



Fund Review

Smallco Investment Fund

ISSUE DATE 02-11-2016

About this Review

ASSET CLASS REVIEWED	AUSTRALIAN EQUITIES
SECTOR REVIEWED	AUSTRALIAN LONG SHORT
TOTAL FUNDS RATED	19

About this Fund

ASIC RG240 CLASSIFIED	YES
FUND REVIEWED	SMALLCO INVESTMENT FUND
APIR CODE	ASC0001AU
PDS OBJECTIVE	NO FORMAL OBJECTIVE - THE MANAGER AIMS TO GENERATE HIGH ABSOLUTE RETURNS BY INVESTING MAINLY IN AUSTRALIAN SMALLER COMPANIES
INTERNAL OBJECTIVE	ABSOLUTE RETURNS
STATED RISK OBJECTIVE	N/A
DISTRIBUTION FREQUENCY	N/A
FUND SIZE	\$315M (JUNE 2016)
FUND INCEPTION	01-11-2000
MANAGEMENT FEE	1.40% P.A. (WHOLESALE) + PERFORMANCE FEE
PERFORMANCE FEE	18.64% OF THE ADJUSTED NET ASSET INCREASE ABOVE THE PREVIOUS HIGHWATER MARK
RESPONSIBLE ENTITY	SMALLCO

About the Fund Manager

FUND MANAGER	SMALLCO
OWNERSHIP	WHOLLY OWNED BY INVESTMENT TEAM: ROB HOPKINS (45%), BILLY RYAN (32%), ANDREW HOKIN (13%), CRAIG MILLER (10%)
ASSETS MANAGED IN THIS SECTOR	\$800 (JUNE 2016)
YEARS MANAGING THIS ASSET CLASS	16

Investment Team

PORTFOLIO MANAGER	ROB HOPKINS, BILL RYAN, ANDREW HOKIN, PAUL GRAHAM & CRAIG MILLER
INVESTMENT TEAM SIZE	5
INVESTMENT TEAM TURNOVER	LOW
STRUCTURE / LOCATION	SYDNEY

Investment process

STYLE	GARP
TYPICAL STOCK NUMBERS	25-35 (TOTAL)
NET MARKET EXPOSURE RANGE	50-150% (TYPICALLY 90%)
TYPICAL CAPITALISATION BIAS	SMALL-TO-MID
GEARING LIMIT	UP TO 50%
STOCK ACTIVE POSITION LIMITS	MAXIMUM OF 10% OF FUND VALUE AT COST, MAXIMUM OF 20% OF FUND VALUE (INCL. APPRECIATION)
SECTOR ACTIVE POSITION LIMITS	EXPOSURE TO A MINIMUM OF 4 GICS SECTORS

Fund rating history

NOVEMBER 2016	RECOMMENDED
OCTOBER 2015	RECOMMENDED
OCTOBER 2014	RECOMMENDED

What this Rating means

The 'Recommended' rating indicates that Lonsec has strong conviction the financial product can generate risk adjusted returns in line with relevant objectives. The financial product is considered an appropriate entry point to this asset class or strategy.

Strengths

- High personal equity ownership of key investment personnel in business.
- High conviction, benchmark unaware approach with a strong focus on companies within the \$100-\$500m market capitalisation bracket.
- Strong relative performance of the Fund.
- Strong commitment to capacity management serves to preserve its investment appeal.

Weaknesses

- Very high fee load relative to the Lonsec Peer Group Average.
- The Fund makes minimal use of shorting, which may be a weakness for investors searching for capital preservation in a decreasing equity market environment.
- The drivers around the equity / cash allocation decision are somewhat opaque.

Fund Risk Characteristics

	LOW	MODERATE	HIGH
BUSINESS SUSTAINABILITY RISK		●	
CAPITAL VOLATILITY			●
SECURITY CONCENTRATION RISK		●	
SECURITY LIQUIDITY RISK			●

Risk categories are based on Lonsec's qualitative opinion of the risks inherent in the financial product's asset class and the risks relative to other financial products in the relevant Lonsec sector universe.

BIometrics

Aggregate risks

	1	2	3	4	5	6	7
STD RISK MEASURE						●	

A Standard Risk Measure score of 6 equates to a Risk Label of 'High' and an estimated number of negative annual returns over any 20 year period of 4 to less than 6. This is a measure of expected frequency (not magnitude) of capital losses, calculated in accordance with AFSA/FSC guidelines.

