Ophir Asset Management
Level 26, Governor Phillip Tower
One Farrer Place
SYDNEY NSW 2000

Dear Fellow Investors,

Welcome to the **October 2018 Ophir Letter to Investors** – thank you for investing alongside us for the long term.

Month in Review

The month of October has certainly developed a nasty reputation for delivering unfavourable outcomes for equity market participants. While statistically the 'October Effect' is purely mythical in nature (the month has actually averaged a positive monthly return over the last century, inclusive of the October 1929 and 1987 market crashes), the significant contraction experienced across global equity markets this month will do little to quell the fear of the Halloween month. Despite the lack of any specific overarching catalyst, global equity markets retraced significantly over the month, with the MSCI World Index falling -7.6%.

While the losses experienced across equity markets this month have been widespread (financial news service Bloomberg estimated cumulative global losses in value for October were greater than US$8 trillion), **the sell-off retained all the ingredients of a typical equity market correction**: broad-based and indiscriminate in nature, largely sentiment-led, lacking in specific catalysts, and acute in both its fall and subsequent stabilisation. After a significant expansion in equity market valuations across domestic and offshore markets earlier this year, the October retracement has ultimately served to realign valuations (and, arguably, investor risk tolerance) with the current economic environment. Indeed, despite broader global economic growth continuing to expand and corporate profitability levels remaining broadly elevated, all ten of the largest countries (by market capitalisation) represented within the MSCI World Index now trade at levels below which they started the calendar year.

	1 month	6 Months	FYTD	5 year p.a.	Inception p.a.
Ophir Opportunities Fund^	**(10.8)%**	**(0.3)%**	**(4.6)%**	**23.0% p.a.**	**32.9%p.a.**
Benchmark*	(9.6%)	(4.2)%	(8.6)%	6.0% p.a.	6.6% p.a.
Value Add (Gross)	(1.2)%	3.9%	4.0%	17.0% p.a.	26.2% p.a.
Fund Return (Net)	(10.6)%	(0.9)%	(5.0)%	18.0% p.a.	25.8% p.a.

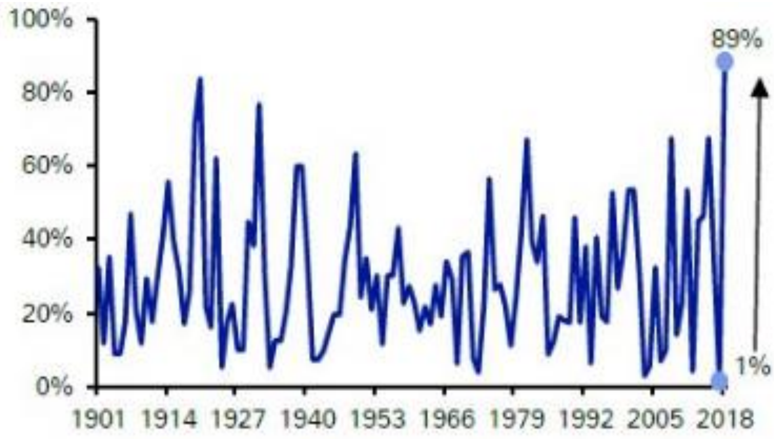
* S&P/ASX Small Ordinaries Accumulation Index (XSOAI)

	1 month	6 Months	FYTD	3 Year p.a.	Inception p.a.
Ophir High Conviction Fund^	**(10.2%)**	**(1.2)%**	**(6.6)%**	**20.2%p.a.**	**25.3% p.a.**
Benchmark*	(8.5%)	(3.1)%	(6.4)%	11.7% p.a.	11.2% p.a.
Value Add (Gross)	(1.7%)	1.8%	(0.3)%	8.4% p.a.	14.1% p.a.
Fund Return (Net)	(10.1%)	(2.2)%	(7.0)%	16.3% p.a.	20.2% p.a.

