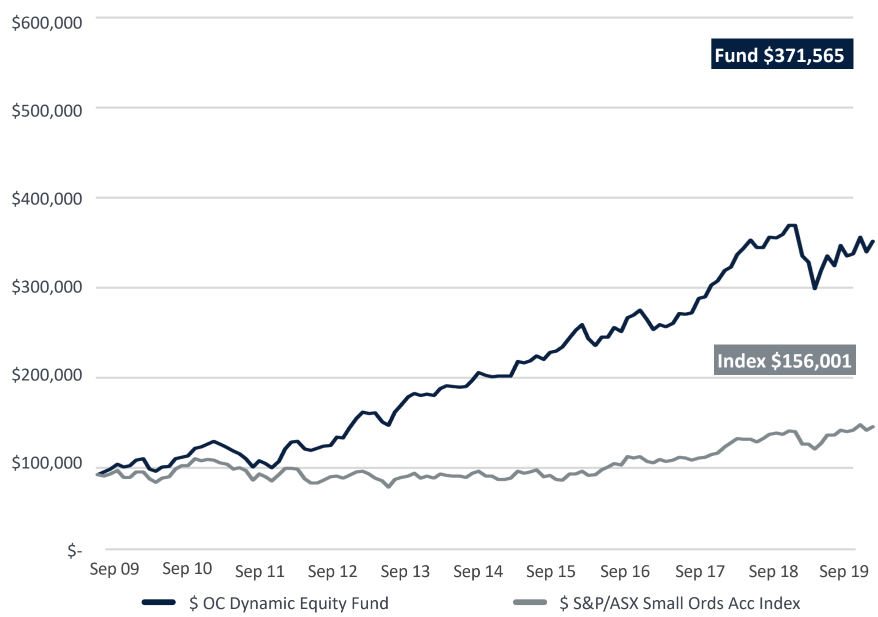
4.2% Fund up 4.2% for the last 3 months

14.1% Returned 14.1% p.a. for the past ten years

We remain confident the Fund will continue to deliver attractive long-term returns

Performance comparison of $100,000 over 10 years*



Total returns

At 30 September 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. (Dec 2000)
OC Dynamic	3.4	4.2	-4.8	8.5	11.5	15.7	14.1	12.4
S&P/ASX Small Ords Accum	2.6	3.1	3.9	8.8	9.6	7.0	4.5	6.4
Outperformance	**0.8**	**1.0**	**-8.7**	**-0.3**	**1.9**	**8.7**	**9.5**	**6.1**
S&P/ASX Small Ind Accum	3.3	3.9	6.9	9.1	10.3	11.5	8.3	6.9
Outperformance	**0.1**	**0.3**	**-11.6**	**-0.7**	**1.2**	**4.2**	**5.8**	**5.5**

The total return performance figures quoted are historical, calculated using hard close, end-of-month mid-prices and do not allow for the effects of income tax or inflation.

Performance review

The Australian equity market remained buoyant in the September quarter, with the small-cap index shrugging off an indifferent reporting season, mixed global economic data and a volatile geo-political environment to post positive returns. Falling interest rates across the globe continue to drive investor risk appetite and the stock market has been a key beneficiary. The S&P/ASX Small Ordinaries Accumulation Index and the S&P/ASX Small Industrials Accumulation Index both finished the quarter in the black, at +3.1% and +3.9% respectively. The OC Dynamic Equity Fund finished the quarter ahead of the indices at +4.2%.

Baby Bunting Group (BBN, +66.7%) was a strong performer and is a core holding that we have written much about in recent years. Our readers will recall that the company suffered a challenging trading period during FY17 and FY18 after numerous businesses in the sector (including BBN's four largest competitors) went broke and exited the market leading to an unsettling period of heavy discounting and stock liquidations. BBN also de-rated during the much-hyped ramp-up of Amazon into the Australian baby market which spooked investors sceptical about BBN's ability to compete against a global online behemoth such as Amazon. Our conviction that the company would be able to manage these major transitory issues, which were not structural in nature, has been somewhat vindicated of late with the FY19 result dispelling any lingering concerns the market may have had about online competition from Amazon, or the challenges of running a largely "bricks and mortar" baby goods retail network following the bankruptcy of its largest competitors.

