Product Assessment

Smallco Investment Fund

Report data as at 30 Apr 2018
Rating issued on 14 Jun 2018

VIEWPOINT

The Fund, managed by Smallco Investment Manager Limited (Smallco), provides investors with an exposure to a high conviction, long/short portfolio of Australian smaller companies equities. The Fund typically does not invest in stocks from the resources sector, biotechnology sector and other structurally challenged industries. Zenith has a high level of regard for Smallco, given its experienced team of investment professionals and robust investment process.

Smallco is a Sydney based boutique fund manager established in 2000 by Rob Hopkins and Bill Ryan, which specialises in managing Australian equity strategies. As at 30 April 2018, Smallco managed approximately $A 848 million firm wide. In response to the high level of funds under management (FUM), Smallco has hard closed the Fund. Zenith has been aware of Smallco's intentions for capacity management over the past few years as its FUM has grown. As a result, Zenith believes Smallco's decision to hard close the Fund is prudent. Given the strength of the investment team and process, Zenith believes that Smallco can continue to deliver upon its objectives.

The investment team of six is led by Hopkins. Hopkins is supported by five other portfolio managers, Ryan, Andrew Hokin, Paul Graham, Craig Miller and Adam Simpson. Whilst Hopkins is designated as the lead portfolio manager for the Fund, a consensus approach to decision making is employed for the purposes of portfolio construction. All team members hold stock coverage responsibilities, with a number of key sectors allocated across the team. Outside of the key sectors, team members are given the freedom and flexibility to cover any stocks in any sector.

Smallco's investment philosophy centres on the belief that equity markets are inefficient and that rigorous fundamental research can identify opportunities to generate excess returns. Smallco targets quality companies that are likely to exceed consensus earnings expectations or stocks that are out of favour that are expected to at least meet earnings expectations. By targeting these features, Smallco aims to invest in companies it believes will double in value over a three-year investment period.

The portfolio construction process is primarily driven by the fundamental bottom-up analysis conducted by the investment team. Smallco constructs the Fund through a benchmark unaware approach. Portfolio guidelines, stock liquidity and downside risk are considered to avoid unnecessary risks within the process.

Whilst Smallco is permitted to vary the Fund's net equity exposure between 0% to 150%, given the long-biased nature of the Fund, its net equity exposure has typically oscillated around the 80% level. Smallco does not tactically make asset allocation decisions, instead the Fund's net equity exposure is primarily a result of available investment opportunities, both long and short.

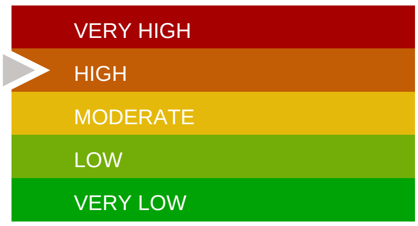
As a relatively concentrated offering, the Fund is likely to exhibit a more volatile performance profile to that of other more diversified Australian equity offerings. Investors should expect greater levels of returns dispersion relative to the benchmark and the potential for significant underperformance over the short-term.

Zenith notes Smallco has continually worked to enhance its investment approach, including for example the introduction of a quality rating system after the Fund experienced a significant drawdown (since fully recovered) post the Global Financial Crisis. Zenith views Smallco's process enhancements favourably.

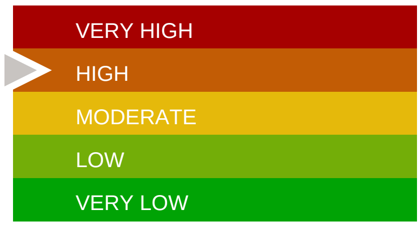
FUND FACTS

- High conviction portfolio holding between 25 and 35 securities
- Portfolio turnover expected to be approximately 40% p.a.
- Long-term net equity exposure of 80%, with short selling only used opportunistically

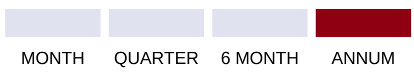
ABSOLUTE RISK (SECTOR)



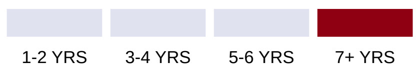
RELATIVE RISK (FUND WITHIN SECTOR)



INCOME DISTRIBUTIONS PER



INVESTMENT TIMEFRAME



APIR Code

ASC0001AU

Asset / Sub-Asset Class

Australian Shares
Long Short

Investment Style

Variable Beta

Investment Objective

To achieve high absolute returns for investors.

Zenith Assigned Benchmark

S&P/ASX Small Ordinaries (Accum)
Bloomberg AusBond Bank Bill Index

Net Returns (% p.a.)

	5 yrs	3 yrs	1 yr
Fund	17.25	14.93	20.65
Benchmark	8.05	11.08	18.45
Median	8.88	6.56	9.18

Income (% p.a.)

	Income	Total
FY to 30 Jun 2017	8.50	9.50
FY to 30 Jun 2016	7.20	20.20
FY to 30 Jun 2015	7.00	15.70

Fees (% p.a., Incl. GST)

Management Cost: 1.55%
Performance Fee: 18.64% of the unit price increase over each 6 month period subject to high water mark

APPLICATIONS OF INVESTMENT

SECTOR CHARACTERISTICS

The Zenith "Australian Shares – Long Short" sector consists of long/short funds investing across the market cap spectrum of the Australian equity market. These funds are able to short sell equities and/or SPI futures to capture excess return opportunities and manage risk. Over the long-term, Zenith expects quality long/short funds to outperform the S&P/ASX 300 Accumulation index given a manager's ability to generate excess returns from short selling.

