JENCAY capital

AFS Licence Number 402024
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Jencay Australia Investment Fund

Quarterly report - June 2014

Performance

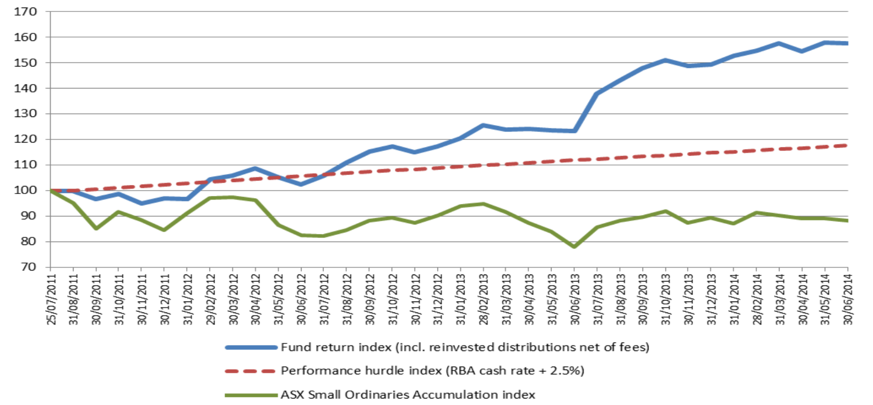
Returns are net of fees, exclude buy/sell spreads and assume reinvestment of distributions/income.	Since inception (annualised)	Latest 12 months	Latest Quarter
Fund total return	**16.7%**	**27.6%**	**(0.1%)**
Performance hurdle (RBA cash rate + 2.5%)	5.7%	5.1%	1.3%
ASX Small Ordinaries Accumulation Index	(4.2%)	13.1%	(2.3%)

Unit Price

	Cum*	Ex*
NAV per unit	**AUD 1.476**	**AUD 1.428**
Application price		AUD 1.435
Redemption price		AUD 1.420

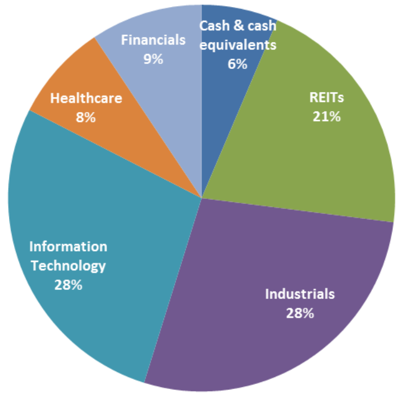
* The Cum price is inclusive of the **4.8c** June distribution. The Ex price is net of the distribution.

Performance Chart



The chart shows 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 15.8m

The Fund was flat for the quarter, in line with the overall index (ASX All Ordinaries) but ahead of the ASX Small Ordinaries index which was down 2%. Many of the Fund's technology stocks were affected by the Nasdaq correction in May and we took the opportunity to buy more of the stocks that were impacted, given no deterioration in the underlying fundamentals of those companies. May and June are typically weak months in the market and therefore good times to be buying. Taking advantage of these lower stock prices, combined with the purchase of our new top 10 stock, software company Pro Medicus, explains the drop in cash levels to 6% and the increase in our tech stock weighting. Galileo Japan Trust and Australian Education Trust were displaced from the top 10 by the new stock Pro Medicus and Mirvac Industrial Trust, which has been in the portfolio for some time.

Top 10 Positions

Weight %	Name	Summary Investment Case
6	**Cash & cash equivalents**	The majority of 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 electronics and other retailers. After the recent sale of their challenged Australian business, the group has been left to focus exclusively on its attractive and growing UK business. With available cash of $30m to pursue UK growth, the business, which should generate circa $7m in PBT, is being valued at $30m, which is only 4x PBT.
5	**Austal**	The world's leading aluminium ship builder. It has secured US Navy contracts to produce 20 ships that will keep Austal's US facility in full production to 2019. Austal's share price is up substantially and although we have trimmed the position moderately, its valuation is still attractive with the business currently trading at 5x expected EBITDA.
5	**Servcorp**	Market leader and world's second biggest serviced office business behind Regus. Founder and CEO owns 50%. 1/5th of its market cap is backed by cash with no debt, due to its prolific cash generation. The dividend yield approaching 4% should grow in excess of 10% p.a. - attractive for a quality company with good management and a large portion of earnings generated outside Australia.
5	**Reckson New York Property Trust**	Real Estate Investment Trust (REIT) holding suburban office property in the New York tri-state area. The share price is half of RNY's NTA (net tangible asset value). Although its share price has been subdued recently we believe there is limited downside but still substantial upside which would benefit from improving portfolio occupancy and/or further declines in the AUD.
5	**Mirvac Industrial Trust**	REIT holding warehouse property in Chicago. MIX recently completed the sale of its non-core properties and has begun marketing their core portfolio with the intention of liquidating the trust and returning cash to unit-holders. We anticipate a healthy return (20% plus) within 6 to 12 months and believe there is limited downside at the current share price.
5	**Pro Medicus**	Radiology software for practice management and remote image viewing. The company historically enjoyed strong market share in Australia but due to a confluence of events have had a lean few years. An astute acquisition during the GFC and significant R&D has elevated PME's viewing platform to the leading product globally. With 3 large US client wins under its belt in the last 12 months, PME is set for strong growth which we believe is not yet fully reflected in the share price.
4	**Australian Vintage**	Australia's second biggest wine producer. AVG had a disappointing first half and was sold down by about 20%. 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 some onerous grape supply contracts. Despite the improving outlook, it trades on a P/E of less than 8x expected 2014 earnings and a dividend yield of 8%.
4	**Enero**	Enero contains the remaining creative, marketing and PR businesses of the failed Photon group. The share price has tripled since we initiated the position 18 months ago and although we have trimmed our holding, we have not sold out completely because we believe the share price does not yet reflect the full potential of the underlying businesses.
4	**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. Although GBST has been a strong performer for the Fund, more than doubling over 18 months, it trades on a prospective EV/EBITA multiple of 12x which we believe is very reasonable for a company with GBST's attractive qualities including very sticky clients, strong cash generation and profitable growth.

