



Product Review

Smallco Investment Fund

ISSUE DATE 28-08-2020

About this Review

ASSET CLASS REVIEWED	AUSTRALIAN EQUITIES
SECTOR REVIEWED	AUSTRALIAN LONG SHORT
SUB SECTOR REVIEWED	VARIABLE BETA
TOTAL FUNDS RATED	8

About this Fund

ASIC RG240 CLASSIFIED	YES
FUND REVIEWED	SMALLCO INVESTMENT FUND
APIR CODE	ASC0001AU
PDS OBJECTIVE	THE MANAGER AIMS TO ACHIEVE HIGH COMPOUND RETURNS BY INVESTING IN THE SECURITIES MARKET, ALTHOUGH RETURNS ARE NOT GUARANTEED
INTERNAL OBJECTIVE	SAME AS PDS OBJECTIVE
STATED RISK OBJECTIVE	NO STATED RISK OBJECTIVE
DISTRIBUTION FREQUENCY	ANNUALLY
FUND SIZE	\$300M (JULY 2020)
FUND INCEPTION	31-10-2000
MANAGEMENT COSTS	1.53% P.A.
PERFORMANCE FEE	18.64% (OF PERFORMANCE ABOVE THE FUND'S PREVIOUS END-OF-SIX-MONTH PERIOD HIGH)
RESPONSIBLE ENTITY	SMALLCO INVESTMENT MANAGER LIMITED

About the Fund Manager

FUND MANAGER	SMALLCO INVESTMENT MANAGER LIMITED
OWNERSHIP	100% STAFF OWNED
ASSETS MANAGED IN THIS SECTOR	\$780M (JULY 2020)
YEARS MANAGING THIS ASSET CLASS	20

Investment Team

PORTFOLIO MANAGER	ROB HOPKINS
INVESTMENT TEAM SIZE	7
INVESTMENT TEAM TURNOVER	LOW
STRUCTURE / LOCATION	CENTRALISED / SYDNEY

Investment process

STYLE	GARP
MARKET CAPITALISATION BIAS	SMALL - MID
BENCHMARK	NO BENCHMARK USED
TYPICAL NUMBER OF STOCKS	25 - 35
STOCK LIMITS	MAXIMUM 10% AT COST / 20% AT CURRENT VALUATION
SECTOR / INDUSTRY LIMITS	EXPOSURE TO AT LEAST FOUR GICS SECTORS
SHORT POSITION LIMITS	MAXIMUM 30% ACTIVE / 50% PASSIVE
GEARING LIMITS	MAXIMUM 30% ACTIVE / 50% PASSIVE

Fund rating history

AUGUST 2020	RECOMMENDED
SEPTEMBER 2019	RECOMMENDED
SEPTEMBER 2018	RECOMMENDED

What this Rating means

The 'Recommended' rating indicates that Lonsec has strong conviction the financial product can generate risk adjusted returns in line with relevant objectives. The financial product is considered an appropriate entry point to this asset class or strategy.

Strengths

- Boutique investment culture supported by strong alignment with large equity ownership among key investment professionals.
- High conviction, benchmark unaware investment process with a strong focus on smaller market capitalisation companies.
- Disciplined approach to capacity management, having previously closed the Fund to investors when capacity was reached.
- Strong track record of outperformance since inception.

Weaknesses

- The total fee load of the Fund is very expensive relative to peers, especially when including the performance fee.
- The Fund makes minimal use of shorting, which may be a weakness for investors who are seeking capital preservation in a deteriorating equity market environment.
- While noting the Fund's outperformance since inception, the persistently elevated cash holding has been a drag on performance.

Fund Risk Characteristics

	LOW	MODERATE	HIGH
BUSINESS SUSTAINABILITY RISK			●
CAPITAL VOLATILITY			●
LEVERAGE RISK		●	
SECURITY CONCENTRATION RISK			●
SECURITY LIQUIDITY RISK			●

Risk categories are based on Lonsec's qualitative opinion of the risks inherent in the financial product's asset class and the risks relative to other financial products in the relevant Lonsec sector universe.

BIometrics

Aggregated risks

	1	2	3	4	5	6	7
STD RISK MEASURE						●	

A Standard Risk Measure score of 6 equates to a Risk Label of 'High' and an estimated number of negative annual returns over any 20 year period of 4 to less than 6. This is a measure of expected frequency (not magnitude) of capital losses, calculated in accordance with ASFA/FSC guidelines.

ANALYST: HONG HON | APPROVED BY: SHAILESH JAIN

Smallco Investment Fund

ISSUE DATE 28-08-2020

	LOW	MODERATE	HIGH
RISK TO INCOME		●	

Features and benefits

	LOW	MODERATE	HIGH
COMPLEXITY			●
ESG	●		

Fee profile

	LOW	MODERATE	HIGH
FEES VS. UNIVERSE			●
FEES VS. ASSET CLASS			●
FEES VS. SUB-SECTOR			●

Fee BIOMetrics are a function of expected total fee as a percentage of expected total return.