* 50% S&P/ASX Small Ordinaries Accumulation Index (XSOAI), 50% S&P/ASX Midcap 50 Accumulation Index (XMDAI)

The erosion in asset value wasn't exclusive to the equity market - outside of gold, US dollars, a small number of hard commodities and the Brazilian Real, there were little places for global investors to register a positive move this month. On Deutsche Bank analysis, some 89% of asset classes (priced in US Dollars) now register a negative total return for the calendar year to date – the highest percentage on record since the data was first collected in 1901. While negative returns are not a new phenomenon by any means, investors can often grow complacent to equity market risk following a period of sustained positive returns (making the reality of a retracement in capital value all the more unfamiliar). Somewhat amazingly, across the same cohort of asset classes, only 1% experienced a negative total return last year.

Percentage of Global Assets with a Negative Total Return (in USD's)



Across the Australian equity market, the trend was not dissimilar (albeit the ASX 200 managed to outperform the average developed equity market return via larger index weightings across materials and the defensive consumer staples sectors). Small and mid-cap companies came under pressure as businesses displaying higher levels of earnings growth (and, therefore, attracting higher valuation multiples) and recent market 'winners' fell firmly out of favour – particularly those within the '*larger small cap*' space. The ASX Small Ordinaries Accumulation Index fell -9.6% for the month, while the ASX Small Industrials contracted -10.6% (under-performing the ASX 100 Industrials Index by a fairly significant -5.1%).

While these are not insignificant moves, **both the pattern of selling and the manner in which the correction has played out has been fairly orderly with little signs of overly panicked or stressed market conditions.** From its previous high of 6,352 recorded on August 30th, the ASX 200 has fallen -688 points to its recent low of 5,664 on 25th October – a retracement of -10.8%. This is not statistically irregular by any means (the stock market will, on average, experience a -10% drawdown once every 18 months, depending on how you cut the data), however the velocity of the most recent pullback likely inflated market participant fears somewhat given it occurred over a relatively short time period. Of the last 41 trading days to end the of October, 26 registered a negative daily move.

Certainly across the smaller and mid-cap company space, some components of the sell-off this month shared similarities with the '*Reflation, Rotation and Redemption'* correction cycle experienced by smaller-cap managers through late 2016. In a similar development to that period, it has been the larger, more liquid and (generally) higher-quality businesses that led the sell-off (given these businesses also offer the greatest amount of near-term liquidity). Like the experience of 2016, these collection of businesses can be impacted further by a larger representation of non-natural owners on the register (e.g. larger cap fund managers) that have ventured down the market cap curve in the pursuit of uncovering earnings growth. In response to recent equity market movements (and likely as a means to raise cash), these non-core positions are invariably exited quickly and the cash repatriated back toward their larger cap home base. Whilst this creates some volatility in the short term, the 2016/early 2017 recovery period also teaches us that these businesses tend to be the first to meaningfully recover as markets stabilise.

Regardless of cause, catalyst or timeframe, however, a reduction in portfolio valuation is obviously not a pleasant or desired experience. October delivered tough performance outcomes for both the Ophir Funds, with the Ophir Opportunities Fund finishing the month -10.6% (net of fees), while the Ophir High Conviction Fund contracted -10.1% (net of all fees).

The vast bulk of retracement in portfolio values this month came primarily as a result of broader market weakness and negative sentiment toward businesses within the higher growth / higher quality space, rather than any significant operational issues reported by companies within each portfolio. Across the 49 companies held cumulatively across both the Opportunities and High Conviction Funds this month, only three delivered operational updates that were below market expectations. Iron ore and lithium miner **Mineral Resources (MIN)** reported a short-term construction delay to its Wodgina lithium operations, online car classifieds company **Carsales.com (CAR)** reported slightly weaker revenues from their domestic display and loan finance divisions (compensated by strong performance from their offshore divisions), while fast-fashion retailer **Lovisa (LOV)** reported sluggish domestic same-store sales (again offset by continued success in their UK and US store rollout program).

