Spheria Australian Smaller Companies Fund

ARSN 117 083 762 APIR WHT0008AU

Performance as at 31st January 2020

	1m	6m	1yr	3yr p.a.	Inception p.a.#
Fund ^	**2.1%**	**4.6%**	**16.1%**	**11.7%**	**10.6%**
*Benchmark**	*3.4%*	*2.8%*	*18.8%*	*12.1%*	*9.6%*
Value added	-1.3%	1.9%	-2.7%	-0.4%	1.0%

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

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

Inception date of the current investment strategy is 11th July 2016. The Fund was established in June 2005. Past performance is not a reliable indicator of future performance.

Top 5 Holdings

Company Name	% Portfolio
Class Limited	4.7
Blackmores Ltd.	4.5
Fletcher Building	4.3
Adelaide Brighton	4.2
Platinum Asset	4.0
Top 5	**21.7**

Source: Spheria Asset Management

Commentary

The Spheria Smaller Companies Fund returned 2.1% (after fees) for the month ending 31 December 2019, underperforming its benchmark by 1.3%.

January saw the Australian stock market going from the sublime to the ridiculous. Seemingly the more money you lost as a business the more your share price rose. Perhaps this is the final outworking of declining interest rates and the near certain view held by the market that the Central Banks of the world will do whatever it takes to keep the market flooded with liquidity. In any case some of the greatest moves by individual shares in January were made by companies with tiny to nonexistent revenues and zero to large losses at the profit line. This frothy excess would be an interesting passing observation for market pundits were it not for the fact that some of these companies now have substantial market caps making their oscillations more than of passing interest. Shares like Mesoblast (MSB.ASX), Polynovo (PNV.ASX) and Paradigm Biopharmaceuticals (PAR.ASX) were all up over 40% over the month on relatively limited fundamental news flow. This suggests that a combination of passive, quantitative and momentum retail money is chasing shares with certain non-fundamental characteristics. It is almost as if the laws of gravity have ceased to apply with these stock prices floating ever higher into the heavens. Unfortunately, sky hooks aren't real and you would expect there to be some reckoning with fundamentals at some point in the future unless economic theory has been permanently redacted by today's Central Bankers. If the latter is true there will be other consequences however including the fact that supporting consistently loss-making businesses will have a negative flow on to the real economy by slowing the growth rates of legitimate businesses via illegitimate competition.

Coming into the results season, we are broadly expecting a challenging set of numbers from the smaller companies space. Whilst the RBA rate cuts last year have started to see property prices return to growth and consumer confidence stabilise, a raft of domestic issues from the Eastern Seaboard fires to the drought conditions in Australia are likely to have impacted consumer behaviour. Over a normal results period we would expect to do relatively well from a bottom up performance basis as earnings, outlooks and valuations somewhat reconcile with company updates.

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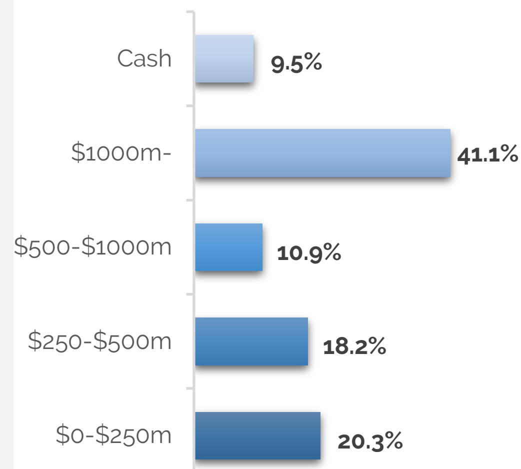
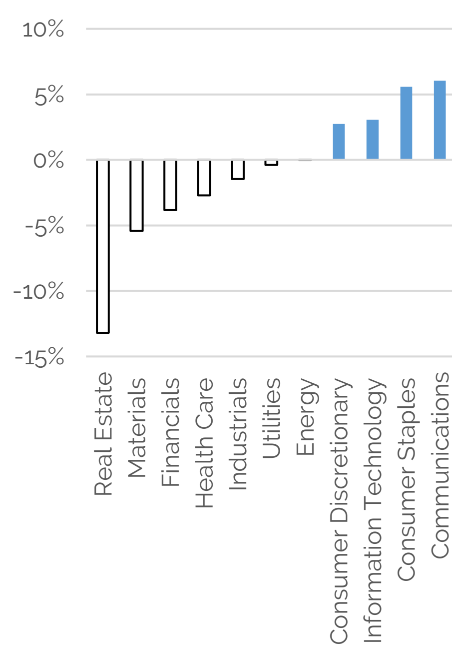
Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Contact us 1300 010 311 distribution@pinnacleinvestment.com.au www.spheria.com.au

