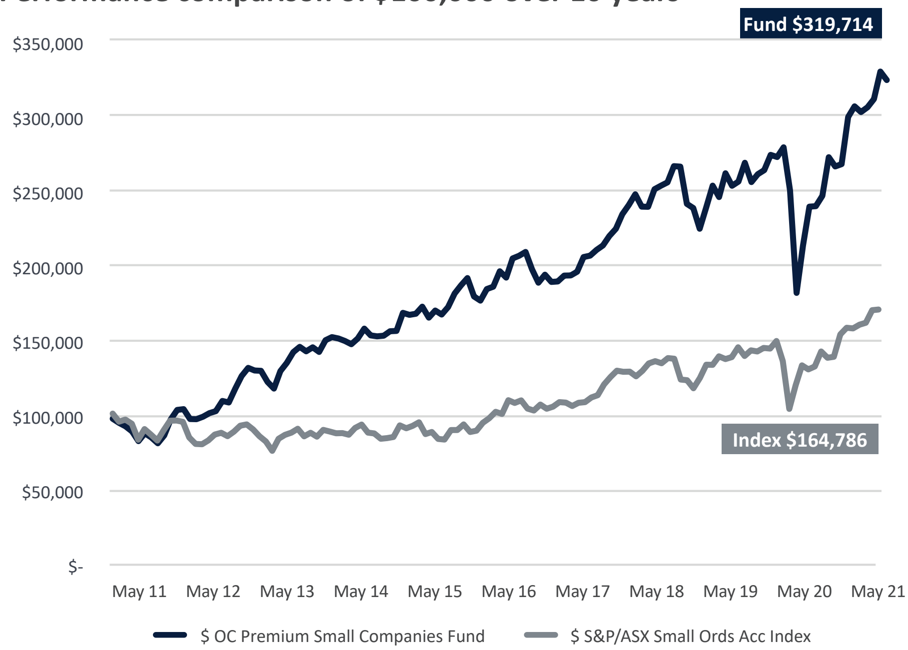
-1.7% Fund down 1.7% for the month

12.4% Returned 12.4% p.a. for the past 10 years

We remain confident the Fund will continue to deliver attractive long-term returns

Performance comparison of $100,000 over 10 years*



Total returns

At 31 May 2021†	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	7 yrs % p.a.	10 yrs % p.a.	Incep % . p.a. (Dec 2000)
OC Premium	-1.7	5.9	34.7	8.7	10.3	11.4	12.4	11.4
S&P/ASX Small Ords Accum	0.3	6.1	26.7	7.9	10.3	9.4	5.1	6.6
Outperformance	**-2.0**	**-0.2**	**7.9**	**0.8**	**0.1**	**2.0**	**7.2**	**4.8**
S&P/ASX Small Ind Accum	-0.6	5.0	25.1	8.5	9.2	9.7	9.4	6.9
Outperformance	**-1.1**	**0.8**	**9.6**	**0.2**	**1.2**	**1.7**	**3.0**	**4.5**

The total return performance figures quoted are historical, calculated using end-of-month hard-close mid-prices and do not allow for the effects of income tax or inflation.

Performance review

The domestic small cap index finished modestly higher in May, with the focus of markets still firmly on inflation and particularly on whether the inflationary outbreaks we are witnessing are structural or transitory and the broader implications for monetary policy. Cyclical stocks continue to outperform as the ongoing rotation from growth to value continues, and technology and other high multiple stocks drift as investors reduce exposure to growth names.

The S&P/ASX Small Ordinaries Accumulation Index eked out a small +0.3% gain for the month, with strength in commodity stocks underpinning a solid outperformance versus the S&P/ASX Small Industrials Accumulation Index which was down -0.6% for the month. After a strong 12 months, the OC Premium Small Companies Fund was down -1.7% in May. The Fund's underweight position in commodity stocks, as well as disappointing earnings updates from Perenti Global and Costa Group were the key reasons for the lacklustre monthly return.

