Lonsec

Recommended

Product Review
Smallco Investment Fund

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About this Review

ASSET CLASS REVIEWED	AUSTRALIAN EQUITIES
SECTOR REVIEWED	AUSTRALIAN LONG SHORT
SUB SECTOR REVIEWED	VARIABLE BETA
TOTAL FUNDS RATED	10

About this Fund

ASIC RG240 CLASSIFIED	NO
FUND REVIEWED	SMALLCO INVESTMENT FUND
APIR CODE	ASC0001AU
PDS OBJECTIVE	TO ACHIEVE HIGH COMPOUND RETURNS BY INVESTING IN THE SECURITIES MARKET, ALTHOUGH RETURNS ARE NOT GUARANTEED
INTERNAL OBJECTIVE	SAME AS PDS OBJECTIVE
STATED RISK OBJECTIVE	NO STATED RISK OBJECTIVE
DISTRIBUTION FREQUENCY	ANNUALLY
FUND SIZE	$425.3M (JULY 2023)
FUND INCEPTION	31-10-2000
ANNUAL FEES AND COSTS (PDS)	4.61% P.A. (INCLUDES PERFORMANCE FEE ESTIMATE OF 2.98% P.A.)
PERFORMANCE FEE	18.64% (OF INCREASE IN NAV, SUBJECT TO THE HIGH-WATER MARK)
RESPONSIBLE ENTITY	SMALLCO INVESTMENT MANAGER LIMITED

About the Fund Manager

FUND MANAGER	SMALLCO INVESTMENT MANAGER LIMITED
OWNERSHIP	100% STAFF OWNED
ASSETS MANAGED IN THIS SECTOR	$766.8M (JULY 2023)
YEARS MANAGING THIS ASSET CLASS	23

Investment Team

PORTFOLIO MANAGER	ADAM SIMPSON & ROB HOPKINS
INVESTMENT TEAM SIZE	7
INVESTMENT TEAM TURNOVER	LOW
STRUCTURE / LOCATION	CENTRALISED / SYDNEY

Investment process

STYLE	GARP
MARKET CAPITALISATION BIAS	SMALL
BENCHMARK	NO BENCHMARK USED
TYPICAL NUMBER OF STOCKS	25 – 35
STOCK LIMITS	MAXIMUM 10% AT COST / 20% AT CURRENT VALUATION
SECTOR / INDUSTRY LIMITS	EXPOSURE TO AT LEAST FOUR GICS SECTORS
SHORT POSITION LIMITS	MAXIMUM 30% ACTIVE / 50% PASSIVE
GEARING LIMITS	MAXIMUM 30% ACTIVE / 50% PASSIVE
CASH LIMIT	MAXIMUM 50%

Fund rating history

SEPTEMBER 2023	RECOMMENDED
OCTOBER 2022	RECOMMENDED
SEPTEMBER 2021	RECOMMENDED

What this Rating means

The **'Recommended'** rating indicates that Lonsec has strong conviction the financial product can generate risk adjusted returns in line with relevant objectives. The financial product is considered an appropriate entry point to this asset class or strategy.

Strengths

- Boutique investment culture supported by strong alignment with high equity ownership among key investment personnel.
- High conviction, 'benchmark unaware' investment process with a strong focus on smaller market capitalisation companies.
- Disciplined approach to capacity management, having previously closed the Fund to investors when capacity was reached.

Weaknesses

- The Fund is one of the most expensive products in the peer group and broader asset class.
- The performance fee structure could be better aligned with the Fund's investment process, including the use of an appropriate hurdle.
- The Fund makes minimal use of shorting, noting that the Manager has seldom made full use of the flexibility in the Fund's investment mandate.
- The Fund may hold high allocations to illiquid securities which may impact performance in distressed market environments or in the case of significant redemptions.

Fund Risk Characteristics

	LOW		MODERATE		HIGH
BUSINESS SUSTAINABILITY RISK				●	
CAPITAL VOLATILITY					●
LEVERAGE RISK		●			
SECURITY CONCENTRATION RISK					●
SECURITY LIQUIDITY RISK					●

Risk categories are based on Lonsec's qualitative opinion of the risks inherent in the financial product's asset class and the risks relative to other financial products in the relevant Lonsec sector universe.

BIOmetrics

Aggregated risks

	1	2	3	4	5	6	7
STD RISK MEASURE						●	

A Standard Risk Measure score of 6 equates to a Risk Label of 'High' and an estimated number of negative annual returns over any 20 year period of 4 to less than 6. This is a measure of expected frequency (not magnitude) of capital losses, calculated in accordance with ASFA/FSC guidelines.

Smallco Investment Fund

	LOW		MODERATE		HIGH
RISK TO INCOME			●		

Features and benefits

	LOW		MODERATE		HIGH
COMPLEXITY				●	
ESG	●				

Fee profile

	LOW		MODERATE		HIGH
FEES VS. UNIVERSE					●
FEES VS. ASSET CLASS					●
FEES VS. SUB-SECTOR					●

Fee BIOmetrics are a function of expected total fee as a percentage of expected total return.