Each long/short manager uses vastly different investment processes, with some managers being fundamentally driven, others using quantitative tools, while others have trading style biases. Funds in this sector employ active extension or variable beta investment styles. Active extension funds can be used in place of a traditional long only fund where the investor wishes to increase the 'activeness' of their fund allocations in equities. That is, the fund can build a higher conviction portfolio by shorting stocks that it thinks will underperform and use the proceeds to invest long in stocks that may outperform. Variable beta funds can be used by investors to reduce the market risk of investing with a long only fund that must be close to fully invested. Variable beta funds can decrease their market exposures to protect against market falls (by increasing shorts or cash holdings). In general, investing in quality variable beta funds should provide investors 'smoother' returns than simply investing in the index.

Zenith benchmarks all funds in this sector against the S&P/ASX 300 Accumulation Index. However, many managers in this category benchmark their funds against the S&P/ASX 200 Accumulation Index. Both indices are market-capitalisation weighted, resulting in those companies with the largest market capitalisations receiving the heaviest weightings within the index. Over the longer-term, Zenith believes there will be minimal difference between the return profiles of these indices.

The Australian share market, as represented by the S&P/ASX 300 Index, is highly concentrated and narrow. Technically, a company is considered large cap if it falls within the S&P/ASX 50 Index, with companies falling between the S&P/ASX 50 and S&P/ASX 100 considered mid cap. All stocks outside of the S&P/ASX 100 Index are considered small capitalisation stocks.

As at 31 May 2018, the Financials and Resources sectors combined represented a significant portion of the S&P/ASX 300 Accumulation Index, with the Financials sector accounting for approximately 30% of the Index, and Materials approximately 18%. The split between Industrials and Resources stocks was approximately 80%/20%. The top 10 stocks represented approximately 40% of the weighting of the Index, and the top 20 stocks represented over 52% of the Index.

PORTFOLIO APPLICATIONS

In general, compared to most other asset classes, equities offer investors the opportunity for higher capital growth over the longer-term with some income. However, this higher growth is also often associated with higher volatility. Therefore, it is recommended that investors adopt a longer time frame when investing in equities.

Investors should also be cognisant of the fact that the Australian equity market only represents approximately 1% of global equity markets (in terms of market capitalisation). Zenith recommends that investors diversify their investments across asset classes, both domestically and globally.

Unlike a traditional long-only Australian equities fund, the Fund utilises a long/short investment strategy, providing Smallco with greater flexibility to add value for investors. The short selling capability enables the Fund to profit during a market downturn and therefore, potentially offer a different return profile to most long-only Australian equity funds. However, Zenith notes that Smallco has only used the Fund's ability to short sell stocks sparingly.

As a variable beta strategy, the Fund has the ability to hold high levels of cash and conversely exhibit a a low level of net equity exposure, enabling Smallco to potentially protect the portfolio in poor market conditions. Conversely, the Fund may potentially lag long only strategies during strong phases of a bull market rally.

Although Smallco has the ability to alter the net equity exposure over a wide range, Zenith notes that the Fund's net equity exposure will generally be determined as a result of available investment opportunities instead of a tactical asset allocation overlay. The Fund's net equity exposure will typically oscillate around the long-term average of 80%.

The Fund's mandate is broad and includes the ability to gear the portfolio. As a result, it is expected that return dispersion will be relatively pronounced. Investors should also note that the Fund will invest predominantly in small capitalisation companies and will not invest in resource companies. Accordingly, Zenith believes that the Fund may be a suitable as a satellite holding within a well diversified Australian equities portfolio and has the potential to enhance the overall portfolio's risk/return profile.

The Fund applies a negative ethical screen over its investable universe, which is administered internally by the investment team. Smallco will not invest in companies with a principal business interest in the manufacture of alcohol, tobacco products, gambling equipment or facilities or armaments. While Zenith believes the use of the screen is honourable, we note the definitions of the exclusions are at the discretion of Smallco as opposed to an independent external Socially Responsible Investing (SRI) expert.

The Fund's portfolio turnover is expected to be approximately 40% p.a., which Zenith considers to be low. Given this expected level of turnover, the majority of the Fund's returns are expected to be delivered via capital appreciation in the unit price, rather than through the realisation of capital gains in income distributions. In addition, realised capital gains are highly likely to be eligible for the capital gains tax discount. As such, holding all else equal, the Fund may be more appealing to investors who are high marginal tax rate payers as it will result in superior after-tax return outcomes.

RISKS OF THE INVESTMENT

SECTOR RISKS

Funds within the "Australian Long Short" sector are exposed to the following broad risks:

MARKET & ECONOMIC RISK: A risk to the performance of funds in the sector is a sustained downturn across the Australian share market. In addition, changes in economic, social, technological or political conditions, as well as market sentiment could also lead to negative fund performance. This risk can be significantly reduced by investors adhering to the Fund's prescribed investment timeframe.

SPECIFIC SECURITY RISK: This is the risk associated with an individual security. The price of shares in a company may be affected by unexpected changes in that company's operations such as changes in management or the loss of a significant customer.

LIQUIDITY RISK: This is the risk that a security or asset cannot be traded quickly enough, due to insufficient trading volumes in the market. When trading volumes are low, buyers/sellers can significantly impact the price of a security when attempting to quickly enter/exit a material position.

STYLE BIAS RISK: Australian equity managers will either employ a Growth, Value or Neutral (combination of Value & Growth) styled approach to investing. Each style is conducive to certain market conditions i.e. Growth should outperform Value in an upward trending market and vice versa in a downward trending market. As with Market Risk, investors should adhere to the fund's investment timeframe to avoid short-term market movements and style impact.

CAPACITY RISK: High levels of funds under management (FUM) can present additional challenges to an Australian equity manager, as high FUM has the potential to hamper the manager's ability to trade efficiently and/or be forced to disclose substantial shareholdings to the market (most common in smaller companies).

