The Encyclical

September Quarter 2017

To Our Unit Holders

Fund Basics			
Unit Price	$2.0898	**Inception Date**	17th September 2003
Distribution Frequency	Annual	**Fund Size**	$428M
Number of Stocks in the Portfolio	59	**Benchmark**	S&P ASX Small Ordinaries Accumulation Index

Performance Statistics to 30 September 2017

	3 Month %	1 Year %	3 Year % p.a.	5 Year % p.a.	Since Inception
EGG Small Companies Fund	+7.03%	-2.86%	+10.09%	+9.91%	+10.98%
S&P/ASX Small Ordinaries Accumulation Index	+4.41%	+2.98%	+8.15%	+5.09%	+5.82%
Outperformance	***+2.62%***	***-5.84%***	***+1.94%***	***+4.82%***	***+5.16%***

* Fund returns are calculated post fees.

For the quarter ending 30 September 2017, the Eley Griffiths Group Small Companies Fund returned +7.03%, compared to a +2.62% move in the Small Ordinaries Accumulation Index (XSOAI).

Market Review & Strategy

The Small Ordinaries Index enjoyed continued verve in the September quarter as the sector extended its outperformance over the ASX100, set in train from early May. No surprise that emerging/micro-cap names outpaced small caps, underscoring investors improving risk appetite across the ex-100 space.

Investors re-embraced the reflation trade with resources and mining services names amongst the benchmarks best performers during the 3 months to September 30. Lithium and 'exotic' minerals stocks, such as **Lynas** and **Syrah**, were notable outperformers among small resource names.

The reporting season concluded broadly as expected with the beat/miss ratio in step (at least at the eps line) and better in terms of top line. High PE stocks held their ground and low PE names enjoyed a bid on positive reporting's. ~ 90% of the Small Industrials saw a trend to minor negative earnings revisions (in keeping with the recent past) with weighted average eps revisions of -2.2% according to JP Morgan. Further, they pointed to -3% revisions for the coterie of recently listed industrial companies (IPO's over the last 5 years).

This manager has grown accustomed to the now common 2 stage share price reactions to result announcements. Day one allows the market to weigh the result, day two sees quant funds react to changing eps momentum and apply volume and volatility (in equal measure) to the stock(s) in question. These occurrences became increasingly predictable through August and were influential on how EGG made adjustments to its portfolio.

On balance, investors appeared satisfied by reporting season end that the small cap space was in good health, bidding a number of stocks higher, with or without earnings upgrades eg **Blackmores, Altium** and **Afterpay Touch**. They also chose to absorb sizable founder/major shareholder selldowns with ease such as **Reliance, Kogan, Noni B** and **Scottish Pacific**.

Corporate activity reappeared during the quarter with takeover bids received for **Programmed Maintenance**, the **Ten Network** and **Astro Japan Property** (a substantial EGG position). Whilst the IPO market remains dormant, a number of small companies took advantage of strong professional investor interest in well-reasoned transactions (refer to the tirade in the *EGG March quarter 2017 Encyclical*) and eagerly supported raisings from **Webjet, NIB Holdings**, **Syrah Resources** and **Seven Group Holdings**.

Technical Summary

Equity markets moved through the line of least resistance during the September quarter with buyers assuming the ascendency in developed and emerging markets alike. Their synchrony almost scripted.

