Spheria Australian Microcap Fund

ARSN 611 819 651 APIR WHT0066AU

Spheria ASSET MANAGEMENT

Performance as at 31st July 2019

	1m	6m	1yr	3yr p.a.	Inception p.a.#
Fund^	**5.0%**	**11.1%**	**-0.3%**	**8.6%**	**10.6%**
*Benchmark**	*4.5%*	*15.6%*	*7.6%*	*9.3%*	*11.5%*
Value added	0.5%	-4.5%	-7.9%	-0.7%	-0.8%
*Microcap Index ***	*8.3%*	*23.7%*	*7.4%*	*4.7%*	*9.2%*

^ Spheria Australian Microcap Fund. Returns of the Fund are net of applicable fees, costs and taxes

* Benchmark is the S&P/ASX Small Ordinaries Accumulation Index.

** Microcap Index refers to S&P/ASX Emerging Companies Accumulation Index.

Inception date is 16 May 2016. Past performance is not a reliable indicator of future performance.

Commentary

If you can keep your head when all about you
Are losing theirs and blaming it on you…

\- Rudyard Kipling

The Spheria Australian Microcap Fund returned 5.0% for the month, outperforming the Benchmark which returned 4.5% by 0.5%.

The market took off in July with the Reserve Bank cutting overnight interest rates by 50bp to a cash rate of 1.00%. We join a long list of developed countries where overnight cash rates are, unbelievably, at or below 1.00%. In many European countries the overnight cash rates are negative – Germany, France, Sweden, Denmark, Switzerland to name but a few. This means investors are prepared to pay the Central banks money to hold their cash overnight – the equivalent of stuffing your cash under the mattress and taking out less the next day. There should be a limit to how negative rates can go of course. At some point, the cost of paying a secure location to hold cash and return it to you at some stage in the future will be cheaper than buying a short-dated government security which should provide some floor to negative rates. Does this mean cash is strangely worth less in the future than it is today – the complete opposite of what economics professors taught us at University? And what are the implications for equity investors? As a small aside, I was reminded of the dangers of putting too much faith in hard currency when I pulled out an old Swedish 100 crown note on a recent trip to Stockholm and was told it was no longer valid. The Swedish Central bank changed over their banknotes between 2015 and 2017 and all banks (except the Central bank) no longer accept the old currency. A somewhat sage reminder that with a Fiat currency – the value lies only in the promise of value by the Government.

Traditional investing has involved outlaying cash today for a stream of future cash flows or a lump sum at some stage in the future. We use a discounted cash flow model to compare stocks on a like for like basis. This has presumed that there is a discount rate to use. If interest rates remain negative we will have to switch to using a "premium" rate such that we pay less for stocks with cash flows today and more for cash flows in the future. Whilst this sounds nonsensical this is effectively how the markets appear to be behaving in the short term. Rate cuts have traditionally spurred on stock

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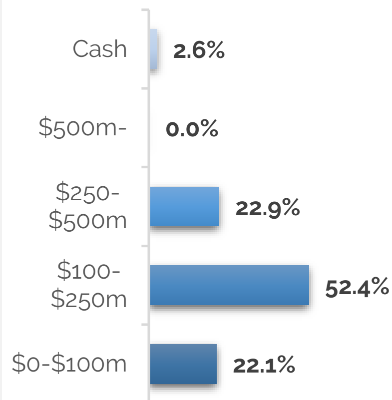
Top 5 Holdings

Company Name	% Portfolio
GBST Holdings	6.7
City Chic Collective	5.1
Class Limited	4.8
Mortgage Choice	4.4
A2B Australia Ltd	4.3
Top 5	**25.3**