It was apparent from the FY19 result that BBN has picked up significant market share from the exit of major bricks and mortar competitors and that its gross margin was once again expanding following the stabilisation of industry conditions (which was characterised by a protracted period of discounting and inventory liquidations). BBN continues its march toward being the 'category killer' in the national baby market and we expect strong earnings growth in the coming few years. Notwithstanding this, we have reduced our weighting in the stock following strong recent share price appreciation.

Pacific Current Group (PAC, +59.3%) bounced strongly from oversold levels during the quarter after posting a solid FY19 result and announcing a minority interest investment in the funds management firm, Proterra Investment Partners (Proterra). PAC has been trading in 'deep value' territory following a volatile period in which several major shareholders had lost investment mandates and their PAC stockholdings were subsequently sold on market putting pressure on the PAC share price. From a fundamental perspective, PAC continues to deliver solid outcomes and the company released a robust June quarter FUM update which showed total FUM at $57.5 billion, (+9.7% for the quarter). The FUM growth was largely underpinned by inflows from tier-one boutiques, GQG and Carlisle, and was helped along by a strong rebound in global equity markets and favourable currency movements. In September, PAC deployed US$20.5m into Proterra, a private equity manager specialising in natural resource investing. The investment rationale is to provide additional capital to the Proterra balance sheet to support growth initiatives. The investment continues the recent trend of the PAC management team investing in asset classes uncorrelated with the broader equity market and it was again determined to be an EPS accretive deal for PAC.

Afterpay (APT, +43.1%) was a stellar performer during the quarter and delivered another fine set of key operating metrics at its FY19 result. Group revenue continues to track ahead of consensus expectations and net transaction profit margins and gross losses are all trending in the right direction, auguring well for the future profitability of the group. US momentum continues to accelerate and APT's US business finished June at a run-rate of $1.7 billion in sales. APT has also announced a strategic collaboration with Visa in the US market and, although deal details are limited, it is expected the partnership will enhance the customer experience and the retailer offering. The recent UK launch has exceeded expectations to date with customer adoption rates ahead of even those seen in the early days of the US launch. This once again highlights the power of the Afterpay business model and its ability to resonate with both consumers and merchants across different geographies.

In late September, APT announced that AUSTRAC had been provided with the confidential interim audit report on the company's Anti-Money Laundering and Counter Terrorism Financing (AML/CTF) compliance. The company noted that the interim report does not provide any recommendations, which will be left until the final report. Nevertheless, APT did state that it hasn't found any money laundering or terrorism financing activity on its platform to date. The company will provide a further update once AUSTRAC has received the final audit report, which is due by 23 November 2019.

Online consumer (B2C) and wholesaler (B2B) travel company **Webjet Limited (WEB, -18.8%)** came under pressure during the quarter following news that UK-based Thomas Cook (TC), a significant customer of WEB's WebBeds B2B business, had entered into liquidation. The impact on WEB's B2B business is material, including:

a. the loss of $150-$200m in Total Transaction Value (TTV) from TC in FY20;
b. a resultant FY20 EBITDA impact of approximately $7m; and
c. an expected bad debt impact of EUR27m (approximately $44m) from TC.

The latter will be treated as a one-off expense to the income statement and can be absorbed by the company's cash reserves and undrawn facilities. There will be no impact from the liquidation on the 3,000 hotel contracts WEB acquired from TC in August 2016 and these remain available for sale to WebBeds customers.

Whilst the TC business had been under pressure for some time, the dire state of the TC business and its ultimate liquidation was a surprise to us given that the TC business was widely expected to be recapitalised by third party investors. Aside from the financial impact (quantified above) WEB share price has further suffered as the failure of TC brings into focus challenges facing the B2B hotel industry and serves as a reminder of the credit risk in the B2B space. Furthermore, WEB is suffering from general negative market sentiment toward travel stocks due to headwinds from specific events such as Brexit and the political turmoil in Hong Kong. Despite these issues, the WEB business remains fundamentally solid and continues to generate strong double-digit organic growth. We expect a trading update from management at the company's AGM in late November, where it will release earnings guidance for FY20. This ought to refocus the market's attention back to what is a fundamentally undervalued growth story.

