



# THB US Micro Cap Fund

## Quarterly Report – September 2017

### Market Commentary

The Russell Microcap® Index (Index) returned 4.3% in AUD in Q3 2017.

Nearly all sectors were positive this quarter, led by Telecom Services (+11.1%) and followed by (Health Care (+10.4%) and Industrials (+7.9%). Utilities (-1.2%) was the only negative performing sector.

US equities rose in the third quarter as the market looked beyond the headline noise of geopolitical tension, natural disasters, and politics to the underlying strength of the US economy. Manufacturing has been solid (from new orders to production to hiring), payroll employment has been robust, and business confidence is at a multi-year high. The small businesses represented by the National Federation of Independent Business (NFIB) are optimistic, with the percentage of businesses saying “now is a good time to expand” nearing a level not seen since 2004.

The Federal Reserve plans to move forward with rate hikes and fiscal policy is moving as well, with Republicans unveiling a plan for comprehensive tax reform towards the end of the quarter. There is further evidence of deregulation with the Federal Register being on track to comprise approximately 60,000 pages in 2017, a 40% decline from the all-time record of 100,000 pages published in 2016.

### Portfolio Commentary

The THB US Micro Cap Fund returned 2.4% in AUD (net of fees) in Q3 2017.

Positive contribution in the THB US Micro Cap Fund came from strong stock selection in Consumer Discretionary (+1.3%) and Financials (+0.4%), which was offset by poor selection in Industrials (-1.3%) and Consumer Staples (-0.6%) as well as an underweighting in Healthcare (-0.3%) given the resurgence in Biotech stocks.

THB’s top five performing stocks (from a contribution standpoint) were Overstock.com (Consumer Discretionary, +1.5%), Johnson Outdoors (Consumer Discretionary, +0.8%), Old Second Bancorp (Financials, +0.4%), LeMaitre Vascular (Healthcare, +0.4%) and ePlus (Information Technology, +0.4%).

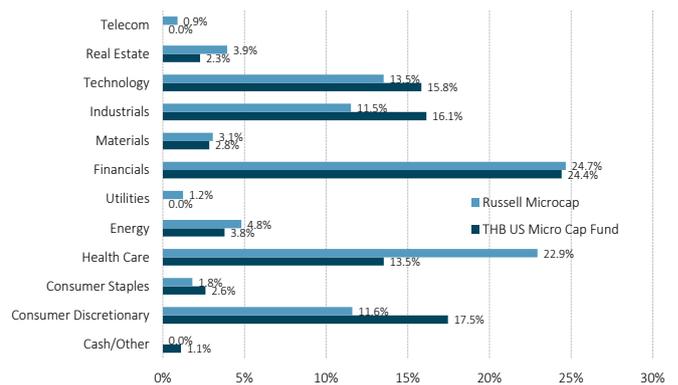
The bottom five performing stocks (from a contribution standpoint) were LSI Industries (Industrials, -0.4%), Autobytel (Information Technology, -0.4%), Insteel Industries (Industrials, -0.3%), Landec (Consumer Staples, -0.2%) and Smart Sand (Energy, -0.2%).

THB believes micro cap companies currently have the benefit of dual tailwinds of underlying economic growth and pro-growth fiscal policy (tax reform, deregulation, etc). Smaller, more domestically-focused companies typically experience a greater benefit than their larger, more internationally diverse counterparts from a strengthening US economy. Smaller companies are also disproportionately burdened by regulation, so the substantial easing seen on this front is a meaningful tailwind for micro caps. Additionally, many micro cap companies are subject to the full fare corporate tax rate of 39%, so tax reform would bring greater relief to these companies than to large cap companies which pay much lower effective rates. Importantly, THB does not believe tax reform is being priced into the market.