Perenti Global (PRN, -38.5%) updated the market during the month and the stock was aggressively sold off on the COVID-19 related issues that are impacting the business. Until the confronting May operational update, PRN had been indicating that COVID-19 impacts had been limited. In a catch up with investor relations just weeks earlier, the company indicated that they had made good progress on matters such as asset realisations and debt refinancing, that the order book had been growing strongly and that the overall business was solidly positioned. Nevertheless, it seems that the insidious reach of COVID-19 has impacted PRN to such an extent that the company could no longer maintain its half on half earnings guidance of 'consistent revenue and margins' which was revised down to 'softer' half on half. COVID-19 is directly impacting the business in terms of increased travel and quarantining costs, disrupting Fly-in, Fly-out (FIFO) workers and local staff rostering, as well as causing operational disruptions due to virus outbreaks on mine sites. There has also been a noted flow on impact in the labour market that PRN accesses in order fulfil its contracts. This is particularly apparent in Western Australia because of rigid state border closures, where rising wages are causing staff turnover and leading to serious difficulties in recruiting staff from other states and overseas. This obviously has had a commensurate flow on impact to margins. We have exited our PRN position due to these disappointing developments, particularly given the lack of near-term resolution of these issues, as well as a lower margin of safety in relation to balance sheet covenants (given the company's lower earnings base).

Costa Group Holdings (CGC, -27.0%) dropped sharply late in the month on a vaguely worded downgrade to earnings expectations that it provided at its AGM. The company, which guided to its seasonally larger first half to be "marginally ahead of the previous comparable period", provided few details about why this would be the case when comparing to a prior period littered with one off factors such as bushfires and NSW drought (to name a few) which were quantified as a $23m impact at the time. Management later clarified that this new guidance was referring to the EBITDA line, before the application of a higher than anticipated depreciation charge leaving open the possibility of NPAT actually declining from the already depressed base in H1 2020. While the reasons for this poor performance were not clearly articulated, the company did mention the same factors called out as being negative but not material at the time of the FY20 result announcement, namely hail, fruit fly and COVID-19 related labour costs (which were also elevated in the prior comparable period). With this uncertainty around the underlying problems and poor performance around market communication and guidance, we swiftly exited our remaining position believing that consensus analyst forecasts for the full year remain too high.

Gym owner and operator **Viva Leisure (VVA, -13.6%)** was down -13.6% for the month after the AFR reported on a legal dispute between VVA, as the franchisor of the Plus Fitness network, and a number of dissatisfied Plus Fitness franchisees. The dispute relates to the potential for competition between franchisee owned gyms and nearby VVA owned gyms. Given that the dispute pertains to the Plus Fitness franchisee network which generates only a relatively small proportion of VVA revenues the share price reaction was larger than expected. Furthermore, the focus of the roll out of further VVA corporate gyms is less likely to conflict with the predominantly NSW based Plus Fitness franchisees given VVA will likely open new gyms in Victoria and Queensland. Later in the month, VVA announced guidance for FY21 earnings which were broadly in line with market expectations. In particular, corporate owned gyms were growing members at mid-teens rate (%) with stronger margins experienced in high intensity group class format HIIT Republic. HIIT Republic enjoys nearly double the revenue per member than that of a 'big box' gym. Furthermore, better margins were achieved in the second half of FY21 with improving margin trajectory for FY22 which would be further improved by any acquisitions of mature gyms.

Eclipx Group Ltd (ECX, +8.9%), a consumer and business fleet and novated leasing specialist delivered a strong H1 FY21 result which was comfortably ahead of consensus forecasts. The excellent result was underpinned by strong end of lease income, with record used car prices realised due to new car supply constraints resulting in profit per fleet unit sold more than doubling from $2,468 in H1 FY20 to $5,944 in H1 FY21. This more than offset a 15% decline in new business written brought about by the lack of new car availability which, whilst a near-term headwind, has resulted a record order pipeline heading into the second half. Fleet and credit impairment income statement charges were another driver of outperformance versus our expectations, swinging from negative to positive as higher provisions (including a COVID-19 overlay in H1 FY20) were not repeated in H1 FY21. ECX has further reduced corporate net debt (driven by strong organic cash flow and no cash tax payments due to the Federal Government instant asset write-off) to $54m from $99m at the FY20 result. The business has undergone a significant turnaround under the guidance of Managing Director Julian Russell and given a solid profit outlook and a strong balance sheet, the company concurrently announced a $20m on-market share buy-back. We expect further consolidation in the broader fleet/novated leasing space, following the recent SG Fleet/LeasePlan tie-up, and ECX is well positioned to be a key participant.