What is this Fund?

- The Smallco Investment Fund ('the Fund') is a long/short 'benchmark unaware' Australian equity product. The Fund adopts a bottom-up investment philosophy which can be categorised as 'growth at a reasonable price' ('GARP') to construct a portfolio of 25 – 35 stocks. The Fund is predominantly long small-cap companies, with the ability to short when appropriate opportunities are found. The Fund does not have explicit internal risk or return objectives and seeks to achieve high compound returns.
- Smallco Investment Manager Limited ('the Manager') believes it can source investment opportunities with above-average return potential by conducting rigorous fundamental analysis into a company's earnings and cash generation abilities, management quality, and industry characteristics. The Manager prefers to use bottom-up analysis as opposed to top-down macroeconomic research to identify investment opportunities.
- The Manager typically focuses on companies in the $100-500m market capitalisation range, believing there are greater inefficiencies within this segment of the market. That said, the Fund has the discretion to hold up to 20% of the portfolio in ASX100 stocks.
- The Fund tends to avoid stocks with more cyclical earnings such as retail, building materials and resources. However, there may be occasions where it will make investments in cyclical stocks based on a top-down view. It also avoids companies with embryonic business models (e.g., biotechnology) believing that earnings are too difficult to forecast.
- The Fund can short stocks, although these positions are expected to be opportunistic rather than being a systematic part of the portfolio. It can also borrow up to 30% of the portfolio via a margin lending facility. The Fund can hold up to 50% of the portfolio in cash and the allocation is primarily driven by the unavailability of attractive investment opportunities (i.e. limited opportunities would warrant a higher cash weight).
- The Fund's PDS dated 31 March 2023 disclosed Annual Fees and Costs ('AFC') totalling 4.61% p.a. This figure comprised (1) management fees and costs of 1.53% p.a., (2) performance fees of 2.98% p.a. and (3) net transaction costs of 0.10%. In line with RG97, some fees and costs have been estimated by the issuer on a reasonable basis. Actual fees and costs may vary to these estimates, with performance fees having the potential to vary significantly based on the Fund's realised performance and the fee's calculation requirements.
- The Fund's buy/sell spread is +0.45/-0.45%. These spreads can be subject to change, most notably during periods of market volatility, and can be sourced from the Manager's website.

Using this Fund

This is General Advice only and should be read in conjunction with the Disclaimer, Disclosure and Warning on the final page.

- Lonsec notes that the Manager has produced a Target Market Determination (TMD), which forms part of the Responsible Entity's Design and Distribution Obligations for the Fund. Lonsec has collected the TMD that has been provided by the Manager and notes that this should be referred to for further details on the Target Market Summary, Description of Target Market and Review Triggers.
- The Fund is a long/short Australian Equity product with the ability to vary its net market exposure between 50-200% and may utilise a broad range of strategies, including short selling. The Fund will utilise short selling and leverage to enhance its risk/return profile and introduces additional risks to investors when compared to traditional long-only Australian Equity funds. Lonsec considers the Fund to have a meaningful exposure to small-cap securities and as such invests in markets that are less liquid and more volatile than the large-cap Australian equity market. The Fund should be used to complement large cap exposures in portfolios, rather than replace them. Lonsec's model portfolio asset allocation (traditional assets only) is limited to 'Growth' and 'High Growth' risk profiles. Lonsec recommends that equity investments are suitable for investors with an investment time horizon of at least five years.
- The Fund is subject to equity market risk and movements (both positive and negative) in the share prices of the underlying securities in the portfolio. Investors should therefore be aware that the Fund may experience periods of negative returns and that there is a risk of potential capital losses being incurred on their investment. Lonsec recommends that investors consider all the additional risks associated with short investing (including the potential for unlimited losses) prior to investing.

Suggested Lonsec risk profile suitability

SECURE	DEFENSIVE	CONSERVATIVE	BALANCED	GROWTH	HIGH GROWTH
				●	●

For guidance on appropriate asset allocations and risk profiles, refer to the latest Lonsec Strategic Asset Allocation Review and Risk Profile Definitions on our website.

Changes Since Previous Lonsec Review

- There have been no material changes to the investment process or team since Lonsec's previous review.