SHORT RISK: Australian long/short funds have the ability to borrow securities and sell them on market (i.e. shorting). Given that such securities will need to be returned to the lender eventually, the short seller may be required to re-purchase the securities on market at a higher price, thereby incurring a loss. Such losses can potentially be unlimited given that there is no theoretical limit on how much the price of a security can rise.

REGULATORY RISK: This is the risk that the value of an investment or effectiveness of the Fund's trading strategy is affected by changes in government regulations and policies. For example, in September 2008, ASIC temporarily banned short selling during the GFC. Should periods of heightened market volatility arise in the future, a short selling ban may be implemented which can potentially impair the investment strategies of Australian long/short funds.

FUND RISKS

Zenith has identified the following key risks of the Company. Although Zenith believes the risks noted are all significant, we have listed them in order of importance. In addition, we have not intended to highlight all possible risks.

KEY PERSON RISK: Zenith views key person risk at Smallco to be moderate to high as per any boutique manager. Zenith views Rob Hopkins, Bill Ryan and Andrew Hokin to be critical members of the investment team and a departure would be a significant loss to the firm resulting in a review of the Fund's rating. However, Zenith acknowledges the material equity stake all three members maintain in the business and we believe that this mitigates the risk of a departure in the medium-term. In addition, Zenith notes that there have not been any departures from the firm since its inception.

CAPACITY RISK: Excessive levels of funds under management (FUM) can inhibit a manager's ability to trade portfolio positions effectively and may therefore limit outperformance potential. As at 30 April 2018, Smallco managed approximately $A 848 million firm wide. In response to the high level of FUM, Smallco hard closed the Fund. Zenith has been aware of Smallco's intentions for capacity management over the past few years as its FUM has grown. As a result, Zenith believes Smallco's decision to hard close the Fund is prudent. Given the strength of the investment team and process, Zenith believes that Smallco can continue to deliver upon its investment objectives.

CONCENTRATION RISK: Zenith notes that the Fund is highly concentrated, holding between 25 and 35 securities. Zenith believes that a concentrated portfolio has greater exposure to stock specific risk than more diversified strategies, and as such investors should be cognisant that the Fund may experience capital volatility in excess of a more diversified strategy.

BUSINESS RISK: Whilst Zenith acknowledges that Smallco is profitable at current levels of FUM, we note that it has a relatively concentrated client base, where a material proportion of firm wide FUM is sourced from a single client. Whilst the loss of this client could materially impact the firm's profitability and longevity, Smallco has noted that, at current FUM levels, they would remain profitable if this did occur.

MARKET RISK: Like most funds in this asset class, one of the key risks to the Fund's performance, is a sustained downturn in the Australian equities market. The Fund's short selling capabilities and ability to hold high levels of cash may potentially provide a greater downside protection in comparison to long-only managers.

LEVERAGE RISK: The Fund has the ability to short sell stocks and use the proceeds to increase its long exposure to stocks. This increases an investor's exposure to Smallco's stock specific decisions and can magnify returns and losses. The maximum gross exposure, namely the sum of the Fund's long and short exposures, is limited to 200% of the value of the Fund's net assets.

Given that the Fund also has the ability to employ explicit leverage, investors should be cognisant of the associated risks. Smallco has the ability to borrow up to 30% of the Fund's Net Asset Value (NAV) and allow the gearing level to passively drift to 50%. Whilst leverage can increase outperformance in upward trending markets, it is likely that negative returns will be amplified in downward trending markets. Zenith notes however that the gearing facility is rarely used, with 2006 being the last instance of gearing being utilised.

COUNTERPARTY RISK: The Fund's custody and counterparty contracts are subject to potential default risk. In particular, the Fund is exposed to counterparty risk with its securities lender, Macquarie Equities. Assets of the Fund are required to be transferred to Macquarie Equities when borrowing stock for short selling. Assets up to the required collateral amount are held on Macquarie Equities' balance sheet and are not segregated from other Macquarie Equities assets. Should Macquarie Equities become insolvent, there is a risk that the assets posted by the Fund may not be recoverable.

QUALITATIVE DUE DILIGENCE

ORGANISATION

Smallco Investment Manager Limited (Smallco) is a Sydney based boutique fund manager established in 2000 by Rob Hopkins and Bill Ryan, which specialises in managing Australian equity strategies. Smallco's boutique structure allows for greater equity participation amongst the broader team. Zenith believes this is a positive as it allows for closer alignment of interests between the investment team and investors in the Fund and also serves as a staff retention mechanism.

Smallco has engaged Link Fund Solutions to managed fund administration, whilst Gateway Financial Marketing is responsible for the provision of retail distribution services. Overall, Zenith believes the outsourcing of such responsibilities enables the investment team to concentrate on excess return generation.

As at 30 April 2018, Smallco managed approximately $A 848 million in FUM on a firm wide basis.

As at the same date, Smallco managed approximately $A 358 million in the Fund.

INVESTMENT PERSONNEL

Name	Title	Tenure
Rob Hopkins	Managing Director/ Portfolio Manager	18 Yr(s)
Bill Ryan	Executive Director / Portfolio Manager	18 Yr(s)
Andrew Hokin	Portfolio Manager	10 Yr(s)
Paul Graham	Portfolio Manager	4 Yr(s)
Craig Miller	Portfolio Manager	13 Yr(s)
Adam Simpson	Portfolio Manager	11 Mth(s)

The investment team consists of six investment professionals and is led by Portfolio Manager and Managing Director Rob Hopkins. Hopkins is supported by five other portfolio managers, Bill Ryan, Andrew Hokin, Paul Graham, Craig Miller and Adam Simpson.

