December 2018 – Datt Capital Absolute Return Fund

To our valued investors,

Thank you for entrusting your capital and co-investing with us.

For December the Fund provided a net return of -2.07% for the month. The majority of the return was driven by decrease in our long equity portfolio. **We made our maiden quarterly distribution to investors of 0.41 cents per unit at the end of December**.

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FYTD
FY19		2.6%	-1.2%	-4.8%	3.53%	-2.07%							-2.15%

Approximate Asset Allocation for the Fund at December month end was:
CRE debt - 63%
Equities - 17%
Cash - 20%

Investment review
<u>Commercial real estate debt</u>
This month we have not evaluated any new opportunities, which is usual for the time of the year.

We received notice that Project D has been completed. Settlement proceeds are sufficient to repay the senior and 2nd mortgage facilities, with repayment anticipated in January.

We also received notice that Project B has achieved it's planning permit as anticipated. As such the sponsor is working with the syndicator to arrange an alternative finance facility. As such we expect repayment of this investment in the coming months.

Our current real estate debt exposures are:

Name	Location	Type	Maturity	Max LVR/LSR	Interest receivable on investment (per annum)
Project A -Mixed use/Residential infill	Melbourne, Inner East	1st Mortgage Land Facility	August 2020	20%	11% with step up to 16% after 9 monthsb
Project B - Industrial	Melbourne, Inner West	1st Mortgage Land Facility	June 2019	60%	11%
Project C - Residential infill	Melbourne, Inner South	1st Mortgage Land Facility	July 2019	65%	11%
Project D - Residential infill	Sydney, Harbour side Inner East	2nd Mortgage Construction Facility	January 2019	70%	14%

<u>Fixed interest</u>
We continue to monitor a number of fixed income instruments in the distressed and special situation space.

Derivatives
We closed out our prior derivatives positions due to upcoming expiry. We will be entering into new long volatility positions in January.

Equities
We have made no equity transactions this month.

Afterpay, one of our core holdings, has been very popular over the Christmas season. It's traction and subsequent growth in the US has been fantastic to watch, and our belief is that it will achieve mainstream ubiquity within the next 2-3 years in the US. In less than 8 months of the product rolling out in the US; it accounts for almost 25% of transaction volume on the system as of December. We expect the US to account for over 50% of transaction volume within 12 months.

We anticipate that Afterpay will be officially launched in the UK in February; which will continue the growth trajectory set by the US market entry as mentioned previously. We expect continuing geographical expansion in the coming years, with much of the groundwork already laid. We expect that a USD debt issue will be finalised within the next 3-6 months, which will be a precursor to a secondary listing on a US stock exchange.

Argonaut and Aeris Resources drilling program at Torrens is expected to start in mid January. We expect the equity prices rise in anticipation of the program in January. Since BHP's fantastic results mentioned in last months newsletter, there has been considerable interest in the Stuart Shelf exploration province; of which Argonaut hold large tenements over some of the most prospective areas.

The broader equity markets have sold off quite heavily, with the ASX Small Ords index falling almost 5% for the month of December. **We expect to selectively increase our equity exposure in January**, given the attractive prices on offer.

Commentary

4 key macroeconomic and geopolitical themes to watch in 2019

BREXIT and the continuing disintegration of the European Union

- We believe that a harder BREXIT scenario is the most likely outcome. We anticipate significant media speculation and increasing market volatility going into the March 29th Brexit deadline date.
- We note that there has been recent media coverage surrounding the 'approval' from the EU of a Brexit deal that the British PM must sell to Parliament. Prima Facie it's a terrible deal, which leaves Britain outside the EU with no voice but still subject to the rules and obligations of membership till at least 2020.
- We believe a 'no-deal' Brexit scenario is a strong possibility given the lack of political clarity and certainty in the British Parliament.
- We note that the EU as a bloc is the UK's largest trade partner, with the UK consistently logging a trade deficit (more imports than exports by value) with the EU with a heavy skew towards goods. For example, the UK is the largest export market for German automotive manufacturers with the US. We believe this provides the UK with significant leverage in their negotiations to exit the EU.
- We anticipate the continuing disintegration of the EU in the coming years for a number of reasons; in particular continuing debt issues, economic structure issues and a greater desire for participating nations to express their own sovereignty as is being experienced at present in the Eastern bloc.

Political uncertainty and division in Australia

- Clear lack of leadership from both major political parties and minor parties; the nation is muddling along maintaining the status quo which isn't bad in itself.
- A key catalyst for market volatility would be if the Labour party were to be elected at the Federal level.
- Labour's proposed changes to capital gains tax, negative gearing, the individual tax thresholds and the refund of tax imputation credits have the potential to severely affect market confidence.
- From our perspective, it seems peculiar that the Labour party would make changes that would decrease the quality of life for the majority of Australians as well as increasing the dependency on the welfare state by many retirees, which in effect undermines the basis of the whole private superannuation system.

Relations between the US and China

- We believe that it is not in either nation's interest to escalate the trade dispute, given how intertwined the economies are.
- Much of the rhetoric between the two nations has been driven by asserting geographic, physical authority and influence rather than trade issues in isolation.
- We are quietly confident that a rational and acceptable trade agreement will be thrashed out in time, without the loss of face for either party.

Volatility in global markets and FX stemming from changes in US monetary policy

- Normalisation of interest rate policy in the US to continue due to the need to avert a pension crisis in the US; a lot of these issues stemming from sub-par returns in the fixed income space.
- This rise in USD interest rates will increase stress on issuers of foreign sovereign and corporate bonds denominated in USD.
- Sovereign foreign FX-denominated currency bonds over a 15 year time horizon have a cumulative average default rate of almost 11% across the rated universe (S&P Global - 42 yr time horizon).

- Sovereign local FX-denominated currency bonds over a 15 year time horizon have a cumulative average default rate of over 6% across the rated universe (S&P Global - 24 yr time horizon).
- The last 50 years have been remarkably peaceful (both at personal and state level) relative to historical measures due to a large number of factors largely related to human development improving over time.
- We believe that more volatility in both the macroeconomic and geo-political environments is inevitable; and may have a knock on affect in terms of sovereign credit worthiness. Consequently, we believe that there may be a broader shift in bias towards corporate and other private real assets in the medium term.

We welcome feedback from our Investors with any questions, suggestions, comments or investment ideas.