
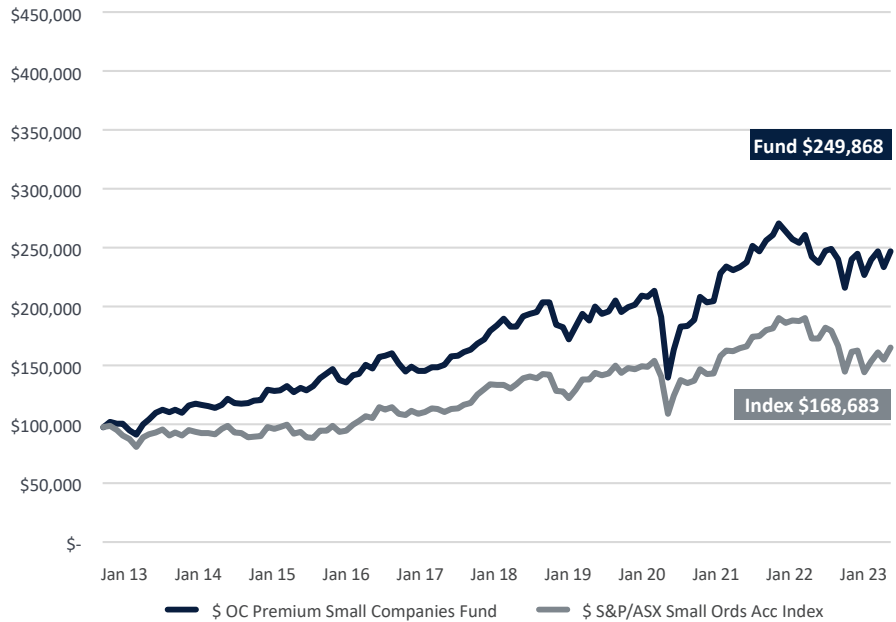


 Fund up 5.5% for the month  
5.5%

 Returned 9.6% p.a. for the past 10 years  
9.6%

 We remain confident the Fund will continue to deliver attractive long-term returns

### Performance comparison of \$100,000 over 10 years\*



### Total returns

At 31 Jan 2023 <sup>†</sup>	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	10 yrs % p.a.	Incep % . p.a. (Dec 2000)
OC Premium	5.5	3.0	1.8	5.0	6.0	9.6	10.4
S&P/ASX Small Ords Accum	6.6	7.6	-4.4	2.4	4.4	5.4	5.8
<b>Outperformance</b>	<b>-1.0</b>	<b>-4.7</b>	<b>6.3</b>	<b>2.5</b>	<b>1.6</b>	<b>4.3</b>	<b>4.7</b>
S&P/ASX Small Ind Accum	6.3	5.5	-7.8	-1.3	3.2	6.5	5.8
<b>Outperformance</b>	<b>-0.8</b>	<b>-2.6</b>	<b>9.6</b>	<b>6.2</b>	<b>2.8</b>	<b>3.1</b>	<b>4.7</b>

The total return performance figures quoted are historical, calculated using cum-distribution end-of-month hard-close mid-prices and do not allow for the effects of income tax or inflation.

### Performance review

Global equity markets had a strong start to the year with a growing view that inflation has peaked and that central bank tightening is nearing an end, as well as positive sentiment around China's reopening, stirring the 'animal spirits' of market participants. Many investors, OC Funds included, entered the new year cautious on the global economic outlook with the impact of dramatic monetary tightening in 2022 yet to flow through to the broader economy and inflation still elevated. Whether this turns out to be a bear market rally remains to be seen. But many investors, nervous about being too conservatively positioned, have gone 'risk on' in recent weeks and, in many instances, last year's biggest stock losers have started the year with the steepest rallies. The stock bourses that endured the steepest falls last year too were amongst the best performers in January including the US Nasdaq +10.7%, the Hong Kong Hang Seng +10.4%, and China H-Shares +10.7%.

Our own small cap indices bounced back strongly from their own annus horribilis in 2022, with the S&P/ASX

Small Ordinaries Accumulation Index +6.6% (-18.4% in CY22) and the S&P/ASX Small Industrials Accumulation Index +6.3% (-21.8% in CY22) in January. Across the domestic small cap universe, many of the best performing stocks during the month were last year's laggards including Kogan.com +28.6% (down 60.3% last year), Zip Co Limited +28.4% (down 88.2% last year), and fund holding SiteMinder Limited +23.7% (down 55.0% last year). The OC Premium Small Companies Fund had a solid month +5.5%, which was slightly behind both small cap indices. Clearly, we were not positioned for the sharp rally that left many investors, ourselves included, too conservatively positioned to keep pace.