What is this Fund?

- The Smallco Investment Fund (the 'Fund') is a concentrated Australian equity product that is predominantly 'long' smaller market capitalisation companies and can effectively 'short' when opportunities are found. The Fund has a flexible investment mandate that includes the ability to gear and hold a high cash weight. It also has a mild ethical overlay, which excludes companies with a principal business activity in alcohol, armaments, gambling and tobacco. The Fund does not have an explicit internal objective and seeks to achieve high compound returns.
- Smallco Investment Manager Limited (the 'Manager') believes it can source investment opportunities with above-average return potential by conducting rigorous fundamental analysis into a company's earnings and cash generation abilities, management quality, and industry characteristics. The Manager prefers to use bottom-up analysis as opposed to 'top-down' macroeconomic research to identify investment opportunities.
- The Manager typically focuses on companies in the \$100-500m market capitalisation range, believing there are greater inefficiencies within this segment of the market. That said, the Fund has the discretion to hold up to 20% of the portfolio in ASX100 stocks.
- The Fund generally avoids stocks with more cyclical earnings such as retail, building materials and resources. However, there may be occasions where it will make investments in cyclical stocks based on a top-down view. It also avoids companies with embryonic business models (e.g. biotechnology) believing that earnings are too difficult to forecast.
- The Fund has the ability to short stocks, although these positions are expected to be opportunistic rather than being a systematic part of the portfolio. The Fund also has the ability to borrow up to 30% of the portfolio via a margin lending facility. Gearing is limited to 50% of the portfolio and primarily employed to manage the portfolio's short exposure.
- The Fund can hold up to 50% of the portfolio in cash. The allocation is primarily driven by the unavailability of attractive investment opportunities (i.e. limited opportunities would warrant a higher cash weight).
- As per the PDS dated 20 April 2020, the fee disclosure for the Fund is as follows – management cost of

1.53% p.a. comprising management fee of 1.40% p.a. and administration cost of 0.13% p.a. During the financial year ended 30 June 2019, the net transaction costs for the Fund were estimated at 0.13% of the NAV of the Fund. Net transaction costs are costs incurred in managing the fund (including explicit and implicit costs of buying and selling assets, the cost of hedging/protection strategies and/or when there are applications or redemptions of fund units by investors) that are not covered by the buy/sell spread. Buy/sell spreads are subject to change depending on market conditions. Refer to the Manager for current buy/sell spreads.

- The Fund also charges a performance fee of 18.64% of the adjusted net asset increase above the previous high water mark. Lonsec highlights the lack of any hurdle for payment of the performance fee other than positive absolute performance above the high water mark. While the Fund does not have an explicit internal objective, Lonsec would prefer to see a performance fee hurdle that is commensurate with the Fund's investment process and performance objectives.
- Lonsec also has research coverage of the Smallco Broadcap Fund (APIR code: ASC0003AU), which is managed utilising a consistent investment process to the Fund. However, it does not have the ability to short or gear, thus charges a lower management cost and performance fee.

Using this Fund

This is General Advice only and should be read in conjunction with the Disclaimer, Disclosure and Warning on the final page.

- The Fund is an Australian equity product which may utilise a broad range of strategies including short selling and gearing, and significantly vary its gross market exposure (50-200%). Short selling is primarily used to enhance overall returns and introduces additional risks to investors when compared to traditional long-only Australian equity funds. Lonsec considers it suitable for blending with other Australian equity strategies, including style biased, small cap, or absolute return products. Lonsec recommends that equity investments are suitable for investors with an investment time horizon of at least five years.
- The Fund is subject to equity market risks, and movements (both positive and negative) in the prices of the underlying securities will impact the portfolio. Investors should therefore be aware of and comfortable with the potential for the Fund to experience periods of negative returns, which result in capital losses being incurred on their investment. As such, the Fund will generally sit within the growth component of a diversified investment portfolio.

Suggested Lonsec risk profile suitability

SECURE	DEFENSIVE	CONSERVATIVE	BALANCED	GROWTH	HIGH GROWTH
		●	●	●	●

For guidance on appropriate asset allocations and risk profiles, refer to the latest Lonsec Strategic Asset Allocation Review and Risk Profile Definitions on our website.

ANALYST: HONG HON | APPROVED BY: SHAILESH JAIN

Smallco Investment Fund

ISSUE DATE 28-08-2020

Changes Since Previous Lonsec Review

- In April 2020, both the Smallco Investment Fund and Smallco Broadcap Fund reopened to new and existing investors.
- There have been no material changes to the investment process since Lonsec's previous review.

