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Dear Investor,

**The Momentum Rolls On**

> *"In the short run, the market is a voting machine, in the long run it is a weighing machine"*
> Benjamin Graham

**While planes can fly themselves we have not got to the point of doing away with pilots, we are close to driverless cars but not quite there yet…BUT we appear to be embracing driverless investing with abandon.** Indeed as Steve Bregman points out in this great presentation (which I suggest you watch), the money flowing into index style funds that invest with no regard whatsoever to value, has created the "most crowded trade in the history of investing".
https://vimeo.com/209940152/f2154e4d3d

I generally like being liked but **telling people to stop partying because things are getting dangerous, never makes you popular** but I find myself in that position.
The boom that has been created by the massive flow of indiscriminate buying (via ETFs) will end badly at some point, yet equally it is providing value opportunities on the other side of the ETF divide. Stocks that sit outside the ETF universe are being shunned and sold. Institutional investors are being punished for higher fees (than ETFs) and perhaps some short-term underperformance (to an artificial index) and this is leading to active selling of Ex-index stocks, which of course, is creating value.
**I can't predict when this will end but end it will and the argument for saving a few basis points a year in fees at the expense of sensible active management will look stupid** when this crowded trade starts to reverse. The large Australian managed super funds that are flocking to driverless investing might just be making the biggest investment mistake of all time.
As an example of how far this boom is extending, below is an article about a new Anti-Gay ETF. We live in interesting/weird times.
http://citywire.co.uk/wealth-manager/news/us-firm-launches-anti-gay-etfs/a996355

As an active value fund manager there is always the risk that I am highly biased in my view and suffering from confirmation bias to support my process and business model. I welcome opposing views but I just can't see how this boom ends well for investors…eventually.
**Value investing is the opposite to indiscriminate buying as described above via ETFs. I remain convinced that the best returns over time will be provided by buying assets cheap and preferencing those with growth attributes while exercising extreme discrimination (not the type that the anti gay ETF might espouse).**

**Exploiting not fighting change**

I caught up for dinner with a mate recently who has built a great business in providing maintenance services to government housing. He finished school and became a carpenter for the then mighty BHP in Newcastle. He then started a building company and after being burned by a developer moved away from residential construction and pivoted into maintenance of government community housing.

Against major listed competitors, he has built a nationwide business with very little starting capital, no political contacts and no specific knowledge of the industry. His success is very impressive and he was asked how he built such a big business against such major rivals. His simple response was a great reminder of what I look for both in business leaders and in companies, he said, ***"in the first few years, my wife and I would go to work and spend hours each day asking ourselves, how can we do this better, is this the most efficient it can be? We still do this on everything we undertake, whether it's racing boats, or simply going down the street to buy the groceries, it's all the same methodology!"***

The business had a great deal of compliance, administration and logistics to manage the thousands of small (and large) jobs each week. My friend embraced technology while his competitors were milking their businesses for cash. He built a better, more efficient and more transparent service provider to government and was rewarded.

It's a reminder here in Australia that if we want to grow and improve productivity we must be prepared to sacrifice short-term earnings and invest in the future or there wont be one. Companies that can't adapt will die; it's just a matter of when.

Australian listed stocks have the highest dividend payout ratio in the world (stated at over 80% although I don't know how many stocks are included in that statistic). This is understandable as shareholders have told their companies they want income but we must be cautious, because just like the environment, if we don't invest today then tomorrow will be worse and the problems we leave behind for future generations will be huge.

**Portfolio**

**The most significant event impacting our portfolio in the April was a $33m capital raise by Kangaroo Plantations (KPT).** The capital raising was done at $2 a share a 20% discount to it's trading price and so the shares have fallen back…that's the short-term negative but the positive is that this is another step in the de-risking of our timber company. The company has paid its $53m outstanding balance for the New Forest assets and now owns a "globally significant timber resource" on Kangaroo Island.

The short-term set back in the share price cost the fund about 1.6% for the month but we remain comfortable that the investment is an attractive risk/reward proposition.

The next step for KPT is to gain state Government approval for its wharf. Given the political nature of this process, we will not forecast a time frame but our trees keep growing and adding value and there is an election next year in SA so let's hope the decision gets made this year.

The portfolio is holding cash assets of about 7%.

**Performance of founder's units to 30 Apr 2017:**

| **Period** | ***Fund** | **ASX 300 Accumulation** | **Outperformance** |
|---|---|---|---|
| **1 Month %** | **-1.9%** | 1% | -2.9% |
| **3 Months %** | **1%** | 6.5% | -5.5% |

| | | | |
|---|---|---|---|
| **6 Months %** | **1%** | 13.4% | -12.4% |
| **1 Year %** | **17.3%** | 17.5% | -0.2% |
| **Since inception (Nov 2014) p/a** | **6.8%** | 7.9% | -1.1% |

Fund Size $13m
*Assumes reinvestment of distributions.

**Little Care Packs**
A special thanks to all those who have donated bags and toiletries for my daughter's charity (keep em coming). The feedback we get is that it helps and it matters to those doing it tough. We are also getting kids involved in doing something that is community based and unselfish in an attempt to instil good values and help build better people.

Good investing,

Nigel Littlewood
5th May 2017

Note: Harness Asset Management Small Companies Value Fund (the Fund) own shares in the stocks mentioned above as at 30 Apr 2017. The above is in no way intended as financial advice, nor any recommendation by the manager of the fund.