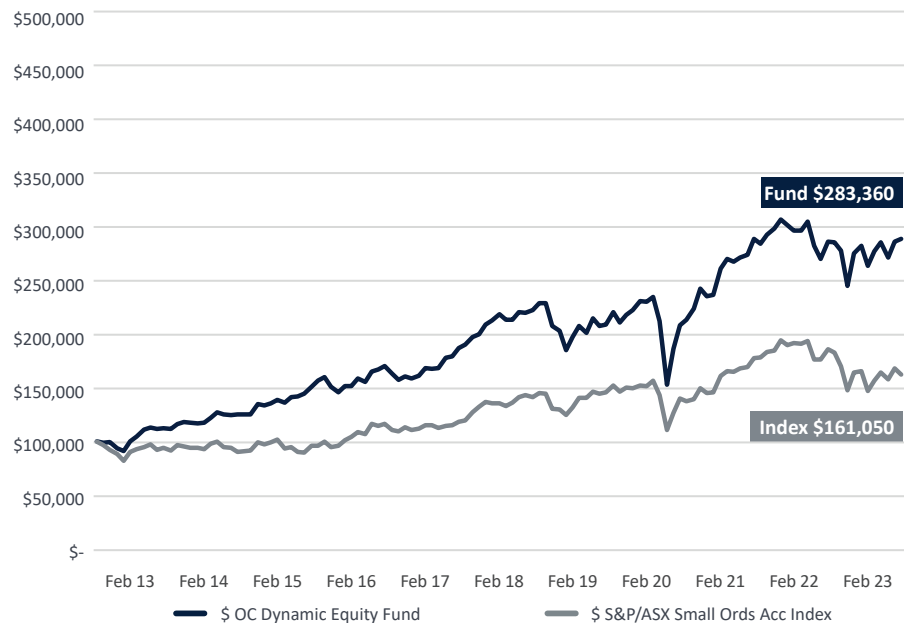


**0.8%** Fund up 0.8% for the month

**11.0%** Returned 11.0% p.a. for the past 10 years

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

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



**Total returns**

At 28 Feb 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 Dynamic	0.8	0.9	6.6	10.6	5.6	11.0	11.8
S&P/ASX Small Ords Accum	-3.7	-1.2	-8.0	4.2	3.6	4.9	5.7
<b>Outperformance</b>	<b>4.5</b>	<b>2.2</b>	<b>14.6</b>	<b>6.4</b>	<b>2.1</b>	<b>6.1</b>	<b>6.1</b>
S&P/ASX Small Ind Accum	-1.7	1.0	-7.4	1.1	2.9	5.9	5.8
<b>Outperformance</b>	<b>2.6</b>	<b>0.0</b>	<b>14.0</b>	<b>9.6</b>	<b>2.8</b>	<b>5.1</b>	<b>6.0</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**

After a strong start to the calendar year, global equity markets retraced in February driven largely by fears that inflation will prove to be stickier and more persistent than had previously been contemplated by many investors. Increasingly hawkish central banks drove up real bond yields and most key global indices ended the month lower including the US DOW (-4.2%) and S&P 500 (-2.6%), the Hong Kong Hang Seng (-9.4%) and the MSCI All Country World Index (-1.9%).

The February reporting period was a mixed bag across the market, with divergent performance across the board from companies, often in the same sector, and few unequivocal macro-call outs. As expected, few management teams and boards were prepared to give numerical forward guidance, and most were guarded in their commentary on the economic outlook. The S&P/ASX Small Ordinaries Accumulation Index and the S&P/ASX Small industrials Accumulation Index were both softer in February, falling by -3.7% and -1.7% respectively. The Fund enjoyed a relatively strong month (+0.8%) with most

of our core holdings producing solid results indicating that our investment theses remain intact.

The Fund has weathered the sell-off in small companies well over the past year and has protected investor capital in what has been a challenging investment environment. The OC Dynamic Equity Fund is up 6.6% over the past 12 months versus the S&P/ASX Small Ordinaries Accumulation Index and the S&P/ASX Small industrials Accumulation Index which are down -8.0% and -7.4% respectively over the same time horizon.

