FUNDS MANAGEMENT

OC Micro-Cap Fund

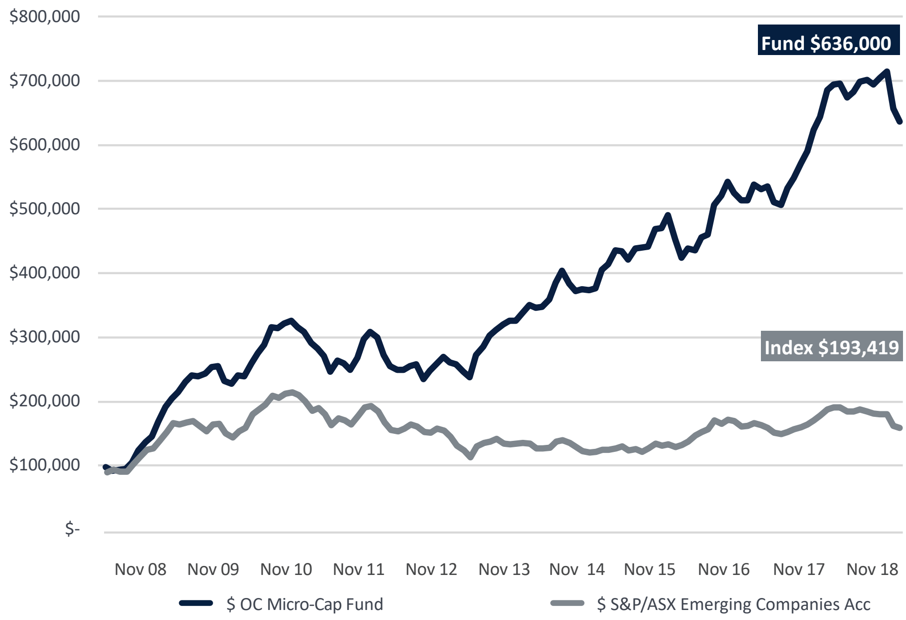
Fund Update | 30 November 2018

-2.9% Fund down -2.9% for the month

20.4% Returned 20.4% p.a. for the past ten years

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

Performance comparison of $100,000 over 10 years[*]



Total returns

At 30 November 2018[†]	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	-2.9	-9.5	-1.0	10.6	14.6	13.5	20.4	13.1
S&P/ASX Emerging Comp. Accum	-2.3	-13.1	-11.7	7.2	3.9	-1.1	6.8	NA
Outperformance	**-0.5**	**3.5**	**10.6**	**3.4**	**10.8**	**14.7**	**13.5**	**NA**

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

Equities remained weak in November as US-China relations continued to dominate market sentiment, overshadowing what was generally an upbeat tone from Fund holdings during the October/November AGM period.

The Fund returned -2.9% for the month which was behind the S&P/ASX Emerging Companies Accumulation Index (-2.3%). Nevertheless, the Fund remains comfortably ahead of the Index over calendar year 2018 to date having returned +7.0% versus a decline of -16.7% for the Index.

The comments from the recent October monthly continue to apply whereby in volatile markets such as these it is important to remain rational and not get caught up in the noise that can follow market corrections. Our investment process focusses on purchasing companies that are trading below their intrinsic value with a margin of safety and in sharp sell-offs, like the one currently being experienced, fearful investors will often indiscriminately sell down good quality companies to attractive levels. This can provide a compelling entry point for OC Fund’s to take new positions or to top up existing oversold positions.

AMA Group (AMA, +11.0%), a leading Australian panel repair business, was a highlight in an otherwise dim micro-cap market when it affirmed its FY19 earnings guidance and announced leadership transition along with a major restructure of its share register. The AMA stock price had recently seemed to be trading in anticipation of an earnings downgrade so the announcement that company earnings were tracking in line with market expectations was welcome positive news. At the same time, the company announced its executive chairman, Ray Malone, would be transitioning into a non-executive role during 2019 and that the highly regarded Andy Hopkins would be assuming executive leadership of the business in the Group CEO role. We view this as a positive development for the business whilst also acknowledging we expect Mr Malone will continue to be a valued contributor in a non-executive capacity. In addition to these changes, AMA also announced a small capital raising (A$10m) and the sell down of shares by founders/ vendors. Interests associated with Messrs Malone and

Hopkins sold down a portion of their shareholdings to facilitate the entry of three new high quality investors onto the register. The new shareholders entering the AMA registers were lead by industry fund behemoth, Australian Super (10%), with less than substantial stakes also being acquired by Myer Family Investments and Colinton Capital Partners, whose principal, Simon Moore, will also join the board of AMA. We view these developments collectively as positive for AMA and look forward to the company continuing to lead industry consolidation over the medium-long term.