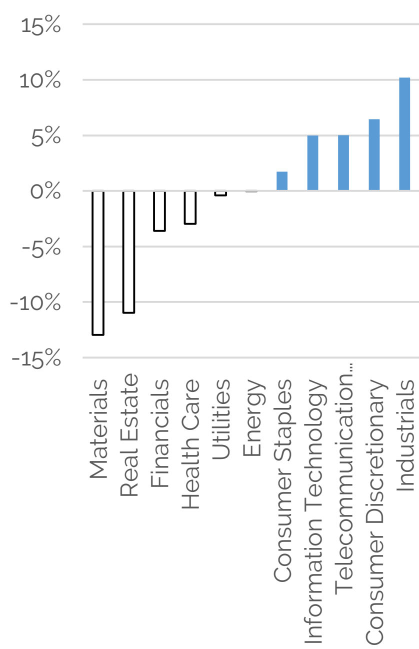
Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

markets as firstly rate cuts are usually stimulatory to the underlying economy and thus encourage business investment or an increase in consumption. Secondly, rate cuts lower discount rates and make shares relatively more attractive as an investment than cash or bonds. Given interest rates are already at virtually zero it appears a flawed way to stimulate economies globally and instead has and is, creating inflated values in some asset areas.

The corollary to low rates is the response of both corporate and Private Equity players. Both are still highly active and low interest rates of course provide a low cost of funding for both actors. We saw this in full swing in July with an increased bid for GBST. GBST was languishing with negative earnings momentum and a highly depressed valuation in February and has now seen 3 successive bidders emerge. Over the course of the month, SS&C technologies bid $3.25 a share trumping Bravura's (BVS.ASX) bid of $3.00. SS&C subsequently revised their bid to $3.60 a share (plus allowed distribution of GBT's franking credits worth $0.15/ share). FNZ then trumped this bid with a binding offer at $3.85 a share (plus franking credits). Spheria is the largest shareholder in GBST and investors stand to benefit from any increased bid from an interested party.

After the close of market on the last day of the month Wellcom (WLL.ASX) received an agreed takeover offer of $6.70 a share with an agreed final and special dividend of $0.21 to be paid to shareholders representing a 31.6% premium to the closing price the night before. The acquiror being Innocean which is a global media company based in South Korea. This demonstrates again some of the valuation appeal we have highlighted in the smaller cap space and the increasingly global nature of even microcap stocks in Australia. Other contributors over July were GR Engineering (GNG.ASX) – up 22.5% on the back of being awarded several Feasibility studies, Supply Network (SNL.ASX) – up 14% on the back of a strong results pre-announcement and Senetas Corp (SEN.ASX) up 40% after renewing a supply agreement with Gemalto. Detractors included Donaco (DNA.ASX) off 20%, Wisetech Global (Not held) which rose 15% and St Barbara (Not Held) which rose 26% on heightened concerns on global risks and a rising gold price.

The current market conditions are trying on even the most patient investors and the apparent inexorable rise of the Tech, Fintech, Medtech (and Spivtech) space appears oblivious to any kind of valuation discipline. We are reminded of the famous line in Rudyard Kipling's poem IF and seek to 'keep our heads' by consistently applying what we believe is the most effective and reliable way to invest money on behalf of our clients. The recent takeover activity serves as a helpful reminder that the invisible hand of the market is at work even if quant-based models and passive investors apparently remain oblivious to the longer term gravitational law of valuation.

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	Spheria Australian Microcap Fund
Benchmark (universe)	S&P/ASX Small Ordinaries Accumulation Index
Investment objective	The Fund aims to outperform the S&P/ASX Small Ordinaries Accumulation Index over the medium to long term.
Investing universe	Primarily listed companies outside the top ASX 250 listed companies by market capitalisation and companies listed on the New Zealand Stock Exchange with an equivalent market capitalisation
Distributions	Annually
Fees	1.35% p.a. management fee & 20% performance fee of the Fund's excess return versus its benchmark, net of the management fee
Cash	• Up to 20% cash • Typically 5% - 10%
Expected turnover	20-40%
Style	Long only
APIR	WHT0066AU
Minimum Initial Investment	$100,000

Platform availability
ASGARD
BT Panorama
BT Wrap
HUB24
IOOF Portfolio Service
Macquarie Wrap
mFund
MLC Wrap / Navigator
Netwealth
One Vue
uXchange

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