SIGMA FUNDS MANAGEMENT®

Sigma Australian Shares Strategy

Monthly update as at 30 November 2015

	Month %	Quarter %	1 year %	2 years % p.a.	3 years % p.a.	4 years % p.a.	Since Inception^ % p.a.
Sigma Australian Shares Portfolio*	(3.8)	(4.4)	(0.7)	(0.2)	10.0	10.4	3.2
S&P/ASX 200 Acc. Index	(0.7)	0.6	2.0	3.1	9.4	10.7	2.2
Value added (detracted)	**(3.1)**	**(5.1)**	**(2.7)**	**(3.3)**	**0.6**	**(0.3)**	**1.0**

**Gross Performance. Past performance is not a reliable indicator of future performance. ^Since Inception: 1st July 2007*

Key points

- Significantly overweight Diversified Miners and underweight Major Banks
- Cyclical sectors expected to benefit as earnings bottom; avoiding expensive defensives
- Fund positioned for US interest rate normalisation; while matching local market dividend yields

Individual stock performance of note

The Fund *underperformed* a falling market in November as near term global growth concerns weighed on share prices of the large diversified miners, BHP Billiton (-21%) and Rio Tinto (-9%). With the commodity complex on its knees, we continue to see a substantial opportunity in the industry leaders, with tier 1 assets and strong balance sheets. Stock contributors included regional banks, Bendigo and Adelaide (+4%) and Bank of Queensland (+4%). However, the gains were offset by a similar rally in the major banks not held (ANZ +3%, CBA +4% and WBC +6%). The bank sector as a whole moved on no real news. Consumer Discretionary stocks JB Hi-Fi (+8%), Nine Entertainment (+7%) and Harvey Norman (+3%) were stronger as consumer indicators (sales and sentiment) surprised positively. The absence of Santos (-21%) contributed to performance in a relative sense. Other stock holdings detracting from performance included law firm Slater & Gordon (-67%) after the market responded negatively to regulatory changes in the UK compounding questions already raised about the firms historical accounting practices. Ironically as business growth slows cash flow is more than likely to improve. Sims Metal Management (-31%) was also weaker after management downgraded near term profits due to a collapse in global scrap prices. Sims remains significantly undervalued, with net cash on the balance sheet, the business remains well positioned to benefit from volume improvements in the key United States segment over the long term. The absence of Healthcare index heavyweight, CSL (+7%) impacted performance in a relative sense.

Economic developments and markets

Global equity markets made little progress (S&P 500 +0.1%: FTSE -0.1%: Nikkei +3.5%, Hong Kong -2.8%), dipping slightly mid-month before recovering to finish the month little changed. In contrast, Emerging Markets declined (MSCI Emerging Index -4.0%) giving back some of the +7.0% gain recorded in the month prior. The S&P/ASX 300 Accumulation Index fell 0.7% in November, with CYTD returns now flat. The local index was dragged down by a slump in the Materials sector (-12.6%), which suffered its largest decline since September 2011. At the other end of the spectrum, Healthcare delivered strong gains (+5.3%), while Banks (+1.3%) and Industrials (+1.1%) also outperformed the benchmark.

The Small Ordinaries Accumulation Index outperformed the S&P/ASX100 equivalent by 0.8%. The Small Industrials Accumulation Index outperformed the S&P/ASX 100 by 0.7%, while the Small Resources Accumulation index also outperformed the S&P/ASX100 Resources index by 0.2%. The Small Ordinaries Accumulation Index has outperformed the S&P/ASX100 Accumulation Index by 6.3% over the last quarter and 4.8% over the year.

Commodity markets were again weaker with iron ore prices as measured by the Qingdao index retracting -13.8%, while spot gold declined -6.8%. Spot Brent Crude fell -10.1% to US$42.82. A combination of warm weather and a muted response thus far from non-OPEC production to the collapse in prices, as well as the threat of further supply gains from Iran early next year continues to pressure prices. The A$

appreciated (1.2%) against the US$ and against most trading partners (EURO: +5.5%; JPY: +3.4%; and CNY: +2.6%).