Lonsec Opinion of this Fund

People and resources

- The investment team comprises seven investment professionals, of which three of the most senior members had previously worked alongside each other at ANZ Securities. While the team tends to adopt a collective decision-making philosophy, Rob Hopkins is the named Portfolio Manager of the Fund and ultimately accountable for its performance. Hopkins possesses over 30 years of investment experience, and Lonsec considers his investment skill set to be well-aligned to the Manager's fundamental, bottom-up stock selection process.
- Hopkins sits alongside the six remaining members of the investment team, namely Bill Ryan, Craig Miller, Andrew Hokin, Paul Graham, Adam Simpson and Han Xu. The investment team exhibits notable co-tenure working together at the Manager and/or at other investment management firms. Pleasingly, there have been no departures from the investment team since inception of the firm in 2000.
- Lonsec has observed a highly performance-driven culture at the firm, one which to date has proven to be conducive to a stable environment with a clear alignment of interests between the investment team and end investors. Hopkins and Ryan remain large equity owners and pleasingly, equity have been afforded to other investment team members, serving to strengthen their engagement with the firm. Additionally, there is a high level of co-investment among staff and the performance fee structure further aligns their interests.
- Key person risk is considered to be high in co-founders Hopkins and Ryan given their integral involvement in the Manager's investment process and broader business. That said, Lonsec acknowledges the equity ownership structure to be a significant mitigating factor and notes the co-portfolio manager structure aids in key investor continuity. Nonetheless, Lonsec would view the departure of these individuals to be a material event.

Research and portfolio construction

- The Manager's investment philosophy is centred on identifying companies that are likely to exceed consensus earnings estimates in the medium-term given pricing inefficiencies are likely to be more prevalent in smaller market capitalisation names. This leads the Manager to seek out a core group of undervalued quality companies through criteria that favour companies with high cash generation ability, attractive earnings outlooks and strong competitive advantages. This is supplemented by opportunistic value ideas where a six to 12 month re-rating trigger exists. Lonsec believes the Manager has demonstrated an investment edge in companies with a market capitalisation between \$100-500m.

- The investment process is considered to be pragmatic and bespoke to the Manager's philosophy through a focus on understanding the key drivers of earnings. Engagement with company management features prominently and underpins the internal research effort, with two investment team members attending each meeting. Lonsec highlights the strong emphasis placed on meeting with company management, believing this to be conducive to high conviction, concentrated approaches. Lonsec has reviewed the Manager for a number of years and developed strong conviction in the Manager's bottom-up research process.
- The Manager also leverages sell-side research in the preliminary stages of the investment process, primarily to expedite the process of familiarisation with new companies and industries. Lonsec notes, however, internally generated research is the driver of investment decisions. Valuation is based on a range of multiples-based tools that are forecasted over a three-year investment horizon. The Manager's dual coverage approach to stocks extends to financial modelling and is considered to promote robustness in challenging key inputs into the models and assist in proving/disproving investment theses. Lonsec considers the approach to be a positive and encourages procedural rigour to the investment process.
- Portfolio construction is primarily driven by the Manager's Quality Rating System to aid in limiting exposure to lower quality names that are trading at attractive prices. Lonsec considers the portfolio construction process to be robust, with a clear link between the team's conviction in each stock, the assessment of its risk and its weight within the portfolio. The high conviction nature of the investment process means only the Manager's best ideas are included in the portfolio and the cash weighting will tend to increase in times of limited opportunities. Lonsec assesses the asset allocation decision between equities and cash to be more art than science in comparison to some multi-asset products that may incorporate some form of systematic determination such as valuation triggers.
- Positions are trimmed as they approach the Manager's assessment of their intrinsic value, and typically sold when they surpass their predicted valuation or there is a negative change in the company's fundamentals. However, Lonsec notes the flexibility around sell discipline with the Manager previously exhibiting a tendency to tolerate holding growth stocks with high valuations if their fundamental growth story remains intact. Notwithstanding, Lonsec considers the Manager to be more pragmatic in reducing positions as they approach the investment team's predicted valuation relative to some of its peers, and is more active in selling positions judged to be lower quality and/or with more cyclical earnings.
- While the Manager has the ability to short stocks and gear, the gearing facility has rarely been used – most recently in August 2007, and the level of shorting in the context of peers is relatively marginal. Candidates for shorting are fundamentally driven (i.e. fundamental analysis indicates that the stock is overvalued) and included only when an

ANALYST: HONG HON | APPROVED BY: SHAILESH JAIN

Smallco Investment Fund

identifiable catalyst exists, indicating it is likely to disappoint market expectations in the short-term. Lonsec considers this approach to be consistent with the Manager's overall investment philosophy. Nevertheless, the shorting aspect of the process is less frequently featured in the Fund relative to other long/short peers.

