

Professional PLANNER

Play the long game in small caps: IML



By
Cut+Paste

September
10, 2015

Investors Mutual Limited (IML) has urged investors and their advisers to shift their thinking when it comes to allocating small caps. Rather than just adding growth to a portfolio, as is the traditional view, small caps can provide diversification to a deep range of industries and generate sustainable long-term returns.

Senior Portfolio Manager and founding member of the IML team, Simon Conn said that small caps are often perceived as the "land of great hope," with investors looking for the next big thing or business owners looking to tap in to a potentially lucrative pool of investor capital.

"The small cap index and its sector composition tend to reflect the prevailing trends of the day, but these fads come and go and often just don't deliver sustainable returns over time to the investors chasing them," Mr Conn said.

Over the last 10 years, the Small Ords Accumulation Index has delivered 2% p.a., whereas a portfolio of quality small cap stocks, such as the IML Smaller Companies Fund managed by Mr Conn, has delivered the far superior return of 8.5% p.a.

"Ultimately, investors need to rethink the way they approach small caps. The chase for capital growth has made small cap investing a short-term play for the majority which, evidence suggests, is an unsuccessful strategy," added Mr Conn.

"By investing in small caps on a long-term basis with a focus on quality companies that provide portfolio diversification, both the income and capital growth returns for investors are broadened. This is particularly important given the concentrated nature of the Australian market index, exacerbated by the subdued economic environment," he said.

Small caps: diversity and depth to endure the economic cycle

Against a backdrop of a subdued economic outlook in Australia and overseas, IML believes diversification across market caps and sectors is an investor's best protection. This is particularly true when it comes to Australian equities, where some 60-70% of the ASX300 is concentrated in just two sectors – resources and financials.

By contrast, the range of sectors available within the small cap universe is wide, providing investors with a diversity of opportunities over the long-term.

"These diverse stocks are often less researched, offering far more opportunity to find quality undervalued companies. IML is focused on such quality companies, which we believe can continue to do well despite the subdued macro environment," Mr Conn said.

During his past two decades at IML, Mr Conn has found that smaller certainly doesn't always mean lower quality.

"The attributes of a quality company include a strong competitive advantage, recurring and predictable earnings, and capable management that can grow these earnings and dividends over time. We have discovered a number of market leaders with these positive attributes within the small cap sector, these companies just happen to operate in a smaller industry," Mr Conn explains.

The following table is a sample of such quality companies in which IML has successfully invested:

Company	Return (FY 14/15)*
Energy Developments	+51%
Amalgamated Holdings	+40%
Shopping Centres Australasia Property Group	+31%
Pact Group Holdings	+42%
Chorus	+60%

Source: IML

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