

TERRACAPITAL

ETHICAL EMERGING COMPANIES FUND

DECEMBER 2018

	1M	3M	6M	FYTD	1Y (rolling 12mths)	2Y (p.a.)	Inception (p.a.)	Inception (cumulative)
Terra Ethical Emerging	-8.0%	-14.2%	-13.3%	-13.3%	-30.1%	-5.5%	4.5%	14.0%
ASX All Ords	-0.4%	-9.0%	-7.3%	-7.3%	-3.5%	4.2%	6.6%	21.1%
ASX Small Ords	-4.2%	-13.7%	-12.7%	-12.7%	-8.7%	4.7%	7.4%	24.1%
Exit Unit Price	\$1.10							

Terra Capital Ethical Emerging Companies Fund movements are shown net of (after) fees. Inception: 1st Jan 2016

Performance & Overview

The Fund returned -8.0% after fees for the month of December 2018. Since inception (Jan 2016) the Fund has returned +14.0% after fees underperforming the market (All Ordinaries Accumulation Index) by 7.1%.

The Unit Price is currently \$1.10

Markets

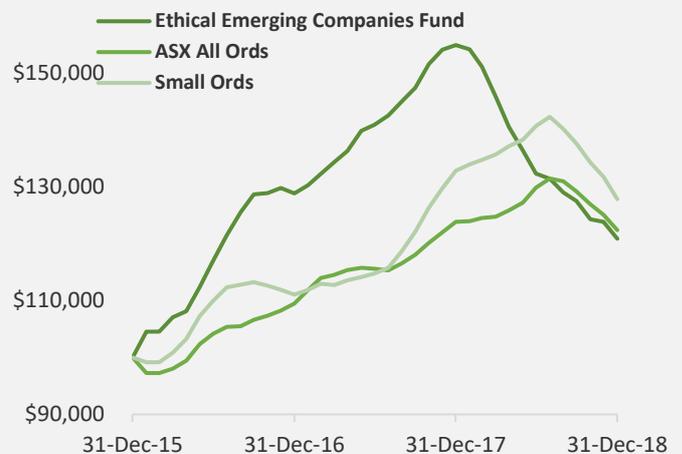
The Australian market had the worst close to the year since 2011, with the S&P/ASX 200 index closing December -0.4% lower. Despite closing in the red, the Australian market outperformed global equities which were impacted by concerns over global economic growth and the potential for a monetary policy misstep by the US Federal Reserve.

Global equity markets continued to remain under pressure as one part of the US yield curve inverted at the beginning of the month. The spread between the 5-year and 3-year yields fell to as low as -4bps, raising further concerns about the outlook for the US economy. The S&P 500 index fell -9.2% and the Nasdaq slid -9.5%.

Market chatter over a potential shift in the US Federal Reserve's guidance at the beginning of the month also spooked equities. These concerns came to fruition with the US Federal Reserve increasing the Fed Funds rate to 2.5%, from 2.25%, but reducing their rate expectations for 2019 to two additional hikes from three, and their long-term expectation to 2.75% from 3%.

Risk assets slid further as fears over the health of US and China relations rekindled following reports that a senior Chinese telecommunications executive had been arrested in Canada on fraud allegations with possible

Value of \$100,000 invested at inception



extradition to the US. These events seemingly unwound the positive sentiment following the G20 meeting where Trump and Xi agreed to a ceasefire.

In Europe, protests in France over the month are likely to impact the economy. Brexit negotiations continue to impact asset prices with both UK bond yields and the British pound falling around mid-month in response to the government's delaying a parliamentary vote on the Brexit deal. Separately, the European Court of Justice ruled that the UK doesn't need the EU's permission to revoke its intention to leave the EU. Intriguingly, this now opens the possibility of a pain-free retreat back to pre-referendum days, if the UK asks for it.

In China, the PBOC cut the funding cost for commercial banks for the first time since February 2016. Asian markets were weaker with the Hang Seng falling -2.5%, the Nikkei moving -10.5% lower, and the SSE Composite index falling -3.6%.