**GUD holdings (GUD, +25.3%)** motored higher over February after delivering a solid 1H23 result relative to bearish market expectations. Broader investor interest in the stock was low given fears that the GUD balance sheet required recapitalising (GUD has 2.5x Net Debt/ EBITDA) and also that the recent acquisition APG had under-performed due to OEM car-dealer supply constraints. To recap, in January 2022 GUD acquired tow bar manufacturer APG which supplies auto OEMs such

as Ford with tow bars and functional accessories for new four-wheel drives and SUVs. This was unfortunate timing as auto OEMs subsequently suffered from supply chain delays due to semi-conductor shortages and widespread lock downs in China which lowered new car production capacity across the industry. This led to reduced demand for APG products and considerable volatility in demand for APG products from the OEMs. We added to our GUD position ahead of the 1H23 result as we believe that new car production will recover over time. More importantly the bulk of GUD's earnings flow from their core aftermarket auto parts division which ultimately supplies mechanics with 'wear and tear' parts for second hand cars through brands such as Ryco, Wesfil and Narva and a stable industry with pricing power. Furthermore, the balance sheet, whilst holding 2.5x Net Debt/EBITDA, was well thought out with 66% of the debt fixed or hedged against rising rates with well diversified maturity tenor, meaning that GUD should be able to de-lever organically via earnings delivery or through dividend reductions. GUD rerated strongly after the 1H23 result as APG delivered a result that exceeded the market's low expectations. We still believe that a gradual improvement in APG operations back to normalised levels should help GUD deliver solid organic earnings growth over the short to medium term. This can help the stock re-rate further as the balance sheet becomes less of a concern. A more conservative balance sheet will widen the appeal of GUD, as many investors filter out companies with more than 2x Net Debt/EBITDA. With the outlook for new car supply continuing to improve, and with the core aftermarket auto parts division likely to provide resilience in a slowing macro environment, we remain upbeat on the prospects for GUD in the coming 12 months.

**Eagers Automotive (APE, +19.9%)** was a standout result for the Fund during reporting season with the stock re-rating on the back of a robust outlook from both a revenue and margin perspective. The new vehicle order bank grew 74.4% in CY22 as vehicle shortages, driven by ongoing supply chain disruptions and semi-conductor shortages, continue to plague the automotive industry. Many in the market had been concerned about the impact of rising interest rates and a slowing economy on the outlook for new car sales, particularly given the historical correlation between the housing market and new car demand. Management, nonetheless, guided to a strong outlook for the business with the top line expected to grow from \$8.5b to \$9.5-\$10.0b in CY23 and margins likely to stay elevated given the ongoing supply challenges underpinning an environment where discounting on new car sales is still minimal. The result presentation material highlighted the significant run off period to work through the existing order bank and indicated there is a minimum two year unwind period for the order book assuming a reversion to a historically high point for supply (2017)

and low point for demand (2020) both of which seem overly conservative. This coupled with a strong backend in parts and servicing, a stabilising used car market and exciting new dealership agreements, including a five year exclusive retail agreement with Chinese electric vehicle behemoth BYD Auto, augers well for a 'strong for longer' thesis for APE from a profitability perspective.

**Temple and Webster (TPW, -39.6%)** was an underperformer during the month following the release of its interim financial result. Whilst the result itself was in line with expectations, the company's update for the first five weeks of trading in early CY23 came in weaker than expected (-7% compared to the prior corresponding period), with TPW management noting that they had perhaps underestimated the benefit that the Omicron variant had in the prior year, and the subsequent reversal of the benefit this year. This has resulted in a deferral of the company's timeframe for its target to return to double digit revenue growth (previously expected in FY23, now more likely in FY24). Whilst the share price performance is disappointing, as noted in our January update, our exposure to the company was small as we were wary of an uncertain near-term retail outlook. Notwithstanding this ongoing near term uncertainty, we have retained our holding in the company. We see TPW as well positioned given its strong balance sheet (with around \$100m net cash) and having 'earnings levers', in the form of an easing cost environment, which it can use to help offset a potential softer top line environment in the coming months. We note that despite the softer outlook, the company has reiterated its target for EBITDA margins between 3-5% in FY23. We see the long-term investment thesis for TPW remaining intact, which we expect to be underpinned by continued e-commerce penetration in Australia, with TPW growing its share within this addressable market.

