

## Why now is a good time to invest in Concord small caps

### Introduction

We believe that sitting on the sidelines in cash, waiting for markets to revert to 'normal' may mean missing out on opportunities to invest in the Australian smaller companies sector and capture long term wealth creation opportunities.

We believe, moreover, that investing in an actively managed small cap fund provides additional benefits, including professional management by a team of small cap experts, increased diversification and buying strength, convenience, and liquidity, which is more difficult to obtain if investing directly.

We believe that now is a good time to invest for the long term in managed small caps, and that the Concord Discovery Fund is an excellent means to achieve strong returns and increased portfolio diversification.

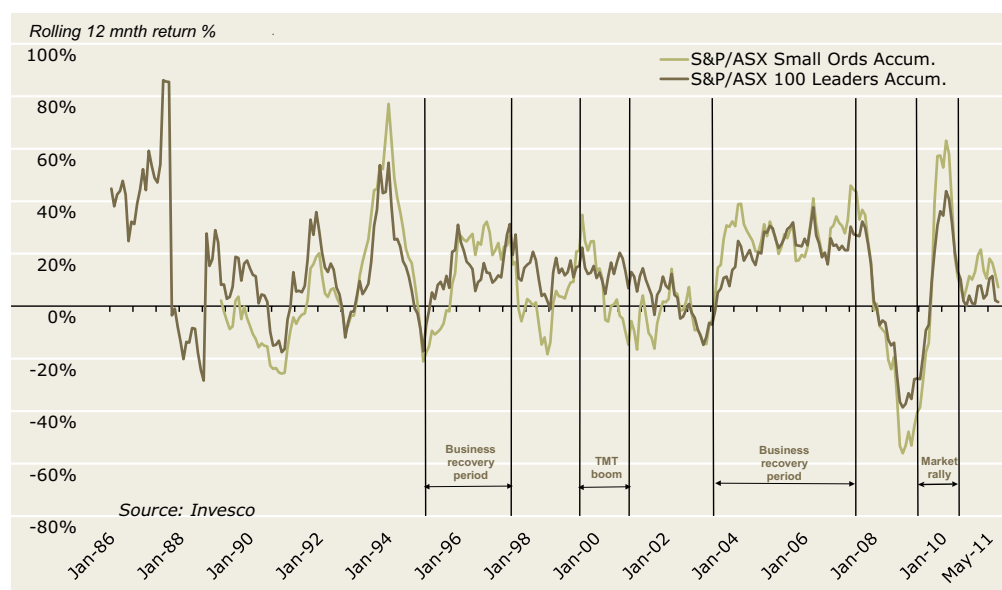
### Why invest in small caps?

The smaller companies or small cap sector of the Australian share market (i.e. outside the top 100 stocks) offers outstanding long-term investment opportunities, such as:

- potential for strong growth in earnings
- an under-researched sector which offers plenty of new investment opportunities and the potential for sustained high returns with not significantly greater risk than the large cap sector
- reasonable valuations compared with the large cap sector
- increased portfolio diversification
- a sector that traditionally performs well in the earlier stages of economic recovery
- investment in emerging technologies and dynamic, nimble companies.

The small cap sector, represented by the S&P/ASX Small Ordinaries index, is trading at relatively low PEs and is therefore attractively valued on an historical basis. Figure 1 below shows the rolling 12 month performance of the Small Ordinaries index over time compared to the large cap sector (S&P/ASX 100 Leaders index). The outperformance of small caps can clearly be seen in the early business recovery periods as markets rally, investor risk tolerance rises, and with it the willingness to invest in smaller stocks.

Figure 1 - small vs. large cap performance over time



“An under-researched sector which offers plenty of new investment opportunities and the potential for sustained high returns with not significantly more risk than the large cap sector”

## Allocating to small caps

The best way to capture the many opportunities offered by small cap stocks is to allocate a portion of your portfolio to the small cap sector on a strategic, long term basis. Successful small cap investing is best rewarded with a patient, long term approach.

The current stage of the economic and investment cycle means that now is an ideal time to allocate a portion of your clients' equity allocation to domestic small caps.

For investors seeking a suitable small cap investment vehicle, the Concord Discovery Fund is an ideal choice. We outline the reasons for this in the next section.

### Why the Concord Discovery Fund for your small cap investment?

The Concord Discovery Fund ('Fund') is a 'best of breed' portfolio. It has an array of features and benefits that, when combined, deliver a strong return outcome and help build wealth. We discuss those features and benefits in more detail, below.

