QUARTERLY REPORT

DECEMBER 2018

The Santa slump

New opportunities to put capital to work

p.4 Video insight

PM Capital
GLOBAL OPPORTUNITIES FUND LIMITED

PM Capital Global Opportunities Fund Limited

ACN 166 064 875 (ASX Code: PGF)

PM Capital
ASIAN OPPORTUNITIES FUND LIMITED

PM Capital Asian Opportunities Fund Limited

ACN 168 666 171 (ASX Code: PAF)

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A note from the CIO

Paul Moore
CIO & Portfolio Manager of the PGF

Dear Investor,

2018 was a year that started with optimism (on the back of Trump's tax cuts) but ended with extreme pessimism and an uncharacteristic December decline that has only been exceeded (on the New York Stock Exchange) in the early years of the Great Depression, back in 1931.

Perversely, in December 2018 the US economy added 312,000 new jobs and unemployment in most large economies is near record lows.

Now we all know that the market is a forward discounting mechanism and there are plenty of market risks that one could point to (as there always are): the so-called trade war, Brexit and an economic cycle that is long in duration. But the reality is to date, signs of economic stress have been muted. There have been no (touch wood) financial collapses of the magnitude of Lehman Brothers back in 2008 to trigger such recent aggressive price action. So what is going on?

> *"Non-farm payrolls surged by 312,000 in December. Economists surveyed by Dow Jones had been expecting payroll growth of just 176,000"*
>
> CNBC Jan 4, 2019

There is plenty of market commentary about all these issues and to be honest, there is too much market wisdom (much of it plagiarised) on the airways these days and it is often hard to discern the genuine opinions from the sales and marketing of financial institutions. There is much in keeping it simple.

> *"So now the market scares going forward are going to be about inflation (and interest rates) whereas in the past it was about the sustainability of the economy."*
>
> PM Capital Investor Forum, March 2018

2018 was all about rising rates and lower liquidity. With the benefit of hindsight, as soon as interest rates genuinely began to adjust (January 2018) to the post Trump environment, the equity market acted as though the economy was headed into an end of cycle recession with so called "late cycle" stocks (business models most exposed to your typical US Federal Reserve tightening-induced recession) selling off. It started with housing stocks, then worked its way through most sectors of the market and culminated in October, when the "rock stars" (Amazon, Netflix, Zillow and many others) sold off sharply. By mid- December, the market had seemingly capitulated, and I suspect it had a lot to do with the lack of liquidity in a trading environment that is often dominated by computer models.

> *"I suspect that passive ETFs are creating systematic risk in the industry by liquidity concentration that will actually cause the next big downturn in markets."*
>
> PM Capital Investor Forum, March 2018

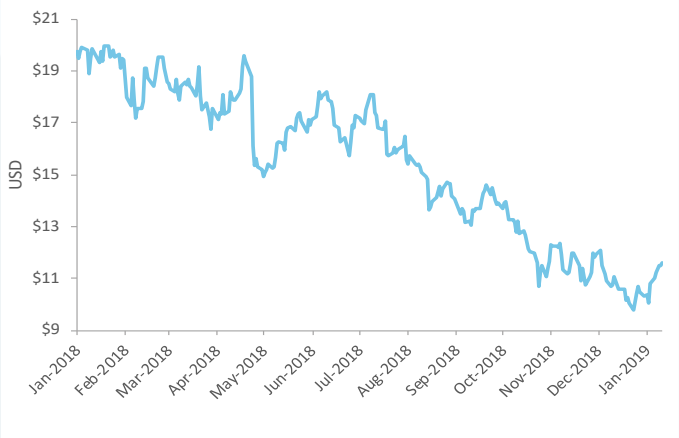
In fact, the December quarter reminded me a bit of the 1987 crash, when markets fell 22% in a single day (I still suspect the magnitude of that move was in large part due to quantitative portfolio insurance strategies of the day). The December quarter 2018, particularly the month of December, was like 1987 – but in slow motion. Every day the market down a few percent. Could this have been the impact of passive, exchange traded funds and computer model-driven trading?

