

Macquarie Australian Small Companies Fund

Monthly report – 31 July 2023

Investment objective

Aims to outperform the S&P/ASX Small Ordinaries Accumulation Index (**Index**) over the medium to long term (before fees). It aims to provide capital growth and some income.

Key information

Fund details

APIR code	MAQ0454AU
Inception date	6 July 2006
Fund size	\$335.8m
Distribution frequency	Quarterly
Management fee*	0.60% pa

Performance fee* 15% of outperformance of the Fund (after management fee and expenses) above return of the Index, subject to a 'high watermark'

Minimum investment (Direct) \$20,000

Unit prices and spreads macquarie.com.au/unit_prices

*Read the Product Disclosure Statement for more details on fees and costs.

Fund performance to 31 July 2023

	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	3.59	3.54	3.54	0.00
3 months (%)	-2.32	-2.47	0.20	-2.67
1 year (%)	6.99	6.12	0.77	5.35
3 years (% pa)	11.40	10.42	5.89	4.53
5 years (% pa)	8.94	7.92	3.18	4.74
Since inception (% pa)	10.66	9.25	3.09	6.16

Past performance is not a reliable indicator of future performance.

Total returns are calculated based on changes in net asset values and assumes the reinvestment of distributions.

Total net Fund returns are quoted after the deduction of fees and expenses. Due to individual circumstances, your net returns may differ from the net returns quoted above.

The management fee was reduced to 0.60% pa from 18 January 2017.

Top 5 overweight positions (alphabetical)

Austbrokers Holdings Limited

CSR Limited

Mcmillan Shakespeare

Nufarm Limited

Webjet Limited

Top 3 stock attribution (alphabetical)

Core Lithium Ltd

Corporate Travel Management Limited

Webjet Limited

*Italics denotes underweight

Bottom 3 stock attribution (alphabetical)

Flight Centre

Regis Resources Limited

Resolute Mining Limited

*Italics denotes underweight

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Fund highlights

The Fund returned 3.54% (post-fees) for the month, performing in line with the benchmark which also returned 3.54%.

The key contributors to relative performance included an underweight position in Core Lithium (CXO) and overweight positions in Webjet (WEB) and Corporate Travel (CTD). Core Lithium underperformed amid ongoing volatility in the lithium sector driven by fluctuating EV demand, impairment announcements, quarterly production updates and M&A.

The key detractors from relative performance included overweight positions in Resolute Mining (RSG), Flight Centre (FLT) and Regis Resources (RRL). Strength in travel stocks continued in July. Flight Centre provided a positive update flagging expectation of higher earnings. Demand for leisure travel remains high, seemingly unaffected by a broad-based slowing of consumer demand. Older, wealthier travellers benefitting from higher income from savings are boosting demand. Corporate travel remains below pre-COVID levels.

Market overview

The Small Ordinaries (+3.5%) outperformed the broader market (ASX200 +2.9%), led higher by strong returns to both the Consumer Discretionary and Technology sectors, both feature more prominently in the Small Ords compared to the broad cap indices.

Smaller consumer facing companies, punished in May and June following poor trading updates, experienced strong reversal while the high-growth small technology sector lifted again on AI euphoria and optimism rates were nearing their peak. On the other side of the ledger, Materials and Healthcare were the biggest drags on the index. July's quarterly production updates revealed a pattern of flatter commodity prices and higher costs, which saw many of the small miners retreat. In Healthcare, the ACCC has raised concerns surrounding ACL's takeover of Healius which saw that company fall almost -10%.

Australian inflation has continued to slow with the quarterly headline rate now at 6% YoY (down from its 8% December peak). Trimmed inflation, the RBA's preferred measure, has also stabilised and is slowing. The good news is that the RBA's 4% hike in rates have gained traction, but inflation is still too high, driven by the stubborn services component which includes the costs of renting, eating out and holidays. Inflation is a lagged statistic and while the interest rate changes have started to change consumer behaviour, the labour market remains tight which leaves the RBA concerned that a wage-price spiral may emerge, exacerbating its inflation battle.

Further rate hikes by the RBA run the risk of over correcting and tipping the country into recession. The local yield curve is modestly inverted but, unlike the US equivalent, this is far from a reliable predictor of impending recessions. Key to the economy outlook is household activity (i.e., consumption), which is half of all national demand, and has been declining in a per capita sense but continues to surprise overall due to strong population growth and the resilience of affluent spenders (who are also enjoying higher returns on their cash savings). A recovery in house and asset prices from 2022 adds to a wealth effect that also underpins consumption. However, consumer confidence continues to wane and while the other pillar of household strength, employment, remains at a multi-decade high, leading jobs indicators are pointing to an impending weakness in the jobs' market.

August's reporting season has commenced following a spattering of negative trading updates during July's month of confessions, mostly driven by expectations of higher costs and falling margins. The ability of companies to benefit from positive operational leverage going forward is diminishing. Since February, trading conditions have darkened putting corporate earnings under greater pressure from already shrinking profit margins. As economic demand wanes, the ability to pass on rising labour costs and higher input costs (electricity, rent and raw materials) becomes more difficult. Add the increasing costs of servicing debt and it has not been surprising that a steady stream of trading updates have fuelled downgrades across cyclical sectors. Earnings expectations are now sharply lower than a year ago.

One of the key observations of all markets this year is low volatility, with measures of fear such as the CBOE VIX and the Australian equivalent now printing well below their long-term trends, only increasing briefly during the US banking solvency concerns. Generally, with lower levels of volatility more subdued returns to investment styles or factors are observed and this has borne out in 2023 to-date. The post pandemic outperformance of value over growth has now stalled and there have been subdued returns to momentum. The current low levels of volatility are unusual given that monetary policy changes have an approximate 12-month lagged effect on economic demand. Confidence in immaculate disinflation is high.

Commodity prices were up in July, with Brent Oil rising US\$10.09 to US\$84.99/bbl and Iron Ore prices rising US\$1.00 to \$114.50/Mt. Gold was also up, rising by US\$42 to US\$1,954.

Bond yields rose slightly in July, with Australian 10-year bond yields increasing 3 bps to 4.05% and US yields rising 14 bps to 3.85%. Not surprisingly, given the uncertain economic outlook the RBA held interest rates steady at its August meeting.

Outlook

The outlook for Australian shares, not surprisingly, remains very inflation and interest rate sensitive. August's reporting season will provide key insights in how companies and the economy are navigating the higher interest rate environment. Forward guidance from the banks and consumer-facing companies will be keenly watched for their economic portents. Compared to global shares, the dramatic impact of the "magnificent seven" is likely to revert but the headwinds facing resources will persist while China's lack of growth persists.

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For more information speak to your financial adviser, call us on 1800 814 523, email mam.clientservice@macquarie.com or visit macquarieim.com

Important information

Macquarie Investment Management Australia Limited ABN 55 092 552 611 AFSL Licence 238321 is the issuer of units in, and responsible entity of the Fund. Macquarie Investment Management Global Limited ABN 90 086 159 060 AFSL 237843 is the investment manager of the Fund.

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