- The Fund's ability to hold up to 50% in cash adds a defensive tilt to the portfolio, and is utilised when investment opportunities are not readily available. The Fund's cash balance has averaged around 20% since Lonsec's previous review, and the Manager has demonstrated in the past its ability to utilise the extent of its cash limit (e.g. during the GFC). Nonetheless, Lonsec notes that the persistently high cash weight has been a drag on performance since inception and, although Lonsec has been encouraged by the Manager's disciplined approach to capacity management, may be an indication of capacity/liquidity concerns.

ESG integration

- The Manager has articulated a commitment to and belief in ESG. While the Manager has not provide evidence demonstrating the commitment (such as proxy voting policies and reporting), Lonsec notes the Manager's Non-Executive Director Michael Walsh has had two decades working in ethical/ESG investing, and Hopkins has implemented and continues to guide the Manager's mild ethical overlay. The Manager also advised it has donated capacity to the Future Generation Fund, which has contributed a significant amount to social investment. Accordingly, Lonsec has assessed the Manager's commitment to be in line with peers.
- Furthermore, while there was some evidence of ESG integration within the investment process, the Manager had no observable approach to the collection or use of ESG data. The Manager has however provided examples where it has demonstrated a high barrier to investing for businesses and/or management teams that have questionable backgrounds. Additionally, Lonsec notes the Fund's mild ethical overlay excludes investment in companies with a principal business activity in alcohol, armaments, gambling and tobacco. Overall, Lonsec considers the level of ESG integration within this Fund to be low relative to peers.

Risk management

- Lonsec believes the Manager has adequate risk controls in place to manage the long and short side of the portfolio, although notes that risk management is largely embedded within the Manager's bottom-up investment process.
- On the long side, the Manager's Quality Rating System assigns a score to each stock in the portfolio from which a weighted average quality rating is calculated for the Fund. An internal portfolio construction rule requires the Fund to meet a minimum quality score. Lonsec believes the use of these scores assist the Manager to avoid unintended risk within the portfolio, enhances sell discipline, and ensures exposure to lower quality and cyclical stocks are controlled.
- The Fund also employs a separate 25% limit on total exposure to what are assessed as lower quality

companies. The Manager has a relatively broad definition of what constitutes lower quality, which includes most non-major resource and mining service stocks, and companies that are considered to be in structurally impaired industries. Additionally, the Fund can invest up to 30% of the portfolio in stocks that are deemed to be illiquid. While Lonsec considers the allocation to be generous, these are consistent with the Manager's tight capacity management.

- On the short side, a shorting agreement stipulates trading rules, a trading schedule is prepared detailing the sell and buyback prices for the stock prior to entering the position, and there is a maximum stop loss of 7% for each short position. Lonsec considers this to be a prudent discipline.
- The Fund may be geared up to 30% actively via a margin lending facility. This may increase passively to a maximum of 50% (i.e. in the event of a decline in the Fund's equity). Gearing is primarily employed to manage the portfolio's short exposure. The Manager has historically been relatively conservative in its employment of gearing (as well as shorting), and has generally only geared the portfolio if an explicit opportunity arises.

Funds under management

- Firm-wide FUM as at July 2020 was approximately \$780m, including \$300m in the Fund. In April 2020, the Manager reopened both the Fund and Smallco Broadcap Fund to new and existing investors.
- Historically, Lonsec has observed prudent discipline by the Manager in relation to capacity management, having previously closed the Fund to investors when capacity was reached. Pleasingly, the Manager has continued to demonstrate prudent judgement through the Fund's reopening. Lonsec is supportive of the Manager's discipline, which should help preserve the Fund's appeal.

Performance

- The Fund does not have an explicit internal objective and seeks to achieve high compound returns. As at 30 June 2020, the Fund has comprehensively achieved its stated objective over the assessed period (net of fees). Over the three years, the Fund has returned 8.8% p.a., outperforming the S&P/ASX 300 Accumulation Index (the assigned 'Benchmark') and peer group median by 3.5% p.a. and 6.4% p.a. respectively.
- The Fund's nearer term performance has been challenged, returning -8.2% over the past 12 month to marginally underperform both the Benchmark and peer group median by 0.6% and 4.1% respectively. However, the longer term track record remains impressive, returning 17.1% p.a. over the past 10 years, outperforming both the Benchmark and peer group median by 9.4% p.a. and 7.5% p.a. respectively.
- Despite the Fund's strong positive returns over the long-term, Lonsec notes that the Fund experienced a significant drawdown during the GFC, and more recently during the March quarter of 2020. Lonsec looks favourably on absolute return strategies displaying conservative drawdowns as it tends to be a reflection of the manager's commitment to capital preservation. However, Lonsec highlights the timing of these drawdowns and frequency in which they

Smallco Investment Fund

have occurred. Furthermore, Lonsec acknowledges the Manager's efforts in improving the robustness of its investment process and significantly expanding analyst resourcing over time.