Features and benefits

	LOW	MODERATE	HIGH
COMPLEXITY		●	
ESG AWARENESS	●		

We strongly recommend that potential investors read the product disclosure statement or investment statement. Lonsec Research Pty Ltd ABN 11 151 658 561 AFSL No. 421445. This information must be read in conjunction with the warning, disclaimer and disclosure at the end of this document. This report supersedes all prior reports.

ANALYST: STEVEN SWEENEY | APPROVED BY: SHAILESH JAIN

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Fee profile

	LOW	MODERATE	HIGH
FEES VS LONSEC UNIVERSE			●
FEES VS PEER GROUP			●
FEES VS ASSET CLASS		●	

Fee BIometrics are a function of expected total fee as a percentage of expected total return.

What is this Fund?

- The Smallco Investment Fund (the 'Fund') is a concentrated, 'benchmark unaware' Australian equity product with a small capitalisation focus. The Fund has a flexible investment mandate, including the ability to short, gear, have a large weighting to ex-100 stocks and / or high levels of cash. It also has a mild ethical overlay which excludes stocks within the alcohol, armaments, gambling and tobacco sectors. Lonsec notes that the Fund does not have a specific performance objective target.
- The Fund is managed by Smallco Investment Management ('Smallco' or 'the Manager'). Smallco believes they are able to source investment opportunities with above average return potential by conducting rigorous fundamental analysis into company's earnings and cash generation abilities, management quality and industry characteristics. Smallco prefers to use 'bottom up' analysis as opposed to macroeconomic research when sourcing investment ideas and constructing the underlying portfolio.
- The Manager particularly targets companies in the \$100-500m market capitalisation range, believing there are greater inefficiencies in this part of the market. That said, the Fund has the discretion to hold up to 20% of the portfolio in 'top-100' stocks.
- The Fund generally avoids sectors with more cyclical earnings such as retail, building materials and resources. That said, there are occasions where it will make investments in cyclical sectors and stocks based on a 'top-down' view. It also avoids companies with embryonic business models (such as biotechs), believing earnings are too hard to forecast.
- As stipulated in this Fund's mandate it is able to hold up to 50% of all capital in cash. The allocation to cash will be primarily determined by the number of attractive investment opportunities in the investment universe (i.e. limited opportunities would warrant an increased cash weighting). At the time of Lonsec's most recent review this Fund had 24% allocated to cash (30 June, 2016). Lonsec notes this was very similar to cash level at last year's review.
- The Fund has the ability to short stocks, although these positions are expected to be opportunistic rather than a systematic part of the portfolio. The Fund was not shorting any stocks at the time of review, which is similar to last years' review. Although, the Manager did deploy a short on CBG around the timing of the Brexit vote.
- The Manager has the ability to borrow up to 30% of the Fund's Net Asset Value (NAV) via a margin lending facility. Gearing will never exceed 50% of the NAV of the Fund. Lonsec notes that gearing facility has rarely been utilised over the Fund's history, and has mainly been employed to manage the Fund's short exposure.

- The Manager charges a management fee of 1.40% p.a. and an administration fee of 0.25%. In addition, Smallco is entitled to a performance fee, payable six monthly, calculated as '18.64% of the adjusted net asset increase above the previous high water mark'.
- Lonsec supports the concept of performance fees as long as they are appropriately structured. Lonsec considers an appropriate structure to be one where the performance fee is in line with industry standard (in percentage terms), where the fee is subject to an appropriate hurdle rate of return, and where the fee is subject to a prior 'high water mark'.
- In this case, Lonsec notes the lack of any hurdle for payment of the performance fee other than positive absolute performance above the high water mark. Lonsec does not believe this aspect of the structure represents best practice.
- In addition to this Fund, Smallco also manage and distribute the Smallco Broadcap Fund (SBF), an alternate offering whose portfolio manager is Andrew Hokin. Whilst the SBF is managed utilising a consistent investment style to this Fund, it does not have the ability to use leverage nor short securities.

Using this Fund

This is General Advice only and should be read in conjunction with the Disclaimer, Disclosure and Warning on the final page.