Smallco Investment Fund

Lonsec Opinion of this Fund

People and resources

- The investment team comprises seven investment professionals, of which three of the most senior members had previously worked alongside each other at ANZ Securities. While the team tends to adopt a collective decision-making philosophy, Adam Simpson is the lead Portfolio Manager of the Fund and is accountable for its performance.
- Simpson joined the firm in 2017 and has over 20 years of investment experience, most recently at Macquarie Group where he was Division Director and Head of Emerging Leaders Research. Notably, Simpson was known to the Smallco investment team prior to joining the firm. Lonsec believes he is a high-quality investor with complementary experience in smaller market capitalisation companies. Simpson's transition to being the lead portfolio manager has taken place over the course of his tenure at Smallco.
- Simpson is primarily supported by Rob Hopkins. Hopkins possesses over 37 years of investment experience and Lonsec considers his investment skill set to be well-aligned to the Manager's fundamental, bottom-up stock selection process.
- Simpson and Hopkins sit alongside the five remaining members of the investment team: Bill Ryan, Craig Miller, Andrew Hokin, Paul Graham, and Han Xu. The investment team exhibits notable co-tenure working together at the Manager and/or at other investment management firms. Pleasingly, there have been no departures from the investment team since inception of the firm in 2000.
- Lonsec has observed a highly performance-driven culture at the firm, one which to date has proven to be conducive to a stable environment with a clear alignment of interests between the investment team and end investors. Hopkins and Ryan remain large equity owners and pleasingly, equity has been afforded to other investment team members, serving to strengthen their engagement with the firm. Additionally, there is a high level of co-investment among staff and the performance fee structure further aligns their interests.
- Key person risk is high in co-founders Hopkins and Ryan given their integral involvement in the Manager's investment process and broader business. That said, Lonsec acknowledges the equity ownership structure to be a significant mitigating factor and notes the co-portfolio manager structure aids in key investor continuity. The involvement of Simpson in managing the Fund and from a succession planning perspective also tempers this risk somewhat. Nonetheless, Lonsec would view the departure of these individuals to be a material event.

Research and portfolio construction

- The Manager's investment philosophy is centred on identifying companies that are likely to exceed consensus earnings estimates in the medium-term given pricing inefficiencies are likely to be more prevalent in smaller market capitalisation names. This leads the Manager to seek out a core group of undervalued quality companies through criteria that favour companies with high cash generation ability, attractive earnings outlooks, and strong competitive advantages. This is supplemented by opportunistic value ideas where a six-to-12-month re-rating trigger exists. Lonsec believes the Manager has demonstrated an investment edge in companies with a market capitalisation between $100-500m.
- The investment process is pragmatic and bespoke to the Manager's philosophy through a focus on understanding the key drivers of earnings. Engagement with company management features prominently and underpins the internal research effort, with two investment team members attending each meeting. Lonsec highlights the strong emphasis placed on meeting with company management, believing this to be conducive to high conviction, concentrated approaches. Lonsec has a strong conviction in the Manager's bottom-up research process.
- The Manager also leverages sell-side research in the preliminary stages of the investment process, primarily to speed up familiarisation with new companies and industries. Lonsec notes, however, internally generated research is the driver of investment decisions. Valuation is based on a range of multiples-based tools that are forecasted over a three-year investment horizon. The Manager's dual coverage approach to stocks extends to financial modelling and is considered to promote robustness in challenging key inputs into the models and assist in proving/disproving investment theses. Lonsec considers the approach to be a positive and encourages procedural rigour to the investment process.
- Portfolio construction is consultative but ultimately led by Hopkins, who is responsible for constructing a portfolio reflecting the Manager's highest conviction ideas. Portfolio construction is primarily driven by the Manager's Quality Rating System to aid in limiting exposure to lower quality names that are trading at attractive prices. Lonsec considers the portfolio construction process to be robust, with a clear link between the team's conviction in each stock, the assessment of its risk and its weight within the portfolio.
- The high conviction nature of the investment process means only the Manager's best ideas are included in the portfolio and the cash weighting will tend to increase in times of limited opportunities. Lonsec assesses the asset allocation decision between equities and cash to be more art than science in comparison to some multi-asset products that may incorporate some form of systematic determination such as valuation triggers.
- Positions are trimmed as they approach the Manager's assessment of their intrinsic value, and typically sold when they surpass their predicted valuation or there is a negative change in the

company's fundamentals. However, Lonsec notes the flexibility around sell discipline with the Manager previously exhibiting a tendency to tolerate holding growth stocks with high valuations if their fundamental growth story remains intact. Notwithstanding, Lonsec considers the Manager to be more pragmatic in reducing positions as they approach the investment team's predicted valuation relative to some of its peers and is more active in selling positions judged to be lower quality and/or with more cyclical earnings.

- While the Manager can short stocks and gear, Lonsec notes the gearing facility has not been used since August 2007, and the utilisation of shorting has been sparse. Candidates for shorting are fundamentally driven (i.e. fundamental analysis indicates that the stock is overvalued) and included only when an identifiable catalyst exists, indicating it is likely to disappoint market expectations in the short-term. Lonsec considers this approach to be consistent with the Manager's overall investment philosophy. Nevertheless, the shorting aspect of the process is less frequently featured in the Fund relative to other long/short peers.
- Additionally, the Fund can invest up to 30% of the portfolio in stocks that are deemed to be illiquid. Lonsec notes that high allocations to illiquid securities may impact performance in distressed market environments or in the case of significant redemptions. One factor reducing this risk is the Fund's typical cash holding.
- The Fund's ability to hold up to 50% in cash adds a defensive tilt to the portfolio and is utilised when investment opportunities are not readily available. The Fund's cash balance has averaged around 18% since Lonsec's previous review, and the Manager has demonstrated in the past its ability to utilise the extent of its cash limit. Nonetheless, Lonsec notes that the persistently high cash weight has been a drag on performance since inception and, although Lonsec has been encouraged by the Manager's disciplined approach to capacity management, may be an indication of capacity/liquidity concerns.