> *"So markets have done really well, the risk with reward has changed and so it does warrant that you want to invest with a much more conservative framework going forward..."*
>
> PM Capital Investor Forum, March 2018

Now part of what has occurred is rational, as rates have needed to normalise and, all things being equal, should lead to a de-rating in business valuations. The hard part is always how much is reasonable, and in that regard, I suspect the market has over-reacted. On Christmas eve, as we looked back at what had transpired, it would appear that Santa Claus was leaving coal in all investors' stockings. For true active investors though, he may have been leaving a gift.

COMMODITIES

Freeport-McMoran share price (USD)
Source: Bloomberg



A note from the CIO

Let us start with Freeport-McMoran Copper, one of the world's largest and lowest-cost copper producers. It is clearly economically sensitive and with the economy of China - the largest incremental consumer of copper - slowing down and the copper price falling, the stock price should also be going down. But by Christmas eve, the stock had declined 50% from its 1 January 2018 price. Having peaked in 2011 and with commodity cycles typically lasting 10 years, I am not sure that we are completely at the end of the down cycle, but also noting copper's importance in alternative energy infrastructure, I suspect that the value of this business longer term is now quite attractive. It is also a bit of a hedge on inflation.

US HOUSING

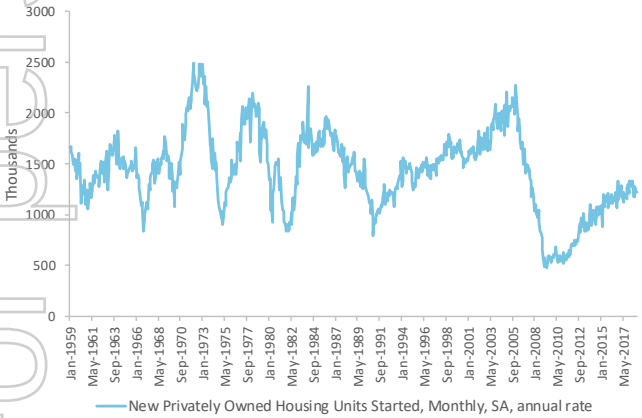
Housing is interesting and in this regard Lennar, one of the largest US home builders has also seen a significant re-rating:

	Stock Price (USD)	Last 12 months' earnings (USD)	P/E (trailing)
1/1/2018	$65	$3.38	19.2
24/12/2018	$38	$5.34	7.1

Earnings increased 60% and the stock is down 40%. Yes there are questions about house prices going forward, with interest rates higher and affordability more difficult, but inventory is low and annual new housing starts are very subdued relative to historic levels. With a 15% earnings yield on trailing earnings, the market may have overly discounted the stock.

US housing starts below long term averages:

US total housing starts, monthly
Source: US Bureau of the Census, St Louis Federal Reserve



BANKING

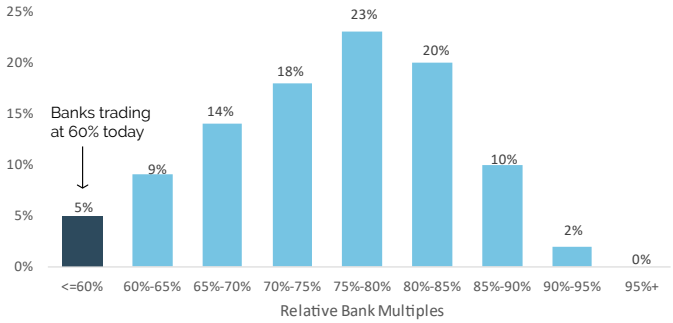
Bank of America is another example:

	Stock Price (USD)	Last 12 months' earnings (USD)	P/E (trailing)
1/1/2018	$30	$1.83	16.4
24/12/2018	$23	$2.54	9.0

Déjà vu - earnings are up 40% and the stock is down 20%. 2019 earnings estimates have changed little, while shareholders are receiving a dividend yield of 2.3% and a return of capital of approximately 7%, adding up to a near-10% return. Balance sheet risk has probably never been lower (leverage and credit risk) and bank valuations relative to the market have also rarely been lower. I am very comfortable owning this business at this price.

Banks rarely cheaper versus the broader market:

Frequency of Bank P/Es relative to S&P500 P/Es (Since 1978) - Excluding Financial Crisis Years
Source: Factset, Bernstein Quant Team
Note: Excludes 2008-09 financial crisis years due to unreliable multiples



GAMING

Wynn Resorts International is the operator of some of the best casinos in the world, with 75% of its earnings derived from Macau.

