

# UBS Australian Small Companies Fund

August 2021

## Fund description

The Fund is an actively managed fund investing in a portfolio of 30–60 Australian small company equity securities across a range of industry sectors.

## Investment strategy

The Portfolio Manager's overarching strategy is to identify those small company shares that are believed to be undervalued by the market. Normally the Fund will hold between 30–60 stocks in companies. Companies are selected for inclusion in the portfolio after a rigorous investment process.

## Investment return objective

The Fund aims to outperform (after management costs) the S&P/ASX Small Ordinaries Accumulation Index over rolling five year periods.

## Active security positions

Overweight	Underweight
IGO	Orocobre Limited
Pinnacle Investment Management	Steadfast Group
AUB	Iluka
Nanosonics Limited	ARB Corporation
SeaLink Travel Group	Virgin Money UK

## Active industry positions

Overweight	Underweight
Health Care Equipment & Services	Real Estate
Transportation	Materials
Food Beverage & Tobacco	Retailing
Media & Entertainment	Automobiles & Components
Consumer Services	Pharmaceuticals Biotechnology & Life Sciences

## Investment performance

Fund	1 month %	3 months %	1 year %	3 years % pa	5 years % pa	Since inception* % pa
Total return	6.92	10.93	39.39	16.54	14.48	13.64
Benchmark**	4.98	8.95	29.51	10.08	10.99	7.01
<b>Added Value</b>	1.94	1.98	9.88	6.46	3.49	6.63

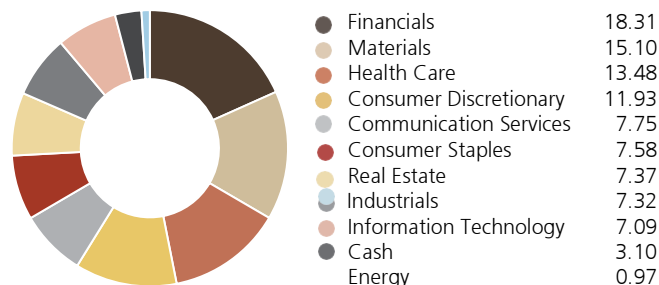
\*Inception date: 31 March 2004. \*\*S&P/ASX Small Ordinaries Accumulation Index. Performance figures are net of ongoing fees and expenses. The performance figures quoted are historical, calculated using end of month redemption prices, and do not allow for the effects of income tax or inflation. Total returns assume the reinvestment of all distributions. Performance can be volatile and future returns can vary from past returns.

## Fund information

Inception date	31 March 2004
Fund size	\$ 141.9 m
Management fee	0.85% pa
Performance fee*	Yes
Minimum initial investment	\$10,000
Typical number of holdings	30 to 60
Distributions	Quarterly
Buy/sell spread	+/- 0.45%
APIR code	UBS0004AU

\* The performance fee equals 20% of the amount by which the Fund outperforms the S&P/ASX Small Ordinaries Accumulation Index.

## Fund positioning (%)



## Top 5 stocks (%)

Pinnacle Investment Management	4.72
AUB	4.48
Nanosonics Limited	4.12
IGO	4.00
SeaLink Travel Group	3.52

## Portfolio review

After fees and expenses, the Portfolio rose by 6.92% during the month, outperforming its benchmark by 194 bps.

The largest positive contributors were Pinnacle Investment Management, Nanosonics and Centuria Capital. Pinnacle delivered a stronger-than-expected FY21 result, with NPAT rising +108% (y/y) to \$67mn, 6% ahead of consensus forecasts, supported by strong performances across its affiliates. Nanosonics also beat expectations as revenue growth of +3% renewed confidence in the market that the company was recovering from its COVID-related disruption. Centuria Capital delivered FY21 results at the midpoint of its guidance range and within consensus, however the market was focused on solid AUM growth (+71%) and the outlook for a more meaningful contribution from its Development income as its pipeline grows to \$1.9bn.

The largest negative contributors were SeaLink Travel, Uniti (not held) and Integral Diagnostics. SeaLink Travel partially retraced prior outperformance despite EBITDA rising 85% (y/y) to \$167.5mn, which was slightly below consensus forecasts. Uniti Group announced that FY21 underlying NPAT grew 8% to \$53mn, as the performance of its Wholesale & Infrastructure (W&I) exceeded analyst expectations with ~16k connections in 2H21. Integral Diagnostics delivered disappointing FY21 results. EBITDA grew +24% to \$94mn – below consensus for \$97mn due to the repayment of JobKeeper – and lockdowns clouded the operating outlook for FY22.

## Market Review

Australian equities delivered their best monthly return since November 2020 during reporting season, overcoming uncertainty relating to protracted lockdowns in NSW and VIC and negative earnings revisions across the market.