The Citadel Group (CGL, -9.2%), **Bravura Solutions (BVS, -11.2%) and Pacific Current Group (PAC, -6.8%)** are three quality, long term, portfolio holdings that were sold down during the month. The downdraft suffered by these names was more driven by market related forces than anything company specific and we would expect each of them to continue to be strong performers for the portfolio. CGL holds an Australian market leading position as a core technology provider to organisations with a particular focus on secure platforms (including in a national security environment). BVS provides software products and services to clients, predominantly in the UK, Australia and South Africa, operating in the strongly growing wealth administration and fund services industries. PAC is a global owner of, and distributor for, boutique asset management business with stakes in 15 enterprises in Australia and the US.

Pivotal Systems (PVS, -20.9%) disappointed the market during the month when it updated investors regarding delays in product delivery schedules requested by some of its key customers. PVS provides best-in-class gas flow monitoring and control technology equipment for the global semiconductor industry. Whilst PVS is considered a market leader in its sector, this is a double edged sword for the business model as there are only a half dozen large semi-conductor manufacturers globally which creates an inherent degree of customer concentration risk for suppliers, such as PVS. PVS customer orders are non-cancellable, however, revenue is recognised only when the product is shipped and customers requesting delays to shipping have caused the earnings deferrals in CY18. To have a downgrade to earnings so soon after IPO (July) is always disappointing but in this instance the downgrade was totally out of managements control and would appear to be a "pushout of earnings" into CY19, rather than "lost earnings", so we are giving PVS a second chance. To its credit, the PVS management team visited institutional investors to personally explain the earnings miss and have undertaken to engage in a more detailed and consultative manner with investors going forward, which we consider critical for businesses in the first year or two post IPO.

MACA Limited (MLD, -25.7%) provided a poor market update at its AGM in mid-November and we have exited our position in the stock as a result. We have previously regarded MLD as a solid WA based mining services business with a strong balance sheet and a good reputation among its customers. Unfortunately, the update flagged margin pressure in its core mining division as the key reason for the downgrade to earnings. As we consider the management of labour availability and pricing and the efficient deployment of capital equipment core competencies of a mining services business, we were disappointed by the update and have sold the position.

Outlook

The G20 Summit held in Buenos Aires in early December had garnered significant amount of investors' attention as they eagerly awaited signs of progress towards multilateral cooperation amid periods of monetary policy tightening, differing economic reform trajectories and varying political agendas. While the two-day summit did facilitate open dialogue between nations, it was largely overshadowed by sideline events such as a dinner between Trump and Chinese President Xi Jinping that saw them agree to a 90-day ceasefire in their trade war and the U.K.'s Theresa May's push to shepherd through her Brexit deal.

Although shortly after the meeting, both the White House and China's Xinhua news agency issued statements peppered with words in a positive tone, such as "highly successful" and "mutually beneficial agreement at an early date", the immediate market optimism on the temporary truce was quickly replaced by the confusion exacerbated by the absence of a joint statement on detailed plan of actions. Financial markets were left struggling to digest talks that the White House portrayed as a major victory for the President with market sentiment swinging widely in the following week on any perceived progress or setback on dealing with the structural issues in the trading relationship (forced technology transfers, intellectual property protection and trade imbalance etc.). Given the apparently wide gap between the two strong-willed leaders' "bid-ask", it still seems unlikely that a comprehensive agreement can be ironed out at any time soon.

Oil prices have been another source of volatility. Following the price plunge by a third since the start of October due to fears of oversupply, oil rallied after Canada's largest producing province ordered unprecedented supply cuts and OPEC broke an impasse over production curbs, agreeing on a larger-than-expected cut with the cartel and allies removing 1.2 million barrels a day from the market. However, optimism was dented slightly after Qatar, accounting for less than two percent of total output, announced its departure from the OPEC. From our view, Qatar's departure seems as a testament to the declining influence of OPEC since direct talks between Russia and Saudi Arabia often bypass the cartel's traditional decision-making process and the surge in North American production has also shifted the balance of power away from the Middle East, adding other elements of complexity to oil price stability.