	Stock Price (USD)	Last 12 months' earnings (USD)	P/E (trailing)
1/1/2018	$170	$5.34	31.8
24/12/2018	$92	$6.84	13.5

Again, earnings are +30%, its stock price down near 50% and the de-rating of the business near 60%. Now you may ask, when China and the USA are engaged in a "trade war", why you would want to own a business that is so heavily exposed to China, particularly when its licence is due for renewal in a few years' time? The answer is that social stability in Macau is very important to the Chinese and operators such as Wynn are critical in dealing with what could otherwise be a very corrupt jurisdiction. Along with that, significant infrastructure has been invested in Macau to support long term growth in visitation. Casinos are strong businesses when well run and at a free cash flow yield of 10%, its valuation is compelling.

A note from the CIO

Wynn has traded close to levels last hit during the Chinese growth crisis:

Wynn Resorts share price (USD)
Source: Bloomberg

TECHNOLOGY

Oracle is a bit of a different story and the market is undecided long term. The stock is actually flat for the year and earnings are up a little - no real re-rating or de-rating. It is seen and priced as a mature business on a P/E of 15 times current earnings. However, it has returned 10% of its share price in dividends and buybacks to shareholders over the past 12 months. It is a cash machine and that by itself justifies its share price. If earnings start to grow, as we expect, the stock will move in line with those earnings plus some, as it will no doubt be re-rated.

ALTERNATIVE MANAGERS

Finally, Apollo Global Management. This is probably the business that I would most like to own outright, at current prices. We always knew the market would trade this stock in line with short term movements in equities, and in particular, credit markets, as its business is managing private equity and credit funds on behalf of its clients and it earns substantial performance fees on its managed assets which are marked to market every quarter. With credit markets adjusting over the quarter, this is exactly what happened and the stock sold off from $US36 to $US24, a decline of 33%. In contrast, funds under management grew 15% over 2018, adding up to a 50% de-rating in market value per dollar managed.

Why do we want to own a business with a volatile earnings stream when the risk/ reward in credit markets was skinny? There are a number of reasons:

- It is a fee business and thus all earnings are free to distribute to shareholders
- The business is structured as a trust, thus minimising tax leakage
- It is run by some of the sharpest minds on Wall Street
- Alignment. Insiders own 50% of the business
- Growth. Funds under management have grown at a compound rate of 13% per annum over the past 5 years
- Valuation. Excluding any performance fees, which can be significant, earnings which are fully distributed to shareholders is generating a 7% yield. Note that fee-related earnings of $2 per share have been compounding at 15% per annum and businesses that grow 15% p.a. typically trade at P/Es of 20+. Apollo at $24 is priced at a P/E of 12, plus you get a balance sheet of $6.60 and all future performance fees. Apollo is probably trading on a trend single digit P/E. (Interesting valuation comparisons include T. Rowe Price Group, a well respected but low growth traditional equities manager selling on 14x next year's earnings, or Unilever, operating in very competitive markets, who I think will struggle to grow at mid-single digits and sells on 20x 2018 earnings).

We have been buying the highlighted businesses over the latter half of the quarter. There are many interesting opportunities to look at now, across many sectors of the market. I would also highlight that December saw record outflows from mutual funds, typically a great contrary indicator.

Record equity outflows past 6 weeks
Source: BofA Merrill Lynch Global Investment Strategy, Datastream, MSCI

Now this is not like 2009 where both valuation and the economy were deeply depressed, so one should still keep some dry powder in reserve, but valuations are very interesting and should be exploited.

As a footnote, I would also remind investors of how irrelevant current events can be and the long term rewards that come from being focused in how one deploys their capital. The reality is that one only needs a few good investments in their lifetime to produce attractive returns and they do tend to come around every ten or so years.