We exited long-term portfolio holding, The **A2 Milk Company (A2M, -12.2%)**, during the quarter largely due to concerns about the medium-term profitability of the company, with consensus estimates looking too high to us. In FY20, A2M management has declared it will spend almost NZ$200m in marketing the A2 brand in the world's two largest consumer markets (being the US and China) with an eye to future growth opportunities. While we view this as a sensible strategy, given the quantum of the opportunity in these markets, it is likely that ongoing brand investment beyond 2020 will limit operating leverage over the coming years, a fact we believe is yet to be captured in consensus estimates.

A2M's traditional growth engine in China, the Daigou (individual reseller) channel, is facing increasing regulatory scrutiny in China, including through greater tax imposts, more stringent registration requirements and increasing customs inspections. A2M management is doing a credible job building the infrastructure of the offline channel, including in the physical mother and baby stores, which will continue the growth of the A2 brand in China. Indeed, A2M has already secured shelf space in over 16,000 physical stores in China as at the end of June 2019. This offline channel will become increasingly important for the future growth of A2M in China as the Daigou channel moderates, and perhaps even shrinks, due to regulatory pressures.

The offline channel will require considerable investment to build out distribution and increase brand awareness including investment in relationships, shelf space and employing "push girls" in-store to promote the A2 brand. At its FY19 result, A2M management announced that its FY20 margin would flatline, largely as a result of increased marketing investment and this has now been factored into analyst consensus. What is less clear, is whether operating leverage will return to the business beyond FY20 and we view analyst consensus as being overly ambitious on this front given the huge marketing investment that the management is flagging over the next few years in both China and the US.

We also note that the management team has announced it will change its long-term incentive scheme from one based on EPS and EBITDA growth to one more focused on revenue growth. This suggests to us that profitability over the next few years is likely to be sacrificed to build market share in the US and China. Longer term this may prove to be wise, but it is unlikely to drive the share price in the short to medium term as analysts are forced to rebase their profit forecasts.

We appreciate that exiting our A2M position is a major pivot from the investment team in a stock that had been a significant holding for the Fund over a long period of time and a lucrative investment. The stock price has continued to fall post our exit and several analysts have recently revised down their future year earnings forecasts. We continue to believe that A2M is solid long-term growth story and will revisit the stock should the share price fall to an attractive re-entry point.

Outlook

After a strong performance in the September quarter, the domestic market has sold off sharply in early October with Australian equities joining a broad-based global pull-back after a series of disappointing data prints out of the US spooked the market and heightened fears that the US economy is slowing. In the US, consumer confidence fell the most in nine months in September, ADP national employment data printed below market expectations and the most recent US ISM survey of manufacturing and services also disappointed. But late last week, just as the bears were really starting to emerge from their caves, it was reported that the US unemployment rate had dropped to just 3.5%, a 50-year low, with the economy adding 136,000 jobs in September. This has reduced fears that the world's biggest economy is heading for a recession and lends some credibility to US Federal Reserve Chairman Jerome Powell's recent comments that the US economy remains on solid ground. It is increasingly clear that ongoing trade tensions are impacting manufacturing activity around the globe, with purchasing managers indices (PMIs) from Germany, Japan, South Korea, China and the US all signalling a contraction in activity.

Against this backdrop, central banks have been pedalling hard to stimulate economic activity and avoid a global downturn by introducing more accommodative monetary policies. The US Federal Reserve joined a host of global peers in further cutting interest rates in September and bond markets are pricing in further monetary easing in the US in coming months, including an interest rate cut in October. China, too, is forging ahead with its own form of stimulus, announcing that it would loosen restrictions on bank lending as it grapples with the effects of the US trade war.

A recent trip to China by the investment team confirmed that the Chinese consumer is doing it tougher than earlier in the year (April) when we last visited mainland China. This view was confirmed many times over the course of our trip, including through our interactions with numerous local merchants whom we came into contact with, and also in several of our formal meetings with Chinese businesses and regulators. There is a prevailing mood of caution about the economic outlook for the country with the younger generation of Chinese concerned about job security for the first time that we can recall. Very few people we encountered expect a near term resolution to the trade dispute with the US and most expect circumstances to deteriorate further before any formal trade deal is reached.

