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Dear Investor,

As we finish up the 2018 calendar year it's been the toughest for equity investors for some time… and perhaps for Australian property owners too. Having said that, investment outcomes will vary wildly as some stocks are up for the year and some are down a lot while plenty trod water. At this point Aussie stock indices appear to be set for a fall of around 10% for the full calendar year, when you add back dividends that's far from a disaster but of course, recent volatility is somewhat unnerving when markets fall quickly.

When we consider the drivers for recent US market falls it seems that investor confidence finally succumb to both fatigue and the accumulation of negative factors such as Trump's trade offensive on China (and others), the relentless increase in US interest rates, high equity valuations and the early signs that perhaps US growth is slowing. As is so often the case there is no clear catalyst that has had a huge and sudden impact on markets just the gradual build up of negatives against a back drop of a mature bull market and stretched valuations. In Australia the fall in property prices has provided additional fodder to Bears looking for reasons to sell.

As is usually the case when the market sneezes, small caps get the flu via an evaporation of liquidity. The reality is that most micro and small caps have more volatility than the broader market and this is a factor we accept despite the discomfort.

We have taken the view that the long-term bull market is over. We are sitting on about 30% cash at this point. Some of our stocks such as Bissaloy, Kip McGrath and Dicker Data have performed relatively well during recent market ructions while a few of our positions appear to be unfairly punished. Of note must be FSA (still our largest position), which, has fallen 37% and cost the fund over 7% over the last 12 months…Ouch. Hindsight is a great tool for self-flagellation and an opportunity to learn more and improve but the future has and always will be unpredictable. Let's just say, with the benefit of hindsight we would have taken profits at higher levels and be buying back stock now. The fundamentals have not changed but when markets correct small financials tend to get belted (that's a scientific term we sometimes use) as investors treat them as the most cyclical of stocks. FSA's P/E has de-rated from around 12x to about 8x. The earnings outlook (at this point) has not changed.

There is little doubt that we should have been more short term in the way we have managed our portfolio in the last year or so. Having said that, we remain comfortable with the prospects of core positions such as Kip McGrath, FSA, UOS, Bisalloy, Locality Planning, Dicker Data and our Uranium position. We must concede that the short-term sentiment and trend remains down but our cash balance provides some buffer.

We remain cautious but still looking for compelling situations. The proclivity of M&A activity has provided us with several short-term arbitrage situations, which have given us adequate and low risk profits.

We would like to wish all readers the very happiest and safest of Christmas periods. No matter what you do, we hope you have a terrific time.

Markets go up and they go down that's the way of our world, we must keep up the hunt for compelling value and remain calm. Merry Christmas.

Performance of founder's units to 30 Nov 2018:

Period	*Fund	ASX 300 Accumulation	Outperformance
1 Month %	**-2.60%**	-2.18%	-0.57%
3 Months %	**-7.46%**	-9.29%	1.83%
6 Months %	**-5.17%**	-3.85%	-1.32%
1 Year %	**-10.30%**	-1.03%	-9.26%
Since inception (Nov 2014) p/a *	**2.85%**	5.73%	-2.88%

Fund Size $8m *Assumes reinvestment of distributions and no tax considerations have been made.

Good investing,
Nigel Littlewood
20th Dec 2018

Note: Harness Asset Management Small Companies Value Fund (the Fund) own shares in the stocks mentioned above as at 30 Nov 2018. The above is in no way intended as financial advice, nor any recommendation by the manager of the fund.