The Encyclical June Quarter 2018

To Our Unit Holders

Our Funds' Performance (after fees) to 30 June 2018

	3 Month %	1 Year %	3 Year % p.a.	5 Year % p.a.	Since Inception p.a.
EGG Small Companies Fund	+10.21%	+32.87%	+16.74%	+14.61%	+12.03%
S&P/ASX Small Ordinaries Accumulation Index	+7.67%	+24.25%	+15.01%	+11.56%	+6.77%
Outperformance	***+2.54%***	***+8.63%***	***+1.73%***	***+3.05%***	***+5.26%***

* Fund returns are calculated post fees.

	3 Month %	6 Month %	1 Year % p.a.	5 Year % p.a.	Since Inception p.a.
EGG Emerging Companies Fund	+11.29%	+11.13%	+41.88%		+34.20%
S&P/ASX Small Ordinaries Accumulation Index	+7.67%	+4.67%	+24.25%		+19.71%
Outperformance	***+3.62%***	***+6.46%***	***+17.63%***		***+14.49%***

* Fund returns are calculated post fees.

Market Review & Strategy

The small cap rally from early May was overwhelmed by a strong move upward in the S&P/ASX 100 from mid June through month end. Investors turned their attention to heavily oversold banks, **CSL, Cochlear** and **Telstra**, with the advance level-pegging the relative performance of small and large caps for calendar 2018.

Significantly, the S&P/ASX 200 cleared technical resistance at 6000 and traded to a 10 year high after a series of unsuccessful attempts, the most spectacular being January's failed sortie. The market assumed a better tone generally in the quarter, buoyed by the return of M&A activity and several effortlessly executed equity raisings.

A three-way fracas (**Fortescue**, Hancock and **Mineral Resources**) ensued for **Atlas Iron,** CKI bid for **APA Group**, Eramet bid for **Mineral Deposits**, a second bidder emerged for **Sirtex** and Bounty made a play for **Tegel**. Hometown bid for **Gateway**, JC Decaux had a tilt at **APN Outdoor** and besieged **Godfrey's** was rescued by its near-centenarian founder. Excluding the Atlas and Godfrey's bids, it is interesting to note that each of the above involved offshore suitors. Further, we now have foreign direct investment gathering pace concurrent with a return of offshore portfolio investment. Both have been absent from the ASX for some time.

Reliance Worldwide raised ~$1.1bn to pursue a UK expansion and **Reece** broke with 100 years of history and ventured offshore, acquiring US-based MORSCO for $1.4bn and raising $560m in equity funding.

Seasonally the June quarter sees the local market move into earnings revision mode and this years downgrade sample has been a little lighter than usual. Regulars, **iSelect, Village** and **Retail Food Group** fessed up whilst **Hanson Technologies, ERM power, Ainsworth, Hub24** and **Greencross** also chimed in with negative commentaries.

The implosion of the **Blue Sky Alternate Investments (BLA)** share price captured market attention throughout the quarter in review. A damning forensic piece by research group Glaucus, a CEO resignation, earnings downgrade and an eagre of unrelenting negative press coverage combined with dramatic effect. A $100m institutional raising in March at $11.50 per share ($1.70 at June 30) added to the theatre. Analysts at EGG have long been cynical of the BLA business model, its pace of expansion and the opacity of the books of account.

Energy stocks performed strongly through the quarter in step with Brent's advance. EGG holdings, Beach Petroleum (+44%), Sundance Energy (+33%) and Australis Oil & Gas (+21%), did not disappoint.

Tech names, **Wisetech, Super Loop** and **Altium** posted solid rallies and consumer fintech, EGG holding **Afterpay Touch Group** (+45%) also starred.

The US stockmarket has seen volatility tick upwards in 2018, with rising interest rates, a flattening yield curve and elevated trade tensions unsettling confidence in the broader market. Growth (cf value) stocks, including small/mid caps have been the markets hot-spot since the January correction.

Technical Summary

Last quarter's *Encyclical* detailed how technically important the positioning of the US stockmarket was post the weekly key reversal in January. Bullish that the S&P 500 index has managed to hold its uptrend from February 2016 and a weekly close > 2780 clears the way for an assault on the January 26 high of 2872. Traders should pencil in 2833, 2940 and 3290 as Fibonacci projected S&P 500 levels post the benchmark clearing 2872.

The task of retaking the January high is of critical importance. Success here will involve volatility and wide daily trading ranges with better than average volumes. A 'sharp rally out, return move to 2872, then rally hard' scenario is how we see it unfolding. We're also watching for the effects of emerging markets (note the poor charts for markets in Turkey, Mexico, Argentina, Indonesia) 'taint' on the US stockmarket but curiously this volatility has been but a passing interest to investors of late. The same phenomena occurred in 1984 and 1997 when the US hiked rates, EM's sold off and the US stockmarket went skyward.