- The Fund is subject to equity market risks and movements (both positive and negative) in the prices of the underlying securities in the portfolio. Investors should therefore be aware of / comfortable with the potential for the Fund to experience periods of negative returns which result in capital losses being incurred on their investment. As such, the Fund will generally sit within the growth component of a diversified portfolio.
- Investors should note that this Fund has the ability to gear. Gearing magnifies the positive and negative returns from investments relative to an un-gearred portfolio.
- Advisors should consult the Lonsec Risk Profile Review and / or the Lonsec Risk Profile Definitions document(s) for guidance on appropriate allocations to Australian equities within a diversified portfolio. Lonsec recommends that equity investments are suitable for investors with an investment-time horizon of at least five years.
- In Lonsec's view, the unconstrained nature of this Fund means it is best used as a 'satellite' strategy to complement large cap exposures in client's portfolios, and can be blended with 'benchmark aware' or low relative risk targeted products.

Suggested Lonsec risk profile suitability

SECURE	DEFENSIVE	CONSERVATIVE	BALANCED	GROWTH	HIGH GROWTH
		●	●	●	●

For guidance on appropriate asset allocations and risk profiles, refer to the latest Lonsec Strategic Asset Allocation Review and Risk Profile Definitions on our website.

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Changes Since Previous Lonsec Review

- The firm has continued to grow its funds under management to approximately \$800 million (up from approximately \$540 million at previous review).
- The Manager has soft-closed the Fund as at 1 March 2016. Existing investors can continue to invest but it is closed to new investors. The same arrangement applies to the Smallco Broadcap Fund.
- Bill Ryan has moved to a flexible working arrangement and now works remotely from his home in rural NSW.
- Lonsec has not been advised of any further changes to the investment team or process since the last review of this Fund.

Lonsec Opinion of this Fund

People and resources

- The Smallco investment team consists of five investment professionals, with three of the most senior members of the investment team having previously worked alongside each other at ANZ Securities. While the team tends to adopt a collective decision making philosophy, Rob Hopkins is the portfolio manager of this Fund and ultimately accountable for its performance. Hopkins possesses over 30 years investment experience, and Lonsec considers his investment skill set to be well aligned to Smallco's fundamental bottom up stock selection process.
- Hopkins sits alongside the four remaining members of the investment team, namely Bill Ryan, Andrew Hokin, Craig Miller and Paul Graham. All members of the investment team, with the exception of Miller, focus exclusively on investment related activities. Graham, the most recent hire, worked previously with Hopkins and Ryan at ANZ Securities prior to Smallco's formation. This practice suggests greater likelihood of enhanced team and cultural fit. While on aggregate the size of the investment team appears smaller than some peers, Lonsec judges the scale of resourcing to be appropriate for the investment process.
- Despite the size of the team, Lonsec notes the team benefits from above average depth of investment experience (almost 20 years average). Furthermore, the Manager is not attempting to cover the whole large cap universe and tends to have a meaningful focus on small and mid cap names.
- Smallco also has several part-time resources, covering accounting, compliance, information technology, and database management. Administration of the Fund is outsourced to White Outsourcing, whilst JP Morgan provides custody services. Given the Manager's boutique structure, Lonsec considers this to be a prudent approach that frees up the time of the key investors.
- Lonsec observes a highly performance driven culture at Smallco, one which to date has proven to be conducive to a stable environment with a clear alignment of interests between the investment team and end investors. Hopkins and Ryan remain large equity owners of the business and, pleasingly, equity stakes have been afforded to other investment team members strengthening their engagement with the firm. Additionally, there is a high level of staff co-

investment and a performance fee structure in place. Lonsec is pleased to note that there have been no departures from the investment team since inception (2000).

- Lonsec considers the **key person risk** in co-founders Hopkins and Ryan to be high, given their integral involvement in the Smallco investment process and the broader business. To this end, Lonsec acknowledges the equity ownership structure to be a significant mitigating factor. Similarly, Andrew Hokin's tenure at the Manager and involvement in the process continues to heighten and Lonsec is pleased to observe his growing equity stake in the business. Lonsec would view the departure of these individuals to be a material event, which could be likely to negatively impact the Fund's rating. That said, Lonsec notes the tripartite portfolio manager structure serves to aid key investor continuity.
- Succession planning is a tricky issue for investment firms, particularly, boutique investment firms reliant on one or two founding investment identities. While there is no indication of any key departures, Lonsec believes it is appropriate that the manager continues to make appropriate planning for the ongoing leadership of both the business and key investment strategies. Lonsec will continue to monitor these aspects in future reviews.
- Pleasingly, given the growth in FuM in recent years, the profitability of the firm has continued to improve and at current levels is no longer a concern. Lonsec continues to be impressed with the firm's longevity and commitment to expanding going forward. The firm's retail-only-focus and elevated price point does assist in supporting business health.

