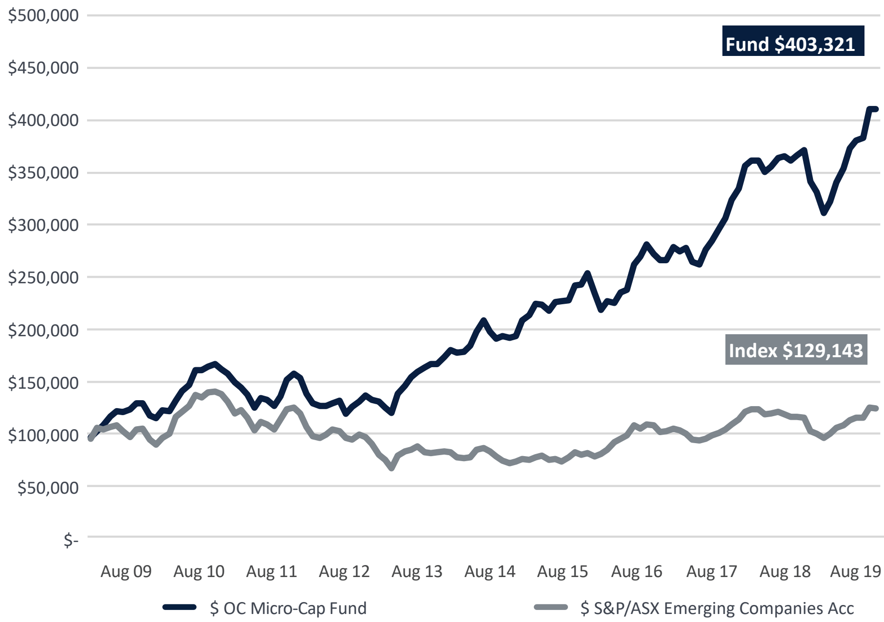
0.1% Fund down 0.1% for the month

15.0% Returned 15.0% 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 31 August 2019†	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. (Mar 2003)
OC Micro-Cap	-0.1	7.7	11.7	14.7	14.2	17.7	15.0	13.9
S&P/ASX Emerging Comp. Accum	-0.7	7.1	7.0	5.6	7.2	3.2	2.6	NA
Outperformance	**0.6**	**0.6**	**4.7**	**9.1**	**7.0**	**14.5**	**12.4**	**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. The total return performance figures quoted are historical, calculated using end-of-month mid-prices and do not allow for the effects of income tax or inflation.

Performance review

The OC Micro-Cap had a solid month finishing August down -0.1% which was ahead of the S&P/ASX Emerging Companies Index which was down -0.7%. It was a solid effort given that the benchmark's biggest contributor, Polynovo (PNV, +26.9%) added over 1% to the Index alone in August and it is well beyond the scope of our investment mandate that given its current market capitalisation is in excess of $1.5b.

We held high hopes for **Baby Bunting (BBN, +26.8%)** coming into the full year result and the company did not disappoint, delivering an impressive result. FY19 has comprehensively dispelled any lingering concerns the market may have had about online competition from Amazon, or the challenges of running a largely bricks and mortar retail baby goods network following the bankruptcy of its four largest competitors over the prior few years. BBN now has some 'clear air' following the failure and shutdown of a string of its major national competitors. It was apparent from the result that BBN has picked up significant market share from the exit of these groups and it has demonstrated growth in gross margin with the stabilisation of industry conditions following a protracted period of discounting as exiting competitors liquidated inventory. Store roll-out will remain a positive driver into the future for BBN, with about six stores per annum expected to be being opened in coming years and the larger format shopping centre stores, such as Chadstone, trading ahead of expectations. We expect continued strong growth in revenue and earnings into the medium term driven by ongoing market share gains, private label, and exclusive offers, which are underpinning strong margin trends and further store roll-out. BBN continues its march towards being the 'category killer' in the national baby good space and management are doing a fine job.

Online retailer **Kogan.Com (KGN, +25.9%)** re-rated after releasing a result that was largely in-line with expectations but captured the markets attention with a robust trading update and additional information on new growth verticals. KGN has experienced strong growth in the high gross margin exclusive channel via extended ranging of white good products. Pleasingly, the recently launched Kogan marketplace generated gross sales of A$7.1m in the month of July which is likely to be a high margin, capital efficient revenue stream. Further verticals such as NZ mobile and credit cards are also likely to contribute to the business in the future and the company now has multiple growth avenues.

