Investors Mutual Australian Smaller Companies Fund

Quarterly report September 2017

INVESTORS MUTUAL LTD

Fund status: OPEN

- Global sharemarkets continued to rally over the quarter thanks to strength in US stockmarkets, which hit new record highs
- The Fund's ex100 benchmark gained +4.4%, thanks to significant strength in the volatile Resources segment
- We continue to be cautious given the competitive pressures impacting companies and the uneven economic environment

	1 month	3 months	1 Year	3 years^	5 Years^	Since inception^
Income	+0.0%	+0.0%	+10.5%	+13.3%	+12.5%	+11.4%
Growth	+0.7%	-2.3%	-11.0%	-1.3%	+1.0%	+3.4%
Total Return*	+0.7%	-2.3%	-0.5%	+12.0%	+13.5%	+14.8%
Benchmark**	+1.3%	+4.4%	+2.1%	+7.4%	+4.1%	+5.8%

^% Performance per annum. *Fund returns are calculated net of management fees, and assuming all distributions are re-invested. Investors should be aware that past performance is not indicative of future performance. Returns can be volatile, reflecting rises and falls in the value of underlying investments. **The benchmark for this Fund is the S&P/ASX Small Ordinaries Index (ex LPT)

Sharemarket Commentary

Global equity markets finished the September quarter on a firm note with the MSCI World Index gaining +5.0%. Global bourses were led higher by the US, as the Dow Jones continued its run of record highs and the S&P500 Index finishing the quarter up +4.5%. Europe's Stoxx50 and Japan's Nikkei were similarly strong over the quarter finishing +4.8% and +2.2% higher respectively.

Sentiment improved late in the quarter as equity markets looked to brush aside geopolitical rumblings such as the threat of nuclear war with North Korea. With markets reacting positively as the Republican Administration finally released a blueprint of corporate tax reforms. Also in the US, the Federal Reserve minutes released in September highlighted the need for further policy normalisation by enacting a program to wind back its balance sheet, a move which pundits labelled QT (quantitative tapering). The Fed also flagged its intention for a further US rate increase by the end of the year. The Fed minutes coincided with a backdrop of stronger US macro data releases, such as the ISM manufacturing gauge hitting a 13 year high. The tax reform proposals, coupled with Fed normalisation news buoyed the USD late in the quarter after it had fallen circa -10% over the previous 6 months.

Domestically, the AUD lost -1.4% against the USD in September, a welcome reprieve given its strength over the previous 6 months. Over the quarter, Base Metal prices gained +9.5%, the gold price gained +3.1% while the oil price gained +14.5% over the quarter as production cuts by OPEC gained traction.

In contrast to its global counterparts, the broader Australian market as measured by the ASX300 Accumulation Index had a lacklustre quarter overall eking out a +0.8% gain. Despite weakness in the Resources sector late in the quarter, courtesy of a hefty correction in the iron ore price, the Resource sector was the best performing sector over the quarter gaining +9.3%. By contrast the Industrials sector was soft falling -0.8%. Reporting season in August proved lacklustre despite the fact that many companies met their FY17 expectations, their forward guidance and outlook for FY18 underwhelmed investors.

The **Fund's ex100 benchmark** strongly outperformed its large cap counterpart by gaining +4.4% over the September quarter. It was a tale of two markets with Small Industrials gaining +2.5%, while the Small Resources surged ahead to post a gain of +12.8% on the back of higher commodity prices.

Within the small industrials segment, Consumer Staples was the top performing sector over the quarter jumping +15.3% as companies exposed to the ongoing soft commodities boom continued to be well supported, with the share prices of a2 Milk, Costa, Blackmores and Bellamy's appreciating markedly. Conversely, the index heavyweight Consumer Discretionary sector had a lacklustre quarter down -1.3% as companies exposed to the Australian consumer were weaker as concerns that consumer spending would be weaker going forward due to high debt levels and weak wages growth. The Healthcare sector also had a challenging quarter falling -8.7% with API down -21.8% after the company flagged a softer end to the year and Mayne Pharma falling heavily after reporting a disappointing FY17 result. We remain confident in the investment case for both companies moving forward.

Fund information	
APIR	IML0001AU
Inception	30 Jun 1998
Size	$179M
Application (Ex)	$1.9179
Redemption (Ex)	$1.9083
Cash	13.9%
Management fee	0.993% p.a.
Investment horizon	4-5 years
Distributions	Semi-annually
Managers	Simon Conn Marc Whittaker

Level of Franking (%)*	
FY12	96.5%
FY13	42.9%
FY14	25.5%
FY15	31.3%
FY16	14.0%
FY17	25.8%

*As per IFSA Standard

Performance & Strategy

The ***IML Smaller Companies Fund*** had a tough quarter with its unit price declining -2.3% against the benchmark's gain of +4.4%. Our caution to the volatile small resources sector held back our relative performance over the quarter with many mining stocks rallying strongly as the sector surged +12.8%. In addition, many of our small cap Industrial holdings such as Mayne Pharma, API, GWA and Pact Group all had disappointing quarters following lacklustre guidance, although we remain comfortable with the management and long-term outlook for these companies. On a positive note, Flight Centre, Steadfast, Shopping Centres Australia and Tox Free all had a solid quarter.

