

Flinders Emerging Companies Fund

Monthly Update: October 2017



Performance (after all fees and expenses)	1 Month (%)	3 Months (%)	1 Year (%)	Since Inception [^] (% pa)
Flinders Emerging Companies Fund	6.9%	16.0%	5.5%	15.0%
S&P/ASX Small Ords Accumulation Index	6.0%	10.3%	14.6%	17.9%
Net Value Added	0.9%	5.7%	-9.1%	-2.9%

[^] Inception date is 30 September 2015. Past performance is no indicator of future performance. Information relates to the Flinders Emerging Companies Trust Class B.

Investment Objective

Exceed S&P/ASX Small Ordinaries Accumulation Index by 3% pa (after-fees) over rolling 3 year periods

Investment Time Frame

5 years

Portfolio Managers

Andrew Mouchacca and Richard Macdougall

Risk Profile

High

Distribution Frequency

Half Yearly

Minimum Investment

\$25,000

Inception Date

30 September 2015

APIR Code

ETL0449AU

M-Funds Availability

Code FEC01

Responsible Entity

Equity Trustees Ltd

Research Ratings

Lonsec: Recommended
IRR: Recommended
Zenith: Approved

Platform Availability

MLC, Netwealth, Powerwrap, HUB24, Macquarie Wrap

Further Information

www.flindersinvest.com.au
or +61 3 9909 2690

Flinders Investment Partners
Level 15, 385 Bourke Street,
Melbourne, Vic 3000
www.flindersinvest.com.au

- **Small cap index takes off!**
- **Growth stocks re-rating**
- **End of year rush to raise capital and IPO**
- **Some AGM bombs**

Market

Small caps (+6.0%) significantly outperformed large caps (+3.8%) in October, extending the trend to six months. Small resources were strong again, rising 6.5% for the month, bringing their quarterly gain to 16.8%. Energy and key industrial commodity prices continued to rise on the back of better global growth figures. While resources held the limelight, industrials performed strongly as well.

Global equity markets performed very strongly in October, shrugging off political issues and focussing on the continuous stream of supportive economic data out of most major regions. Talk of Trump's tax cuts and economic package getting closer also helped sentiment.

Of specific interest was the gradual move back to growth stocks. We've mentioned a few times in recent months that the beginning of this year saw a dramatic de-rating of growth stocks (especially in small caps) and a sharp reduction in risk appetite. This trend has started to reverse and we expect a relative recovery in growth companies over the next few months. Please see the update on the next page.

Another aspect of the market in October was the increased number of corporate deals being offered. A stronger market and with Christmas approaching, we are seeing plenty of equity raisings and a sharp jump in IPO activity. While not many have been of significant size, the cumulative impact could be to drain liquidity from the market as we approach year end.

Finally, Annual General Meetings (AGM) held in recent weeks have allowed companies to provide trading updates for FY18 thus far. A number of companies have disappointed including iSentia Group, Thorn Group, Vita Group, WPP AUNZ, Fletcher Building, and Baby Bunting, and their share prices subsequently sold off (some quite aggressively). The trading updates from these companies should not be too surprising given the weak trading/results provided by many of them during reporting season in August. Fortunately the Fund has avoided these disappointers so far in the AGM season (which continues into November).

Portfolio

The Fund had a strong month both in absolute and relative terms, returning +6.9%, outperforming the benchmark by +0.9%. Drivers of Fund outperformance included:

Key Contributors: Construction industry software company **Aconex (+22.5%)** continued to move higher in October along with a number of other tech stocks that had lagged in recent times. **Mantra Group (+22.3%)** was subject to a takeover bid from French hospitality group Accor early in the month. **Beach Energy (+20.1%)** announced the acquisition of Origin's exploration and production assets that had operated under the name of Lattice Energy. The acquisition and consequent capital raising resulted in earnings upgrades as it broadens Beach's portfolio of domestic oil and gas reserves. We consider it an excellent acquisition that will add significantly to shareholder returns over time. Recreational Vehicle (RV) hire, sales and manufacturer, **Apollo Tourism & Leisure (+17.8%)** announced that they were on track to reach earnings from their newly acquired RV retail outlets and that key brand,

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Winnebago was performing above expectations. Plus expansion into the Canadian and US markets was also going to plan. This helped lift the stock that had been lagging the market in recent months. And **New Century Resources (+19.1%)** continued its steady rise on the back of a strong underlying Zinc price and the news that they had purchased the minority holdings of their Century Zinc Mine project.