Hotel technology provider **SiteMinder (SDR, +23.7%)** rallied over the month which culminated in the release of the company's quarterly activities report, incorporating a detailed interim trading update. SDR provides systems for loading rooms and optimising prices across multiple independent hotel booking platforms, as well as systems for running hotels, hotel websites and facilitating direct

bookings to avoid platform commissions. The company reported stronger transactional revenue and increased average subscription revenue per client in conjunction with a targeted headcount reduction in non-sales roles. As a result, SDR expects to reach cashflow breakeven well before its prior forecast. The positive update was a welcome relief for the stock which had drifted lower since its positive ASX debut in late 2021 on the back of lingering COVID-19 related headwinds. The positive trading update, the reopening of the Chinese travel sector, and the market's increased risk appetite, have also seen the stock trade higher in the early days of February.

**Temple and Webster (TPW, +23.9%)** was a strong performer during the month, largely benefitting from a bounce back in the broader consumer discretionary sector. TPW is a recent addition to our portfolio. We see it as a quality name which, due to concerns of a softer near-term trading environment, had seen its share price fall to a more attractive valuation level. TPW is the leading pure-play online home retailer for home furnishings and homewares in Australia. Its customer value proposition is focused on providing consumers with the best range of product (over 240k listed items), highly curated content, and market leading levels of customer service (high NPS scores). This has seen its website attract 3 million visits per month. We regard management of the business highly. CEO and MD, Mark Coulter, is one of the co-founders of the business, and has led the business since 2016 where he has delivered strong operating results and shareholder value through the period of his tenure. TPW has a proven business model that is easy to understand. It operates largely as an online marketplace, with 75% of product sourced via a drop-ship model, whereby products are sent directly from its external supplier base (approximately 500 vendors) to the consumer. This capital light business model has allowed it to scale rapidly with minimal working capital requirements. As a result, it also has much lower levels of inventory risk compared to traditional bricks and mortar retailers with TPW's inventory risk largely confined to its private label range. TPW also has a rapidly emerging B2B and DIY (The Build) segment which collectively now account for around 12% of the business. Due to the uncertain near-term retail outlook TPW, at this stage, remains a smaller position in the Fund. However, we are positive on the longer-term opportunity for the company, which we expect to be underpinned by continued e-commerce penetration with Australia remaining several years behind comparable western markets such as the US and UK. Additionally, TPW ought to continue to grow its share within this market. We expect that as the company continues to scale, margins will gradually converge (from current low levels) to that of comparable bricks and mortar retailers over the longer term.

**Austal Limited (ASB, -20.2%)** fell sharply in January following a material downgrade to FY23 EBIT guidance,

driven by an onerous contract provision on the US Towing, Salvage and Rescue Ship (T-ATS) project ASB is delivering for the US defence force. ASB designs and manufactures steel and aluminium defence and commercial vessels, predominately for defence forces and commercial ferry operators globally. Whilst ASB is negotiating with the US Government to recover the provisioned amount (US\$41m) through the submission of a Request for Equitable Adjustment, there remains significant uncertainty around the size and timing of any recovery despite the cost overruns being the result of adjustments made to the design post the award of the initial contract to ASB. The T-ATS ship building program is the first material steel-based shipbuilding program at ASB's new state-of-the-art steel shipbuilding facility in Mobile, Alabama, which enables the simultaneous production of aluminium and steel hulled ships. The announcement highlights the risk associated with fixed priced shipbuilding, especially in a new program. There is also currently much political 'noise' in the media around ASB securing US government contracts at the expense of US owned contractors, with leading Republican Ron DeSantis backing the concerns of a fellow Republican Party colleague around ASB's involvement in building submarines and ships for the US Navy and US Coastguard. Given the heightened uncertainty around the company and the negative investor sentiment, we have exited the stock.

During the month, the Fund initiated a number of new positions including **Corporate Travel Management (CTD, +24.6% or +19.7% from average entry price)** and **HUB24 Limited (HUB, -1.8% or +4.6% from average entry price)**, both of which had been sold down to attractive entry levels. CTD is a global provider of corporate travel solutions with a strong management team led by Jamie Pherous. The business continues to scale and appears to be winning market share in Europe, the USA and Australasia, and has strong tailwinds coming out of the COVID-19 travel downturn. HUB is a quality provider of platform solutions to the wealth management industry. It has been one of the fastest growing speciality platform providers in recent years, driven by regulatory catalysts (stemming from the Royal Commission in 2018) and its market leading position in functionality/technology. With many of its competitors, in the form of the large legacy bank owned platforms, continuing to see outflows due to years of underinvestment, we see opportunity for HUB to continue to take market share in a large addressable market and we are positive on its earnings prospects.

