SIGMA FUNDS MANAGEMENT®

Sigma Select Equities Fund

Monthly update as at 31 March 2017

	Month %	Quarter %	FYTD %	1 year % p.a.	3 years % p.a.	5 years % p.a.	Since Inception^ % p.a.
Sigma Select Equities Fund*	2.3	2.8	24.8	24.1	5.0	11.3	8.5
S&P/ASX 300 Acc. Index	3.3	4.7	15.6	20.2	7.5	10.8	8.0
Value added (detracted)	**(1.0)**	**(1.9)**	**9.2**	**3.9**	**(2.5)**	**0.8**	**0.5**

**Gross Performance. Past performance is not a reliable indicator of future performance. ^Since Inception: 2nd May 2011*

Key points

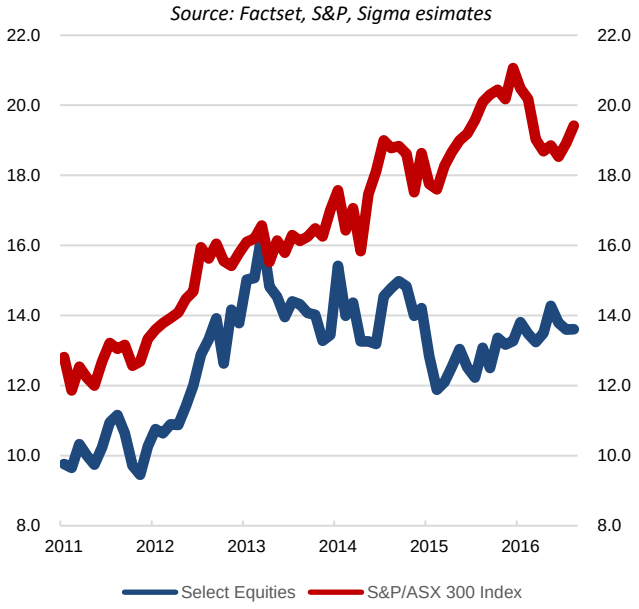
- Fund's cash levels increased to 16%, up from 5% twelve months ago due to market overvaluation
- Avoiding expensive safe havens that currently dominate that ASX300 Index
- Fund offers portfolio diversity, healthy cash generation, sustainable dividends & unpriced upside

Portfolio observations, changes and outlook

The Sigma Select Equities Fund ("the Fund" or "Select") *underperformed* a rising market in March. Approximately 65% of the AEQ by market cap (excludes the four major banks and two major miners) is currently trading on a lofty PE multiple of 19x (Figure 1). Historically, when equity markets have attained these levels, low to negative returns are ***near* certain.** Consequently, the Fund's cash levels are rising in line with market overvaluation.

Figure 1 - PE ex BHP, RIO & Major Banks: S&P/ASX 300 vs Select

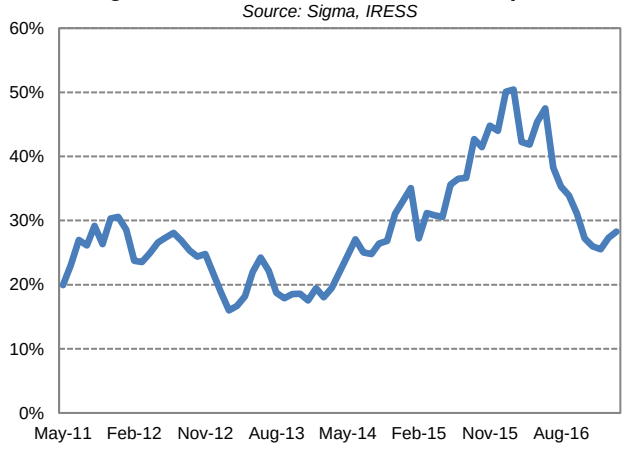
Source: Factset, S&P, Sigma esimates



Perversely, protecting hard earned capital in the current environment requires investors to embrace a more ***volatile portfolio* of businesses where *valuation support* is clearly evident**. Regardless of your views on risk, growth, quality, momentum etc., portfolios trading on high PE multiples have historically delivered low returns. Thus being true to our value label requires commitment to our *valuation disciplines*.

Figure 2 - Select Relative Valuation Upside

Source: Sigma, IRESS



Accordingly, Select's valuation metrics (Figure 2) remain supportive of delivering *positive returns* (+16% upside) in an overvalued market *(market has 12% downside overall)*, albeit we expect to have more volatile outcomes over the short-to-medium term in line with recent experience.

