FUNDS MANAGEMENT

OC Premium Small Companies Fund

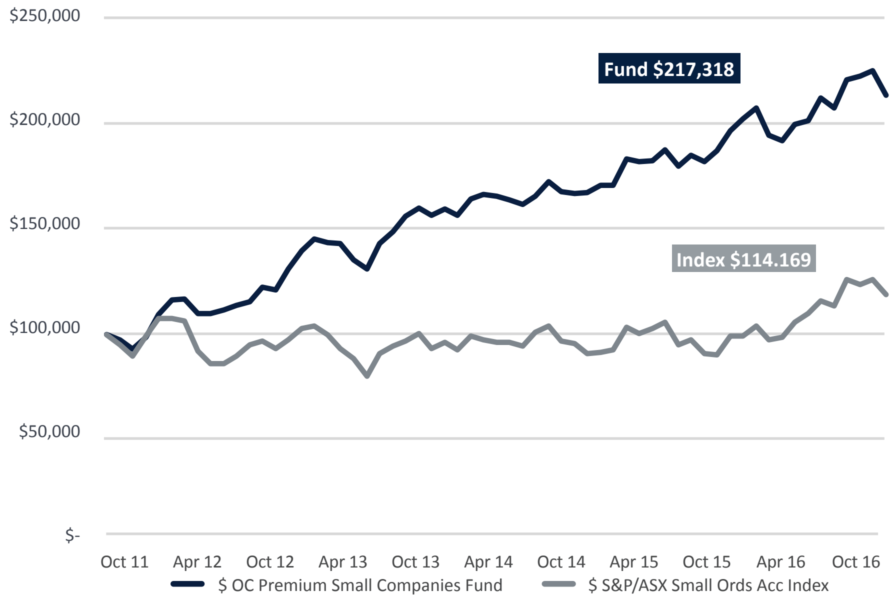
Fund Update | 31 October 2016

-5.4% Fund down 5.4% for October

10.4% Returned 10.4% p.a. for the past three years

We remain cautiously optimistic the Fund is well positioned

Performance comparison of $100,000 over 5 years*



Total returns

At 31 October 2016	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 Premium	-5.4	-3.5	8.7	10.4	16.9	13.8	4.8	11.4
S&P/ASX Small Ords Accum	-4.7	-4.8	14.9	4.4	2.7	2.2	0.3	5.4
Outperformance	**-0.7**	**1.3**	**-6.2**	**5.9**	**14.2**	**11.6**	**4.5**	**6.0**
S&P/ASX Small Ind Accum	-5.3	-5.1	9.3	6.4	11.0	7.3	2.4	5.9
Outperformance	**-0.1**	**1.6**	**-0.6**	**4.0**	**5.9**	**6.5**	**2.4**	**5.5**

Performance review

Global and local markets have been in 'risk-off' mode in the run-up to the US Presidential election and OC was not immune to the sell-off with the OC Premium Small Companies Fund finishing the month down 5.4%. The Fund finished the month slightly behind both the S&P/ASX Small Ordinaries Accumulation Index and the S&P/ASX Small Industrials Index which returned -4.7% and -5.3%, respectively, and was weighed on by some stock-specific news discussed below. The Fund has an excellent long-term track record having returned +16.9% p.a. over the past five years. This is well ahead of both the S&P/ASX Small Ordinaries Accumulation Index and the S&P/ASX Small Industrials Index which have returned +2.7% and +11.0%, respectively, over the same time horizon.

Ardent Leisure (AAD, -27.1%) – was severely impacted by a tragic incident at its Dreamworld theme park on the Gold Coast. The incident in late October claimed the lives of four customers and Dreamworld has remained closed pending investigations by relevant authorities. It is regrettable that a Fund holding has been involved in such as heart-breaking event and there remain several unknowns about the incident. The share price reaction has been severe given the Theme Parks division represents less than 25% of group earnings in FY 2017, but is perhaps understandable in light of the tragic event and the ongoing uncertainty about AAD's level of culpability. Ironically, AAD's new Managing Director, Deborah Thomas, was just starting to earn her stripes with the investment community following a challenging 12-18 months, bolstered by the disposal of the Good Life Health Clubs business for a credible price and the Marinas sale entering the "final stages of negotiations with a suitable purchaser". These two disposals would leave AAD well capitalised to focus on the growth of the Main Event Entertainment business, one of the fastest growing bowling anchored entertainment destinations in the US, which we believe will be the mainstay of AAD for many years to come. We will follow developments around Dreamworld closely, but believe the stock has been oversold.

