Jencay Australia Investment Fund

Quarterly report – 31 December 2014

JENCAY capital
AFS Licence Number 402024
ACN 148810413

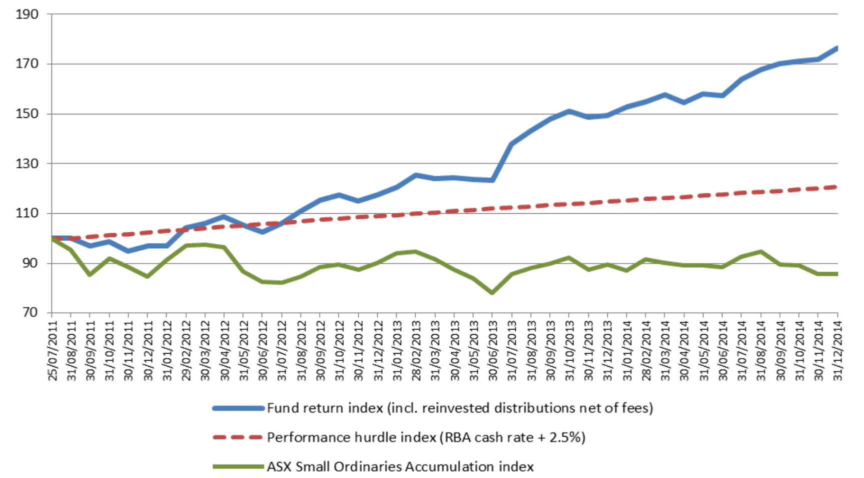
Performance

Returns are net of fees, exclude buy/sell spreads and assume reinvestment of distributions/income	Since inception (annualised)	Latest 12 months	Latest Quarter
Fund total return	**18.1%**	**18.6%**	**4.1%**
Performance hurdle (RBA cash rate + 2.5%)	5.6%	5.1%	1.3%
ASX Small Ordinaries Accumulation Index	(4.2%)	(3.8%)	(3.9%)

Unit Price

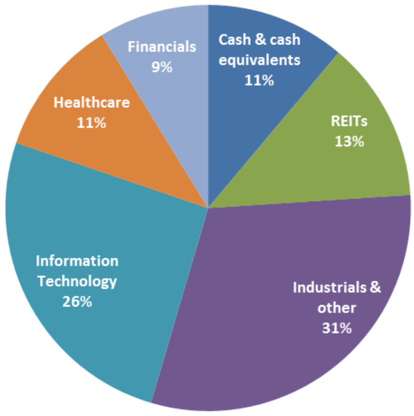
NAV per unit		**AUD 1.607**
Application price	(0.5% spread added)	AUD 1.615
Redemption price	(0.5% spread deducted)	AUD 1.599

Performance Chart



The chart tracks the movement in value of AUD100 invested in the Fund at inception, relative to the Reserve Bank of Australia cash rate plus 2.5% (performance hurdle) and relative to the ASX Small Ordinaries Accumulation index. Returns are net of fees, exclude buy/sell spreads and assume reinvestment of distributions/income.

Fund Composition



Fund size : **AUD 19.4m**

The fund advanced 4% for the quarter in comparison to a 2.5% increase for the ASX All Ordinaries Index and 4% decline for the ASX Small Ordinaries Index. The plunging oil price dominated headlines and hammered the ASX Energy sector. Fortunately the fund has no energy exposure. Further declines in the AUD during the quarter were of assistance to the fund. Mirvac Industrial Trust exited the portfolio following completion of a Scheme of Arrangement at a price more than double our original cost, and as a result the fund's weighting to REITS declined. Nearmap, a stock we've held for approximately 15 months, replaced MIX in the top 10, following price gains. Given the underperformance of small caps, we continue to see value and find new opportunities in the smaller, less liquid end of the market.

