ELEY GRIFFITHS GROUP

TO OUR UNIT HOLDERS

Our Fund's Performance (after fees) to 30 September 2020

Returns post fees	3 Months %	6 Months %	1 Year %	3 years % p.a.	5 years % p.a.	10 years %p.a.	Inception* p.a.
EGG Small Companies Fund	11.05	33.65	0.39	9.02	10.25	7.88	10.63
S&P/ASX Small Ord Accumulation Index (XSOAI)	5.67	30.93	-3.33	6.53	9.97	3.53	6.12
Outperformance	**+5.38**	**+2.72**	**+3.72**	**+2.49**	**+0.28**	**+4.35**	**+4.51**

Returns post fees	3 Months %	6 Months %	1 Year %	2 years % p.a.	3 years % p.a.	Incep^ %p.a.
EGG Emerging Companies Fund	14.83	49.41	11.87	12.65	18.71	20.48
S&P/ASX Small Ord Accumulation Index (XSOAI)	5.67	30.93	-3.33	0.24	6.53	7.40
Outperformance	**+9.16**	**+18.48**	**+15.20**	**+12.41**	**+12.18**	**+13.09**

**Inception September 2003*
^Inception March 2017

Market Review & Strategy

Australian small companies continued their year long outperformance of big caps during the September quarter with the Small Ords Accumulation Index +51.2% from the March 23 COVID-19 lows versus the ASX100 Accumulation Index +28.2%.

For the quarter the Eley Griffiths Group Small Companies Fund and Emerging Companies Fund finished +11.05% and +14.83% respectively versus the Small Ordinaries Accumulation Index of +5.67%.

This investor fervour, variously known as the reopening trade, was directed towards those domestic companies whose earnings will benefit from a surge in personal consumption courtesy of Government safety nets, JobKeeper and JobSeeker as well as access to the largest savings pool in 50 years. It is not surprising then that consumer discretionary stocks were the standout performers for the quarter. From furniture retailer, **Nick Scali (NCK)** (+31%), to electrical/home furnisher **Harvey Norman (HVN)** (+28%) and apparel stalwart **Premier Investments (PMV)** (+19%), the trend was unequivocally bullish for operators in the Australian retail sector.

Interest remains elevated among small cap discretionary REITs. **Rural Funds Group (RFF)** (+20%), **Arena (ARF)** (+24%) and recently listed **HomeCo (HMC)** (+13%) to name a few. A proposed REIT spin off from HomeCo, the **Daily Needs REIT**, would raise $325m from investors in early October and lay claim to the years largest IPO.

August was a solid month for global equities but stockmarkets lost momentum in the early days of September with blow-off price action in US stocks, notably tech, taking oxygen from market bulls. It became obvious that an orchestrated out-of-the-money call option buy programme in big tech names had been put on throughout August, essentially building out the September 2 highs across several stock indices. The culprit later revealed as Japanese tech investor, Softbank. Such an option strategy requires a delta hedge to be put in place by market makers involving sizable stock purchases executed with immediacy. A breathtaking melt-up in stocks would follow. Once complete, stocks succumbed to the line of least resistance which was to the downside. By the week ending September 24, US stock funds had experienced their 3rd largest fund outflow ever, with tech stock related funds seeing their biggest outflows in 18 months.

Locally, the August reporting season concluded as Eley Griffiths Group analysts suggested it might. Beats outnumbered misses with beats rewarded by the market. During the prior month, almost 60% of stocks revising earnings ahead of the season upgraded and 70% of those names rallied through the month according to JP Morgan.

Small companies reported buoyant gross margins (given the absence of price discounting), evidence of cost-outs, improved cashflows (through focused working capital management) and attentive supply chain management. EGG investee companies on average saw revenue growth of ~2% with modest eps increments whilst Small Ords constituents on average reported revenue contraction of ~0.7% and eps downgrades of around 3%. Outlook statements and management guidance were predictably held over until annual general meetings, commencing mid October.

The cash call on the equity market persisted through the quarter with around $53bn raised CYTD via placements and entitlement issues. This equates to ~2.6% of the total Australian market and is a long way shy of stalling the market advance. The volume of transactions rose on the prior quarter and the motivation for a capital call also became increasingly discretionary as compared with the urgency of many of the June quarter raises.