Hopkins has over 30 years of industry experience. Prior to founding Smallco, Hopkins was the Head of Small Companies Research at Macquarie Equities, BT Alex Brown, ANZ Securities and Macintosh. Hopkins also held various roles at other sell-side firms.

Ryan has over 20 years of industry experience. Prior to founding Smallco, Ryan worked together with Hopkins at ANZ Securities for a number of years.

Hokin has over 20 years of industry experience and joined Smallco in July 2007. Prior to joining Smallco, Hokin held a senior position within Macquarie Equities. Zenith believes Hokin has improved the rigour of the investment process since his arrival, whereby a quality rating system was introduced to the security selection process.

Graham joined Smallco in June 2014 and has over 20 years of industry experience. Prior to joining Smallco, Graham held senior positions at a number of prominent sell-side firms such as Nomura, Credit Suisse and Citigroup.

Miller has over 10 years of industry experience and joined Smallco in June 2005. Prior to 2014, Miller was responsible for a significant portion of the firm's business management requirements, which included business development, client servicing and compliance. Since the firm's partnership with Gateway Financial Marketing, Miller has been able to increase his analytical responsibilities and overall contribution to the investment process.

Simpson is the latest addition to the team, having joined Smallco in July 2017. Prior to joining Smallco, Simpson worked at Macquarie for a period of 15 years where he was most recently the Head of Emerging Leaders Research at Macquarie Equities.

All team members hold stock coverage responsibilities, with a number of key sectors allocated across the team. Outside of the key sectors, team members are given the freedom and flexibility to cover any stocks in any sector.

Whilst Hopkins is designated as the lead portfolio manager for the Fund, a consensus approach to decision making is employed for the purposes of portfolio construction, with all team members being involved in the process.

The team has remained stable, with no staff departures since the inception of the firm. Where applicable, each team member is entitled to a profit sharing arrangement that is commensurate with their equity/shadow equity holding, which Zenith believes provides a strong incentive to remain with the firm at least in the medium-term.

Overall, Zenith considers the Fund's investment team to be well experienced and well resourced in the management of Australian equities.

INVESTMENT OBJECTIVE, PHILOSOPHY AND PROCESS

Instead of providing a specific return target or timeframe, the Fund aims to achieve high absolute returns for investors. Smallco seeks to achieve the Fund's investment objective through utilising a relatively concentrated, long/short strategy that is predominantly invested in Australian small capitalisation companies.

Zenith would prefer to see the delineation of a specific outperformance target, as opposed to a descriptive, qualitative objective. Zenith believes this will provide investors with greater transparency with regards to returns expectations and to the level of risk imbedded in the Fund.

Smallco's investment philosophy centres on the belief that equity markets are inefficient and that rigorous fundamental research can identify opportunities to generate excess returns.

At the core of the investment process is the use of fundamental research to identify attractive investment opportunities that are trading at a discount to their intrinsic value.

Smallco targets quality companies that are likely to exceed consensus earnings expectations or stocks that are out of favour that are expected to at least meet earnings expectations. By targeting these features, Smallco aims to invest in companies it believes will double in value over a three-year investment period. The resultant portfolio is expected to exhibit growth characteristics.

Whilst the Fund's investment process is predominantly fundamental and bottom-up in nature, Smallco also seeks to add value via a macroeconomic overlay which is used as a source of idea generation and feedback loop.

SECURITY SELECTION

Smallco focuses its research on stocks with market capitalisations from $100 million to $500 million, as it believes it is a space that is relatively under researched, but possesses sufficient liquidity. Smallco does however also maintain coverage on a selection of larger cap (constituents of the S&P/ASX 100 Index) and micro cap stocks (stocks with a market capitalisation of less than $100 million).

Smallco is generally cautious about investing in stocks with a market capitalisation of less than $100 million, given their higher level of earnings forecast risk and that they often do not have well developed financial discipline and reporting.

Smallco also typically excludes stocks from the resources sector, biotechnology sector and other structurally challenged industries from further due diligence as it believes their earnings are too difficult to forecast with sufficient accuracy.

In addition, Smallco applies a negative ethical screen over the Fund's investable universe. Smallco will not invest in companies with a principal business interest in the manufacture of alcohol, tobacco products, gambling equipment or facilities or armaments.

Smallco seeks to identify quality companies that exhibit the following characteristics:

- Strong cash flow
- High Return on Funds Employed (ROFE)
- Attractive earnings outlook
- Strong competitive advantage
- Strong board and good management

Company visits and meeting with senior management form a key part of the security selection process. The aim of the research process is to produce an internally generated target price that reflects the company's long-term intrinsic value. Target prices are compared against current market prices to determine a stock's level of attractiveness.

Smallco's valuation process incorporates a combination of the following metrics which are based on three year forecasts:

- Price-to-cashflow
- Price-to-earnings ratio (PE Ratio)
- Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA)

In order to aid in idea generation and to serve as a feedback loop, Smallco informally utilises a macroeconomic overlay where an assessment of the economy is made.

A quality rating system is utilised to prevent the portfolio from holding an excessive amount of lower quality stocks. Every stock considered by the investment team is assigned a numerical rating ranging from 0 to 10 based on its quality and cyclicality. The rationale behind the quality rating system, was the significant drawdown experienced by Smallco's flagship long/short Australian equities fund during the 2008-2009 period.

Candidates for the Fund's short positions are a by-product of the idea generation process for long positions. For a stock to be considered as a short selling candidate, it typically needs to fulfil the following criteria:

- Potential return of 20% to 30%
- Operating in a structurally challenged industry
- A catalyst or event (e.g. reporting season) where the company is likely to disappoint relative to market expectations in the short-term

Portfolio holdings and potential candidates for inclusion or short selling are subject to a rigorous peer review process as part of the monthly portfolio review.

