SIGMA FUNDS MANAGEMENT®

Sigma Emerging Companies Fund

Monthly update as at 30 April 2016

	Month %	Quarter %	FYTD %	1 year %	3 years % p.a	Since Inception^ % p.a.
Sigma Emerging Companies Fund*	0.5	6.5	0.9	(5.5)	2.9	2.1
S&P/ASX Small Ord. Accumulation Index	3.0	9.7	11.4	(5.1)	4.4	2.9
Value added (detracted)	**(2.5)**	**(3.2)**	**(10.5)**	**(10.6)**	**(1.5)**	**(0.7)**

**Gross Performance. Past performance is not a reliable indicator of future performance. ^Since Inception: 10th October 2012*

Key points

- Small Cap "value opportunity" clearly evident as traditional metrics remain compelling
- Cyclical sectors expected to benefit as earnings bottom and risk appetite increases
- Fund positioned for cyclical re-rating and away from lower return defensives

Individual stock performance of note

The Fund *underperformed* a rising small cap market in April. Codan (+32%) outperformed after upgrading guidance following stronger than expected demand in Africa for its new metal detector, which was a technological improvement on the old model. Broadspecturm (+25%) finally succumb to the Ferrovial takeover offer, with the Board capitulating and accepting the revised $1.50 bid, pressured by PNG Supreme Court's ruling that the Manus Island detention centre serviced by the group breached the country's constitution. Resource exposures, Alacer Gold (+40%) benefited from finally receiving permitting in Turkey for its gold mine expansion, while Whitehaven Coal (+18%) participated in the general resources rally (mining stocks globally were up around 20%). Not owning market darlings, Mantra Group (-18), Blackmores (-9%) and Premier Investments (-5%) contributed in a relative sense. Stock holdings detracting included Nine Entertainment (-28%) post downgrading profit due to weaker than expected revenue growth during the March quarter. The position has been maintained as Nine stands to benefit from media reform when passed by the Government, as well the potential for licence fee relief announced with the Federal budget. A downgrade from Murray Goulburn (-45%) due to lower milk prices was the other key detractor. Given the prompt exit of the CEO and CFO, we exited the position post month end on alignment concerns between the farmers and shareholders. Significant fund overweights in Tox Free Solutions (-5%), APN News & Media (-5%) and Ingenia Communities (-2%) were all weaker despite new real news. Finally, the underweight to resources dragged on relative performance with Resolute Mining (+80%), Evolution Mining (+29%), OZ Minerals (+17%) and Northern Star Resources (+13%) all impacting.

Economic developments and markets

Global equity markets eked out mostly positive returns (S&P 500 +0.4%: FTSE 100 1.1%: German DAX +0.7%: Shanghai Composite -2.2%: Nikkei -0.6%: Hong Kong 1.4%) as global growth concerns faded. Equities were generally supported by a surge in resource stocks and as a consequence the S&P/ASX 300 Accumulation Index outperformed significantly rising by 3.3%.

Domestically, Resources (+15.4%) outperformed reflecting the ongoing strength in commodity prices, while Banks (1.5%) continued to lag as rising bad debts fears linger. The Small Ordinaries Accumulation Index slightly underperformed the S&P/ASX100 equivalent by 0.3%. The Small Industrials Accumulation Index underperformed the S&P/ASX 100 by 1.1%, while the Small Resources Accumulation index outperformed the S&P/ASX100 Resources index by 1.0%. The Small Ordinaries Accumulation Index has now outperformed the S&P/ASX100 Accumulation Index by 3.6% over the last quarter and 10.7% over the year, and by 6.3% per annum over 2 years.

Commodity markets experienced a sharp reversal. Oil rallied strongly establishing YTD highs, with WTI (US$46) and Brent (US$48) up by 24% and 29% respectively. A rapid escalation in outages and improving Chinese economic data underpinned the move. Iron Ore prices rose another 23% to US$66 per tonne (after rising 19% in March) after production

cuts announced by the "Big 3" (BHP, RIO and Vale) and an improving Chinese demand story narrowed the perceived supply-demand imbalance. Base metals turned up sharply with the LME Metals Index rising 6.3%. Nickel (+11.4%), aluminium (+10.5%), zinc (+6.9%), lead (+6.4%), copper (+3.8%) and tin (+3.2%) all rose over the month. Spot Gold rose 4.9% as rising US economic risks added upside bias to the precious metal. While Silver (+15.6%) was the major mover in precious metals. The A$ depreciated 0.7% against the US$ and most of Australia's trading partners.

US Economic data was generally strong. The ISM manufacturing index for March rose to 51.8, the first reading in seven months above 50, suggesting expansion. While the non-manufacturing ISM for March rose to a better than expected 54.5. Labour force data was generally strong, with non-farm payrolls for March increasing to slightly better than expected 215k, though the unemployment rate rose to 5.0%. Initial jobless claims for the week ending 16th April fell to 248k – the lowest level since November 1973.