ESG integration

- Lonsec's ESG integration assessment considers how rigorous, robust, and structured the ESG process for the Fund is, as well as how well it integrates into the overall investment process and the Manager's overall policy and reporting framework. The assessment is not intended to assess the underlying holdings of the Fund's portfolio or the Manager's adherence to any form of impact, green / sustainable or ethical standards.
- At the overall corporate level, Lonsec views the Manager's overall ESG framework as significantly behind peers. The Manager has not articulated a commitment to the integration of ESG within their investment process to Lonsec. There is no evidence in their public positioning, nor does the Manager seem to have any ESG related policies or frameworks in place.
- The Manager has indicated that their Responsible Investment style is 'ESG Integration' and as such they take Environmental, Social and Governance factors into consideration when assessing investment opportunities. With a primary ESG style of 'Stewardship' Managers will usually focus their ESG strategy on Engagement and Voting as the key tool in managing their ESG risks. While stewardship approaches are common across most Managers, they can form the key ESG strategy employed by some Managers. Due to the qualitative nature of this style, Lonsec highlights the need for Managers to provide clear and detailed reporting on both engagement and voting activities and recommends investors review the fund stewardship reporting where available.
- Within the management of this specific Fund, Lonsec notes:
  - The Manager has no observable structured approach to the collection of ESG data within their investment process. The Manager does not source general external ESG data instead relying on collecting its own ESG data through company meetings and web sites. Lonsec believes that this is less robust than peers.
  - There is no focused internal ESG research carried out by the Manager for this Fund.
  - There is no relationship between ESG factors and the stock selection process.
  - While some ESG rules drive exclusions or position caps, there is no clear use of portfolio level measurement of ESG characteristics apparent. There are no portfolio level ESG based limits or targets in place for the Fund.
  - While the Manager has systems in place to track engagements, evidence of actual engagement to deliver ESG objectives is minimal. There is no clear system for prioritising engagements or for measuring success.
  - ESG does not form a component of the Manager's broader compliance framework and overall transparency provided to investors is lagging. Pleasingly, voting on the Fund is directed by the Fund's portfolio manager directly.

Risk management

- Lonsec believes the Manager has adequate risk controls in place to manage the long and short side of the portfolio, although notes that risk management is largely embedded within the Manager's bottom-up investment process.
- The Fund's design means there are minimal formal portfolio risk limits, in line with other high conviction peers. The potential stock concentration in the Fund is high with a single stock being up to 20% (at current valuation) of the portfolio. Furthermore, exposure to any one sector can be significant, although closely monitored by the Manager. Portfolio risk limits comprise at least four GICS sectors with a maximum of 20% (soft).
- On the long side, the Manager's Quality Rating System assigns a score to each stock in the portfolio from which a weighted average quality rating is calculated for the Fund. An internal portfolio construction rule requires the Fund to meet a minimum quality score. Lonsec believes the use of these scores assist the Manager to avoid unintended risk within the portfolio, enhances sell discipline, and ensures exposure to lower quality and cyclical stocks are controlled.

Smallco Investment Fund

- On the short side, a shorting agreement stipulates trading rules, a trading schedule is prepared detailing the sell and buyback prices for the stock prior to entering the position, and there is a maximum stop loss of 7% for each short position. Lonsec considers this to be a prudent discipline.
- The Fund also employs a separate 25% limit on total exposure to what are assessed as lower quality companies. The Manager has a relatively broad definition of what constitutes lower quality, which includes most non-major resource and mining service stocks, and companies that are considered to be in structurally impaired industries. Additionally, the Fund can invest up to 30% of the portfolio in stocks that are deemed to be illiquid. While Lonsec considers the allocation to be generous, these are consistent with the Manager's tight capacity management.
- The Fund may be geared up to 30% actively via a margin lending facility. This may increase passively to a maximum of 50% (i.e. in the event of a decline in the Fund's equity). Gearing is primarily employed to manage the portfolio's short exposure. The Manager has historically been relatively conservative in its employment of gearing (as well as shorting) and has generally only geared the portfolio if an explicit opportunity arises.

Capacity management

- Firmwide FUM as of 31 July 2023 was approximately $766.8m, including $425.3m in the Fund. In April 2020, the Manager reopened both the Fund and the Smallco Broadcap Fund to new and existing investors.
- Historically, Lonsec has observed prudent discipline by the Manager in relation to capacity management, having previously closed the Fund to investors when capacity was reached. Pleasingly, the Manager has continued to demonstrate prudent judgement through the Fund's reopening. Lonsec is supportive of the Manager's discipline, which should help preserve the Fund's appeal.