In the US, the Fed left rates on hold, with the November FOMC statement conveying a relatively hawkish tone. The labour market data this month was much stronger than expected, supporting the call for the Fed lift-off in December. Non-farm payrolls increased from 137,000 to 271,000. The unemployment rate fell from 5.1% to 5.0%. The labour force participation rate remained steady at 62.4%.

The Australian Commonwealth 10-year bond yield rose 25bps, reaching 2.86%, a larger move that its US equivalent, which rose +6bps to 2.21%. The former's move largely reflects the stellar jobs report, as well as higher inflation expectations (Australia 10-year breakeven inflation rose 12pts to 2.2%). As a result of these moves, the Aus 10-year spread over US Treasuries moved 19bps higher to 0.63%. Elsewhere across developed markets, 10-year government bond yields were modestly lower: UK (-10bps), Japan (-1bps) and Germany (-4bps).

On the domestic economic front the labour force survey was unambiguously strong. The economy added 58,000 (market exp. 15,000) jobs in October, the largest one-month gain since 2012. The unemployment rate fell to 5.9% (market est. 6.2%) and the participation rate increased to 65.0%. There has been more traction on the consumer front, with retail sales up +0.6% for the September quarter and 0.4% m/m. This follows a rise of 0.7% m/m in the June quarter and a rise of +0.6% in the March quarter. Household goods retailing (-0.8% m/m) was the only drag in the otherwise firm result. The RBA decided to leave cash rates unchanged at 2.0%.

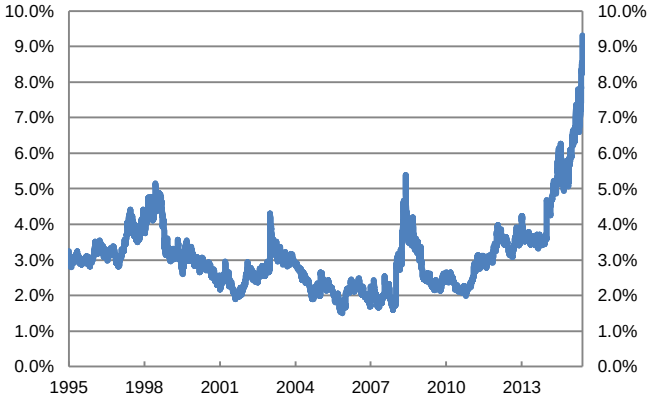
Portfolio changes and outlook

The Fund's relative valuation upside currently stands at 39%, a since inception high. In absolute terms, the portfolio has 41% upside relative to the market which is fairly valued (+2%) in our view (see graph). While the portfolio remains attractive on valuation grounds, our business risk metrics are the least attractive since inception. This has been the case for some 18 months, and as communicated in our quarterly strategy reviews we fully expect more volatile outcomes relative to market (as recent performance indicates), however we continue to believe the valuation upside will more than compensate for the volatility.

The following two charts highlights the changing fortunes over time of two of Australia's largest listed companies. At the height of the GFC in late 2008 and early 2009 nobody wanted to buy Australia's largest and least riskiest bank, the Commonwealth Bank of Australia, even as the dividend yield approached 10% (fully franked!). You couldn't give the stock away at below $30 per share. A few years on, the market is now willing to pay nearly $80 per share for the same business. Post the GFC, the industry position of CBA and all the majors have been strengthened considerably. Higher profits with lower risk has been the result. The large diversified miners are in a similar position. The current shake out will benefit shareholders in the coming years. While BHP may end up cutting the dividend (like CBA did during the GFC) we believe profitability and net cashflow is more than likely to improve substantially going forward.