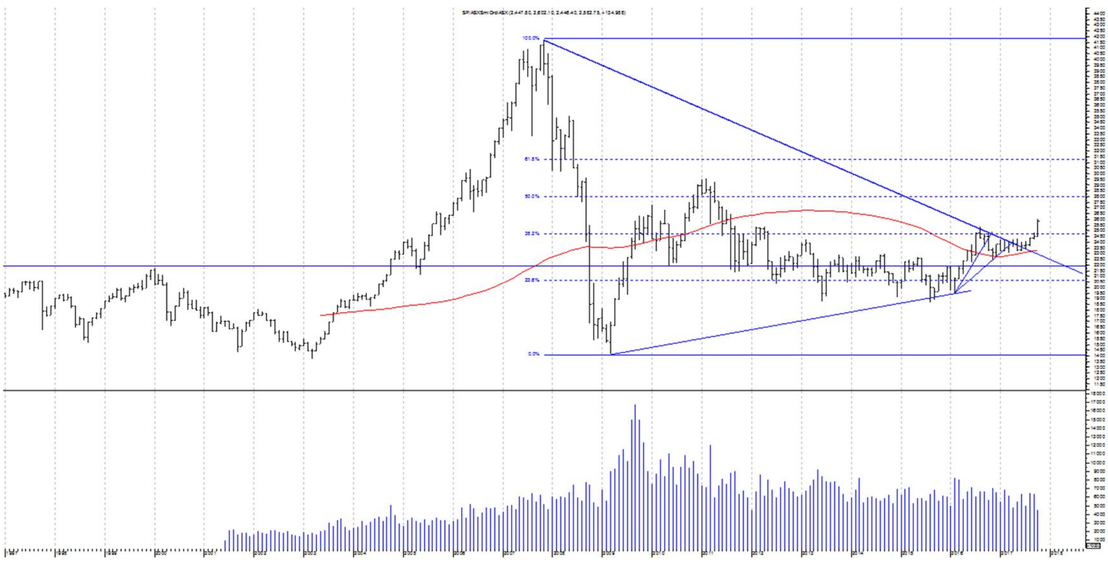
Through Asia, frenetic price action swept indices in **Korea, Taiwan** and **Jakarta** to a succession of new highs and propelled **Japan** (a record 15 consecutive up days), **Hong Kong** and **Singapore** to significant heights.

The same scene has played out in Europe. Even the peripheral markets of **Spain** and **Italy** look constructive-who'd have thought!

Last gasp blow-off or the next up-leg to the bull market in global stocks? I'm betting the latter. As a rule, new highs are bullish not bearish and the number of impressive trendline breaks or successful return moves enthuses this author.

Closer to home, the **ASX 200** has cleared an important downtrend line from November 2007 and appears well positioned to trade above 6000-a feat not achieved since Jan 2008! The Coppock indicator indicated a solid low in June 2015, confirmed in Jan 2016. A valid break of 6000 will up-draft investors to 6390 then 6680 and onto 6800 (the old high). To date the Aussie market is in the minority of laggard markets that have stubbornly refused to rally. I would concede that the **ASX Mid Cap 50** has been the local market's sweet spot for several years and is within grasp of all time (Nov 2007) highs.

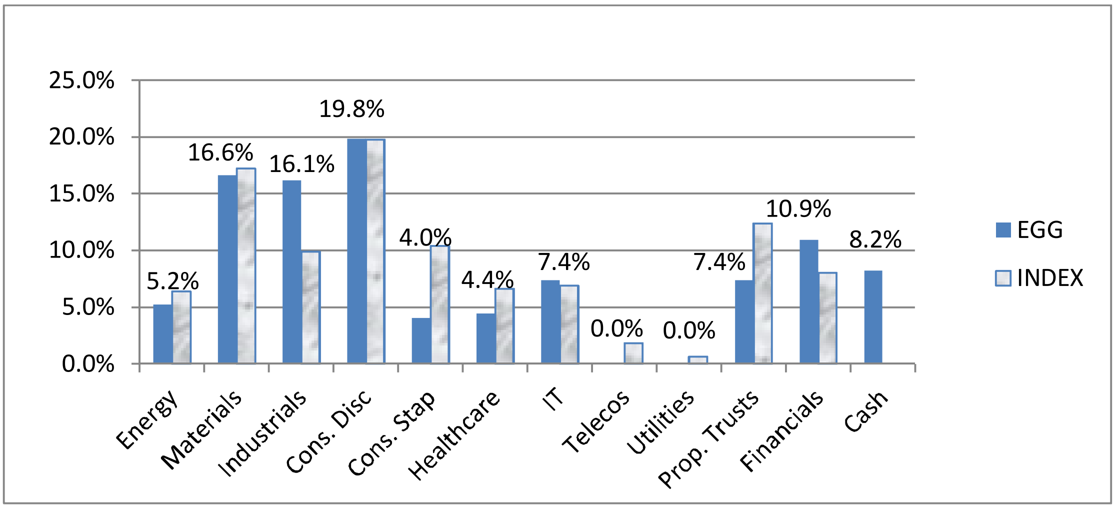
Few charts look as constructive as the **Small Ordinaries Index (XSO**), with the monthly chart below highlighting the Aug 31 break and signalling the commencement of a powerful bull-drive. The ultimate target here is 4176. The Small industrials sub-index has been redoubtable but it is the small resources names that should lead the complex higher.



