SIGMA FUNDS MANAGEMENT®

Sigma Select Equities Fund

Monthly update as at 31 May 2017

	Month %	Quarter %	FYTD %	1 year % p.a.	3 years % p.a.	5 years % p.a.	Since Inception^ % p.a.
Sigma Select Equities Fund*	(0.9)	2.5	25.0	20.2	4.9	12.8	8.3
S&P/ASX 300#	(2.7)	1.4	13.6	10.8	6.0	11.7	7.4
Value added (detracted)	**1.8**	**1.1**	**11.4**	**9.4**	**(1.1)**	**1.1**	**0.9**

**Gross returns. #S&P/ASX 300 Accumulation Index, the benchmark. ^Inception date: 2nd May 2011*

Past performance is not a reliable indicator of future performance.

Key points

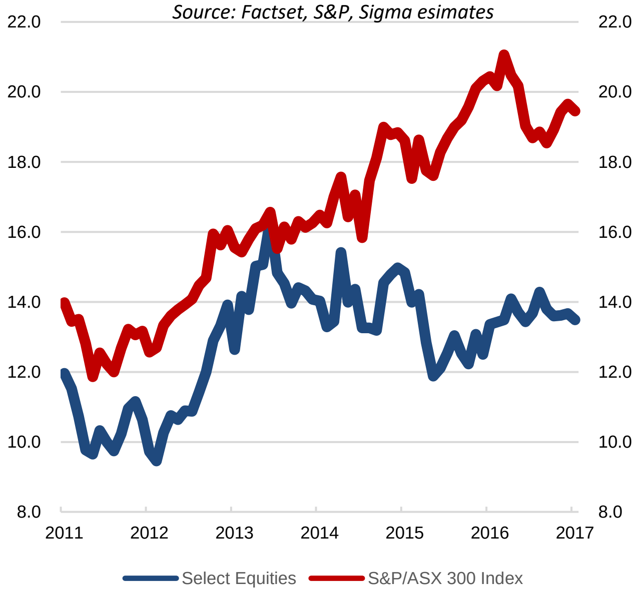
- Fund's cash levels increased to 16%, up from 5% twelve months ago due to market overvaluation
- Avoiding expensive safe havens that currently dominate the S&P/ASX 300 Accumulation Index
- Fund offers portfolio diversity, healthy cash generation, sustainable dividends and unpriced upside

Portfolio observations, changes and outlook

The Sigma Select Equities Fund ("Fund" or "Select Equities") *outperformed* a falling market in May. 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 near 20x (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 Equities

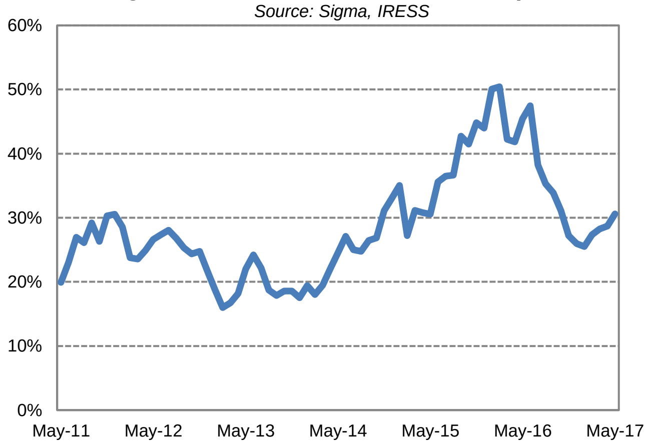
Source: Factset, S&P, Sigma esimates



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 philosophy requires commitment to our *valuation disciplines*.

