Small Companies Fund

Quarterly Report

December 2014

To Our Unit Holders

Fund Basics			
Unit Price	$1.9180	**Inception Date**	17th September 2003
Distribution Frequency	Annual	**Fund Size**	$451M
Number of Stocks in the Portfolio	51	**Benchmark**	S&P ASX Small Ordinaries Accumulation Index

Performance Statistics to 31 December 2014

	3 Month %	1 Year %	3 Year % p.a.	5 Year % p.a.	Since Inception
EGG Small Companies Fund	-1.13%	+0.63%	+10.54%	+5.35%	+10.77%
S&P/ASX Small Ordinaries Accumulation Index	-3.89%	-3.81%	+0.58%	-2.01%	+4.66%
Out performance	***+2.76%***	***+4.44%***	***+9.96%***	***+7.36%***	***+6.11%***

* Fund returns are calculated post fees.

For the quarter ending 31 December 2014, the Eley Griffiths Group Small Companies Fund returned **-**1.13**%,** compared to a 3.89% decrease in the Small Ordinaries Accumulation Index.

Market Review & Strategy

The Small Ords extended its underperformance relative to the 100 leaders throughout the quarter, falling 3.89%. Mining and mining services names conceded significant ground through the period, predominantly on lower commodity markets and selling from dispirited equity market players.

A meltdown in crude oil markets followed OPEC's decision not to constrain output at its November meeting. This did not sit well with professional traders, who read it as confirmation of a subdued global growth prognosis, already evident in recent weak iron ore and coal markets.

Resource investor confidence is at a very low ebb, reversing the fragile recovery that was underway through the first half of 2014. Eley Griffiths Group significantly scaled back its market-weight exposure to resource stocks in mid-late September, coincident with the US dollar's strong rally.

The early stages of an earnings downgrade cycle took hold during the quarter. Although mining sector dominated, a number of consumer discretionary names guided lower, many using the annual general meeting event to adjust market expectations.

Eley Griffiths Group intel suggests this momentum is set to continue across many sectors of the market, with building/construction materials and healthcare sectors to remain relative safe harbours for our portfolio.

2014 was a year of extraordinary activity in primary and secondary issuance. Our analysts reviewed almost 50 IPO candidates in 2014, participating in a select handful only.

The 10 largest initial public offerings raised ~ $12.5bn in 2014, 4 of these occurring in the final quarter. By comparison, the top 10 raised ~ $4.2bn in 2013.

The successful $5.7bn Medibank Private IPO in November (3rd largest offer globally in 2014), whilst positive for retail and institutional investors within week one of trading, became emblematic of a languid IPO market.

Institutional investors are now riven with deal fatigue. Deal cancellations, re-pricings, underwhelming IPO debuts and recent sightings of a 'carpet-bagger' or two suggest it is time for investment banks to temper the equity call on the market. Détente should occur in early Q2 2015.

The Australian Dollar has been in corrective mode since May 2013, with accelerating momentum from September this year. This trend looks set to extend. Expectations of further interest rate accommodation in 2015 began to surface through December in response to softening local data.

Predictably, this has kept offshore equity buyers out of our share market, but interestingly, has aroused several offshore corporates with takeover bids received for Roc Oil, Oakton, Transfield and Recall Holdings in past months.

Technical Summary

At the time of writing, some 33% of the stocks comprising the Small Ordinaries Index were trading above the 100 day moving average. This moving average is known as the ‘investment line’, and is the simplest expression of whether we are in an ascending/descending market.

At the end of October, 43% were above the investment line and November 45% were above. This confirms the deterioration in sentiment that occurred in December quarter and points to fewer and less fewer stocks being able to sustain the bull market impulse, however brief it was!

The Index’s failure to trade through resistance at 2280/90 encouraged traders to test the downside and the line of least resistance proved to be the bull market uptrend from the March 2009 lows. This level of ‘natural’ support yielded in the early days of December.

