



CONTANGO MICROCAP LIMITED
INVESTMENT COMMENTARY

QUARTERLY UPDATE - DECEMBER 2015

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A WORD FROM THE CHIEF INVESTMENT OFFICER

CIO Monthly Note

January 2016

Volatility welcomes in the New Year



Unfortunately, news headlines in the first week of the New Year have been dominated by volatility in financial markets.

The recent market volatility has been caused mainly by developments in China including the depreciation of the renminbi. To put the

volatility into some context, it is important to recognise that the Chinese economy is going through a major transition.

China's old model of growth relied on exports and debt-fuelled investment. For a long time this model worked with real GDP growth averaging over 10% in the 2000s. So why has this model of growth broken down?

Firstly, demand for China's exports is dependent on economic conditions in the broader global economy, including in developed economies. The problem is that economic conditions in developed economies have been weak with low growth and not much demand for exports from China. This is reflected in the latest export data from China which shows export growth turning negative in late 2015.

Secondly, China's debt financed investments have become less productive over time. Generally, projects with high benefit-cost ratios like well-targeted public infrastructure add to economic output. But the debt and investment increasingly found its way into less productive means such as on speculation and into already oversupplied industrial capacity.

This has left the Chinese economy in a vulnerable position with slowing growth, excess capacity and an elevated debt burden. Moving to a more sustainable growth model requires reversing these trends.

The good news is that the Chinese government is aware of the problem and has set out a reform agenda. But we shouldn't overestimate what the Chinese authorities can do and we should also expect some policy errors along the way.

The handling and communication of the recent renminbi depreciation can be viewed in this light. While it is true that the renminbi is expensive, seemingly random depreciations of 1%-2% are too small to effectively stimulate the economy but large enough to cause financial market disruption.

Looking forward, our basecase is still for no hard-landing in China although demand for commodities will be weak as trend growth moderates. As a result, all of Contango's portfolios are underweight resources and are likely to remain that way throughout 2016.

Although it may be tempting to exploit 'value' opportunities in some beaten up resource stocks, investors should be cognisant of the larger economic backdrop and the still subdued outlook for commodity prices.

George Boubouras
Chief Investment Officer
Contango Asset Management Limited
(this note was written 12 January 2016)

AUSSIE BATTLERS EKES OUT POSITIVE GAIN IN 2015

GLOBAL OVERVIEW

Following three consecutive years of solid growth, the Australian equity market managed a modest total return (including dividends) of 2.8% in 2015. The local market's subdued performance was consistent with weak markets across the globe.

The global MSCI ACWI index declined -4.3% over the year, driven by weakness in key US markets (DJI -2.2% and S&P 500 -0.7%) coupled with aggressive selling in emerging markets (-17.0%). Europe (3.8%) and Japan (9.1%) bucked the trend, both delivering positive returns and the US NASDAQ (5.7%) enjoyed better fortunes than the S&P 500 and DJI.

Not surprisingly, it was the Energy and Materials sectors that weighed on markets given the poor performance of key commodity prices over the year.

The Energy sector finished down -27.7% over the year and the Materials sector finished down -15.2%. Outside of these sectors, the majority of the ASX 300 Index finished up with the standout being the more defensive Utilities (22.8%) sector. Consumer Discretionary (18.7%) and Industrials (16.7%) also performed well.

Following a dismal showing in the third quarter of 2015, world equity markets did finish the year of relatively well with a 4.6% return in the fourth quarter. Emerging markets even managed to eke out a small gain (0.3%). Despite the Fed raising rates for the first time since 2006, the US DJI (7.0%) and the S&P 500 (6.5%) both managed to deliver strong returns in the December quarter.

In the quarter, the local market also delivered a strong return of 6.5%. Consumer Discretionary (13.0%) was the best performer, followed by Healthcare (12.3%) and Financials. Materials (-6.9%) and Energy (-1.3%) continued to underperform.

During the December quarter, the market's main focus was on the Fed which raised rates for the first time since June 2006. Despite some volatility, markets generally received the news well with US long bonds only selling off 1-4 basis points on the day of the decision.

Also of note, the IMF added the Chinese Renminbi to the list of reserve currencies which make up the SDR. This was the first change since the Euro replaced the Deutsche mark and the French franc in 1999.

In Europe, the ECB cut its deposit rate 10 basis points to -0.3% and announced a six-month extension to its QE programme, taking the programme out to March 2017.

Domestically, the RBA left the cash rate on hold, with the statements announcing the decisions largely unchanged, save for a few words.

Global Indices	1 mth	3 mth	12 mth
Dow Jones Industrial	-1.7%	7.0%	-2.2%
S&P 500	-1.8%	6.5%	-0.7%
NASDAQ Index	-2.0%	8.4%	5.7%
Euro Stoxx 50 Price Index	-6.8%	5.4%	3.8%
FTSE 100	-1.8%	3.0%	-4.9%
German Aktien Index (DAX)	-5.6%	11.2%	9.6%
France CAC40	-6.5%	4.1%	8.5%
Nikkei 225 Index	-3.6%	9.5%	9.1%
Hang Seng Index	-0.4%	5.1%	-7.2%
Shanghai Composite Index	2.7%	15.9%	9.4%
India BSE 200 Index	0.4%	0.8%	-1.5%
MSCI ACWI (US\$)	-1.9%	4.6%	-4.3%
MSCI ACWI Ex Aust (AU\$)	-2.9%	0.5%	7.8%
ASX 300	2.7%	6.5%	2.8%

United States

During the quarter, the Fed raised interest rates for the first time in almost ten years. The Fed's target rate range increased by 25 basis points to 0.25%-0.50%. The increase was widely anticipated by the market with little reaction on the day. The FOMC statement was notably dovish with the word "gradual" emphasised on more than one occasion. Looking forward, the FOMC's 'dot plot' is consistent with four hikes in 2016.