**Dominos Pizza Enterprises (DMP, -33.1%)** was a negative contributor to the Fund during the month following the release of a disappointing 1H23 result. The company also provided an update for trading in the first 7 weeks of 2H23, with -2.2% same-store-sales growth (SSSG) for the Group also falling well short of the mark. Consequently, management now anticipate SSSG for FY23 to be below its medium outlook of +3-6% per annum, and with franchisee profitability currently under pressure, new store openings are expected to be below its medium-term outlook of +8-10% per annum. The company noted that since the update it provided at its early December capital raising, it had seen a noticeable drop off in delivery sales, potentially reflecting the impact of increasing average prices in the months prior and "*not getting the Value Equation right*". With DMP's December update fresh in investors' minds, the February disclosure of a rapid deterioration in operating trends caught the

market by surprise and resulted in some questions around the credibility of the company's earlier messaging, resulting in the stock selling off sharply on the day of the result (-23.8%). Whilst we too were caught off guard by the quantum of the downgrade, the extent of the damage was partially offset by our decision to reduce our holding ahead of the result with the stock having performed well since we initiated a position. Amidst a softer consumer environment, and with cost headwinds likely to persist, we expect it will be difficult for DMP to drive top line growth in the near term and see franchisee profitability continuing to remain under pressure. These challenges have compromised our original investment thesis and, as such, we have chosen to exit our position.

## Outlook

The strength in markets in January had been driven by a growing narrative that inflation had peaked and that central bank tightening was nearing an end, with many investors, nervous about being too conservatively positioned, having gone 'risk on'. This optimism unwound over the course of February with key inflation read outs printing hotter than expected, real bond yields pushing higher, and central banks overall becoming more hawkish in their tone. Whilst we remain attuned to the overall macro-economic environment, we try to distance ourselves somewhat from the short-term market 'noise' which can lead to hasty or premature decisions on portfolio positioning. As we mentioned in the January Monthly review, we *"did not...subscribe to th[is]...more bullish view"* on a near-term dovish central bank pivot and we remain positioned for an economic slowdown that must inevitably come as central banks try to rein in inflation.

The US Federal Reserve's (the Fed) preferred inflation indicator, Core PCE inflation, which excludes volatile food and energy prices, unexpectedly accelerated in January increasing 0.6% from a month earlier to 4.7%. After a slow down into the end of CY22, consumer spending accelerated +1.1% from the previous month, the most in nearly two years after consecutive monthly declines. The stronger than expected labour market has reignited the debate about the trajectory of monetary policy in the world's biggest economy with some economic commentators now pushing for a return to double-barrelled 50 basis point rate increases to get the Fed back ahead of the curve on inflation. Indeed, at least three Fed officials have publicly signalled their openness to a 50 basis point increase after they all opted for a downshift to 25 basis points on February 1. This view was reinforced by Atlanta Fed President Raphael Bostic, who told reporters: *"I want to be completely clear: there is a case to be made that we need to go higher,"* Bostic said, *"Jobs have come in stronger than we expected. Inflation is remaining stubborn at elevated levels. Consumer spending is strong.*

*Labor markets remain quite tight."* Whilst Mr Bostic told reporters that he is still favouring raising rates by 25 basis points in March, it highlights a willingness from some of the Fed board to lift borrowing costs higher than we envisaged if the economy remains strong. Should this approach play out, it obviously narrows further the already challenging pathway to a soft landing for the US economy.

The picture domestically seems a little more positive in terms of avoiding a recession with the aggressive hiking cycle and elevated inflation starting to impact at the coalface of the economy. The December quarter national accounts data showed that economic growth or GDP growth slowed to 0.5% which was below consensus expectations of 0.8%. Annual growth slowed to 2.7%, from 5.9% in the previous quarter. The national accounts showed the weakest growth in household consumption since the COVID-19 induced lockdowns in the September quarter of 2021 and households are now spending 5.4% of disposable income on housing interest payments, the highest share since 2014. This figure will likely continue to increase as the Reserve Bank ratchets up interest rates further in the coming months. In a positive development, the monthly CPI decelerated sharply in January to 7.4% (from 8.4%) which was well below consensus expectations of 8.1%. The unemployment rate also unexpectedly jumped to 3.7% from 3.5%. Whilst the RBA will welcome the weaker inflationary print and the softening in the jobs market, we caution against reading too much into one month's data in terms of calling out a meaningful trend.

