Tribeca Australian Smaller Companies Fund Class A

GRANT SAMUEL FUNDS MANAGEMENT

Tribeca Investment Partners

QUARTERLY FUND UPDATE

Performance

At 31 December 2018

	1 month %	3 months %	1 year % pa	3 years % pa	5 years % pa	7 years % pa	Since inception[1] % pa
Class A Units[2]	(6.68)	(17.43)	(9.40)	4.73	5.44	6.90	6.11
Benchmark[3]	(4.18)	(13.70)	(8.67)	7.45	5.62	4.82	3.38
Value added	(2.50)	(3.73)	(0.73)	(2.72)	(0.18)	2.08	2.73

1. Inception date: 5 August 2010
2. Returns are based on end of month redemption prices and calculated after the deduction of ongoing fees and expenses but before tax and assume distributions are reinvested.
3. S&P/ASX Small Ordinaries Accumulation Index

Past performance is provided for illustrative purposes only and is not a guide to future performance.

Fund facts

Top 5 holdings	Portfolio%	Index%[1]
Steadfast Group Limited	4.1	1.3
OceanaGold Corp	3.3	0.2
PWR Holdings Ltd.	3.3	--
Independence Group NL	3.2	1.1
Austal Limited	3.2	0.4

Portfolio characteristics	Portfolio%	Index%[1]
Communication Services	6.3	5.3
Consumer Discretionary	12.3	15.4
Consumer Staples	6.6	7.7
Energy	7.8	6.3
Financials (ex-Property Trusts)	8.6	8.9
Healthcare	4.2	7.7
Industrials	13.3	7.0
Information Technology	8.8	10.6
Materials	27.0	19.5
Property Trusts	--	11.3
Utilities	--	0.5
Cash	5.1	--
TOTAL[2]	**100.0**	**100.0**

[1] S&P/ASX Small Ordinaries Accumulation Index

[2] May not total due to rounding

Commentary

Global risk appetite collapsed during the quarter as central banks continued to scale back qualitative easing, with forecasters claiming they will become net asset sellers in Q4 2018 for the first time since the GFC. Continuing concerns such as trade wars, emerging market weakness and high oil prices triggered volatility that rippled across stock markets and asset classes across the globe, with most indices finishing the deeply negative. Suffice to say, emerging markets ultimately outperformed while developed markets bore the brunt of the pain. Domestically, the broad S&P/ASX200 Accumulation Index was one of the better performing markets globally, closing 8.2% lower for the quarter. Given the risk aversion, small caps underperformed, the S&P/ASX Small Ordinaries Accumulation Index diving 13.7% as resources (iron ore +2.3% supported the large miners) and industrials both underperformed their larger peers by roughly similar amounts.

US midterm election results were largely in line with expectations, with Republicans losing the House but managed to gain some seats in the Senate, which will likely limit Republican party policy ambitions going forward. US economic indicators softened through the quarter but remained at solid levels, as the lagged impact from stronger USD and tighter liquidity slowed activity levels. Markets became preoccupied with the trajectory of growth and started speculating when the economy would fall into recession, spurring demand for safe haven assets (US 10 year treasury yield -38bps). China continued to try and balance the impacts from the trade war and deleveraging program while maintaining acceptable levels of growth. Slowing global growth and roiling markets lead to a postponement of tariff increases by the US while the two sides opened a 90-day window to frame up a trade deal. Subsequently, the US Federal Reserve also acknowledged the recent impacts to growth, lowering their forecast increase for rates in 2019 and their estimate for the level of neutral rate positioning.

Within the domestic small cap market, outside of gold, AREITs and consumer staples not much escaped the market drawdown. Energy was the worst performing sector after a confluence of events surrounding Iranian sanctions lead to an oversupplied oil market into year end. Oil prices fell 35% for the quarter, ignoring the OPEC+ and Canadian decision in early December to moderate supply, and this significantly impacted our overweight positions in energy (including domestic gas). Our underweight position in AREITs was also painful, with the collapse in bond yields and obvious revisions to future inflation from lower oil prices supporting the sector despite property cap rates around all-time lows.

Underlying much of the above seems to be a market struggle over the length and breadth of the current business cycle. Our portfolio was set in the context of a normal business cycle and we expected to move through a late cycle inflationary period that would likely benefit materials and some cyclicals and prove harder for some longer duration stocks. From a macro point of view, inflationary expectations have been dampened in the short term as lower oil prices feed through the global marketplace, however the end result may well be that the current cycle is extended. Moreover, should the US Fed signal a pause in its rate cycle and the USD weaken, financial conditions would loosen and again provide a fillip to global growth.

From a stock performance point of view, our oil overweights were a significant drag on performance. WorleyParsons (WOR -41.5%) had been a top contributor for the Fund and we had significantly reduced our overweight when they announced an acquisition and large capital raise, as it was the day before oil prices collapsed. We think the acquisition makes strategic sense and will deliver value for shareholders over time. Sundance (SEA -55.6%) was hammered given their position in onshore US shale. However, break even is low, quality of their field is good and reserve life is long and we expect the stock to rebound. Senex (SXY -45.6%) is largely an east coast gas exposure but wasn't spared, despite its closest comparable (Cooper Energy +2.2%) remaining resilient. Seven Westrac (SVW -37.3%) was largely caught in the cyclical downdraft.

