Ophir Asset Management
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Dear Fellow Investors,

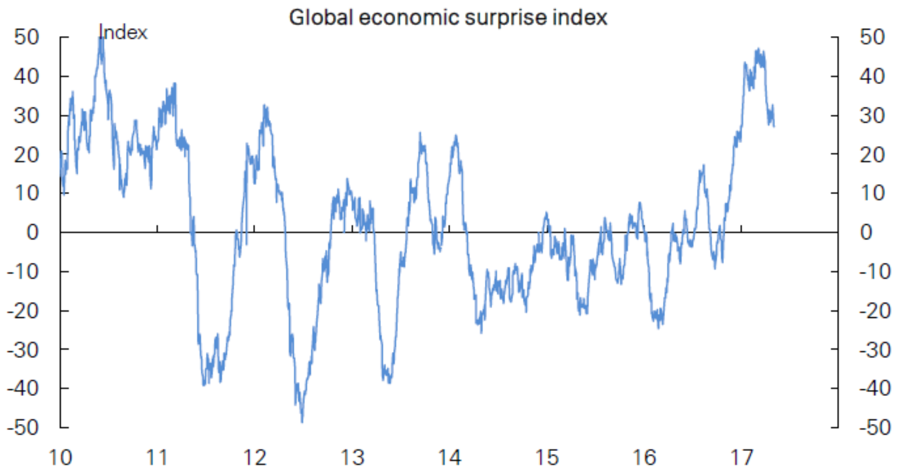
Welcome to the **April 2017** Ophir Letter to Investors – thank you for investing alongside us for the long term.

Month in Review

To the casual market observer, a review of the monthly performances of global share markets in April may have drawn a conclusion the month was a relatively benign affair. The S&P 500 finished the month +1.2%, just half a percentage point from its mid-March high, while the ASX 200 added +1.0%. The measure for US stock market volatility drifted to levels not seen since 2005 and the NASDAQ broke through the 6,000 mark. On the numbers alone, April appeared a relatively subdued affair.

The assumption, of course, would have been entirely incorrect and it perhaps highlights the unique state of affairs that global equity markets currently find themselves. On balance, April delivered enough macro and geopolitical news flow to satisfy an entire quarter of news items – from a North Korean missile crisis to US airstrikes in Syria, to a contentious French election and the release of US first quarter earnings.

Markets also digested a raft of economic data that, while still broadly positive, would suggest that recent rates of global economic growth have slowed to a degree, while commodity markets continued their weakening from recent highs (including iron ore falling -24% intra month). These are not insignificant developments and in different times any one of the above outcomes could have served to materially move markets in their own right. However, despite the torrent of activity, we enter May with the bulk of developed world stock markets still resembling a virtual sea of calm, with global bonds perhaps the only market seeming to adjust to the news flow (the US 10-year yield has now compressed 42 basis points from its March highs).



Source: Bloomberg Finance LP, Deutsche Bank

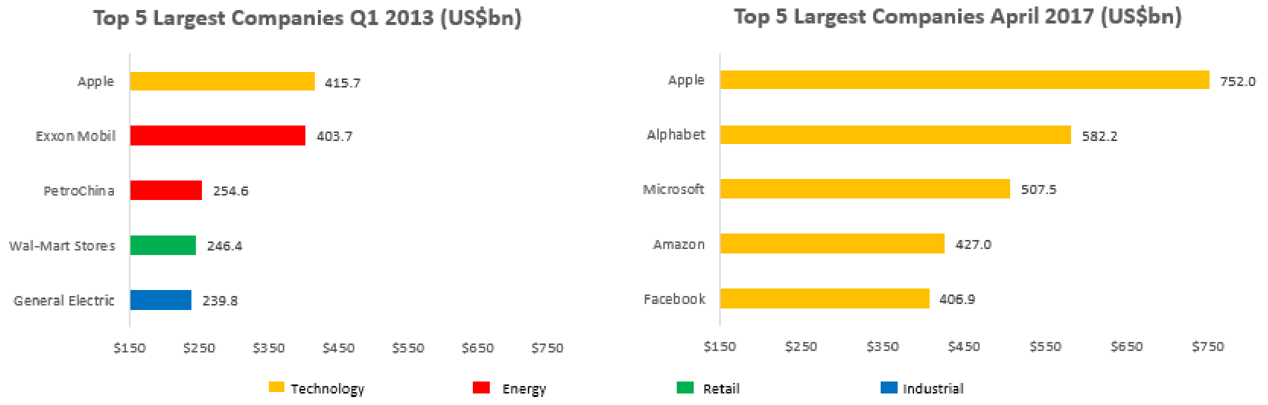
As 'bottom-up' investors seeking to generate alpha from small and mid-size Australian companies, the impact of monthly geopolitical events rarely impacts the underlying investment thesis of our portfolio holdings, however we do maintain a close eye on the global economic data. The reflation trade that powered a lot of the upside in global markets (and proved the initial catalyst for the rotation of funds away from Australian small cap growth and into the larger cap and cyclical names) has arguably experienced some degree of slowdown through April, an interesting development. US manufacturing growth, after peaking in February, continues to grow albeit at a pace below consensus expectations. The **Global Economic Surprise Index** (above) also appears to have found a near term peak.