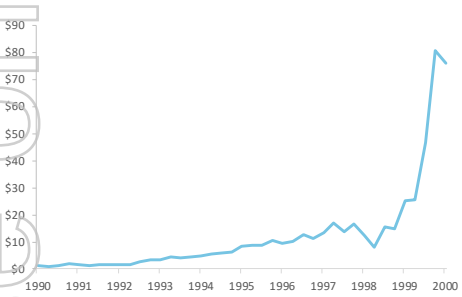
In the nineties, the internet emerged and companies such as Analog Devices increased 30 times in value. In the noughties, it was the emergence of China and commodity companies

A note from the CIO

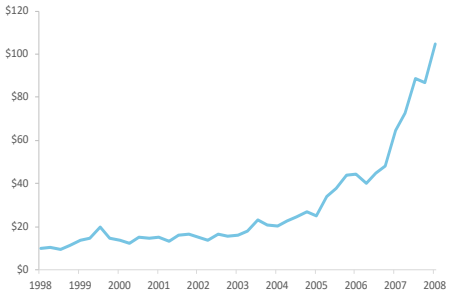
others (see charts below).

What will emerge over the next ten years is what is now important. It is a conundrum, but these opportunities can be very hard to find, but at the same time have typically been staring you in the face the whole time!

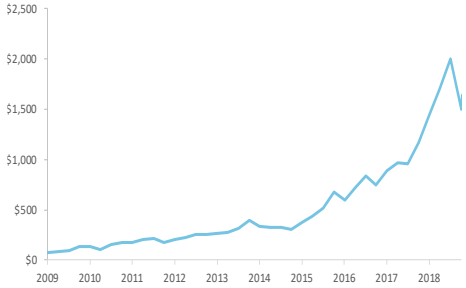
The '90s - the internet
Analog Devices share price (USD)
Source: Bloomberg



The '00s - commodities
Rio Tinto share price (USD)
Source: Bloomberg



Rise of the global disruptors
Amazon share price (USD)
Source: Bloomberg



Paul Moore - Chief Investment Officer

Quarterly video update

In this video update, Paul Moore, Chief Investment Officer and Portfolio Manager, Global Strategies:

- Reviews how investors 'capitulated' during the quarter
- Discusses why the losses may have been an over-reaction
- Names some stocks - in as diverse industries as commodities and gaming – that he finds attractive now given the market action

Access the video here.

Listed Company Overview

	PM Capital Global Opportunities Fund Limited	PM Capital Asian Opportunities Fund Limited
Asset Class	Global equities	Asian (ex-Japan) equities
Listing Date	11 December 2013	21 May 2014
Suggested Time Frame	Seven years plus	Seven years plus
Shares on Issue	351,161,024	56,541,541
Share Price[1]	$1.09	$0.99
Market Capitalisation	$ 382.8 million	$ 60.0 million
NTA before tax accruals + franking credits (per share, ex-dividend)	$1.1985	$1.0657
Company Net Assets before tax accruals + franking credits	$ 420.9 million	$60.3 million

PM Capital Global Opportunities Fund Limited

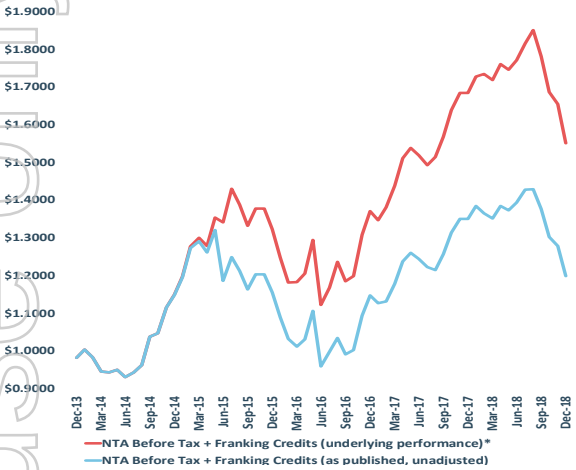
- **The Company** aims to create long term wealth through a concentrated portfolio of 25-45 global companies that we believe are trading at prices different to their intrinsic values.
- **The Company's investment objective** is to provide long-term capital growth over seven-year plus investment horizon through investment in a concentrated portfolio of undervalued global (including Australian) equities and other investment securities.