Research and portfolio construction

- Lonsec has reviewed the Manager over a number of years and has continued to build its conviction levels in Smallco's 'bottom up' research process over this period. Specifically, Lonsec believes Smallco offer a competitive advantage in researching stocks in the \$100-\$500m market capitalisation bracket, which tend to be less well covered by other market participants. Given this small cap focus, Lonsec notes the Manager subscribes to a long-standing 'quality' investment style, which is quite pervasive across the small cap specialist peer group.
- Lonsec believes Smallco's portfolio construction process to be robust, with a clear link between the team's conviction in each stock, the assessment of its risk, and its weight within the portfolio. The high conviction nature of the investment process means only the Manager's best ideas are included in the portfolio. The portfolio will hold cash if there are not enough strong ideas to fill the portfolio. Lonsec assesses the asset allocation decision between cash and equities to be more 'art than science' in comparison to some multi-asset products which might incorporate some form of systematic determination, such as a valuation trigger.
- Portfolios will tend to be concentrated at stock and sector level, with initial individual stock positions of up to 10% allowed on purchase, up to a limit of 20% based on market movement. That said, Lonsec notes some consideration has been given to diversification, with a requirement the portfolio has exposure to

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a minimum of four Global Industry Classification Standard (GICS) sectors.

- Stocks are sold when they move above the Manager's assessment of intrinsic value, or there is a negative change in the company's fundamentals. Lonsec notes the Manager tends to tolerate holding growth stocks with high valuations if the fundamental growth story is still judged to be a positive. Nonetheless, Lonsec notes the Manager tends to be more pragmatic in reducing stock weights as they approach the investment team's predicted valuation than some of its peers. Additionally, it is more active in selling positions judged to be 'lower quality' and / or positions with more cyclical earnings.
- Whilst the Manager has the flexibility to short sell and gear the Fund, the gearing facility is rarely used and the level of shorting in the context of peers in the sector is relatively marginal. Candidates for shorting are fundamentally driven (i.e. fundamental analysis indicates that the stock is overvalued) and are included only when an identifiable catalyst exists, indicating it is likely to disappoint market expectations in the short term. Lonsec considers this approach to be consistent with its overall investment philosophy. Nevertheless, the shorting aspect of the process is less frequently featured in this Fund than typical long-short competitors. The opportunistic nature of this aspect is evident in the Manager's shorting of CBG with the market turning negative on the stock during the aftermath of Britain's vote to leave the European Union.

Risk management

- Lonsec believes that the Manager has risk controls in place to manage the long and short side of the portfolio. On the short side, a shorting agreement stipulates trading rules, there is a maximum stop loss of 7% for each position, and prior to entering each new short, a trading schedule is prepared detailing the 'sell' and 'buy back' prices for the stock in question. Lonsec considers this to be a prudent discipline.
- On the long side, the Manager assigns a quality score to each stock in the portfolio from which it calculates a weighted average 'quality rating' for the portfolio. The portfolio is required to meet a minimum overall quality rating. Lonsec believes the use of these scores assists the Manager in mitigating unintended risk within the portfolio, making sell decisions, and ensuring the cyclical and exposure to lower quality stocks is controlled.
- The Fund also employs a 25% limit on total exposure to 'lower quality' companies. Smallco has a relatively broad definition of 'low quality', which includes most non-major resource and mining service stocks and others considered to be in weak competitive positions.
- The Fund may be geared up to 30% actively via a margin lending facility. This may passively increase to a maximum of 50%, i.e. this can occur in a situation in which the Fund's equity declines. Gearing is primarily used to manage the portfolio's short exposure. The Manager has historically been relatively conservative in its application of gearing (as well as shorting) and has generally only geared the

portfolio if a distinct opportunity arises. This Fund has not used gearing in the last nine years.