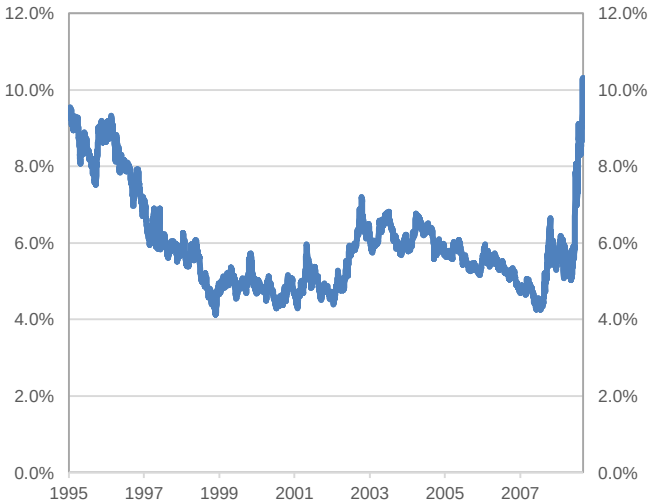
BHP's Historical Dividend Yield

Source: Annual Reports, IRESS



CBA Historical Dividend Yield near the GFC

Source: Annual Reports, IRESS



Stocks Added

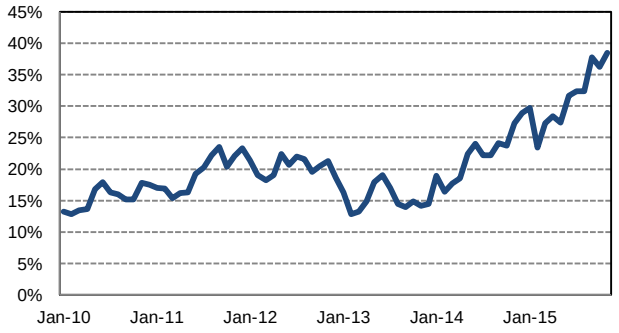
None

Stocks Sold

None

Australian Shares : Relative Valuation Upside

Source: Sigma Estimates, IRESS



Pricing Metrics	1-Yr PE	Net Div. Yield	Price/ Book Value	Price to NTA
Sigma ASF	12.7	5.4%	1.1	1.7
S&P/ASX 200	15.0	4.9%	1.8	2.5
Date	**Nov-15**	**Nov-14**	**Nov-13**	**Nov-12**
Stock Numbers	25	25	30	37
Active Share	70.1%	64.0%	48.8%	49.6%

Source: Sigma estimates, GS Portfoliowise

Top 5 active positions

Stock	Active weight %
By Large Cap stocks:	
Bank of Queensland	5.1
Bendigo and Adelaide Bank	4.8
AMP	4.7
Harvey Norman Holdings	4.7
Rio Tinto	4.5
By Small Cap stocks:	
Nine Entertainment	2.3
Seven West Media	1.5
G8 Education	1.1
Whitehaven Coal	0.9
McMillian Shakespeare	0.9

Note: Active weights refer to positions above benchmark only.

Asset allocation

Sector	Active weight %
Financials ex-Real Estate	11.7
Consumer Discretionary	7.6
Materials	4.4
Information Technology	(0.9)
Industrials	(1.4)
Utilities	(1.7)
Energy	(3.2)
Consumer Staples	(3.4)
Health Care	(4.6)
Telecommunications	(5.3)
Real Estate	(7.1)
Cash & Other	3.9

Note: Active weights refer to positions above or below benchmark.

Strategy summary

Sigma Australian Shares is a concentrated 'Large-cap' strategy blending the highest conviction stock ideas from Sigma's Large Cap investment team, leading to:

- Superior outperformance,
- Lower risk, and
- Increased consistency.

Features of Sigma Australian Shares:

- High conviction value-biased portfolio of 15 to 30 stocks
- Focused primarily on the Top 100 stocks listed on the Australian Stock Exchange
- Return Objective of 4% over the benchmark over rolling 3-5 year periods

Benefits of Sigma Australian Shares investment approach:

- *Capital protection* is our first priority, and achieved through an absolute as well as relative valuation focus while maintaining a diversified portfolio of large Australian businesses;
- *Outperforming* by allocating capital to a focused portfolio of undervalued business that increase the probability of achieving the Return Objective.

About Sigma Funds Management

- Value-style Australian equities manager which aims to outperform without the downside of "value traps" through an investment approach called *Value: Risk Adjust*
- Independent and majority employee-owned firm founded in 2009 by six experienced investment professionals who previously worked together at a leading global investment manager

Contact

For more information contact Pinnacle Investment Management, the Fund's distributor, on 1300 010 311.

See also www.sigmafunds.com.au