

Quarterly Review of Funds

Blue sky for mine services

Small Caps

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Small companies riding the resources boom provided some of the best returns last quarter, but it is mining services companies and not blue-sky miners that fund managers say will be the star performers in 2006.

Goldman Sachs JBWere head of Australian equities Tim Hannon says the difficulty faced by several managers is that a lot of the performance was coming from speculative mining and exploration companies.

"If you look at the market at the moment there are a raft of companies without cashflow that are performing quite well... take for example the ones that have gone into uranium [exploration]," he says.

Hannon says companies such as Paladin Resources, which rose a whopping 60 per cent last month, did not fit with his fund's investment criteria despite the fact that it had enjoyed significant share price gains. "It does hurt your shorter-term performance," he says.

GSJBW's emerging leaders fund suffered in the last quarter, with the manager recording a return of negative 3.61 per cent.

While small company plays have been responsible for strong performances for general Australian equity funds, research from asset consultant Morningstar revealed that, on average, large company funds outperformed small company funds by about 6 per cent in calendar 2005.

On average, small cap funds returned 17.7 per cent compared with 23.9 per cent for large cap funds.

However, most managers, including Hannon, expect small company funds to produce double-digit returns this year.

WINNERS AND LOSERS

Small company fund performances* Ranked on return for the quarter to Dec 31 2005

Top performers		Net assets	3mth return	1yr return
		\$m	%	%
1	Colonial First State Future Leaders	789.93	6.72	18.77
2	Smallco Investment	85.64	4.83	26.11
3	Colonial First State Developing Companies	295.38	4.75	8.26
4	Macquarie Master - Small Companies	16.65	2.50	22.48
5	MFP Small Companies	121.40	2.54	26.44
Bottom performers		Net assets	3mth return	1yr return
		\$m	%	%
23	EQT Small Companies	24.58	-8.29	-1.77
22	Goldman Sachs JBWere Emerging Leaders	323.45	-3.61	15.17
21	Advance Australian Smaller Companies	11.52	-3.35	8.00
20	Challenger Smaller Companies (Retail)	38.21	-2.94	2.52
19	Perpetual WJ Perpetual's Smaller Co	121.42	-2.40	3.82

*Includes only funds with over \$10 million in net assets



Source: Morningstar

GSJBW's emerging leaders fund has done better over a longer period with its three-year performance recording a healthy 23.5 per cent return.

Hannon says the fund has favoured stocks that show good longer-term growth prospects such as grain-handler ABB Grain and childcare operator ABC Learning.

Fellow value manager Invesco has done a little better out of the resources run and noted that it was mining service companies such as Macmahon Holdings, Worley Parsons, Downer and Ausdrill which contributed to performance from that sector.

"These companies benefitted from the increased volume of contracting work and not just price," says Invesco small companies head Cynthia Jenkins.

Another company which has done well out of mining services is equipment provider Boom Logistics, which Hannon says his fund still holds.

Jenkins said these businesses would continue to benefit from larger players such as Rio Tinto and BHP Billiton's willingness to outsource specialist services on major projects.

Mining and engineering contractor Macmahon Holdings was one of the biggest beneficiaries of the trend. Last December, the mid-cap company lifted its order book to a record \$1.2 billion after winning a \$250 million iron ore contract with BHP Billiton — the largest in its 42-year history.

As a value manager, Invesco's performance in the last quarter has been slight at only 0.6 per cent, however the fund has a strong record over the medium to long-term with its three-year performance returning a strong 25 per cent for investors.

Colonial First State had two of its small cap funds among the top three performers for the quarter, while little known boutique fund manager Smallco ranked well, coming in second with a quarterly return of 4.83 per cent.

Until recently, Smallco has specialised in only managing funds from private individuals rather than on behalf of institutions. The manager has a little less than \$50 million in net assets but has no plans to increase funds under management beyond about \$250 million.

By contrast, Colonial's best performing fund for the quarter, the future leaders fund, has almost \$800 million under management.

Smallco's strong performance has largely been a result of investments into financial services companies with monopoly characteristics such as the Sydney Futures Exchange and IRESS Market Technology.

But the ugly duckling of 2005 could represent value, says Invesco's Jenkins who is looking closely at the retail sector. Rebel Sport is one retailer on which it is keen.