Bennelong Avoca Emerging Leaders Fund

Monthly performance update

As at 31 January 2019

At a glance

Feature	Fund fact
APIR code	BFL0008AU
Benchmark	S&P/ASX Small Ordinaries Accumulation Index
Investment objective	3-5% p.a. above benchmark measured over rolling 5-year periods
Portfolio managers	Jeremy Bendeich/John Campbell
Stock number	29
Fund size	$9.23m
Active stock limit	± 8%
Cash limit	0-10%
Inception date	1 July 2011
Recommended investment period	Long term (five years plus)
Minimum investment	$20,000
Buy/sell spread	+/-0.30%
Entry/exit fees	Nil
Management fee	1.25% p.a. (including GST net of reduced input tax credits) of Net Asset Value of the Fund
Performance fee	17.5% (including GST net of reduced input tax credits) of any amount by which the Fund's investment return (before fees and expenses) is more than 1.25% p.a. greater than the return generated by the S&P/ASX Small Ordinaries Accumulation Index

Performance in review

The S&P/ASX Small Ords Accum. Index (XSOAI) posted a +5.6% return in January 2019 compared to the S&P/ASX 100 Accumulation Index (XTOAI) at +3.7%. XSOAI underperformed XTOAI by -4.7% over the past year and outperformed by +1.4% p.a. over the past three years.

The top five performers in XSOAI in January were Nearmap +41.3%, Integrated Research +38.2%, Beach Energy +33.8%, Sundance Energy +33.3% and Healius +30.5%. The bottom five performers in XSOAI in January were Navigator Global -28.1%, Costa Group -25.5%, Metals X -16.5%, FAR -13.4% and New Century Resources -12.1%.

The Small Resources Accum. Index (XSRAI) rose +8.1% in January vs the Small Industrials Accum. Index (XSIAI) at +4.9%. XSRAI underperformed XSIAI by -6.8% in the year but outperformed by +19.6% p.a. in the three years to 31 January 2019.

Global equities rebounded sharply in January. The MSCI World ex-Aust (loc) rose +7.3%, S&P 500 +8.0%, NASDAQ +9.8%, FTSE 100 +3.6%, German DAX +5.8%, French CAC +5.6%, the Nikkei +3.8% and the Shanghai Composite +3.8%.

Global bonds generally saw further declines in yields with US 10 years down -5bp, UK 10 years -5bp, German 10 years -9bp, JGBs flat and Australian 10 years -9bp.

Pre-reporting season, all eyes were on the banking Royal Commission report which was released early February. Other key news items included the Vale dam wall failure, which drove iron ore prices to year highs. Resource stocks performed strongly in January as a result. Earnings downgrades were issued by Challenger and cement producer Wagners, which drove that stock down to post-IPO lows.

Performance

Timeframe	Fund return	Benchmark	Value added
1 month	4.70%	5.56%	-0.87%
3 months	-1.38%	0.78%	-2.16%
1 year	-8.72%	-3.06%	-5.67%
3 years p.a.	6.34%	11.33%	-4.99%
5 years p.a.	4.46%	7.37%	-2.91%
Since inception* p.a.	3.75%	3.37%	0.39%

Performance figures are net of fees and gross of any earnings tax. 'Value added' calculation does not use rounded performance figures. *Inception date is 1 July 2011.

The portfolio returned +4.70% in January vs +5.56% for XSOAI, an alpha of -0.87%. Since inception, the portfolio has returned +3.75% vs +3.37% for XSOAI, an alpha of +0.39%.

The top five contributors for January were Worleyparsons +60bp, Costa Group +43bp (not held), Seven Group +35bp, Independence Group +32bp and Next DC +28bp.

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The top five detractors for January were AUB Group -66bp, Freelancer -45bp, Beach Energy -39bp (not held), Ardent Leisure -35bp and Afterpay -28bp (not held).

Outlook and strategy

With the 1 March hard deadline in the 90-day pause in the US / China trade wars fast approaching, and with the UK scheduled to leave the EU on 29 March (with or without a deal), understandably, global geo-political issues are currently dominating capital markets. At the same time, China's economic slowdown persists, giving investors plenty to think about. Rates have fallen of late, and equity markets remain weak and jumpy notwithstanding the January rally.