At the time of writing, the script for the US market appears to be playing out constructively but several rated commentators have proffered the view that price action since January is 'exhaustive' rather than a 'bullish consolidation' and that a market top is being configured. We disagree with this view.

The ASX200 broke convincingly above 6000 in April and accelerated through the January high with surprising ease. It is hard to underestimate the significance of this development for the local market as it rallies toward 6400. You might reasonably expect some work to be done here ahead of the climb to 6800, the benchmarks historic high. Oversold bank stocks have only recently assisted with the advance and their continuing vigour will be key to this unfolding move.

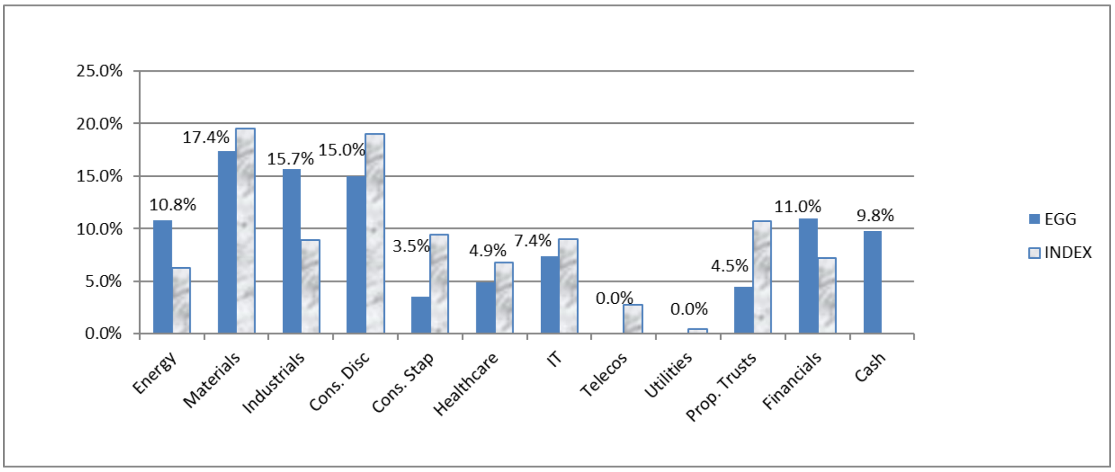
The outlook for the Small Ordinaries Index, although conceding ground to the ASX100 during the June quarter, remains compelling. Breadth is improving, with the number of stocks trading above the investment line (100 day ma) at 62% as at June 30 versus 38% at March end. 2960 is a critical level of resistance for the small cap market.

The short term direction for the US dollar continues to be hard to divine, essentially congestion within a long term up trend with short term indicators and cross-rates pointing to a move lower. The US dollar loves a long, sweeping campaign. Witness the 1985-1992 rally, the 1992-2001 correction and the 2008-2018 (?) bull drive. We will continue to monitor the unit.

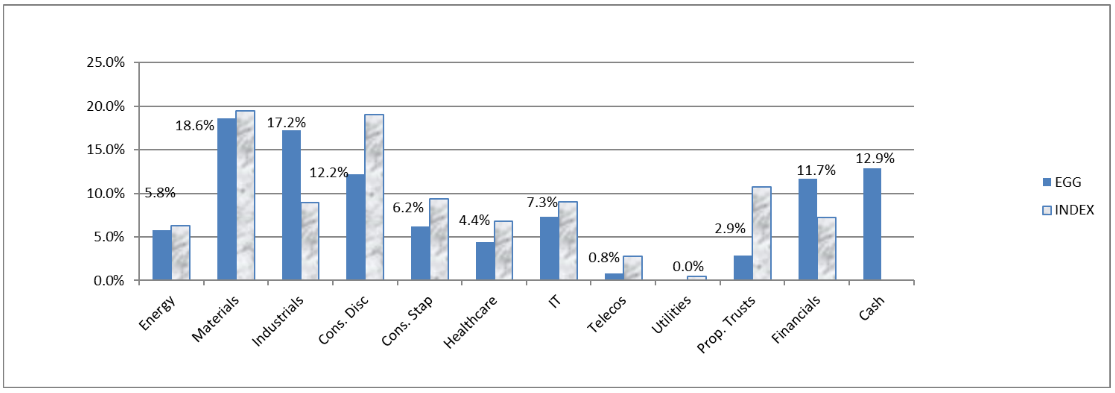
Hard commodities have fallen foul of aggressive long liquidation across the board, arguably past due given lengthy, disruption free rallies in recent months. The bull cases for base metals and crude are intact but have been 'dusted-up' somewhat. Gold is teetering and needs to hold $1240 or begin a more serious retreat. The September quarter *Encyclical* will discuss these markets at greater length.