Global asset management company **Janus Henderson Group (JHG, +11.3%)** continued to move higher during the month with its undemanding valuation metrics (CY21 PE of 10.7x and yield of 4%) attracting greater attention from investors rotating away from growth businesses into companies that are the beneficiary of a reflationary environment. JHG has long been overlooked by fund managers due to its low growth outlook but fund outflows in the business have moderated over the past 12 months, with the low margin quantitative strategies the only remaining source of meaningful outflow, and the performance across key strategies has remained solid. JHG has also attracted the interest of activist shareholder Trian Fund Management (Trian) who has acquired a 10% stake in the company. Trian could help unlock value by proposing that JHG be acquired by a larger fund manager in a combination that unlocks revenue and operating synergies or by encouraging it to continue to use its balance sheet strength to repurchase its own stock, which has been an earnings accretive strategy for the company over our two years of our ownership.

Outlook

Inflationary pressures and economic recovery remain the dominant focus across markets heading into the end of the financial year. The question of whether we are witnessing the beginning of an inflationary wave which could force the hand of policy makers and necessitate interest rates rising at a time when the global economy is still relatively early in its recovery phase is becoming more contentious, as signs of inflationary breakouts become more prevalent. Indeed, the US core Consumer Price Index (CPI) – which excludes the volatile food and energy prices – came in well ahead of economists' expectations at +3% in April, albeit off a low base at the beginning of the pandemic. The US core CPI increased +0.9% month on month (the largest increase since 1981) reflecting gains in nearly every major category and elevating concerns that the world's largest economy may start overheating. Additionally, the core personal consumption expenditures price index (PCE) increased +3.1% in April from a year earlier. Federal Reserve officials in the US consider the core PCE to be the best gauge of inflation as the index captures price movements across a variety of goods and services and is generally considered a wider ranging measure of inflation as it captures changes in consumer behaviour and has a broader scope than the Labor Department's CPI measure.

The US economy continued its ongoing economic recovery adding 559,000 jobs in May, double April's disappointing total, and the unemployment rate ticked down to 5.8% from 6.1%, according to data released by the Bureau of Labor Statistics at the start of this month. Half of all US residents have received their first dose of vaccination and confirmed coronavirus cases in the US have fallen to levels not seen since March 2020 in a further positive sign for an ongoing economic recovery. The US Federal Reserve is now forecasting CY21 GDP growth of +6.5%, up strongly from an earlier projection of +4.2% in December 2020. The US economy is being squeezed by bottlenecks in the supply chain, as manufacturers and suppliers try to ramp up production capacity to meet the new demand. Shortages, exacerbated by regional droughts in the US, have led to the rapid escalation in prices for products ranging from computer chips to lumber, plastics, grains and meat and poultry.

The Australian economy too continues to outperform expectations and has rebounded back to 2019 economic activity levels, being one of few developed economies to achieve this feat along with Singapore and South Korea. The unemployment rate continues to fall with the rate declining to 5.5% in April, with the feared 'JobKeeper Cliff' proving to be a non-event. In the monthly RBA board meeting statement, Governor Philip Lowe noted that "there are reports of labour shortages in some parts of the economy… and a further decline in the unemployment rate to around 5% is expected by the end of this year". From a Fund perspective, labour pressures have particularly been an issue over in the West with several listed companies calling out labour related challenges when tempering forward earnings expectations including Fortescue Metals Group, Perenti Global and Mineral Resources to name a few. In other areas of the economy, housing remains buoyant with the residential property market surging to new highs, underpinning a wealth effect whereby consumers feel more inclined to spend on areas such as new cars and in retail which is a clear positive for consumer confidence (ex-Victoria). Business investment is also robust, as is the construction sector with new dwelling activity showing ongoing sign of improvement.

The International Monetary Fund is now forecasting the world economy will expand by +6.0% in 2021, up from its +5.5% forecast in January as vaccines are rolled out and as advanced economies spend aggressively to counter the damage caused by the pandemic. Against a backdrop of strong global growth and emerging inflationary pressures, we remain focussed on the outlook for interest rates given that lower bond yields have been a key driver of multiple expansion across equity markets in recent years. The evidence in the bond market clearly suggests that Wall Street has made up its mind and the consensus view is that the rise in US inflation and other global inflationary pressures will be transitory. Indeed, the US 10-year Treasury Rate has actually fallen to 1.53% as at June 8, from 1.73% as at the end of April, and the consensus CPI forecasts from 48 of Wall Street's brightest and best economists on Bloomberg is equally clear-cut with the consensus inflation print in Q1 to Q4 of CY22 forecast to come in at a benign +2.2% in each quarter.

