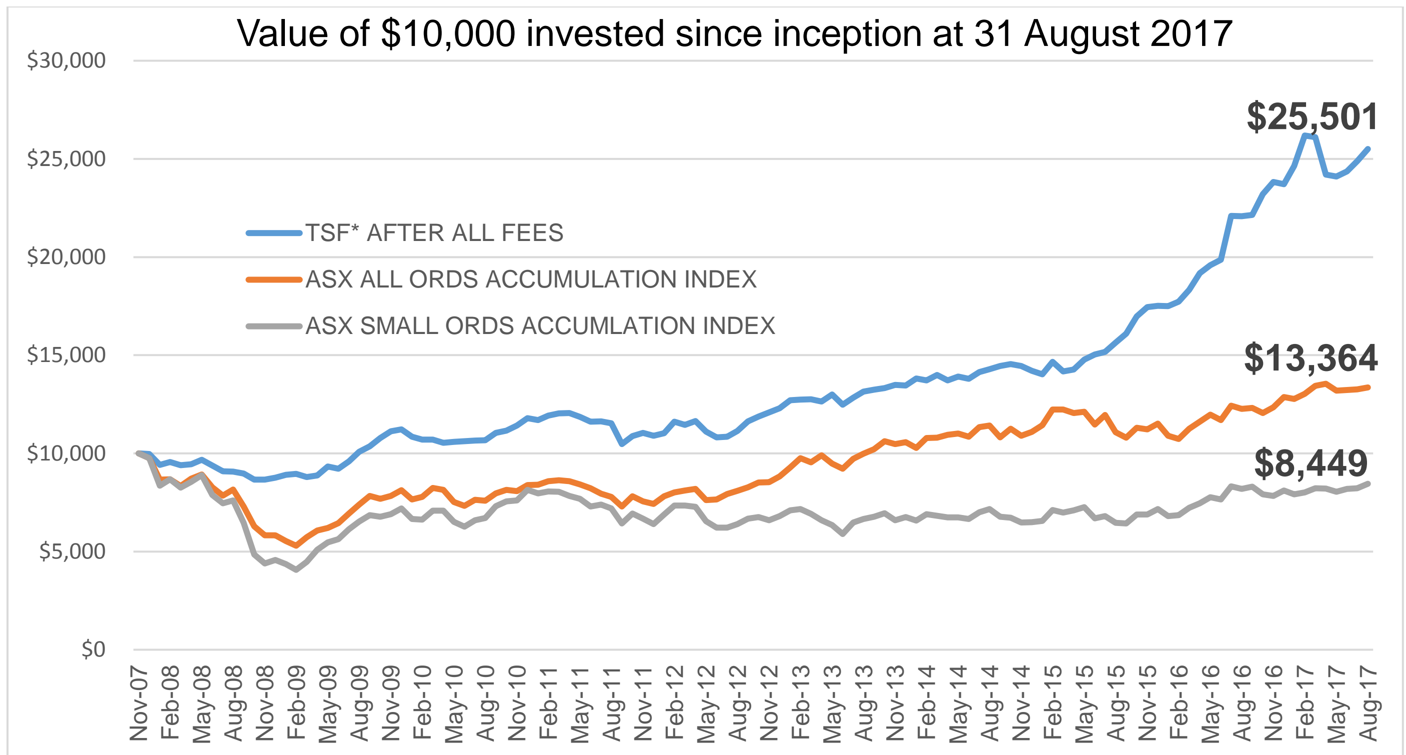
The Supervised Fund (TSF)

Monthly Report – August 2017

PERFORMANCE ANALYSIS	TSF AFTER FEES	ALL ORDS ACCUM	BENCHMARK
Month ending 31 August 2017	**2.4%**	0.2%	0.40%
6 months to end of August	**-2.6%**	2.6%	2.5%
12 months to end of August	**15.5%**	8.9%	5.0%
3 years p.a.	**20.9%**	5.4%	5.0%
Since Inception p.a. (Dec 2007)	**10.1%**	3.0%	5.0%



*Please note TSF returns assume reinvestment of all distributions (as do the indices).

