Emerging Companies Portfolio Service Fact Sheet – December 2017

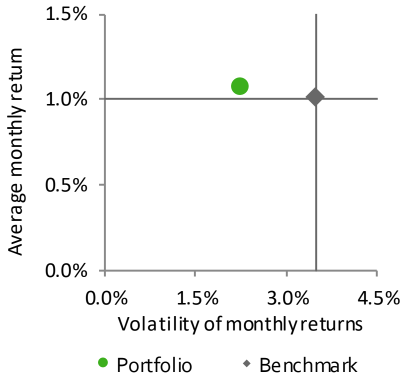
ARK INVESTMENT PARTNERS

Investment Report

In the December quarter the Reference Portfolio returned 8.46% compared with 10.57% for the S&P/ASX Small Industrials (TR) Index, underperformance of -2.11% despite generating a very strong absolute return with an elevated cash exposure.

The market notably accelerated during the December quarter as investors enthusiastically embraced the global reflation theme and its implications for corporate profitability, particularly in the US which is set to benefit from supportive fiscal measures at a relatively late stage in the cycle. Locally the outlook is improving but remains somewhat mixed with strong employment gains yet to translate into wage growth, inconsistent consumer spending and slowing in key residential property markets.

Returns and Volatility



Share price movements across the portfolio were largely positive during the December quarter with **Aconex** (+73.8%) and **Elders** (+63.5%) generating exceptional returns. Aconex received a takeover offer from international tech giant Oracle during the quarter while Elders benefitted from its ongoing restructure and strong agricultural trading conditions. **Rhipe** (+31.5%) and **Lovisa** (+30%) provided solid trading updates and **Impedimed** (+27.7%) outlined a number of positive developments around the commercialisation of its technology.

The poorer performers during the quarter included **Class** (-18.9%) and **Ellex Medical Lasers** (-11.5%). Sentiment towards Class was affected by slower SMSF additions in the June and September quarters as customers prioritised compliance with the recent superannuation changes. This slowdown was expected and we believe growth will recover strongly as advisers resume business-as-usual with increased regulatory complexity driving the adoption of more sophisticated SMSF administration products. Ellex provided a slightly soft AGM trading update but maintains an encouraging longer-term outlook as iTrack commercialisation ramps up, recent capacity investments are brought into operation, and the Phase III trial of its 2RT technology for early stage age related macular degeneration nears completion.

At 31 December 2017, 23.7% of the Reference Portfolio was held as cash.

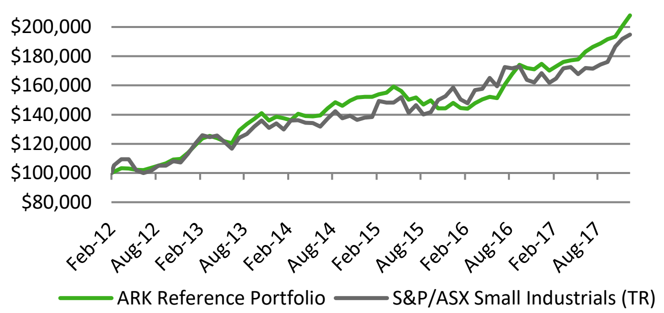
Investment Returns as at 31 December 2017

	1 Month	3 Months	1 Year	3 Years	5 Years	Since Inception
Portfolio performance	**3.69%**	**8.46%**	**18.99%**	**10.96%**	**12.82%**	**13.29%**
Portfolio outperformance	*2.14%*	*-2.11%*	*3.30%*	*-1.26%*	*1.35%*	*1.25%*
S&P/ASX Small Industrials (TR)	**1.55%**	**10.57%**	**15.69%**	**12.22%**	**11.47%**	**12.04%**

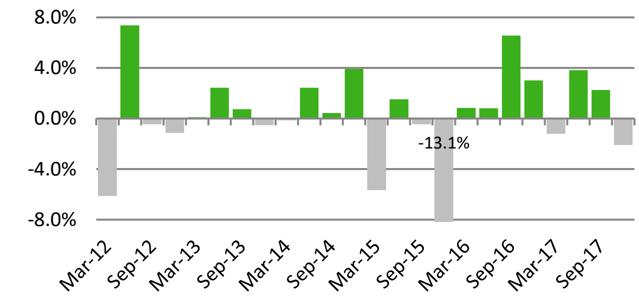
Investment returns are quoted after all fees and costs and before tax (i.e. excluding capital gains tax and the benefit of franking credits). Multi-year period returns have been annualised. Inception date is 20 February 2012. Volatility is measured using standard deviation. Performance information relates to ARK's original client portfolio (referred to as the Reference Portfolio), other client portfolios may have experienced different performance.