Indeed, while 'growth' type businesses underperformed the more value-orientated sectors throughout the month, **it was again the deeper value and cyclical-type companies that delivered the bulk of reported earnings disappointments in October** (led by Fairfax Media -22.4%, Nine Entertainment Group -25.2% and Boral -18.8% amongst the key misses). While both Ophir Funds have been somewhat penalised this month by retaining a bias toward higher-quality companies, we continue to feel this is the right exposure for the current stage of the market cycle.

With the 'P' of the Price/Earnings (PE) ratio having now retreated fairly significantly in recent months, the opportunity set available to us to purchase good quality businesses at increasingly attractive valuations is now demonstrably better than it was just two months ago. After a period of strong multiple expansion through the first half of 2018, the ASX Small Ordinaries has subsequently retraced its one-year forward PE to 15.2x – now in line with its five-year average.

Of course, the key requirement for investors to extract full advantage of attractively priced businesses is having immediate access to capital. Having to exit an existing position that has, in some cases, retraced 15-20% (and realising an absolute loss on the holding in the process) to fund a new investment tends to dilute the return one can achieve by simply deploying retained cash holdings directly. In more volatile markets where assets are being priced on sentiment rather than fundamental earnings ability, cash is undeniably king.

As regular readers of these Letters will be aware, in recent months both Funds have been actively reducing positions in a number of higher-growth investments where we felt valuations had become extended and/or lacking in catalysts to drive a meaningful re-rating for the business higher. **Where attractive opportunities to re-deploy that cash haven't been immediately forthcoming, we have been equally happy at this point in the cycle to simply retain higher than average cash positions** in order to have the ability to capitalise on any meaningful periods of market volatility and/or corporate activity.

As a result, both Ophir Funds entered October with historically higher than average cash levels and we have used the recent weakness to deploy a portion of this capital into a number of opportunities where valuations have fallen - in some cases - by 20-25%. Our concentrated Ophir High Conviction Fund, for example, began the month with a 15.6% cash positon, in addition to a further 4% weight in education business **Navitas Limited (NVT)** that became the subject of a takeover offer in late October (ultimately meaning our available capital to deploy theoretically represents ~19% of the portfolio).

With a broader number of well-priced businesses now representing healthier valuations and a meaningful cash position available to deploy, we certainly retain a level of optimism around the opportunities for both portfolios over the months ahead.

Portfolio Management through times of Volatility

Through periods of heightened market volatility, it is natural to receive some questions from investors around portfolio construction and how we, as long-only investment managers, can look to ensure that portfolios can be protected through periods of inevitable downturn. We wrote an extensive Letter on this in March this year (you can access the letter here) – to surmise for new investors/readers, we always look to focus on five key areas when evaluating downside risk:

1) **Focus on Balance Sheet**

As a general rule, we will always tend to avoid highly geared businesses across both Funds and instead favour companies where we have a high degree of comfort in their ability to self-fund all near term obligations. Strong balance sheets not only ensure that shareholders will avoid emergency-type capital raisings through times of acute market distress, but also provide management with the lucrative optionality of being able to deploy capital into acquisitions at a time when competitors may be forced sellers.

2) **Focus on Quality of Business**

While balance sheets indicate financial leverage; we also want to have a thorough understanding of operational leverage (or how sensitive a company's earnings are to an underlying driver or economic variable). Ultimately, higher quality businesses are those that are able to demonstrate a resilience of earnings regardless of the underlying market cycle and won't face critical headwinds in the face of global recessionary environment. While earnings growth may slow, higher quality businesses are not likely to present a scenario in which shareholders could face a permanent loss of capital. Our exposure to businesses with more economically resilient business models or non-correlated earnings streams will tend to increase through periods of broader market uncertainty.

3) **Don't Overpay for those Businesses**

Excluding periods of heightened market volatility or distress (when even excellent businesses can sometimes be available at attractive prices), business quality doesn't generally come cheap. The ultimate return generated on capital invested is always a function of the price paid and there is little upside in paying overtly high prices for even the best quality businesses. Investing, to us, starts and finishes with valuation and ensuring appropriate parameters exist around valuation metrics for each portfolio inclusion (and of the portfolio as whole) ensures capital is invested sensibly and actively rotated when valuation support is removed.