The Fund also opportunistically increased its holding in **PEXA Group Limited (PXA, +8.9%)** during the month after an in-specie distribution of PXA stock from major shareholder Link Administration Holdings put selling pressure on the stock which, along with negative sentiment associated with subdued near-term property listing volumes in Australia, created a compelling buying

opportunity. PXA is the sole electronic exchange for real estate in Australia. The exchange links buyers and sellers, conveyancers, incoming and outgoing mortgage providers, land registries and settles directly via central bank clearing. PXA is also currently developing a similar solution for the England and Wales markets with a target of 20% of lenders (by market share) to be signed up by the end of FY23. The UK solution is currently the sole provider under development in this market and PXA has already processed their first re-mortgage transactions.

We expect further opportunities to add to the OC Funds portfolio across the February reporting period and have a short-list of quality stocks that we will be paying close attention to during the month.

## Outlook

Entering the new year, the prevailing wisdom from most market pundits, OC Funds included, was that the market faced mounting headwinds in the form of steep rises in the cost of money, stubbornly high inflation which likely necessitated further interest rate pain, geo-political uncertainty and company earnings that were likely to come under pressure in 2023 as the global economy slowed in the face of these challenges. We enter the February reporting season with a very different narrative gaining some currency. There is an alternate view that inflation has now peaked and is coming down, central banks are nearing the end of their steep tightening cycle, China has re-emerged from its COVID-19 induced slumber and will fuel the growth of the global economy, and that there is now a pathway to a soft landing across key Western economies, including the US, the Eurozone and the UK.

To be clear, we do not currently subscribe to the latter more bullish view, although we are heartened that inflation does seem to have topped out and signs of disinflation (a situation where the inflation rate is falling) in the US augurs well for peak rates being lower than we had previously forecast. The latter outcome would certainly be a material positive for asset values, should it eventuate, and would mean that any recession ought to be a lot shallower than if inflation had proven to be much stickier. We nevertheless remain concerned that the steep rate hikes of the past year are yet to fully hit the broader economy. Indeed, the US 10-year minus 3-month bond yield spread, historically viewed as a window into the outlook for the economy, is steeply and stubbornly inverted (the spread is currently -1.17%); at this level it is flashing a stark recessionary warning. Jeremy Grantham from Boston based asset management firm GMO succinctly pointed out, with regards to the US economy, that *"[t]his spread has gone negative only 8 times in the past 50 years and all 8 times have been followed by recessions. To rub it in, there have been no other*

*recessions. That is, every one of them was preceded by a negative reading."* We acknowledge that Mr Grantham is a noted 'permabear', albeit one with an impressive track record. We also note that we are in unprecedented times coming out of the COVID-19 pandemic and there have been many distortions including central bank intervention (quantitative easing/tightening) and supply chain dislocations which make predicting the future particularly challenging. But we are reluctant to ignore history and the fact that there are now increasing indicators that the economy is indeed slowing, rates are still rising and that inflation remains well above the target range for our central banks, despite positive signs. While we have added some risk to the portfolio on a more upbeat inflationary outlook, we remain relatively conservatively positioned overall from a portfolio perspective.

The key source of market optimism in January was undoubtedly the US inflation data which printed mid-month and showed that the consumer price index (CPI), a measurement of what consumers pay for goods and services, rose 6.5% last month from a year earlier, down from 7.1% in November and well below a 9.1% peak in June. It was the sixth straight month that inflation had declined and in the words of Federal Reserve (The Fed) chairman Jerome Powell: *"We can now say, for the first time, the disinflationary process has started."* US GDP, adjusted for inflation, printed at annualised rate of +2.9% in Q4 2022 which, although below the +3.2% rate in the third quarter, was a strong end to the year.