ASX Code	PGF
Category	Global equities (long/short)
Investment style	Fundamental, bottom-up research intensive approach
Number of stocks	As a guide, 25-45 stocks
Shares on issue	351,161,024
Suggested investment time	7 years +
Listing date	11 December 2013

PM Capital Global Opportunities Fund

Paul Moore
Global Portfolio Manager

NTA Performance [2]



* Excludes the impact of: Changes in ordinary share capital (i.e., option exercise, DRP); Dividends; and Tax paid. After all costs and expenses, including (but, not limited to): management fees; listing fees; registry costs; audit costs; and directors' fees.

Net Tangible Asset (NTA) backing per ordinary share (all figures are unaudited)[1]	September 2018	December 2018	Change	Perf. since inception p.a.[4]	Perf. since inception total[4]
NTA before tax accruals plus franking credits[2]	**$1.3764**	**$1.1985**	**-12.9%**	**+ 9.1%**	**+ 55.1%**
NTA after tax[3]	**$1.2698**	**$1.1459**	**-9.8%**		

1. Past performance is not a reliable indicator of future performance. 2. 31 December 2018 includes $0.0258 of franking credits. 3. Net Tangible Assets (NTA) refers to the net assets of the Company after the accruals for net current and deferred tax liabilities/assets. 4. Performance adjusted for capital flows associated with the payment of dividends, share issuance as a result of the dividend reinvestment plan, and including the value of franking credits.

Current Portfolio*

Portfolio investments	Weighting^^
Post GFC Housing Recovery - US	12.4%
Post GFC Property Recovery - Europe	7.7%
Global Domestic Banking	34.8%
Service Monopolies	17.4%
Gaming - Macau	6.8%
Alternative Investment Managers	16.4%
Other	8.2%
Long Equities Position	103.7%
Short Equities Position	-15.4%
Net Invested Equities	88.3%
Total holdings	47

Current stock examples
Howard Hughes Corporation
Cairn Homes
Bank of America
Alphabet
MGM China Holdings
KKR & Co L.P.

Currency exposure*	
USD/ HKD	64.0%
EUR	17.5%
GBP	6.7%
AUD	11.8%
Total exposure	100.0%

* Stated as effective exposure.

* As at 31 December 2018
^^ Quoted before tax liability on unrealised gains.

PM Capital long term global equities track record

Since inception (October 1998) returns of the PM Capital Global Companies Fund, which has a similar mandate to that of PGF:

PM Capital Global Companies Fund	MSCI World Net Total Return Index (AUD)	Excess Retrun
376.8%	131.7%	245.1%

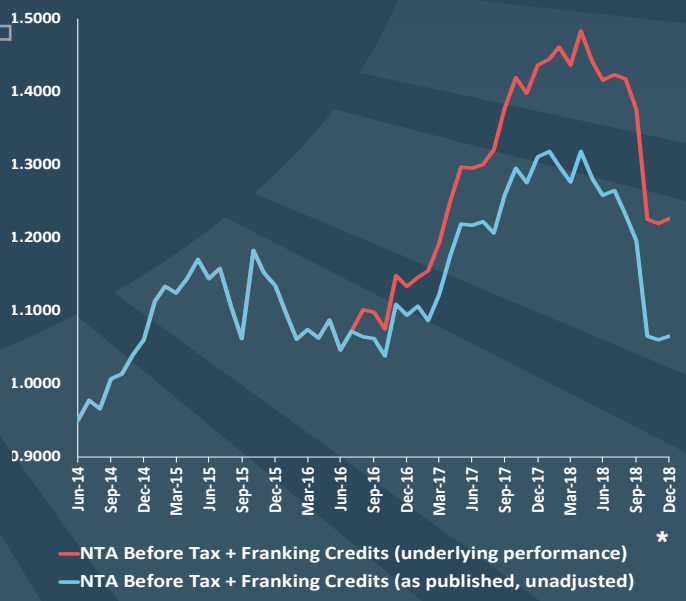
Winner
2018 Money Management/ Lonsec **Fund Manager of the Year** Award, Long/Short Global Equities

Finalist
Zenith / Professional Planner International Equities (Listed Investment Companies) **Fund of the Year 2018**

PM Capital Asian Opportunities Fund Limited

- **The Company** aims to create long term wealth through a concentrated portfolio of typically 15-35 Asian centric companies that we believe are trading at prices different to their intrinsic values.
- **The objective of the Company** is to provide longterm capital growth over a seven-year plus investment horizon through investment in a concentrated portfolio of predominantly undervalued listed Asian equities and other investment securities in the Asian Region (ex-Japan).