Key Detractors: The clear and largest drag on the portfolio's relative performance was due to strength in **Bellamy's (59%), Blackmores (35%) and A2 Milk (30%)** for which the portfolio has no exposure. While we appreciate the growth prospects for the infant milk and vitamin sector as well as the market opportunity into China via the Daigou trader channel, we find the valuations difficult to justify at these levels. Health & Beauty company, **McPhersons (-12.7%)** eased as sales into some of its key retailing customers slowed marginally; and, utility service provider **Service Stream (-4.1%)** was weaker despite NBN connections reaching record weekly levels together with growth in its pipeline of business to the solar and energy utility industries.

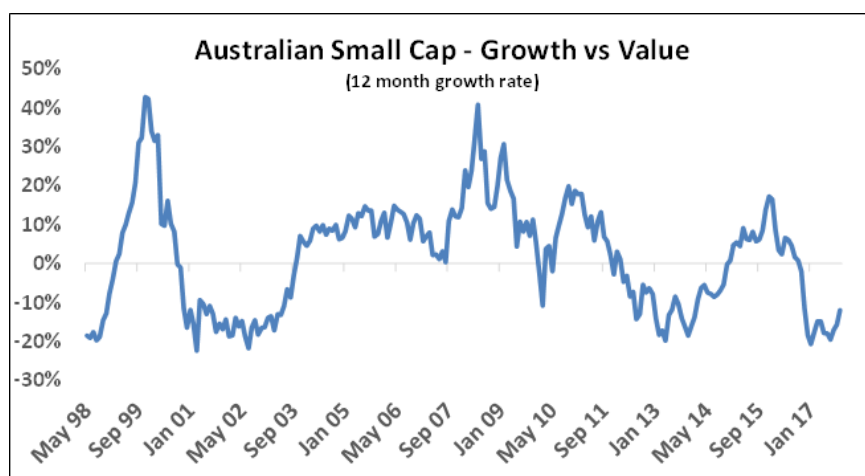
Performance Attribution [^]		Top 5 Active Positions [^]
Top 5 Contributors	Top 5 Detractors	
Aconex	A2 Milk Company*	G8 Education
Apollo Tourism & Leisure	Bellamy's Australia*	Service Stream
Beach Energy	Blackmores*	SG Fleet Group
Mantra Group	McPhersons	Speedcast International
New Century Resources	Service Stream	Webjet

[^] Alphabetical order * Denotes stock not held

Growth vs Value in Australian Small Caps Update

We highlighted in our June quarterly update as well as our Growth vs Value research report in April 2017 (please visit flindersinvest.com.au for these reports) that Australian Small Cap Growth stocks had underperformed Australian Small Cap Value stocks by some margin since the beginning of 2016.

We indicated that this performance differential had been at extreme levels in recent months, and that this would normalise at some point (as a reminder, also worth keeping in mind that Growth stocks have outperformed Value stocks in Australian Small Caps ~60% of the time since inception of the series i.e. a growth bias investment strategy adds value in small caps). In the recent period, this differential has started to narrow, with Growth stocks outperforming Value stocks by ~5% (see turning point in chart below).



Pleasingly, the Fund has stayed true to label (i.e. Growth orientation) with strong outperformance in recent months. Importantly, it seems like the outperformance for Growth stocks in small caps is only just starting, and we look forward to further outperformance in the coming months as the style differential normalises.

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