Figure 2 - Fund Relative Valuation Upside

Source: Sigma, IRESS



Accordingly, the Fund's valuation metrics (Figure 2) remain supportive of delivering *positive returns* (+23% upside) in an overvalued market *(market has 8% 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:

- Qantas Airways, which continued to run strongly (+18%; +10% in Feb 2017,+6% in Mar 2017,+9% in April) after the investor day was positively received by the market. Tightly managing capital spend while growing the capital light frequent flyer business was a highlight;
- Travel retailer, Flight Centre (+14%) continued to rally as the markets expectations of a slow-down in profit have not materialised;
- Agriculture infrastructure provider, Graincorp (+16%) was buoyed by the better than expected result underpinned by a record harvest;
- The large diversified miners RIO Tinto (+4%) and BHP Billiton (+1%) were up in a down market on no real news;
- Global scrap provider, Sims Metal Management (+8%) seemed to rally on the perception of a better outlook for margins in the steel industry; and
- The absence of two largest stocks in the index, Commonwealth Bank (-9%) and Westpac (-10%) benefited performance in a relative sense.

Fund performance was negatively impacted by:

- Negative sentiment towards retailer, Harvey Norman (-10%: 5% in April; 12% in March 2017) continued. Concerns over an inflated Australian housing combined with the entry of Amazon and company specific accounting complexities in relation to franchise support structures gained a lot of negative media attention of late. However, the balance sheet and cash flow generation at Harvey Norman has never been stronger. Therefore, we believe the market will refocus on the fundamentals in time;
- The Fund's bank holdings were impacted by the bank levy post budget: ANZ (-12%), NAB (-9%), Bendigo and Adelaide Bank (-8%) and Bank of Queensland (-7%). The overall bank position outperformed due to absence of the two Sydney based banks; and
- The absence of Telstra (+4%), Sydney Airport (+8%) and Aristocrat Leisure (+12%) detracted from performance in a relative sense.

Stocks Added

Super Retail Group (SUL) A position in SUL was initiated following a 30% decline in the share price as investors reacted negatively to slower sales momentum and concerns on the entry of Amazon. Investors are currently discounting a pessimistic view of both the cyclical and structural retail environment across discretionary retail exposures providing us with an opportunity to acquire one of the stronger franchises within the sector. We regard the group as competitively strong in its three core divisions with the benefit of lower risk through diversification. The company has a good track record in managing cyclical sales volatility and its strategy to structurally improve business competitiveness remains sound.

Stocks Sold

None

Pricing Metrics	1-Yr PE	Net Div. Yield	Price/ Book Value	Price to Cash Flow
Select Equities	13.2	4.9%	1.6	4.8
S&P/ASX 300	17.3	4.5%	3.0	8.4
Date	**May-17**	**May-16**	**May-15**	**May-14**
Stock Numbers	32	33	33	39
Large Caps	17	18	19	22
Small Caps (ex-100)	15	15	14	17
Active Share	72.8%	74.6%	72.8%	61.1%
Small Cap Weighting	14.6%	18.9%	13.6%	11.6%

Source: Sigma estimates, FactSet

Top 5 active positions

Stock	Active weight %
By Large Cap stocks:	
Rio Tinto	4.3
Bank of Queensland	3.9
BHP Billiton	3.8
Bendigo and Adelaide Bank	3.6
Flight Centre	3.3
By Small Cap stocks:	
Sims Metal Management	2.2
Nine Entertainment	1.6
CYBG Group	1.3
Seven West Media	1.0
HT&E	0.9

Note: Active weights refer to positions above benchmark only.

Strategy summary

Select Equities' investment strategy 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 Select Equities unique?

- Concentrated, value-biased portfolio of 20 to 40 stocks
- Broad investment universe (S&P/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

Asset allocation

Sector	Active weight %
Consumer Discretionary	6.4
Materials	3.6
Consumer Staples	(0.9)
Financials ex-Real Estate	(1.2)
Information Technology	(1.3)
Industrials	(1.5)
Energy	(2.3)
Utilities	(2.4)
Telecommunications	(3.8)
Health Care	(6.3)
Real Estate	(6.5)
Cash & Other	16.2

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

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 Select Equities' strategy.

About Sigma

- 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, i.e. 51% owned by Azimut, Italy's leading independent asset manager, with the remaining 49% owned by Sigma's executive founders.

Contact

For more information contact Pinnacle Investment Management Limited, the Fund's distributor, on 1300 010 311. See also www.sigmafunds.com.au

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