Analyst
Peter Green

Release authorised by
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