Funds Under Management

- Since Lonsec's most recent review, the Manager has been able to grow its FuM from \$540m to \$800m. Through ongoing consultation with the Manager, Smallco states its capacity will be breached as ex-ASX 100 positions exceed \$300m of its total FUM. Accordingly, the Manager has moved to limit access to this Fund by closing the Fund to new investors as at March 2016.
- Lonsec has pleasingly observed prudent discipline by the Manager historically with respect to FuM capacity management, having previously closed the Fund to investors when capacity was reached. A further testament to this discipline is the target fund size of the Broadcap strategy being determined on the basis of preserving its ability to meaningfully invest in stocks in the <1 billion market cap range. Lonsec supports Smallco's discipline on this aspect which should serve to preserve the appeal of the offer.

Performance

- The objective of the Fund is to generate positive absolute returns over a rolling three year time period. Given the relatively high equity exposure (circa 80%) and the shorting capabilities of the Fund, Lonsec considers this objective to be relatively conservative. Nevertheless, the Fund has been comprehensively able to achieve its stated objective over the assessed period (all figures net of fees to 30 September 2016).
- The Fund returned 18.0% p.a. and 30.0% p.a. over the three and five-year periods respectively, outperforming the Lonsec assigned benchmark, the S&P/ASX 300 Accumulation Index ('the Benchmark') by 12.0% p.a. and 19.0% p.a. respectively. Over this period, the Fund has also outperformed Lonsec's 'Australian Long Short' peer group median by 10.5% p.a. and 17.4% p.a. over its respective three and five-year periods.
- The Fund has also delivered strong returns over the past year, delivering 25.4% to outperform the Benchmark by 11.9%. Key relative contributors over the one-year period were overweight positions in APN Outdoor, Ooh Media and Aconex.
- Despite the Fund's strong positive returns over the longer period, Lonsec notes that the Fund incurred a significant drawdown during the GFC. Lonsec looks favourably on total return type strategies displaying conservative drawdowns, as it tends to be a reflection on manager's commitment to preserving unit holder's capital. Nevertheless, there is much water under the bridge since then and the Manager has not experienced a drawdown anywhere near this magnitude since. Furthermore, Lonsec notes the Manager has improved the robustness of its investment approach and significantly expanded analyst resourcing since then.
- Pleasingly, the Fund has continued to exhibit a higher Information Ratio than Lonsec's 'Australian Long Short' peer median across all assessed periods. Lonsec looks favourably on products generating relatively high information ratios, believing it to be a reflection of manager skill. Overall, the Manager has delivered strong absolute performance outcomes.

Smallco Investment Fund

Overall

- Lonsec has maintained the 'Recommended' rating at this review. The Fund continues to benefit from an experienced investment team applying a high conviction, benchmark unaware philosophy resulting in differentiated small cap exposure versus many competitors. Despite the strong long-term performance, Lonsec notes the fee load remains at the high end compared to peers in this sector.
- Lonsec stresses the suitability of this strategy is limited to investors able to withstand significant 'small cap' exposure, potential gearing, stock concentration and high weightings to cash.

People and Resources

Corporate overview

Smallco Investment Manager (Smallco) commenced operations in October 2000 and has a specialist focus on investing in smaller Australian listed companies. Smallco has approximately \$800m of Funds under Management (FuM) across three strategies: this Fund, a family office mandate, and the "Smallco Broadcap Fund". The Manager was profitable in FY16 and has no debt.

Size and experience

NAME	POSITION	EXPERIENCE INDUSTRY / FIRM
ROB HOPKINS	MANAGING DIRECTOR	31 / 16
BILL RYAN	EXECUTIVE DIRECTOR	21 / 16
ANDREW HOKIN	SENIOR PORTFOLIO MANAGER	22 / 9
PAUL GRAHAM	ASSISTANT PORTFOLIO MANAGER	22 / 2
CRAIG MILLER	BUSINESS MANAGER / ANALYST	11 / 11

The Smallco investment team comprises five investment professionals with an average of 20 years of investment experience. The team is led by Rob Hopkins (Managing Director) and Bill Ryan (Executive Director). Hopkins, who has 30 years of industry experience, previously led small companies research at brokerage firms Macquarie Equities, BT Alex Brown, ANZ Securities, and Macintosh Securities. Ryan, with 20 years of industry experience, previously worked at ANZ Securities.