Investors have been closely watching economic data and comments from central bank officials for signs of runaway inflation and the possibility the central bank may begin to pull back on its massive stimulus measures. Specifically, we are watching for the start of the tapering cycle, as a return of inflation and economic growth prompts central banks globally to ease the emergency monetary policy measures that were introduced at the height of the pandemic last year. Some central banks, including the Bank of Canada have already begun to scale back their quantitative easing (QE) programs and there is a growing expectation in the market that the RBA will be one of the next to taper. Should this occur, it is likely to be a positive for financial stocks which the Fund is overweight and a negative for long duration growth stocks which we have reduced in recent months.

At its May board meeting the RBA reiterated its position that the cash rate is "unlikely" to rise "until 2024 at the earliest” but did open the door to tapering earlier by announcing they will make a decision at the July meeting on extending QE and shifting the maturity of the yield control curve (where it buys three-year bonds in order to keep benchmark borrowing rates low and help drive further employment growth) from the Apr-24 to the Nov-24 bond. The RBA said repeatedly that the conditions necessary for a rate rise was inflation “sustainably within the 2 to 3 per cent target range”, and a labour market that was “tight enough to generate wages growth that is materially higher than it is currently”. These conditions are still not present, and we therefore feel it is likely, on balance, that the RBA may defer any decision on tapering until later in the calendar year. Markets nonetheless are looking through the RBA’s commentary and pricing in a much more optimistic view on economic growth by indicating that the cash rate is set to lift as soon as late next year. Bank bill futures in Australia now imply a cash rate of 1.1% by June 2024, which would equate to at least four 25 basis point rate hikes over this time horizon.

The recent coronavirus lockdown in Victoria has inflicted another bitter blow to struggling businesses and households in Victoria and we empathise with those suffering either financially and/or from a mental health perspective. Fortunately, it seems restrictions will be progressively lifted in time for the Queen’s Birthday weekend, although not without a tremendous impact on many Victorians. It is a further reminder of the terrible human cost that COVID-19 has inflicted on many and the fragile nature of the recovery, until we can reach herd immunity.

June is a busy time for the OC Fund’s team and despite the Victorian lockdown we have been extremely active in catching up with our Fund holdings ahead of the blackout period, before the August results period. Whilst we did not escape the May ‘earnings confession’ period unscathed, we remain confident that our portfolio is well positioned to report strong results in August and remain upbeat on the prospects of our holdings into the new financial year.

Top 5 holdings#

Company	ASX code
Bapcor Limited	BAP
Eagers Automotive	APE
Mineral Resources	MIN
Sealink Travel Grp	SLK
Vocus Group Limited	VOC

The top 5 portfolio holdings are in alphabetical order and may not be representative of current or future investments.

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[†]The total return performance figures quoted are historical, calculated using cum-distribution end-of-month hard-close mid-prices and do not allow for the effects of income tax or inflation. Total returns assume the reinvestment of all distributions. The performance is quoted net of all fees and expenses. The index does not incur these costs. This information is provided for general comparative purposes.
[*]The performance comparison of $100,000 over 10 years is for illustrative purposes only. All returns shown are based on Australian dollar figures. Past performance is not a reliable indicator of future performance. The total returns shown are prepared on an ongoing basis (i.e. they include all ongoing fees and expenses and assume reinvestment of all distributions). They do not take personal taxation into account. The comparison with the S&P/ASX Small Ordinaries Accumulation Index is for comparative purposes only. Index returns do not allow for transactional, management, operational or tax costs. An index is not managed and investors cannot invest directly in an index.

Past performance is not a reliable indicator of future performance. Positive returns, which the OC Premium Small Companies Fund (the Fund) is designed to provide, are different regarding risk and investment profile to index returns. A performance fee of 20.5% is payable annually on any excess performance (after deducting the management fee) above the benchmark, S&P/ASX Small Ordinaries Accumulation Index, to 30 June. A performance fee is only payable where the Fund has returned 5% or more since the last performance fee was paid. This document is for general information purposes only and does not take into account the specific investment objectives, financial situation or particular needs of any specific reader. As such, before acting on any information contained in this article, readers should consider the appropriateness of the information to their needs. This may involve seeking advice from a qualified financial adviser. Copia Investment Partners Ltd (AFSL 229316, ABN 22 092 872 056) (Copia) is the issuer of the OC Premium Small Companies Fund (ARSN 098 644 976). A current PDS is available from Copia located at Level 25, 360 Collins Street, Melbourne Vic 3000, by visiting ocfunds.copiapartners.com.au or by calling 1800 442 129 (free call). A person should consider the PDS before deciding whether to acquire or continue to hold an interest in the Fund. Any opinions or recommendation contained in this document are subject to change without notice and Copia is under no obligation to update or keep any information contained in this document current.