On growth, US third quarter GDP was revised down one-tenth to a sluggish 2.0%. But a slowdown in inventory accumulation masked a solid increase in domestic final demand.

During the quarter, the US labour market data was undeniably strong, partly supporting the call for Fed lift-off. Non-farm payrolls increased 654k in the quarter, initial jobless claims declined to 267k, the unemployment rate fell to 5.0% and the labour force participation rate increased to 62.5%.

On the consumer, the University of Michigan consumer sentiment index rose from 87.2 in September to 92.6 in December. Consumers are likely benefitting from lower petrol prices and the steady improvement in the labour market. The

Conference Board Consumer Confidence Index increased 3.9 points in December to 96.5, reversing some of the declines reported in October and November.

On housing, the Case-Shiller 20-city composite index ended the quarter up 5.5% over the year. Building permits increased 16.7% in the quarter, but Housing starts decreased from 1,207 in September to 1,173 in November. The implementation of the "Know Before You Owe" loan disclosure rules weighed on loan and construction demand during the quarter.

On manufacturing conditions, the Markit, Philadelphia Fed and Empire State surveys all showed a deterioration in conditions over the quarter. The Empire State survey posted its fifth consecutive contractionary reading. The weakness is likely attributable to lower energy prices, the stronger dollar and a continuing inventory drag.

The Markit Services PMI fell to 53.7, the lowest reading since last December. All of the components within the services PMI moved lower, with the largest declines in new business and business expectations.

China

During the quarter, the Chinese Renminbi became the fifth currency to be included in the IMF's Special Drawing Rights (SDR). This is the first alteration to the basket of currencies comprising the SDR in over 15 years.

On the policy front, China's policymakers held the annual Central Economic Work Conference (CEWC) in December. The conference emphasized proactive fiscal policy and prudent monetary policy to support new sources of growth and tackle overcapacity, high debt and financial risk.

The economic data remained subdued in China. Third quarter GDP growth came in at 6.9% compared to 7.0% in the second quarter. Industrial production growth slowed to 5.6% in October before picking back up to 6.2% in November. Fixed investment growth increased over the quarter as newly started investment projects picked up.

The PMI data showed some stabilisation with the seasonally adjusted Caixin China Composite PMI index rising from 48 in September to 50.5 in November. The Caixin China Manufacturing PMI increased from 47.2 to 48.6.

There was also some evidence that central bank easing is starting to flow through the economy. During the quarter, the PBoC lowered the regulated

reserve ratio (RRR) and M1 money supply growth increased from 11.4% in September to 15.7% in November. Although, M2 money supply growth was relatively unchanged at around 13%.

China's CPI inflation remained subdued rising only 1.3% in October and 1.5% in November. The uptick in November was driven by food prices which were affected by rain and heavy snow.

Europe & Japan

In Europe, the ECB cut the deposit rate 10 basis points to -0.3% and announced a six-month extension to the duration of its QE programme, taking the programme out to March 2017.

The Markit Eurozone PMI was remarkably resilient given the string of unfortunate events in the Europe including a terrorist attack. The Manufacturing PMI increased 0.8 points to 53.1. Notably, the manufacturing sector reported increased exports and production expectations, consistent with the PMI, although the Services PMI did fall -0.5 points to 53.9, yet it remained solid.

In Japan, the economy rebounded in the third quarter after a soft second quarter. Growth picked up from -0.5% to 1.0% annualised. However, inflation remained weak at only 0.3% in November. The BoJ kept the rate of QE at 80 billion yen despite some expecting them to do more.

GLOBAL INTEREST RATES / CREDIT MARKETS

Over the year, the US yield curve 'bear flattened' with the spread between the 2 year and 10 year bond rates narrowing by 29 basis points.

At the long end, the US 10-year bond yield rose 10 basis points to 2.27%. The reaction to the Fed rate announcement was relatively modest on the day of the decision with yields rising only 1-4 basis points.

The Australian yield curve 'bull steepened' over the year, with the spread between the 10 year bond yield and 3 year bond yield widening by 26 basis points. The Australian short end rallied on speculation of more RBA rate cuts while the long end sold off on the back of the Fed's decision.

Interest Rates	Level	1 mth	3 mth	12 mth
AUS UBS Composite Bond	8,561	0.3%	-0.2%	2.6%
AUS UBS Bank Bill Index	8,365	0.2%	0.5%	2.3%
	%	basis point change		
AUS Cash Rate	2.00	0	0	-50
AUS 90 day Bank Bill rate	2.35	9	19	-42
AUS 10 year Bond yield	2.81	-5	21	8
US Federal Funds rate	0.50	25	25	25
US 30 year Bond yield	3.02	5	16	27
US 10 year Bond yield	2.27	6	23	10

EXCHANGE RATES

Over the year, the USD rose 9.25% against a basket of major currencies. The index was supported by the Fed's rate decision but also by weakness in the Euro (-10.3%) which largely reflected the ECB's decision to cut the deposit rate and extend its QE programme.

Over the year, the AUD was weak depreciating 10.7% against the USD and 5.7% in trade weighted terms. However, since its low of 69 cents in September, the AUD has climbed over 3% on the back of strong employment data and strengthening business conditions. Therefore, the AUD outperformed most other commodity currencies despite the weak commodity price environment (CAD 8.0%, BRL 4.2% and ZAR 15.9%).

Exchange Rates	Level	1 mth	3 mth	12 mth
AUD/USD	0.729	0.9%	3.9%	-10.7%
AUD/YEN	87.72	-1.4%	4.3%	-10.2%
EURO/USD	1.085	2.7%	-2.9%	-10.3%
AUD/EUR	0.672	-1.9%	6.9%	-0.5%
AUST TWI	62.70	1.5%	4.7%	-5.7%

COMMODITIES

It was a very tough year for global commodity prices as subdued global growth and excess supply weighed on markets.