Fees

- Lonsec considers the AFC of the Fund (4.61% p.a.) to be high, noting it to be amongst the highest aggregate fee load in the Australian Equity universe.
- Lonsec considers the lack of any hurdle for payment of the performance fee other than positive absolute performance above the high-water mark, to be misaligned to the underlying risk characteristics. While the Fund does not have an explicit internal objective, Lonsec would prefer to see a performance fee hurdle that is commensurate with the Fund's investment process and performance objectives.

Product

- Smallco Investment Manager Limited is the Responsible Entity ('RE') of the Fund and thus is a related entity. The RE is responsible for operating and managing the MIS, holds an AFSL and as such is required to comply with its AFSL and RE obligations as outlined under the Corporations Act. Lonsec notes the RE has built experience in operating and managing over an extended period and is expected to have a governance framework in place to deal with any perceived conflicts of interest.
- The Fund is a relatively vanilla listed Australian equity strategy. Hence, Lonsec does not consider it to be operationally challenging to implement. The Fund can utilise shorting and a margin lending facility to lever the fund, however, Lonsec does not consider these facets of the fund to be overly challenging to execute given the Manager's experience. Focussing on small cap investing may pose some operational and liquidity challenges at times of market dislocation given the daily liquid nature of the Fund.
- The Fund's size at the time of review was $425.3m (July 2023). Lonsec considers wind-up risk for the Fund to be minimal.

Performance

- The Fund does not have an explicit internal objective and seeks to achieve high compound returns.
- As of 31 July 2023, over the three and five-year periods, the Fund returned 11.8% p.a. and 7.8% p.a. respectively. The Fund underperformed the S&P/ASX 300 Accumulation Index ('the assigned Benchmark') by -0.1% p.a. over the three-year period whilst outperforming the assigned Benchmark by 0.3% p.a. over the five-year period. Similarly, the Fund underperformed the peer median over the three-year period by -0.7% p.a. whilst outperforming over the five-year period by 0.5% p.a.
- The Fund's nearer term performance has been strong, returning 14.7% over the 12-month period, outperforming the assigned Benchmark by 3.6% and the peer group median by 4.4%.
- Lonsec notes that the Fund has a significant small cap bias, with the Fund limited to 20% exposure to ASX100 companies and does not invest in resources. As such, the Fund may be more appropriately measured against the S&P/ASX Small Industrials TR Index ('the Index'). As of 31 July 2023, over the three and five-year periods, the Fund outperformed the Index by 6.7% p.a. and 5.0% p.a. respectively. There is also strong outperformance relative to the Index over the past 12 months, as the Fund returned 14.7%, while the Index returns were much softer with a 2.6% return.
- The Fund typically displays high volatility, as measured by standard deviation. Over the three-year period to 31 July 2022, standard deviation for the fund was 20.3% p.a., compared to the peer median of 15.2% p.a.

Overall

- Lonsec has maintained the Fund's **'Recommended'** rating at its most recent review. Supporting the rating is Lonsec's conviction in the investment team who has maintained strong outperformance since inception. Furthermore, the Manager has continued to demonstrate prudent discipline in relation to capacity management, which serves to preserve the Fund's investment appeal.
- Detracting from the rating is the Fund's high aggregate fee load and Lonsec considers the performance fee structure to be misaligned to the underlying risk characteristics of the Fund. Additionally, Lonsec is wary of high allocations to illiquid holdings and will continue to monitor this aspect in future reviews whilst It is also noted

that the Manager has seldom made full use of the flexibility in the Fund's investment mandate.

People and Resources

Corporate overview

Smallco Investment Manager Limited is a boutique funds management firm based in Sydney. The firm was founded in April 2000 by Rob Hopkins and Bill Ryan and remains privately owned by senior members of the investment team. The firm specialises in managing small and mid-cap Australian Equity strategies, with $766.8m of FUM (as of July 2023) across three strategies.

Size and experience

NAME	POSITION	EXPERIENCE INDUSTRY / FIRM
ROB HOPKINS	MANAGING DIRECTOR	37 / 23
BILL RYAN	EXECUTIVE DIRECTOR	27 / 23
ADAM SIMPSON	PORTFOLIO MANAGER	20 / 6
CRAIG MILLER	PORTFOLIO MANAGER	18 / 18
ANDREW HOKIN	PORTFOLIO MANAGER	28 / 16
PAUL GRAHAM	PORTFOLIO MANAGER	28 / 9
HAN XU	PORTFOLIO MANAGER	16 / 5

The investment team comprises seven investment professionals with an average 25 years of investment experience. Managing Director Rob Hopkins and Executive Director Bill Ryan lead the team.

