

Bennelong Avoca Emerging Leaders Fund

Monthly performance update

As at 30 September 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	30
Fund size	\$10.83m
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 Accumulation Index (XSOAI) posted a -0.3% return in September 2018 compared to the S&P/ASX 100 Accumulation Index (XTOAI) at -1.3%. XSOAI outperformed XTOAI by +7.0% over the past year and by +5.3% p.a. over the past three years.

The top five performers in XSOAI in September were Mesoblast +31.1%, Scottish Pacific +23.1%, Pro Medicus +22.7%, Starpharma +21.9% and Beadell Resources +18.7%. The bottom five performers were Lynas Corp -27.2%, Estia Health -20.2%, Japara Healthcare -19.8%, New Century Resources -18.9% and Blackmores -18.5%.

The Small Resources Accum. Index (XSRAI) fell -0.1% in September vs the Small Industrials Accum. Index (XSIAI) at -0.4%. XSRAI outperformed XSIAI by +3.8% in the year and +18.2% p.a. in the three years to 30 Sept 2018.

Global equity markets were generally positive in September, with trade and interest rate concerns taking a (temporary) back seat. The MSCI World ex-Aust (loc) rose +0.8%, S&P 500 +0.6%, NASDAQ -0.7%, FTSE 100 +1.2%, German DAX -1.0%, French CAC +1.7%, Nikkei +5.5% and the Shanghai Composite +3.5%.

Global bond yields were on the march in September and the recent yield curve flattening trend took a pause. US 10 year yields rose +20bp, Australian 10 years +15bp, German 10 year +14bp, UK 10 years +13bp and JGB 10 years +2bp.

Post-reporting season corporate news included the announcement of a Royal Commission into Aged Care (Japara, Estia and Regis all consequently down -15 to -20%), Myer's FY18 result (LFL sales -1.7% Q4 but the stock up +14%) and a PE takeover bid for Scottish Pacific (stock up +20%).

Performance

Timeframe	Fund return	Benchmark	Value added
1 month	-1.64%	-0.35%	-1.29%
3 months	0.36%	1.10%	-0.75%
1 year	12.06%	20.32%	-8.25%
3 years p.a.	12.56%	16.95%	-4.40%
5 years p.a.	6.05%	8.74%	-2.69%
Since inception* p.a.	5.71%	4.86%	0.85%

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 -1.64% in September vs -0.35% for XSOAI, an alpha of -1.29%. Since inception, the portfolio has returned +5.71% vs +4.86% for XSOAI, an alpha of +0.85%.

The top five contributors for September were Seven Group +52bp, Whitehaven Coal +35bp, Independence Group +31bp, Lynas Corporation +20pts (not held) and Trade Me +19bp.

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The top five detractors for September were Blackmores -94bp, Aveo Group -78bp, AUB Group -32bp, Webjet -22bp and Beach Energy -19bp.

Outlook and strategy

Across the developed world, 10-year interest rates are rising. The USA has strong economic growth and low unemployment, and can afford a small drag from increased tariffs (after having passed tax cuts earlier this year). China, on the other hand, is stimulating its economy in response to a more significant tariff drag. These two global macro backdrops are actually positive for commodity producers and industrial cyclicals, but less so for defensives and long duration assets.

Turning to the Australian consumer, we are less enthused. The combination of out-of-cycle rate rises by the banks, tighter lending standards, highly indebted households and weakening house prices points towards headwinds for domestic consumption. Uncertainty about the impact of Labor's tax policies on housing and superannuation are adding to these headwinds. The falling Australian dollar will no doubt cushion this hit to aggregate demand (a positive for exporters), but it points to a poor outlook for domestic discretionary retailers and other consumer-dependent sectors.

Given the rising tide of populism in politics, we doubt that Australia will embark on any meaningful economic reform to drive productivity. Both parties have no population policy; rather the migration valve is turned on to supplement GDP growth when required. The infrastructure investment needed to accommodate this growth will take decades. Companies like Seven Group remain well placed to benefit from this theme via sales and service of Caterpillar equipment and rental of Coates Hire equipment. Contractors are a much riskier way to play this thematic, as RCR Tomlinson's recent downgrade and emergency capital raise highlighted.

We believe an ageing population will demand higher and better services, as well as planning for intergenerational wealth transfers. Our positions in Equity Trustees and Aveo follow sound business models that meet these needs.

Private Equity is cashed up and increasingly active. Businesses with good cash flow, low gearing and sound business models but with near-term headwinds are being bought. Avoca looks to own these types of businesses, as often the increasingly momentum-driven market applies very short-term thinking to companies that have good medium-term prospects. We are examining a number of opportunities for inclusion at appropriate prices.

Largest 10 holdings

Stock name	Portfolio weight
SEVEN GROUP HOLDINGS LIMITED	7.14%
EQUITY TRUSTEES LIMITED	5.59%
WORLEYPARSONS LIMITED	5.59%
AUB GROUP LTD	5.41%
BLACKMORES LIMITED	5.38%
AVEO GROUP LIMITED	5.36%
GUD HOLDINGS LIMITED	5.35%
OZ MINERALS LIMITED	5.01%
INDEPENDENCE GROUP NL	4.56%
FLETCHER BUILDING	4.28%

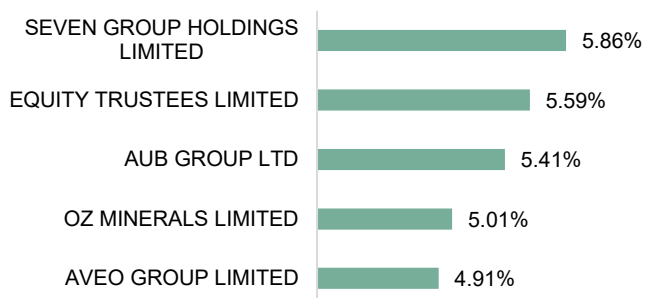
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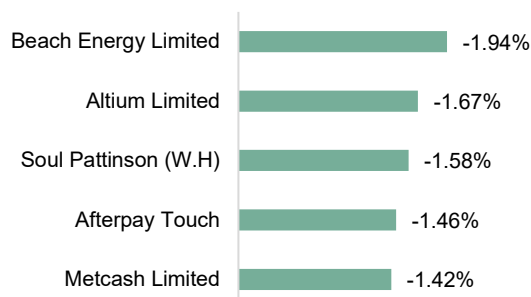
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Portfolio analysis

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.

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