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Dear Investor,

What a Month

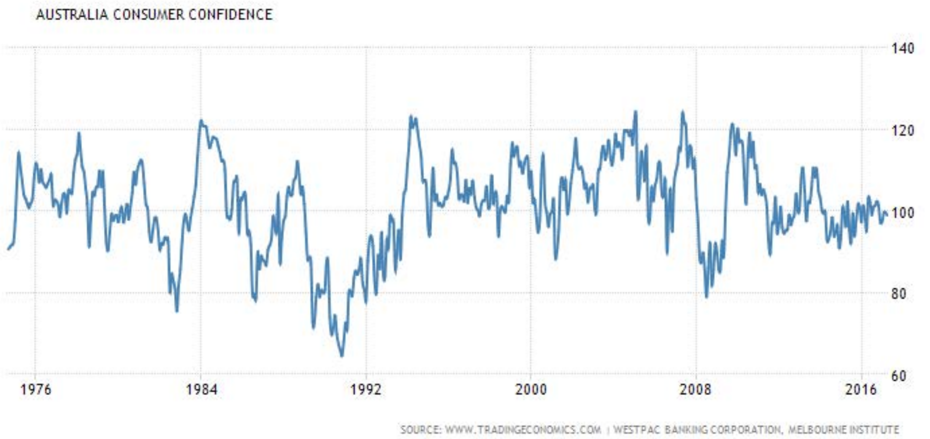
The budget always keeps us entertained at this time of year and this year we were greeted with a Labor style budget from a Liberal coalition that had been fretting the loss of votes to the far right…How strange it is.
I can't help but enjoy the irony of Labor's position. I'm sure most Labor pollies thought they were playing good opposition politics by opposing all coalition policies in the Senate only to now have a senate-driven budget taking the wind out of their sails. If the coalition wins the next election, (I imagine) Labor will look back and say "Wow how did we let that happen". The government has provided a politically pragmatic budget, which, should be acceptable to most…except the drug taking unemployed perhaps. I liked Jackie Lambie's suggestion that politicians should be subject to drug tests too….
As usual, as investors, there was little to impact our decision making process. We own one stock that is leveraged to infrastructure spend and no banks.

Donald Trumps presidency lurches from one sensational headline to the next and it was only a matter of time before an over stretched US market started to respond. The only thing that wouldn't be a surprise from this presidency would be impeachment.
As always, trying to predict how these political machinations may impact markets is pointless. We continue to hunt for investment opportunities that provide capital safety and sound returns. Market volatility (in the longer term) will only help us in this endeavour.

Consumers Continue To Withdraw

I suspect that shopping has been Australian's favourite past time for as long as I have been alive. However, Aussies have liked it too much and spent too much. All of the borrowing to bring future consumption forward has been taking its toll on personal balance sheets and levels of disposable income.
The charts below tell the story of the history of the deteriorating state of the Aussie wallet and its impact on retail spending. This trend combined with the entrance of more foreign and online retailers explains the dire condition of so many Australian based retailers (Myer and RCG downgraded last month). While we don't own any retailers, we do have some exposure via our holding in wholesaler, Shriro (ASX:SHM), which has a unique driver in its international barbecue strategy, which we believe, outweighs the Aussie retail exposure risks at this point.

Consumer confidence is pretty neutral yet retail spending continues to struggle.



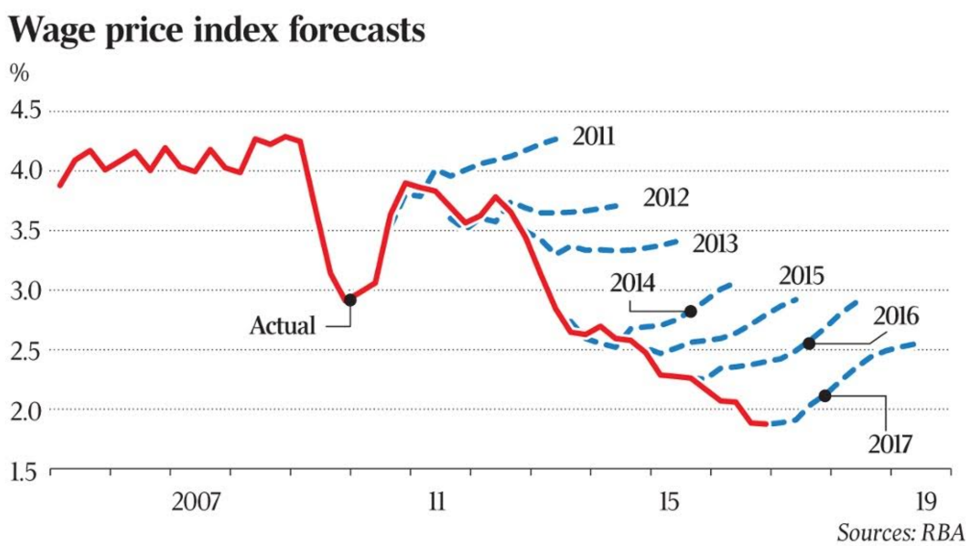
Growth in retail spending is positive but continues to trend lower.