There wasn't much in the way of merger and acquisition activity during the period in review. Nordgold bid for **Cardinal Resources (CDV)**, PE firm PEP bid for **Citadel Group (CGL)** (an EGG holding) and **Uniti Wireless (UWL)** and First State Super separately vied for fibre optic cable business **Opticomm (OPC).** Wealth group **IOOF (IFL)** bid $1.4bn for MLC Wealth, a deal that seemed to be greeted with disquietude from analysts and financial services types.

Technical Summary

Stocks

The health of US stocks has been well served by its September retracement. **S&P500** futures positioning, according to the CFTC, is at a modest net long of 1.22 which is constructive. The NYSE cumulative advance/decline line recently hit new highs suggesting that the breadth of the market is healthy and not solely reliant on a narrow cabal of stocks/sectors. Bullish to see the investment line (aka 100 day moving average) provide important support at 3210 for the S&P500.

The **Russell 2000** (US Small caps) has more hard work ahead with a 7% rally required to reclaim its 2018 highs and a shot at outperformance.

Students of Japanese candlestick charting won't have missed the ominous *hanging-man* that appeared on both the **Nasdaq** and **Nasdaq 100** charts on September 2, correctly presaging the markets turn down. Positioning in Nasdaq 100 Mini futures has swung around appreciably in the CFTC's most recent report. Short covering of contracts has moved the contract into a net long position. This explains the near re-test of the September high. The primary uptrend looks solid and the investment line continues to point upwards. Corrections here feel buyable.

The CBOE put/call ratio for US stocks is presently at 20 year lows suggesting complacency and little fear of a major market retreat. Investor survey, the AAII Bull Index, is mired in neutral settings so it would be fair to describe investors as indifferent/moderately bullish. A long way from euphoric.

Elsewhere, the **MSCI Emerging Markets** Index has been quietly grinding upward within its primary uptrend that started in 2002. It is up 1% CYTD. Impressive given the index has outpaced most developed markets. Emerging market debt markets are also performing creditably, with the Lazard EM Debt ETF -2% CYTD. This tells us more about likely US dollar direction than underlying developing economies. Its also why the gold outlook remains constructive given the historical correlation between the two but more on gold shortly.

The **S&P/ASX 200 Index** cleared resistance in early August and has shown good momentum if on reduced daily turnovers. Configuring nicely. Recently a well known market savant suggested to me that bank stocks had put in long term lows and would now rally. I did some work and concluded that NAB appeared the most compelling, having held an important support line from 1983.

The **Small Ordinaries Index** has rallied nicely in recent weeks and is now within 5% of a resistance line originating from the 2007 highs. This is reassuring for small cap investors but I would caution that the oscillator is showing bearish divergence on a short term basis, suggesting some weakness ahead. Any weakness should be bought ahead of a test of 3042 on the index. Breadth remains impressive, with 68% of the benchmark above the investment line. Incidentally, the **Emerging Companies Index** is trading at the highest levels since 2011, breaking free of its 2007 resistance line in August. This looks blue-flame bullish.

Commodities/Currencies

Interesting to note this week that the US futures regulator, the CFTC, voted to enforce individual betting limits on speculators across 16 commodity contracts. This is clearly in response to the oil market shenanigans earlier this year. CFTC data is routinely scrutinized by EGG analysts to gauge speculative positioning.

I remain constructive on **Gold** but the lower highs and lows since the August crescendo is unsettling, as is the 4:1 long futures positioning. The 2011 high of $1921/oz did not hold and will remain magnetic to traders. **Silver** tells much the same story, rejecting $30/oz but I will not rule out a test of $50/oz (attained in 1980 and 2011) before this precious metal bull market has concluded.

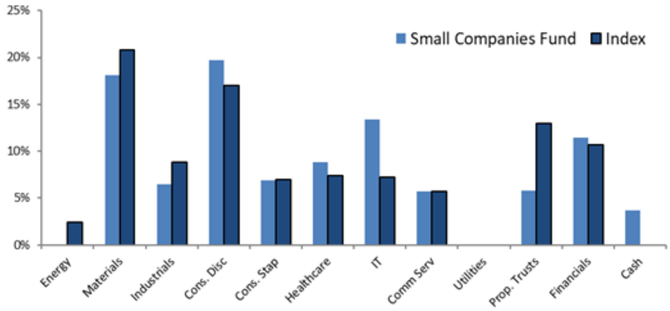
Copper remains attractive. Speculators are now 2:1 long, an uptick from our last update. The red metal continues to confirm the uptrend line from 2002.