4) **Remain Mindful of Liquidity**

Like highly geared balance sheets, it is not until one faces periods of heightened financial stress that the underlying liquidity of an investment (or lack thereof) becomes immediately apparent. Smaller and micro-cap companies tend to wear the greatest cost of tighter liquidity conditions during market drawdowns and we are mindful to ensure a large proportion of both portfolios are invested in easily tradeable securities. Often this is just a function of size – at end October 2018, the average market capitalisation of the Ophir Opportunities Fund was $800m, while the average position in the Ophir High Conviction Fund is $3.2bn.

5) **Invest Alongside You**

Finally, whilst not a structural measure, we always remind investors that we have our own personal wealth invested directly alongside their own. The entirety of our own personal liquid investments are held within the Ophir Funds – the protection of capital in the Funds for us means the protection of our own entire savings pool. This ensures that we think and act like unitholders, with only our unitholders best interests in mind.

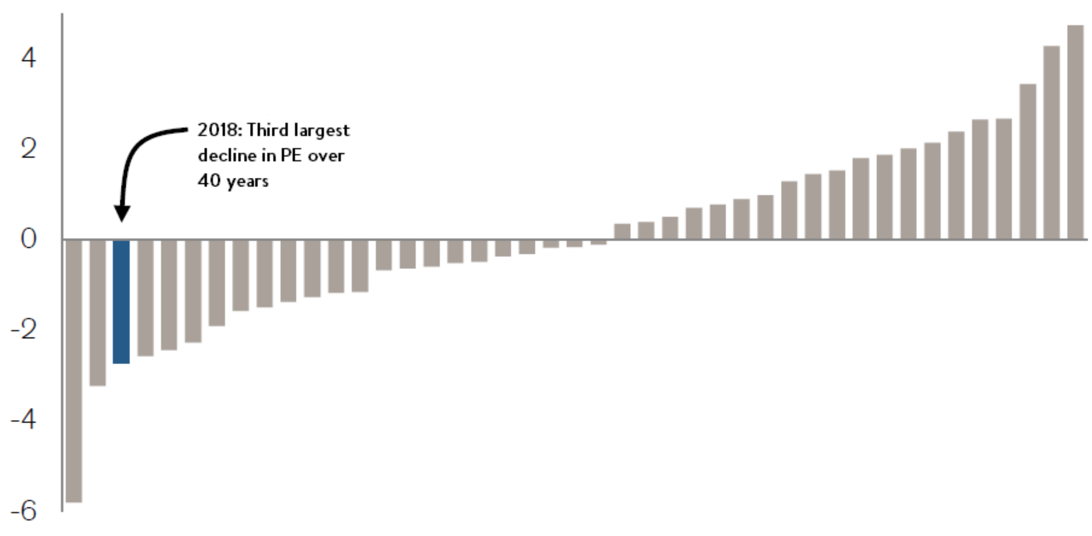
Thoughts on the Outlook

Not unlike the regenerative quality of an Australian summer bushfire, equity market corrections are a necessary evil of healthy and well-functioning markets. More often than not, they allow share markets to recalibrate and consolidate over the shorter-term, whilst also acting as an agent to transfer capital from weaker, short-term hands into those that can benefit from a longer term mindset. While the recent correction has eroded value in the immediate short term, we continue to remain optimistic on the corporate outlook for Australian-listed businesses and the opportunities ahead for both portfolios.

Certainly, with global interest rates still close to generational lows, it is not an overly brave call to suggest that interest rates across the world are heading higher over time and equity portfolios need to account for this risk. The great unknown, of course, is the timing of these moves and we expect to see continued equity market volatility with each leg up in in US long bond yields.