- Pleasingly, the Fund has continued to exhibit a higher Information Ratio than the peer median over the longer term.

Overall

- Lonsec has maintained the Fund's **'Recommended'** rating at its most recent review. Supporting the rating is Lonsec's conviction in the investment team who has developed a strong track record of outperformance since inception. Furthermore, the Manager has continued to demonstrate prudent discipline in relation to capacity management, which serves to preserve the Fund's investment appeal.
- Detracting from the rating is the Fund's total fee load which has been the most expensive among peers. Lonsec also notes that the Manager has seldom made full use of the flexibility in the Fund's investment mandate.

People and Resources

Corporate overview

Smallco Investment Manager Limited is a boutique funds management firm based in Sydney. The firm was founded in April 2000 by Rob Hopkins and Bill Ryan, and remains privately owned by senior members of the investment team. The firm specialises in managing small and mid-cap Australian equity strategies, with \$780m of FUM (as at July 2020) across three strategies – the Smallco Investment Fund, Smallco Broadcap Fund and a family office mandate.

Size and experience

NAME	POSITION	EXPERIENCE INDUSTRY / FIRM
ROB HOPKINS	MANAGING DIRECTOR	34 / 19
BILL RYAN	EXECUTIVE DIRECTOR	24 / 19
CRAIG MILLER	PORTFOLIO MANAGER	14 / 14
ANDREW HOKIN	PORTFOLIO MANAGER	25 / 12
PAUL GRAHAM	PORTFOLIO MANAGER	25 / 5
ADAM SIMPSON	PORTFOLIO MANAGER	17 / 2
HAN XU	PORTFOLIO MANAGER	12 / 1

The investment team comprises seven investment professionals with an average 22 years of investment experience. The team is led by Managing Director Rob Hopkins and Executive Director Bill Ryan.

Hopkins with 33 years of industry experience has previously led small companies research at brokerage firms Macquarie Equities, BT Alex Brown, ANZ Securities and Macintosh Securities. Ryan with 22 years of industry experience previously worked at ANZ Securities.

Team structure

The Fund is managed by Hopkins, while Andrew Hokin manages the Smallco Broadcap Fund. Craig Miller, Paul Graham, Adam Simpson and Han Xu are responsible for research and providing support to the portfolio managers. Miller also serves as the firm's day-to-day business manager.

Remuneration / Alignment of interests

All key investment professionals have either equity ownership or profit share arrangements. Additionally, there is a high level of co-investment among staff.

Research Approach

Overview

RESEARCH PHILOSOPHY	FUNDAMENTAL, BOTTOM-UP
TARGET COMPANY	COMPANIES WHICH ARE LIKELY TO EXCEED CONSENSUS EARNINGS EXPECTATIONS OR OUT OF FAVOUR
MINIMUM MARKET CAPITALISATION	\$100M (SOFT)
NUMBER OF STOCKS IN MANAGER'S UNIVERSE	500
NUMBER OF STOCKS FULLY MODELLED/RESEARCHED	115
RESEARCH INPUTS	COMPANY MEETINGS (MANAGEMENT, COMPETITORS, SUPPLIERS), INDUSTRY ANALYSIS
BROKER RESEARCH	USED TO SUPPLEMENT INTERNAL RESEARCH
VALUATION OVERVIEW	PRICE-TO-EARNINGS RATIO, EBIT/EBITDA AND PRICE-TO-CASHFLOW MULTIPLES

Universe filtering

The investment universe is initially screened for a minimum market capitalisation of \$100m. The Manager then applies a Porter-style Quality Rating System filter with each stock reviewed and assigns a numerical rating (between 0 to 10) based on its quality and cyclicality. The refined investment universe comprises approximately 115 stocks, which are considered candidates for further bottom-up, fundamental research.

The Manager excludes resource stocks, biotechnology companies and companies with cyclical earnings. Additionally, a light green ethical overlay is applied that exclude companies whose principal business interest involves alcohol, tobacco, gambling equipment or facilities and armaments.

Research approach

Meetings with company management form part of the bottom-up research process with the aim of identifying companies likely to exceed consensus earnings estimates. Company meetings provide a forum to prove/disprove the investment thesis with two members of the investment team assigned to each stock in the refined universe.

Top-down and macroeconomic analysis does not feature heavily in the investment process, and is rather used as a feedback mechanism to assist in concentrating the Manager's bottom-up research effort.

On the short side, the aim is to identify companies that are trading at a significant premium to valuation and have an identifiable situation that will likely cause the stock to underperform market expectations over the short-term. Ideas for the short side generally come from the same refined universe as the long side and may be identified during the process of searching for potential long positions.

Valuation

The valuation process is comprised of an amalgamation of multiples-based accounting ratios such as Price-to-Earnings ratio, and EBIT/EBITDA and Price-to-Cashflow multiples. Multiple accounting ratios are implemented to compare a company's current trading price against the Manager's assessment of its intrinsic value.

