Aurora
INVESTMENT TRUST

Aurora Investment Trust – December 2016

Share Price: £1.74 **Net Asset Value: £1.73** **Premium: 0.6%**

Data as at 31 December 2016

Top 10 Equities at 31 Dec 2016	(%)
Bellway	14.7
Tesco	12.7
Lloyds Banking Group	11.3
Sports Direct	8.1
Barratt Developments	7.3
Morrisons	6.5
Vesuvius	5.3
GlaxoSmithKline	5.0
JD Wetherspoon	4.4
Redrow	4.0
Cash Position	3.2

The NAV was up 3.0%, versus the market which was up 5.0%.

Firstly, an acknowledgement that the end of December marks the conclusion of our (Phoenix's) first calendar year as Investment Manager to the Trust. (Well, almost, the formal commencement date was January 28th). The NAV of the Trust rose 11.6% in 2016, trailing a strong market that rose +16.8%. No performance fee was earned because we didn't beat the market. No management fees are ever charged by Phoenix to Aurora and so the only costs borne by investors this year have been the running costs of the Trust itself. This year's positive contributors were led by the supermarkets, Morrison's was up 60% and Tesco +38%. Other strong performers in 2016 were Vesuvius +25%, GlaxoSmithKline +22%, JD Wetherspoon +21%, Diageo +17% and Unilever +16%. Barratt Developments and Lloyds finished down 21% and 11% respectively after being hit by the Brexit vote in June. Our biggest fallers were Hornby -68% and Sports Direct -52%. A full review of how the portfolio performed over 2017 will be included in the Annual Report. In the meantime, as was the case in the September Aurora factsheet, this month we have included a longer commentary (in italics, below) taken from the December-end quarterly report very recently sent to Phoenix UK Fund investors. We include these longer commentaries in the Aurora report when we think that we have written something that will be of interest to Aurora investors. The reference to historic long-term performance is for the Phoenix UK Fund. The Phoenix UK Fund has the same investment strategy and therefore (with minor exceptions,) the same portfolio as Aurora.

Although we have underperformed the market in 2016, over 2, 3, 4, 5….18 years (in fact every number of years back to Phoenix's launch in 1998), we have outperformed the stock market before and after fees.

Over what is now a track record stretching back 18 years and 8 months, we have achieved a compound investment return of 785% versus 156% for the FTSE All Share Total Return. That is 12.4% per annum versus 5.2% for the market, an outperformance of 7.2% per annum. Over nearly 19 years, net of fees Phoenix UK Fund investors have earned cumulative total returns of 461%, that's 305% ahead of the market. It is an annualised 9.7% return versus 5.2% for the market.

Brexit

We can try and anticipate the outcome of the UK's negotiated exit from the EU by using a game theory framework developed by John Nash in 1951 (Nash was made famous in Sylvia Nasar's excellent book, A Beautiful Mind, which was made into a film). The exit negotiation fits the form of a "non-co-operative game". In Nash's theory the participants keep adjusting their positions based upon their own objectives modified by their knowledge of the other side's objectives. The predicted outcome, known as the Nash equilibrium, is the point where participants don't believe they can improve their position by changing it, taking into account the positions of the other parties.

There are many parties to this negotiation, but what is clear from the major ones is that their primary goals are political not economic.

The UK has put immigration ahead of prosperity because it has decided that the vote was against the principle of "free movement" of workers. This was not inevitable, in fact immigration did not appear on the ballot paper. 48% of voters opted to Remain in the EU and a portion of those voting to Leave did so

on the principle of sovereignty not immigration. So a reasonable case can be made that a majority of the populace were not against free movement. However, the country is led by a Prime Minister who has spent the past 6 years as the minister responsible for delivering a policy of reducing immigration. The other main ministers leading the Brexit negotiations hold anti-immigration positions (except Boris Johnson). There isn't a leading UK politician who doesn't know that immigration has had a positive economic effect on the UK and raised the standard of living, so this position is ideological not naïve. The result is that it prevents the UK from staying in the single market.