Nevertheless, the economic headwinds in the US are starting to mount, particularly in interest rate sensitive areas of the economy, with home sales and construction activity under pressure and manufacturing output declining in both November and December. In recent weeks, there have been growing lay-offs from high profile US firms including Amazon, Goldman Sachs, Alphabet (Google's parent company), Microsoft and Salesforce. This trend is expected to continue as interest rates rise and the economy slows. Notwithstanding these well published job losses, January employment data out of the US surprised on the upside. The US economy added 517,000 jobs in January, comfortably beating consensus expectations of growth of only 188,000 jobs. Remarkably, the US unemployment rate is back at 3.4%, a 53-year low, which leave the Fed plenty of scope for further rate hikes in the coming months. Although we still expect the US to enter a recession this year, it is now more likely to be a shallow one.

In early February, the Fed affirmed market expectations by increasing the target range for the Fed funds rate by 25 basis points to 4.50-4.75%. Powell's proceeding press conference had plenty to latch onto for both the bulls and the bears. On the hawkish side, he reiterated the committee's prior view that there remains work

to be done to curb inflation and was still expecting a “couple” more rate increases and is prepared to raise its policy rate by another 25 basis points at the next two meetings. The bulls, however, were emboldened by Powell’s acknowledgement that the US economy has entered a period of “disinflation” with price pressures cooling. Further, he left scope for a policy pivot in the future by conceding that officials are open to adjusting their plans if price pressures cool faster than expected. Long duration growth stocks, including technology names, rallied sharply in the following days as bond markets and money markets priced in lower peak interest rates than had previously been anticipated.

The inflationary trajectory in our own backyard is less clear, with the Australian CPI hitting a 33-year high of 7.8% in the December quarter. Whilst this was below the RBA’s 8.0% forecast, it was above consensus market expectations of around 7.5%. Significantly, trimmed mean inflation, the RBA’s preferred measure that smooths out large price movements, rose 1.7% over the quarter to 6.9% annually, suggesting strong momentum in prices. This number was well above the RBA’s expectations of 6.5% and remains too high. It made the early February 25 basis points rate hike by the Reserve Bank of Australia (RBA) a near certainty. The stronger-than-anticipated acceleration in annual inflation was driven by a near 9% jump in household power bills and a 13% leap in domestic travel and accommodation. The market is hopeful that inflation has now peaked in Australia, and we are simply lagging the US on the path towards disinflation; it certainly seems to be pricing in this outcome. The hawkish policy statement by RBA governor Philip Lowe following the February board meeting suggests that the RBA is unlikely to take any chances in its fight against inflation and has flagged at least two more rate hikes over the months ahead.

From an economic perspective, there are signs that rate hikes are beginning to slow the domestic economy. Whilst Corelogic data suggests that the pace of declines in the capital city housing market moderated slightly in January, employment declined in December marking the first decline since July 2022, notwithstanding the unemployment rate remained steady at an upwardly revised 3.5%. More surprisingly, retail sales fell 3.9% in the final month of last year, according to the Australian Bureau of Statistics (ABS), the first decline after 11 straight months of growth and eight straight months of record spending. We caution about reading too much into this single print, with ABS head of retail statistics Ben Dorber acknowledging that spending patterns continued to change around Black Friday and Cyber Monday sales, with consumers potentially having brought forward Christmas season spending into November.

Perhaps of greater relevance to the outlook for the consumer and the broader Australian economy is the sharp change in circumstances being faced by a great number of mortgage holders in the coming months, as the mortgages fixed at record low rates during the pandemic start to roll-off and homeowners face a mortgage cliff. It is widely reported that the ‘fixed rate’ share of mortgages will fall from a historically high proportion of 40% to a more normalised level of 15% by the end of 2023. Those borrowers with fixed rate mortgages maturing will clearly face significantly higher interest rates and monthly repayments. Most fixed rate mortgages will roll from around 2.5% rate to near 6% which, for an average 30yr \$600k loan, implies a lift in monthly repayments of \$1,226 a month. Therefore, whilst the RBA may be soon approaching peak rates, the rate pain for many mortgage holders is only just starting. We remain cautious on the domestic consumer ahead of this event, although the government remains well placed to stimulate the economy should a protracted downturn eventuate. The commodities boom continues unabated, and iron ore prices have recently strengthened into the Chinese economic reopening. This will provide the ‘lucky country’ with an additional trade windfall which could be used by the government to prop up the householder down the track should circumstances warrant it.

