

June 2010

'... "Microcaps" should be a major beneficiary of the ongoing improvement in domestic (and to a lesser extent, global) macroeconomics and provide good leverage to recovering cyclical earnings.'

Portfolio Review

The Microcap Fund performance for the month of June 2010 was -1.89% versus the benchmark return of -4.90%.

The Fund benefited from solid performances by Mineral Resources, Thorn Group, Kathmandu Holdings and Horizon Oil. Detractors to the Portfolio included positions in CSG Limited, Citadel Resources, and TPG Telecom.

Market Review

The Australian equity market (as measured by the S&P/ASX 300 Accumulation Index) closed the month 2.7% lower, which has left the market down 10.1% for the calendar year to date, but up 13.1% for the 2009/10 financial year. Returns outside the large cap stocks were slightly below the performance of the broader market with the S&P/ASX Mid Cap Index recording a gain of 11.7% whilst the S&P/ASX Small Ordinaries returned 11.2%. The performance in the Mid Cap Resources (-1.8%) contributing to the relatively weaker outcome. The equity market was mainly driven by continued concerns over European sovereign debt, moderating growth expectations in the US and China, and the implications for the rate of global recovery. Domestically, the market also continued to deal with the uncertainty around the proposed Resource Super Profits Tax (RSPT), the potential for a profits tax to be extended to other sectors, and a change in the Office of Prime Minister.

Outlook

Whilst a more subdued growth outcome is likely, the market has moved to price in a very bearish scenario. Current consensus earnings price the market at 10.9 times the FY11 forecast – almost a 30% discount to historical trading norms. The market will undoubtedly repeg earnings assumptions in the wake of the forthcoming August reporting season and the risk is for some downward adjustment to this forecast, which currently rests at +25.3% year on year EPS growth. However with such a large discount embedded in prices valuation support is likely to emerge and the market should begin to focus on the level of underlying earnings recovery, rather than the immediate direction of earnings adjustments. FY12 is still being viewed as a further recovery year with +13.2% built into assumptions and resulting in a single digit PE of 9.6 times. The hiatus of foreign direct investment appears to have been somewhat alleviated at a corporate level with the emergence of a new government and consequent scrapping of the proposed RSPT, however offshore investor flows are likely to be slow to return as the market maintains a watchful stance on an uncertain domestic political landscape. Aside from the distractions of politics, the domestic economy remains very buoyant with strong employment and GDP data continuing to flow. The global backdrop has weighed significantly upon domestic market outcomes despite the strong Australian macroeconomics. A reasonable result season and a refocus on the supportive underlying metrics should prove to be the catalyst for a domestic market rerating.

The Microcap market segment continues to be penalised in the current flight to safety but the fundamental story remains positive. The well capitalised domestic corporate landscape is likely to result in moves to consolidate market share

and open up growth options via merger and acquisition activity. And there is some evidence this is starting to occur with bids for Sigma, Watty, Mosaic, Dexion and others in recent months. The small and micro cap space is likely to be a very active market segment, particularly once confidence and clarity on future domestic and global growth prospects returns. Ultimately "Microcaps" should be a major beneficiary of the ongoing improvement in domestic (and to a lesser extent, global) macroeconomics and provide good leverage to recovering cyclical earnings.

Portfolio Characteristics

Returns as at 30th June 2010

Period	Portfolio Return %		Benchmark ¹ %	Out/Under Performance %	
	Gross	Net		Gross	Net
One Month	-1.09	-1.89	-4.90	3.81	3.01
Three Months	-7.16	-8.69	-13.18	6.02	4.49
Since Inception Date: February 2010	5.41	1.92	-9.18	14.59	11.10

¹ S&P/ASX Emerging Companies

Top 10 Stocks

1. CSG
2. Grange Resources
3. Mineral Resources
4. Matrix Composites & Engineering
5. Thorn Group
6. Citadel Resource
7. TPG Telecom
8. Saracen Mineral
9. Tap Oil
10. Automotive Holdings