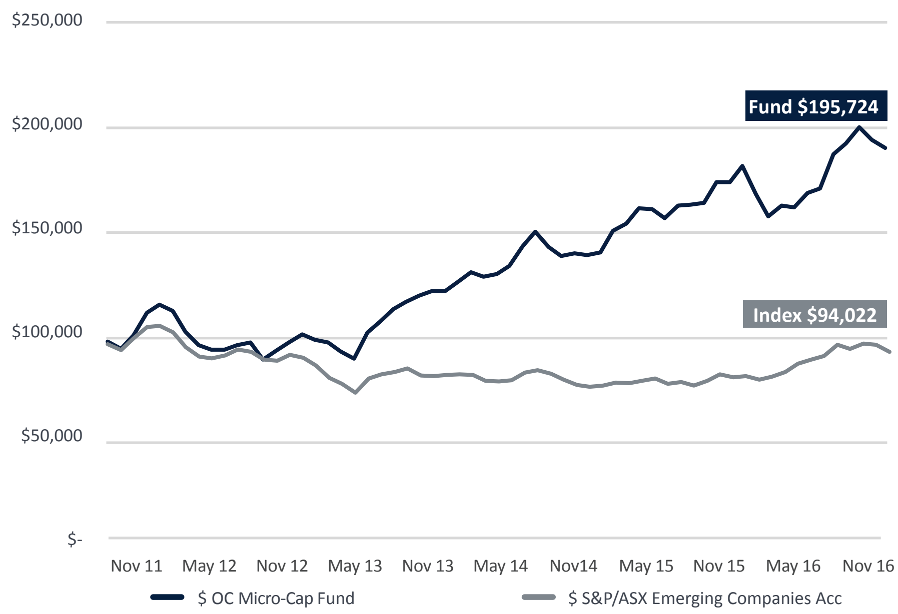
OC Micro-Cap Fund
Fund Update | 30 November 2016

-2.0% Fund down 2.0% for the November period

16.9% Returned 16.9% p.a. for the past three years

We remain confident the Fund is well placed to deliver strong long-term returns

Performance comparison of $100,000 over 5 years*



In October 2016, the OC Concentrated Equity Fund became the OC Micro-Cap Fund. The Fund previously comprised three underlying investment strategies, one of which, the Emerging Leaders strategy, is now the primary underlying investment strategy of the OC Micro-Cap Fund.

Total returns

At 30 November 2016	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	7 yrs % p.a.	10 yrs % p.a.	Incep. % p.a. (Nov 2003)
OC Micro-Cap	-2.0	-1.3	9.3	16.9	14.4	12.0	10.1	13.3
S&P/ASX Emerging Comp. Accum	-5.6	-2.5	25.6	7.2	-1.2	-0.6	-0.5	N/A
Outperformance	**3.5**	**1.2**	**-16.3**	**9.8**	**15.7**	**12.6**	**10.6**	**N/A**

Inception date for the Fund is 21/11/2003. Inception date for the Index is 31/12/2003. The performance reflects the performance of the OC Micro-Cap Fund since the change of strategy on 30 September 2016 and the performance of the OC Concentrated Equity Fund prior to that date. Performance is after fees applicable at the time.

Performance review

In challenging market conditions, the OC Micro-Cap Fund returned -2.0% for the month of November, well ahead of the S&P/ASX Emerging Companies Accumulation Index which was down 5.6%. The micro-cap space broadly was under pressure following heavy sector rotation of late, which has seen many small-cap and micro-cap stocks sold down as large-cap banks and resources stocks have received renewed investor interest. Furthermore, junior gold mining stocks, which make up a reasonable portion of the micro-cap index, have been sold off heavily in November with the gold price falling due to a combination of a ‘risk-on’ market environment and the expectation the US Federal Reserve will increase interest rates in December, which tends to dampen enthusiasm for gold.