The crude oil price declined -31.0% over the year with most of the selling occurring in the second half. Subdued global demand, an unseasonably warm start to the northern hemisphere winter and excess supply from the US all combined to drive the price lower. The trend decline in price continued in the December quarter with no production cuts from OPEC to stabilise the market.

Over the year, base metals lost almost a quarter of their value with the LME Metals Index down -24.4%. The decline was driven by slowing demand from China and the global economy. All of the constituents in the index fell with zinc down -26.5%, copper down -26.1%, tin down -24.9%, aluminium down -17.7% and lead down -2.5%. Notably, the LME nickel price declined -42.0% with the weakness partly attributable to China's anti-dumping duties.

On iron ore, the hangover of the mining super cycle persisted through the year, with the price falling -36.5% to US\$43.5 a tonne. Soft demand from China and additional supply from Australia combined to drive the ore price lower. This trend continued throughout the year with the price falling over 20% in the December quarter.

Precious metals fared marginally better than other commodities with spot gold declining by only -10.4% over the year. The gold price was driven by speculation regarding the timing of the Fed rate hike and geopolitical tensions in the Middle East. The Fed's deferral in October increased holdings of physically backed gold ETFs and lengthened net money manager positioning which supported the price somewhat.

Commodities	Level	1 mth	3 mth	12 mth
Gold (US\$/oz)	1,061	-0.3%	-4.8%	-10.4%
Oil WTI (US\$/bbl)	37.1	-11.0%	-18.2%	-31.0%
Aluminium (US\$/lb) LME	68.4	4.5%	-3.5%	-17.7%
Copper (US\$/lb) LME	213.3	2.3%	-7.7%	-26.1%
Nickel (US\$/lb) LME	393.0	-0.8%	-14.0%	-42.0%
CRB Commodities	176.1	-3.5%	-9.1%	-23.4%
Iron Ore Price	43.5	-1.1%	-21.6%	-36.5%

DOMESTIC ECONOMIC DEVELOPMENTS

The Australian economy continued its transition from mining to non-mining during 2015. As a result, growth was below trend and the RBA was forced to cut rates twice early in the year.

A key drag on the economy was the slowdown in mining capex. The third quarter private capex survey revealed that Australian firms cut capex by a substantial -9.2% (consensus -2.9%). The forward looking component was also weak with estimates of a -20% contraction for the coming year.

Stopping the RBA from undertaking additional easing were the potential risks to the housing market. The risks were identified and discussed in the RBA's Financial Stability Review. As a result, APRA implemented additional supervisory measures to reinforce sound housing lending standards. This had a negative impact on investor lending which declined to 35% of new loans which is the lowest level since 2012.

In addition to concerns around investor housing, the economic data did improve in the second half of the year prompting the RBA to take a wait-and-see approach on interest rates.

Economic growth surprised on the upside in the third quarter coming in at 0.9%. However, the major contributor was net exports which masked a sobering quarterly contraction in domestic demand (-0.6%).

The Australian labour market, as reported by the ABS, was red hot in 2015. The economy allegedly added 302k jobs in the 11 months to November. The unemployment rate fell from 6.4% to 5.8% in November with the participation rate increasing from 64.7% to 65.3%. However, the ABS has come under scrutiny for its labour force data with sample rotation adding significantly to the growth numbers.

Consumer inflation was subdued over the year with the headline rate averaging around 1.5%. The index was weighed down by the decline in energy prices. Core inflation moderated from 2.3% to 2.1% over the year but remained within the RBA's target band.

In the December quarter, the economic data was generally solid. On the consumer front, retail sales were up 0.5% in November and 0.6% for the September quarter. The Westpac Consumer Confidence index rose (7.4%) over the quarter to 100.8.

The NAB business confidence survey rose from 1.3 in September to 4.8 in November, following the

change in Prime Minister. Importantly, the business conditions measure, which has the strongest correlation with domestic activity, ended the quarter 10.2.

During the quarter, the Reserve Bank of Australia left the official cash rate on hold. The RBA had to juggle a number of competing forces, but the risks were biased towards further easing. The central bank lowered its inflation forecast based on the assessment that "the latest reading contained some signal, not just noise". The RBA also noted that the beneficial effects of a weaker A\$ are proving slow to manifest through the real economy.

At the annual Long Run address, RBA Governor Glenn Stevens highlighted the impending economic adjustment to the very large and long-running terms of trade event. This is coinciding with a household sector which no longer has a major role to play in leading growth by significantly increasing its leverage.

Indicator	Outcome
Employment change, persons, mth, Nov	71 400
Unemployment rate, %, Nov	5.8
Consumer confidence, index, Dec	100.8
NAB business confidence, Nov	+5
RBA cash rate, %	2.00
Credit growth, %, yoy, Nov	6.6

AUSTRALIAN EQUITY MARKET

The ASX 300 Index returned a modest 2.8% in 2015. This was driven by a 2.1% return in the large cap ASX 100 Index and a strong 10.2% return in the Small Ordinaries Index.

Resources continued to underperform with the ASX 300 Resources Index down 24.9% over the year and the Small Resources Index down 14.7%.

In the December quarter, the market returned a strong 6.5% driven by a 9.1% return from the Industrials which offset the -8.7% decline in Resources.