Portfolio at 31 August 2017

Top 15 Positions	% of NAV
Kangaroo Island Plantation Timbers Ltd	24%
Cash	15%
HGL Limited	11%
Hillgrove Resources Limited (equity, notes and calls)	8%
Gale Pacific Limited	6%
Po Valley Energy Limited	5%
ETFS Physical Gold	4%
Bisalloy Steel Group Limited	4%
Sirtex Medical Limited	3%
Bell Financial Group Limited	3%
Ariadne Australia Limited	3%
Nine Entertainment Co Limited	3%
NZME Limited	2%
Base Resources Limited	2%
HT&E Limited	2%

- 0.9% of capital is invested in (put) options over stock market indices.
- 2% of capital is invested in non-ASX listed investments (excluding cash).
- 6% of capital is invested in ASX200 members.
- 16% of capital is invested in oil, gas and resources companies (excluding gold).
- 5% of capital is invested in physical gold and gold mining companies.
- 57% of capital is invested in companies with a market capitalisation of less than $150m.

Commentary

The Fund's result in August was mostly driven by gains in Bathurst Resources Limited (up 32%), Kangaroo Island Plantation Timbers (up 13%), Bisalloy Steel Group Limited (up 12%) and HGL Limited (up 4%), with the biggest detraction coming from Nine Entertainment Co Limited (down 5%).

Financial Year 2017 Reporting Period

During August, 12 of our holdings that represent above 1% of unitholder capital reported financial results. While varied, most results were in line with our expectations and none were materially disappointing. However, what frequently surprised us was the market's panicky, negative reaction to what we perceived as either innocuous or even positive results. We regularly found ourselves leaning on Rudyard Kipling's insightful counsel: "If you can keep you head when all about you are losing theirs." Here are two examples of companies held by Supervised whose results disappointed the market, prompting a sell–off in their share price, yet within three weeks had recovered most of their losses.

On 23 August, Sirtex Medical Limited reported a 5% increase in dose sales and a 21% decline in underlying net profit after tax. The main reasons for the decrease in margins were higher sales and marketing costs to support future growth and expenditure on major clinical studies. On the day of reporting, the stock fell by 10% from $16.26 per share to $14.56 per share. We believed the stock was still inherently undervalued, with a trailing–twelve–month P/E multiple (at $14.56 per share) of 20x and a forward multiple, based on our estimates, of 13x, due to prospects for significant future growth in dose sales (see commentary in our May 2017 performance report). By comparison, Sirtex's average P/E multiple during FY17 was 23x and during FY16, 47x. Consequently, we held onto our stock, which we believed was oversold due to market panic. Three weeks later, the stock price had rallied by 8% to $15.77 per share, recovering nearly all of its value since its post–report sell–off. We see further potential for appreciation and remain happy holders at current share price levels. As at the day of writing (18 September 2017), the stock had fallen to $14.76, near the recent low.

Nine Entertainment Co was a similar story. It released its financial year 2017 results on 24 August, reporting a 3% decrease in revenue and a 3% increase in net profit after tax. The company was able to improve margins by cutting costs in its free–to–air division and growing its more profitable digital business. It also guided for FY18 earnings at the upper end of analysts' forecasts. On the day of reporting, at $1.53 per share, the trailing–twelve–month P/E multiple was 11x. By comparison, the company's average P/E multiple during FY17 was 27x. We felt 11x was cheap, with earnings growth expected over the next five years due to consolidation in the FTA division and growth in the digital business (see commentary in our March 2017 performance report). Consequently, we were comfortable with our 3% holding. However, over the next week, the share price fell by 16%, to as low as $1.275 on 31 August. There was no logical reason for the decline, only a few (what we deemed hollow) news articles questioning the future of Australian media companies. Three weeks later, the share price had recovered most of its losses to reach $1.475, after going ex–dividend of 5c on 4 September. As at the day of writing, the stock is $1.47.

More broadly, during August we went to around thirty company results presentations at various broker offices and listened to numerous earnings calls. We feel this is an invaluable way of gaining insight into economic and industry specific trends both in Australia and overseas. We were pleasantly surprised by the strong growth in domestic industrial companies, particularly those exposed to the resources sector. This is largely a result of the increased spend by mining companies on repair and maintenance of capital equipment. Such industrials still look well placed, with Rio Tinto forecasting their sustaining CAPEX would double over the next 6 months and BHP increasing their CAPEX budget for FY18 by 33% year–on–year. The worst performing companies tended to be in the consumer discretionary sector, particularly non–digital retail. This was largely influenced by the increasing shadow of Amazon and, for those exporting, the rise in the AUD.

Global markets continue to rise, with the MSCI World Index (in USD) up 14% over the last twelve months. Consequently, we see fewer opportunities from the perspective of undervalued companies. Nevertheless, we believe our portfolio is in a good position for growth, with numerous stock specific catalysts yet to transpire. We are also happy with our 15% cash weighting and 1% worth of puts over the S&P, which amounts to a 35% hedge of our portfolio.

18 September 2017.

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