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Dear Investor,

> **"Every once in a while, the market does something so stupid it takes your breath away." Jim Cramer**

While the annual family holiday put a hole in January in terms of days in the office, the down time was valuable. As I had a broken arm and was not skiing, I had plenty of time for reflection. Having visited both Canada and America, it seemed clear that both economies are growing, inflation is present and rates are rising. This will have serious impact (at some point) on asset prices and particularly those that are at historically high valuations (most). **The bond market will fall and at some point the equity market's exuberance will deflate too.** The last few days' volatility has perhaps signalled the end of the bull market as we knew it.

Property markets are also likely to normalise (after several years of strong gains) as bank's funding costs rise which, will be passed along to borrowers and banks become more cautious in their lending (already happening). There remains some regulatory risk that negative gearing will be cancelled or changed in some way too.

The timing as always is unpredictable but irrational exuberance always pervades the final chapter of a bull market probably best exemplified right now by the crypto currency boom. I met with a young lawyer last week for lunch who told me he had made a great profit in trading Bitcoin and while he had taken his initial capital out, had the view that the bull market would continue… when I asked why, he of course, had no idea. *"Never mistake a bull market for brilliance"*

Each week we glance at the most shorted stocks in our market and on discussion, my fellow investor Tony Hansen mentioned the great Porsche short squeeze of 2008. It is such a great example of how even professional investors can act downright crazy.

One of the great short squeezes of all time happened when Porsche built a position in VW in the German market back in 2008. As the shares rose on the Porsche buying short sellers started to bet that the shares would eventually fall back but instead of stopping its buying, Porsche extended it to a 42.6% position with another 31.5% via the options market. Suddenly the short sellers realised there was no one to buy from as the next major holder (Lower Saxony) said it would not sell its 20%. The short sellers had short sold more stock than was available to purchase and the shares rallied from 200 Euro to over 1000. The hedge funds got buried. You wonder if any of those short sellers asked the question, what happens if Porsche bids for this company? Is the risk worth it? Was that negativity the ultimate mirror opposite to the emotional exuberance we expect in a raging bull market?

Frantic February

At the time of writing the market has had a wild few days with volatility racing back in to markets. The saying "don't fight the fed" has been used for generations and comes straight to mind given that rates were raised 3 times last year and will (most likely) continue to move higher this year. Is this the end of a 10 year equity bull market and a 30 year bond bull market or a temporary set back? only time will tell.

We are now in reporting season again and so far **Credit Corp (CCP)** has delivered a respectable result but as is so often the way, the market had priced it in. The shares fell back it seems due to commentary by the company that it is investing in growth in the USA which may lead to slightly higher costs and lower earnings (than forecast) for the 2019 year. The stock had rallied into the result. We took profits based on the concern that the credit cycle may have turned and the p/e de-rating risk in CCP is big and so potential downside is unappealing at this stage.

Please don't hesitate to contact us to discuss any potential investment in the fund.

Performance of founder's units to 31 Jan 2018:

Period	***Fund**	**ASX 300 Accumulation**	**Outperformance**
1 Month %	**-1.09%**	-0.39%	-0.70%
3 Months %	**2.34%**	3.18%	-0.84%
6 Months %	**11.17%**	8.16%	3.00%
1 Year %	**8.42%**	12.37%	-3.95%
Since inception (Nov 2014) p/a *	**7.48%**	8.16%	-0.68%

Fund Size $13m *Assumes reinvestment of distributions.

Good investing,
Nigel Littlewood
7th Feb 2018

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