Lonsec

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The Good, The Bad And The Brave Of The Small Cap Sector

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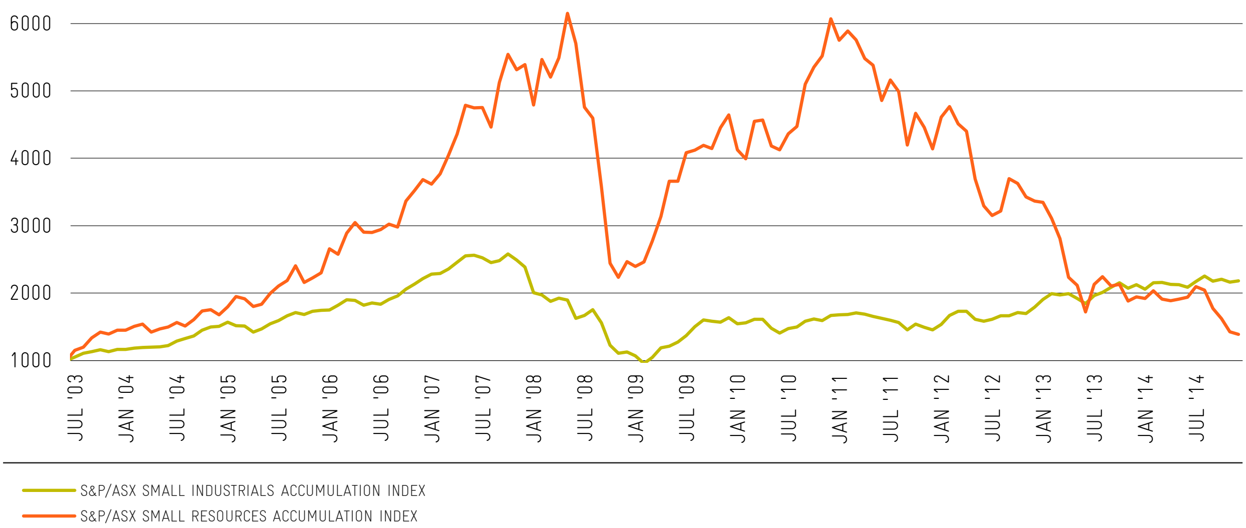
Resource and mining services companies continue to drag down the small capitalisation market, with their losses overshadowing otherwise strong results and the beginnings of a welcome restructure within the small cap sector.

According to the latest review of small companies by leading research house Lonsec, the plunging value of resource companies has had a positive impact on the structure of the small cap market, despite being the major reason the sector has underperformed during recent years.

As the value of resource stocks fall, so too does their weighting within the index, Lonsec analyst Nick Thomas said. "This is leading to a healthier balance of companies and industries within the popular sector," Mr Thomas said.

"The poor performance of resources has become a well-worn theme for small caps, persisting for the past four years. More recently, the main drags within the sector have been iron ore, gold and energy companies, this has also flowed through to put pressure on companies within the mining services sector," he said.

Small Industrials vs Small Resources Cumulative Returns 2003 – 2014



Source: Bloomberg

During 2014, The ASX S&P Small Ordinaries index recorded a 3.8 per cent fall, however, this was dominated by a 28.4 per cent plunge by small resources companies, which wiped out a 2.8 percent gain by small industrials.

Funds rated within the Lonsec small cap peer group, however, had already shown a strong bias away from resource companies last year. According to its latest review of the small companies fund sector, Lonsec-rated managers outperformed the market on average by 6 percentage points to produce a 2.2 per cent gain after fees, compared with the index 3.8 per cent loss.

"Fund managers who have shown strong industrial stock selection, as well as avoiding the blow ups in mining and mining services, have produced solid returns during the past three years,'' Mr Thomas said.