The most recent sell-off has brought equity markets valuations back to more appealing levels, not just across Australian small and mid-cap companies but also more broadly. Across the US equity market for example, significant retracements across both the S&P 500 and NASDAQ occurred at the same time as ~78% of companies delivered better-than-expected third quarter earnings results. While share prices declined in-line with global averages over the month, reported EPS growth for US companies hit +24.9% (noting S&P 500 profit margins grew by 12% year-on-year, their largest 12-month increase in history). This divergence in 'P' from the 'E' has seen 2018 now register the third largest contraction in price/earnings multiple in a calendar year in over 40 years.

S&P 500 Change in Calendar Year Price/Earnings – 1976-Present



Source: Credit Suisse, Factset, Standard & Poors

While rising US bond yields and an increasingly aggressive US Federal Reserve will ultimately lead to further equity market volatility, we would suggest that both factors also likely lead to continued support for the US Dollar from here. While there were little asset classes for investors to hide in October, the US Dollar provided once avenue of solace, generating a further +2.1% rise on a trade-weighted basis – its seventh consecutive month of appreciation.

While we don't seek to add companies to the portfolio purely for an ability to generate US dollar revenues, both funds do currently retain a fairly significant skew towards businesses with a high proportion of their earnings generated offshore. This is largely a result of the fact that a sizeable number of businesses within Australia that are generating high levels of earnings growth are doing so via exposure to higher-growth offshore markets. With an AUD-domiciled cost base and US/Euro revenues, we expect a number of these businesses to continue to benefit from the tailwind provided from a stronger US dollar and we continue to remain comfortable with the current skew in both portfolios towards international earners.

Closer to home, we remain positive on the trajectory of the current economic cycle, albeit recognise we are in the later stages of the bull market run and more normalised volatility from here is expected. Australian businesses are continuing to find good opportunities to grow (and grow quickly), margins are expanding and access to capital remains cheap. While equity market volatility has been further compounded by domestic concerns around the East Coast housing market, financial regulation and an increasingly tepid outlook for discretionary retailers, Australian and international boardrooms are still deploying capital aggressively. October saw another month of larger corporate M&A deals, with **Navitas (NVT), Healthscope (HSO)** and **MYOB (MYO)** all receiving initial or increased takeover offers, while **WorleyParsons (WOR), Webjet (WEB), Ramsay Healthcare (RHC)** and **Freedom Foods (FNP)** all announced major acquisitions.

Across both Ophir Funds, overall portfolio composition hasn't changed dramatically this month, primarily as both our conviction on current holdings and our view on the broader market outlook hasn't materially altered post the sell-off. In a low-growth domestic environment, we continue to believe that businesses that are displaying an ability to generate above-market rates of earnings growth will continue to be rewarded. The price at which we can access those businesses will ultimately be determined by the ebb and flow of market sentiment in response to the latest global macro news point.

Current macro concerns around US trade outcomes, volatile political relationships and uncertain interest rate projections will invariably continue to persist for some time. **This is no different to any other time in the cycle** and one would expect that if there is any constant in the current market environment it is that global economic conditions will continue to remain uncertain. Recent equity market volatility represents a return to more normalised levels (following a 2017 calendar year that experienced the lowest levels of equity market volatility on record) and we remain expectant that price volatility will grow an increasing feature over the months ahead.

For bottom-up, active stock pickers, more volatile equity market environments should deliver increased opportunities to generate outperformance – with an improved opportunity set ahead courtesy of the recent reset in valuations, we continue to remain optimistic of delivering solid returns on our invested capital.

An update on the Ophir High Conviction ASX Listing.

We have been delighted with the support received this month from existing investors in the Ophir High Conviction Fund regarding the conversion of the Fund into an ASX-listed investment trust.

Following a formal Meeting of Unitholders earlier today (13 November 2018), the resolution to convert the fund has been passed **in favour**. The Fund will now begin the process of conversion, with an expected listing on the ASX on Friday, December 19th.