Accumulated Australian Indices	1mth	3mth	12mth
All Ordinaries	2.6%	6.6%	3.8%
ASX 100	2.6%	6.1%	2.1%
ASX 100 Industrials	3.4%	8.8%	7.7%
ASX 100 Resources	-2.6%	-10.0%	-25.8%
ASX 200	2.7%	6.5%	2.6%
ASX 300	2.7%	6.5%	2.8%
ASX 300 Industrials	3.4%	9.1%	8.3%
ASX 300 Resources	-2.0%	-8.7%	-24.9%
Small Ordinaries	3.9%	11.3%	10.2%
Small Industrials	3.8%	11.9%	15.0%
Small Resources	4.5%	7.2%	-14.7%

As at 31 December 2015. Source: Bloomberg * Total return

Not surprisingly, it was the energy (-27.7%) and Materials (-15.2%) sectors that weighed on the local market over the year given the sharp decline in commodity prices. Outside of these sectors, the majority of the index finished higher. The standout performers was the more defensive Utilities (22.8%) sector, Consumer Discretionary (18.7%) and Industrials (16.7%).

In the December quarter, the story was much the same with Materials (-6.9%) and Energy (-1.3%) continuing to underperform. The outperformers were the Consumer Discretionary (13.4%) and Healthcare (12.4%) sectors.

Australian Sector *	1 mth	3 mth	12 mth
Materials	1.3%	-6.9%	-15.2%
Consumer Discretionary	6.3%	13.4%	18.7%
Consumer Staples	7.1%	6.2%	1.0%
Energy	-7.5%	-1.3%	-27.7%
Financial	3.7%	10.6%	6.1%
Financial (ex LPT's)	3.6%	11.5%	4.7%
Healthcare	0.6%	12.4%	16.2%
Industrials	-0.5%	5.6%	16.7%
Information Technology	3.8%	9.2%	11.9%
Property Trusts	4.0%	6.0%	14.4%
Telecoms	4.3%	0.9%	1.8%
Utilities	3.0%	8.6%	22.8%
S&P/ASX300	2.7%	6.5%	2.8%

As at 31 December 2015. Source: Bloomberg * Total return

Sectors in detail

The Consumer Discretionary sector (13.4%) was the best performer over the quarter. The sector was driven by strong performances across the board including in Consumer Services, Media and Retailing. The standout stock performance was Domino's Pizza (43.5%) with Crown (26.3%), APN Outdoor (58.4%), OOH! Media (51.8%) and Myer (35.8%) also performing strongly. The sector was buoyed by the strong employment data, strong housing market and improvement in consumer confidence.

Healthcare (12.4%) also outperformed over the quarter despite a bounce in the currency. Sector performance was driven by a strong performance from CSL (18.1%). CSL flagged new products due for release in 2016 which will support earnings growth. Mayne Pharma (37.6%) and Ramsay Health Care (16.2%) also performed well.

The Financials ex-REITs (11.5%) outperformed on the back of a solid performance from the Banks (12.8%). Of the majors, CBA (17.6%) and Westpac (17.2%) were the best performers on a flight to quality while NAB (4.2%) and ANZ (6.9%) underperformed.

Outside of the banks, Diversified Financials (14.6%) performed well driven by Magellan (43.4%), Challenger (22.1%) and Macquarie group (10.1%). REITs (6.0%) had a solid quarter but underperformed the broader financials. Outperformers were Mirvac (17.8%) and Lendlease (13.6%).

IT (9.2%) had a good quarter led by Technology One (31.4%), iProperty (34.4%) and Carsales.com (19.6%). SMS Management (-41.4%) was the clear underperformer as it continued to work through its restructure.

The Utilities (8.6%) sector was driven by a solid performance from AGL Energy (13.2%) and a very strong performance from the smaller Infigen Energy (63.0%). ERM Power (-30.1%) underperformed after a downgrade following margin pressure.

Consumer staples (6.2%) marginally underperformed the broader market. The sectors performance was driven by very strong returns from Bellamy's (73.2%), Bega Cheese (56.5%), Metcash (53.8%) and Blackmores (49.4%). But the sector was weighed down by the relatively modest performance of Westfarmers (6.1%) and the outright weakness in Woolworths (-1.4%). Woolworth's continued its search for a new CEO but Chairman Gordon Cairns said he "will not be rushed to any quick fixes" and it is likely the search could take some time.

Performance in the Industrials (5.6%) sector was mixed with strong gains in Professional Services (9.0%), modest returns in Transport (4.6%) and ongoing weakness in Capital Goods (-4.5%). Brambles (18.8%) had the largest impact on the sectors return. The outperformers were Broadspectrum (32.7%), Seek (28.2%) and Seven Group (26.3%). The Capital Good stocks continued to underperform including Bradken (-51.5%), Cardno (-48.8%) and Austal (-30.2%) on the back of falling commodity prices.

Telcos (0.9%) underperformed following a flat result from Telstra (0.0%). The outperformers were Chorus (56.4%), Vocus (27.9%), and M2 Group (22.7%).

Resources underperformed over the quarter dragged down by both Energy (-1.3%) and Materials (-6.9%). Within the Energy sector, Caltex (26.8%) performed well but this was offset by falls in Origin (-11.9%), Oil Search (-6.6%) and others.

Within Materials, BHP (-19.6%) detracted the most from performance followed by Rio Tinto (-8.0%) and South 32 (-22.0%). Other underperformers included Kingsgate Consolidated (-48.6%), Arrium (-33.3%) and Sims Metal Management (-23.6%).

EQUITY MARKET – OUTLOOK

The outlook continues to evolve mostly as we have expected with sub-trend global growth driven by solid growth in the US, partly offset by weakness in emerging markets.

We expect developed economies to perform somewhat better than emerging economies on the back of ongoing solid growth in the US, a modest recovery in Europe and weak but positive growth in Japan. Growth in Emerging economies however is expected to remain under pressure from weak commodity prices, tightening financial conditions and soft momentum.

A key factor driving the outlook for growth and equity markets will be the evolution of US and global bond yields.