Overall, Zenith believes the security selection process adopted by Smallco is sufficiently robust and that the research conducted by the investment team is comprehensive.

PORTFOLIO CONSTRUCTION

The portfolio construction process is primarily driven by the fundamental bottom-up analysis conducted by the investment team. Smallco constructs the Fund through a benchmark unaware approach, with the number of positions and weightings determined by investment opportunities rather than the relative benchmark composition.

The portfolio construction approach allows for the team’s best ideas based on the risk/return profile and the team's conviction level to be represented in the Fund. Portfolio guidelines, stock liquidity and downside risk are considered to avoid unnecessary risks within the process.

The size of an individual position is mainly dependent upon its target price and the quality rating. As a guide, initial position sizes of 3%, 5% or 7% will be implemented based on a combination of these two factors.

The Fund's positions will predominantly be in small cap stocks, with exposures to S&P/ASX 100 stocks limited to 20% of the portfolio. This limit does not apply to small cap positions which have graduated into the S&P/ASX 100 Index due to strong performance.

Short positions are only entered into opportunistically and where they are sufficiently compelling based on the output of the security selection process. Since the Fund's inception, the average level of short selling within the portfolio has been under 10%.

As part of the portfolio construction process, an overall weighted average quality rating is calculated for the portfolio. The weighted average portfolio rating is not permitted to fall below 4, which is what Smallco assesses as the market average. In addition, Smallco employs a separate 25% limit on total exposure to companies rated 3 or less. Zenith believes the presence of the quality rating system promotes portfolio discipline and mitigates the risk of the portfolio being overly exposed to lower quality stocks.

Zenith notes that in 2016 the Fund's investment strategy was changed to allow the portfolio to increase the exposure to illiquid stocks to 30%, which was previously 25%. Smallco defines illiquid holdings as holdings in which they own greater than 75% of the securities average monthly market volume. Given the Fund typically holds a material exposure to small capitalisation securities, Zenith believes the previous limit of 25% was sufficient and more appropriate.

The Fund typically holds between 25 and 35 securities, with portfolio turnover expected to be approximately 40% p.a. The Fund can also hold a maximum of 50% in cash. Zenith believes that actively managed equities funds should remain fully invested and that the asset allocation decision be left to the individual investor.

Portfolio holdings will be sold, reduced or reviewed under the following circumstances:

- Smallco's valuation target has been achieved
- The investment thesis for a stock changes
- Availability of superior investments
- To avert a breach in any of the Fund's portfolio construction constraints

Short positions are subject to stop-loss limits. Whilst Zenith notes that the use of stop-losses promotes sell discipline, it can potentially lead to the portfolio crystallising losses at an inopportune time.

Whilst Smallco is permitted to vary the Fund's net equity exposure between 0% to 150%, given the long-biased nature of the Fund, its net equity exposure has typically oscillated around the 80% level. Smallco does not tactically make asset allocation decisions, instead the Fund's net equity exposure is primarily a result of available investment opportunities, both long and short. Zenith notes that this differs from some of the Fund's peers, where tactical allocations between equities and cash can be made to suit the prevailing market conditions as an additional source of value add.

Smallco also has the ability to employ explicit leverage within the Fund. The portfolio may be geared up to 30% actively and allowed to drift passively to a maximum of 50%. Zenith notes that Smallco has been relatively conservative in its application of gearing which has not been used since 2006.

Zenith is comfortable with Smallco's portfolio construction approach which ensures a strong connection between the output of their security selection process and the resultant weight of the stock in the portfolio. However, we note that the Fund is long-biased in nature and that its typical net equity exposure is not expected to deviate materially from its long-term average.

RISK MANAGEMENT

Portfolio Constraints	Description
Security Numbers	25 to 35
Weight - Holding Rel. Portfolio (%)	max: 20% maximum 10% at time of purchase
Short Positions (%)	max: 30% allowed to drift passively to 50%
Minimum GICS Sector Exposures	required to hold stocks across at least 4 GICS sectors
Exposure to Illiquid Stocks (%)	max: 30%
S&P/ASX 100 Exposure (%)	max: 20%
Stop loss - Hard (%)	max: 7% typically covered at 2%
Leverage (%)	max: 30% allowed to drift passively to 50%
Cash (%)	0% to 50%
Expected Portfolio Turnover (%)	40% p.a.

The Fund's formal risk management constraints, as outlined above, are broad and provide Smallco with a significant amount of scope to achieve its investment objective.

Investors should be aware of the concentrated nature of the Fund and relatively generous limit relating to maximum individual security weights. Given the Fund is invested predominantly in small capitalisation securities, Zenith believes a more conservative position limit should be in place.

Smallco defines illiquid holdings as holdings in which they own greater than 75% of the securities average monthly market volume. Zenith believes that Smallco's assessment of stock liquidity is not as conservative as peers. Investors should be aware that during a significant market event the liquidity profile of the overall portfolio could be low, leading to potential capital impairment.

Smallco's detailed bottom-up approach to stock selection, including the quality rating system, acts as the main tool for mitigating the risk of poor stock selection.

Stop-losses are applied at the individual stock level. A hard limit is applied where the loss from an individual short position equates to 7% of the portfolio. Whilst Zenith believes this limit is too broad and potentially exposes the Fund to an excessive loss from a single position, we note that loss making short positions are typically removed at the 2% level.

Formal internal meetings occur on a monthly basis to monitor the portfolio's characteristics, exposures and market events. However, given the flat investment team structure, Zenith notes that communication amongst the team occurs on an ongoing basis.

Notwithstanding the issues noted above, Zenith believes Smallco's risk management processes are adequate, particularly given the detailed due diligence conducted as part of the security selection process. However, investors should be aware there is significant reliance on management judgement and skill.