Top 10 Positions

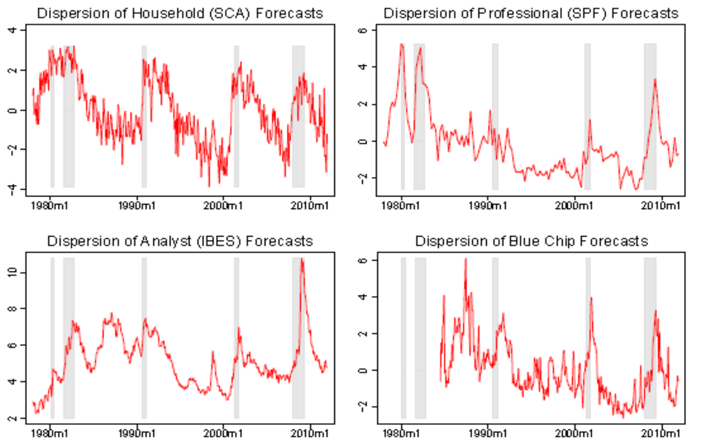
Weight %	Name	Summary Investment Case
11	**Cash & cash equivalents**	Approximately half the cash is held in an ASX listed exchange traded fund whose only asset is a USD call deposit with JP Morgan. The remainder is on call deposit with the custodian, JP Morgan and is denominated in AUD.
5	**Thinksmart**	Provider of consumer credit via leading UK electronics retailers. The group will be using a large portion of the cash raised from the sale of their Australian business in an off-market buyback tender. We believe the price range offered is significantly less than fair value and are likely to remain a holder. The business is growing strongly and the buyback will be accretive to remaining shareholders.
5	**Pro Medicus**	Radiology software for practice management and remote image viewing. Their world leading radiology image viewing platform is growing strongly. They recently secured another large US health network, its 4th significant US client win in the last 18 months. Despite a 30% plus return since purchase 8 months ago, we believe the upside from any additional client wins is still not priced in.
5	**GBST**	Leader in the provision of stockbroking and wealth management platform software. Many of their products are world class which is driving strong growth in the UK, US and Asia. GBST has been a stellar performer for the fund but trades on a prospective EV/EBITA multiple of 11x which is still modest for a market leader with entrenched client positioning and strong growth prospects.
5	**Austal**	The world's leading aluminium ship builder with significant, long term US Navy contracts in addition to its commercial and other military sales. Although we have enjoyed a strong share price performance from Austal, it is still being valued on a low multiple of future earnings (<11x) and continues to benefit from the weakening AUD.
5	**Reckson New York Property Trust**	Real Estate Investment Trust (REIT) holding suburban office property in the New York tri-state area. RNY is taking longer to improve occupancy than we expected. Nevertheless the share price is only 60% of RNY's NTA (net tangible asset value), indicating limited downside but still substantial upside if portfolio occupancy improves and/or the AUD declines further.
5	**Servcorp**	Market leader and world's second biggest serviced office business behind Regus, with the founder and CEO owning 50%. 1/5th of its market cap is backed by cash, with no debt due to its prolific cash generation. The 4% dividend yield should grow in excess of 10% p.a. Despite a strong share price run it is valued at less than 10x 2015 normalised EBIT - attractive for a quality company with good management and a large portion of earnings generated outside Australia.
4	**Australian Vintage**	One of Australia's biggest wine producers, holding the title of "International Winemaker of the Year" for two of the last four years. Agriculture companies are notoriously unpredictable in the short term but over the medium term we expect earnings to improve substantially due to growth in higher margin branded wine sales, a weaker AUD, and the rolling off of onerous grape supply contracts. Despite the improving outlook, it trades on a P/E of less than 8x expected 2015 earnings. Reasonably high debt is a risk.
4	**Galileo Japan Trust**	REIT holding office, retail and residential property in Japan, primarily Tokyo. It is currently trading at 75% of NTA and on a (tax deferred) distribution yield exceeding 8%. It appears that the Japanese property cycle has bottomed with evidence that rentals and valuations are starting to improve. In contrast to GJT, Japanese domiciled REITS are currently trading above NTA.
4	**Nearmap**	Using proprietary technology, Nearmap captures high resolution images from light aircraft and renders them seamlessly on a subscription based website within 2 days of capture (a more current and clear version of Google Earth). Australian revenues are growing at 40% plus per annum on a relatively fixed cost base. Nearmap has just started capturing images in the far larger US market with a view to commercialisation. Although the P/E multiple is high, its free cash flows are prolific, with growth and investment being funded internally.

Are households better predictors of recessions than professional investors?

Federal Reserve Study

In February 2014, the Research division of the US Federal Reserve Board (Dan Li and Geng Li), released a paper challenging the common view that professional investors are smarter than retail investors.

Essentially the study found that amongst households, views on the economy diverge sharply just prior to the onset of recessions (sharp jump in the dispersion trend line prior to the recession, in the first chart below), whereas the views amongst professional forecasters and investors don't diverge until the tail end of recessions (professionals are well behind the curve with the dispersion trend line only jumping toward the end of recessions, as shown in the remaining three charts below). Recessions are indicated by the light shaded areas.