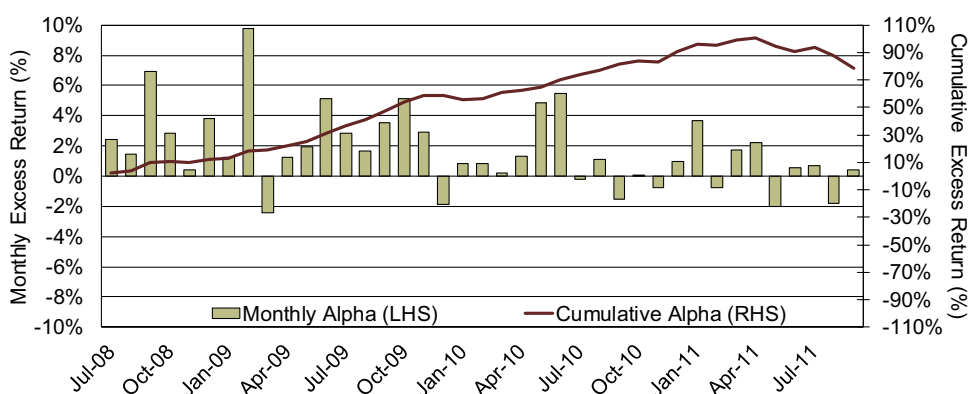
#### 1. An outstanding performance track record across market cycles

The Concord small cap capability commenced on 1 July 2008. The Fund, which started in February 2011, uses this capability.

Since inception to 30 September 2011 the Concord small cap capability returned 15.68% per annum (before fees) versus the benchmark Small Ordinaries Accumulation index return of -6.09%. That equates to a cumulative added value (alpha) of more than 80%, or 21.77% per annum (before fees). Over the three year period to 30/9/11 the Fund's alpha is slightly lower but still very strong at +20.49%.

This very strong track record, shown in figure 2 below, is testament to the quality and strength of the Concord investment team and the team's rigorous, research-intensive investment approach.

Figure 2 - Concord Discovery Fund performance to 30/9/11



1 Year		2 Years		3 Years		Since Inception (30 June 2008)	
Return* % p.a.	Alpha % p.a.	Return % p.a.	Alpha % p.a.	Return % p.a.	Alpha % p.a.	Return % p.a.	Alpha % p.a.
-7.8	4.3	9.2	12.4	20.4	20.5	15.7	21.8

\*before fees

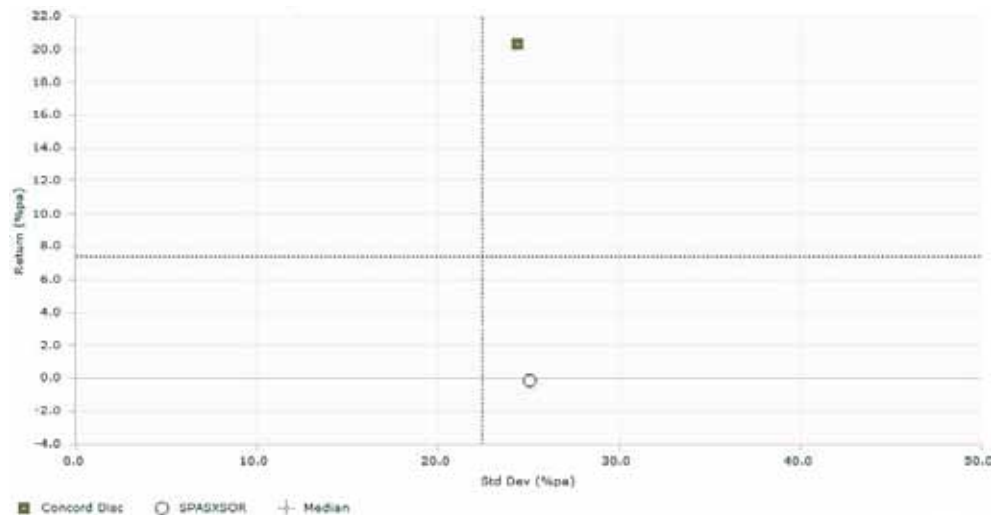
Investments can go up and down. Past returns are not a reliable indicator of future returns. Future returns may be affected by a range of factors including economic and market influences. Performance data is shown after ongoing fees and assumes reinvestment of income.

Figure 3 overleaf shows the Fund's risk-return track record over three years on a before-fees basis to 30 September 2011. Over this period the Fund (square) has returned 20.4% p.a. (before fees) with a risk (standard deviation) of around 24.4% p.a.

The return compares very favourably against both the Small Ordinaries Index (circle) return of -0.1% p.a. and the median return of 7.4%. Fund volatility is lower than benchmark.

"Since inception to 30 September 2011 the Concord small cap capability returned 15.68% per annum (before fees) versus the benchmark Small Ordinaries Accumulation index return of -6.09"

Figure 3 - Fund risk/return vs. benchmark



Source: Mercer

The Fund's typically strong performance against benchmark in volatile, adverse market conditions is due to our consistent approach to small cap investing. That is, we only invest in quality businesses with a competitive advantage in industries which themselves have a reasonable competitive outlook.