Fund Details	
Benchmark	Russell Microcap® Index <sup>1</sup>
Inception Date	5 September 2014
Fund Size	A\$204.8 million

Net Performance – 30 September 2017			
	Fund <sup>2</sup>	Russell Microcap®	Difference
1 Month	9.4%	9.3%	0.1%
3 Months	2.4%	4.3%	(1.9%)
1 Year	23.6%	19.3%	4.2%
2 Years p.a.	16.4%	11.5%	4.9%
Since Inception p.a. <sup>3</sup>	14.4%	16.5%	(2.1%)

### Sector Allocation<sup>4</sup>



- The Russell Microcap Index is a capitalisation weighted index of 2,000 stocks that captures the smallest 1,000 companies in the Russell 2000 and 1,000 smaller US based listed stocks.
- Performance figures are presented in AUD on a net, pre-tax basis and assume the reinvestment of distributions. Past performance is not an indicator of future performance.
- Fund inception date was 5 September 2014 however inception performance is calculated from 1 October 2014.
- Portfolio holdings and allocations are subject to change and should not be considered as investment recommendations to trade individual securities. The securities identified and described do not represent all of the securities purchased, sold or recommended for client accounts. The reader should not assume that an investment in the securities identified were or will be profitable. There is no assurance that any securities discussed herein will remain in the portfolio at the time you receive this report, or that securities sold have not been repurchased. There can be no assurance that investment objectives will be achieved. A full list showing every holding’s contribution to the overall account’s performance during the measurement period and calculation methodology is available upon request.

## Sector In Focus

The US consumer continues to strengthen, an important factor considering consumer spending comprises approximately 70% of GDP. The Conference Board's measure of consumer confidence is near its highest level in 17 years, and Bloomberg's Consumer Comfort Index hit an 11-year high during the quarter.

The improving psyche of the US consumer provides a solid backdrop to the Consumer Discretionary sector, an area in which THB continues to see significant opportunity within the portfolio. The following examples highlight a few of THB's portfolio holdings benefiting from a strong consumer and innovation.

### **Overstock.com**

Overstock.com (OSTK) is one of the leading e-commerce retailers primarily focused in the discount and closeout home furnishing market. It provides manufacturers with a one-stop liquidation channel to sell both large and small quantities of excess inventory without disrupting the traditional markets.

The company is well-positioned to benefit from the continued growth of e-commerce and the increasing share of the home goods category sold online.

Founder and CEO, Patrick Byrne who started the company in 1999, owns 26% of the shares outstanding and has kept the entrepreneurial culture of the company. Through small start-up investments over the past few years, Patrick successfully developed OSTK's blockchain subsidiary and launched the first of its kind digital securities trading platform, tZERO, which is also the only one approved by SEC and FINRA.

OSTK returned 82% during the quarter after Delaware law allowing corporations to maintain shareholder lists and corporate records using blockchain technology went into effect in August. Additionally, Overstock announced a joint venture to launch the first ICO (Initial Coin Offering) exchange that complies with SEC and FINRA. These developments were critical milestones in the adoption of blockchain technology and, THB believes, increased the intrinsic value of Overstock's blockchain subsidiary which could potentially be spun-off. Blockchain enables the automatic processing and verification of transactions through algorithms without the need of third party intermediaries. Financial institutions around the world are recognizing its disruptive potential and are exploring various ways to utilize the technology in their operations. Blockchain could also be applied to multiple industries beyond the financial services such as retail, healthcare, and real estate where the need for verification and the risk of fraud are high.

Overstock's strong growth profile, cash rich balance sheet, and leading blockchain technology are not yet reflected in its stock valuation trading at a significant discount to its peer group.

### **Johnson Outdoors**

Johnson Outdoors (JOUT) is a portfolio holding which returned 52% during the quarter after nearly doubling its operating profit year-over-year and raising its dividend.

The company's brands hold leading market share positions in their respective categories and participate in attractive growth markets targeting the outdoor consumer. JOUT's focus on premium quality and innovation has won its products numerous industry awards and aspirational status among consumers. The SCUBAPRO line is the most respected diving brand in the world, famous for its core life-support products, and the Minn Kota motors line has some of the most innovative products on the market. JOUT's Old Town Canoe brand, founded in 1898, has strong historical heritage and its antique models from the early part of the century have been restored and are beloved by many.