Adam Simpson is the Portfolio Manager of the Fund and has 20 years of industry experience and six years tenure at Smallco. Prior to Smallco, Simpson was at Macquarie where he had been a Division Director and Head of Emerging Leaders Research.

Hopkins with 37 years of industry experience has previously led small companies research at brokerage firms Macquarie Equities, BT Alex Brown, ANZ Securities and Macintosh Securities. Ryan with 25 years of industry experience previously worked at ANZ Securities.

Team structure

The Fund is managed by Simpson, while Andrew Hokin manages the Smallco Broadcap Fund. Craig Miller, Paul Graham, and Han Xu are responsible for research and providing support to the portfolio managers. Miller also serves as the firm's day-to-day business manager.

Remuneration / Alignment of interests

All key investment professionals have either equity ownership or profit share arrangements. Additionally, there is a high level of co-investment among staff.

Research Approach

Overview

RESEARCH PHILOSOPHY	FUNDAMENTAL, BOTTOM-UP
TARGET COMPANY	COMPANIES THAT ARE LIKELY TO EXCEED CONSENSUS EARNINGS EXPECTATIONS OR OUT OF FAVOUR
MINIMUM MARKET CAPITALISATION	$100M (SOFT)
NUMBER OF STOCKS IN MANAGER'S UNIVERSE	500
NUMBER OF STOCKS FULLY MODELLED/RESEARCHED	115
RESEARCH INPUTS	COMPANY MEETINGS (MANAGEMENT, COMPETITORS, SUPPLIERS), INDUSTRY ANALYSIS
BROKER RESEARCH	USED TO SUPPLEMENT INTERNAL RESEARCH
VALUATION OVERVIEW	PRICE-TO-EARNINGS RATIO, EBIT/EBITDA AND PRICE-TO-CASHFLOW MULTIPLES

Universe filtering

The investment universe is initially screened for a minimum market capitalisation of $100m. The Manager then applies a Porter-style Quality Rating System filter with each stock reviewed and assigns a numerical rating (between 0-10) based on its quality and cyclicality. The refined investment universe comprises approximately 115 stocks, which are considered candidates for further bottom-up, fundamental research.

The Manager excludes resource stocks, biotechnology companies and companies with cyclical earnings. Additionally, a light green ethical overlay is applied that exclude companies whose principal business interest involves alcohol, tobacco, gambling equipment or facilities and armaments.

Research approach

Meetings with company management form part of the bottom-up research process with the aim of identifying companies likely to exceed consensus earnings estimates. Company meetings provide a forum to prove/disprove the investment thesis with two members of the investment team assigned to each stock in the refined universe.

Top-down and macroeconomic analysis does not feature heavily in the investment process, and is rather used as a feedback mechanism to assist in concentrating the Manager's bottom-up research effort.

On the short side, the aim is to identify companies that are trading at a significant premium to valuation and have an identifiable situation that will likely cause the stock to underperform market expectations over the short-term. Ideas for the short side generally come from the same refined universe as the long side and may be identified during the process of searching for potential long positions.

Valuation

The valuation process is comprised of an amalgamation of multiples-based accounting ratios such as Price-to Earnings ratio, and EBIT/EBITDA and Price-to-Cashflow multiples. Multiple accounting ratios are implemented to compare a company's current trading price against the Manager's assessment of its intrinsic value.

Smallco Investment Fund

Portfolio Construction

Overview

FUND BENCHMARK	NO BENCHMARK USED
INTERNAL RETURN OBJECTIVE	TO ACHIEVE HIGH COMPOUND RETURNS
INTERNAL RISK OBJECTIVE	NO STATED RISK OBJECTIVE
PORTFOLIO MANAGEMENT APPROACH	BENCHMARK UNAWARE, CONCENTRATED
INVESTMENT STYLE	GARP
PORTFOLIO DECISION MAKING	PORTFOLIO MANAGER CONSENSUS
STOCK SELECTION	BOTTOM-UP
TOP-DOWN INFLUENCE	MINOR CONSIDERATION
MARKET CAPITALISATION BIAS	SMALL – MID
TYPICAL NUMBER OF HOLDINGS	25 – 35
EXPECTED PORTFOLIO TURNOVER	30% P.A.
PORTFOLIO EXPOSURE IN TOP 10 HOLDINGS	63.4% (JULY 2023)

Decision making

Portfolio construction is the responsibility of Simpson. However, given the collective decision-making philosophy, consensus views will also have some influence on positioning. The Manager aims to construct a portfolio with 25-35 of the most attractive stocks (primarily based on current discount to valuation) as identified during the research phase, while considering the portfolio risk limits.

Position sizing is at the discretion of Simpson, with sizing dependent on a company's discount to its intrinsic value and score from the proprietary Quality Rating System. Additional factors considered in position sizing include the Fund and stocks' liquidity, risk of sustained capital loss, and likely investment outcomes. In general, positions of 3%, 5% or 7% will be implemented, with the ability of a position to extend up to 10% (at cost) and 20% (at current valuation).