Healthscope (HSO, -28.0%) – issued an operational earnings downgrade during the month and we have exited our position in the stock. HSO tempered earnings expectations saying it had experienced slower-than-expected revenue growth in its hospitals in the first quarter and raised concerns around private health insurance affordability as an underlying driver of volume weakness. The quantum of the slow-down surprised us and we have sold our position.

Bapcor (BAP, -15.3%) – announced a capital raising in late September to fund the potential all-cash takeover of NZ-listed business, Hellaby Holdings. Hellaby has automotive distribution and wholesaling operations in Australia and NZ that represent a highly complementary fit to BAP's existing trade-focused distribution business. The proposed transaction will also enable BAP to enter the NZ automotive parts market and use its scale and proven industry expertise to improve the service and range of products offered. While we also view the transaction as complementary and a sound strategic expansion of BAP's footprint, the market sold the stock down below the raising price probably due to a combination of the general stock market downdraft we experienced during October and on concerns the transaction may not complete, leaving BAP overcapitalised with a 'lazy' balance sheet. Subject to the deal completing (we will know by December), it will be earnings-per-share accretive for BAP shareholders and could drive significant growth in the medium term. We have used the recent share price weakness to increase our position in the company.

Mineral Resources (MIN, +4.5%) – as we have written previously, MIN remains an outstanding and conservatively run mining services business that offers investors exposure to several different commodities, predominantly iron ore, lithium, manganese and gold. MIN's main business is to provide pit-to-port solutions across the mining infrastructure supply chain including mining, crushing, processing and materials handling and its client list reads like a 'who's who' of global majors including Rio Tinto, BHP, Newmont and Barrick. In a period, such as now, where we are seeing strong iron ore price appreciation (+21.3% during October) and strong sentiment toward lithium, MIN can deliver extra value for shareholders on top of its core mining services business. Given the strong iron ore price, our internal forecasts are well above the company's earnings guidance and market consensus expectations and we would not be surprised to see earnings guidance upgraded at the upcoming AGM.

Ainsworth Game Technology (AGI) – was added to the portfolio during late October when the company provided a trading update significantly below market expectations and the share price came back to an attractive entry point. AGI is engaged in the design, development, manufacture, sale and servicing of gaming equipment through direct sales and distributors in Australia, the US, South America, NZ, Asia and Europe. Founder Len Ainsworth recently sold his +50% stake in the business to European trade buyer, Novomatic AG, at a significant premium to where the stock is currently trading. While regulatory approvals will take time (US approvals are expected in 2017), we expect Novomatic to be able to drive significant synergies in the business over the medium to long term and provide strong cross-sell opportunities, particularly in the US and Europe. We expect H1 FY16 to be a cyclical low point for AGI with the H2 benefiting from higher Australian unit sales driven by new product releases, US growth continuing its solid trajectory and the initial delivery of synergies from Novomatic.

Outlook

The sell-off in the Australian share market in October was largely due to events across the Pacific with rising bond yields in the US and election uncertainty ahead of the November 8 Presidential election weighing heavily on our market. The victory by polarising Republican candidate Donald Trump caught the market by surprise leading to significant volatility in equity markets. Trump's economic policies have been somewhat vague and, at times, contradictory during election campaigning. But in the near term, we believe our portfolio is well positioned to perform strongly given his policies are overall supportive of markets and our current sector tilts and exposures.

In the US Congress, Republicans now control both the House of Representatives and the Senate, resulting in rare single-party control. Despite this, the election of a candidate that many senior members of the party failed to endorse means division within the ranks of the Republican Party may make implementing policy change more difficult than it would appear on face value.