When considering the EU, we have to think not of the collective position, but all the individual positions because any agreement will require a total consensus. For many of the core EU members the survival of the EU is the primary driver. If the UK achieves a simple and successful exit, it will destabilise the EU and give rise to parties in EU countries coming to power promising exit referendums. So the EU position will include those that favour a bad outcome for the UK even if it hurts the EU economically. The EU has a long history of putting politics ahead of economic self-interest.

So those who focus on the economic justification for a reasonable Brexit outcome are likely to be disappointed because it will come down to the lowest common political considerations. Given the number of parties involved, the most likely outcome is no agreement. If the "Nash equilibrium" is worse than no deal then no deal will be the most probable outcome.

One twist that could help is if there is a crisis in the EU that threatens its stability and the drawn out Brexit negotiations are considered to be adding to that risk; then the EU position could shift so that a quick deal is preferable and the Nash equilibrium would move closer to the UK's position.

The UK is undermining its ability to negotiate by triggering an article that will cause an automatic expulsion after two years. What will happen then is unclear because the UK would still be a member of the WTO, but bound by EU commitments to the WTO including share of quotas. To change those commitments requires the agreement of all 164 members of the WTO including the EU.

When the UK is out of the EU it will be able to negotiate its own trade deals and it believes that it is interested in free trade. This is only partially true. A free trade agreement with China would see swaths of sensitive UK industries put out of business, like steel for example. The same goes for the US, which would wipe out much of UK agriculture. Whereas in the past the UK could protect its sensitive industries when negotiating as part of the world's biggest market (the EU) it has less bargaining power on its own. The result is likely to be messier and will take longer than currently envisaged.

The consequence of the above is only gradual. The UK will receive less inward investment; London will be a slightly less attractive place to do business. We saw an example of this recently in a sector we know. The global no.2 and no.3 in Vesuvius's industry merged, one Brazilian (Magnesita) and the other Austrian (RHI). The agreement was for the head office to be based in London, but after the Brexit vote this was changed to Amsterdam to stay in the EU. The company though will be listed on the London Stock Exchange. We will see more of this.

Nissan was about to build a new model and would have switched it to a factory inside the EU where most of the vehicles are destined, to avoid the quotas and

tariffs for non-EU exporters. The UK has given Nissan undertakings so that it has stayed in the UK, but there will be many other businesses that are less significant and politically sensitive that will not get that government intervention and will instead locate their production inside the EU.

It's hard to see how the UK will not go economically backwards on a relative basis for at least the short to medium term. However, the UK's general open trading instincts and competitiveness should in the long term see it rebound and succeed. The industries in which it excels like finance, pharmaceuticals, technology, media and education are globally flourishing and are little impacted by trade agreements. London is still a very attractive place to do business, which is why some of the world's largest and most dynamic companies (Apple, Google and Amazon) have announced big new London based HQ buildings since the referendum

Risk

The biggest factor impacting the long term economics - and therefore the intrinsic values of most businesses we look at - is the internet and innovation in general. We study and are interested in geopolitical developments and they tend to move markets, but more value is being destroyed and created by innovation than anything else. What we pay the greatest attention to is those risks; like how is the internet changing the way we shop, bank, consume media and how is that changing the profitability of businesses we follow. How will new technologies like electric and driverless cars and vans change the business world and how quickly. We want to avoid being on the wrong side of those changes because they have a tendency to happen quickly. We like to track demographic trends because they tend to move observably slowly and predictably but innovation doesn't, especially in an age of instant global communication. You can try and judge these risks by reading the technology press, listening to experts and going to conventions, but we think a better way is to just study the habits of customers, and this is what we do best.

We spoke last quarter of the absurdities in the bond market. That pendulum may have begun to swing back the other way. As we read of how there may be moves out of bonds this year, it's worth pointing out as we have previously that there is "no moving out" on a collective basis in secondary markets. Every seller needs a buyer, so if a lot of sellers turn up then the price needs to find a level where a lot of buyers are attracted. Initially falling prices are more likely to scare buyers off than encourage them. We could be in for an interesting period in the bond market. We think our businesses will not be materially affected.