The Manager may engage in a moderate amount of short selling to complement long positions. Short selling by the Manager is considered opportunistic.

Buy and sell drivers

At a high level, stocks that trade below the Manager's assessment of their intrinsic value, combined with sound company management, high cash generation ability, strong competitive position and attractive earnings outlook are candidates for portfolio inclusion. Conversely, stocks are sold when they reach the Manager's predicted valuation or if there is a negative change in the company's fundamentals.

Risk Management

Risk limits

SEPARATE INVESTMENT RISK MONITORING	NO
STOCK LIMITS	MAXIMUM 10% AT COST / 20% AT CURRENT VALUATION
SECTOR / INDUSTRY LIMITS	EXPOSURE TO AT LEAST FOUR GICS SECTORS
SHORT POSITION LIMITS	MAXIMUM 30% ACTIVE / 50% PASSIVE
GEARING LIMITS	MAXIMUM 30% ACTIVE / 50% PASSIVE
CASH LIMIT	MAXIMUM 50%
USE OF DERIVATIVES	NOT PERMITTED

The Fund is managed with a broad range of risk limits at the stock and sector level in absolute terms. Position sizes are limited to 10% of the portfolio at cost, to a maximum of 20% at current valuation. Sector exposures comprise at least four GICS sectors. Other limits implemented include restricting the exposure to securities deemed illiquid to a maximum 30% of the portfolio.

Short positions can actively comprise up to 30% of the portfolio and with the ability to passively increase to 50%. Short positions each have stop loss limits in place of up to 7% of the portfolio per short position. Gearing limits are in place with the ability to actively gear up to 30% of the portfolio and passively increase to 50%.

Risk monitoring

The Manager monitors a range of performance metrics, such as attribution of the long versus short side, win/loss ratio and absolute return ratio. Diversification, risk, quality, cyclicality and liquidity controls in place are monitored daily.

Fund performance and positions with respect to its risk parameters are formally considered at the quarterly board meeting where, in particular, diversification at the stock and sector level, and liquidity are considered.

Risks

An investment in the Fund carries a number of standard investment risks associated with investment markets. These include performance, liquidity, counterparty, market and tax risks. These and other risks are outlined in the PDS and should be read in full and understood by potential investors. Lonsec considers the following to be the major risks:

Equity market risk

Investments in equity markets are subject to numerous factors, which may have an impact on the performance of an investment (both positive and negative). Unexpected changes in economic, technological, structural, regulatory or political conditions can have an impact on the returns of all investments within a particular market.

Liquidity risk

The Fund may encounter difficulties or be unable to sell some of its asset due to factors specific to that investment or prevailing market conditions. It may also potentially result in delays in processing, or even the suspension of redemptions if some of its assets are unable to be sold.

Gearing / Leverage risk

The Fund may gear up to a maximum of 50% of its net asset value, which increases the risk of an investment as it amplifies potential gains and losses. The Fund is also permitted to short-sell stocks (i.e. borrow and sell a stock it does not own) and have gross exposure to equities of over 100% of the portfolio. The combination of gearing and short selling may increase the Fund's maximum gross exposure to equities to 200%.

Lonsec

Smallco Investment Fund

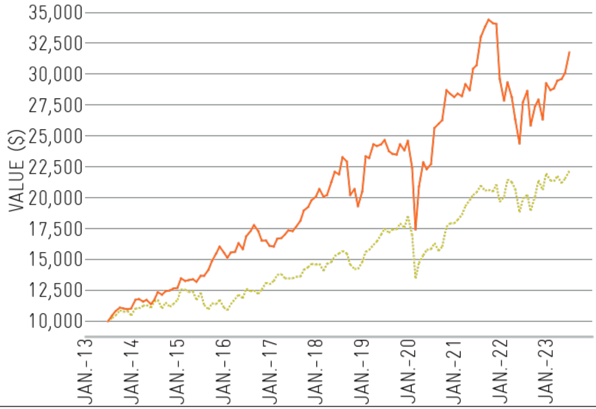
Quantitative Performance Analysis - annualised after-fee % returns (at 31-7-2023)