Hopkins and Ryan co-founded Smallco in April 2000 and own 45.3% and 31.7% of the firm respectively.

Andrew Hokin (Senior Portfolio Manager) has 13% ownership and Craig Miller (Business Manager / Analyst) has a 10% equity stake. The most recent hire, Paul Graham (Assistant Portfolio Manager) has no equity but participates via a profit share agreement.

The Smallco Investment Fund is managed by Hopkins, Ryan and Hokin, while Hokin also manages the Broadcap Fund. Craig Miller is responsible for research and providing support to the portfolio managers. Miller also serves as the firm's day-to-day business manager, allowing Hopkins and Ryan to focus on investment management. Graham contributes research for all products.

Research Approach

Overview

INVESTMENT STYLE	GROWTH-AT-A-REASONABLE-PRICE (GARP)
STOCK UNIVERSE	ASX 500
STOCKS FULLY MODELLED	115
LIQUIDITY	MINIMUM MARKET CAP-\$100M
TOP DOWN	0%
BOTTOM UP	100%
RESEARCH FOCUS	FUNDAMENTAL
QUALITATIVE ANALYSIS	MANAGEMENT QUALITY, COMPETITIVE POSITIONING, RETURN ON FUNDS EMPLOYED (ROFE), EPS GROWTH, CASH GENERATION
KEY RESEARCH INPUTS	MANAGEMENT, COMPETITORS, SUPPLIERS, INDUSTRY ANALYSIS
BROKER RESEARCH	MANAGER RELIANCE LARGELY SKEWED TO INTERNAL RESEARCH. SMALLCO WILL ONLY USE BROKER RESEARCH TO SUPPLEMENT INTERNAL RESEARCH AND ONLY WHEN IT IS CONFIDENT IN THE BROKER ANALYSIS
VALUATION APPROACH	AS APPROPRIATE: P/E, EBIT MULTIPLE, EBITDA MULTIPLE, PRICE TO CASH FLOW MULTIPLE

Stocks are valued using a range of metrics with standard templates used across all sectors.

The Manager filters the investible universe via application of a porter style 'Quality Rating System' with each stock considered achieving a numerical rating (between 0 to 10) based upon both its quality and cyclicity. An overall weighted average rating is produced for the portfolio. The weighted average portfolio rating is not allowed to fall below 4 – what the Manager assesses to be the market average. Additionally, the Manager imposes a 25% limit on exposure to companies rated 3 or less. At the time of review the portfolio weighted average of the Fund was 4.4.

Short side

On the short side, Smallco aims to identify companies that are trading at a significant premium to valuation and that have an identifiable situation that will likely cause the stock to underperform market expectations over the short-term. Given this short-term focus, short positions are usually covered within a six month period. Ideas for the short side generally come from the same target universe as the long side's 'research universe' and may be identified during the process of searching for potential long positions.

The Manager ideally seeks an identifiable trigger when selecting short candidates – ie. companies displaying both poor fundamentals and a perceived overvalued share price versus Smallco's valuation. The Manager adopts a cautious approach with regards to short positions, with hard stop loss limits in place (7% limits).

Portfolio Construction

Overview

FUND BENCHMARK	S&P/ASX 300 ACCUMULATION INDEX
RETURN OBJECTIVE	ABSOLUTE RETURNS
RISK OBJECTIVE	N/A
TYPICAL TURNOVER RANGE	30-40%

Smallco Investment Fund

Portfolio construction is the joint responsibility of Hopkins, Ryan and Hokin, with decision making based on the 'consensus' view amongst the team. The Manager aims to populate the portfolio with 25 to 35 of the most attractive stocks (primarily based on the stock's current discount to valuation) as identified during the research phase, whilst also taking into account the risk guidelines in place.

The Manager is not compelled to short stocks as this is considered to be a more opportunistic source of 'alpha'. Fund performance and positions vis-a-vis its risk parameters are formally considered at the quarterly Board meeting.