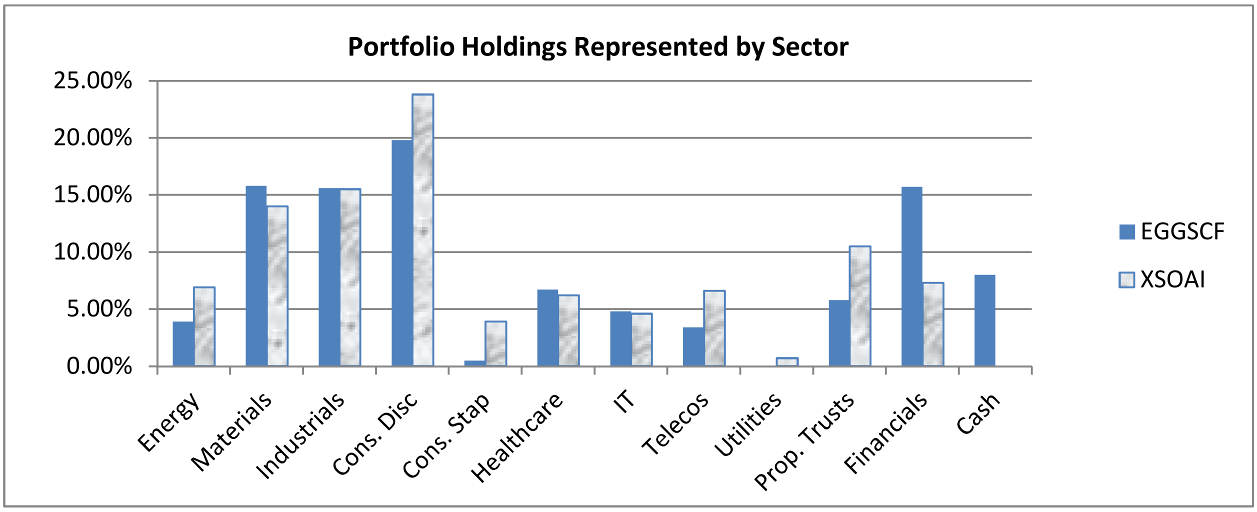
A variety of technical and momentum indicators point to lower price action ahead for the Small Ordinaries Index.

The Portfolio

During the quarter the portfolio enjoyed solid gains from our highest conviction stocks. In fact, 6 of our largest ten positions featured in the top ten contributors to the portfolio in the quarter. Magellan Financial Group (+30%), Auckland International Airport (+21%), CSR (+20%), Healthscope (+11%) and Invocare (+10.5%) all posted positive returns in a down market. Our largest gain versus the benchmark came from a zero holding to LNG Limited (-41.5%).

Stocks that hurt the portfolio during the quarter included Sundance Energy (-59%), Saracen Mineral Holdings (-29%), Panoramic Resources (-51%) and Skilled Group (-53%). Not owning Sirtex Medical (+30%) and BWP Trust (+20%) also detracted from performance.

Top 10 Stocks as at 30th November 2014			
IRESS Limited	3.84%	**Magellan Financial Group Ltd**	3.07%
InvoCare Limited	3.80%	**Slater & Gordon Limited**	2.89%
iiNet Limited	3.63%	**Fletcher Building Limited**	2.76%
Macquarie Atlas Roads Group	3.39%	**Auckland International Airport**	2.55%
Ardent Leisure Group	3.18%	**Healthscope Limited**	2.50%



In recent months we added several names to the portfolio.

APN Outdoor offers leverage to the Australasian outdoor advertising industry. Outdoor has proven to be a resilient medium that is growing its share (c.4.5%) of a total advertising pie of $13bn. The digitisation of large format boards (30/150 sites converted) is the current business model enhancement that will help underwrite the next 3 years earnings trajectory.