The company has launched several strategic initiatives to increase its direct to consumer presence online which is expected to favourably impact both sales and margins.

Besides its preeminent brand positioning, the company stands out with its pristine balance sheet with \$94 million in cash (\$10.70 per share) and no debt, strong free cash flow generation, and improving profitability.

### **Bassett Furniture**

Founded in 1902, Bassett Furniture is a leading retailer and manufacturer of branded home furnishings. Today, Bassett operates over 100 store locations with high quality and custom-made products.

Bassett is the only furniture brand that has an exclusive licensing agreement with HGTV, which ranked among the most watched cable networks in 2016. The HGTV Design Studio by Bassett helps customers do all the planning with personal designers which drives meaningful increase in average ticket and same store sales.

After restructuring its operations during the downturn, the company has returned to growth with plans to open six to eight new stores next year. Additionally, Bassett's investments in e-commerce and technology enhancement to its website are starting to pay off. The company is a direct beneficiary of the continued housing recovery and home improvement market and stands out with its strong balance sheet and FCF generation.

## Portfolio Statistics<sup>1</sup>

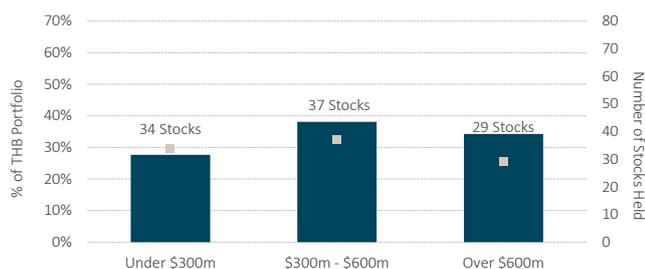
As at 30 September 2017		
	Fund	Russell Microcap®
Weighted Avg Market Cap	\$555m	\$571m
Price/Sales	1.2x	1.1x
Price/Book	2.0x	2.9x
Dividend Yield	0.8%	1.2%
Number of Securities	100	1,522
Standard Deviation	14.8%	15.8%
Sharpe Ratio	0.8	0.8
Beta	0.9	
Tracking Error	5.3	
Information Ratio	(0.1)	

1. Portfolio statistics are reported in USD.

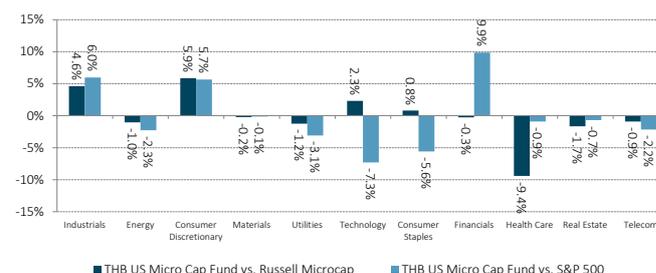
## Top 10 Holdings

Stock	Sector	Weight
Overstock.com	Consumer Disc	3.0%
Old Second Bancorp	Financials	2.8%
First Busey Corp	Financials	2.1%
Heritage Financial	Financials	2.0%
LeMaitre Vascular	Healthcare	1.9%
UFP Technologies	Materials	1.9%
Johnson Outdoors	Consumer Disc	1.8%
Bassett Furniture	Consumer Disc	1.8%
PCSB Financial	Financials	1.8%
Allied Motion Technologies	Industrials	1.7%

## Companies by Market Capitalisation



## Active Sector Positioning



## Investment Strategy

Thomson Horstmann & Bryant, Inc. (THB) is an employee-owned boutique investment management firm based in Connecticut specialising in smaller company strategies. THB's US Micro Cap strategy is based on the belief that there are inefficiencies in the micro cap segment of the market due to lack of analyst coverage, difficulty in identifying value and the impact that management skill has on the direction of smaller companies. THB utilises a disciplined, fundamental bottom-up approach that blends both qualitative and quantitative methods to construct a well-diversified portfolio of companies that possess attractive operating metrics, yet with comparable valuation to the Russell Microcap® Index.

**BROOKVINE**



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