While debt continues to climb, we find it difficult to see how consumer spending can increase materially.

The deteriorating savings ratio has not contributed to better retail spending. People have less money due to higher costs. Balance sheets are putting people in more precarious financial positions. What happens if residential property prices retreat?

The growth or lack of, in wages is creating negative wages growth in real terms for many Australians particularly if we are honest about the impact of rent and property price inflation. The below red line is wages growth over the last decade or so. The dotted lines are Government forecasts. This is an area that governments have either refused to be honest about or incompetent in predicting (despite the obvious trend). Could there be a more sensitive political driver?

Expert Wage Growth Forecasts:



The trend of increasing consumer debt and deteriorating wages integrity has been a thematic for us in regards to our large position in **FSA group** which, helps many of these over-geared consumers with their debt problems. We remain of the view that the debt agreement business will continue to grow in the years ahead and fuel further earnings growth.
The retail sector has been sold off and there could be contrarian opportunities but we haven't found one yet.

The Broader small stock market continues to struggle, as capital appears to continue to move from active to passive management products and negativity around consumer spending, growth and political uncertainties prevail. This may prove to be the early stages of a longer bear trend or simply a typical May-June seasonality period. (June is the most seasonally negative month of the year) Only time will tell.
Despite our cautious approach to building our portfolio, it has fallen in value even without specific bad news for our stocks. The broader sell off has pulled our stocks lower and the rout in consumer facing stocks has exceeded our expectations. We will be more nimble next time we sense a shift in market sentiment.
This underperformance is uncomfortable but when we review the fundamentals of the businesses we own, we remain confident for the longer-term.

United Overseas Australia
UOS, one of our core portfolio stocks held its Annual General Meeting last month in Kuala Lumpur. Instead of going as we have the last few years, we sent a couple of trusted investment collaborators. Both came back enthusiastic about the year ahead. With a single Perth investment already doing well (bought on a 10% yield) and the early stages of a major investment effort in Vietnam, UOS is starting to deploy capital away from Malaysia, albeit carefully. Management has the view that Vietnam is where Malaysia was 20 years ago and is providing a significant long-term opportunity for development. There are a number of (currently owned) major properties that are likely to experience revaluation in the current year, we asses NTA will move above $1 a share. For a company that has compounded equity at over 20% p/a for over 30 years, we are very comfortable owning this one at around 40% discount to assessed net tangible assets per share. Very good management, sound business and it's pretty cheap providing solid capital preservation.

Elon Musk Video
For those who aren't familiar with Elon Musk, this video provides a bit of an insight into his latest efforts. He is truly one of the most extraordinary thinkers & doers of our time!!

The portfolio is holding cash assets of about 9%.

Performance of founder's units to 31 May 2017:

Period	*Fund	ASX 300 Accumulation	Outperformance
1 Month %	**-2.8%**	-2.47%	-0.4%
3 Months %	**-5%**	1.42%	-6.42%
6 Months %	**-1.2%**	7.3%	-8.5%
1 Year %	**9.6%**	10.8%	-1.22%
Since inception (Nov 2014) p/a	**5.2%**	6.46%	-1.26%

Fund Size $13m
*Assumes reinvestment of distributions.

Good investing,

Nigel Littlewood
2017

Note: Harness Asset Management Small Companies Value Fund (the Fund) own shares in the stocks mentioned above as at 31 may 2017. The above is in no way intended as financial advice, nor any recommendation by the manager of the fund.