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Recommended Fund Review

**Australian Eagle Trust (Long-Short Fund)**

**APIR: ALR2783AU**

FUND

The **Australian Eagle Trust (Long-Short Fund)** (the “Fund”) is managed by Australian Eagle and was incepted in July 2016. Australian Eagle is a large cap Australian equities manager with a focus on quality.

It employs a long-short, low turnover, portfolio with 25-35 longs and 12-25 shorts. The Fund is structured as an open-ended unlisted registered managed investment scheme.

INVESTMENT OBJECTIVE

The Fund aims to outperform the S&P/ASX 100 Accumulation Index (‘the Benchmark’) over a rolling five-year period by investing in a portfolio of Australian companies.

The Fund is a quality, actively managed fund that invests in Australian listed companies. Australian Eagle is focused on generating returns through differentiated insights into the fundamentals of a stock coupled with a valuation-overlay. The Fund is typically 150% long and 50% short resulting in a net 100% long exposure.

GOVERNANCE AND COMPLIANCE

Responsible Entity

The Trust Company (‘Perpetual’, ‘the RE’) is the Responsible Entity of the Australian Eagle Long Short Fund. Pleasingly the RE is a tier one service provider and not a related party.

Compliance

The Responsible Entity’s Compliance Committee is responsible for overall compliance as part of its function in forming long-term alliances and supporting a stable of investment management businesses.

FUNDS UNDER MANAGEMENT

* Firmwide - $1.1bn
* Australian Eagle Trust (L/S Fund) - $450mn

Large cap equity focus, thus there is plenty of capacity remaining allowing headroom for growth. Business has been growing with Australian Eagle taking on the Montgomery Long only FUM.

PRODUCT FEATURES

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The Fee is considered high in an absolute sense and high on a peer relative basis. A reduction in the performance or management fee would be considered appropriate.

INVESTIBLE STATUS

The Fund is open to wholesale and retail investors, with a minimum investment of $25,000 and is available on platforms.

BUSINESS

Australian Eagle was established in Sydney in 2004 and specialises in Australian equities. The firm is owned and operated by the team and manages in excess of $1.1bn through a domestic long only strategy and the Australian Eagle Long short Fund. In 2022 Australian Eagle partnered with Montgomery and took on the FUM from their Large cap long only strategy. Montgomery provides distribution and back-office support in exchange. A potential concern is the distribution focus of Montgomery, given their existing FUM has shifted into the Australian Eagle Long Only strategy. Their focus may be on distributing that fund over the long-short. However, the Australian Eagle Long Short Fund is the only Long Short manager in Montgomery’s suite and thus tempers concern to a degree. The distribution focus will be a watchpoint going forward.

INVESTMENT TEAM

The team is lead by CIO, Sean Sequeira, who has been at Australian Eagle since 2004. Sequeria is assessed as being experienced and a highly capable leader of the investment team. Alan Kwan is the named portfolio manager on the Fund, however, Sequeria has ultimate decision-making authority, veto rights and the key figure head. Providing support are two additional analysts as well as an investment committee that includes a risk manager and Albert Hung. Hung was the architect of the strategy when it was being first built out. The manager has indicated that Hung is stepping back his involvement and acting more as a mentor.

The team is considered to be adequately resourced given the narrowness of the investment universe and the length of time they have been working together. On a peer relative basis track-record and co-tenure is high.

Remuneration and Incentives

Pleasing both Sean and Alan are equity holders in the business and have a profit share arrangement. In addition to this they are both significantly co-invested in the Fund. Whilst there is no direct performance bonus based on the outperformance of the Fund, the equity structure and co-investment is seen as sufficient and the co-PMs are considered to be adequately aligned with investors.

Key Person Risk

A departure of Sequeira would be a considerable loss for the Fund and would trigger a re-assessment of the investment case.

INVESTMENT PHILOSOPHY AND PROCESS

Investable Universe

The Fund will seek ideas from the ASX100 although has the freedom to go outside and maintains a research list of 130 names. The 130 names include all the ASX100, plus 30 names that they see of interest. The Fund is benchmarked against the S&P/ASX 100 Accumulation Index.

Philosophy

The manager seeks to buy quality companies with long term competitive advantages and a sensible risk buffer. The manager aims to hold those investments until their competitive advantages are materialised and reflected in returns.

Idea Generation

The manager believes a focus on quality, valuation and identifying a catalyst to trigger a re-rating upwards will enhance returns. Idea generation is constrained given the size of the universe. The team will cover the ASX100 in detail and analysts are free to choose any other stocks to make up the remaining 30. The manager does not believe meeting with company management adds value to the process at this end of the market.

