SIGMA FUNDS MANAGEMENT®

Sigma Select Equities Fund

Monthly update as at 31 May 2016

	Month %	Quarter %	FYTD %	1 year % p.a.	2 years % p.a.	3 years % p.a.	Since Inception^ % p.a.
Sigma Select Equities Fund*	0.8	11.2	(7.9)	(14.0)	(2.0)	5.1	6.1
S&P/ASX 300 Acc. Index	3.1	11.7	3.4	(2.1)	3.7	7.7	6.8
Value added (detracted)	**(2.3)**	**(0.5)**	**(11.3)**	**(11.9)**	**(5.7)**	**(2.6)**	**(0.7)**

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

Key points

- Objective investors can profit by embracing mispriced uncertainty
- Avoiding expensive safe havens that currently dominate that ASX300 Index
- Fund offers portfolio diversity, healthy cash generation, sustainable dividends & unpriced upside

Individual stock performance of note

The Sigma Select Equities Fund ("the Fund" or "Select") *underperformed* a rising market in May as defensive-quality-yield remained well supported by the RBA's surprise rate cut.

Fund performance was driven negatively by:

- The falling share prices (RIO -13%; BHP -8%) of the large diversified miners representing approximately 16% of the Fund. Since the start of the CY2016 the share prices of two large diversified miners have significantly lagged the 40% (avg.) rise in the riskier resource names (Fortescue, South32, Whitehaven, Iluka, OZ Minerals and Alumina) after falling by an equivalent amount (-25%) in the 2H of CY2015. While impacting near term fund performance, the underlying cash generation of the diversified names will ultimately reward investors over the medium term and share prices are likely to respond accordingly;
- Other detractors included AMP (-4%) after announcing Life insurance claims had spiked in 1Q16, and Sims Metal Management (-14%) which reversed some of the recent gains driven by stronger steel prices;
- Orica (-10%) was also down after reporting a weaker than expected profit result in a tough operating environment;
- Qantas (-4%) fell for the second straight month as the market debates whether the profit cycle has peaked;
- While the absence of CSL (+10%) and Commonwealth Bank (+5%) detracted from performance in a relative sense.

Fund performance was driven positively by:

- Macquarie Group (+22%) post reporting solid results and FY17 guidance indicating record profits are likely to be maintained, addressing concerns they would downgrade in line with global peers;
- Australian Agricultural Company (+22%) rose above NTA after delivering a stronger than expected result on the back of rising beef prices and a more focussed brand strategy;
- McMillian Shakespeare (+22%) which rallied strongly in response to the Australian Labor Party announcing they were not proposing any changes to fringe benefits in the salary packaging sector;
- Finally, APN News & Media (+16%) was stronger post raising capital and restructuring the business. With the balance sheet repaired and the impending divesture of the newspaper businesses in Australia (by sale) and NZ (by IPO) announced, management intends to focus on the core radio and outdoor media assets which generally command higher multiples;
- The absence of Wesfarmers (-5%) added to performance in a relative sense.

Portfolio observations, changes and outlook

The following table illustrates the Funds returns by financial year:

Select Gross Performance by Financial Year

Financial Year	2012* %	2013 %	2014 %	2015 %	16FYTD %
Select	(10.8)	27.2	22.0	5.9	(7.9)
Index	(10.7)	21.9	17.2	5.6	3.4
Relative	**(0.1)**	**5.3**	**4.8**	**0.3**	**(11.3)**

**Includes 2 months from financial year 2011. Past performance is not a reliable indicator of future performance*

Over the last 18 months or so we have been communicating that Select's positioning is more than likely to generate above average returns for investors, however expect the volatility to increase as the "value" lies within the economically sensitive sectors of the economy. Accordingly, as world markets have become concerned with "global growth" in the face of rising US rates the Fund has been caught up in the downdraft with financial year to date returns down more than the market as table above illustrates.

Back in 2011 & 2012 during the European Financial crisis, the market had a lot of upside, as highlighted in the following table, showing the valuation upside for Select and the market at the start of each financial year since 2012:

Valuation upside at the start of each Financial Year

Start – FY*	2012	2013	2014	2015	2016	May16
Select	46%	53%	36%	33%	35%	43%
Index	23%	26%	12%	6%	0%	-3%
Relative	**23%**	**27%**	**24%**	**27%**	**35%**	**45%**

**Start of the Financial Year*

At the start of FY2012 and FY2013 undervaluation was plentiful across a wide universe of stocks as indicated by the 23% & 26% upside respectively for the market. While the Fund had substantially more upside (46% and 53% for the same points in time), Sigma's proprietary *Business Risk Assessment* was showing the Fund's risk profile was in line with the market or slightly better.