Chinese economic data strengthened. For the first time since mid-2015, the "official" manufacturing PMI for March rose above 50. Industrial production for March grew by a stronger than expected 6.8%, while Chinese house prices continued to accelerate, with new home prices nationally raising 4.9% y/y. The 0.7% rise month-on month in house prices was the twelfth consecutive month of increase and the largest monthly increase since May 2013. Furthermore, strong credit growth in 1Q supported a significant increase in mortgage loans, with new medium and long-term household loans rising from 820bn yuan in 4Q15 to 1100bn yuan in 1Q16.

On the domestic economic front, Employment growth for March rose 26k, to take the unemployment rate to 5.7%, which is a two-and-a-half-year low on an unchanged participation rate (64.9%). However, the survey details were less upbeat, with the composition of employment skewed to part-time workers. Headline CPI surprised on the downside at negative 0.2% q/q, the first negative print q/q since Q4 2008 or +1.3% y/y. Underlying inflation measures were also well below expectations. The core trimmed mean printed at 0.2%, the lowest print since 1997, with the annual core inflation rate falling to 1.7%. The RBA held the cash rate at 2.0%.

Portfolio changes and outlook

We continue to see substantial upside (+40%) across a diversified portfolio of 50 names. Over the last 18 months, *value* stocks have generally remained unloved and out of favour with the market, while momentum and earnings certainty has been priced at a premium. A theme we see persistent in the broader S&P/ASX 300 Index as well. Sigma believes the market remains too pessimistic on earnings prospects for many of the predominantly cyclical companies we own. With strong balance sheets, supportive policy setting and compelling valuation upside, we believe investors will be compensated in the fullness of time for taking on more risk at a time when the market is paying up for earnings certainty.

Portfolio Changes

Stocks Added

Motorcycle Holdings (MTO) is a retailer of motor bikes brands such as Harley Davidson, BMW, Honda, Suzuki, Kawasaki and Triumph, and predominantly through outlets on the east coast clustered mostly around Brisbane and Sydney. MTO is proposing to grow by acquiring other dealers, and then expanding the range of products offered in terms of used bikes, finance, warranty & parts. As the only corporatized entity in a highly fragmented industry, MTO is well positioned to the "roll up" of choice. The CEO is not exiting through the IPO process, and along with management will retain 29% of the company upon listing, highlighting the conviction in the growth strategy. The stock is being listed on FY16 PE of 11x.

GUD Holdings (GUD) is a diversified industrial business with a mix of consumer and industrial brands from Sunbeam, Davey pumps, Oates Cleaning, Ryco Filters, Lock Focus and Narva. The company has been increasing its presence in the automotive aftermarket parts business with the acquisition of BWI. Auto now comprises 75% of EBIT and has steadier demand drivers than other parts of the business. The company has recently sold the remaining interest in Sunbeam to its JV partner Jarden international for $35m. This should alleviate balance sheet concerns and helps simplify the portfolio of businesses. If the company is able to offload Dexion, which has also been problematic, there is considerable scope for rerating given Burson's trades on 22x FY17 PE. Assuming a disposal at that point, greater than >80% of GUD's earnings would be exposed to the automotive parts aftermarket. GUD is trading on a FY17 PE of 12.1x.

Stocks Sold

None

Top 5 active positions

Stock	Active weight %
Overweights:	
G8 Education	4.6
Tox Free Solutions	4.5
Ingenia Communities Group	4.4
Seven West Media	3.8
ERM Power	3.5
Underweight:	
Northern Star Resources	1.7
Blackmores	1.7
Macquarie Atlas Roads	1.5
NIB Holdings	1.4
Evolution Mining	1.3

Note: Active weights refer to positions above benchmark only.

Asset allocation

Sector	Active weight %
Industrials	12.6
Consumer Discretionary	6.5
Utilities	5.0
Financials-A-REIT	3.1
Information Technology	(1.7)
Telecommunication Services	(2.0)
Energy	(2.0)
Financial-x-Real Estate	(2.5)
Consumer Staples	(5.5)
Healthcare	(5.6)
Materials	(10.7)
Cash & Other	2.8

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

Strategy summary

Sigma Emerging Companies is a 'value based' investment approach that specifically focuses on avoiding "value traps", leading to:

- Superior performance potential,
- Lower risk, and
- Increased consistency.

What makes Emerging Companies unique?

- Value-biased portfolio of 40 to 60 stocks
- High conviction small cap positions: we back our ideas
- Focused on downside protection through *Sigma's Value: Risk: Adjust* investment approach

What makes Sigma's Emerging Companies Fund different?

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 two *interlinked* strategies: Sigma Select and Emerging Companies. As the best Small Cap ideas are also high conviction holdings in Select, the whole investment team is focused on delivering outperformance.

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