



## From the desk of James Abela

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February 2018 results season were reasonable. Generally, there were a few more results that 'beat' expectations versus those in line or disappointed, which suggests expectations were realistic. Hot spots remained on similar themes and delivered solid outlooks in the areas of mining services, construction, consumer services, infant formula (such as a2 Milk and Bellamy's), global agriculture (such as Costa Group) and software. On the other hand, soft spots continued in traditional retail (such as Myer), telecommunication services (Amaysim Australia) and the challenged roll-ups (such as legal services).

Stand-out performances from companies such as a2 Milk, Altium, Corporate Travel Management and Appen show there are some brilliant leaders in the Australian mid and small caps arena that have built a uniquely valuable differentiated asset that have the viability, sustainability and credibility to become the future leaders of tomorrow. Outstanding performances over 10-year periods include global structural growers in healthcare, technology and consumer services such as Cochlear, Resmed, Fisher & Paykel, REA Group and Seek.

Valuations and growth outlook appear reasonable at around 16x PER for 10% EPS growth, 3% dividend yield and Price to Book of 2.0x. Likewise, Australian medium-term growth and recent global indicators continue to provide bullish signals in mining, construction, employment trends and general business conditions. Combine this with expected low inflation supports the thesis of synchronised global growth and the benefits of the "Goldilocks environment" that remains not too hot and not too cold.

However, from a global perspective, there are growing concerns that risk is mispriced. Bond yields are rising - now near 3% compared to only 2% only a few quarters

ago - and the VIX index, more commonly known as the 'fear index' has lifted from decade lows. The 'Fear of Missing Out' (FOMO) is fading as uncertainty rises globally. Locally, there have been a number of technology and micro-cap stocks that were beneficiaries of liquidity and high risk tolerance which are enduring major setbacks or have been wound down completely. Winds of change seem to be signalling to investors to consider risk much more now than in the recent past.

Specifically, for the Future Leaders Fund, risk has been deeply considered when sifting through the mountain of financial accounts and presentations of results season. The sustainability of business models and cash flows, as well as valuations, is an acute focus. Within the Future Leaders Fund portfolio this means that some high free cash flow yielding value opportunities have been increased; long duration transition opportunities with firm underlying asset values continue to be held or increased to create balance with the best valuation and growth picks of the market in momentum and quality.

Since the December 2017 'From the Desk of' report to clients, there has been rising of trade talk and deals, increasing expectation of rising interest rates in the USA and the winding back of quantitative easing by many countries. 2018 is emerging as a transition year compared to the galloping bull market of the last nine years. Portfolio balance and structure may become the critical drivers in 2018 as volatility rises, discount rates rise and convictions are tested.

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