Viva Leisure (VVA; +15.6%) is a regional gym network, primarily based around Canberra and the ACT, which moved higher during the month after reporting its inaugural result as an ASX listed company following its IPO in June. VVA's result was ahead of its FY19 prospectus forecast, particularly with respect to key metrics being active members (approximately 57,000) and locations (42). At the result, VVA also confirmed it is on track to exceed its FY20 prospectus forecast in terms of locations, with 15 green fields sites identified to be rolled out and a further 24 locations in discussions to be acquired. The organic opportunities and the inorganic pipeline combined have the potential to add considerable bulk to both the network and earnings power of VVA and we estimate should drive +70% EBITDA growth in FY20.

Medicinal cannabis stocks, **Cann Group (CAN; -14.2%)** and **Althea (AGH; -21.4%)**, each took a breather during the month as the broader micro-cap market was more focussed on those companies reporting earnings. CAN and AGH are each concept model stocks, currently pre earnings, but with a clear pathway to cashflow positive operations. They remain the quality exposures in their sector and are at the vanguard of the nascent Australian medicinal cannabis industry.

CAN is focussed on breeding, cultivating and manufacturing medicinal cannabis for sale and use within Australia and into export markets, through its relationship with Canadian partner, Aurora Cannabis, Inc. a 23% shareholder in CAN. CAN recently announced the expansion of its Mildura facility to the production of 70,000 kilograms per annum, which will be in operation by the end of 2020, and will be generating EBITDA of around $100m per annum when it achieves full production capacity. Aurora has agreed to be the primary offtake partner for CAN product at pre-agreed pricing levels.

Althea updated the market advising that 1,925 patients have been prescribed AGH products (including 392 new patients in August alone), and almost 300 health care professionals across Australia have now actively prescribed AGH product. Like CAN, AGH has a Canadian big brother on its register, in the form of Aphria, Inc. with a 25% stake in the company.

We see the updates from CAN and AGH as encouraging, despite the share price pull-backs during the month, and we are looking forward to the continuing evolution of these stocks as the Australian medical cannabis market continues to evolve.

Over The Wire Holdings (OTW; -12.4%) finished lower over the month after reporting a disappointing FY19 result. Increased personnel investment in the core business coincided with softer than expected project wins from a recently acquired business. The revenue and earnings upside from these project have been deferred from FY19 to FY20 and are largely responsible for the earnings disappointment. OTW is a telecommunications, cloud and IT solutions provider that has a national network with points of presence in all major Australian capital cities and in NZ. OTW has a strong management team, with a track record of growing both organically and inorganically, but this misstep has forced us to exit the position in favour of other high performing small-micro telco positions. We will continue to keep a watching brief on OTW with a view to re-entering the position should our confidence in the business model and the management team increase.

Outlook

August began with Trump's escalation of trade hostilities and ended with the new UK Prime Minister, Boris Johnson's suspension of the UK parliament; equity markets in the month went decidedly 'risk-off' as economic, financial and geo-political risks fuelled renewed volatility and a flight to safety. Global bond yields fell over the period, amid fears that the Sino-American trade war could tip the US economy into recession, with the US 10-year yield dropping 52 basis point over the course of the month. Indeed, the flood of money into safe-haven assets has pushed more than $US17 trillion of bonds into negative yield territory. Persistent low and negative rates across advanced economies have also propelled the gold price to record highs given there is now virtually no opportunity cost in holding the yellow metal.

Concerns around global economic slowdown have recently intensified as manufacturing gauges remained downbeat across the globe. The ISM US Manufacturing Purchasing Managers' Index fell to 49.1 in August (where a reading below 50 indicates the sector is shrinking), the lowest since 2016. Furthermore, the US and China each enacted new tariffs against the others imports effective from the end of August which caused a major blow to confidence with other PMI's around the world, including Germany, Japan and South Korea, joining the US Index in signalling a contraction of activity.

These soft readings come ahead of policy meetings at the European Central Bank and the Federal Reserve later this month and bond markets are pricing in further monetary easing to tackle the downturn. China is also forging ahead with its own form of stimulus, announcing that it would loosen restrictions on bank lending as it grappled with the effect of its trade war with the US. The People's Bank of China has cut its reserve requirements for all banks by 0.5% which will free up long-term funding of around 900 billion yuan (A$184 billion), which banks can use to increase lending in China as policymakers attempt to reinvigorate the Chinese economy.

