March 2019

# InFocus

# Aberdeen Standard Australian Small Companies Fund

| Delivered consistent outperformance over the long term | Only invests in high-quality companies offering sustainable growth prospects | Derives return from different sources to large caps, providing diversification benefits |
|---|---|---|

*"Companies best placed to sustain growth will be those that own their intellectual property; provide services designed to improve productivity; or those positioned for expansion nationally or internationally."*

**Robert Penaloza**
Head of Australian Equities, Aberdeen Standard Investments

## 1. Market outlook

While market conditions give grounds for near-term caution, we are optimistic about longer-term opportunities. We are witnessing a negative wealth effect in Australia as tighter credit controls and softer house prices dampen consumer spending. This year's federal election promises to unsettle sentiment further. At the same time, Australia's three largest trading partners – China, the US and Europe – are each facing economic and/or political uncertainties. It's why we expect heightened market volatility this year. As an investor we aim to look beyond that. We believe this is an environment in which businesses will look to save money, cut costs and improve efficiency. Companies best placed to sustain growth will be those that own their intellectual property; provide services designed to improve productivity; or those positioned for expansion nationally or internationally. The strongest companies have allied dominant domestic positions with diversification into overseas markets, opening up new channels for growth (see *InFocus: Healthcare; Consumer Staples*). While we are seeing signs of a slowdown in domestic consumption in China, rising consumer wealth remains supportive of demand for high-quality products in which Australasia has a unique selling point, such as fresh fruit. We favour companies that have established strong distribution and brand equity in the local market. Those that have opened manufacturing bases there, or are looking to do so, will be best placed.

## InFocus: Healthcare

### Fisher & Paykel Healthcare

A medical equipment manufacturer. Its core products aid breathing disorders for use on both hospitals and at home and are sold worldwide. It invests heavily in research and development to protect the intellectual property of its products and ensure consistent revenue growth.

## InFocus: Consumer Staples

### Costa Group

An agricultural producer that owns intellectual property in substrate production of fresh produce, enabling it to grow its fruits all year round. It's in the process of expanding its plantation acreage offshore and is making forays into China.

## 2. Benefits of being active

Sector weightings can be misleading. We are overweight financial and real estate sectors, but we don't invest in banks, nor in companies highly leveraged to residential property prices. Our exposures are highly diversified. In financials (see *InFocus: Financials)* we invest across wealth management platform providers, an insurance broker, an asset manager, a private health insurer and a stock exchange. Our real estate exposures similarly span commercial warehousing, petrol stations and property developers with a bias to Western Australia – an undervalued market far removed from price softness on the East coast.

Aberdeen Standard Investments

We only invest in companies where we retain confidence in their long-term prospects. For example, while **Port of Tauranga**[1] is growing steadily in line with GDP, Port of Auckland is facing capacity constraints. With its good transport links, Port of Tauranga is well positioned to accommodate additional growth. Separately, we think private health insurer **NIB Holdings** is well positioned to benefit from structural industry growth, given Australia's ageing population and public funding constraints. It has also articulated its position for potential post-election regulatory changes that could see insurance premiums capped at 2% for two years. Our heavy underweight to materials is because we don't own any mining stocks directly. However, we do invest in mining services firms **Lycopodium** and **Monadelphous**, which have diversified earnings and whose share prices aren't as closely tied to volatile commodity prices as mining firms themselves.

## InFocus: Financials

Netwealth and Hub24 look well placed after the Royal Commission's crackdown on financial misconduct. Their platforms provide independent investment solutions, aligning them more closely with client interests than traditional financial firms.

## 3. Process of outperformance

While information technology stocks may offer appeal to yield-starved investors due to their high growth potential, when we analyse underlying company figures, in many cases we find that share prices have run ahead of earnings prospects. They simply don't justify the high multiples they're trading at. When it comes to technology, investors need to understand the underlying intellectual property of a company. An example may be in fintech finance companies. Essentially what many of these tech companies are offering is easy access to cheap credit, allowing people to consume products before paying for them. This is a form of high-risk, unregulated lending. Their rapid adoption may be symptomatic of underlying stress in the economy. As an investor, what we try to do is place a fair and conservative value on a company's advantages. We look to understand the value of their intellectual property against peers. If they are a domestic leader, we try to comprehend how easy that is to replicate when reaching overseas. We work in sector pods with colleagues across our global investment team, discussing factors such as scale, intellectual property and barriers to entry to understand what drivers a business is subject to. We only invest in IT companies that own their intellectual property. In many cases they have disrupted their industries to strengthen their market share (see *InFocus: Information Technology*). It is this active investment process backed by fundamental research and a global investment team that has enabled us to deliver long-term outperformance (see *Performance* table).

[1]We are permitted to invest in New Zealand stocks that are dual listed; and up to 15% of the portfolio into New Zealand-only stocks not included in the S&P/ASX Small Ordinaries Index.

## InFocus: Information Technology

### Vista Group

Cinema software provider with a 40% global market share. It owns intellectual property for automation of data ranging from movie production to screening, enabling big production houses to understand customer behaviour.

### Xero

Provides cloud-based accounting software. It disrupted incumbent firms reliant on server-based desk-top solutions and is expanding overseas, including the US. It invests heavily on the development of its software. Its ecosystem incentivises customers to stay on the inside.

## Performance (%)

| | | Per annum | | |
|---|---|---|---|---|
| | 1 Year | 3 Year | 5 Year | Since Inception[2] |
| Aberdeen Standard Australian Small Companies Fund net returns[3] | 3.85 | 8.93 | 10.05 | 11.38 |
| Aberdeen Standard Australian Small Companies Fund gross returns[4] | 5.16 | 10.31 | 11.44 | 12.64 |
| S&P/ASX Small Ordinaries Accumulation Index | 3.48 | 13.44 | 7.74 | 6.57 |
| Net returns[3] vs index | 0.37 | -4.51 | 2.31 | 4.81 |
| Gross returns[4] vs index | 1.68 | -3.13 | 3.70 | 6.07 |

[2]This figure represents the annualised performance of the Fund from the first full month of operation. **Prior to 1 May 2009 performance was obtained under a different process and different manager.**

[3]Net performance figures are calculated using end-of-month exit prices, post standard fees, reflect the annual reinvestment of distributions and make no allowance for tax. If investing through an IDPS Provider, the total after fees performance returns of your investment in the Fund may be different from the information we publish due to cash flows specific to your portfolio and any fees charged by the IDPS Provider.

[4]Gross performance figures are calculated using end-of-month exit prices, pre-fees, reflect the annual reinvestment of distributions and make no allowance for tax. These returns are provided for the purpose of wholesale investors only. Retail investors should refer to net returns.

Please note: Prior to 20 June 2012 the Fund was known as the Aberdeen Classic Series Australian Small Companies Fund. Prior to 1 May 2009 the Fund was known as the Credit Suisse Australian Small Companies Fund.

Past performance is not a reliable indicator of future results.

*We hold the companies highlighted.*

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