To assess what a Republican Trump government with control of both houses of Congress means for our portfolio, we must first look at his key economic policies. To date, these include:

- Expansionary fiscal policy - corporate and personal tax cuts have been promised which ought to be stimulatory. Tax cuts typically get spent rather than saved which is a positive for business investment, labour and ultimately US consumption.
- Infrastructure spending – "We are going to fix our inner cities and rebuild our highways, bridges, tunnels, airports, schools, hospitals," Trump said. "We're going to rebuild our infrastructure, which will become, by the way, second to none. And we will put millions of our people to work as we rebuild it". This is obviously great for investment and employment growth, although details on specifics remain scant.
- Trade – Trump has promised to end "unfair trade policies". He is likely to re-evaluate trade agreements

(Trans-Pacific Partnership is unlikely to be advanced and North American Free Trade Agreement renegotiated) and toughen the US's stance on Chinese and Mexican imports, among others. Overall, these protectionist trade policies could lead to a US-led trade war which could have significant negative implications for global growth.
- Healthcare reform – Trump has promised to make sweeping changes to the 'Affordable Care Act' (Obamacare) to relieve the American people of the "tremendous economic burden". Details remain fluid with Trump softening his stance on a promised total repeal of Obamacare in recent days, post meeting with President Obama at the White House.

Overall, the policies laid down by Trump are market friendly and ought to be supportive on growth in the US economy. From the perspective of the OC portfolio, we have several companies that may be direct beneficiaries of an increase in US infrastructure spending namely **Aconex**, **WorleyParsons** and **Netcomm Wireless**. Others such as **Ardent Leisure** and **Servcorp** would benefit from the improved consumer and business spending environment which several proposed policies seem to imply.

On balance, Trump's economic policies look to be inflationary and this has had a dramatic impact on global bond markets over the past week. Yields on US 30-year bonds, which are more sensitive than shorter maturities to the outlook for inflation, jumped the most this week since January 2009. With the US economic recovery seemingly on track, it seems likely the US Federal Reserve will raise interest rates sooner rather than later, with a December rate increase a real possibility.

The portfolio is likely to be a relative beneficiary of rising US rates as we remain underweight interest-rate sensitive sectors such as REITs and Utilities. We are also heavily underweight in the gold sector which has been sold off heavily since the election as bond yields rise.

Base metals, bulk commodities (iron ore and coal) and oil have all rallied on the back of Trump's pro-growth strategies and as markets overall become more optimistic. While we only have limited direct exposure to these commodities in our portfolio, we do have several core positions that will benefit from strength in them including **Mineral Resources**, **WorleyParsons** and **Speedcast**.

Given the lack of political experience of the President-elect and his sometimes ambiguous and often contradictory proposals on the campaign trail, there remains a significant amount of uncertainty which will likely lead to heightened volatility in markets in the coming weeks. Over the next six weeks, Trump's key political appointments will be watched carefully because they will show whether he can create some unity across the country and whether he has a team capable of delivering on his lofty ideas. To date, we have seen a far more pragmatic and conciliatory side to the President-elect who has even gone so far as to be generous in his praise of Hillary Clinton and deeply respectful of President Obama whom he has said he intends to use as counsel.

The market has thus far focused on the elements of a Trump presidency that bodes well for economic growth, like tax reform and infrastructure spend, as opposed to dwelling on potentially detrimental outcomes such as trade wars or protectionism and limits on immigration. The next few weeks will give us greater clarity as policies are fleshed out and as senior advisors are appointed. For now, we remain cautiously optimistic the Fund is well positioned to perform strongly during the first phase of a Trump presidency.

Top 5 holdings#

Company	ASX code
Bapcor Ltd	BAP
Mineral Resources Ltd	MIN
QMS Media Limited	QMS
Vocus Communications Limited	VOC
Webjet Limited	WEB

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* The performance comparison of $100,000 over 5 years is for illustrative purposes only. All returns shown are based on Australian dollar figures. Past performance is not a reliable indicator of future performance. The total returns shown are prepared on an ongoing basis (i.e. they include all ongoing fees and expenses and assume reinvestment of all distributions). They do not take personal taxation into account. The comparison with the S&P/ASX Small Ordinaries Accumulation Index is for comparative purposes only. Index returns do not allow for transactional, management, operational or tax costs. An index is not managed and investors cannot invest directly in an index. There is no guarantee these objectives will be met.

The top 5 portfolio holdings are in alphabetical order and may not be representative of current or future investments. The securities listed may not represent all of the portfolio's holdings and may represent only a small percentage of the strategy's portfolio holdings. Future portfolio holdings may not be profitable.