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Dear Investor,

SMALL CAP CARNAGE

It seems like every other day a broker calls me to say that a client has lost a mandate and they are working on a block trade (large quantity) in a small cap stock that I follow. It appears there is institutional money being cycled out of small cap funds. This is combined with the flows out of active and into passive (index, ETF) funds. This trend in the US appears to have reached boom like proportions and **at the end of this market cycle there will be blood on the streets.**

I suspect many investors who have walked away from capable, active managers will regret it when they realise that while they may be saving a small amount in fund expenses they have ended up in a momentum trading juggernaut that is similar in style to pyramid schemes. The reality is that **as expensive stocks get bigger and represent a larger portion of indices, the value guys will be selling and the passive investors will be chasing the stocks ever higher.** Despite the black magic that many people attribute to short-term market movements, ultimately market movement is about value. Those in the most over-priced stocks are hit hardest when markets reverse. **While these index funds may be the flavour of the month right now, at some point the boom will end, the trend will reverse and people will panic and these passive investment funds will be NOT so passive as they sell over-priced stocks in order to redeem funds to panicked investors.**

I intend to avoid such catastrophe for my fund and the precious capital of my investors by buying value and selling when things get over priced. While we are unlikely to avoid being impacted by a significant market retreat, our portfolio and mandate is designed to withstand such a fall with no permanent damage and exploit compelling opportunities.

"To outperform over time, managers must find edges that enable them to earn excess returns. We believe we have real edges as a firm, such as our truly long-term focus and flexible investment mandate (including the ability to own significant cash balances)"
Seth Klarman

On the subject of the current small cap down turn in Australia, we have been fortunate to buy shares at attractive prices that we didn't expect, such as Dicker Data (DDR) and Shriro (SHM).

We had sold some of our DDR position at higher levels over recent months. The half yearly result was another good one and the shares pushed through to a high of \$2.50 then the stock retreated and we topped up our position at \$2.15 a few weeks later as the stock pulled back for no apparent fundamental reason.

See the 1 year DDR chart below for an example of just how volatile the shares can be for a company whose valuation is nowhere near as volatile.

DICKER DATA LIMITED FPO



Let's hope there are more such opportunities. While this sort of pull back may impact the monthly valuation (refer to the table below) it is great for long-term performance. To buy more of this well run small cap on a forecast P/E of <13x paying us a fully franked div yield of 7.4% is a sensible risk/reward decision.

Performance of founders units as at 31 Mar 2017

Period	*Fund	ASX 300 Accumulation	Outperformance
1 Month %	-0.29%	3.27%	-3.5%
3 Months %	2.0%	4.7%	-2.7%
6 Months %	5.3%	9.8%	-4.5%
1 Year %	20.9%	20.2%	0.72%
Since inception (Nov 2014) p/a *	8.0%	7.8%	0.26%

Fund Size \$13m

*Assumes reinvestment of distributions.

SHRIRO

We bought a few more Shriro shares in February as it pulled back for no apparent fundamental reason. The stock got down to a price that provided a current year dividend yield of close to 9%. Just seemed too cheap to us and has since bounced. Below are some images of the Everdure barbecue launch in the UK. Given the brand is being represented by the famous British chef, Heston Blumenthal, we are optimistic about sales of our barbecues during this coming UK Summer.



WARREN BUFFETT FILM

For Warren Buffett fans, HBO has made a good documentary which, for some reason you can view at: <https://www.youtube.com/watch?v=C8zwGmUuefl>

If you are really into investing and knowing more about the man, you will probably watch it twice.

There is nothing I can say about investing that Warren hasn't said better.

LITTLE CARE PACKS

I have asked for help before to support my daughter's (Poppy) movement to help homeless people. Given the momentum, I will probably keep asking. If you can pick up little bags (such as on airplanes), we will fill them with toiletries and donate to those in need. We also appreciate any toiletry donations such as toothbrushes, tooth paste deodorants etc. Everything gets used and nothing gets wasted or used to run the operation.

We had a proud moment this month when Orange Sky Laundry (a wonderful Australian charity that supplies laundry services to the homeless), named its first Shower Van after Poppy. I spent a little time on the street last Friday night and it is evident, people in need really appreciate the care packs and other services that people provide.

For a little video introduction on Little Care Packs please go to:

<https://www.youtube.com/watch?v=MVZJjhciRc&t=2s>

Good investing,

Nigel Littlewood

6th April 2017

Note: Harness Asset Management Small Companies Value Fund (the Fund) own shares in the stocks mentioned above as at 30 Nov 2016. The above is in no way intended as financial advice, nor any recommendation by the manager of the fund.

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