Risk Management

Risk limits

SEPARATE RISK MONITORING	NO
STOCK ACTIVE POSITION LIMITS	MAXIMUM OF 10% OF FUND VALUE AT COST, MAXIMUM OF 20% OF FUND VALUE (INCLUDING APPRECIATION)
SECTOR ACTIVE POSITION LIMITS	EXPOSURE TO A MINIMUM OF 4 GICS SECTORS
CASH	MAXIMUM 50%
SHORTS	30% ACTIVE (50% PASSIVE). TYPICALLY <25% WITH HARD STOP LOSS LIMITS
GEARING	30% ACTIVE (50% PASSIVE)

Risk monitoring

Smallco monitors a range of performance statistics, such as attribution of the long side versus the short side, win / loss ratio and absolute return ratio. The diversification and liquidity controls in place are formally monitored on a quarterly basis by the Smallco Board.

Gearing

The Fund may borrow money to increase the Fund's investments. The Fund's gearing will never be more than 50% of the net asset value of the Fund. Under normal circumstances the Fund is expected to be between 80% and 130% invested i.e. between 20% in cash and 30% geared. At 30% geared, this would provide exposure of approximately \$1.30 for every \$1.00 invested in the Fund. Lonsec notes that the Manager has indicated that the gearing facility is only in place to be used opportunistically and that the default position of the Fund is to be ungeared most of the time. The Fund hasn't used this gearing facility since 2006/07. Gearing adds additional risk to an investment; please refer to 'Gearing and Leverage Risk' below.

Risks

An investment in the Fund carries a number of standard investment risks associated with investment markets. These include performance, liquidity, counterparty, market and tax risks. These and other risks are outlined in the PDS and should be read in full and understood by potential investors. Lonsec considers the following to be the major risks:

Equity market

Investments in equity markets are subject to numerous factors which may have an impact on the performance of an investment (both positive and negative). Unexpected changes in economic, technological,

structural, regulatory or political conditions can have an impact on the returns of all investments within a particular market.

Gearing and leverage risk

The Fund may gear up to a maximum of 50% of its net asset value. Gearing adds additional risk to an investment, as it amplifies losses (as well as gains). As such, advisers should ensure that their clients are comfortable with the risks associated with gearing. The Fund is permitted to 'short-sell' stocks (i.e. borrow and sell a stock it does not own) as well enter into cash borrowings. Combined with the ability to gear, the Fund's maximum gross equity market exposure is 200%.

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Quantitative Performance Analysis - annualised after-fee % returns (at 30-9-2016)

Performance metrics

	1 YR		3 YR		5 YR		10 YR	
	FUND	PEER MEDIAN	FUND	PEER MEDIAN	FUND	PEER MEDIAN	FUND	PEER MEDIAN
PERFORMANCE (% PA)	25.38	9.82	17.99	7.42	30.01	12.64	10.95	7.29
STANDARD DEVIATION (% PA)	11.20	11.64	9.53	11.93	10.76	12.29	17.69	14.88
EXCESS RETURN (% PA)	11.88	-3.00	11.95	1.71	18.99	1.54	5.96	2.16
OUTPERFORMANCE RATIO (% PA)	66.67	41.67	58.33	50.00	61.67	53.33	57.50	54.17
WORST DRAWDOWN (%)	-5.56	-7.74	-5.56	-11.09	-5.89	-11.96	-66.63	-42.73
TIME TO RECOVERY (MTHS)	3	NR	3	NR	2	6	47	56
SHARPE RATIO	2.07	0.68	1.63	0.56	2.52	0.85	0.38	0.25
INFORMATION RATIO	1.49	-0.50	1.27	0.37	1.96	0.33	0.55	0.44
TRACKING ERROR (% PA)	7.95	5.68	9.41	5.79	9.71	5.27	10.91	5.29

FUND: SMALLCO INVESTMENT FUND

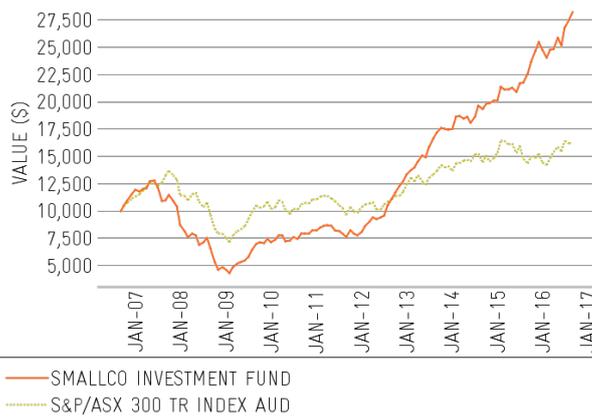
LONSEC PEER GROUP: AUSTRALIAN EQUITIES - AUSTRALIAN LONG SHORT