Apiam Animal Health (AHX, -20.7%) - traded lower during the month as it revealed in its AGM commentary that a near-perfect storm of circumstances led to a weak first quarter of trading which would impact on H1 earnings. In its dairy cattle business for instance, the low farm gate milk price combined with attractive beef prices, saw dairy farmers aggressively cull their herds in July/August leading to reduced demand for veterinary services from Apiam vets. There were similar exogenous factors impacting on demand for veterinary services in the beef feedlot and piggery businesses which combined to materially subdue Q1 earnings. Channel checks, industry data and our company visit in late November have given us confidence that these circumstances have not persisted and that normal trading has resumed. For instance, dairy farmers commenced restocking herds in September/October and Apiam vets are back in the field servicing these animals in line with normal trading. Apiam has a number of initiatives which should see FY17 earnings not far below original prospectus forecasts despite the Q1 dip, and we remain comfortable with the business.

Clean Teq Holdings (CLQ, +7.0%) - is a good example of a “Concept Model Stock” that the Fund holds. Concept Model Stocks are typically medium to long-term investments that meet our operational risk assessment requirements and valuation criteria but are not currently profitable or cash-flow positive. While still early stage, Concept Model Stocks will have an identifiable pathway to profitability within five years. CLQ owns a world-class, shallow, high-grade scandium/nickel/cobalt deposit at Syerston in outback NSW. The core minerals within this deposit are critical ‘future economy’ minerals including:

- scandium (for use in light-weight alloy strengthening such as in jet aircraft) and CLQ recently signed a collaboration agreement with French giant, Airbus, and
- cobalt (for use in lithium-ion batteries) for which the world’s rapidly evolving battery manufacturing industry has no reliable western world supplier.

CLQ is co-chaired by executive director, Sam Riggall, who was previously Rio Tinto’s lead negotiator on its enormous +US$20bn Oyu-Tolgoi copper mine in Mongolia. Riggall’s co-chair at CLQ is Richard Friedland, a billionaire resources industry veteran who recently addressed CLQ investors on a global roadshow and shared his vision of Syerston as being a game-changing project for CLQ. CLQ also has a water purification business with pilot projects in China which we expect will be realised at a good premium to its current valuation in the short to medium term.

BC Iron (BCI, +30.7%) - is a good example of an “Event-Driven” trade that the Fund will participate in from time to time. BCI has a pipeline of iron ore assets from exploration and development projects through to an operating mine delivering a royalty stream. In order to take advantage of opportunities presenting in the current distressed market for resource projects, the company resolved to undertake an entitlement offer at a deep discount to the prevailing share price and we assessed the deal as offering sufficient upside (and importantly reasonable downside protection) to warrant our participation. BCI is backed by Kerry Stokes’ private investment group, Wroxy Pty Ltd, who partially underwrote the entitlement offer (giving us further comfort around the capital raising) and who has emerged as a 26% shareholder. BCI appointed Alwyn Vorster as its new managing director in September: Vortser is well known to us from his prior roles in the industry as a pragmatic deal-maker and is held in high regard by the market more broadly. Vorster’s unique skillset is well suited to a company such as BCI which has a well-diversified pipeline of assets (and other opportunities) in a sector rapidly rebasing at higher levels due to improving commodity prices. We recently exited our position for a tidy profit.

A number of the Fund’s high quality growth stocks de-rated materially during the month on no negative news flow including **Appen Limited (APX, -15.6%)**, **Baby Bunting Group (BBN, -9.3%)** and **Catapult Group (CAT, -8.4%)**. We remain comfortable that these businesses continue to track in line with our operational expectations and we are confident they will re-rate in time on delivery of strong financial outcomes in the coming years.

Outlook

In early December, the September quarter domestic GDP data was released showing an unexpected 0.5% contraction in real GDP which saw the annualised rate slow to 1.8% (from 3.1% year-on-year). This highlights the fragile state of the Australian economy which continues to transition after the mining boom. The elevated number of negative earnings revisions released by listed companies in October and November, which has continued into December, is tangible evidence that real pain is being felt in the boardrooms of corporate Australia.

The uncertainty brought about by the July Federal election may well have been a factor in deferring investment spending with both business and dwelling investment particularly weak and net exports detracting from growth for a second consecutive quarter. Despite the weak GDP print, the RBA remained on hold at its November and December meetings with the cash rate remaining at 1.5%. The November board minutes suggest GDP growth is expected to pick up across the economy following a year-end flat spot.