Investments go up and down. Past performance is not necessarily indicative of future returns.

Returns since inception



Quarterly performance relative to benchmark



Important Information

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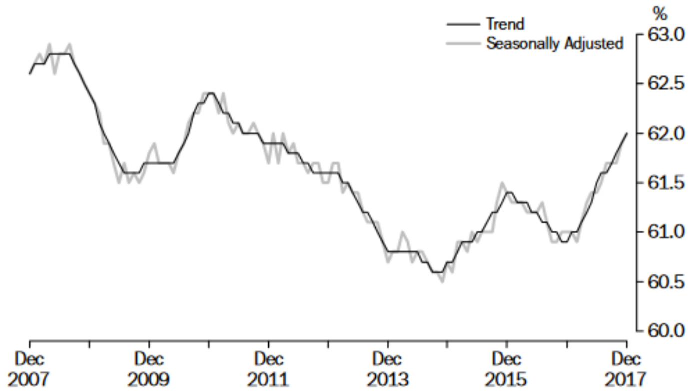
Investment Environment

Stock prices materially accelerated in the December quarter with investor enthusiasm for equities stoked by strong synchronised economic growth across the major global economies and an expectation that monetary policy will remain relatively accommodative for the foreseeable future as inflation measures are yet to meaningfully stir. US economic growth will also be assisted by expansionary fiscal policy as corporate tax cuts fuel economic activity and swell corporate profitability. The extent to which shareholders will benefit from the tax cuts over time will be highly dependent on the dynamics of the industries in which their companies operate, but the net effect will be positive. Accordingly, investors appear to be rationally responding to an improving outlook for economic growth and corporate profitability. While sharing this view, we are concerned about its implications for price stability at this late stage in the cycle. A benign inflation assumption has proved profitable for investors in recent times, but perhaps we are at the point at which that assumption should be revisited.

Commodity prices benefitted during the quarter from the uptick in global economic activity with oil notably recovering as OPEC members exerted firm control on production. Looking forward, further price growth is likely to be limited by increased non-OPEC production at these higher prices. For Australia, the price of steel inputs rose strongly during the quarter and thermal coal prices remained elevated. Similarly, minerals connected to electric storage (lithium, graphite, cobalt etc.) experienced strong price appreciation amidst an improving demand outlook. Several key Australian agricultural commodities, especially wool, cattle and sheep, continued to perform well during the quarter providing impetus to many regional economies and the rural sector more generally.

Local employment data continued to improve through the December quarter with a noticeable uptick in full time job creation and workforce participation. While underemployment remains elevated, it is beginning to retreat from the highs of the last couple of years as slack is taken out of the market. Continued improvement in the participation rate indicates that workers perceive a stronger employment market and are re-joining the workforce. Charting total employed persons as a percentage of the working age population (i.e. ignoring workforce participation) gives a high-level view of the strong recovery in the employment market over calendar year 2017.

GRAPH 1, EMPLOYMENT TO POPULATION RATIO, PERSONS, December 2007 to December 2017



Source: Australian Bureau of Statistics, *6202.0 - Labour Force, Australia, Dec 2017*

Despite this ferocious rate of job creation, wage growth remains low owing to the high level of underemployment. We expect job growth to resume a more sustainable trajectory over the coming year further reducing slack in the job market, whether this will be sufficient to support wage growth is a key uncertainty for 2018.

The moderation of residential property prices appears to have broadened across additional capital city markets in the December quarter. With markets cooling from their white-hot temperatures of recent years, price softness is being accompanied by a normalisation of clearance rates. Whilst price declines to date have been relatively minor (outside of WA and NT and certain capital city unit markets), an acceleration of this trend could have serious repercussions for consumer confidence given household debt is now approaching 200% of disposable income despite ongoing tightening of borrowing standards by the banks. In terms of new supply for these markets, multi-unit residential building approvals unexpectedly surged in November with the growth entirely attributable to Victoria as NSW and Queensland both recorded declines. It remains to be seen whether this supply will ultimately be brought to market given the weaker pricing conditions currently prevailing in some unit markets.