This is an exciting development for the Fund and, in our view, a terrific outcome for existing investors in the Fund. As a reminder, the two key reasons why we have sought to move the Fund to a closed-ended listed investment trust:

- A stable capital base ensures the Fund is not impacted by capital flowing in and out of the fund in response to applications and redemptions. This means that capital is always available to be deployed, allowing the Fund to take full advantage of counter-cyclical investment opportunities and periods of market distress;

- The ASX listing will enable new and existing investors to again purchase units in the Fund, without impacting the existing capacity, or size, of the Fund. Importantly, **this is not a capital raising** – any new investors to the Fund will need to purchase units from existing investors via the ASX. **This includes ourselves** – with both Funds currently closed, the listing will again enable us (and the wider Ophir staff) to continue to allocate our own personal capital into the fund and retain our strong ongoing alignment with our fellow investors

We greatly appreciate our investors support for the change in structure. Requiring a 75% approval vote is a high hurdle to reach, and **we hold great comfort that not only a large majority of investors participated in the vote, but a high proportion of those voting have done so in favour**.

Existing investors will be receiving some documentation in coming days regarding the process of conversion.

In the next few weeks, we will be organising a round of "**Meet the Manager**" events in Sydney, Melbourne, Brisbane, Perth and Adelaide to touch base with investors ahead of the listing and provide an update on the current portfolio's. We will make details available on these events shortly.

As always, thank you for entrusting your capital with us.

Kindest regards,

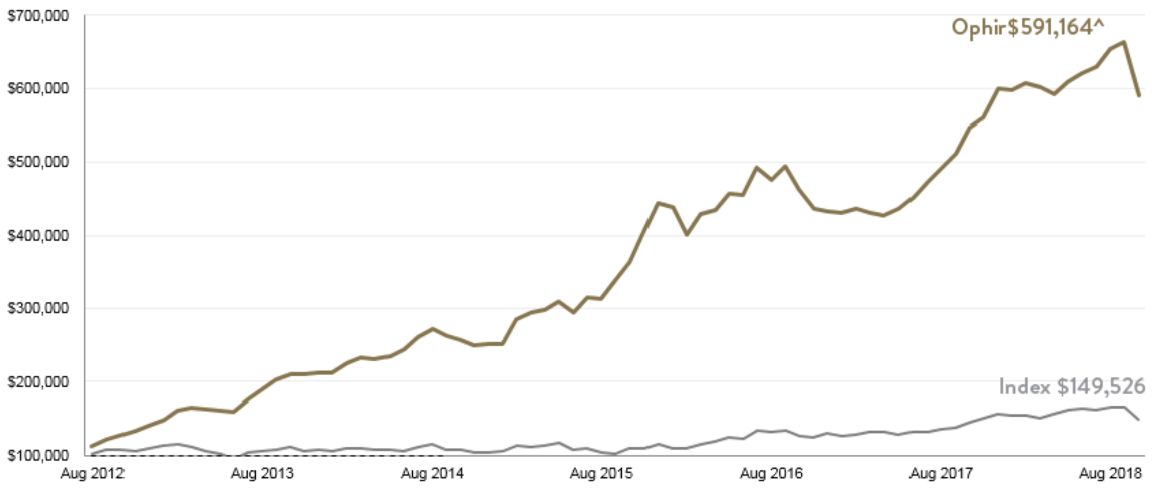
Andrew Mitchell & Steven Ng

Co-Founders & Portfolio Managers

Ophir Asset Management

The Ophir Opportunities Fund

Growth of A$100,000 (pre all fees) since Inception



* Chart represents gross value of $100,000 invested since inception and assumes dividends reinvested.
Please note past performance is not a reliable indicator of future performance.

The **Ophir Opportunities Fund** returned -10.8% for the month, underperforming the benchmark by 1.2%. Since inception, the Fund has returned +32.9% per annum, outperforming the benchmark by 26.2% per annum.