The Portfolio

The Small Companies Fund was positioned as below:



…and the Emerging Companies fund:



During the March quarter, our Small Companies Fund (SCF) enjoyed the rallies from **Afterpay Touch Group** (+45.2%), **Xero** (+34.6%) and **Saracen Minerals** (+23.4%). Our positions in **iSelect** (-20.1%) and **Ausdrill** (-32.0%) detracted from performance. In the Emerging Companies Fund (ECF), positions in **Emeco** (+30.9%), **Synlait Milk** (+33.3%) and **Praemium** (+50.4%) provided a strong updraft. **3P Learning** (-15.5%) and **Decmil Group** (-17.1%) dragged on the portfolio.

SCF Top 5 Stocks	ECF Top 5 Stocks
Whitehaven Coal Limited	Noni B Limited
Saracen Mineral Holdings Ltd	Emeco Holdings Limited
Cleanaway Waste Mgmt Ltd	Synlait Milk Limited
Reliance Worldwide Corp. Ltd	Alliance Aviation Services Limited
ARB Corporation Limited	Aurelia Metals Limited

One or both EGG funds held the following stocks during the quarter and changes may have been made to portfolio positioning.

It's been a long while since Eley Griffiths Group last had a metals exposure in the Lachlan Fold belt of NSW in the portfolio. That changed some months back when a position in **Aurelia Minerals** was established. The group's two principal assets are the Peak Mine and Hera, offering gold as well as Cu/Zn/Pb production across their operations. A sizable regional exploration package covering some 1400km2 also sits within the business. The mines are highly cash generative and the initial focus will be mine life extension at Hera and utilising unused mill capacity at Peak. Managements *argus eye* on operating costs and conservative stewardship provides much comfort to us. Aurelia has excelled at amortising debt and had a net cash balance of $20m at beginning of May.

We quit the register of the **A2 Milk Co** after a lengthy period of ownership with the stock now a resident of the ASX100. It is hard to be anything but effusive for managments achievements over the past several years but we have noted a recent slowing in the growth in Chinese sales volumes. The group's heavy reliance on the Chinese daigou (trader) channel to market is also not without risk but has been managed well to date. Our March quarter purchase of Freedom Foods (refer March quarter *Encyclical*) does afford us some exposure to this key export market.

EGG's modest position in **Ainsworth Game Technology** was sold during the quarter. We entered the name cognisant that revenue and volume growth had been sluggish for a number of years but believed the arrival of Novomatic to the register would bring net benefits to the group. The lack of new game performance (or the absence of a hit game) has weighed on sentiment and our confidence around FY19 earnings consensus was becoming shakier by the day.

We returned as shareholders in the **Nine Entertainment Company** during the quarter, buoyed by a robust FTA advertising market and reassured by the medium winning back share of wallet from on line. Predictably the Commonwealth Games provided somewhat of a speed bump to ratings momentum but we regard this as a transient element to a strengthening ratings/revenue share story. Three government elections in FY19 should prove a fillip to earnings for the sector, as will likely post Royal Commission bank 'image restoration' spend. Whilst trading at a premium to Seven West (FY19 11.5x v 7.7x), we believe this is readily defendable given NEC’s superior franchise, stronger balance sheer and more favourable short/medium term earnings outlook.

Outlook

The path forward feels a little easier for Aussie stocks versus that confronting the US stockmarket. Ultimately the direction of the latter will hold sway but Eley Griffiths Group feel the Australian market will outperform the US market in the short term.

Several major US stock indices have failed to reclaim their January highs. At times price action has appeared insipid for the S&P 500. Breadth for the index has narrowed notably, in fact Goldman Sachs (GS) confirmed the top 10 S&P 500 stocks have contributed > 100% of the benchmarks 2018 ytd return.

Top down, a loss of momentum in the US economy (GS GDPg 2.9% (18e), 2.2% (19e) and 1.5% (20e)) will progressively weigh on investors. Throw in higher wages growth, firming interest rates, an uncertain external sector and you are fostering conditions for margin pressure and lower share price returns. This is not an immediate issue however, neither is the flattening yield curve that seems to hijack a growing number of market commentaries.

Seasonally, the September quarter is not kind to equities. We sense investors will be looking to US corporate chiefs to be ‘jawboning’ bullish outlook statements at the pending Q2 reporting season to sustain share price momentum.

Australia on the other hand feels decidedly upbeat having been recently liberated, technically speaking. Our reporting season opens in around 2 weeks and warnings to date have been more contained than usual. Expectations are for a reasonable season. Valuations are not excessive and an equity risk premium of 6.9% is supportive of a generous portfolio allocation to equities over bonds.

Despite a spongy listing day, the successful $2.7bn IPO of Viva Energy speaks to heightened investor confidence in the local market. In fact it was the market’s the biggest equity call in 4 years.

We expect the bullish tone for stocks to continue, with small and emerging companies to perform well through the balance of 2018.

Eley Griffiths Group Ratings

SCF

Lonsec	**Recommended**	**Zenith**	**Recommended**
February 2018	2nd Highest Rating	February 2018	2nd Highest Rating

ECF

Lonsec	**Highly Recommended**	**Zenith**	**Recommended**
February 2018	Highest Rating	February 2018	2nd Highest Rating