Smallco Investment Fund

ISSUE DATE 28-08-2020

Portfolio Construction

Overview

FUND BENCHMARK	NO BENCHMARK USED
INTERNAL RETURN OBJECTIVE	TO ACHIEVE HIGH COMPOUND RETURNS
INTERNAL RISK OBJECTIVE	NO STATED RISK OBJECTIVE
PORTFOLIO MANAGEMENT APPROACH	BENCHMARK UNAWARE, CONCENTRATED
INVESTMENT STYLE	GARP
PORTFOLIO DECISION MAKING	PORTFOLIO MANAGER CONSENSUS
STOCK SELECTION	BOTTOM-UP
TOP-DOWN INFLUENCE	MINOR CONSIDERATION
MARKET CAPITALISATION BIAS	SMALL - MID
TYPICAL NUMBER OF HOLDINGS	25 - 35
EXPECTED PORTFOLIO TURNOVER	30% P.A.
PORTFOLIO EXPOSURE IN TOP 10 HOLDINGS	63.6% (JULY 2020)

Decision making

The Manager aims to construct a portfolio with 25-35 of the most attractive stocks (primarily based on current discount to valuation) as identified during the research phase.

Position sizing is primarily driven by a company's discount to its intrinsic value and score from the proprietary Quality Rating System. Additional factors considered in position sizing include the Fund and stocks' liquidity, risk of sustained capital loss, and likely investment outcomes. In general, positions of 3%, 5% or 7% will be implemented, with the ability of a position to extend up to 10% (at cost) and 20% (at current valuation).

The Manager may engage in a moderate amount of short selling to complement long positions. Short selling by the Manager is considered opportunistic.

Buy and sell drivers

At a high level, stocks that trade below the Manager's assessment of their intrinsic value, combined with sound company management, high cash generation ability, strong competitive position and attractive earnings outlook are candidates for portfolio inclusion. Conversely, stocks are sold when they reach the Manager's predicted valuation or if there is a negative change in the company's fundamentals.

Risk Management

Risk limits

SEPARATE INVESTMENT RISK MONITORING	NO
STOCK LIMITS	MAXIMUM 10% AT COST / 20% AT CURRENT VALUATION
SECTOR / INDUSTRY LIMITS	EXPOSURE TO AT LEAST FOUR GICS SECTORS
SHORT POSITION LIMITS	MAXIMUM 30% ACTIVE / 50% PASSIVE
GEARING LIMITS	MAXIMUM 30% ACTIVE / 50% PASSIVE
CASH LIMIT	MAXIMUM 50%
USE OF DERIVATIVES	NOT PERMITTED

Position sizes are limited to 10% of the portfolio at cost, to a maximum of 20% at current valuation. Sector exposures comprise at least four GICS sectors. Other limits implemented include restricting the exposure to securities deemed illiquid to a maximum 30% of the portfolio.

Short positions can actively comprise up to 30% of the portfolio and with the ability to passively increase to 50%. Short positions each have stop loss limits in place of up to 7% of the portfolio per short position. Gearing limits are in place with the ability to actively gear up to 30% of the portfolio and passively increase to 50%.

Risk monitoring

The Manager monitors a range of performance metrics, such as attribution of the long versus short side, win/loss ratio and absolute return ratio. Diversification, risk, quality, cyclicity and liquidity controls in place are monitored daily.

Fund performance and positions with respect to its risk parameters are formally considered at the quarterly board meeting where, in particular, diversification at the stock and sector level, and liquidity are considered.

Risks

An investment in the Fund carries a number of standard investment risks associated with investment markets. These include performance, liquidity, counterparty, market and tax risks. These and other risks are outlined in the PDS and should be read in full and understood by potential investors. Lonsec considers the following to be the major risks:

Equity market risk

Investments in equity markets are subject to numerous factors which may have an impact on the performance of an investment (both positive and negative). Unexpected changes in economic, technological, structural, regulatory or political conditions can have an impact on the returns of all investments within a particular market.

Liquidity risk

The Fund may encounter difficulties or be unable to sell some of its asset due to factors specific to that investment or prevailing market conditions. It may also potentially result in delays in processing, or even the suspension of redemptions if some of its assets are unable to be sold.

Gearing / Leverage risk

The Fund may gear up to a maximum of 50% of its net asset value, which increases the risk of an investment as it amplifies potential gains and losses. The Fund is also permitted to short-sell stocks (i.e. borrow and sell a stock it does not own) and have gross exposure to equities of over 100% of the portfolio. The combination of gearing and short selling may increase the Fund's maximum gross exposure to equities to 200%.