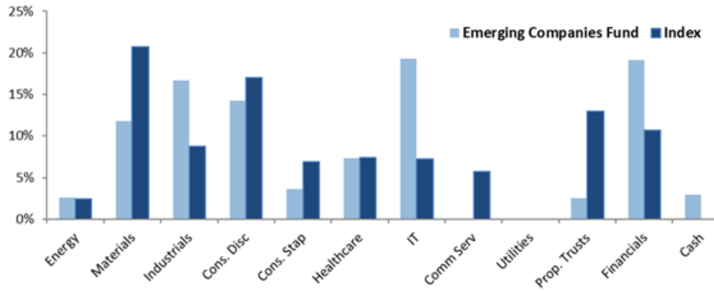
The **USD Index** has been increasingly shorted in past months so positioning suggests the easy price action to the downside might be done for now. The unit is towards the lower end of its historic range and needs to see a failure at 88.25 before a meaningful move lower is on.

The discussion around the **Australian dollar** is antithetical to that of the USD. Since peaking at $0.7414 on September 1 the currency has been posting lower highs/lows in response to a contraction in nominal and real 10 year bond differentials (with the US 10 years). Any failure at the swing low of $0.7006 would be the coup de grace on its recent bull drive.

The Portfolio

Fund Sector Allocations





During the September quarter, our Small Companies Fund (SCF) benefited from the strong performance of **Netwealth Group (NWL), Temple & Webster Group (TPW)** and **Pointsbet Holdings (PBH).** Our positions in **Omni Bridgeway (OBL), Adbri (ABC)** and **IRESS (IRE)** detracted from performance. In the Emerging Companies Fund (ECF), positions in **Temple & Webster Group (TPW), Sezzle Inc (SZL)** and **Coronado Global Resources (CRN)** contributed to the portfolio. **OFX Group (OFX), Omni Bridgeway (OBL),** and **The Reject Shop (TRS)** detracted from performance during the period.

One or both EGG funds held the following stocks during the quarter and changes may have been made to portfolio positioning.

A position was taken in **Beacon Lighting (BLX)** during the period in review. A long established lighting and fan retailer/wholesaler, the group has survived several housing cycles and the incursion of aggressive competitors, Bunnings and since departed, Masters. The demise of small, suburban specialist lighting shops has made for a more concentrated market place for Beacon to operate in. Beyond a growing 110 store network there is an international opportunity in US/European markets as well as a bigger push into the trade business, targeting electrical componentry on 'the other side of the wall'. Recent trading has been strong with cashed up customers increasingly focused on home improvements. We admire the stoic management team and think 16.0x FY21 PE is reasonable for a strong operating business with several medium term growth options.

EGG re-joined the **Adairs (ADH)** register early in the quarter as we strengthened our retail and consumer discretionary exposures into reporting season. Having grown comfortable with the trajectory of physical re-openings coupled with confirmation in late June that discretionary spend in and around the home was ballooning, Adairs made for a logical portfolio addition. We have always liked management, the vertical integration and the loyalty of the customer base. Management did what was necessary during the peak COVID months and protected the balance sheet, while redirecting attention to their online offering. Adairs emerged from the malaise with chunky comparative sales as loyal consumers upgraded their linen and accoutrements. Meanwhile a realignment of interests with landlords assisted earnings and the groups underappreciated online furniture offering began to take share in a market enjoying exponential growth.

During the quarter we increased our exposure to **Navigator Global (NGI**). NGI is a holding company that owns 100% of Lighthouse partners, a US based, fund of fund alternatives manager. Lighthouse has experienced a period of outflows, almost entirely relating to the acquisition of Mesirow, a business in run off that NGI paid nothing for. The case for increasing our holding at $1.20 was driven by valuation (6x cashflow) and a view that the period of outflow was coming to an end. As it turns out, NGI had been working on a material transaction with Dyal Capital Partners to purchase equity stakes in 6 leading alternative managers, collectively representing $35B in funds under management (FUM). The transaction will be earnings accretive, accelerate NGI's move up the value chain into product manufacturing and also diversify NGI's earnings, underwriting a very healthy 9% dividend yield (at current trading of $1.60).