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Portfolio

After strong stock market performance in late 2017, 2018 began with a global synchronized recovery, historically low volatility, extreme bullishness, a ramping economy, and optimism about the year ahead. However, in the second half of 2018 we saw markets falter as the US and China trade war developed and European/UK Brexit negotiations increased uncertainty and volatility. This increased volatility was felt hardest in small cap stocks as uncertainty scared off buyers causing liquidity and stock prices to deteriorate.

As we reported throughout the year, we continue to observe the underlying operations of the stocks held in the Ethical Emerging Companies Fund perform well and continue to meet our investment thesis. Frustratingly, this does not always correlate to positive stock price performance.

We believe the Q418 market crash, the fourth in the last 40 years, more than discounts the slowing domestic and global economy. As long as the Fed stops making policy and communication mistakes, the Trump Administration resolves the trade conflict with China, and the yield curve remains positive.

The recent comments from Fed Chair Powell at the American Economic Association and recent comments from the Administration did help relieve the fear around these issues. All considered we don't believe the outlook for 2019 is as grim as the mainstream media suggests.

Marijuana Update

As discussed previously, in 2019 we believe the key driver for cannabis investors will be how many new US states legalise the adult use of cannabis and which companies have existing US operations in those states. Less likely in 2019, but still on investors' radar, is the likelihood of the US government federally legalising the adult use of cannabis products completely.

Most Canadian listed cannabis companies still have very high valuations however, there have been some positive developments during December which may support valuations and spur further investment into the sector.

Passing of the Federal Governments Farm Bill

In late December, the US Federal Government passed the farm bill which federally legalised hemp production and cannabidiol* (CBD) products. There are three major positive catalysts that should support valuations as a result of the passing of the farm bill:

1) Marijuana companies with existing retail brands (this includes most Canadian and some Australian companies) can now sell their Hemp and CBD products nationally in the US which will should translate to an increase in sales.

2) The sale of hemp and CBD products will allow cannabis companies to launch brands and develop brand loyalty in anticipation of states completely legalising adult use marijuana. Adult use of cannabis products is a substantially bigger market than the Hemp and CBD markets.

3) Large banks, hedge funds, multinational tobacco and consumer staples companies are now able to invest in cannabis companies that have hemp and CBD operations where they weren't allowed to previously as these products were federally illegal. It's been reported that Coca Cola have been closely watching the cannabis market but have restrained from investing previously due to it being federally illegal.

In addition to passing the farm bill, a further 5 states (CT, IL, NJ, NY and PA) are closer to legalising the adult use of cannabis in 2019. We have positioned our cannabis holdings in the Ethical Emerging Companies fund so we are exposed to CBD/Hemp sales and further US legalisation.

**(CBD – currently there are multiple preliminary clinical research studies on cannabidiol uses which included studies of reduced anxiety, cognition, movement disorders, and pain).*

Outlook

The fourth quarter of 2018 saw the worst small cap stock performance in 5 years. While these corrections are not unprecedented, they are not the norm. These gyrations test our will; however we remain committed

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to adding value via picking stocks as we have done for the past 8 ½ years.

2018's performance was highly disappointing; however, we remain cognisant of the fact that strong returns are on offer in the small cap space and we are steadfast in our resolve to invest in the best opportunities in the market identified through our process.

In our opinion, 2019 begins from the most attractive point in many years in terms of small cap stock

valuations and we remain aware that timing an equity market recovery is impossible but as the recoveries from 2008 and 2011 show; you don't want to miss them when they come.

We thank you for your ongoing support and welcome any feedback.

Ethical Emerging Companies Fund Strategy

The Fund is a global, long only emerging companies fund established in January 2016. The Fund's strategy is fundamentally driven, high conviction, high concentration and we pride ourselves on our relationships with our investors. Terra Capital's research driven process and true active management is complimented by a focus on risk management.

The objective of the Fund is to deliver superior absolute returns over the medium to long term by investing in small to medium-sized listed and a portion of unlisted companies.

Fund Details

NAV	\$1.1073
Entry Price	\$1.1101
Exit Price	\$1.1045
Fund Size	\$24.9m
APIR Code	TCN0001AU

Fund Exposure

Software & Services	20%
Media, Fintech & Financial Services	19%
Pharmaceuticals, Biotechnology & Life	13%
Infrastructure & Services	13%
Technology Software & Hardware	10%

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