While we continue to remain confident in the broader global recovery, the slowing rates of growth would appear that we may now have seen "peak reflation" – where growth continues albeit at a slower rate. This is a factor that could create some near term headwinds for equity markets that have rallied hard on the improving forward looking statistics.

Despite slightly weaker economic growth, US corporates delivered a solid Q1 reporting season with 'beat' rates higher than average and top line growth running at levels not seen in the last 5 years. While pleasing to see Corporate America has returned to form, in our view valuations have arguably already factored in a large degree of this growth. Of most interest, the US businesses that generated revenue from offshore operations have been the noticeable outperformers in the Q1 earnings period – suggesting the growth baton may be passing from the US to the Asian and Eurozone economies.

Confirmation this month that US retail giant **Amazon** would soon enter the Australian market created a virtual hysteria amongst media outlets and sell-side research alike. The e-commerce behemoth has proven to be a formidable competitor in its chosen markets, bringing to market the new world business model of growth at all costs. The emergence of enormous companies that 10 years ago barely even registered a blip in market cap has again highlighted the rapid changes we are seeing in the leadership of companies globally.

As smaller company investors, we are relatively accustomed to seeing rapid growth from new businesses that have identified a new market or way to disrupt a lazy incumbent. The rapid growth and domination of new companies and business models at the mega-cap end of the market, however, is an entirely new phenomenon and reminds us that the corporate landscape has never been so fluid. Only 1 of the top 5 largest companies in the world in 2013 still made the list in 2017. Of the top 5, all are now tech businesses. **Three of these companies (Apple, Facebook and Amazon) have accounted for more than a third of the total increase in the S&P 500 this year.**



The learning from this is obvious: the pace of innovation continues to increase rapidly, and businesses that win the innovation race are now tending to control enormous chunks of their end markets as a result. This isn't a development consigned solely to the online space – perhaps in an even greater symbol of the willingness of the market to support new business models, electric car maker Tesla this month saw its market capitalisation eclipse that of the Ford Motor Company.

The Australian corporate landscape has evolved, though not in the same dramatic fashion. While the Top 5 positons have seen movement in rankings, the majority of the top 10 businesses in Australia are still traditional, older world businesses – namely banking, resource development and supermarkets. Australian investors instead have been left to contend with how the emerging offshore businesses will impact the operations of these more traditional Australian business models.

In this month's Strategy Notes we look at one of our portfolio positions, **Premier Investments (PMV)** and how we see that company navigating some of the structural and competitive challenges currently facing Australian-listed retailers.

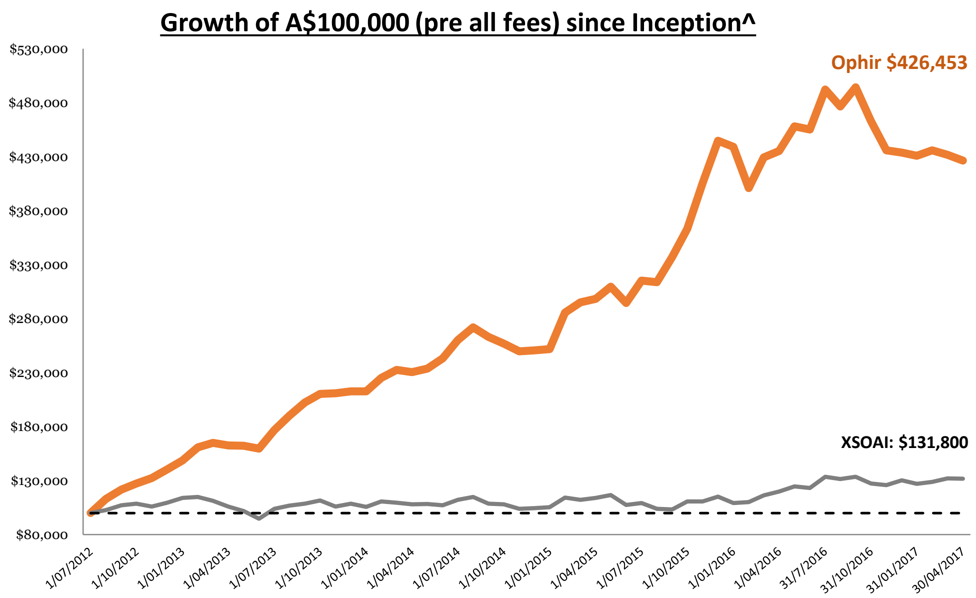
While the large and mega-cap end of the markets have continued to enjoy relatively halcyon days, the small cap investment community in Australia is experiencing mixed results. Dragged lower by its Resources tilt, the Small Ordinaries marginally underperformed the ASX 200 by 0.2% for the month, although the Small Industrials again outperformed their larger counterparts for the second month running. We are seeing a continuation of the trend of better performance out of the 'larger smaller caps', where businesses that suffered through the rotation trade of last year have attracted renewed interest as they deliver on growth.