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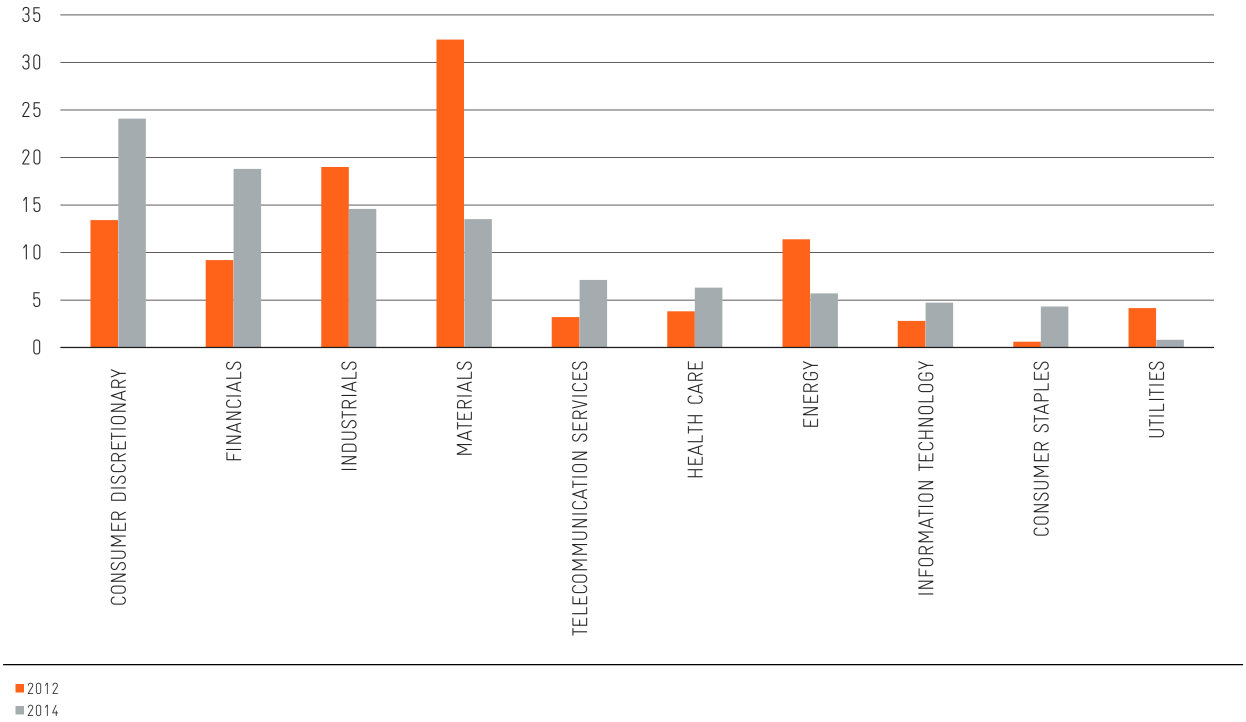
Small Cap Sector Weights (%)



Source: ASX

The reweighting of the index as resource stocks fall from grace is also having a more positive impact on the wider small cap market sector.

"The obvious impact from the disparity between resources and industrials is that the materials and energy sectors now make up a far smaller proportion of the benchmark index," Mr Thomas said.

"They have been replaced by increases in consumer discretionary stocks, financials and, to some extent, healthcare and telecommunications.

"The number of new public offerings in the past two years has also helped this trend. Overall the balance and diversity within the index now looks far healthier,'' he said.

Small Cap Performance Extremes 2014

NAME	GICS SECTOR	RETURN
SIRTEX	HEALTHCARE	143%
DOMINO'S PIZZA	CONSUMER DISCRETIONARY	58%
G8 EDUCATION	CONSUMER DISCRETIONARY	37%
SLATER & GORDEN	CONSUMER DISCRETIONARY	31%
TPG TELECOM	TELECOM	29%

Source: Bloomberg

NAME	GICS SECTOR	RETURN
RED FORK ENERGY	ENERGY	-98%
BC IRON	MATERIALS	-88%
ATLAS IRON	MATERIALS	-85%
NRW HOLDINGS	INDUSTRIALS	-71%
MEDUSA MINING	GOLD	-65%

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RELEASE ENDS

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Lonsec Research Pty Ltd is an investment research and investment consulting business that focuses on providing investment insight, advice and solutions to stakeholders in the wealth management industry.

Lonsec's experience in generating investment insight and advice solutions makes it a valuable research and consulting partner for financial advisory businesses. With its genesis as a dealer group research unit and a long history of providing investment research and investment consulting services to financial advisers, Lonsec's experienced analysts and consultants have a sound understanding of the advice processes and financial products used in both the accumulation and retirement phases of the investor lifecycle.

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