

Sigma Select Equities Fund

Monthly update as at 30 June 2015

	Month %	Quarter %	1 year %	2 years % p.a.	3 years % p.a.	4 years % p.a.	Since Inception^ % p.a.
Sigma Select Equities Fund*	(6.6)	(3.9)	5.9	13.7	18.0	10.5	9.6
S&P/ASX 300 Acc. Index	(5.3)	(6.5)	5.6	11.3	14.7	8.3	7.4
Value added (deducted)	(1.3)	2.6	0.3	2.4	3.3	2.2	2.2

*Gross Performance. Past performance is not a reliable indicator of future performance. ^Since Inception: 2nd May 2011

Key points

- Significantly overweight Diversified Miners and underweight Major Banks
- Cyclical sectors expected to benefit as earnings bottom; avoiding expensive defensives
- Fund positioned for US interest rate normalisation; while matching local market dividend yields

Individual stock performance of note

The Fund *underperformed* a declining market in June. Outperformers of note related mostly to stocks that held their ground as the market fell. Bendigo and Adelaide Bank and Macquarie Group were essentially flat in the month and by default outperformed. Weakness in major index heavy weights, Wesfarmers (-10%) and CSL (-8%) on no news were the top contributors to performance in a relative sense. Small cap holding Ingenia Communities (+6%) rallied as the market anticipated stronger than expected sales results, which was confirmed post month end. Stock detractors related mostly to media stocks after Nine Entertainment (-27%) fell post downgrading EBITDA guidance by 8%, citing a softer free to air advertising market, however specific programing issues are the more likely cause in our view. Notwithstanding, Seven Media (-18%) and APN News & Media (-16%) all fell, with APN weakening for the third month in a row post the takeover speculation. The absence of Commonwealth Bank (flat) and Telstra (-1%) detracted from performance in a relative sense.

Economic developments and markets

The S&P/ASX 300 Accumulation Index was down (-5.3%) in June, its worst monthly performance since May 2012. For the financial year 2015, the Australian Equity market ended up (+5.6%) mostly as result of dividends paid. Gains over the course of the month were swallowed up by a month-end sell-off as global investors reacted to news of a breakdown in negotiations between Greek Prime Minister Alex Tsipras and the nation's creditors, increasing the likelihood of an exit from the currency union. In response to a "run on banks deposits" the Government imposed capital controls and shut banks, limiting daily cash withdrawals to 60 euros per day. The missed interest payment (Euro \$1.6bn) to the IMF on

Tuesday, 30 June may eventually result in Greece becoming the first developed country to default to the IMF.

Economic data out of the US painted an increasingly positive picture, adding support for a September "interest rate lift-off". The Q1 economic contraction was less severe than first thought (-0.2% vs -0.7% estimate), labour market data revealed another strong month of jobs growth as well as signs of wage pressure emerging, and consumer spending posted its strongest gain in nearly six years (+0.9% in May). Equity markets responded negatively to heightened prospects of interest rate rises, the S&P500 closing (-2.1%) lower, and bonds sold off with 10 year yields backing up 23bps to 2.35%.

The Chinese equity markets volatile ride continued with the Shanghai A shares index rallying 12% by the June 12th, to end up down -7% for the month after rallying 5.5% on the final day to be up +109% for the financial year. The Chinese authorities announced the countries pension funds would be allowed for the first time to invest in stocks.

On the domestic economic front, stronger than expected jobs growth (steady participation and a surprise fall in the unemployment rate to 6.0%) continued for the second consecutive month. The RBA left the cash rate unchanged in June at 2.0%, although the central bank noted that further depreciation of the AUD was "both likely and necessary" to continual rebalancing the economy. Locally, the Market ex Resources (-4.8%) outperformed Resources (-9.1%) aided by a resilient Bank sector (-2.3%). The Consumer Discretionary sector was the weakest performer this month, although all sectors were in the red. Small Caps underperformed the ASX 100 (-5.1%) by 2.7%. Both Small Industrials and Small Resources underperformed their Large-Cap counterparts by -2.7% and -2.3% respectively.

Portfolio changes and outlook

Select's *relative* valuation upside currently stands at 35%, a since inception high. The portfolio currently has 35% upside relative to the market which is fairly valued in our view (see graph). While the portfolio remains attractive on valuation grounds, our *business risk metrics* are the *least attractive* since inception. This has been the case for some 18 months, and as communicated in our quarterly strategy reviews we fully expect more volatile outcomes relative to market (as recent performance indicates), however we continue to believe the *valuation upside* will more than compensate for the volatility.

