Clime Smaller Companies Monthly Investment Report

March 2019

Market Commentary

While the rate of growth moderated during the month of March, with the S&P/ASX200 Accumulation Index up 0.7%, the first quarter of 2019 has come as a welcome relief for growth asset investors. Following the sharp pullback last November and December, global investor sentiment and market prices have recovered some of their optimism, largely off the back of a more dovish US Federal Reserve.

The reversal of fortunes in risk assets has come despite generally disappointing macro data across Europe, the US and China and the tempering of corporate earnings forecasts globally. The rally in global equities to date in 2019 has not been driven by expectations for better growth and rising corporate profits, but by reassurance that global central banks would temper their inflation-fighting objective and seek instead to sustain the post-GFC recovery.

Another factor supporting the equity market recovery has been the sense that the sell-off late last year was overdone. The near 30% de-rating in global equity PE ratios from end-January 2018 to end-December 2018 was both brutal and unexpected, given that the world's largest economy, the US, was growing strongly and experiencing a buoyant year for corporate earnings. But of course, markets are forward-looking, and fears of "peak earnings", a Sino-American trade war, a hard landing in China and a Federal Reserve determined to "normalise" rates sapped confidence and soured the mood. The fact that many of these fears have proved either unfounded or exaggerated has supported the rebound.

Now that the first quarter is over, we must assess whether that rebound is either warranted or sustainable. Over the course of the first 3 months of 2019, the S&P/ASX200 has risen 10.9% while global markets have enjoyed similarly impressive quarterly returns. A good part of those figures may be making up the losses from the quarter before that, but it remains for the market to be tested for the most critical factor, which is value.

The likelihood of material further upside for equity markets in the short term is, in our view, now dependent on central banks allowing financial conditions to remain loose, policymakers stimulating activity through prudent infrastructure spending and fiscal relief for households, the successful conclusion to trade talks, the US economy remaining reasonably strong and some sparking of growth in the European and Chinese economies.

In particular, we highlight the effectiveness or otherwise of the broad range of measures implemented by the Chinese authorities to cushion their growth slowdown. The Chinese consumer is the "single most important (factor) in the world economy", said Jim O'Neill, former Goldman Sachs chief economist. "The next 40 years of global growth might be about the Chinese consumer. It is very unlikely that any other country could step in to drive global consumption," he said. China has contributed around 30% of the global economy's growth since 2013, compared to 11-13% from each of India, the European Union, and the United States. The strength of China's economy is critical.

A key support to developed economies (the US, the Eurozone and Japan) remains consumption growth backed by solid labour markets and continued wage growth. To date, the absence of wage growth has been the disappointing factor in the recovery that we saw during last year, and this has been a spur to the growth of populism in many countries. A pause in the central banks' rate rising program and a well-targeted stimulus from China should provide the basis for global growth a little below trend. Resolution of trade conflicts would no doubt also reduce uncertainty and support global growth.

In an environment where economic risks are building and global growth is slowing, careful assessment of investment opportunities is required. The change in tone from the US Fed, and its increased sensitivity to growth and the financial cycle, has led to a fundamental reassessment of risks and opportunities in many financial markets, as the "lower for longer" thesis on interest rates reasserts itself. At the same time, while trade talks between the US and China seem to be progressing, the Brexit imbroglio and many other political risks remain heightened. However, these risks and changes in economic growth expectations present opportunities and an argument for active management and active asset allocation.

Clime's base case is that overall global equity returns in the medium term are likely to be positive but more muted than investors have been used to for most of the post-global financial crisis period. Nonetheless, we expect that late cycle volatility and macro-thematic market drivers combined with company-specific opportunities will provide a satisfactory set of portfolio alternatives for patient investors.

Thank you for your continued support of Clime.

Adrian Ezquerro
Head of Investments

Clime Smaller Companies Fund

The Clime Smaller Companies Fund (CSCF) returned 5.0% (net of fees) for March, continuing the strong performance over February.

While it has been a strong first quarter of the calendar year, we think markets will remain volatile relative to previous years due to generally elevated leverage globally, trade tensions, and the potential for rising interest rates from current low levels.

The main detractor for portfolio performance was Hansen Technologies (ASX: HSN), and we took the opportunity to add to our position.

HSN's billing software is deeply embedded within utility and telco customers, resulting in close to 100% customer retention over long periods. Management have an exemplary track record of acquisitive growth, and with the balance sheet now in a net cash position the company has the capacity to continue this path. Shares are trading below average market multiples, which is unusual for a business of this quality.

Key contributors were Jumbo Interactive (ASX: JIN), Audinate (ASX: AD8), HUB24 (ASX: HUB), and Citadel (ASX: CGL).

On the back of an excellent 1H19 result, JIN was admitted to the ASX300 Index. With this came interest from institutional investors and Tier 1 brokers, which acknowledges the highly attractive features of the JIN business model and growth outlook.

AD8 and HUB performed well on no news. We believe the market is increasingly acknowledging the large opportunity in front of both businesses.

CGL has rebounded after a sell-off on the 1H19 result, which included only modest revenue growth but strong SaaS revenue growth. As the value of SaaS revenue is realised over the customer lifetime, the economic value is perhaps not fully appreciated. The burgeoning Citadel-IX business is quickly gaining traction and could become a large contributor to the business in coming years.

Distributions

Period Ending	Wholesale Units (cents per unit)
30 June 2018	4.3495
30 June 2017 (Inception 24/4/2017)	0.1372

Snapshot

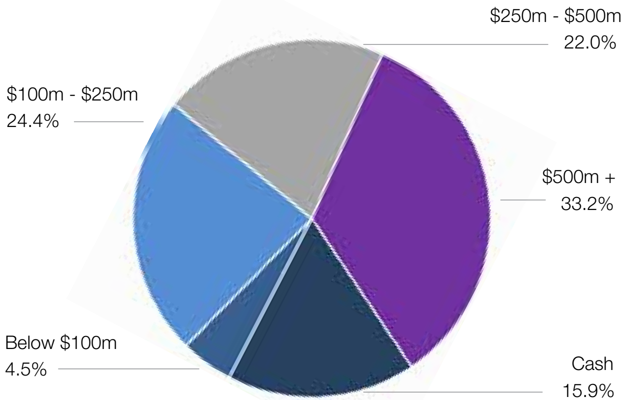
Portfolio Return (Month)	Portfolio Return (1 Year)	Portfolio Return (Since Inception)	Fund Size
5.0%	9.1%	15.8% p.a.	$28.6m

Performance (31/03/19)

	1 month	3 months	6 months	FYTD	1 year	Inception*	Inception (Total)
Portfolio Return (net of fees)	5.0%	9.6%	-0.6%	5.8%	9.1%	15.8%	32.8%
Fund Objective ^	0.8%	2.3%	4.8%	7.3%	9.9%	9.9%	20.0%

* Inception: Wholesale Units: 24 April 2017. Performance figures for more than 1 year are annualised, calculated after all applicable fees and taxes. Returns have been calculated based on starting and ending unit prices after taking into account all ongoing fees, and assuming reinvestment of distributions. ^ CPI + 8% p.a. including GST.

Asset Allocation by Market Capitalisation



Prominent Fund Holdings (alphabetical order)

Afterpay Touch Group Ltd (ASX: APT)

Audinate Group Ltd (ASX: AD8)

Citadel Group Ltd (ASX: CGL)

Lycopodium Ltd (ASX: LYL)

Macquarie Telecom Group Ltd (ASX: MAQ)

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