Suite 11.02
Level 11
37 Bligh St
Sydney 2000
NSW

Harness Asset Management Investment Report Sept 2015

Dear Investor,

Welcome to the Harness Asset Management Sept 2015 update.

As my friend Ben McGarry says…"There are old fund managers and bold fund managers but there are no old, bold fund managers" Risky portfolios have been bruised of late!

Markets have undergone a healthy correction over the last 6 months. The chart below provides a graphical story of the past year for our broad market index. It is now approaching a 17% reversal from its highs set 6 months ago. As usual plenty of reasons are provided for the timing of the fall and there is an abundance of time and energy devoted to the discussion of the macro environment with the Chinese economic slow down and US interest rates taking centre stage. We generally find such deliberations, time wasting and unhelpful. At a recent investment club catch up, I noticed a predominance of discussion around China's growth outlook and a potential recession in Australia and I had to stop the discussion and remind participants that such focus was unproductive. We get together to discuss potential money making ideas and to further our knowledge of stocks that are of particular interest. Fear mongering doesn't help and this was the first time I noticed such a distraction. It is critical that during periods of volatility and fear in markets that we maintain our discipline and continue to hunt for bargains and buy when others are fearful and cash up when others are greedy and paying too much.

Below is a chart of the All Ords - a simple graphic of a pretty difficult year.

Source: Big Chart

Below is an update of our performance as at the end of Sept. As you can see we have surrendered recent gains as the market has pulled back. Our fund has now surrendered about 5% from its highs earlier in the year while the ASX 300 Accumulation index has given up 13% from its high monthly close back in Feb. Clearly our value strategy is effective and creating out-performance in a weak market but make no mistake, we take little solace in losing less than the market our focus is on absolute positive returns over time. We are in the process of fine tuning our value approach in order to improve our performance going forward. I must stress that Value Investing demands patience and a long-term view.

The reporting season is a busy time for fund managers. We try to cover the results of hundreds of companies in a month or so, which is quite exhausting. Recent volatility has made it increasingly stressful for many in the market and we find ourselves trying to ignore *the noise* and focus on the long game by exploiting fear when it rears its head. We were pleased to discover that none of our major investments gave us cause for concern as they delivered sound results.

Performance of founder's units to 30 Sept 2015 (distributions reinvested):

Period	Fund	ASX 300 Accumulation
1 Month	-0.01%	-2.86%
3 Months	-2.1%	-6.47%
6 Months	6.48%	-11.06%
Since inception (Nov 2014)	1.7% p/a	-5.33% p/a
Size of fund	$10m	

The timing of our correction largely followed the lead provided by the US market now down about 13%.

Dow Jones 1yr

Source: Big Charts

Portfolio
At the time of writing we own 34 stocks and about 13% of the portfolio is in cash. Our intention is to reduce the number of stocks held over time and be more concentrated when possible.
We continue to hunt for unloved stocks that are being offered cheaply by the market. In industries such as old media and mining services there are no shortage of potential targets but we are being selective and taking our time. Many of these businesses are cheap for good reason.
We remain positive on the outlook for our portfolio and look forward to (at least) some of our stocks being re-rated in the year ahead.

What Do We Own?

FSA Group (ASX: FSA)
FSA reported an acceptable result for the full year and we have banked another fully franked dividend. We expect modest earning's growth in 2016 driven by an increase in the size of FSA's lending products and easy bill pay customers. This growth combined with a dividend yield of about 5.5% should give us double-digit returns. In the event that the Australian economy deteriorates significantly, FSA's debt services business could grow strongly. This gives FSA an interesting hedging characteristic that compliments the broader portfolio.
As we have said before, FSA possesses good management who own a significant stake in the company, its balance sheet is sound and it maintains a strong 50% market share in the debt agreement market.
The long-term outlook remains attractive and its price is undemanding.

PMP (ASX: PMP)
A few weeks ago we received a positive update from this deep value, catalogue printing play and the stock has increased by 20% while the ASX 200 has fallen around 17%. While the business itself is stable and unlikely to improve, the company has been very well managed to recapitalise it after a near death experience several years ago.
PMP has repaid its old debt and refinanced at more attractive terms. This has led to PMP just paying its first dividend in years. We expect PMP will be net debt free within 6 months and based on our expected dividend payout of 6c this year, PMP is trading on a yield of over 10%. On top of that, PMP is now in a strong position to drive corporate activity in its space, several options are possible but patience is required. We expect double-digit returns in the year ahead and retain a free option on potential corporate activity that could add substantial value.

Energy Action (ASX: EAX)
This one must go down as a bit of an investment lesson/reminder this year. We bought EAX too early, it had delivered several earning's downgrades and we judged that they were finished…we were wrong. The company downgraded again and understandably, the shares got belted. We have continued to build our knowledge about this one and rather than deciding we were just wrong (and selling), we remain of the view that the odds favour the shares moving higher in 2016. We have spent time with management, and board members in an attempt to better understand the company, its culture, and industry. Given its niche space

(electricity broking and consultancy), it has taken quite a bit of time and effort for us to develop a good understanding.
The stock is trading on an undemanding forward P/E of under 7x and a dividend yield of 4%. Other institutional investors generally ignore EAX but odds strongly favour us making money on this one in the year ahead from current levels around $1.10.

Arowana (ASX: AWN)
It's often said that last year's stars (best performers) will be this year's dogs (poor performers). Arowana has reinforced this observation. After doubling in 2014, it has had a poor 2015 falling about 40% from its highs. We have held due to strong management and attractive valuation with Net Tangible Asset backing around 50c a share. AWN possesses cash (31c p/s) and a 25% stake in Intueri (ASX:IQE) (16c p/s) which has had a terrible time since listing in 2014. Intueri keeps falling but we expect some sort of resolution will need to be found in the year ahead given how cheap it appears.
AWN has disappointed this year but we expect patience will result in sound returns from these levels in the future.

Rural Funds Poultry (NSX:RFP)
This is the smallest company we own with a modest capitalisation of $6m. It trades at a discount to its working capital so risk is pretty low despite its restricted liquidity. RFP has a simple business. It manages 17 chicken farms with 154 sheds under long -term contracts with Baida (Steggles). It requires low levels of capital and pays out all its earnings, providing us with an attractive dividend yield of over 11% fully franked at the current share price of 90c. We have patiently built a 6% stake in this NSX listed micro cap and while earnings growth is unlikely, the dividend yield is excellent and provides us with our double-digit returns.

Trying To Give Back
Many of you may know, my 8 year old daughter, Poppy started her own charity/movement a year or so ago when she became concerned about the homeless people in Sydney.
Last year, we donated about 250 toiletry bags to homeless people.
Our *"care packs"* include such items as: deodorant, soap, shampoo, conditioner, moisteriser, toothbrush and toothpaste.
If you can help with donations of small bags (airline business class bags are ideal) or any small toiletry products, anything provided will go to people doing it tough.
Much thanks to those who have already helped, the feedback we have had is very positive.
We hope to provide 500 this calendar year.

If you have any questions about Harness, our portfolio or strategy, please call.

Good investing,

Nigel Littlewood
Ph 0414585070

Note: Harness Asset Management Small Companies Value Fund (the Fund) own shares in the stocks mentioned above as at 30 Sept 2015. The above is in no way intended as financial advice, nor any recommendation by the manager of the fund.