Underlying activity in the US is solid and is driving a recovery in the labour market. Although the Fed began normalising rates in December, the future path of interest rate rises is likely to be very gradual and the terminal rate much lower than in previous cycles. The US economy is still deleveraging, inflation is subdued and the broader indicators of labour force excess capacity remain elevated. Therefore, it is likely that US bond yields will remain low which will help support growth and equity markets.

In Europe, economic activity has been weak and inflation has been very low but, following the announcement of QE by the ECB and subsequent depreciation in the Euro, we expect growth and inflation to pick up somewhat in 2016.

On Emerging Markets, our baseline forecast for China is for no hard landing although the risks have increased mostly around its financial markets. We envisage a gradual moderation in trend growth and a well-managed deleveraging with no major debt or credit crisis. So far, this scenario has played out mostly as expected with policymakers providing support as required including a modest devaluation of the Yuan.

Under this scenario, demand for commodities should remain subdued and commodity prices will remain under pressure. Both iron ore and oil face unfavourable supply dynamics with additional oil supply likely to come on stream if the price rises aggressively. However, we remain on the look-out for any large-scale supply cuts that would have an impact on pricing.

Locally, the outlook is for sub-trend growth as the economy continues to transition from mining investment to non-mining investment, net exports and consumption.

While this transition is slow, there is mounting evidence that it is underway. Employment growth has picked up driven by a recovery in NSW and Victoria centred on services and construction. This has stabilised the unemployment rate and has encouraged more people to enter the labour market. Although we don't expect a cyclical upswing, this labour market strength will support national income growth and consumption.

In this environment the RBA is likely to remain on hold. However, the recent independent rate hikes by the commercial banks will put pressure on the RBA to not let financial conditions tighten further.

In summary, given modest but positive global growth and supportive monetary policy, global equity markets should continue to grind higher over the next 12 months. Equity valuations have improved recently following some volatility, but although valuations now look more attractive, we expect the volatility to continue into 2016 as the Fed raises rates and as Emerging Markets adjust. Despite this, equities are still expected to generate higher returns on an accumulation basis than either bonds or cash in 2016.

The Aussie market in particular will be supported by the global equity rally but also the lower AUD which will boost earnings growth for the trade exposed industrials and resource companies.

In this environment, we prefer companies that have solid growth profiles and high free cash flow yields.

SMALL COMPANIES REVIEW

For the December quarter Contango Microcap Limited delivered a return of 11.15% compared to a return for the Small Ordinaries Index of 11.32%. For the month of December, the fund returned 5.91% compared to a return of 3.91% for the Small Ordinaries index resulting in outperformance of 200 bp.

Over the quarter the Small Ordinaries index returned 11.3% compared to the ASX100 index return of 6.1%. Small Industrials (11.9%) outperformed Large Industrials (8.8%) whilst Small Resources (7.2%) outperformed Large Resources (-9.9%).

The best performing sectors over the quarter were Consumer Staples (26.3%), Telecommunication Services (24.6%) and Consumer Discretionary (13.6%). The worst performing sectors were Energy (-8.0%), Industrials (2.3%), and Real Estate (4.6%).

Consumer Staples saw strong performance from Bellamy's Australia Ltd (72.1%) as they continue to benefit from Chinese demand, announced good price rises in November and saw a number of brokers put through earnings upgrades. Bega Cheese Ltd (60.2%) was also a solid performer helped by signing a partnership with Blackmores Ltd to develop and manufacture a range of nutritional foods and as a result of Fonterra Shareholders Fund deciding to divest its stake in the business. Blackmores Ltd (54.8%) continued to benefit from ongoing demand from Chinese consumers for its health products.

Telecommunication Services was also up strongly during the quarter assisted by good performance from Vocus Communications Ltd* (31.2%) which announced a merger with low cost Telco M2 to create a new \$3 billion player in the domestic telco space. The new company will be the fourth largest telco in Australia and the third largest in New Zealand. Spark New Zealand Ltd (14.7%) also enjoyed a good quarter helped by some broker upgrades and two acquisitions which builds its capacity in the Cloud business which is a key growth area.

The Consumer Discretionary sector had a number of outperformers. The outdoor media space saw some strong performers in APN Outdoor Group Ltd (60.2%) and Oh!media Ltd (51.77%) as digitalisation in the outdoor media space continues to grow strongly resulting in a series of earnings upgrades. Several of the retailers also performed well including Myer Holdings Ltd (35.8%), The Reject Shop Ltd (32.4%) and Super Retail Group Ltd (30.2%) as retail sales into the Xmas period look to be stronger than expected.

The Energy sector was dragged lower again due to the continued fall in the oil price with WTI (US\$/bbl) down by circa 18.2% for the quarter. Within the sector the weakest performers were Sundance Energy Australia Ltd (-39.3%), Liquefied Natural Gas Ltd (-35.7%) and Whitehaven Coal Ltd (-23.5%).

The Industrials sector is a disparate one with a number of individual stock stories dragging down the performance. That said mining and energy services companies continued to be challenged with Bradken Ltd (-51.5%), MMA Offshore Ltd (50.5%) and Cardno Ltd (-49.5) in the bottom 5 performers of the Small Ords index. Austal Ltd (-29.5%) also added to the industrials underperformance with the company suggesting that there was some margin pressure in the US shipbuilding division (although a weakening A\$ should alleviate some of this) and after news that the US Defence Secretary had sort to reduce the planned procurement program from 52 to 40 vessels.

The best performing stock was Lynas Corp Ltd (200%). Admittedly the rare earth producer rose from a low base and its performance was enhanced as a major competitor, Molycorp Inc cut production and filed for Chapter 11 protection. As mentioned earlier Bellamy's Australia Ltd (72.1%), continued to benefit from Chinese demand while Infigen Energy Ltd (72.1%) benefited following greater certainty from the Government regarding its renewable energy targets in addition to the completion of the sale of its US windfarms.

