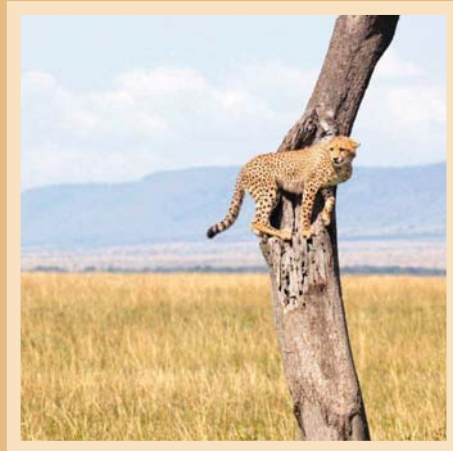
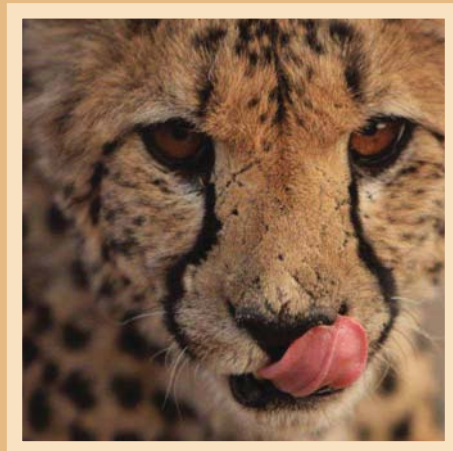


Some investors' need for speed leaves them, well...



Better to take a more measured approach.
Hunt with experts. And eat well.



First Samuel Small Cap Investing.
Meet the need for speed.



First Samuel Small Cap Investing. Meet the need for speed.

So, everyone has told you that to be a successful share market investor you need to get into small cap stocks.

"Small cap stocks outperform large cap stocks over the long term."

Right?

Wrong.

But the best small cap stocks do.

There is much myth about investing in the share market.

One is that small cap stocks outperform large cap stocks.

Small cap stocks (i.e. small market capitalisation) are those companies that have a market cap smaller than about \$1 billion.

(The "market cap" of a company is the number of ordinary shares on issue by the company multiplied by the price per share. It is a rough approximation of the value of a company as assessed by share market investors.)

Why the myth 1? Exciting?

Small cap stocks include the exciting new and nimble companies. They are bought because investors like their exciting story.

Some of the more well known and recent companies include Worley Parsons and Incitec Pivot.

Well, that's true as far as it goes.

But don't forget that the small cap universe also holds the dross, that is the mid (or medium) cap companies that have failed and hence fallen back to being small.

You might have heard of Virgin Blue or Elders.

The small cap universe also contains small companies that just haven't made it. Sigma Pharmaceuticals and PaperlinX are well known small cap companies that seem destined to forever be small cap.

Why the myth 2? Outperformance?

As the table shows, the small cap universe in Australia has under performed all of the broad market (All Ords), large caps (top 50 stocks) and mid cap stocks (51-100).

And that is even after the Small Ords (the index for small companies) has had the boost of small resources in the past 2 years (+88% and +31% respectively).

So, ignore small caps?

No.

The best small caps easily outperform the best mid and large caps.

In the last 20 years mid cap stocks have the best performance

Cap type	All Ords	Large cap	Mid cap	Small cap
Cap ranks	1-500	1-50	51-100	101-300
Size range	\$0 - \$51b	\$5b - \$51b	\$1b - \$5b	\$'0 - \$1b
1991	34%	36%	35%	19%
1992	-3%	-3%	5%	-4%
1993	40%	39%	77%	64%
1994	-9%	-7%	-15%	-9%
1995	21%	21%	24%	12%
1996	14%	11%	21%	28%
1997	11%	18%	-4%	-2%
1998	8%	14%	5%	4%
1999	19%	16%	13%	25%
2000	5%	9%	-6%	-15%
2001	10%	11%	16%	2%
2002	-8%	-10%	5%	-9%
2003	16%	12%	23%	32%
2004	28%	26%	43%	27%
2005	21%	23%	23%	20%
2006	25%	23%	26%	34%
2007	18%	16%	17%	17%
2008	-40%	-36%	-46%	-53%
2009	40%	36%	36%	57%
2010	3%	0%	4%	13%
Average	11.6%	11.8%	12.9%	10.6%
Years as best	1	6	7	6

■ = best return of the four cap types for that period

Source: IRESS. Data is accumulation indices i.e. includes dividends

Average is the compound annual return, expressed as % p.a.