Diplomatic relations between Australia and China also seem to have taken a turn for the worse since our last visit. The term 'diplomatic freeze' seems to be the best way to describe the relationship in the diplomatic channels, with relations reportedly deteriorating noticeably in the wake of the Australian government's decision to ban Huawei from Australia's 5G telecommunications roll-out. One high level contact (confirmed by others on our trip) said that meeting requests, from Australian politicians, regulatory authorities or companies, made to important Chinese

Communist Party contacts were simply being ignored. Clearly this is concerning given that China is Australia's largest trading partner and it signals a note of caution about the prospects of any Australian company seeking regulatory approval to do business in China in the near-term.

The political circus surrounding Trump has ratcheted up a notch with the news that the Democratic party is planning to hold an inquiry into whether the President ought to be impeached over inappropriate contact with the Ukrainian President concerning former US vice-president, and 2020 election rival, Joe Biden. Nancy Pelosi, speaker of the US House of Representatives, has announced a formal impeachment inquiry into Trump, acquiescing to mounting pressure from fellow Democrats and plunging a deeply divided nation into an election year clash between Congress and the White House.

The impeachment proceedings have temporarily displaced news of the ongoing trade war and the geo-political tensions in the Middle East from the front pages of the financial press. Nevertheless, with trade talks between China and the US set to resume this week it will again no doubt garner plenty of attention in the coming weeks. We remain cautious about the prospects of an outright resolution of trade differences any time soon, with even Trump himself expressing some doubt about the likelihood of a near-term deal. Heading into these talks, the OC Funds portfolio remains conservatively positioned and we have ample capacity to deploy cash should a meaningful pull back in markets be triggered by an ongoing faltering of trade talks.

Domestically, monetary policy has been front and centre following the RBA's decision to lower the cash rate by 25 basis points to an unprecedented 0.75% in early October. Dovish commentary by RBA Governor Phillip Lowe, particularly around the risks to the global economy with further monetary easing is "widely expected", has instilled widespread belief that domestic rates are heading towards zero and that quantitative easing may soon be coming to Australia. Indeed, Dr Lowe is openly acknowledging that the effectiveness of monetary policy as a tool to stimulate economic activity is highly debatable as rates approach zero.

Nevertheless, in an environment where interest rates are falling across the globe, holding domestic rates steady would leave the AUD vulnerable to currency appreciation (due to likely capital inflows) which would clearly be detrimental to Australia's trade position. We therefore expect rates in Australia to continue to fall in the short to medium term. This would likely be supportive of Fund holdings with exposure to the consumer, such as Baby Bunting, Lovisa and Bapcor, each of which reported a positive trend in recent trading during their reporting season market updates.

The combination of tax cuts, interest rate cuts, house price stabilisation (particularly in Sydney and Melbourne), continued high levels of spending on infrastructure and a more positive outlook for investment in the resource sector are cause for optimism. With a broad universe of stocks to choose from in the small-company space, we are comfortable that our portfolio is well positioned to generate solid returns for investors over the medium term.

Post reporting season, the investment team has been busy poring over the details of a raft of IPO candidates including Latitude Financial, Retail Zoo, MPC Kinetic, Damstra and PropertyGuru. Furthermore, there has been an elevated level of secondary market activity in the small-companies space with transactions including Kathmandu's acquisition of iconic surf company, Rip Curl, AMA Group's acquisition of Suncorp's large panel business Capital Smart and Sealink's acquisition of Australia's largest private operator of metropolitan public bus services, Transit Systems Group; each of these have involved capital raisings. We will meet with the management teams of each of the IPO candidates over the next month and our analysis often involves site visits, competitor discussions, and sell-side analyst meetings. Our investment process is rigorous, and we will undoubtedly pass on many of these deals. We thank our investors for their ongoing support and look forward to talking to investors about some of the deals that we do decide to participate in over the coming few months.

Top 5 holdings#

Company	ASX code
Mineral Resources	MIN
Nextdc	NXT
Seven Group Holdings	SVW
Webjet	WEB
WorleyParsons	WOR

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

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