Local retail conditions improved slightly in the early part of the quarter with incremental sales growth recorded in November. The ABS singled out sales activity from the release of the iPhone X and increasing promotional activity, being the Black Friday sales event which falls on the day after the US Thanksgiving Day holiday. We expect the Black Friday sales to have simply pulled forward pre-Christmas or Boxing Day sales activity rather than growing total sales. Slow wage growth, increasing debt levels and property market uncertainty are likely to have offset the improvement in the employment market and ensured ongoing weakness in consumer spending across the pre-Christmas and Boxing Day sales period. We expect this data to be in line with the relatively sluggish retail trend that has persisted for most of 2017. Anecdotally it appears that some of the pressure from declining retail profitability is beginning to be felt by retail landlords as tenants seek to reduce rents on renewal and shrink their store footprints. This pressure is likely to increase over coming years and the implications for retail property values could be compounded by an expansion of capitalisation rates if interest rates rise.

Portfolio Positioning

Today's interest rate environment remains broadly supportive of equity valuations and we remain very confident in the outlook for our current investments. However, we would not be surprised if investment markets were to become more challenging over 2018/19 after a long period of low volatility where a rising tide has lifted most boats. Should markets rediscover some of their historic liveliness, they will demand more discipline from investors in terms of active risk monitoring and agile risk management.

The quarter was relatively active for us as we took the opportunity to rebalance some of our positions to ensure a more even and manoeuvrable balance of exposures. In addition to taking profits on several positions that approached our view of fair value, we were able to introduce some new positions and bulk up several existing underweight positions that offered attractive investment metrics despite a relatively fully valued market. Cash increased incrementally during the quarter as a result of these transactions. As we have noted previously, we would prefer to invest this cash in attractive investment opportunities but are prepared to be patient in identifying appropriate opportunities.

What is the service?

Investors in the Emerging Companies Portfolio Service appoint ARK to actively manage a portfolio of small and mid-cap ASX listed investments on their behalf. The service is structured to allow clients to obtain the benefit of dedicated investment management without relinquishing ownership of their investments.

What are the advantages of the service?

The key advantages of the service are:

- A dedicated manager oversees your exposure to small and mid-cap listed investments.
- You retain legal and beneficial ownership of your investments giving you greater transparency and control.
- You can customise the tax consequences of your investments to suit your individual situation.
- Your assets are separated from other investors.

What investments are considered?

We solely invest in ASX listed small and mid-cap industrial companies and do not invest in resource companies.

Why small and mid-cap industrial companies?

Relative to their larger counterparts, these companies:

- are overlooked by many professional investors,
- tend to be less well understood by the market, and
- often have higher growth prospects and more risk.

These characteristics make this sector of the market an attractive environment for active investment management.

Our disciplined, risk focused investment process is designed to identify attractive investment opportunities in this sector of the market whilst reducing risk.

What is our investment approach?

Our ideal investment targets are well-managed companies with advantageous competitive characteristics that can reliably produce excess free cash flows and have the potential to re-invest those earnings at attractive rates of return. However, we will consider other investments where our risk-adjusted valuation implies an attractive level of return.

We value investments based on our own proprietary research underpinned by extensive analysis. Before investing in a company we seek to thoroughly understand its business and associated risks and opportunities particularly:

- its financial performance and condition,
- management's integrity and ability,
- the industry's competitive landscape, cyclical outlook and operating environment,
- the key risks and drivers of the business, and
- the market's perception of the company and how, if at all, our view diverges from it.

How is your portfolio managed?

In addition to ensuring that each investment is attractive in its own right, we carefully consider how an investment will affect the risk profile of your portfolio. Our guiding principle is to maximise the profit potential for your portfolio within relatively conservative risk boundaries.

We undertake continuous portfolio review in conjunction with a structured process for the realisation and acquisition of investments. This ensures that individual investment weightings reflect our view of the relationship between price and value for each security, portfolio mix and the relative attractiveness of other investments.

Investment Summary

Investment Manager		ARK Investment Partners Pty Ltd ABN 12 150 856 223 (AFSL No. 487510)
Investment Objective		Outperform the S&P ASX Small Industrials Total Return Index over a 3 year period
Ownership		Legal and beneficial ownership remains with investors
Recommended Investment Period		3+ years
Investment Restrictions		Available to Wholesale Clients only
Minimum Initial Investment		$100,000 (no minimum for additional investment)
Fees	Entry/ Exit Fee	Nil
	Management Fee	Up to 1.0% per annum of the value of the managed capital
	Performance Fee	20% of any out-performance above the S&P ASX Small Industrials Total Return Index

Further Information

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