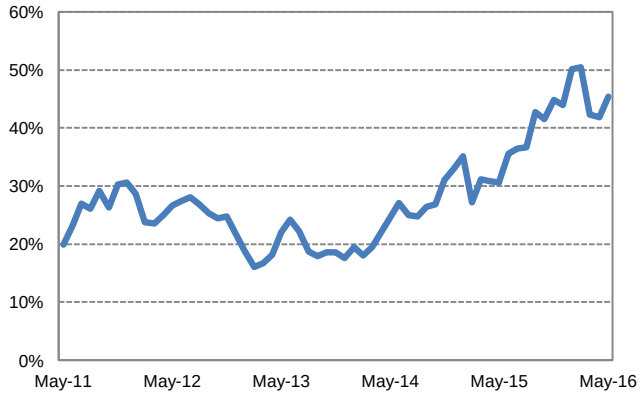
Post the significant rally in markets over FY2013/2014 the market as a whole is no longer undervalued and the opportunity set has narrowed considerably. The **"defensive-quality-yield"** (**DQY**) thematic has resulted in *overpayment for certainty with low future returns* the most likely result. As approximately 60% of the Australian Equity market falls into this camp (Defensive stocks & Major Banks), we expect returns for the market as a whole to be low going forward.

However, embracing the perceived "uncertain and unloved names" neglected by the prevailing DQY dynamic is not an easy road for most investment managers. Most realise they will be compensated for *embracing the near term uncertainty* but cannot do so as they feel nervous about the near term volatility created within their portfolios, particularly in the post GFC world where investors are *paying up for certainty*.

While Sigma's Business Risk Assessment has clearly indicated the Fund has a higher fundamental risk profile than the market the relative valuation upside more than compensates. As a team we continue to remind ourselves of the first golden rule of investing – **Don't Overpay!** Since inception in May 2011, the portfolio today has the greatest potential for outperformance as highlighted in the Select Relative Valuation Upside graph – i.e. *we are pregnant with performance.*

Select Relative Valuation Upside

Source: Sigma, IRESS



Stocks Added

Australia & New Zealand Banking Group (ANZ) was acquired for the first time since inception (and after an absence of 6 years for the broader fund). Concerns over the rapid expansion into low returning-higher risk Asian markets are now being addressed under the new CEO. Importantly, the markets expectations for elevated bad debts (more than 50% higher than the other major banks) more the captures the retreat, albeit acknowledging a bumpy ride ahead. The reinstated focus on Return on Equity is welcome news for shareholders.

Flight Centre Travel Group (FLT) was added post the profit downgrade in late May. The stock has fallen some 29% from March 2016 to be approximately 42% off all-time highs reached approximately two years earlier. Trading on 13x (downgraded earnings) with a solid balance sheet and a dependable franchise, we believe the market is overreacting

to cyclical nature of the industry believing the current trends (softening commission rates etc.) are more structural in nature.

Stocks Sold

Broadspectrum (BRS) was sold post the board recommending Ferrovial's increased $1.50 all-cash bid was attractive in light of the uncertainty with the Manus Island detention centre contract post the PNG Supreme Court's ruling the facility breached the country's constitution.

Clydesdale Bank (CYB) inherited through the Fund's holding in National Australian Bank (thus a small position) was sold post a significant rally in the share price.

Perpetual (PPT) was sold to reduce the Fund's exposure to Markets in general.

Pricing Metrics	1-Yr PE	Net Div. Yield	Price/ Book Value	Price to Cash Flow
Select Equities Fund	15.9	4.9%	1.5	4.8
S&P/ASX 300	19.1	4.4%	2.9	8.8
Date	**May-16**	**May-15**	**May-14**	**May-13**
Stock Numbers	33	33	39	33
Large Caps	18	19	22	23
Small Caps (ex-100)	15	14	17	10
Active Share	74.6%	72.8%	62.1%	55.6%
Small Cap Weighting	18.9%	13.6%	11.6%	6.6%

Source: Sigma estimates, FactSet

Top 5 active positions

Stock	Active weight %
By Large Cap stocks:	
Harvey Norman	5.5
Rio Tinto	5.3
BHP Billiton	5.0
Bendigo and Adelaide Bank	5.0
Bank of Queensland	4.6
By Small Cap stocks:	
Sims Metal Management	2.3
Seven West Media	2.0
APN News & Media	1.9
Nine Entertainment	1.7
Tox Free Solutions	1.5

Note: Active weights refer to positions above benchmark only.

Asset allocation

Sector	Active weight %
Consumer Discretionary	9.8
Materials	8.1
Financials ex-Real Estate	2.8
Energy	(1.1)
Industrials	(1.2)
Information Technology	(1.2)
Utilities	(1.5)
Consumer Staples	(2.4)
Telecommunications	(5.6)
Real Estate	(6.0)
Health Care	(7.2)
Cash & Other	5.5

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 Aziumt, Itlay'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