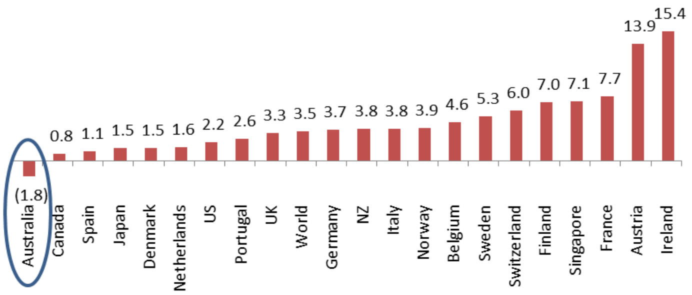
Small is beautiful in the investment world

Small cap index returns

Over long periods of time small cap equity indices generally outperform their large cap brethren. The NSCI index (Numis Smaller Companies Index), which covers the smallest companies that together make up the bottom 10% of the UK's total market value each year, has achieved an annual return of 15.8% since 1955, in comparison with 12% for the UK All-Share index. With compounding, since 1955, the NSCI has returned 11,605% vs 811% for the All-Share, a spectacular difference. Small cap indices have outperformed large cap indices in most markets, when measured over the long term.

Surprisingly, Australia's small cap index has been one of the only ones globally to underperform its large cap anchor over the last 10 years as illustrated by the chart below:

Return spread between the MSCI small cap and large indices on a per country basis over the past 10 years *(source Goldman Sachs)*



Due to the underperformance shown above, Australian small caps now seem significantly cheaper than large caps, potentially heralding future outperformance.

Small cap fund returns compared to the index and large cap fund returns

Large cap funds, in aggregate, tend to closely track their indices over most time scales. In contrast the aggregate small cap fund manages to outperform its relevant small cap index reasonably consistently. Small cap funds are therefore typically a strong source of Alpha (outperformance). The table to the right illustrates this phenomenon for Australian managers over the last 5 and 10 years.

Comparison of Fund vs. Index returns for Australian Large and Small cap managers *(% per annum, source: Morningstar April 2014)*

	Australian large cap		Australian small cap	
	5 years	10 years	5 years	10 years
Index return	**12.3**	**9.4**	**5.8**	**4.9**
Fund returns				
75th percentile	14.3	11.3	19.4	13.6
50th percentile	**13.1**	**10.6**	**16.5**	**11.7**
25th percentile	12.2	9.9	15.1	11.3
Annual index outperformance by median fund	**0.8**	**1.2**	**10.7**	**6.8**

Not only has the median small cap fund significantly outperformed the small cap index over 5 and 10 years (by 10.7% p.a. and 6.8% p.a. respectively), the bottom quartile small cap fund (15.1% p.a.) has outperformed the top quartile large cap fund (14.3% p.a.) when measured over 5 years, despite the significant headwind of the underperforming small cap index. This is remarkable and begs the question, how? We believe there are three key reasons:

1. Australia's stock market contains approximately 2300 listed companies, but only the top 100 are considered large caps. In the large cap space, funds tend to hold very similar portfolios consisting mainly of mature, bloated and bureaucratic companies that make up the bulk of the top 100.
2. The Small Ordinaries Index, consisting of companies 101 to 300, ranked by size, is generally not representative of small cap fund portfolios. There is a lot of variation in the composition of small cap funds because they can invest in any of the circa 2200 companies that sit outside of the top 100 and therefore have significantly more latitude to find those "under the radar" gems. Evidently small cap managers select more winners and fewer losers from the large universe available to them.
3. With far fewer brokers and Institutional Investors covering small caps, the small cap space is significantly less efficiently priced than the large cap space. As a result stocks are more likely to trade at prices far from fair value, offering more upside, and often less downside, to discerning investors.

Australian small cap funds have outperformed large cap funds whilst swimming against the tide of their lagging small cap index over the last decade. Although we cannot predict when the Australian small cap index will start catching up, it will be interesting to see how small cap funds perform when it does. The evidence suggests that Australian small caps are a sensible place to invest over the medium to long term.

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

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