ADMINISTRATION AND OPERATIONS

Operations

The Compliance Committee is responsible for the operational risk framework.

Service Providers

Securities Lender

Macquarie Equities

Administrator

Link Fund Solutions

Custodian

JP Morgan

Auditors

Crowe Horwath

Pricing

The Fund's assets and liabilities are usually valued each NSW business day. Generally, listed securities are valued using the last available market close price quoted on the relevant exchange. Other assets are valued at their recoverable value with liabilities valued at cost.

Personal trading

Personal trading is allowed, however, prior approval must be gained from the principals.

Compliance

Smallco holds an Australian Financial Services Licence (AFSL). Smallco has lodged the Fund's compliance plan with ASIC and established a compliance committee with a majority of external members.

INVESTMENT FEES

The Sector average management cost (in the table below) is based on the average management cost of all flagship Australian Shares - Long Short funds surveyed by Zenith.

A management cost of 1.55% p.a. (including expense recoveries) applies to this Fund. The Fund also has a performance fee of 18.64%, payable on any increase in the net asset value of the Fund, subject to the recoupment of all prior negative performance. The performance fee is calculated and paid semi-annually.

Zenith believes the performance fee for the Fund is poorly structured due to the lack of an appropriate benchmark. Given the Fund will typically exhibit equity like risk/return characteristics, an appropriate benchmark is required to ensure that any performance fees payable are justified. As it currently stands, Zenith believes that the hurdle applied to the performance fee is too low and not commensurate with the Fund's risk profile.

Overall, Zenith believes the Fund's fee structure to be expensive, relative to peers, given its stated objectives. However, we believe the fees paid over the past three years (ending 30 June 2017) are attractive given the Fund's risk adjusted performance over the same period.

There is also a buy/sell spread of 0.45% charged on Fund entry and exit. Zenith believes the buy/sell spread is high on an absolute and relative basis, and therefore, we believe there is scope for this to be reduced.

(The fees mentioned above are reflective of the flagship version only, fees may differ when the product is accessed through an alternative investment vehicle such as platform).

Fees Type	Fund	Sector Average (Wholesale Funds)
Management Cost	1.55% p.a.	1.11% p.a.
	Description	
Performance Fee	18.64% of the unit price increase over each 6 month period subject to high water mark	
	Buy Spread	Sell Spread
Buy / Sell Spread	0.45%	0.45%

PERFORMANCE ANALYSIS

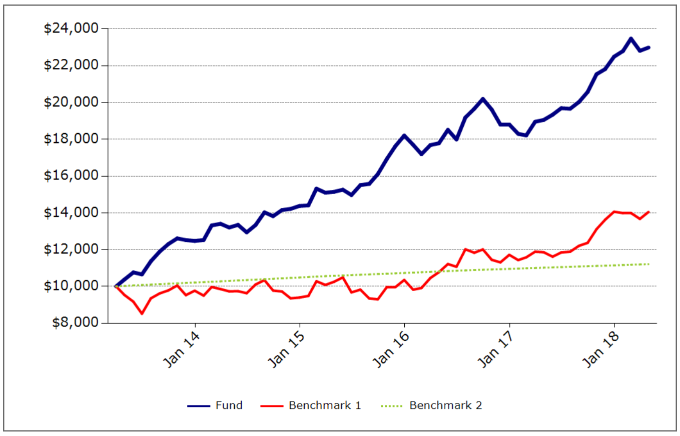
Report data: 30 Apr 2018, product inception: Jan 2001

Monthly Performance History (%, net of fees)

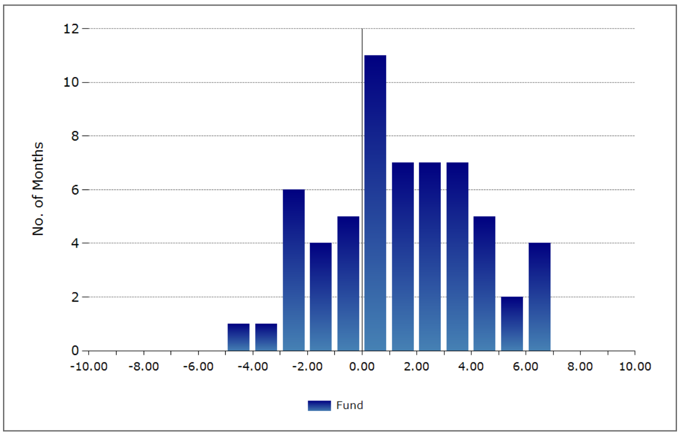
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	FUND YTD	BM1 YTD	BM2 YTD
2018	1.36	2.97	-2.82	0.77									2.21	-0.11	0.59
2017	-2.70	-0.48	4.08	0.53	1.49	1.83	-0.15	1.88	2.71	4.69	1.29	3.09	19.60	20.02	1.75
2016	-2.77	-2.87	2.88	0.56	4.09	-2.82	6.64	2.48	2.71	-2.88	-4.14	0.03	3.31	13.19	2.07
2015	0.22	6.31	-1.44	0.31	0.76	-1.90	3.59	0.45	3.42	5.04	4.17	3.27	26.62	10.16	2.33
2014	0.41	6.33	0.67	-1.51	1.08	-3.04	3.09	5.17	-1.50	2.41	0.45	1.12	15.26	-3.80	2.69

Benchmark 1: S&P/ASX Small Ordinaries (Accum), Benchmark 2: Bloomberg AusBond Bank Bill Index

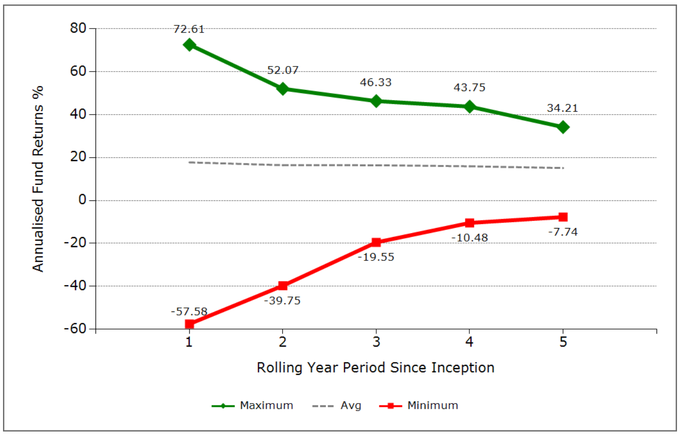
Growth of $10,000



Monthly Histogram



Minimum and Maximum Returns (% p.a.)