It is difficult to look through these issues to the other side as there are a multitude of credible outcomes, some sharply positive, some sharply negative and many in between. Putting oneself in the place of policy makers to assess the likelihood of the various scenarios is a worthwhile thought exercise, but involves some psychological understanding of both the main players (Trump, Xi, May, Juncker) and bit players so ultimately may serve only to add to the confusion.

At Avoca, all we can do is think about what the rational course of action would seem to be for all sides of the two conflicts. Without question, resolving the US / China trade dispute and Brexit by offering concessions on both sides would seem the economically and politically rational course of action. The alternative of the USA staring down China and moving to the next phase of tariffs would be a disastrous signal and would almost certainly see stock markets tumble and global economic growth take a material hit. Perhaps the USA would fare relatively better than China, but US voters would unlikely be mollified by that.

That said, it is unlikely that the US / China trade dispute will be "resolved" by 1 March and whilst a deal between the UK and the EU is still a fair chance before 29 March, the economic implications of such a deal will likely not be totally clear. So, by the end of March, whilst we may have some promising geo-political signals of detente, we probably won't have a green light on the full resumption of global growth. In this context, the IMF's recent downgrade of its 2019 global growth outlook to 3.5% (down from 3.7% in October) looks prudent.

On top of these global issues, we continue to have concerns surrounding the Australian domestic economy. Households are suffering the negative wealth effect of falling house prices with the promise of more to come if the federal opposition's CGT / negative gearing reforms are enacted. With low wage growth and stalled employment, there is no mood of consumer optimism abounding. Residential construction appears to be in a multi-year decline as do retail sales. Infrastructure and resource capex remain the bright lights of the economy. We are actively positioned away from true consumer discretionary and have a significant exposure to the resource and infrastructure sectors through Seven Group and to a lesser extent Downer.

Largest 10 holdings

Stock name	Portfolio weight
SEVEN GROUP HOLDINGS LIMITED	7.22%
EQUITY TRUSTEES LIMITED	6.75%
BLACKMORES LIMITED	6.49%
AUB GROUP LTD	5.96%
GUD HOLDINGS LIMITED	5.41%
AVEO GROUP LIMITED	5.04%
INDEPENDENCE GROUP NL	5.03%
NEXTDC LIMITED	4.97%
OZ MINERALS LIMITED	4.62%
WORLEYPARSONS LIMITED	4.33%

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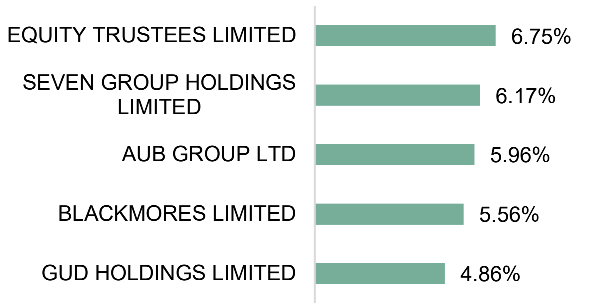
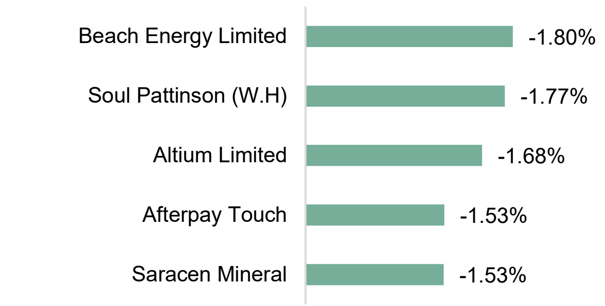
Portfolio analysis

Five largest overweighted stocks



Five largest underweighted stocks



How to invest

The Fund is open to investors directly via the PDS (available at avocaim.com.au) or a range of platforms.

Platforms
BT: Wrap, Super Wrap
Federation
IOOF: AET, IPS, SuperWrap, Pursuit Select, TPS
Netwealth: Super Service, Wrap Service, IDPS
Powerwrap: Smartwrap

Contact details

For more information, call 1800 895 388 (AU) or 0800 442 304 (NZ) or visit avocaim.com.au

The Fund is managed by Avoca Investment Management, a Bennelong Funds Management boutique.