	1 Month	1 Year	5 Year (p.a.)	Inception (p.a.)	Since Inception
Ophir Opportunities Fund (Gross)	(10.8%)	8.0%	23.0%p.a.	32.9%p.a.	491.2%
Benchmark*	(9.6)%	2.6%	6.0%p.a.	6.6%p.a.	49.5%
Gross Value Add	(1.2%)	5.4%	17.0%p.a.	26.2%p.a.	441.6%
Net Fund Return	(10.6%)	6.7%	18.0%p.a.	25.8%p.a.	319.4%

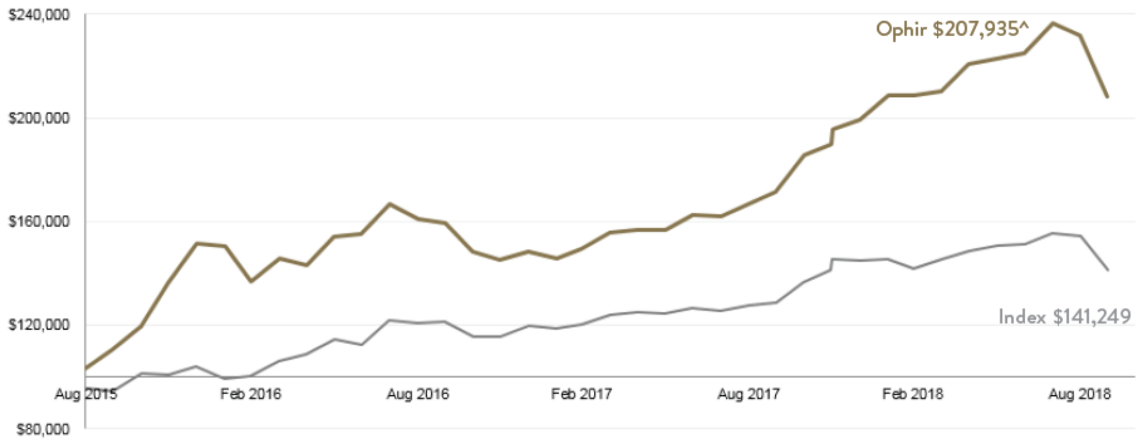
* S&P/ASX Small Ordinaries Accumulation Index (XSOAI)

	Buy Price	Mid Price	Exit Price
Oct 2018 Unit Price – Opportunities Fund	2.3348	2.3267	2.3185

Key contributors to the Opportunities Fund performance this month included **PWR Holdings (PWH), Navitas Limited (NVT)** and **Sundance Energy (SEA).** Key detractors included **Pinnacle Investment (PNI), Adairs Limited (ADH)** and **Corporate Travel (CTD).**

The Ophir High Conviction Fund

Growth of A$100,000 (pre all fees) since Inception



* Chart represents gross value of $100,000 invested since inception and assumes dividends reinvested.
Please note past performance is not a reliable indicator of future performance.

The **Ophir High Conviction Fund** returned -10.2% for the month, underperforming the benchmark by 1.7%. Since inception, the Fund has returned +25.3% per annum, outperforming the benchmark by 14.1% per annum.

	1 Month	1 Year	3 Year(p.a.)	Inception (p.a.)	Since Inception
Ophir High Conviction Fund (Gross)	(10.2)%	12.1%	20.2%p.a.	25.3%p.a.	107.9%
Benchmark*	(8.5)%	3.5%	11.7%p.a.	11.2%p.a.	41.2%
Gross Value Add	(1.7%)	8.6%	8.4%p.a.	14.1%p.a.	66.7%
Net Fund Return	(10.1)%	9.1%	16.3%p.a.	20.2%p.a.	81.7%

* 50% S&P/ASX Small Ordinaries Accumulation Index (XSOAI), 50% S&P/ASX Midcap 50 Accumulation Index (XMDAI)

	Buy Price	Mid Price	Exit Price
31 Oct 2018 Unit Price – HC Fund	1.7845	1.7792	1.7739

Key contributors to the High Conviction Fund performance this month included **Navitas Limited (NVT), Evolution Mining (EVN)** and **Aurelia Metals (AMI).** Key detractors included **Lovisa (LOV), Afterpay Touch (APT)** and **Corporate Travel (CTD).**