ABSOLUTE PERFORMANCE ANALYSIS

Return	Incpt.	5 yr	3 yr	1 yr
Fund (% p.a.)	14.53	17.25	14.93	20.65
Benchmark 1 (% p.a.)	6.33	8.05	11.08	18.45
Benchmark 2 (% p.a.)	4.37	2.26	1.96	1.75
Median (% p.a.)	10.42	8.88	6.56	9.18
Ranking within Sector	**Incpt.**	**5 yr**	**3 yr**	**1 yr**
Fund Ranking	1 / 5	2 / 18	2 / 21	3 / 25
Quartile	1st	1st	1st	1st
Standard Deviation	**Incpt.**	**5 yr**	**3 yr**	**1 yr**
Fund (% p.a.)	16.82	9.34	9.24	6.20
Benchmark 1 (% p.a.)	16.89	12.95	12.02	8.19
Median (% p.a.)	11.81	10.92	10.99	7.50
Downside Deviation	**Incpt.**	**5 yr**	**3 yr**	**1 yr**
Fund (% p.a.)	10.32	3.68	4.20	2.69
Benchmark 1 (% p.a.)	10.93	6.76	6.34	2.78
Median (% p.a.)	6.25	5.91	5.90	3.62
Risk/Return	**Incpt.**	**5 yr**	**3 yr**	**1 yr**
Sharpe Ratio - Fund	0.60	1.60	1.40	3.05
Sortino Ratio - Fund	0.98	4.08	3.08	7.02

The commentary below is as at 30 April 2018.

Instead of providing a specific return target or timeframe, the Fund aims to achieve high absolute returns for investors.

Zenith would prefer to see the delineation of a specific outperformance target, as opposed to a descriptive, qualitative objective. Zenith believes this will provide investors with greater transparency with regards to returns expectations and to the level of risk imbedded in the Fund.

The Fund has generated strong absolute returns over all periods under assessment. Zenith notes that the Fund has demonstrated material outperformance relative to the benchmark and the median manager over all periods under assessment.

The Fund has also produced investment returns with an absolute volatility (as measured by Standard Deviation) that is generally below the benchmark over all periods of assessment.

The Fund has achieved strong Sharpe and Sortino ratios over longer periods of assessment, representing solid risk/return characteristics.

RELATIVE PERFORMANCE ANALYSIS

Alpha Statistics	Incpt.	5 yr	3 yr	1 yr
Excess Return (% p.a.)	8.19	9.19	3.85	2.20
% Monthly Excess (All Mkts)	58.17	50.00	41.67	33.33
% Monthly Excess (Up Mkts)	49.61	33.33	26.09	22.22
% Monthly Excess (Down Mkts)	72.15	75.00	69.23	66.67
Beta Statistics	**Incpt.**	**5 yr**	**3 yr**	**1 yr**
Beta	0.75	0.50	0.53	0.49
R-Squared	0.57	0.49	0.47	0.41
Tracking Error (% p.a.)	11.86	9.28	8.80	6.35
Correlation	0.75	0.70	0.69	0.64
Risk/Return	**Incpt.**	**5 yr**	**3 yr**	**1 yr**
Information Ratio	0.69	0.99	0.44	0.35

The commentary below is as at 30 April 2018.

Zenith seeks to identify funds that can outperform in over 50% of months in all market conditions, as we believe this represents consistency of manager skill. The Fund has only been able to achieve this outcome over the long-term.

The Fund has displayed a significantly stronger consistency of outperformance during falling market conditions.

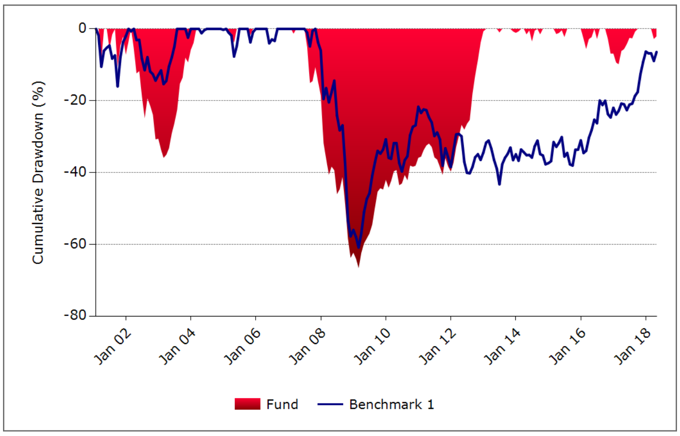
Zenith notes that the Fund has exhibited a beta, or sensitivity, to the market of less than 1, which indicates that the Fund is less sensitive to movements in the S&P/ASX Small Ordinaries Accumulation Index than most traditional long-only investments. This is not unexpected given the Fund's net equity exposure has typically been less than 100% over the long-term.