I include a chart of the relative performance of the ASX Small Ords versus the **ASX 100** stocks over the past 5 years (the downward inclination pointing to small cap underperformance). Investors find themselves at an interesting juncture. Will Small's extend their recent outperformance or will the resistance line check the advance as it has convincingly done on 2 other occasions? The absolute strength of the XSO tells me the index is out!

Commodity markets continue to diverge. Precious metals appear indifferent, base metals continue to present bullishly (**Ni** destined to end its 6 ½ years bear market) and soft commodities (of all persuasion) remain insipid. The **Baltic Dry Index** is trading at levels last seen in March 2014. US **Lumber** is now at 2 year highs, doubling over the past 2 years.

Watch oil. **WTI** looks to have bottomed at $26.21 in February 2016 but the meandering price action of late requires a concerted buying campaign to take prices above $54.50. Crude has returned to backwardation and Brent commands a +$6.00/bbl premium now.



The Portfolio

During the September quarter, our small company portfolio saw strong appreciation from **Afterpay Touch Group** (+42%), **Smartgroup Corporation** (+31%) and **RCR Tomlinson** (+30%). Nil weights in **Mayne Pharma Group** (-39%), **Trade Me Group** (-15%) and **Mesoblast** (-33%) helped performance.
Detractors during the quarter included **IRESS** (-9%) and **EBOS Group** (-4%). Nil weightings in **Beach Energy** (+46%) and **Pilbara Minerals** (+67%) also hurt performance.

Top 10 Stocks as at 30 September 2017	
Afterpay Touch Group Ltd	ARB Corporation Limited
Cleanaway Waste Mgmt Ltd	G8 Education Limited
IRESS Limited	Premier Investments Ltd
Saracen Mineral Holdings Ltd	Smartgroup Corporation Ltd
Steadfast Group Limited	The A2 Milk Company Ltd

Your manager returned to the register of **Platinum Asset Management** after a reasonable absence, believing the company's valuation to be excessively discounting the group's recent woes. Performance of the Platinum International Fund had been gradually improving for some time, staff turnover stabilised and investor inflows were yet to respond to the manager's favourable portfolio settings and numbers. The team's backing of emerging markets at the expense of the US equity market is now showing in performance figures. It is a safe bet that market consensus earnings are not factoring in a material uptick in flows (September quarter net inflow + $415m) and the prospect of performance fees more than offsetting the recent base fee reductions. We have long-held the investment team at Platinum in high regard and are not surprised by the stocks violent upward move of late.

Sidestepping a disappointing IPO and turbulent early listed life, EGG acquired a position in **Scottish Pacific** during the quarter. The group provides Australasian SME's with specialist working capital solutions as well as debtor/trade financing facilities. Its recent FY17 result was more or less in line with downgraded prospectus guidance. The outlook for FY18 appears upbeat with firm July trading pointing to continued growth in the company's loan book, much improved cash conversion (extrapolating H2 FY17 trends) and the first sightings of integration synergies from the three-way merger immediately prior to listing.

Undeterred by its re-rating this year, EGG initiated a position in **Ainsworth Game Technology (AGI)**, sensing an earnings watershed in recently reported FY17 results. The somewhat controversial investment by Austrian-based Novomatic in ~ 54% of AGI's outstanding shares will ideally clear various regulatory hurdles by December 2017 and should be positive for the group. Its Pac-Man product is being well received in US and Australian casinos and a growing pipeline of opportunities is likely to be before the group.

EGG accepted Blackstone's bid for their substantial shareholding in **Astro Japan Property** during the period in review.