Mayne Pharma's (MYX) share price declined significantly over the quarter, after announcing a disappointing FY17 result due to strong competition in the US generics market in the second half of the year. While this pricing pressure will also impact FY18, a range of initiatives such as cost cutting and new product launches will help offset some of this weakness. In addition, the company's branded products and contact manufacturing divisions are expected to post good growth going forward. At current prices, we believe the company is oversold, trading at a discount to peers in the US industry. At this stage, we are holding our position in the company while closely monitoring the company's progress into FY18.

Pact Group (PGH) declined -10.6% for the quarter after the FY17 results showed soft underlying market conditions offset by the benefits of acquisitions and self-help initiatives. The long-term partnership with Woolworths in crate pooling operations commenced in Aug-17, which we see as a solid investment which further diversifies Pact's business and reflects the capable strategic execution being carried out by Pact's experienced management team.

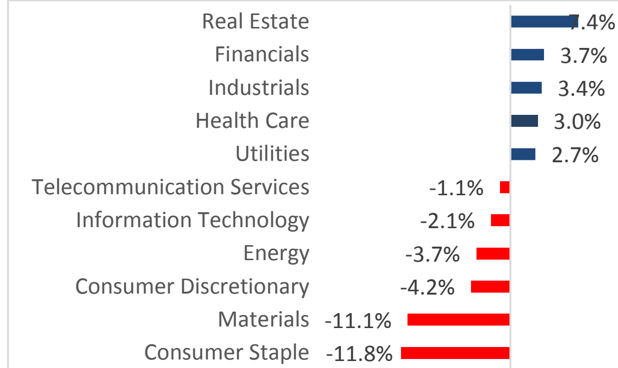
Integral (IDX) rallied +2.4% for the quarter after the diagnostics company reported a solid FY17 result. The result highlighted continued growth in examinations in excess of Medicare data in states where IDX operates. In addition, the new CEO outlined a clearer strategic plan to improve operational performance, and Medicare data since year end has reflected improving diagnostic imaging industry trends.

Z Energy (ZEL) share price declined -9.3% over the quarter as a Government study into NZ fuel industry margins was extended, leading to increased uncertainty within the industry. Despite the uncertainty, ZEL's business continues to perform well. ZEL recently held an investor day, in which, the company reiterated earnings guidance. This revealed internal initiatives to reduce costs by another NZ$30-35m by 2020, and provided a positive update on capital management. Under its new dividend policy, ZEL is trading at prospective ~7% dividend yield (FY19).

Outlook

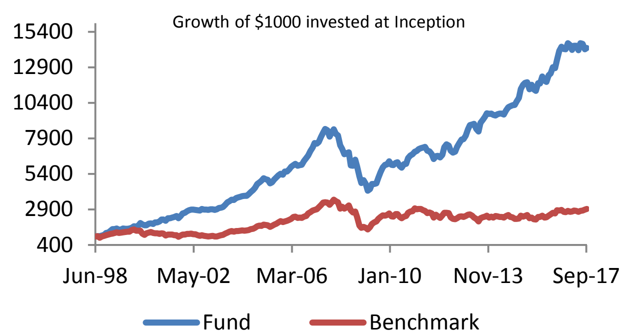
We remain cautious given the continued low growth and highly competitive economic environment which is making it difficult for many companies to grow their earnings. We continue to focus our attention on good quality companies that we believe are well positioned to sustainably grow their earnings and dividends in the years ahead while also maintaining a healthy level of cash in the portfolio as we await further opportunities to buy good quality stocks at the right level. We are still cautious on the Resource sector given the continued high levels of supply apparent in most commodity markets.

Sector Weights



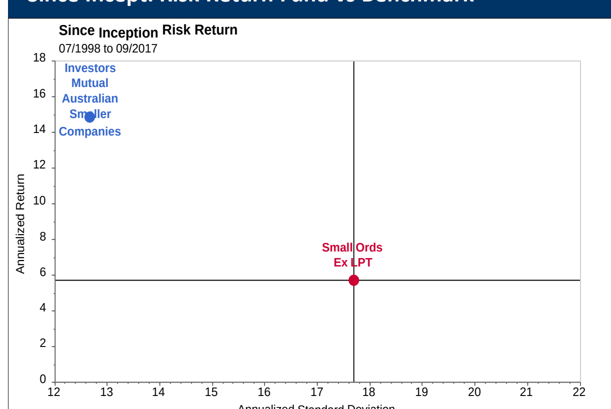
Portfolio top holdings	ASX Code
Tox Free	TOX
Pact	PGH
Centuria Capital	CNI
Shopping Centres Australasia	SCP
Fletcher Building	FBU
Z Energy	ZEL
Southern Cross Media	SXL
Ht&E	HT1
Integral Diagnostics	IDX
Hotel Property Investments	HPI

Since Inception Cumulative Perf. Fund vs Benchmark



Source: IML

Since Incept. Risk Return Fund vs Benchmark



Source: Factset

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