



Smallco Investment Fund

Quarterly Update 31 December 2018

SIF Portfolio Commentary

Smallco Investment Fund (SIF) was down 15.8% for the December quarter versus the Small Ordinaries index down 13.7%. For the 2018 calendar year the Smallco Investment Fund was down 2.5% versus the Small Ordinaries index down 8.7% for the same twelve month period.

The December quarter saw a sharp selloff in equities in both offshore and the domestic markets. Fears early in the quarter for the potential of faster than expected Fed rate rises were compounded later in the period by escalating trade tensions and Brexit ructions. Closer to home a rapidly cooling property market and its potential impact on the consumer raised questions on the Australian economy's momentum heading into calendar year 2019.

The AGM commentary and trading updates from the vast majority of the fund's major holdings were in line with or even modestly ahead of our expectations. GTN was the main exception, delivering a disappointing trading update driven in part by a weaker domestic advertising market. The portfolio was however not spared in the global equity sell off as we saw a partial unwind of the rerating enjoyed by quality growth companies in the past year or two.

We have been commenting for well over a year that we were cautious of the valuation levels in the Australian stock market and had increased our cash weightings. These higher cash weightings allowed us to selectively add to our positions in our favoured quality franchises at significantly lower prices.

The cash redeployment is however being done cautiously and cash levels remain relatively high at ~24% (versus ~30% end of September). Valuations of a number of the stocks we would like to own remain high versus historic levels and while the consensus expectation that world growth will slow but still remain relatively healthy at around trend levels in 2019 appears reasonable at this stage, risks to this thesis remain elevated in the current environment.

Appen (APX) has been a strong contributor to the fund whose long term holding was added to early in the quarter. Appen is a global leader in the development of human annotated datasets and language services. Whilst the near term valuation is still relatively demanding Appen is one of the few small caps in our market that gives direct exposure to the large investment being undertaken in the development of machine learning and artificial intelligence capabilities by global technology companies.

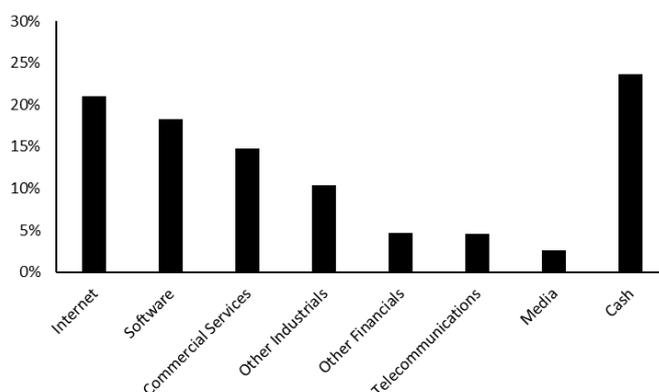
Appen's already strong 2018 growth outlook was upgraded in November. We believe the demand for their services and thus their medium term earnings outlook remains strong as global consumer technology companies, automakers and governments invest in their machine learning capabilities across a diverse range of industries such as mobile devices, digital assistants, autonomous vehicles, law enforcement, and social media.

SIF Performance

Return to 31 December 2018	
3 months	-15.8%
1 year	-2.5%
3 year p.a.	6.4%
5 year p.a.	11.9%
10 year p.a.	20.3%
Since inception (31.10.00) p.a.	13.5%
Value of \$100,000 invested at inception	\$1,001,367

Fund returns calculated after all fees and expenses and based upon exit price and reinvestment of distributions.

SIF Structure: by sector (look through)



SIF Significant Holdings (alphabetical order)

Altium
Appen
Corporate Travel Management
REA Group
Webjet

Please feel free to contact Craig Miller, one of our portfolio managers, for any queries or needs on 02 8256 1000.



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SIF Fund Description

SIF is a concentrated, index unaware Australian equity fund investing predominantly in smaller listed companies. SIF may invest in cash when opportunities are scarce and invest up to 20% of the fund in Australian companies within the ASX100. SIF is currently closed to new investment.

Smallco believes that higher returns are available from smaller companies as these companies are generally not as well followed by the market which in turn makes mispricing more common. Particular focus is placed upon companies with a market capitalisation of between \$100m to \$500m - the Smallco "sweet spot".

SIF typically holds 25 to 35 stocks on the premise that it is better to have a holding of core stocks that offer solid investment fundamentals than a large number of "OK" investments.

Smallco's dominant investment tool is fundamental analysis. Focus is placed upon internal financial modelling supplemented by some broker research. We are strong believers that earnings are the key driver of share prices and as such, the greater the accuracy in forecasting earnings the more consistent the outperformance.

Stock weightings within the portfolio are determined by the assessment of the quality of the stock, the likely investment outcome, liquidity and the risk of sustained capital loss.

SIF very rarely invests in mining stocks, is very averse to loss making companies, and takes an extremely cautious approach to biotech and structurally impaired industries.

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Key Investor Information

Strategy	SIF is a concentrated, Australian equity smaller company focused fund that invests predominantly long but can effectively short when opportunities are found.
Process	Smallco manages SIF employing a bottom up fundamental research approach focusing upon earnings direction, risks and the underlying businesses quality.
FUM	\$314.1m AUD
Mid Price	\$4.4621 (31 Dec 2018)
Distribution	Annually 30 June
Inception Date	31 October 2000
Portfolio Managers	Rob Hopkins, Bill Ryan, Andrew Hokin, Paul Graham, Adam Simpson, Han Xu and Craig Miller
APIR Code	ASC0001AU
Minimum Initial	\$40,000
Buy/sell costs	+/- 0.45%
Management Fee	1.40% of net assets *
Admin cost (FY18)	0.14% of net assets *
Performance Fee	18.64% of the performance above the Fund's previous end-of-six-month period high. Payable 6 monthly. *
Service providers	Custody: JP Morgan Administration: Link Fund Solutions
Liquidity	Time to exit 50% of SIF assets: < 1 day

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ARSN 103 148 107

This document does not take into account the investment objectives, financial situation and particular needs of each reader. Accordingly, nothing in this document should be construed as a recommendation by Smallco, or any associate of Smallco or any other person, concerning an investment in the fund.

* Unless otherwise stated, all fees quoted are inclusive of GST, after allowing for an estimate for Reduced Input Tax Credits (RITC). Past performance is not a reliable guide as to future performance. Returns are not guaranteed.