Medibank Private is a dominant player in the private health insurance industry with the federal government remaining committed to supporting the high, and growing, rate of participation. Revenue growth should be underwritten by member and pricing growth (est at 2X CPI) with enhanced margins available through cost-outs and improved claims management. The balance sheet is debt free and the nature of health insurance dictates that capital reserving needs are relatively modest.

We also quit a number of names from the portfolio.

Asaleo Care was a successful IPO for us but the continuing retracement of the AUD will not help the groups growth expectations (pulp/paper prices are US Dollar denominated). The company has some short term currency hedging as an offset but prosecuting price increases in the current environment will be difficult.

Breville Group endured a significant recoil in its market rating following a number of negative developments. The unexpected departure of their well regarded CEO was followed by news of a market slump in the USA juicing machine retail category. Competition locally has been increasing in past years and the arrival of unwelcome retail trading conditions in Australia will negatively impact the company in the short to medium term.

Outlook

The US market continues its ascent, overbalancing price with time and posting new highs into the final days of 2014. In layman's speak, the market is short term overbought.

The breadth of the advance is truly amazing. The S&P100 and 500 each went to new highs, the Dow Industrials and Utilities also and, the somewhat fully priced, Russell 2000 and Wilshire 5000 indices also found rarified air.

This price action unfolds as the US dollar extends its rally and the Fed has indicated it is being patient with respect to beginning the process of normalising monetary policy settings. The recent flow of stronger than expected economic data offset by deflationary pressure from a stronger USD and a collapse in the Oil price has rendered forecasts of a rate hike at midyear in the US less certain. The market has taken this constructively.

The unfolding Russian crisis seems only a sideshow, yet a similar episode in 1998 took centre stage and ushered in significant volatility in global equity markets. Emerging markets seem to have taken the US dollar advance in their stride. India and almost all Asian stock market's have been rallying since the greenback began appreciating in September. South American bourses have so far yet to respond.

Locally, we will benefit from global equity market momentum into Q1, but will have a number of short term factors mitigating the updraft.

Consumer confidence has deteriorated somewhat despite improved east coast property markets. Anecdotes to hand suggest that retail conditions remain challenging and a continuation in the months ahead seems likely.

Wages growth will be negligible in 2015 and the labour market is tipped to worsen looking forward. Not surprisingly, business investment will be restrained too, but as we move into the June quarter we are likely to see the lagged effects of several stimuli take hold.

The softer Australian dollar will start to show up in better GDP figures and the lower oil price will act as a quasi-tax cut/interest rate cut. Macquarie Equities estimate a $0.23c/l fall in petrol pricing is equivalent to a 0.25% rate cut. The prospect of an official easing in interest rates will have come into focus, if not have occurred by mid 2015. This will give a fillip to small cap domestic cyclicals.

Commodity markets will continue to be volatile with a downside bias, as the US Dollar Index (DXY) pushes towards 96, an 11 year high.

The interim reporting season in February won't be short of challenges, with membership of the 'h2 Club' becoming crowded. How investors react to the earnings 'confessions' in January and February will be an important test for the market.

Merger and acquisition activity will feature in 2015 as companies seek out acquired growth with low cost funding. 2014 was unusually quiet on this front. We will apply our usual high level of due diligence to new capital raisings that will increase in frequency moving into June quarter.

The EGG Small Companies Fund had positioned itself defensively by the end of December. Cash holdings were well above normal ranges. Healthcare and infrastructure names are notable within the portfolio.

We have sought minimal exposure to the Australian consumer and a domestic industrial tilt to building materials groups and wealth managers. A number of our domestic industrial holdings have significant international exposures such as Iress, Slater & Gordon, Fletcher Building, Macquarie Atlas Roads and Austal. These companies are well placed to grow earnings in FY15.

Eley Griffiths Group Ratings			
Morningstar	September 2014	**Silver**	2nd Highest Rating
Lonsec	February 2014	**Recommended**	2nd Highest Rating
Zenith	March 2014	**Recommended**	2nd Highest Rating