Much has been written about the Chinese reopening from strict COVID-19 lockdowns and it is certainly a welcomed development, particularly given it is the world’s second largest economy, as well as Australia’s largest trading partner. Communist Party officials are promising to use “full firepower” to re-ignite the Chinese economy and the immediate impact on commodity prices has bolstered our terms of trade. In the coming months, we anticipate benefits to the education and tourism sectors, as well as the flow of skilled migrants to help ease the employment bottlenecks. The reopening has certainly been taken as a major positive in equity markets and reduced the likelihood of a hard landing in the global economy. Certainly, it has the potential to add to inflationary pressures if one wanted to be glass-half-empty, but it is hard to view it as anything other than overwhelmingly positive for Australia.

The recent thaw in relations between Australia and China also offers cause for optimism. Prime Minister Anthony Albanese and Chinese President Xi Jinping met on the sidelines of the G20 summit in November, followed shortly after by a successful visit to Beijing by Foreign Minister Penny Wong in December. Top trade officials from both countries are scheduled to meet virtually in the coming days with China’s punitive \$20 billion trade sanctions on Australia products, including wine, barley and rock lobster, likely to be high on the priority list for the Australian delegation. China remains an economic powerhouse and

successful bilateral trade with the Middle Kingdom can only further our nations prosperity into the future, despite the obvious ideological challenges.

Reporting season has kicked off in Australia and debt collector and payday lender Credit Corp and multi-affiliate investment management firm Pinnacle Investment Management were first out of the gate in small-cap land. Both results came in behind consensus expectations although, interestingly, both have rallied after initial sell offs as market participants choose to look through near term earnings weakness and instead focus of the medium-term growth outlook. This requires investors to have conviction in a strengthening economy (and stock market) into calendar year 2024. The Fund holds neither of these stocks, but it will be interesting to see if this trend continues for the remainder of February. Will the market continue looking through any near-term earnings weakness and reward those companies that ought to perform strongly once the economy breaks the shackles of inflation and rates come back down? Or will bearish sentiment

take hold and drive us back into a bear market? Market sentiment remains fragile, so we are reluctant to forecast these early observations as a either a trend or sustainable; there are a great many unknowns about the months that lie ahead. The OC Funds team has many company meetings scheduled in reporting season and we look forward to sharing our key insights with investors in early March.

### Top 5 holdings<sup>#</sup>

Company	ASX code
APM Human Services	APM
GQG Partners	GQG
Mineral Resources	MIN
Pexagroup	PXA
Seven Group Holdings	SVW

<sup>#</sup>The top 5 portfolio holdings are in alphabetical order and may not be representative of current or future investments.

## CONTACT COPIA

1800 442 129 | [clientservices@copiapartners.com.au](mailto:clientservices@copiapartners.com.au) | [copiapartners.com.au](http://copiapartners.com.au)



<b>John Clothier</b>	General Manager, Distribution	0408 488 549   <a href="mailto:jclothier@copiapartners.com.au">jclothier@copiapartners.com.au</a>
<b>Mani Papakonstantinos</b>	Distribution Manager	0439 207 869   <a href="mailto:epapakonstantinos@copiapartners.com.au">epapakonstantinos@copiapartners.com.au</a>
<b>Jude Fernandez</b>	Distribution Manager	0414 604 772   <a href="mailto:jfernandez@copiapartners.com.au">jfernandez@copiapartners.com.au</a>
<b>Sam Harris</b>	Distribution Manager	0429 982 159   <a href="mailto:sharris@copiapartners.com.au">sharris@copiapartners.com.au</a>
<b>Greg Black</b>	Distribution Manager	0407 063 433   <a href="mailto:gblack@copiapartners.com.au">gblack@copiapartners.com.au</a>
<b>Justin Cilmi</b>	Distribution Manager	0428 153 431   <a href="mailto:jcilmi@copiapartners.com.au">jcilmi@copiapartners.com.au</a>

<sup>†</sup>The total return performance figures quoted are historical, calculated using cum-distribution end-of-month hard-close mid-prices and do not allow for the effects of income tax or inflation. Total returns assume the reinvestment of all distributions. The performance is quoted net of all fees and expenses. The index does not incur these costs. This information is provided for general comparative purposes.

<sup>\*</sup>The performance comparison of \$100,000 over 10 years is for illustrative purposes only. All returns shown are based on Australian dollar figures. Past performance is not a reliable indicator of future performance. The total returns shown are prepared on an ongoing basis (i.e. they include all ongoing fees and expenses and assume reinvestment of all distributions). They do not take personal taxation into account. The comparison with the S&P/ASX Small Ordinaries Accumulation Index is for comparative purposes only. Index returns do not allow for transactional, management, operational or tax costs. An index is not managed and investors cannot invest directly in an index.

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