We remain cautious on the housing sector with looming over-supply, particularly in the apartment market, and we remain cautious on companies exposed to the housing market over the coming years (property developers, mortgage brokers etc.).

From a sovereign risk perspective, it seems only a matter of time before Australia loses its AAA credit rating as the budget deficit continues to increase which would likely lessen the attractiveness of our debt to international investors.

In contrast, the US economy continues to expand at a solid rate. Employment growth is increasing at a moderate pace (unemployment is below 5%), housing construction is strengthening and non-residential construction continues to rise thanks to private sector activity. President-elect Trump has a policy platform that appears to be market friendly and ought to be supportive of growth in the US economy. Key Trump policies include:

- tax reform, including reducing the corporate tax rate
- fiscal stimulus, including infrastructure spending
- healthcare reform, promising sweeping changes to

Obama-care, and
- unilateral international trade reform, possibly indicating more protectionist policies (this would be a negative).

With the US economy seemingly on track, the US Federal Reserve will raise rates sooner rather than later, with a December rate increase a near certainty. On balance, Trump's economic policies look to be inflationary which have had a dramatic impact on global bond markets over the past month or so.

Historically, the start of a Fed rate tightening cycle has not been a drag on equities, and the relative attractiveness of equities over bonds coupled with the unwinding of low-growth/low-inflation positions, should be supportive of solid equity market returns. Our portfolio is substantially underweight most bond-sensitive sectors, such as REITs, utilities and infrastructure, which may continue to come under pressure over the medium term as US interest rates start to rise.

While the valuation differential between value stocks and low volatility, bond-sensitive stocks and long-duration growth stocks has narrowed, this thematic may continue to play out in the coming months. Fund holdings, including **Ive Group, Millennium Group** and **BPS Technology Ltd**, considered to be 'value stocks', have been recent beneficiaries of this thematic shift.

With Christmas approaching, we would like to take this opportunity thank our clients for their support throughout the year. We remain confident the Fund is well placed to deliver strong long-term returns for our investors.

We wish you all the best for the festive season and a safe holiday period.

Top 5 holdings#

Company	ASX code
Appen Ltd	APX
EML Payments Limited	EML
National Veterinary Care Ltd	NVL
Updater Inc	UPD
VEEM Ltd	VEE

Fund overview

Long only and benchmark unaware, the OC Micro-Cap Fund, previously the OC Concentrated Equity Fund, is predominantly invested in 25 to 60 micro-cap stocks listed, or about to list, on the Australian Securities Exchange (ASX) or the New Zealand Stock Exchange.

The Fund aims to provide investors strong long-term capital growth by investing in companies with:

- a market capitalisation of less than $350 million at the time of initial acquisition
- sustainable business models, and
- attractive investment qualities.

Over a rolling five-year period, the Fund aims to provide a total return of 5%+ in excess of the S&P/ASX Emerging Companies Accumulation Index.

Strategic asset allocation	
Listed securities (including hybrid securities such as convertible notes, redeemable preference shares and partly paid shares)	70 - 100%
Cash	0 - 20%
S&P/ASX 300 Index	0 - 20%
Unlisted securities*	0 - 10%
New Zealand listed securities	0 - 10%
Derivatives	0%

**Must have a pathway to IPO within six months.*

Number of stocks	25 - 60
Maximum ownership of any company	7.5%
Maximum absolute stock position	8%

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* The performance comparison of $100,000 over 5 years is for illustrative purposes only. All returns shown are based on Australian dollar figures. Past performance is not a reliable indicator of future performance. The total returns shown are prepared on an ongoing basis (i.e. they include all ongoing fees and expenses and assume reinvestment of all distributions). They do not take personal taxation into account. The comparison with the S&P/ASX Emerging Companies Accumulation Index is for comparative purposes only. Index returns do not allow for transactional, management, operational or tax costs. An index is not managed and investors cannot invest directly in an index. There is no guarantee these objectives will be met.

The top 5 portfolio holdings are in alphabetical order and may not be representative of current or future investments. The securities listed may not represent all of the portfolio's holdings and may represent only a small percentage of the strategy's portfolio holdings. Future portfolio holdings may not be profitable.