NB: 2009 & 2010 small cap performance was boosted by small resources' companies returns of 88% and 31% respectively

The best managed small caps outperform both the large caps market and the small caps market.

First Samuel's approach to small cap investing has been extremely successful – see chart.

This success has four key elements:

1. It's our research

We do not rely on stock brokers for ideas, research or “insights”. We are happy to use their data, but not their recommendations.

Brokers are remunerated on transactions, so their interest is in trading.

Thus the broker focuses on the “story” or excitement of a small cap.

On the other hand, we filter the market universe and then undertake our own and deep research into stocks that have, amongst other attributes, sustainable earnings.

That research includes visiting the company, meeting their executives and assessing the character of management.

And when those stocks become cheap enough, and they complement other stocks in the small cap portfolio¹, we buy them.

2. We invest with at least a 3 year view

Our objective is to buy small cap companies that will become mid-cap companies.

This can take time. So we try to assess what companies will be like in 3 years, not guess what their stock price will be in 3 months.

Hence, we are not traders. We do not seek to buy a hot stock and quickly sell out.

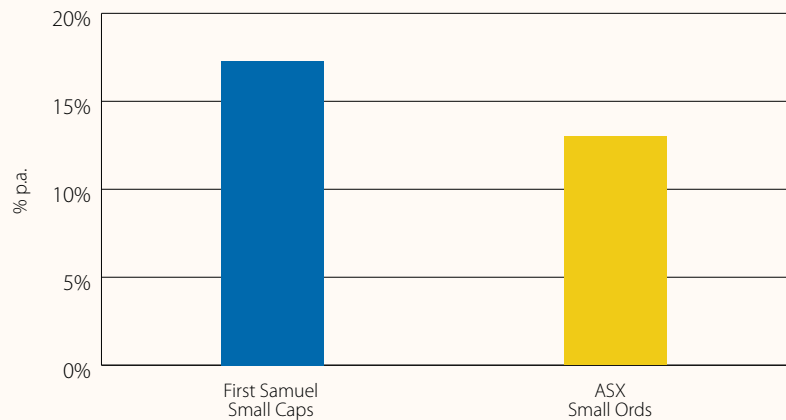
Not only does trading raise Capital Gains Tax issues and have transaction costs, it also changes the investing focus to the “story” or the emotion of the company.

Sure, there are sometimes good stories about companies: the next gold discovery, the next medical research breakthrough or the next technology application that will rival Google.

¹ Actually, there is no such creature as the “small cap portfolio.” Each First Samuel client has their own portfolio, designed and managed to their needs.

Sure, there is a core group of stocks that ideally we put in each client's portfolio. But ongoing management of tax, prohibited stocks and legacy stocks ensures that no two portfolios are identical.

Over a decade First Samuel small caps have outperformed the market by over 5% p.a.



Performance for 10 years to 31-Dec-10. Past performance does not guarantee similar future performance. Includes dividends. First Samuel performance is before franking credits and fees.

Better, we believe, to buy stocks that have a sustainable future. Even if they may be boring.

Our approach is *not* being flown by a broker to a remote gold mining site or being entertained at the football or ballet.

Our approach can be boring: it is understanding the basic building blocks of the company, the character of its management and the opportunity of its industry.

And that success can take time. Boring becomes successful.

3. Asymmetric investing: Heads I win, tails I don't lose much

The investment risk is that the downside may be bigger than the upside, no matter how big the upside might be.

We firstly focus on what happens if things go wrong: how much can I lose?

Then look at the upside.

A stock that has a 50% chance of upside also has a 50% chance of downside.

And an expected return of 0%!

4. We like dividends

Our approach has at its heart the sensible premise that sustainable dividend growth is the sure way to sustainable and predictable capital gains.

So we like companies that pay good dividends and we can see growth in those dividends.

That is why we generally avoid companies that do not pay dividends or whose dividend future is flat or uncertain.

Better the certainty of a dividend from a meat pie maker than an uncertain capital gain from a gold prospector.

Small caps success

First Samuel has been successfully managing small cap portfolios for over a decade.

We have earned the trust of our clients to manage their portfolios in a sensible and sustainable manner.

Talk to us. Or visit
www.firstsamuel.com.au

THE FIRST SAMUEL TEAM



“The provision of individual, indispensable and enduring relationships that create, manage and protect wealth”

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“The Lord declares those who honour me I shall also honour”

From the First Book of Samuel, chapter 2, verse 30

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