ANALYST: HONG HON | APPROVED BY: SHAILESH JAIN

Smallco Investment Fund

Quantitative Performance Analysis - annualised after-fee % returns (at 30-6-2020)

Performance metrics

	1 YR		3 YR		5 YR		10 YR	
	FUND	PEER MEDIAN						
PERFORMANCE (% PA)	-8.22	-5.57	8.77	2.16	11.12	4.43	17.12	9.62
STANDARD DEVIATION (% PA)	34.68	24.22	23.88	15.46	19.50	13.70	15.95	12.28
EXCESS RETURN (% PA)	-0.61	0.02	3.53	-3.08	5.12	-1.58	9.41	1.87
OUTPERFORMANCE RATIO (% PA)	33.33	50.00	50.00	41.67	51.67	42.50	55.83	52.92
WORST DRAWDOWN (%)	-29.30	-24.78	-29.30	-24.78	-29.30	-24.78	-29.30	-24.78
TIME TO RECOVERY (MTHS)	NR	NR	NR	NR	NR	NR	NR	NR
SHARPE RATIO	-0.26	-0.29	0.30	0.04	0.48	0.20	0.91	0.57
INFORMATION RATIO	-0.04	0.03	0.29	-0.50	0.43	-0.29	0.90	0.31
TRACKING ERROR (% PA)	14.00	13.04	12.20	10.74	11.92	10.17	10.45	6.55

FUND: SMALLCO INVESTMENT FUND

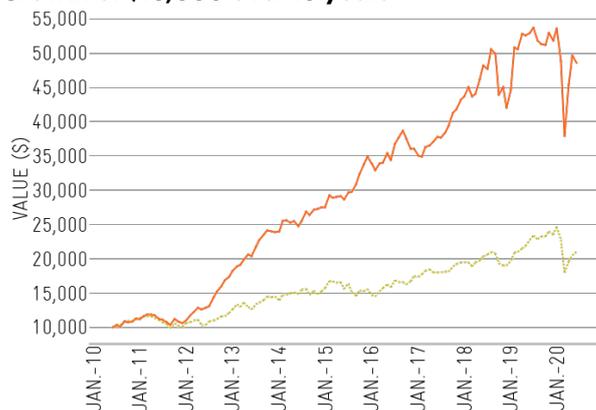
LONG SEC PEER GROUP: AUSTRALIAN EQUITIES - AUSTRALIAN LONG SHORT - VARIABLE BETA

BENCHMARK USED: S&P/ASX 300 TR INDEX AUD

CASH BENCHMARK: BLOOMBERG AUSBOND BANK BILL INDEX AUD

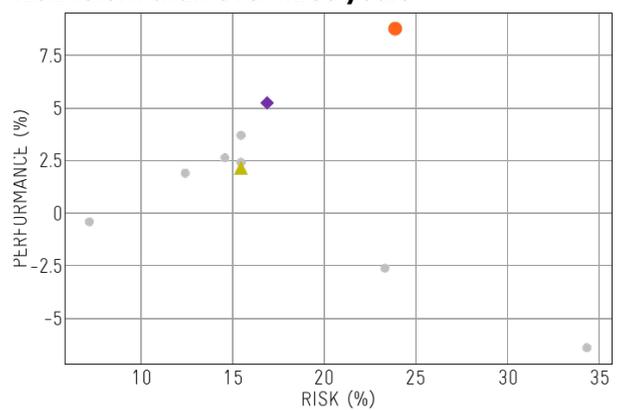
TIME TO RECOVERY: NR - NOT RECOVERED, DASH - NO DRAWDOWN DURING PERIOD

Growth of \$10,000 over 10 years



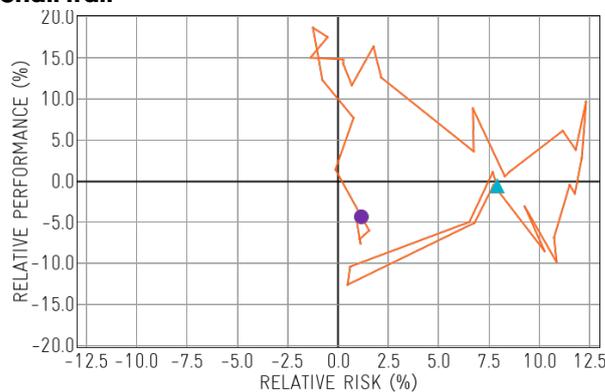
— SMALLCO INVESTMENT FUND
 S&P/ASX 300 TR INDEX AUD

Risk-return chart over three years



● SMALLCO INVESTMENT FUND
 ◆ S&P/ASX 300 TR INDEX AUD
 ▲ PEER MEDIAN
 ● PEERS

Snail trail



● START (06-2017) ▲ END (06-2020)