## 2. An excellent complement to large cap equities

The Fund is an excellent complement to large cap Australian equities, whether investing directly or investing in a managed fund via a platform.

Investors who obtain their domestic equity exposure via direct equities typically focus on large cap stocks because they are more familiar, more established, and more research is available. However, this can limit an investor's opportunity for a higher risk-return outcome and greater diversification through a small cap exposure. Investing directly in small cap Australian equities is typically more problematic than large caps for a number of reasons: a relative lack of information/research is available; trading costs and liquidity is more difficult to obtain; stock allocation sizes are generally smaller than with large caps; thorough research coverage of the (ex 100) research universe is much more difficult to ensure.

By adding an exposure to small caps, via the Concord Discovery Fund, investors can improve their portfolio returns without increasing risk, while increasing their portfolio diversification, and ensuring maximum peace of mind given the Fund has a strong independent research rating (*Zenith 'Recommended' rating*). Moreover, the Fund has a track record of very strong outperformance driven by a clear robust investment process.

The Fund is also an excellent complement to a client's existing exposure in a large cap managed fund, creating opportunities for a better risk-return outcome and increasing portfolio diversification. By investing in the Fund, your clients can not only achieve this desirable outcome, but also gain greater peace of mind knowing that their small cap exposure is through a top performing and well-rated fund.

### For example:

If a client added a 15% exposure to small caps, via the Concord Discovery Fund, to their existing exposure to the S&P/ASX 50 Index, their returns over 3 years would have increased by over 3.2% p.a. with risk increasing by just 0.7%.

(Source: Invesco, data is gross of fees; at 31/8/11).

## 3. A strongly rated product

Concord's small cap equity strategy has been in existence since June 2008, while the Concord Discovery Fund was launched in February 2011. In that time, however, the Fund has already earned a strong rating from Zenith Investment Partners.

In its July 2011 report<sup>†</sup>, Zenith comments on the Fund's credentials as follows:

*"Zenith believes the Fund's portfolio construction and decision-making process is strong and that the allocation of the Fund to three separate sub-sector portfolios...results in a clearly defined process".*

*"Zenith believes the allocation of the Fund to three separate industry/sector sub-portfolios, effectively eliminates the potential for opposing views of dilution of conviction at the sub-portfolio level".*

*"Consistent with its style neutral bias, the Fund is expected to outperform in both rising and falling market conditions".*

*"The Concord Discovery Fund's style-neutral approach makes the Fund an attractive option for investors seeking a single fund exposure to the Australian small companies sector".*



“The Concord small cap team has a proven ability to ensure their best investment ideas convert directly to high conviction, value-adding stock positions”

#### 4. A top investment management team and asset management approach

The Fund is managed by a team of three analysts at Concord Capital. Each member of the team aims to find the best small cap investment ideas through intensive stock research and a rigorous peer review process. The team is shown below.

<p><b>Garry Duncan</b> <i>Analyst/Portfolio Manager</i></p>	<p>Garry has been at Concord since its inception in 2000, and his 20 year-plus investment experience and background in geology have enabled him to consistently unearth good investment ideas in the smaller resources and energy sectors of the Australian share market. Garry holds a Bachelor of Applied Science, a Masters of Accounting, a FINSIA accreditation, and a Diploma of Geology.</p>
<p><b>Justin Farley, CFA</b> <i>Analyst/Portfolio Manager</i></p>	<p>Justin has 14 years of investment experience, specialising in smaller companies, predominantly in industrial sectors. Justin holds a CFA accreditation, as well as a Bachelor of Commerce (honours).</p>
<p><b>Matt Booker</b> <i>Analyst/Portfolio Manager</i></p>	<p>Matt has 14 years of experience as an analyst, including five years specialising in Australian small companies. Matt holds a Bachelor of Economics majoring in Actuarial studies, and is an Associate of the Institute of Actuaries of Australia.</p>

The philosophy underlying the management of the Fund is that markets are inefficient, and that there are identifiable and repeatable ways to add value through fundamental bottom-up stock research. The team believes that the fundamental case for small cap investing lies in good stock ideas rather than taking positions in sectors.

This investment philosophy has produced strong small cap returns in a variety of different markets. The team's investment approach does not target commonly defined style factors such as 'growth', 'value' or 'industry'. Rather, the approach favours finding quality businesses with a competitive advantage in industries which themselves have a competitive outlook.