The S&P/ASX Small Ordinaries Accumulation Index lifted by 5.0% in August, taking its 12-month return to +29.5%. In comparison, the broader ASX300 Index returned 2.6% and the MSCI Global Index returned 2.7%. However, FY21 reporting season saw more misses than beats despite recording +28% growth y/y, and FY22 forecasts were revised down at -1.2% for the ASX200 and -1.5% for the Small Ords

Nevertheless, equity valuations rose globally amid lower bond yields, with the US 10-year bond yield declining 21 bps to 1.23% in response to dovish commentary from the US Fed and the Australian 10-year bond yield flat at 1.16%.

At a sector level, Communication Services (+11.0%) generated the highest return as Uniti Group (UWL, +24.4%) impressed the market with its FY21 result – delivering more connections than anticipated with its 'last mile' network infrastructure – while Chorus Group (CNU, +15.6%) as regulatory uncertainty partially resolved.

Elsewhere, Financials (+10.0%) contributed strongly to the benchmark's return. Insurance broker Steadfast (QBE, +10.9%) benefited from a higher pricing environment, while asset managers including Pinnacle Asset Management (PNI, +32.4%) and Australian Ethical Investment (AEF, +30.4%) saw strong FUM growth amid record-high equity markets. Elsewhere, Real Estate (+7.7%) saw strong gains from REITs including fund manager Centuria Capital (+17.5%), shopping mall owner SCA Property (SCP, +8.9%) and Residential REIT Ingenia Communities (+12.0%) amid stronger-than-expected results.

Conversely, Materials (+0.2%) underperformed as Steel (-11.6%) declined in response to lower iron ore (-15%) and steel prices and Construction Materials (-0.6%) retreated following strong prior outperformance.

## Outlook

The Australia economy completed 1H2021 with strong momentum, prompting the RBA and consensus to upgrade expectations for both 2021 and 2022 calendar year growth. Both the size of the economy and the number of people employed comfortably exceed pre-pandemic levels. Clear highlights were the unemployment rate declining from a peak of 7.5% in July 2020 to just 4.6% in July 2021 and June quarter GDP rising 0.7%, well ahead of expectations. Nevertheless, renewed COVID-related lockdowns in Melbourne and Sydney will sharply impact the data in 3Q21 and materially alter our growth forecasts for the remainder of 2021 and 2022.

We believe the interruption to economic growth from renewed lockdowns will be an aberration within an improving trend, rather than a view altering event. Indeed, the fundamentals that will drive the economic recovery remain in place. The recovery in labour market income has been sufficient to offset the gradual withdrawal of temporary fiscal support. Moreover, the accumulation of an estimated \$171bn in excess household saving, in concert with strong asset price gains, leaves the consumer uniquely positioned to underpin economic growth in 2021-22. Dwelling investment is set to provide solid support for economic growth over the next 12 months following a surge in demand for new housing construction, and a broader-based lift in business investment expectations is an important step in ensuring a sustained economic recovery. We expect the global economy to expand 6.5% and the Australian economy to expand 4.75% in 2021, a downward revision from our pre-lockdown forecast of 6%. We expect another strong year of economic growth in 2022 of 4.0%.

While we continue to expect US inflation to surprise on the upside over the remainder of 2021, the biggest inflation surprises are now behind us and our expectation that global business surveys would likely peak around mid-2021 appears to have been realised. The peak in global business surveys, in concert with slower bond issuance relative to central bank buying, helped push real bond yields to record lows over recent weeks. As the Federal Reserve signals increased willingness to taper its purchases and global economic and inflation indicators remain elevated, we expect bond yields will again start to move higher through the remainder of 2021. We expect US 10 year yields to approach 1.80% by the end of 2021.

The A\$/US\$ has recently been buffeted by concerns of a peak in global industrial growth indicators, slowing China economic momentum and recent declines in iron ore prices. Nevertheless, Australia's external accounts are in their best position since the early 1970s, and despite some moderation in commodity prices the A\$/US\$ should remain supported by global reflationary forces through 2021-22. Reflecting the factors above, we have lowered our expectations for the A\$/US\$ somewhat over the remainder of 2021, and now expect the A\$/US\$ to finish the year in the 76-78c range, down from a forecast 81-83c range previously.

We are most overweight stocks within the Health Care, Financials and Consumer Staples sectors, and are underweight Materials, Real Estate and Consumer Discretionary.

## Client Services

Telephone: (03) 9046 4041    Freecall: 1800 572 018    Email: [ubs@unitregistry.com.au](mailto:ubs@unitregistry.com.au)    [www.ubs.com/am-australia](http://www.ubs.com/am-australia)

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