Worst performing stocks over the quarter included Dick Smith Holdings Ltd (-72.3%) which had a series of earnings downgrades, and Capital Health Ltd (-51.7%) which confirmed at its AGM that it had made a significantly softer than expected start to FY16 relative to the prior year. As aforementioned mining services company, Bradken Ltd (-51.5%) suffered from the continuing tough conditions in the resources space.

In the month of December, the Small Ordinaries index rose by 3.9% outperforming the ASX100 index which rose 2.6%. Small Industrials increased 3.8% whilst Large Industrials rose by 3.4%. Small Resources rose 4.5% compared to Large Resources which fell -2.6%.

The best performing sectors were Consumer Staples (9.8%), Materials (6.9%) and Consumer Discretionary (5.8%). The worst performing sectors were Energy (-11.3%), Utilities (-7.4%) and Industrials (+0.2%).

The Consumer Staples sector similar to their performance over the quarter, saw Bega Cheese Ltd (27.8%) Bellamy's Australia Ltd (26.0%) and Blackmores Ltd (18.7%) outperform. Metcash Ltd (22.4%) also performed strongly after a better than expected 1H16 profit result and some EPS upgrades.

The Materials sector performance was assisted by lithium explorer, Orocobre (57.0%) as the lithium price continued to increase and as recent outcomes at the UN Climate conference may lead to greater use of rechargeable batteries in the future to help lower greenhouse gas emissions. Goldminer St Barbara Ltd (24.5%) rebounded after weakness in November and a broker upgrade. Saracen Mineral Holdings Ltd* (18.5%) also had a solid month as it announced that they were ahead of schedule and under budget at the Thunderbox gold project.

Within the Consumer Discretionary sector Nine Entertainment Co Holdings Ltd* (17.6%) extended its affiliation arrangements with WIN for a six month period as speculation continues as to whether and how media laws will be changed. Corporate Travel Management Ltd (16.5%) announced its sixth US acquisition by purchasing Montrose Travel continuing to gain scale in the important US market while oOh!media Ltd (14.0%) continued to benefit from earnings upgrades.

The Energy sector continued its horror run with the oil price falling -11% (WTI US\$/bbl). Sundance Energy Australia Ltd (-38.2%) was the biggest underperformer followed by Liquefied Natural Gas (-33.9%) and Whitehaven Coal Ltd (-26.3%).

The main detractor to the Utilities sector performance was Energy World Corp Ltd (-22.0%) while Infigen (-1.1%) fell slightly in December after recording a good quarterly performance.

As usual with a diverse sector the industrials performance was mixed with the main negatives being Austal Ltd (-33.8%) and Cardno Ltd (-31.8%) as discussed earlier. Mineral Resources Ltd (-19.0%) was also weak having the twin problems of being in the mining services business in addition to owning an iron ore mine.

Best stock performers for December were Broadspectrum Ltd (62.8%), Orocobre Ltd (57.0%) and Chorus Ltd (29.5%). Worst performers were Dick Smith Holdings Ltd (-46.2%), Kingsgate Consolidated Ltd (-41.3%) and Sundance Energy Australia Ltd (-38.2%).

* denotes stocks held in portfolio bp.

SMALL COMPANIES OUTLOOK

The outlook for small industrials is solid with the low interest rate and lower currency environment supporting the sector. There is also mounting evidence that the transition from mining to non-mining lead growth is underway which will also support the sector.

However, without the strong cyclical upswing, we continue to look for companies with strong balance sheets and solid growth profiles that are mostly independent of the economic cycle. We continue to favour more defensive companies, including REITs and infrastructure.

Small resources should continue to underperform with the wind down in the mining investment boom and weakness in commodity prices. We remain underweight Energy based on our negative view on oil prices and, likewise, we remain underweight iron ore exposed sectors including mining and capital goods.

Despite this underweight, we continue to monitor for value opportunities where the structural outlook for the company is solid. We are also looking for companies exposed to particular commodities that offer unique opportunities.

KEY STOCK CONTRIBUTORS

Key positive contributors over the quarter were Hub24 Ltd* (91.9%), A2 Milk Co Ltd* (166.4%), Mobile Embrace Ltd* (68.9%), Mayne Pharma Group Ltd* (37.6%) and QMS Media Ltd* (47.4%). Key negative contributors over the quarter were Slater and Gordon Ltd (71.9%), Austal Ltd* (-33.8%), Godfrey's Group Ltd* (-38.6%), Dick Smith Holdings Ltd (-72.5%) and Blackmores Ltd (49.4%).

Key positive contributors over the month were Hub24 Ltd* (33%), A2 Milk Co Ltd* (62.4%), Orocobre Ltd* (37.7%), Saracen Mineral Holdings Ltd* (24.5%), and Polynovo Ltd* (81.3%). Key negative contributors over the month were Austal Ltd* (-38.7%), Blackmores Ltd (18.7%), BROADSPECTRUM Ltd (63.7%), Altium Ltd* (-4.9%) and Praemium Ltd* (-15.2%).

*denotes stocks held in the portfolio

PORTFOLIO CHANGES

New Additions

During December a number of stocks were added to the portfolio.

Apium Animal Health Ltd (AHX) listed in December and operates a commercial veterinary practice and product supply business concentrating on the pig, dairy, feedlot, sheep, equine and companion animal sectors. The company has good growth opportunities and was well priced.

The fund took a placement in General Mining Corp Ltd (GMM) which is a lithium and potash play. We like the lithium play due to the increase in lithium battery use in motor vehicles and the likelihood that overtime battery technology will help in the fight against greenhouse gases.

McGrath Ltd (MEA) a real estate services company listed in December. The company's focus to date has been on establishing presence in high socio economic areas operating with a level of professionalism that has been lacked by many small operators in a highly fragmented industry. Real estate agents are highly cash generative.