The three-strong small cap team at Concord has generated a very strong track record of both absolute returns and added value versus benchmark (alpha) since it started in June 2008. This track record is detailed on page two, but to reiterate: the Concord small cap strategy has delivered a total return (before fees) of 15.68% per annum for an alpha of 21.77% per annum (before fees) from June 2008 to September 2011.

In delivering such strong returns for clients, the Concord small cap team consistently applies a clear, proven and high conviction investment approach that is best described as fundamental, concentrated and bottom-up, with a focus on return enhancement rather than risk management.

There are a number of key implications of Concord's small cap investment approach:

- **Greater depth and breadth for strong value add opportunities** - Concord's small cap team can go both 'deeper' and 'wider' outside the ASX 100 Leaders index. The index we use is the S&P/ASX Small Ordinaries index, where we invest in mid to smaller size companies, i.e. those outside the S&P/ASX 100 Leaders index. These companies range in size from the 101-300 largest stocks, but we can and do look for compelling opportunities outside the ASX 300 (micro caps).

The table below shows the Fund's market cap exposures versus benchmark (at 30/9/11):

Market cap segment	Fund %	Benchmark <sup>§</sup> %	Active weight %
1-20	0.00	0.00	0.00
21-50	0.00	0.00	0.00
51-100	2.60	0.00	2.60
101-200	35.15	74.03	-38.89
201-300	19.03	25.97	-6.93
301-500	27.18	0.00	27.18
500+	10.62	0.00	10.62
[Cash]	5.42	0.00	5.42

<sup>§</sup> S&P/ASX Small Ordinaries Accumulation index

Indeed, our concentration on emerging investment opportunities outside the top 100 stocks (mostly within the top 101-300 companies) has added most value (around 60%) relative to benchmark over the life of the Concord small cap strategy.

- **A focus on long term rather than momentum investing** - our concentration on in-depth research to find high quality small cap investment ideas, and on portfolio construction where only the best, high conviction investment ideas are in the final portfolio, has been justified over time, with consistently strong performance for clients since the inception of the Concord small cap capability in mid-2008.

The small cap part of the domestic equity market is often lucrative for stock picking fund managers because it can be susceptible to a high degree of research neglect.

Examples of small cap stocks the team has invested in over the last three years which have added significant value for investors are:

- FlexiGroup
  - Platinum Asset Management
  - Mincor Resources
  - Oroton Group
  - IRESS
- **Large capacity** - Concord's small cap strategy has plenty of capacity given the team can manage up to 0.5% of the market capitalization of the Small Ordinaries index and current FUM is well below considerations.
  - **A high alpha target; not particularly index-aware** - the Fund's concentrated, higher alpha-seeking return profile is a strong complement within a well-diversified portfolio. Concord's small cap team manages the Fund to add significant value by discovering those companies that are undervalued in the market relative to our price expectations.

“Our team and process is carefully configured to add wealth for investors over the long term, rather than being susceptible to shorter term market gyrations and emotion”

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### Outlook and summary

The Concord small cap team offers a few comments about the current environment for small cap stocks:

*“Our strategy remains unchanged in that we are finding good companies trading at very attractive long term valuations. We continue to focus on companies with strong balance sheets and cash flow. There may be a spurt of merger and acquisition activity given the lack of top line growth and relatively healthy corporate balance sheets.”*

As ever, investing in the small cap sector contains risks. However, we believe those risks, when managed effectively by seasoned small cap investment professionals, are outweighed by a host of investment opportunities, including:

- investing in dynamic companies with strong growth prospects
- investing in an under-researched sector with plenty of 'alpha' opportunities
- greater portfolio diversification
- potential to invest in leading edge technologies stocks and industries
- investing in a sector that traditionally performs well in the earlier stages of economic recovery.

The Concord Discovery Fund captures all the above benefits and delivers yet more, including:

- An outstanding performance track record across market cycles
- An excellent complement to large cap equities
- A well-resourced, experienced, stable investment team
- A repeatable transparent and disciplined investment process that ensures a high conviction on the best ideas in the final portfolio
- A strongly rated product
- Large capacity
- A high alpha target; not particularly index-aware.

Critically, our proven small cap approach, via the highly experienced Concord small cap team, works throughout all cycles having delivered strong performance in times of volatility as well as in a strong market. Our proven, research-intensive investment approach is configured to help build wealth for investors over the long term, rather than being susceptible to shorter term market gyrations and emotion.

Your Invesco representative:  
For more information on this Fund, please  
contact the relevant Invesco representative:



**Sam Sorace**  
National Retail Sales Manager  
(Vic, SA, Tas)  
Phone: 0413 050 909



**Matthew Hattersley**  
Manager Retail Sales  
(NSW, Qld)  
Phone: 0414 847 511



**David Ray**  
Manager Retail Sales  
(NSW, ACT & WA)  
Phone: 0437 404 445

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