The smaller and micro-cap end of the market, however, continues to face the headwinds of a number of liquidity overhangs, with the ASX Emerging Companies Index* now firmly in correction territory (having fallen -11.7% since mid-Feb). The Mid-Cap index, on the other hand, has increased +2.8% over the same period. We'd expect that divergence in return to normalise over time, however for the time being we continue to maintain our tactical tilt further up the market cap curve in higher quality businesses given where we sit currently in the business cycle.

As always, we are more than happy to further discuss the portfolio positioning and strategy of the Funds with our co-investment partners. If you would like to arrange an update from the team or have any specific queries, please don't hesitate to contact our Investment Director Rob Saunders on (02) 8188 0397.

*With a minimum market cap requirement of $500m, the Ophir High Conviction Fund doesn't have any exposure to the micro-cap end. The Opportunities Fund can invest in companies with a market cap as low as $100m, however as a broad strategy we have maintained a tactical tilt further up the market cap curve given the late stage of the cycle. The median market cap of companies in the Emerging Companies Index for example is $183m vs the portfolio-weighted mean market cap of the Opportunities fund of $637m as at 30/04/2017.

The Ophir Opportunities Fund



The **Ophir Opportunities Fund** returned -1.21% for the month, underperforming the benchmark by 1.0%.

Since inception, the Fund has returned +326.5%, outperforming the benchmark by +294.7%.

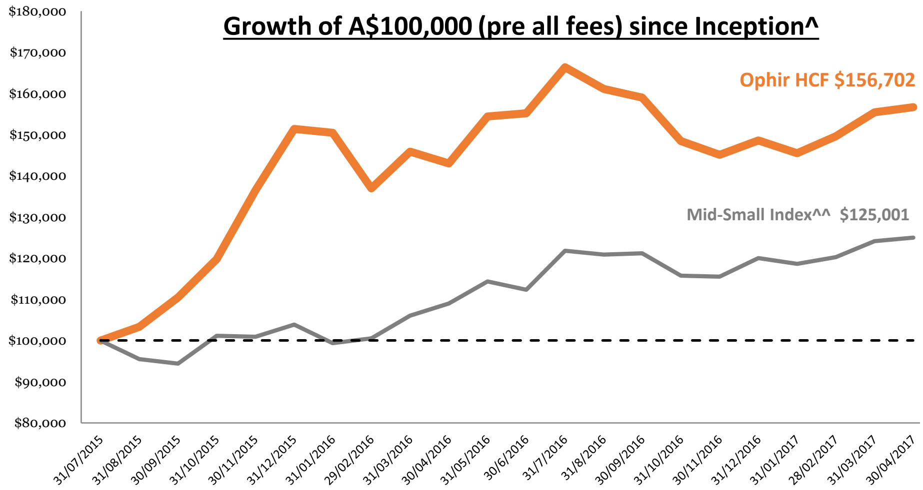
The April 2017 Unit Price is **$2.3214**

	1 Month	6 Months	1 Year	Inception (p.a)	Since Inception
Ophir Opportunities Fund (Gross)	-1.2%	-7.8%	-2.0%	36.5%	326.5%
Benchmark*	-0.2%	3.6%	10.1%	6.1%	31.8%
Value Added	-1.0%	-11.4%	-12.1%	30.4%	294.7%

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

Key contributors to the Opportunities Fund performance this month included **A2 Milk (A2M), Integrated Research (IRI) and Skydive the Beach (SKB).** Key detractors included **NetComm Wireless (NTC), RCR Tomlinson (RCR) and Smart Group Corporation (SIQ).**

The Ophir High Conviction Fund



The **Ophir High Conviction Fund** returned 0.81% for the month, outperforming the benchmark by 0.1%.

Since inception, the Fund has returned +56.7%, outperforming the benchmark by +31.7%.

