

Sigma Select Equities Fund

Monthly update as at 31 January 2017

	Month %	Quarter %	FYTD %	1 year % p.a.	3 years % p.a.	5 years % p.a.	Since Inception ^ % p.a.
Sigma Select Equities Fund*	0.6	10.2	22.0	26.7	6.0	11.8	8.3
S&P/ASX 300 Acc. Index	(0.8)	6.4	9.6	17.3	7.4	10.4	7.2
Value added (deducted)	1.4	3.8	12.4	9.4	(1.4)	1.4	1.1

*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 17%, up from 3% 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”) *outperformed* a falling market in January. Approximately 70% 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 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.

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

Source: Factset, S&P, Sigma estimates

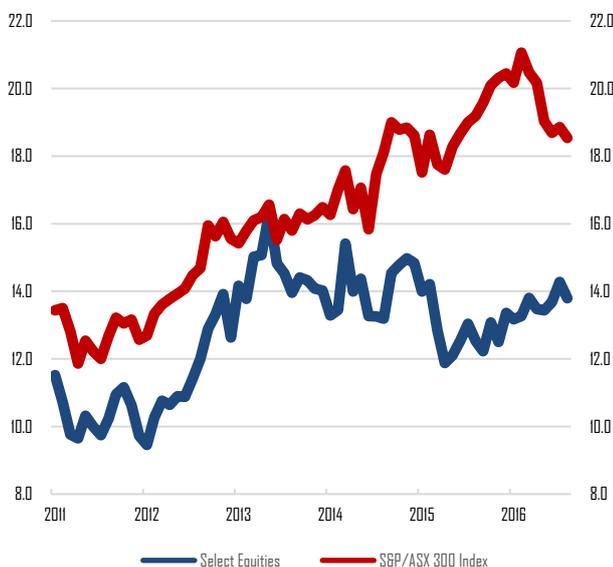


Figure 2 - Select Relative Valuation Upside

Source: Sigma, IRESS



Accordingly, Select's valuation metrics (Figure 2) remain supportive of delivering *positive returns* (+17% upside) in an overvalued market (*market has 9% 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:

- The large diversified miners, RIO Tinto (+11%) and BHP Billiton (+7%) which continued to rally as the market anticipates stronger than expected results;
- Origin Energy (+8%) was firmer as APLNG's ramp up continued to exceed expectations. Combined with firmer electricity forward curves suggesting future tailwinds for the Energy Markets business, the outlook for the group is starting to change after a period of challenging conditions;
- Qantas Airways (+2%) was up on no real news;
- The absence of index heavy weights Brambles (-16%) post a profit downgrade, Scentre Group (-5%), Wesfarmers (-4%) and Westpac (-3%) benefited performance in a relative sense.

Fund performance was negatively impacted by:

- Travel retailer, Flight Centre (-4%) which continued to weaken as the market anticipates a softer travel environment;
- APN News & Media (-11%) was weaker on no real news;
- Scrap metal supplier, Sims Metal Management (-12%) was weaker despite an earnings upgrade, with the market focussed on the uncertainty around scrap metal markets in the second half of FY17;
- The absence of BlueScope Steel (+21%) and CSL Limited (+11%), both rallying post profit upgrades impacted performance in a relative sense. Likewise, the resources strength and a solid quarterly production report supported Fortescue Metals (+13%) at month end which is not held by the Fund.

Stocks Added

None

Stocks Sold

None

Pricing Metrics	1-Yr PE	Net Div. Yield	Price/Book Value	Price to Cash Flow
Select Equities Fund	13.9	4.7%	1.6	4.9
S&P/ASX 300	16.9	4.5%	2.7	7.9
Date	Dec-16	Dec-15	Dec-14	Dec-13
Stock Numbers	31	34	37	35
Large Caps	16	18	20	23
Small Caps (ex-100)	15	16	17	12
Active Share	72.0%	79.5%	69.4%	61.2%
Small Cap Weighting	13.6%	17.0%	11.7%	8.9%

Source: Sigma estimates, FactSet

Top 5 active positions

Stock	Active weight %
By Large Cap stocks:	
BHP Billiton	5.3
Rio Tinto	4.5
Bank of Queensland	4.1
Bendigo and Adelaide Bank	3.9
Harvey Norman	3.4
By Small Cap stocks:	
Sims Metal Management	2.3
APN News & Media	1.4
Tox Free Solutions	1.4
Nine Entertainment	1.0
Peet Limited	0.8

Note: Active weights refer to positions above benchmark only.

Asset allocation

Sector	Active weight %
Consumer Discretionary	5.3
Materials	4.1
Financials ex-Real Estate	0.6
Information Technology	(1.3)
Industrials	(1.4)
Energy	(2.4)
Consumer Staples	(2.4)
Utilities	(2.5)
Telecommunications	(4.5)
Health Care	(5.4)
Real Estate	(6.6)
Cash & Other	16.5

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

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