MegaPort Ltd (MP1), was taken in an IPO. MP1 is a software company that provides a connectivity platform that allows customers to have interconnectivity between various networks and cloud providers that are connected to the platform.

Pulse Health Ltd (PHG) was added via a placement. PHG is a private hospital operator with a niche focus on specialist hospitals (rehabilitation, day surgery, mental health). It currently has 7 hospitals in NSW/QLD and is in the process of commissioning a surgical hospital in the Gold Coast. The strategy is to operate in niche areas and to position business towards the trend of day surgery procedures. The company recently did a placement to fund the purchase of Vision Eye Institute the largest provider of ophthalmic services in Australia.

Polynovo Ltd (PNV) is a Melbourne-based medical device company that designs and manufactures solutions for its NovoSorb biodegradable polymer technology. PNV's focus is to commercialize its products in the treatment of burns and wounds using its Biodegradable Temporizing Matrix (BTM) and negative pressure wound therapy using Novopore. The company has several key technology advantages versus its competitors. The company was listed in December.

PSC Insurance Group Ltd (PSI) was added through an IPO. PSI is primarily an insurance broker with some underwriting exposure. The strategy is to focus on acquiring, establishing, enhancing and turning around insurance intermediary businesses in Australia and the UK.

Real Estate Investar Group Ltd (REV) was also taken in an IPO. The company is a provider of integrated services to Australian and New Zealand property investors to assist in the identification, analysis, acquisition tracking and accounting of investment property. The company has a strong relationship with Fairfax media.

Superloop Ltd (SLC) was acquired via a placement and is a telecommunications infrastructure company that designs, constructs, and operates an underground fibre-optic cable network. The placement was issued to help fund the purchase of CINENET Systems Pty Ltd which is Australia's only high speed broadband data network created specifically for screen media industries.

Temple and Webster Pty Ltd (TPW) was purchased in an IPO and was listed in December. The company operates as an online shopping company offering members access to furniture, homewares, home décor, arts, gifts and lifestyle products.

Portfolio Exits

Sandfire Resources NL (SFR) was sold on the view that the outlook for copper continues to deteriorate and like most Commodities the industry is waiting for the high cost operators to close. This will take time and despite the new discovery at Monty in WA. Profitability will be reduced into FY16 and FY17 as we forecast copper below the \$US2.00 range.

After selling Dick Smith Holdings Ltd (DHS) for some time the position was completely exited. As mentioned in the last couple of monthly reports the company had been under pressure for some time with poor sales performance, high inventory levels and cash flows that were not improving.

Senex Energy Ltd (SXY) was removed as while the shift in current strategy from oil to gas production is prudent this strategy will take time to implement and any miss on delivery on gas production will be problematic for the business longer-term. Risks have increased substantially so the position was sold.

PORTFOLIO SECTOR DETAILS AS AT 31/12/15

Sector	Active Position
Consumer Discretionary	-0.3%
Consumer Staples	-4.3%
Energy	0.1%
Financial-x-Property Trusts	-2.8%
Health Care	3.3%
Industrials	-0.1%
Information Technology	10.5%
Materials	-8.2%
Property Trusts	-2.2%
Telecommunication Services	-2.6%
Utilities	0.7%
Cash	2.7%
SPI	2.8%

Portfolio Top 20 Stocks	Weight
Mayne Pharma Group Limited	4.3%
Hub24 Limited	4.1%
SG Fleet Group Limited	4.0%
Saracen Mineral Holdings Limited	3.0%
QMS Media Limited	2.9%
Automotive Holdings Group Limited	2.8%
Altium Limited	2.5%
Elanor Investor Group	2.4%
A2 Milk Co Limited	2.3%
Austal Limited	2.3%
Villa World Limited	2.1%
Orocobre Limited	2.0%
GPT Metro Office Fund	2.0%
Catapult International Group Limited	2.0%
Village Roadshow Limited	2.0%
Webjet Limited	2.0%
Collins Food Limited	1.8%
360 Capital Group Limited	1.8%
Mobile Embrace Limited	1.8%
Empired Limited	1.7%

Performance	Contango Microcap Portfolio	S&P/ASX Small Ords Accum	Added Value
1 Month	5.9%	3.9%	2.0%
3 Months	11.2%	11.3%	-0.1%
6 Months	9.8%	7.0%	2.8%
1 Year	14.8%	10.2%	4.6%
3 Years pa	11.0%	1.7%	9.3%
5 Years pa	3.0%	-2.5%	5.5%
7 Years pa	13.6%	6.6%	7.0%
10 years pa	11.3%	1.4%	9.9%
Inception (Mar 04) pa	15.7%	4.6%	11.1%