The April 2017 Unit Price is **$1.4134**

	1 Month	6 Months	1 Year	Inception (p.a)	Since Inception
Ophir High Conviction Fund (Gross)	0.8%	5.6%	9.6%	31.0%	56.7%
Benchmark*	0.7%	8.0%	14.7%	14.4%	25.0%
Value Added	0.1%	-2.4%	-5.1%	16.6%	31.7%

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

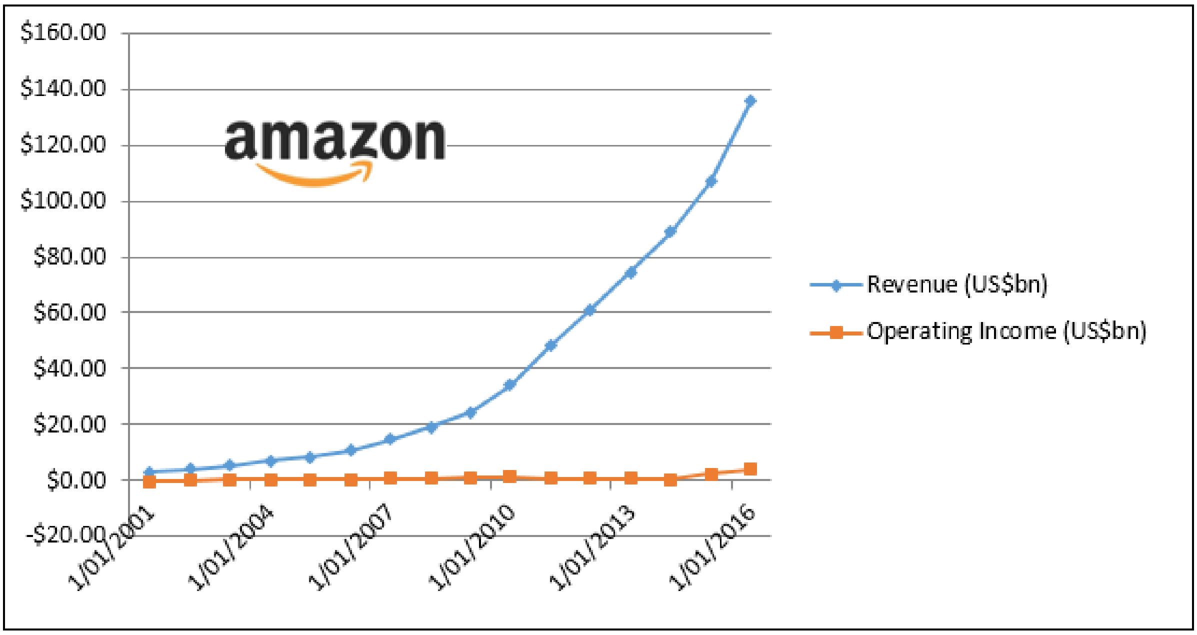
Key contributors to the High Conviction Fund performance this month included **A2 Milk (A2M), Steadfast Group (SDF)** and **Challenger (CGF).** Key detractors included **Premier Investments (PMV), Tassal Group (TGR)** and **Smart Group Corporation (SIQ).**

<u>Strategy Notes – Welcome to the Jungle</u>

Australian investors have been greeted with a near wall of hyperbolic commentary surrounding the pending arrival of **Amazon** into the Australian retail market. While predictions for the demise of traditional retailing as we know it seem exaggerated, there are rightly many reason for caution – take any metric on the growth of the business in the US and the statistics are staggering. As it stands today, it is estimated that more than ~80m Americans (more than 50% of households) now hold a paying subscription to the Amazon Prime service.

The growth and success of Amazon is a great example of the "winner-takes-most" business model that a number of large disruptive-style businesses have successfully executed over the past decade. Armed with a technology edge and an extensive marketing budget, the new entrant identifies an unfulfilled or underwhelmed market and pours an excessive amount of capital and resources into winning that market with little regard for near term profit.

Amazon's growth strategy has been no different - continually reinvesting profits to ensure rapid revenue and market share growth – the scale, however, is much larger. With a shareholder base that is supportive of the strategy, the amount of capital that management are able to recycle back into growth initiatives is extraordinary. The graph below charts Amazon's top line revenue since 2001 against its reported operating income – an image that will likely cause some concern to existing bricks and mortar retailers in Australia. It would be no surprise to learn that **Amazon is also now the global leader in research and development spend** – their recent quarterly highlights a US$4.8bn R&D expenditure line for the past quarter alone. As highlighted in a recent analysis by Barrons, at a market cap of ~US$450bn, no company has ever reached such a size with so little in cumulative profit (approximately US$5bn in total cumulative profits since listing in 1997).



The impact of Amazon's aggressive entry into the US market has been swift, particularly for a number of the bricks and mortar businesses that were the once sought-after anchor tenants for new regional shopping malls through middle America. A combination of excess mall capacity, a weaker consumer and the disruption of new entrants has subsequently seen the growth rate...