Research Process

Process is quality biased and has been implemented in the long only portfolio since the early 2000s. This score is driven by 10 sub-components comprising of variables such as industry and company growth, management quality, capital management and shareholder returns. Each of the 10 sub-components is rated from 1 to 5 and accumulated. Only companies with a Quality Score equal to or greater than 30 are considered investible for the long side of the portfolio. The quality score is re-tested every six months and whenever significant news comes out to ensure accuracy.

In addition to this the manager will conduct a valuation analysis to rank stocks based on their “valuation gap”. Analysts will use valuation methods depending on the industry and competitive factors. The manager pairs the quality score with the valuation gap which creates a rubric that determines position size.

In relation to the Fund’s shorting program, the same methodology of security analysis is employed with short candidates tending to arise from lower quality stocks that likely have pronounced negative Growth.

Atchison believe the manager’s process is highly structured and rules based. This ultimately enhances the repeatability and consistency of the process.

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Portfolio Construction

The final portfolio will consist of roughly 25-35 long positions and 12-25 short positions. The portfolio construction process is rules based and driven primarily from the scoring rubric. Clear and pre-determined weights for each score based on the intersection of the quality score and the valuation score.

The Manager has a set guide for position sizing based on the assessment of quality and valuation upside. This is seen as a strength compared to some less structured peers. Sell decisions are based on a deterioration of quality or when valuation has extended beyond the team’s assessment.

Risk Management

They do have the ability to wind down the short exposure when they see times of stress which is a positive. The Manager is relatively unconstrained in terms of positioning and managing the Fund. There are few risk limits in place, however, this is consistent with the high conviction design. Shorts have a maximum holding period of one year, which is seen as long and potentially hurtful to alpha.

PORTFOLIO CHARACTERISTICS

Portfolio Turnover

The manager is active in adding and trimming names; however, actual name turnover is low. Long positions are typically held for 3 years while short positions are held for up to or less than a year.

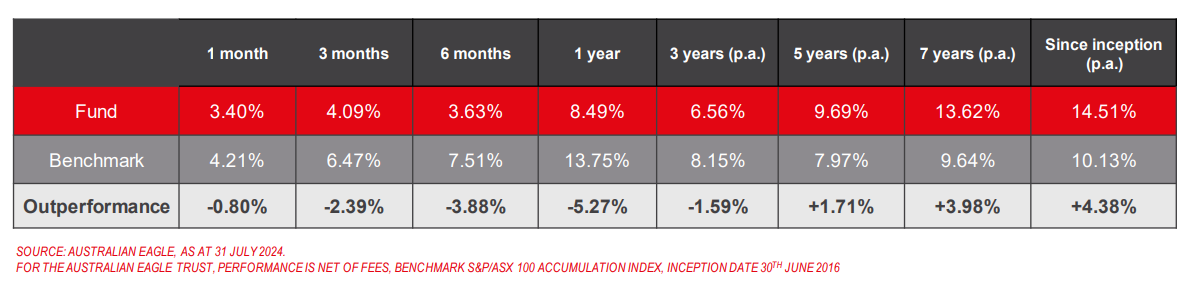
Liquidity

The Fund invests in large-mid cap Australian equities and as such liquidity is not considered to be a concern.

Leverage

The Fund does employ leverage utilising a 150/50 portfolio maintaining a 200% gross exposure. The Fund takes 150% of its NAV long and 50% of its NAV short. Leverage magnifies both gains and losses and as such should be treated with precaution.

Performance – 31 July 2024



Performance Opinion

The Fund's performance has faced considerable pressure, underperforming the benchmark by 5.3% over the 12 months to July 2024. This underperformance has been largely driven by the short side, which contributed over 6% in negative attribution. The Manager’s relatively small investment universe has limited their ability to effectively construct a meaningful short book.

In theory, a long/short strategy should generate returns across market cycles, regardless of market direction. However, recent performance has exposed weaknesses in the strategy, particularly the Manager's constrained stock selection universe and the difficulty in swiftly exiting poorly performing short positions. This inability to adapt and rotate out of losing shorts has magnified the strategy's downside during periods of volatility, raising concerns about its resilience in dynamic market environments.

CONCLUSION

* The Fund is lead by a highly capable CIO with support from a long co-tenured investment team. The team is small on a relative basis, however, the universe they cover is considered non-intensive and manageable.
* The process is pragmatic, repeatable and has been tested through time having been used since the early 2000s by its founders.
* An area of concern revolves around the size of the universe to construct a meaningful, alpha generative short book. Only 130 stocks to construct a 50% short book is considered challenging.
* The return here in the long run is going to come from the gearing on the long side and be biased to times where mid-caps will outperform.
* In future Atchison will need to assess the growth in FUM of the Long only book vs the growth of the L/S book. This will shed light on how Montgomery is pushing the two products – Atchison believe Montgomery will place an emphasis on distributing the Long only given it has their original client FUM.

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