Performance metrics

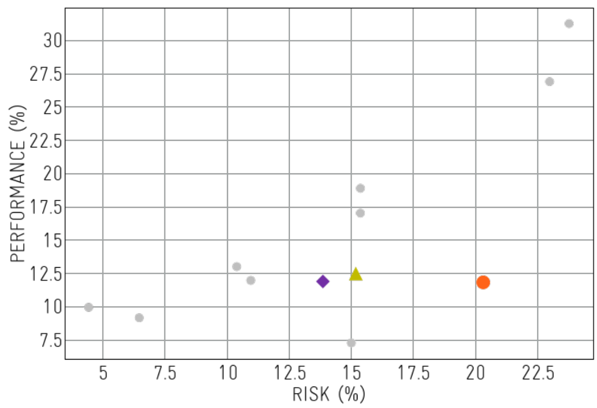
	1 YR		3 YR		5 YR		10 YR	
	FUND	PEER MEDIAN	FUND	PEER MEDIAN	FUND	PEER MEDIAN	FUND	PEER MEDIAN
PERFORMANCE (% PA)	14.70	10.32	11.84	12.51	7.76	7.29	12.26	9.33
STANDARD DEVIATION (% PA)	18.82	14.03	20.31	15.18	23.84	16.30	18.03	13.61
EXCESS RETURN (% PA)	3.61	2.87	-0.07	6.03	0.30	0.85	3.97	2.30
OUTPERFORMANCE RATIO (% PA)	58.33	50.00	41.67	54.17	41.67	49.17	50.00	49.17
WORST DRAWDOWN (%)	-9.68	-6.06	-29.07	-11.93	-29.30	-24.78	-29.30	-25.79
TIME TO RECOVERY (MTHS)	4	2	NR	NR	5	12	5	14
SHARPE RATIO	0.61	0.65	0.53	1.13	0.27	0.42	0.59	0.58
INFORMATION RATIO	0.38	0.38	-0.01	0.73	0.02	0.09	0.34	0.26
TRACKING ERROR (% PA)	9.38	6.66	13.07	7.23	13.43	8.20	11.51	6.03

PRODUCT: SMALLCO INVESTMENT FUND
LONSEC PEER GROUP: AUSTRALIAN EQUITIES - AUSTRALIAN LONG SHORT - VARIABLE BETA
PRODUCT BENCHMARK: S&P/ASX 300 TR INDEX AUD
CASH BENCHMARK: BLOOMBERG AUSBOND BANK BILL INDEX AUD
TIME TO RECOVERY: NR - NOT RECOVERED, DASH - NO DRAWDOWN DURING PERIOD

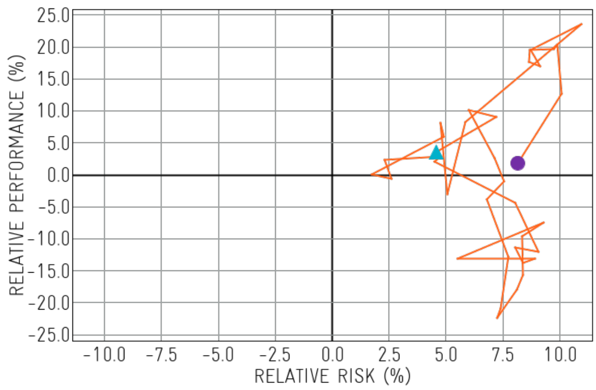
Growth of $10,000 over 10 years



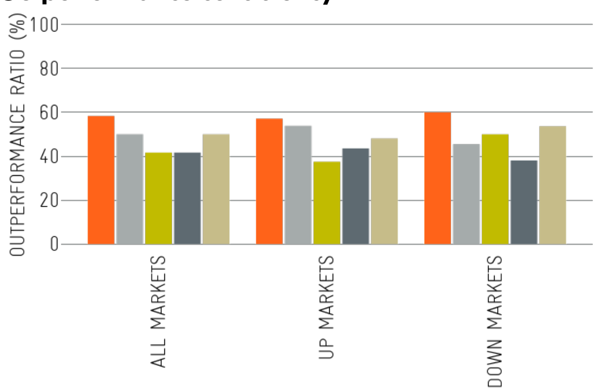
Risk-return chart over three years



Snail trail



Outperformance consistency



Smallco Investment Fund

Glossary

Total return 'Top line' actual return, after fees

Excess return Return in excess of the benchmark return

Standard deviation Volatility of monthly Absolute Returns

Tracking error Volatility of monthly Excess Returns against the benchmark (the Standard Deviation of monthly Excess Returns)

Sharpe ratio Absolute reward for absolute risk taken (outperformance of the risk free return (Bank Bills) / Standard Deviation)

Information ratio Relative reward for relative risk taken (Excess Returns / Tracking Error)

Worst drawdown The worst cumulative loss ('peak to trough') experienced over the period assessed

Time to recovery The number of months taken to recover the Worst Drawdown

Snail Trail A trailing 12-month relative performance and relative risk measurement over the benchmark. The trail is generated using a 12-month rolling window over the specified period

About Lonsec

Lonsec Research Pty Ltd (Lonsec) is an investment research house with specialist areas of expertise, that was originally established in 1994 and the current entity was registered on 23 June 2011. From 1 July 2011, Lonsec became a fully owned subsidiary of Lonsec Fiscal Holdings Pty Ltd, a privately owned entity with a multi-brand strategy of providing leading financial services research and investment execution. Lonsec believes that professional financial advisers need informed opinions on the best investment strategies and financial products to provide real value for their clients. To meet this need, Lonsec has in place an experienced research team, which draws on a robust research process to undertake in-depth assessment of managed fund products.

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