In recent days, investor nerves have been temporarily calmed by hopes of a breakthrough following the announcement that Washington and Beijing are set to resume stalled trade talks in October. Nevertheless, falling expectations for consumer price growth, plunging bond rates and flatter and, in some countries (including the US), inverted yield curves all point to mounting doubts among the investment community over the effectiveness of monetary policy in reflating the economy.

On the domestic front, concerns that economic growth may have contracted in the June quarter had some market participants calling for further rate relief as early the recent September RBA Board meeting. But news of Australia's first current account surplus since 1975, which was driven by an export surge in iron ore, coal and gas, tempered expectations ahead of the board's September meeting. The economy grew +0.5% in the three months to June and Australia's annual economic growth has slowed to a limp at +1.4%, the lowest rate since the aftermath of the GFC when Australia was fighting the threat of recession with massive doses of fiscal and monetary stimulus.

Despite the soft GDP print, the combination of tax and interest rate cuts, house price stabilisation in Melbourne and Sydney, continued high levels of spending on infrastructure and a more positive outlook for investment in the resources sector has led the RBA governor to signpost that the economy may be reaching a gentle turning point. We remain a little more circumspect and believe that economic growth will print below the RBA's 2.75% target for CY19. Markets are still pricing in two further near-term interest rate cuts, with consensus expectations of a further 25 basis point cut at the November 2019 meeting and another 25 basis point cut by May 2020.

The Australian small cap market declined over the August 2019 reporting season, driven by a combination of deteriorating macro-economic indicators and negative earnings revisions at a corporate level. Goldman Sachs Investment Research found that the ratio of consensus EPS downgrades to upgrades hit the highest level since the GFC across the small-cap universe. Indeed 51% of companies had consensus EPS cuts of greater than 2.5%, well above the 38% average over the past decade. Just 15% of stocks saw consensus earnings upgrades of greater than 2.5%, well below the 10-year average of 22%. Prima facie this would usually be indicative of a rapidly deteriorating economic back-drop. Tempering this somewhat is that fact that the sell-side has become increasingly renowned for overly bullish forward earnings assumptions leading up to year end in recent years and widespread forward earnings revisions during the full-year results period are now quite common-place.

Some of the more interesting observations from the August reporting season include the following:

1. Contrary to subdued investor expectations, discretionary retail was one of the surprise packets with most companies in the space delivering financial results largely in-line with guidance, positive outlook statements and modest FY20 EPS upgrades. Both JB HiFi and Super Retail Group highlighted that recent trading has been assisted by expansionary fiscal and monetary policy, with smaller ticket purchases benefiting from tax cuts and government handouts. Sales growth for retailers such as Adairs Limited and fund holdings, Baby Bunting Group and Lovisa Holdings, has been robust, lending further weight to the suggestion that economic stimulus is flowing directly to the consumer. It will be interesting to see whether this is just a temporary boost or the start of a broad recovery in consumer spending.

2. There are data points now emerging to suggest that the residential housing market has bottomed and may even be enjoying moderate price growth again after a sustained contraction. Despite national new listing volumes decreasing 20 per cent in July, Domain Holdings Australia has called out some encouraging signs of buyer activity starting to spike, including increased attendance at "open for inspections". Recent auction clearance rates have strengthened considerably, particularly in the key Melbourne and Sydney markets, and property analytics business, CoreLogic, reported solid price growth in both these markets in August.

3. Federal and State infrastructure project pipelines remain solid. Core portfolio holdings, including Bingo Industrials and Seven Group Holdings, have reported improved earnings visibility thanks to infrastructure projects starting to commence along the eastern seaboard after lengthy delays. The real economy is expected to continue, benefiting from $100 billion in Federal infrastructure spend over 10 years, along with $93 billion investment committed by the NSW government and $107 billion of Victorian government capital projects commencing or underway.

The Fund remains "cashed up" at present, with a cash balance in-excess of 10%, providing ample flexibility to capitalise on any pull back in the market in the coming months. Whilst this level is well above our typical cash weighting of around 4-6%, we feel it is prudent in view of the elevated financial, political and geo-political risks which could provide a cheaper entry point into stocks in the coming months and the somewhat stretched valuations of some of the quality names in the small-cap space.

Post our reporting season management catch-ups, we will once again head out on the road with an extensive company visitation program planned in the coming weeks. We thank our investors for their ongoing support and remain committed to our goal of generating strong long-term risk-adjusted returns for our clients.

Top 5 holdings#

Company	ASX code
Cann Group Ltd	CAN
Imdex Ltd	IMD
McPherson's Ltd	MCP
Probiotec Limited	PBP
Propel Funeral	PFP

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

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[†]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 10 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.