Bennelong Avoca Emerging Leaders Fund

Monthly performance update

As at 30 November 2018

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	$9.26m
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 Ordinaries Accum. Index (XSOAI) posted a -0.37% return in November 2018 compared to the S&P/ASX 100 Accumulation Index (XTOAI) at -2.40%. XSOAI underperformed XTOAI by -0.68% over the past year and outperformed by +2.97% p.a. over the past three years.

The top five performers in XSOAI in November were G8 Education +36.6%, Kidman Resources +34.0%, Appen +30.6%, BWX +29.9% and Orocobre +29.7%. The bottom five performers were RCR Tomlinson -100.0%, FAR -44.8%, Sundance Energy Australia -39.3%, Mesoblast -33.4% and Wagners -26.0%.

The Small Resources Accum. Index (XSRAI) fell -4.07% in November vs the Small Industrials Accum. Index (XSIAI) at +0.81%. XSRAI underperformed XSIAI by -2.41% in the year and outperformed XSIAI by +19.21% p.a. in the three years to 30 November 2018.

European equities broadly underperformed US and Asian equities in November. The MSCI World ex-Aust (loc) rose +1.43%, S&P 500 +2.04%, NASDAQ +0.49% and the Nikkei +1.96%. Conversely, the FTSE 100 -1.60%, German DAX –1.66%, French CAC -1.70% and the Shanghai Composite -0.56%.

Global bond yields continued a downward trajectory in November with US 10 years down -14bp, UK 10 years -11bp, German 10 years -8bp, JGBs -3.7bp and Australian 10 years -2.5bp.

In November, M&A activity continued where Greencross was acquired by Vermont Australia for $5.55 per share and Eclipx unanimously recommended McMillan Shakespeare’s takeover offer with an implied valuation of $2.85 per share. G8 Education rose +36% after the announcement of improving occupancy trends. RCR Tomlinson went into administration due to costs arising from delayed solar projects connecting to the grid.

Performance

Timeframe	Fund return	Benchmark	Value added
1 month	-2.40%	-0.37%	-2.03%
3 months	-13.95%	-10.25%	-3.70%
1 year	-10.05%	-1.63%	-8.42%
3 years p.a.	5.22%	10.38%	-5.17%
5 years p.a.	3.69%	7.06%	-3.37%
Since inception* p.a.	3.69%	3.28%	0.41%

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 -2.40% in November vs -0.37% for XSOAI, an alpha of -2.03%. Since inception, the portfolio has returned +3.69% vs +3.28% for XSOAI, an alpha of +0.41%.

The top five contributors for November were Freelancer +47bp, Next DC +39bp, Beach Energy (not held)

+23bp, Mineral Resources +23bp and G8 Education +18bp.

The top five detractors for November were Fletcher Building -71bp, Seven Group -60bp, Austbrokers -45bp, Aveo -39bp and Worley Parsons -35bp.

Outlook and strategy

Macro and political uncertainties – namely US/China trade wars and Brexit – continue to dominate global news flow and investor sentiment. Our current positioning is premised on a relatively normal cycle with some form of near-term resolution or at least a road map to resolution of the trade dispute. Our performance is very positive on days when that looks the likely outcome. This occurs because some of our larger positions (e.g. Seven Group) have been significantly oversold in a market that has become excessively defensive.

When markets overreact to short-term earnings headwinds, this provides an opportunity for either private equity or corporates to buy assets (e.g. TradeMe and Graincorp, both of which have seen takeover bids and both of which have near-term earnings headwinds). This also provides us with opportunities. We recently rebuilt a large position in NextDC. The market became overly concerned about the timing of large new contract announcements. Based on their existing operations, we got a value of $5.50-$6.15. By buying in that range, we get the future development pipeline (which is extensive) for free.

In the domestic economy, concerns over the impact of a deflating housing market are leading to some valuation discrepancies. For example, most consumer discretionary stocks have been sold off, in particular car retailers (which we do not own). Whilst we believe that is fair, GUD – which sells car parts to independent repairers – has also been sold off (approx 25%). GUD's addressable market is growing, demand is highly defensive, pricing is stable and they are gaining market share. Accordingly, we continue to add to the position.

Our negative view on high PE stocks has begun to play out, but it is still at an early stage of correction. The US Russell Growth Index has underperformed the Russell Value Index by 2% over the last six months, a trivial reversal but perhaps significant given Russell Growth has been outperforming Value for the past 10 years. In Australia, we estimate small growth stocks median PE has de-rated around 4% from pre-reporting season multiples (from 30.4x to 29.1x). However, relative to the broader market which is off more, there has been no relative de-rate. We have, however, managed to find some value in growth stocks and have added to Webjet post concerns over their acquisitions, and exposure to Thomas Cook (minor).

Commodity stocks look relatively cheap, and provide positive exposure to a trade war resolution. On mid-cycle assumptions, we expect they will rebound relatively quickly as markets calm.

It is frustrating that our portfolio's short-term performance is beholden to global geo-political events. That said, the pull-back in prices presents a much better risk reward opportunity for the long-term investor.

Largest 10 holdings

Stock name	Portfolio weight
SEVEN GROUP HOLDINGS LIMITED	6.84%
BLACKMORES LIMITED	6.22%
EQUITY TRUSTEES LIMITED	6.17%
AUB GROUP LTD	6.13%
NEXTDC LIMITED	5.84%
WORLEYPARSONS LIMITED	5.76%
GUD HOLDINGS LIMITED	5.61%
OZ MINERALS LIMITED	5.44%
AVEO GROUP LIMITED	5.27%
INDEPENDENCE GROUP NL	4.35%

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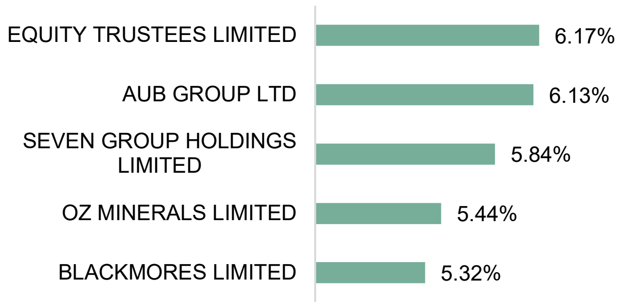
Portfolio analysis

Five largest overweighted stocks



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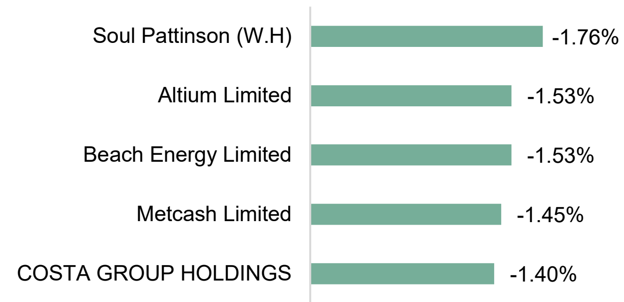

How to invest

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.