Individual stock performance of note

Fund performance was driven positively by:

- Media companies, Nine Entertainment (+25%), Seven West Media (+18%) and NZME Limited (+20%) were higher as the market digested their positive comments about an improving advertising market. Speculation about the future of the Ten Network also led to theories that two television networks would gain market share that would offset any impact from the fragmentation of media spend;
- Insurance giants AMP (+6%) and QBE (+7%) were both stronger on little news;
- Qantas Airways continued to rally (+6%: +10% in Feb 2017) after posting strong results and announcing the potential for further capital management at year end;
- The absence of index heavy weights Telstra (0%) and Scentre Group (-2%) benefited performance in a relative sense.

Fund performance was negatively impacted by:

- Negative sentiment towards retailer, Harvey Norman (-12%). Concerns over an inflated Australian housing market combined with company specific accounting complexities in relation to franchise support structures gained a lot of negative media attention during the month. While complicated and costly as a motivational tool, long term observers of the business understand the fundamental mechanics and reasons for it's deployment. Importantly, cash flow generation at Harvey Norman has never been stronger, therefore, we believe the market will refocus on the fundamentals in time;
- Falls in the large diversified miners, BHP Billiton (-2%) and RIO Tinto (-3%). Strong results were overshadowed by near term profit taking after a substantial share price runs. A turn in commodity sentiment also added to weakness;
- The absence of index heavyweights, Commonwealth Bank (+4%), Wesfarmers (+6%) and CSL (+7%) detracted from performance in a relative sense.

Stocks Added

Graincorp (GNC) is an integrated grain business supplying grain and processed grain products to customers in domestic and international markets, with a focus on wheat, barley and canola. Improved operating performance combined with diversification into Malts & Oils provides a more stable earnings base going forward. The current bumper east coast harvest is likely to be underestimated as well. The stock is trading at a 20% discount to valuation.

Stocks Sold

None

Pricing Metrics	1-Yr PE	Net Div. Yield	Price/ Book Value	Price to Cash Flow
Select Equities Fund	13.4	4.8%	1.6	4.4
S&P/ASX 300	17.5	4.4%	2.9	8.3
Date	**Mar-17**	**Mar-16**	**Mar-15**	**Mar-14**
Stock Numbers	32	35	35	37
Large Caps	17	18	20	23
Small Caps (ex-100)	15	17	15	14
Active Share	72.5%	79.3%	71.2%	60.5%
Small Cap Weighting	13.9%	20.5%	12.2%	9.9%

Source: Sigma estimates, FactSet

Top 5 active positions

Stock	Active weight %
By Large Cap stocks:	
Rio Tinto	4.4
BHP Billiton	4.1
Bank of Queensland	4.0
Bendigo and Adelaide Bank	3.6
Harvey Norman	3.2
By Small Cap stocks:	
Sims Metal Management	2.3
APN News & Media	1.4
Nine Entertainment	1.3
Tox Free Solutions	1.2
Seven West Media	1.0

Note: Active weights refer to positions above benchmark only.

Asset allocation

Sector	Active weight %
Consumer Discretionary	6.3
Materials	4.0
Industrials	(0.8)
Consumer Staples	(0.9)
Information Technology	(1.3)
Financials ex-Real Estate	(1.3)
Energy	(2.3)
Utilities	(2.7)
Telecommunications	(4.1)
Health Care	(6.1)
Real Estate	(6.3)
Cash & Other	15.5

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

Strategy summary

Sigma Select is a concentrated 'broad-cap' strategy blending the highest conviction stock ideas from Sigma's Large Cap and Small Cap investment teams, leading to:

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

What makes Sigma Select unique?

- Concentrated, value-biased portfolio of 20 to 40 stocks
- Broad investment universe (ASX 300) increases alpha opportunities and diversification benefits
- Timely execution of Small Cap exposure (up to 25%) to capture beta opportunity
- Efficient alpha extraction from holding meaningful Small Cap positions
- Focus on downside protection: cash allocation (up to 25%) varies according to market outlook

Why aren't other investment management firms doing this?

Most investment management firms comprise distinct Large Cap and Small Cap teams with separate incentive structures and competing interests. In contrast, Sigma's Large Cap and Small Cap teams are equal partners and completely aligned to the success of the Select strategy.

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*
- Sigma is an investment partnership, 51% owned by Azimut, Italy's leading independent asset manager with the Executive founders owning the remaining 49%

Contact

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

See also www.sigmafunds.com.au