Key Investment Indicators	Dec-15	Month	Quarter	6 Month	FYTD	12 Month
Accumulated Australian Indices						
All Ordinaries	47,788	2.6%	6.6%	0.4%	0.4%	3.8%
ASX 100	12,245	2.6%	6.1%	-1.0%	-1.0%	2.1%
ASX 100 Industrials	15,200	3.4%	8.8%	3.3%	3.3%	7.7%
ASX 100 Resources	7,071	-2.6%	-10.0%	-24.0%	-24.0%	-25.8%
ASX 200	48,346	2.7%	6.5%	-0.5%	-0.5%	2.6%
ASX 300	47,727	2.7%	6.5%	-0.4%	-0.4%	2.8%
ASX 300 Industrials	102,161	3.4%	9.1%	4.0%	4.0%	8.3%
ASX 300 Resources	13,637	-2.0%	-8.7%	-23.6%	-23.6%	-24.9%
Small Ordinaries	5,725	3.9%	11.3%	7.0%	7.0%	10.2%
Small Ordinaries Industrials	8,084	3.8%	11.9%	12.2%	12.2%	15.0%
Small Ordinaries Resources	2,185	4.5%	7.2%	-19.6%	-19.6%	-14.7%
ASX 300 Accumulated GICS Sector Indices						
Materials	51,630	1.3%	-6.9%	-17.1%	-17.1%	-15.2%
Consumer Discretionary	16,560	6.3%	13.4%	14.7%	14.7%	18.7%
Consumer Staples	77,524	7.1%	6.2%	7.8%	7.8%	1.0%
Energy	61,614	-7.5%	-1.3%	-25.1%	-25.1%	-27.7%
Financial	68,699	3.7%	10.6%	1.8%	1.8%	6.1%
Financial (ex A-REITs)	75,930	3.6%	11.5%	0.8%	0.8%	4.7%
Healthcare	106,514	0.6%	12.4%	11.6%	11.6%	16.2%
Industrials	43,345	-0.5%	5.6%	9.4%	9.4%	16.7%
Information Technology	6,507	3.8%	9.2%	7.8%	7.8%	11.9%
Property Trusts (A-REITs)	38,992	4.0%	6.0%	7.2%	7.2%	14.4%
Telecoms	25,392	4.3%	0.9%	-4.2%	-4.2%	1.8%
Utilities	76,574	3.0%	8.6%	10.5%	10.5%	22.8%
Global Indices						
Dow Jones Industrial	17,425	-1.7%	7.0%	-1.1%	-1.1%	-2.2%
S&P 500	2,044	-1.8%	6.5%	-0.9%	-0.9%	-0.7%
NASDAQ Index	5,007	-2.0%	8.4%	0.4%	0.4%	5.7%
Euro Stoxx 50 Price Index	3,268	-6.8%	5.4%	-4.6%	-4.6%	3.8%
FTSE 100	6,242	-1.8%	3.0%	-4.3%	-4.3%	-4.9%
German Aktien Index (DAX)	10,743	-5.6%	11.2%	-1.8%	-1.8%	9.6%
France CAC40	4,637	-6.5%	4.1%	-3.2%	-3.2%	8.5%
Nikkei 225 Index	19,034	-3.6%	9.5%	-5.9%	-5.9%	9.1%
Hang Seng Index	21,914	-0.4%	5.1%	-16.5%	-16.5%	-7.2%
Shanghai Composite Index	3,539	2.7%	15.9%	-17.3%	-17.3%	9.4%
India BSE 200 Index	3,378	0.4%	0.8%	-3.5%	-3.5%	-1.5%
MSCI ACWI (US\$)	399	-1.9%	4.6%	-5.7%	-5.7%	-4.3%
MSCI ACWI Ex Aust (AU\$)	1,411	-2.9%	0.5%	-0.5%	-0.5%	7.8%
S&P 500 US GICS Sector Indices						
Energy	448	-10.0%	-0.6%	-18.6%	-18.6%	-23.6%
Materials	274	-4.4%	9.1%	-9.8%	-9.8%	-10.4%
Industrials	464	-2.2%	7.4%	-0.6%	-0.6%	-4.7%
Consumer Discretionary	621	-3.0%	5.4%	2.3%	2.3%	8.4%
Consumer Staples	518	2.5%	6.9%	6.0%	6.0%	3.8%
Health Care	833	1.6%	8.8%	-3.2%	-3.2%	5.2%
Financials	322	-2.4%	5.4%	-2.2%	-2.2%	-3.5%
Information Technology	721	-2.3%	8.7%	4.3%	4.3%	4.3%
Telecommunication Services	150	1.7%	6.2%	-2.3%	-2.3%	-1.7%
Utilities	220	1.8%	0.1%	4.5%	4.5%	-8.4%
Commodities						
Gold (US\$/oz)	1,061	-0.3%	-4.8%	-9.5%	-9.5%	-10.4%
Oil WTI (US\$/bbl)	37.1	-11.0%	-18.2%	-37.1%	-37.1%	-31.0%
Aluminium (US\$/lb) LME	68.4	4.5%	-3.5%	-8.4%	-8.4%	-17.7%
Copper (US\$/lb) LME	213.3	2.3%	-7.7%	-17.8%	-17.8%	-26.1%
Nickel (US\$/lb) LME	393.0	-0.8%	-14.0%	-25.8%	-25.8%	-42.0%
CRB Commodities Index (USD\$)	176.1	-3.5%	-9.1%	-22.5%	-22.5%	-23.4%
Iron Ore price (USD\$)	43.5	-1.1%	-21.6%	-28.1%	-28.1%	-36.5%
Exchange Rates						
UBS Composite Bond Index - All Maturities	8,561	0.3%	-0.2%	1.9%	1.9%	2.6%
UBS Bank Bill Index	8,365	0.2%	0.5%	1.1%	1.1%	2.3%
Basis Point Chg						
Aust. Cash Rate	2.00	0.0	0.0	0.0	0.0	-50.0
AUS 90 day Bank Bill rate	2.35	9.0	19.0	21.0	21.0	-42.0
AUS 10 year Bond yield	2.81	-4.6	20.6	-19.7	-19.7	8.1
US Federal Funds Rate	0.50	25.0	25.0	25.0	25.0	25.0
US 30 year Bond yield	3.02	4.6	15.9	-10.5	-10.5	26.7
US 10 year Bond yield	2.27	6.2	22.9	-8.2	-8.2	9.9
Exchange Rates						
AUD/USD	0.729	0.9%	3.9%	-5.4%	-5.4%	-10.7%
AUD/YEN	87.724	-1.4%	4.3%	-7.1%	-7.1%	-10.2%
EURO/USD	1.085	2.7%	-2.9%	-2.5%	-2.5%	-10.3%
AUD/EUR	0.672	-1.9%	6.9%	-3.0%	-3.0%	-0.5%
TWI	62.70	1.5%	4.7%	-1.7%	-1.7%	-5.7%