Outlook

These days the challenge to writing an outlook piece for the stockmarket is to try and avoid rehashing the same supportive comments for global equities. I guess a bull case is a bull case even if valuation yardsticks aren't quite as appealing this quarter as they were in the last.

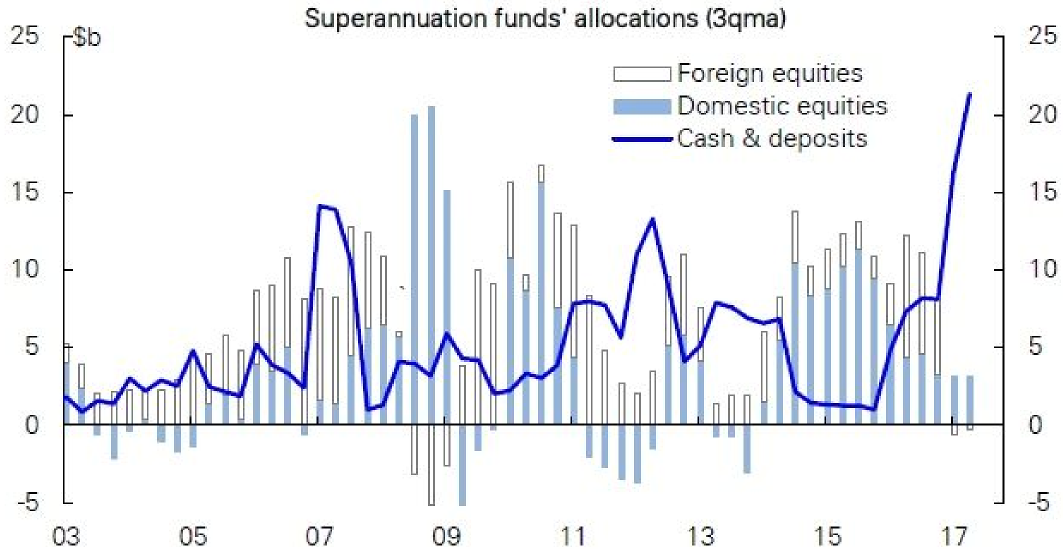
In the US stockmarket, PE's, Price/Sales and Price/Book are each on the full side but by no means excessive. The equity risk premium sits at ~ 4.8%, continuing to endorse the case for equities over bonds. Goldman Sachs this week advised that the S&P500 ROE had improved to ~ 15.4% for CY17, the highest since 2014, in line with the post GFC average but shy of the long term peak of 19.9%. Improving energy company earnings the contributor.

The US Q3 earnings period is underway and the occasional 'peak earnings' retort has been sighted in commentaries. No escaping the fact that their market is on track for ~ 10% earnings growth this year and consensus assumes about the same for 2018. Recall minimal growth was recorded in 2014, 2015 and 2016. Secure passage of the US tax reform legislation (NB: corporate tax rate to 20%) has variously been given a 65% chance of success in 2018. Restoration of profit growth will presage increased capital investment by US corporates (read: it's what equity investors will want to see).

I was wondering whether seasonal weakness in the US, September through October, might prevail upon their stockmarket but it appears not to have eventuated. Volatility remains at very low levels.

Locally, if the technical summary hasn't aroused your interest then the recent Deutsche Bank/ABS chart on super fund allocations might do the trick. Cash and deposits continue to build and this is the store of liquidity that will be pivotal in moving our equity market higher.

Figure 5: Most of these inflows went to deposits – in time they're likely to be allocated to asset classes, including domestic equities



Source: ABS, Deutsche Bank

Investors should be aware that the annual general meeting season is currently underway and this will be a useful look-in on how corporate Australia is faring. So far nothing to be alarmed about.

I am reminded of Sir John Templeton's 4 stages of a bull market. Pessimism, sceptism, optimism and euphoria. It would be hard to argue right now that the worlds equity markets are euphoric but they are certainly optimistic. The rally in equities looks set to grind higher.

Eley Griffiths Group Ratings

Zenith February 2017	**Recommended** 2nd Highest Rating	**Lonsec** February 2017	**Recommended** 2nd Highest Rating
		http://eleygriffiths.com.au/news-reports/	