Stocks that did well included Oceana (OGC +17.3%) and Northern Star (NST +11.3%) which benefitted from better AUD gold prices, while PWR Holdings (PWH +3.4%), Austal (ASB -1.5%) and Lynas (LYC -0.6%) where resilient in the face of the challenging market conditions.

Outlook

Markets remain under pressure as the withdrawal of central bank liquidity has driven risk premia higher and set off a cycle of panic. Historically, the equity market has been a good predictor of recessions, although it does give plenty of false positives. The equity market doesn't possess a separate consciousness that forecasts the economy, rather it is a very sensitive barometer of liquidity conditions. As liquidity tightens, either due to policy action by central banks or as counterparty risk increases as credit quality deteriorates, it is reflected quite rapidly in equity prices. The market also moves around freely with animal spirits so bear markets can give a false lead on an impending recession.

Our expectation for some time has been that the withdrawal of QE would have a significant impact on markets and that a lot of its effects would be reversed. That is, bond yields would move higher and PE dispersion within the equity market would contract. There is no precedent for this shift in policy though and the impact has turned out to be somewhat different. We did see bond yields move higher and technology shares come under pressure through the middle of the year, although the subsequent loss of momentum has compounded upon itself to create a bear market. There are two likely reasons for this. Firstly, the order of QE unwind has been led by the US which has caused the USD to strengthen. This has created some disruption in emerging markets and pressured growth. It has also seen Japan and the EU maintain policies to flatten yield curves which has acted as a restraint on the US yield curve as well. Secondly there has been plenty of political policy uncertainty, particularly around US-China trade relations. These traditional signs of a recession with a weaker equity market and flattening yield curve, combined with policy uncertainty have driven further selling of risk assets. Relative pricing within equities has reflected a broad risk off tone with cyclical earnings being sold down heavily to the extent that the market is now discounting a shallow to moderate recession.

Whilst there are some financial market indicators pointing to trouble for growth we think these are being influenced more by QE normalisation than the real economy. The US yield curve has flattened as the Fed has raised rates at the short end while the BoJ and ECB have been buying bonds at the long end which spills into global markets. US investment grade credit spreads have also widened, but this is also a likely return to more normal levels after being suppressed by QE. The US Senior Loan Officers Survey points to commercial lending standards still being eased and shows no impending credit event. Real cash rates are near zero to negative around the developed world and with solid employment growth and a functioning banking system the deleveraging event that will cause a serious recession is not apparent. Since the GFC most of the increased leverage in the world has been in the government sector, with the exception of a few countries like Australia where household leverage has increased significantly. As such, it is difficult to see a recession in the US without a significantly higher level of the yield curve forcing deleveraging by the government and fiscal austerity.

With falling prices for risk assets, the Australian equity market has reacted predictably if not consistently. Defensive assets and cash like proxies have generally outperformed. The irony of this is that the stocks that were some of the biggest beneficiaries of quantitative easing and the suppression of real yields have been the best performers during quantitative tightening as markets have panicked about growth. Anything with a cyclical flavour, including industrials, consumer stocks, mining and mining services have been heavily sold down. The major exception to this was the big miners BHP and Rio Tinto who have significantly outperformed not just other miners, mining services companies and the market as a whole, but many defensive stocks. The inconsistency of this cannot be explained by franking credits alone and is indicative of how technically driven and disconnected from fundamentals the market has become. In essence, we have had a very technical driven sell-off triggered by the withdrawal of central bank liquidity which has seen many stock prices disconnect from fundamentals.

While we remain sanguine around the prospects for global growth we are a little more concerned around the outlook for the Australian economy and particular the housing sector. Positioning wise, we recently added some tech names ahead of reporting season where we see potential for upgrades at reporting season, though remain underweight. We have also selectively added to existing holdings were opportunities have presented. In terms of portfolio tilts, we carry over weights in materials, industrials and energy while underweight health and also REITs, where we feel valuations remain reasonably full.

For more information about the Grant Samuel Tribeca Smaller Companies Fund, please visit www.gsfm.com.au.

Important information

Investment Manager: Tribeca Investment Partners Pty Ltd ABN 64 080 430 100 AFSL 239070, Responsible Entity: Equity Trustees Limited ('EQT') ABN 46 004 031 298 AFSL 240975, Distribution partner: Grant Samuel Funds Management Pty Ltd ('GSFM') ABN 14 125 715 004 AFSL 317587. This report is provided for information purposes only and is not intended to take the place of professional advice. Neither Tribeca, EQT nor GSFM give any warranty as to the accuracy, reliability or completeness of the information in this report nor do they undertake to correct any information subsequently found to be inaccurate. Opinions expressed may change without notice. This report has been prepared without taking into account the investment objectives, financial situation or particular needs of any particular person. Before making an investment decision in relation to the Fund, you should consider the appropriateness of this information having regard to your own objectives, financial situation and needs and read and consider the Fund's product disclosure statement ('PDS') dated 28 September 2017 and the Tribeca Investment Partners Reference Guide which forms part of the PDS. Retail investors may invest in the Fund through a licensed financial adviser or an investment platform using the PDS for that platform which can be obtained from the operator of the platform. This document is issued on **16 January 2019.**