Portfolio

We like our portfolio and feel it is well set to deliver good long term returns. Our supermarkets are both performing positively and have been all year, meaning more customers buying more products and spending more money, not higher share prices. Currency devaluation should raise food prices this year, which will ripple nicely through their returns. These were the biggest part of our "Not Working Yet" section in the 2015 Q4 report.

As we've previously pointed out, our businesses serve basic needs that aren't much impacted by macro factors and so we expect resilient performances no matter the conditions. We spent time with Sports Direct executives in the quarter and have come away with a good appreciation of what to expect in detail and we are watching on the ground to see it in action. We expect good things.

We have had positive returns now for 8 years in a row, at some point that run will be broken. We will have down years, there is nothing that we do in our approach that seeks to mitigate that risk.

We share our mistakes with you, but they are usually based on something we did. In our year end letter a year ago we told you we had been working for a couple of years to identify investments in the area we thought offered the greatest opportunity, that was the extractive mining industry. Well we have underperformed the overall market this year largely because we aren't invested in that sector which is up 230% in 2016.

The problem is that we did identify one suitable business and did a huge amount of work on it. We put it through our process and set a price at which we would buy it. This is a new area for us and modelling long term metal prices is not straightforward but we had built long term demographic demand models and had the dynamic cost curves for the major iron ore mines in the world. We debated the valuation heavily in the investment team, as we always do, and we revised the price we would pay twice from £21 to £18 and then down to £16. As that price approached, I (and this is Gary now speaking) moved the limit down again to £15.10. In the end the stock, Rio Tinto, missed that price limit by 3% (it got to £15.57) and has now more than doubled. It's not wrong to stick to limits, we have no other way of applying ourselves in a disciplined way. But my final adjustment of the limit was not scientific, it wasn't a response to a reappraisal of the risks and intrinsic value. In other words, it was outside of our process. It was just extra padding, designed to give extra comfort, but a mistake and an expensive one.

Industrial metals are going to be in a state of oversupply for the next few years so it may be possible that we will get a future window, but we can't redeem this mistake with a future success. What value we can get from it, is to avoid doing the same thing again in the future.
In summary, we expect to keep making mistakes, to have down years, but ultimately by sticking to our approach, by continuing to do our homework, to keep generating excellent long term returns.

Aurora shares are eligible to be invested in an ISA. Neither the Aurora Investment Trust nor Phoenix Asset Management Partners run such a scheme. You should consult a financial adviser regarding a suitable self-select ISA provider.

Investment Objective

We seek to achieve long-term returns by investing in UK-listed equities using a value-based philosophy inspired by the teachings of Warren Buffett, Charlie Munger, Benjamin Graham and Phillip Fisher. Our approach, combined with thorough research, invests in high quality businesses run by honest and competent management purchased at prices that, even with low expectations, will deliver excellent returns.

Contact

Phoenix Asset Management Partners Ltd
64 – 66 Glentham Road London SW13 9JJ
Tel: +44 (0) 208 600 0100
Fund Manager since 28 January 2016

Portfolio Manager:	Gary Channon
Listing:	London Stock Exchange
Inception Date:	13 March 1997
ISIN:	GB0000633262
Bloomberg:	ARR

Fees

Management:	None
Performance:	One third of returns in excess of the market

Regulatory Notice:

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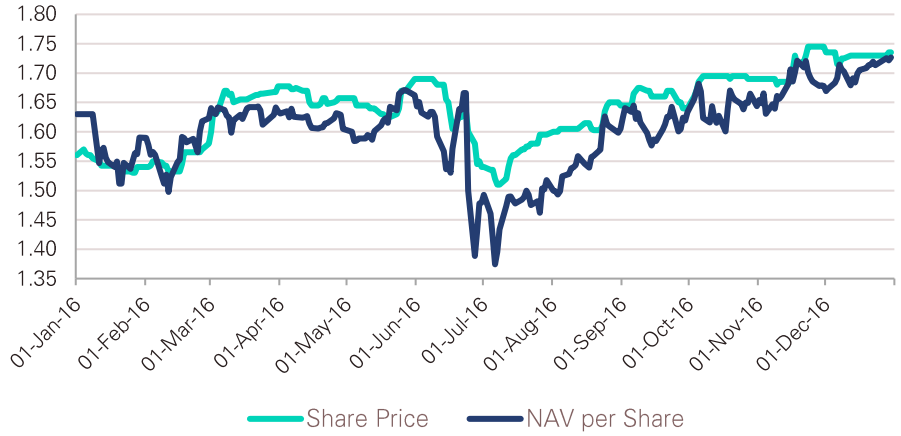
Redrow	4.0
Cash Position	3.2

Share Price & NAV per Share to 31 December 2016



Trust Performance

The appointment of Phoenix Asset Management Partners ("PAMP") came into effect on 28th January 2016. PAMP's investment track record for its flagship Phoenix UK Fund can be viewed in the table and graph on the page 3. The investment strategy of the Aurora Investment Trust is the same as that of the Phoenix UK Fund.

During January 2016, the portfolio was changed to align to Phoenix. The IM Agreement between Aurora and Phoenix formally began on 28 January.

Track Record

Performance	NAV Return %	Share Price Return % **	All-Share Index % **	Relative NAV to ASX %
01/01/16 – 31/12/16	6.6*	12.0	16.8	-5.2
Dec 2016	3.0	-0.6	5.0	-2.0

*Following an internal review these figures were amended in June 2018.
** Share price return with dividends reinvested; All Share Index returns with dividends reinvested.

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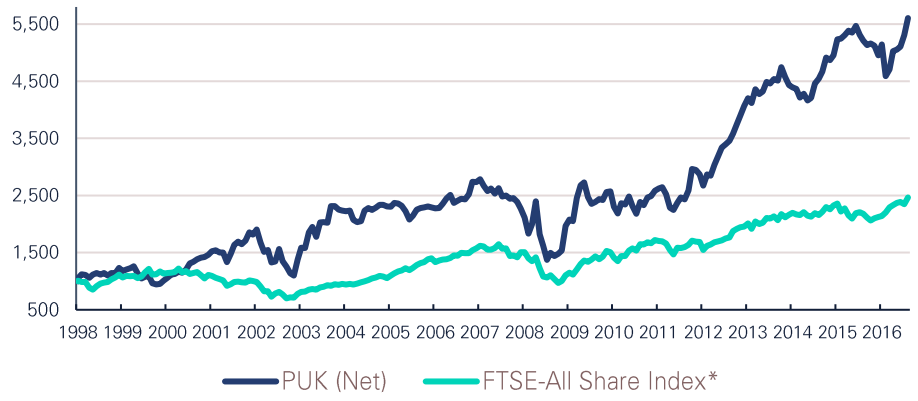
Phoenix UK Fund Track record

Fund Performance (%)	Gross Return	Net Return	All-Share Index*	Relative NAV to ASX
2016 (31 Dec 2016)	9.0	7.6	16.8	-9.2
2015	20.1	14.7	0.9	13.8
2014	2.0	0.1	1.2	-1.1
2013	40.5	31.3	20.9	10.4
2012	48.3	42.2	12.5	29.7
2011	3.0	1.9	-3.2	5.1
2010	1.1	0.0	14.7	-14.7
2009	62.8	59.7	30.2	29.5
Cumulative Since Inception	785.3	460.6	155.6	305.0
Since Inception Annualised	12.4	9.7	5.2	4.5

The data on this page reflects the track record of the Phoenix UK Fund. The investment strategy of the Aurora Investment Trust is the same as that of the Phoenix UK Fund.

Phoenix UK Fund Value of £1,000 invested at launch to 31 December 2016



* Data from 30th April 1998, All-Share Index Returns with dividends reinvested

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