What we have been witnessing since the beginning of 2018 is the recurring pattern of disconnect between market sentiment and macroeconomic reality, where reinforcing feedback loop of negative shocks and speculations pushes the market into an uncharted territory that goes beyond anything justified by economic or earnings fundamentals. It is crucial that we do not lose sight of the weight of evidence from real economy amongst clouding uncertainties.

The US economy still looks to be in good shape. While the bears talk about the ageing bull market, elevated corporate leverage and waning effects of the 2017 tax cuts, the Fed has been restoring confidence by repeatedly signalling that its historic hikes have done most of the heavy lifting with the neutral cash rate only one or two more hikes away. Looking ahead, as the Fed adopts a "wait-and-see" data dependent approach, investors should expect a much slower pace of rate normalisation in 2019. The incoming stream of strong economic data, such as 49 year-low unemployment rate of 3.7% and moderate household debt levels, does not seem to lend significant weight to the much-mooted idea that the US economy will shortly head into a recession.

As headwinds to growth and confidence gather, Chinese policymakers have been flexible in easing policy to buffer a slowdown. Fiscal policy is turning more stimulatory as authorities implement VAT cuts and the recent sharp increase in municipal bond issuance is typically a leading indicator of a ramp-up in infrastructure investment. While high system-wide leverage suggests limited room for more debt-fuelled growth stimulus without jeopardising China's systematic stability down the road, the need for policy focus to shift from cyclical stimulus to deeper structural reforms to ensure sustainable growth has come under the spotlight. Concrete policy actions tackling the financial system's structural inefficiencies such as the continued large presence of zombie state-related enterprises would likely be received favourably by the market.

On the home front, the Reserve Bank of Australia kept the official cash rate on hold for a 28th consecutive month, awaiting the final piece of the puzzle – solid wages growth and inflation – to commence its hiking cycle. Political risk will likely remain in focus in 2019. With betting markets and opinion polls strongly suggesting Australia's opposition Labor Party (ALP) will win Government at the coming Federal election, its broader policy mix including a much larger personal income tax package, combined with a marked improvement in Australia's fiscal position could potentially amplify the upswing of the economic cycle. Standing from the vantage point at year end, we remain cautiously optimistic about Australia's growth trajectory, notwithstanding September quarter annualised GDP growth printing below consensus expectations at 2.8%. Key tailwinds into calendar year 2019 include accommodative monetary policy, the largest pipeline of public infrastructure projects since the 1980s and normalising conditions in the mining states which ought to unfold in the new year.

While the many changing economic and political factors that are colliding to heighten volatility can be confusing, investors need to dial down the noise at this stage. Our disciplined investment approach has seen our portfolio include a spread of quality businesses featuring strong balance sheet, solid cash generation and sustained growth momentum and capable of withstanding any further market turbulence. With the broader market adopting a risk-off mood and seeking higher liquidity, small-cap stocks are vulnerable to being oversold and there are some quality stocks which we had previously viewed as being too expensive which are now screening as attractive under our investment process. We are continuing to assess them for portfolio inclusion and hence rational investors with patient capital will be rewarded over the medium to long term.

With Christmas approaching, we would like to take this opportunity to thank our clients for their support through what has been a challenging 2018. Despite the recent volatility, we remain confident the Fund will continue to deliver attractive long-term returns.

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

Top 5 holdings#

Company	ASX code
AMA Group	AMA
Imdex Limited	IMD
Jumbo Interactive	JIN
Pacific Current Group Ltd	PAC
The Citadel Group	CGL

The top 5 portfolio holdings are in alphabetical order and may not be representative of current or future investments.

CONTACT COPIA

1800 442 129 | clientservices@copiapartners.com.au | copiapartners.com.au

John Clothier	General Manager, Distribution	0408 488 549 | jclothier@copiapartners.com.au
Iain Mason	Director, Institutional Business	0412 137 424 | imason@copiapartners.com.au
Mani Papakonstantinos	Distribution Manager	0439 207 869 | epapakonstantinos@copiapartners.com.au

[†]The total return performance figures quoted are historical, calculated using soft close, end-of-month mid-prices and do not allow for the effects of income tax or inflation. Total returns assume the reinvestment of all distributions. The performance is quoted net of all fees and expenses. The index does not incur these costs. This information is provided for general comparative purposes. Soft close unit prices are interim unit prices struck at month end before all transactions for the month have been completed. Performance data available on the OC website, ocfunds.com.au, however, is based on hard close unit prices which are struck after all transactions for the month have been completed.

[*] 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.