NTA performance since inception[2]



ASX code	PAF
Category	Asian (ex-Japan)[6] equities
Investment style	Fundamental, bottom-up research intensive approach
Number of stocks	As a guide, 15-35 stocks
Shares on issue	56,541,541
Suggested investment time	7 years +
Listing date	21 May 2014

*Excludes the impact of: Changes in ordinary share capital (i.e., option exercise, DRP); Dividends; and Tax paid. After all costs and expenses, including (but, not limited to): management fees; listing fees; registry costs; audit costs; and directors' fees.

PM Capital Asian Opportunities Fund

Kevin Bertoli
Asian Portfolio Manager

Net Tangible Asset (NTA) backing per ordinary share (all figures are unaudited)[1]	September 2018	December 2018	Change	Perf. since inception p.a.[4]	Perf. since inception total[4]
NTA before tax accruals plus franking credits[2]	**1.1884**	**1.0657**	**- 10.3%**	**4.5%**	**22.6%**
NTA after tax[3]	**1.1316**	**1.0398**	**- 8.1%**		

1. Past performance is not a reliable indicator of future performance. 2. 31 December 2018 includes $0.0723 of franking credits. 3. Net Tangible Assets (NTA) refers to the net assets of the Company after the accruals for net current and deferred tax liabilities/assets. 4. Performance adjusted for capital flows associated with the payment of dividends, share issuance as a result of the dividend reinvestment plan, and including the value of franking credits.

KEY POINTS

- Investor concerns remain high
- Growth stocks particularly affected
- New positions initiated amid the market weakness

PERFORMANCE

The Company, together with global equity markets more broadly, experienced a meaningful drawdown during the period. Investor unease throughout the period centred on slowing economic growth, firstly in emerging markets (China most notably) and then as the quarter progressed, the United States.

October was responsible for the bulk of the declines in the Asian region, with the MSCI Asia ex-Japan (AUD) recording its largest monthly decline in a decade as the twin threats of the US/ China trade dispute and rising US interest rates brought into question the upbeat economic growth forecasts investors had been anticipating only a handful of months ago.

The 10-year US Treasury yield moved through 3% for the first time since 2011, spiking to 3.23% in early October, in expectation of persistent tightening in interest rates by the US Federal Reserve. Higher rates in the US continue to support a stronger USD which has threatened to put a material strain on emerging market economies.

November and December were more subdued months for Asian equity markets as attention shifted to the United States. An overly aggressive Fed, coupled with increasing political conflict which has resulted in the longest government shutdown or record, stoked fears of a possible recessionary environment. In just three short months the 10-year US Treasury yield retreated to 2.68% at year end.

At the portfolio level a majority of the underlying equity positions were in negative territory for the quarter, with the most significant detractors to performance being Baidu, iCar Asia and Turquoise Hill Resources.

PORTFOLIO ACTIVITY

Investors have become increasingly cautious about companies that have yet to reach a consistent breakeven position. Many of these, including iCar Asia, were sold off aggressively over the quarter. We continue to view the operational progress made by iCar's management positively and believe this will be reflected in the share price in due course. Its Malaysian operation achieved EBITDA breakeven in the September quarter, with Thailand reaching the same milestone in the most recent quarter. A meaningful step change in the Indonesian business is also being overlooked - Indonesia has been the largest cash burn market for the Company and management recently moved to a paid subscription model from freemium which will change the economics materially.

As the #1 automotive classified business across three of the largest markets in ASEAN that are all transitioning to profitability, iCar's current $A52 million market capitalisation seems to undervalue it, particularly in light of recent private market transactions in the classifieds space across the region.

Baidu declined 31% despite releasing third quarter results that beat expectations. NASDAQ listed Baidu has sold off with the majority of US listed Chinese ADRs, many of which are internet focused, and US technology stocks more broadly. While it is clear the Chinese economy is slowing, Baidu remains leveraged to growing segments of the economy (digital advertising, streaming, artificial intelligence) and furthermore remains attractively valued, having not reached the lofty highs of some other overhyped FAANG names in recent years.