DRAWDOWN ANALYSIS

Drawdown analysis assesses the relative riskiness of a Fund versus the benchmark, in reference to capital preservation. The maximum Drawdown is recorded as the percentage decline in the value of a portfolio from peak to trough (before a new peak is achieved). All Drawdown analysis is calculated commencing from the inception date of the Fund in question, and Drawdown analysis for the Fund and benchmark(s) are calculated independently. That is, the largest drawdown for the Fund and benchmark(s) will not always refer to the same time period.

Drawdown Analysis	Fund	Benchmark 1
Max Drawdown (%)	-66.64	-60.87
Months in Max Drawdown	20	16
Months to Recover	47	-

Worst Drawdowns	Fund	Benchmark 1
1	-66.64	-60.87
2	-35.91	-16.03
3	-10.58	-15.38
4	-9.82	-7.70
5	-8.70	-4.88



The commentary below is as at 30 April 2018.

The Fund experienced drawdowns that were greater than those of the benchmark in 2002 and 2008. The Fund has subsequently recovered from its maximum drawdown whereas the benchmark has not.

The drawdowns also occurred prior to the introduction of the quality rating system in July 2008, which seeks to prevent the portfolio from holding an excessive number of lower quality stocks. Zenith notes that the Fund has not experienced a material drawdown since.

INCOME/GROWTH ANALYSIS

Income / Growth Returns	Income	Growth	Total
FY to 30 Jun 2017	8.50%	1.00%	9.50%
FY to 30 Jun 2016	7.20%	13.00%	20.20%
FY to 30 Jun 2015	7.00%	8.70%	15.70%
FY to 30 Jun 2014	0.90%	20.50%	21.40%
FY to 30 Jun 2013	1.12%	56.86%	57.98%
FY to 30 Jun 2012	1.39%	13.15%	14.54%

The Fund does not target specific income levels.

Where applicable, distributions are paid annually.

The Fund's portfolio turnover is expected to be approximately 40% p.a., which Zenith considers to be low. Given this expected level of turnover, the majority of the Fund's returns are expected to be delivered via capital appreciation in the unit price, rather than through the realisation of capital gains in income distributions. In addition, realised capital gains are highly likely to be eligible for the capital gains tax discount. As such, holding all else equal, the Fund may be more appealing to investors who are high marginal tax rate payers as it will result in superior after-tax return outcomes.

REPORT CERTIFICATION

Date of issue: 14 Jun 2018

Role	Analyst	Title
Author	Thushani De Silva	Investment Analyst
Sector Lead	Jacob Smart	Investment Analyst
Authoriser	Jacob Smart	Investment Analyst

RATING HISTORY

As At	Rating
14 Jun 2018	Recommended
31 May 2017	Recommended
9 Jan 2017	Recommended
21 Jun 2016	Recommended
12 Jan 2016	Recommended
2 Jul 2015	Recommended
2 Jul 2014	Approved
Last 5 years only displayed. Longer histories available on request.	

DISCLAIMER AND DISCLOSURE

Zenith Investment Partners (ABN 27 103 132 672) is the holder of Australian Financial Services Licence 226872 and is authorised to provide general financial product advice. This Product Assessment Report (report) has been prepared by Zenith exclusively for Zenith clients and should not be relied on by any other person. Any advice or rating contained in this report is limited to General Advice for Wholesale clients only, based solely on the assessment of the investment merits of the financial product. This report is current as at the date of issue until it is updated, replaced or withdrawn and is subject to change at any time without notice in line with Zenith's regulatory guidelines. Zenith clients are advised to check the currency of reports and ratings via Zenith's website for updates. Any advice contained in this report has been prepared without taking into account the objectives, financial situation or needs of any specific person who may read it. It is not a specific recommendation to purchase, sell or hold the relevant product(s). Investors should seek their own independent financial advice, obtain a copy of, and consider any relevant PDS or offer document and consider the appropriateness of this advice in light of their own objectives prior to making any investment decision. Zenith charges an upfront flat fee to the Product Issuer, Fund Manager or other related party to produce research on funds that conform to Zeniths Research Methodology. Zenith's fee and Analyst remuneration are not linked to the rating outcome in any way. Views expressed in Zenith reports accurately reflect the personal, professional, reasonable opinion of the Analyst who has prepared the report. Zenith may also receive a fee for other non-research related services such as subscription fees for Zenith's research services and/or for the provision of investment consultancy services. Conflicts management arrangements are in place where Zenith provides research services to financial advisory businesses who provide financial planning services to investors and are also associated entities of the product issuers, with any such conflicts of interest disclosed within reports as appropriate. Full details regarding such arrangements are outlined in Zenith's Conflicts of Interest Policy
www.zenithpartners.com.au/ConflictsOfInterestPolicy

Zenith's research process seeks to identify investment managers considered to be the 'best of breed' through a comprehensive, multi-dimensional selection process. Zenith utilises both quantitative and qualitative factors in its ratings models. Models maximise commonality across different asset classes while retaining flexibility for specialist asset classes and strategies. The selection process is rigorous in both its qualitative and quantitative analysis and each component is equally weighted. Zenith does not manage any proprietary assets and as such Zenith is able to choose investment managers with absolute independence and objectivity. More detailed information regarding Zenith's research process, coverage and ratings is available on Zenith's website
www.zenithpartners.com.au/ResearchMethodology

 The information contained in this report has been prepared in good faith and is believed to be reliable at the time it was prepared, however, no representation, warranty or undertaking is given or made in relation to the accuracy or completeness of the information presented in this report. Except for any liability which cannot be excluded, Zenith does not accept any liability, whether direct or indirect arising from the use of information contained in this report. Past performance is not an indication of future performance.

Full details regarding the methodology, ratings definitions and regulatory compliance are available at
www.zenithpartners.com.au/RegulatoryGuidelines

Zenith has charged Smallco Investment Manager a fee to produce this report.