BENCHMARK USED: S&P/ASX 300 TR INDEX AUD

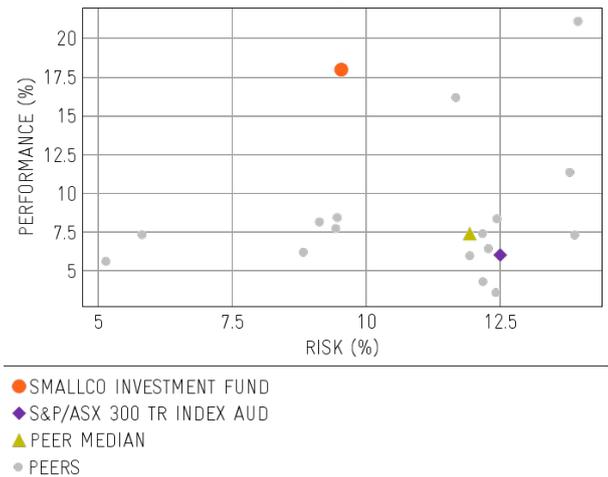
CASH BENCHMARK: BLOOMBERG AUSBOND BANK BILL INDEX AUD

TIME TO RECOVERY: NR - NOT RECOVERED, DASH - NO DRAWDOWN DURING PERIOD

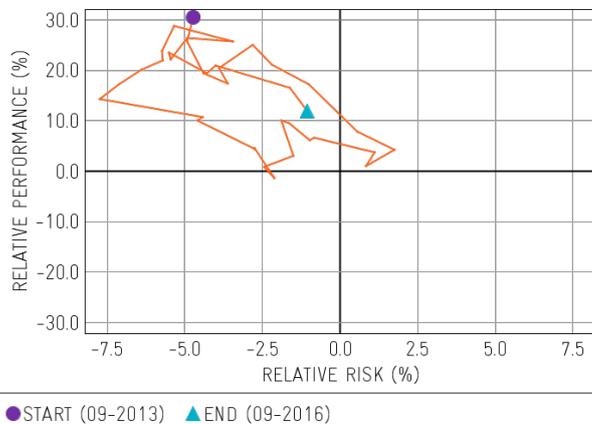
Growth of \$10,000 over 10 years



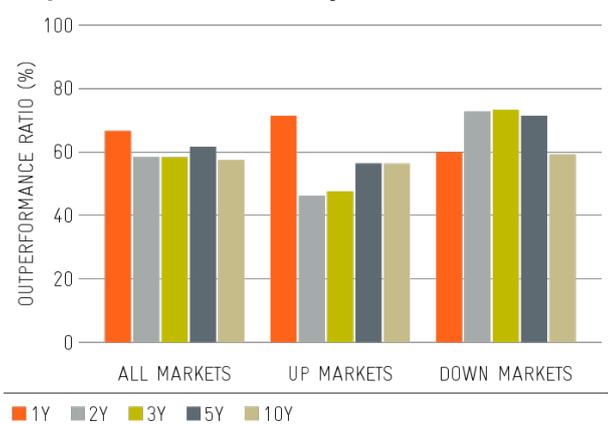
Risk-return chart over three years



Snail trail



Outperformance consistency



ANALYST: STEVEN SWEENEY | APPROVED BY: SHAILESH JAIN

Smallco Investment Fund

Glossary

Total return 'Top line' actual return, after fees
Excess return Return in excess of the benchmark return
Standard deviation Volatility of monthly Absolute Returns
Tracking error Volatility of monthly Excess Returns against the benchmark (the Standard Deviation of monthly Excess Returns)
Sharpe ratio Absolute reward for absolute risk taken (outperformance of the risk free return (Bank Bills) / Standard Deviation)
Information ratio Relative reward for relative risk taken (Excess Returns / Tracking Error)
Worst drawdown The worst cumulative loss ('peak to trough') experienced over the period assessed
Time to recovery The number of months taken to recover the Worst Drawdown
Snail Trail A trailing 12-month relative performance and relative risk measurement over the benchmark. The trail is generated using a 12-month rolling window over the specified period

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