PM Capital Asian Opportunities Fund

Turquoise Hill Resources fell 22%. Copper producers and the copper price are viewed by investors as proxies for global growth therefore it is unsurprising that the sector came under pressure. We remain confident that a deficit will arise in the copper market in the coming years driven principally by inadequate supply growth, benefiting our holdings through higher copper prices. We added to our copper exposure over the period by establishing a position in Hong Kong-listed producer MMG Limited.

Positive contributors to performance included gaming companies MGM China and Nagacorp as well as consumer goods companies Heineken Malaysia and Dali Foods. The gaming names' positive performance came after a difficult period in the September quarter, while the consumer companies outperformed the broader market given their defensive characteristics.

In late November we visited Macau and Hong Kong, meeting both with casino and VIP junket operators. Current operating conditions are not reflective of the share price correction seen in recent months. While growth rates have slowed from peak months earlier this year, activity has not deteriorated further. Furthermore, our long term view of the sector remains intact. Subsequent to the trip we initiated a position in Melco Resorts, reinvesting the proceeds of a sell down in our Nagacorp position.

The Australian Dollar (AUD) depreciated 3%, assisting performance. We have gradually increased our AUD position over the past six months via a put option strategy. At 31 December the portfolio had an effective AUD exposure of 35.5%, representing a meaningful shift in positioning from the 20.3% at the beginning of the period and 12.7% twelve months ago.

OUTLOOK

The rapid sell off across asset classes in the past year has resulted in a much-needed adjustment to valuations. While this is positive we remain cautious, as in many cases consensus earnings expectations likely remain inflated, particularly in a slowing China environment, artificially boosting valuations. We are also cognisant of the overall uplift experienced in equity valuations over the past decade, a period in which equities have been supported by loose monetary policy, therefore looking at 5 or 10 years average valuation might not be considered a normalised valuation range.

At 31 December the invested position was 94.9%, a marginal reduction compared to the end of the September quarter. In addition to the positions highlighted above we are in the process of initiating several new investments to take advantage of the weakness seen across regional markets.

Portfolio investments	Weighting
Consumer - Breweries	10.9%
Consumer - Other	11.7%
Financials	18.5%
Gaming - Macau	14.3%
Gaming - Other	4.5%
Capital Goods & Commodities	11.6%
Oil & Gas Infrastructure	10.0%
Online Classifieds & Ecommerce	9.5%
Technology Hardware	5.2%
Long Equities Position	**96.2%**
Short Equities Position	-1.3%
Net Invested Equities	**94.9%**

Current stock examples
Heineken Malaysia
Dali Food Group
DBS Group
MGM China Holdings Ltd
NagaCorp
Turquoise Hill Resources
Sinopec Kantons
Baidu
Total Holdings 29

Currency exposure*	
HKD	34.0%
AUD	32.5%
USD	25.6%
INR	3.2%
Other	4.7%
Total exposure	100.0%

* Stated as Effective Exposure.

Kevin Bertoli - Asian Equities Portfolio Manager

Important information

This Quarterly Report is issued by PM Capital Limited (ABN 69 083 644 731, AFSL No. 230222) as investment manager for the:

PM CAPITAL Global Opportunities Fund Limited

ACN 166 064 875 (ASX Code: PGF)

PM CAPITAL Asian Opportunities Fund Limited

ACN 168 666 171 (ASX Code: PAF)

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The Index for the PM Capital Global Opportunities Fund Limited is the MSCI World Net Total Return Index in Australian dollars, net dividends reinvested. The Index for the PM Capital Asian Opportunities Fund Limited is the MSCI AC Asia ex Japan Net Total Return Index in Australian dollars, net dividends reinvested. See www.msci.com for further information on the MSCI indices.

See the company announcements platform at www.asx.com.au, and www.pmcapital.com.au, for further information.

1. As at close of market trading Friday 28th December 2018.

2. Past performance is not a reliable indicator of future performance.

6. The Asian region (ex-Japan) includes Hong Kong, China, Taiwan, Korea, Indonesia, India, Sri Lanka, Malaysia, Philippines, Thailand, Vietnam, Pakistan and Singapore, but excludes Japan. The Company may also obtain exposure to companies listed on other global exchanges where the predominant business of those companies is conducted in the Asian region (ex-Japan).

RESPONSIBLE ENTITY

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