Clover Corp (CLV) was quit from portfolios during the period as our suspicions intensified around the sustainability of H2 20 retail demand. Our fear was that an uplift in demand was largely restocking rather than genuine new demand, a takeaway from recent A2Milk and Bubs updates. The company's late October announcement confirmed as much.

We sold our holding in **Independence Group (IGO)** in July. We had owned IGO / Sirius Resources (which it acquired in 2015) for some time, so the decision to exit entirely was not taken lightly. Whilst the macro backdrop for its commodity exposure (Nickel, Gold predominately) remains strong, we had known for some time that from an operational standpoint (grade specifically), both assets (Nova and Tropicana) were at, if not close to their peak, productivity wise. That is simply the nature of finite-life resource assets, and the way in which they are mined (to maximise NPV). Higher prices may well ensue, but as the grade / output profile declines, costs will invariably increase. In order to maintain / grow production volumes, the pressure to discover new orebodies, mine life extensions to existing assets, or consider other growth alternatives (e.g. M&A) continues to build. That is clearly something the market and IGO is now grappling with.

*Quarterly Attribution – Top 5**

Code	Small Companies	Sector
ARB	ARB Corporation	Consumer Discretionary
BKW	Brickworks	Materials
NWL	Netwealth Group	Financials
PPH	Pointsbet Holdings	Consumer Discretionary
TPW	Temple & Webster Group	Consumer Discretionary

Code	Emerging Companies	Sector
CRN	Coronado Global Resources	Materials
DTC	Damstra Holdings	Information Technology
SZL	Sezzle Inc	Information Technology
SOM	SomnoMed	Health Care
TPW	Temple & Webster Group	Consumer Discretionary

**Alphabetical order*

Outlook

'IPO market parties like its 1999' beamed the front page of the Wall Street Journal on September 24. Snowflake debuts at twice its IPO price. The same paper posited that US$146bn in mergers and acquisitions had been chalked up as at the end of June and that the market was in full-blown deal mania. The US market is broadly on track for the highest levels of issuance since the dot.com mania of 2000 by all accounts. It's hard not to question the prevailing paradox of investors in a heightened state of excitement while the US public health emergency remains elevated and the economy continues its fragile recovery trajectory.

Locally we have a growing inventory of IPO's, many pulled from financial sponsors years ahead of their anticipated release dates. Bookbuilds are being eagerly bid and household investor activity continues at high levels. Intriguing to see 2000 dotcom poster stock, **Prophecy International (ASX:PRO)**, stir this week following nearly two decades of dormancy. Is this a bullish or bearish marker?

There are any number of events the market will need to negotiate in the run into year end. In the US there is the Q3 reporting season currently in front of investors, there is the November 3 US Presidential election, the prospect of a democrat president (and Bidenomics) and there is the disrupted passage of the much anticipated stimulus bill to be finalised.

For now I am opting to interpret the aforementioned WSJ headlines as late in the market cycle rather than an indication of a matured bull market. The broadening advance of stocks (those above their 100 day moving average) and the growing list of stocks achieving 52 week and all-time highs is beneficial to the market advance. Valuations have long since been attractive but they aren't quite nose-bleed yet either. I never leave home without my equity risk premium data and this measure at 5.2% in Australia and 6.5% in the US is irrefutably favourable for a continuing high allocation to stocks.

Everything about this market cycle has played out differently to all that have come before it. I expect the timing of its ultimate conclusion to confound us too.

Research Ratings

Small Companies Fund			
Zenith	Recommended	2nd Highest Rating	February 2020
Lonsec	Recommended	2nd Highest Rating	August 2020
Morningstar	Silver	2nd Highest Rating	October 2020
Emerging Companies Fund			
Zentih	Recommended	2nd Highest Rating	February 2020
Lonsec	Highly Recommended	Highest Rating	August 2020

Existing investor administration:
Link Fund Solutions
LFS_registry@linkgroup.com |+61 2 9547 4311

Investment Enquires
John Price | Head of Distribution & Operations
john@eg-group.com.au|+61 2 8311 5175

PDS & Applications Forms
info@eg-group.com.au
https://eleygriffithsgroup.com/invest/