While Nine Entertainment (NEC) cited a softer free to air market as the reason for the downgrade, we suspect the reliance on a fewer number of shows as the more likely cause. Seven West Media (SWM) added weight to this view when guidance was reaffirmed during the month. However the market has taken a more negative stance, pursuing a "structural thesis" due to the entry of online streamlining services Netflix and Stan. Accordingly all three media stocks fell by 26% on average during the June Quarter (NEC -26%; SWM -24%; APN -29%). However, we believe the market is substantially overplaying the extent which these new services will eat into the advertising revenue of the major free to air television networks. Anti-siphoning laws regulating media companies access to significant sporting events remains the substantial barrier to entry, and we believe the overseas experience of free to air television networks is unlikely to be repeated in Australia

As a group, these stocks have an average weighted PE of 7.6 and fully franked dividend yield of 7.8%. Furthermore, all have significantly de-geared their balance sheets over recent years. In NEC's case, the company "net cash" position is being returned to shareholders through ongoing buybacks.

Much improved balance sheet positions, strong cash-flow generation, substantial discounts to valuation (NEC 75%; APN 80%, SWM 122%) and a clear market perception differential lead us to add to all three during the period.

Stocks Added

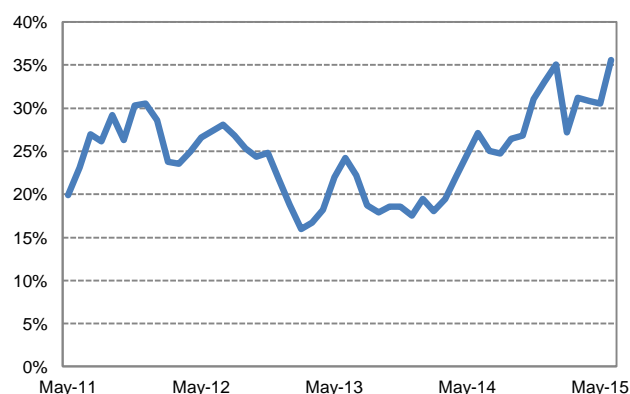
Slater & Gordon (SGH) is an Australian law firm specialising in insurance claims, commercial, family and asbestos related law. SGH made a material acquisition in the UK that more than doubled the size of the UK business. The transaction is significantly EPS accretive and creates a good platform for further growth. Post the significant share price fall during the month (-45%) a position was established. The market is overreacting to the accounting related to revenue recognition. As a result the Fund established a position at close to net tangible assets, which represents predominantly work in hand.

Stocks Sold

Nil

Select Relative Valuation Upside

Source: Sigma, IRESS



Pricing Metrics	1-Yr PE	Net Div. Yield	Price/Book Value	Price to NTA
Select Equities Fund	14.6	4.4%	1.1	1.8
S&P/ASX 300	15.9	4.2%	1.8	2.5
Date	Jun-15	Jun-14	Jun-13	Jun-12
Stock Numbers	34	38	33	31
Large Caps	20	23	22	21
Small Caps (ex-100)	14	15	11	10
Active Share	72.9%	63.5%	55.8%	57.2%
Small Cap Weighting	13.7%	10.8%	7.9%	9.5%

Source: Sigma estimates, GS Portfoliowise

Top 5 active positions

Stock	Active weight %
By Large Cap stocks:	
Harvey Norman Holdings	5.2
Rio Tinto	4.5
Bendigo & Adelaide Bank	4.2
QBE Insurance	4.1
Qantas	4.0
By Small Cap stocks:	
Seven West Media	1.4
APN News & Media	1.4
Nine Entertainment	1.3
JB Hi-Fi	1.2
Tox Free Solutions	1.1

Note: Active weights refer to positions above benchmark only.

Strategy summary

Sigma Select is a concentrated 'broad-cap' strategy blending the highest conviction stock ideas from Sigma's Large Cap and Small Cap investment teams, leading to:

- Superior outperformance,
- Lower risk, and
- Increased consistency.

What makes Sigma Select unique?

- Concentrated, value-biased portfolio of 20 to 40 stocks
- Broad investment universe (ASX 300) increases alpha opportunities and diversification benefits
- Timely execution of Small Cap exposure (up to 25%) to capture beta opportunity
- Efficient alpha extraction from holding meaningful Small Cap positions
- Focus on downside protection: cash allocation (up to 25%) varies according to market outlook

Asset allocation

Sector	Active weight %
Materials	9.1
Consumer Discretionary	7.9
Energy	3.0
Industrials	(0.6)
Information Technology	(1.1)
Utilities	(1.3)
Financials ex-Real Estate	(1.7)
Consumer Staples	(2.3)
Real Estate	(5.3)
Telecommunications	(5.8)
Health Care	(6.1)
Cash & Other	4.2

Note: Active weights refer to positions above or below benchmark.

Why aren't other investment management firms doing this?

Most investment management firms comprise distinct Large Cap and Small Cap teams with separate incentive structures and competing interests. In contrast, Sigma's Large Cap and Small Cap teams are equal partners and completely aligned to the success of the Select strategy.

About Sigma Funds Management

- Value-style Australian equities manager which aims to outperform without the downside of "value traps" through an investment approach called *Value: Risk Adjust*
- Independent and majority employee-owned firm founded in 2009 by six experienced investment professionals who previously worked together at a leading global investment manager

Contact

For more information contact Pinnacle Investment Management, the Fund's distributor, on 1300 010 311.

See also www.sigmafunds.com.au

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