Outperformance consistency



■ 1Y ■ 2Y ■ 3Y ■ 5Y ■ 10Y

Smallco Investment Fund

Glossary

Total return ‘Top line’ actual return, after fees
Excess return Return in excess of the benchmark return
Standard deviation Volatility of monthly Absolute Returns
Tracking error Volatility of monthly Excess Returns against the benchmark (the Standard Deviation of monthly Excess Returns)
Sharpe ratio Absolute reward for absolute risk taken (outperformance of the risk free return (Bank Bills) / Standard Deviation)
Information ratio Relative reward for relative risk taken (Excess Returns / Tracking Error)
Worst drawdown The worst cumulative loss (‘peak to trough’) experienced over the period assessed
Time to recovery The number of months taken to recover the Worst Drawdown
Snail Trail A trailing 12-month relative performance and relative risk measurement over the benchmark. The trail is generated using a 12-month rolling window over the specified period

About Lonsec

Lonsec Research Pty Ltd (Lonsec) is an investment research house with specialist areas of expertise, that was originally established in 1994 and the current entity was registered on 23 June 2011. From 1 July 2011, Lonsec became a fully owned subsidiary of Lonsec Fiscal Holdings Pty Ltd, a privately owned entity with a multi-brand strategy of providing leading financial services research and investment execution. Lonsec believes that professional financial advisers need informed opinions on the best investment strategies and financial products to provide real value for their clients. To meet this need, Lonsec has in place an experienced research team, which draws on a robust research process to undertake in-depth assessment of managed fund products.

Analyst Disclosure and Certification

Analyst remuneration is not linked to the research or rating outcome. Where financial products are mentioned, the Analyst(s) may hold the financial product(s) referred to in this document, but Lonsec considers such holdings not to be sufficiently material to compromise the rating or advice. Analyst holdings may change during the life of this document. The Analyst(s) certify that the views expressed in this document accurately reflect their personal, professional opinion about the matters and financial product(s) to which this document refers.

LONSEC STRONGLY RECOMMENDS THIS DOCUMENT BE READ IN CONJUNCTION WITH THE RELEVANT PRODUCT DISCLOSURE STATEMENT IMPORTANT NOTICE: Issued by Lonsec Research Pty Ltd ABN 11 151 658 561 AFSL 421 445 (Lonsec). Lonsec receives a fee from the fund manager or financial product issuer(s) for researching the financial product(s), using objective criteria and for services including research subscriptions. Lonsec’s fee is not linked to the rating(s) outcome. Lonsec Investment Solutions Pty Ltd ABN 95 608 837 583 CAR (CAR: 001236821) of Lonsec receives fees under separate arrangement for providing investment consulting advice to clients, which includes model portfolios, approved product lists and other financial advice and may receive fees from this fund manager or financial product issuer for providing investment consulting services. Refer to the Conflicts of Interest Policy at: <https://www.lonsec.com.au/conflicts-of-interest-policy/> Lonsec does not hold the financial product(s) referred to in this document. Lonsec’s representatives and/or their associates may hold the financial product(s) referred to in this document, but details of these holdings are not known to the Analyst(s). **Warnings:** Past performance is not a reliable indicator of future performance. Any advice is General Advice based on the investment merits of the financial product(s) alone, without considering the investment objectives, financial situation and particular needs of any particular person. It is not a recommendation to purchase, redeem or sell the relevant financial product(s). Before making an investment decision the reader must consider his or her financial circumstances or seek personal financial advice on its appropriateness. Read the Product Disclosure Statement for each financial product before making any decision about whether to acquire a financial product. Lonsec’s research process relies upon the participation of the fund manager or financial product issuer(s). Should the fund manager or financial product issuer(s) no longer participate in Lonsec’s research process, Lonsec reserves the right to withdraw the document at any time and discontinue future coverage. The product rated in this publication may have related financial products or be associated with other financial products and platforms. The rating may only be applied to the financial product outlined in this publication at first instance, seek professional advice before you make an investment decision on related or associated financial products and platforms. You should be aware that the mandate, fees, underlying investments, the issuers of the related and associated financial products and platforms may be different from the financial product specified in this publication. Disclaimer: This document is for the exclusive use of the person to whom it is provided by Lonsec and must not be used or relied upon by any other person. No representation, warranty or undertaking is given or made in relation to the accuracy or completeness of the information presented in this document, which is drawn from public information not verified by Lonsec. Financial conclusions, ratings and advice are reasonably held at the time of completion but subject to change without notice. Lonsec assumes no obligation to update this document following publication. Except for any liability which cannot be excluded, Lonsec, its directors, officers, employees and agents disclaim all liability for any error or inaccuracy in, misstatement or omission from, this document or any loss or damage suffered by the reader or any other person as a consequence of relying upon it. ©2020 Lonsec. All rights reserved. This report may also contain third party material that is subject to copyright. To the extent that copyright subsists in a third party it remains with the original owner and permission may be required to reuse the material. Any unauthorised reproduction of this information is prohibited.