As expected, the RBA increased interest rates a further 25 basis points at the March board meeting, bringing the cash rate to 3.6%. It marks the tenth hike in the cash rate since it moved off near zero (0.10%) in May 2022. RBA governor Philip Lowe in his accompanying state tempered his language slightly from the previous month although he reiterated the need for *"further tightening of monetary policy...to ensure that inflation returns to target"*. The market is divided on when the RBA will pause its monetary tightening, although a further 25 basis points in April remains the consensus view. We will continue to closely monitor the pace of the domestic economic slowdown, with a view to portfolio positioning, although our domestic economy still looks better placed than the US and Europe and UK the UK to avoid a painful recession.

Reporting season has just wrapped up and it was a mixed bag across the domestic small cap market. Pleasingly, the Fund's holdings, on balance, reported stronger results than the overall market which allowed us to outperform the small cap indices during the month. Indeed, several of our core holdings released updates that either upgraded prior company guidance (e.g. Steadfast Group

Limited, Seven Group Limited and AUB Group) or gave commentary that led to meaningful positive consensus earnings revisions from the sell-side analysts (e.g. Eagers Automotive Group, SG Fleet Group and Autosports Group). Wages inflation was probably the most broad-based call out across the listed stocks in company reporting season, which interestingly seems at odds with the recent wage inflation data in the national accounts and the soft read from the December quarter seasonally adjusted wage price index (WPI) (+0.8%) released by the ABS. Most companies we spoke with over the past month cited wages pressure as a key challenge and this was also widely called out in the media and by sell-side analysts in their reporting season commentary. Labour shortages too are still impacting many businesses, although border re-openings and an increase in skilled migrants and backpackers should help alleviate skills shortages in some areas going forward.

Other key trends observed by the OC Funds team in our reporting season meetings included:

- Muted guidance from companies on the economic outlook – most companies refrained from giving numerical earnings guidance with many citing an uncertain macro-economic outlook given the steep path of rate hikes over the past 10 months and the still elevated inflationary environment;
- Consumer outlook getting tougher – despite a resilient end to the year for the consumer, several companies have flagged challenges ahead and a more muted start to the new year including Nick Scali and Temple & Webster;
- Lingering COVID impacts in healthcare - staff absenteeism or patient cancellations (due to ill-health) impacting margins (e.g. radiology and IVF), and also health systems bottlenecks (elective surgery);
- Cost of debt is rising – interest expense has risen rapidly for indebted companies and will continue hit company earnings as rates go higher, or as fixed rate debt rolls off and is refinanced at higher interest rates;
- Insurance premiums continues to rise - particularly cyber insurance, with little respite expected in the near-term (with insurance brokers are the key beneficiaries);
- Supply chain pressures appear to be easing and freight costs and energy input costs are falling - logistic costs nevertheless remain well above pre-COVID-19 levels; and
- Cost pressures have peaked – many firms are suggesting that cost pressure have peaked (with labour cost being the exception) and they may be starting to ease given improvements in the supply chain and key commodity inputs.

The Fund remains conservatively positioned at present,

with a cash balance in-excess of 10%, providing ample flexibility to capitalise on macro-induced weakness in the market in the coming months. Whilst this level is well above our typical cash weighting of around 4-6%, we feel it is prudent in view of the elevated macro-economic risks. Post our reporting season management catchups, we will once again head out on the road with an extensive company visitation program planned in the coming two months. We thank our investors for their ongoing support and remain committed to our goal of generating strong long-term risk-adjusted returns for our clients.

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

Company	ASX code
Eagers Automotive	APE
APM Human Services	APM
GQG Partners	GQG
Mineral Resources	MIN
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>

\*The total return performance figures quoted are historical, calculated using hard-close end-of-month 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.

\*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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