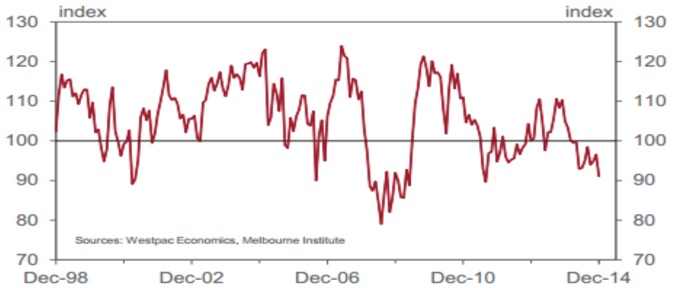


Source: US Fed paper. The Survey of Professional Forecasters (SPF) is a survey of professional investors and analysts (buy-side). The IBES Analyst Forecasts represent financial analyst forecasts of near-term company Earnings Per Share (sell-side). The Blue Chip Indicator is a survey of economists from large banks, consulting firms or academic institutions (Economists). Dispersion of views amongst all three groups lags the Household sector.

The differences may be because consumers come from a wide range of backgrounds, whereas investment professionals are a tightly knit group, potentially suffering more from group think. Consumers may be closer to the coalface of the unfolding economy or perhaps sharply deteriorating household sentiment creates recessions?

The Australian situation

While the Fed study reflects the US situation we would imagine the findings to be universally relevant. An Australian Consumer Confidence Index is compiled by the Westpac-Melbourne Institute, which may give a clue on current Household thinking in Australia. The most recent chart is shown below.



According to one of the authors of the study, well regarded Westpac Chief Economist, Bill Evans "The Index fell 5.7% in December. This is a very disturbing result. The Index is now at its lowest level since August 2011 when it briefly fell below 90. Prior to that you have to go all the way back to May 2009 to see a period when the Index printed consistently below today's level." Following release of the latest Index numbers and disappointing quarterly GDP figures, Bill Evans promptly lowered his projections for the RBA cash rate.

According to the Australian Bureau of Statistics (ABS), September quarter GDP grew a modest 0.3% relative to the June 2014 quarter. Although modest, the reported growth was misleading - GDP movement is essentially a volume based measure that eliminates price changes. Plummeting commodity prices reduce the income we earn on our exports but this is ignored in the GDP movement figures. When prices are incorporated, GDP actually went backwards in nominal terms which prompted some to suggest Australia is already in an "Income Recession", particular in per capita terms.

The currency and interest rate markets have started to factor in a slowing economy and the expectation of RBA cash rate reductions – the Australian three and five year bond rates are now both below the 2.5% RBA cash rate. In contrast, the Australian Equity market and the majority of professional Economists still forecast robust earnings and GDP growth respectively - are they again behind the curve? It seems that we should all pay more attention to the views of the real experts – Households! We continue to favour stocks that will be resilient under a weakening domestic economy i.e. foreign revenue earners.

Fund Key Features

Comprehensive Terms are contained in the Information Memorandum which can be downloaded from the website www.jencay.com.au or sent to you upon request

Custodian	JP Morgan Chase Bank N.A.
Administrator	White Outsourcing Pty Ltd
Fund auditor	PricewaterhouseCoopers
Inception	25 July 2011
Investment strategy	The Fund seeks to generate attractive risk-adjusted returns over the long term and protect capital by buying securities trading significantly below fair value (bargains) and holding cash on deposit when bargains are not available in the market. The Fund has a small cap bias in accordance with the Manager's opinion that the majority of bargains are found amongst small caps.
Product type	Wholesale managed investment scheme available to wholesale clients and sophisticated investors
Investment universe	All securities listed on the Australian Securities Exchange (ASX) and cash to be held on deposit
Fund size cap	$200 million in net subscriptions. To manage liquidity the Trustee may limit the quantum of monthly inflows.
Investment restrictions	▪ Maximum of 40 individual securities ▪ Maximum exposure of 15% to a single security ▪ No short positions ▪ No leverage ▪ A maximum of 10% of the fund can be invested in companies with no earnings history such as biotechnology, resource exploration, new technology
Minimum initial investment	$100,000
Minimum additional investment	$20,000
Minimum redemption amount	$20,000
Base management fee	1% p.a. excluding GST. Management Expense Ratio 1.025% p.a. inclusive of non-recoverable GST.
Performance fee	20% of returns above the Hurdle rate subject to a high water mark. The Hurdle rate is the Reserve Bank of Australia Cash Rate Target plus 2.5%.
Entry fee	None
Buy spread	0.5%
Sell spread	(0.5%)
Redemption notice	6 months' redemption notice required otherwise 5% early exit penalty to be applied

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