During January we had strong contributions from City Chic Collective (CCX.ASX) which rose 21%, Fletcher Building (FBU.ASX) which rose 9% and Healius (HLS.ASX) up 7%. We have spoken before about CCX which we continue to like. CCX share price has risen strongly over the past 18 months since we have been a shareholder after it restructured itself by selling off the legacy SFH brands (Katies, Rivers, Crossroads, Autograph and Millers). This left the high growth City Chic brand unencumbered by the slower growth tail brands. CCX operates a plus sized retail format for women aged 18-35 targeting the fashion end of the market with a mid-market price point. They have continued to optimise the store base and moved into larger format stores which are more productive. CCX's online component continues go from strength to strength and now represents 44% of group turnover. In October 2019 they bought Avenue's US online business out of bankruptcy – Avenue has over a 20 year history serving the plus sized consumer in the US. Avenue's online revenue was around A$100m pa and whilst there will clearly be some transition involved with a switch to new owners and some brand disruption, they paid US$16.5m which could look like a very attractive price in time. With a strong growth profile overseas, a strong component of online sales (which will well and truly exceed 60% of revenue in FY 20) and a consistent strong cash flow history we think CCX is well positioned to continue to perform. A recent interview with the CEO and head of design can be found here https://www.linkedin.com/video/live/urn:li:ugcPost:6631388200004915200/

FBU remains an attractively valued building materials stock. After many years of questionable capital allocation the direction, under new management, appears to be positive. They have divested international operations, repaired the balance sheet and commenced buying back the company's shares. The NZ government recently announced a NZ$12bn infrastructure spend which is likely to provide a boost to NZ based building companies and provide a helpful backdrop.

Against these performers the Fund suffered relative under performance from a number of shares it didn't own in January. Saracen Minerals (SAR.ASX – not owned) was up 19%, Polynovo (PNV.ASX – not owned) rose 42%, Mesoblast (MSB.ASX – not owned) rose 44%. Seven West Media (SWM.ASX – owned) declined 24% over the month. SWM has struggled over the past month as the ACCC has preliminarily blocked the sale of their magazine division (Pacific Magazines) to Bauer media and their bid to merger Prime TV (PRT.ASX) – their regional affiliate – has so far been stymied by the actions of several large shareholders. Whilst this is disappointing, SWM remains a strongly cash generative business and is under new management who we believe will run the business more efficiently. SWM is trading on just 5x EV/EBIT and has investments in several very valuable digital businesses (Airtasker, Health Engine and Society One) which are currently receiving little to no valuation from the market and yet have and external valuation of around $95m.

Current market conditions make fundamentally based investing challenging and yet paradoxically are providing good longer term investment opportunities. The seemingly extreme moves in popular shares are correspondingly leaving behind unpopular shares many of which exhibit good investment fundamentals to us – sound balance sheets, good cash flow generation and certainly in many cases attractive valuations. We continue to find good opportunities that exhibit growth and value characteristics and we don't think the economics laws of gravity have been broken yet!

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	Spheria Australian Smaller Companies 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 100 ASX listed companies by market capitalisation and companies listed on the New Zealand Stock Exchange with an equivalent market capitalisation
Distributions	Half yearly
Fees	1.10% 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	30-40%
Style	Long only
APIR	WHT0008AU
Minimum Investment	$25,000

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