UBS

UBS Asset Management

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All data as at 31 January 2022

UBS Yarra Microcap Fund

January 2022

Fund description

The Fund is an actively managed fund investing in a portfolio of 35 to 65 predominantly Australian Microcap equity securities across a range on industry sectors.

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
Monash IVF Group	Iluka Resources
Ridley Corporation	ARB Corporation
Alliance Aviation Services	Seven Group Holdings
GR Engineering Services	Shopping Centres Australasia Property Group
Generation Development Group	Charter Hall Long WALE REIT

Active industry positions

Overweight	Underweight
Software & Services	Real Estate
Capital Goods	Materials
Health Care Equipment & Services	Diversified Financials
Food Beverage & Tobacco	Energy
Consumer Durables & Apparel	Consumer Services

Investment Strategy

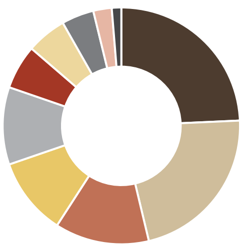
The Portfolio Manager's overarching strategy is to identify those Microcap shares that are believed to be undervalued by the market, based on an assessment of the companies' future cash flows. Normally the Fund will hold between 35–65 stocks in companies with a market capitalisation of generally less than $250m at the time of initial purchase. The Portfolio Manager searches for businesses that have exposure to growing markets or are benefiting from changes in market structure and are in a rapid growth phase of their life cycle.

Fund information

Inception date	12 August 2014
Fund size	$ 71.1 m
Management fee	1.20% pa
Performance fee*	Yes
Minimum initial investment	$500,000
Typical number of holdings	35 to 65
Distributions	Semi-annually
Buy/sell spread	+/- 0.70%
APIR code	UBS0057AU

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

Fund positioning (%)



Information Technology	24.28
Industrials	21.99
Materials	12.85
Consumer Discretionary	10.60
Health Care	10.57
Consumer Staples	6.04
Financials	5.46
Cash	4.40
Real Estate	2.51
Communication Services	1.29

Investment performance

Fund	1 month %	3 months %	1 year %	3 years % pa	5 years % pa	Since inception* % pa
Total return	(5.88)	(3.85)	23.08	24.35	15.70	16.47
Benchmark**	(9.00)	(7.99)	6.65	10.12	9.63	8.26
Added Value	**3.12**	**4.14**	**16.43**	**14.23**	**6.07**	**8.21**

*Inception date: 12 August 2014. **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.

Portfolio performance

After fees and expenses, the Portfolio declined by 5.88% during the month, outperforming its benchmark by 312 bps.

The largest positive contributions were Lunnon Metals, Calidus Resources and PTB Group. Lunnon Metals provided multiple updates on the progress of their exploration programme at Baker shoot. The drilling results confirm the high grade, near surface resource with intercepts of 7.0m @ 9.22 Ni and 10m @6.82 Ni far exceeding the 1% Ni cut-off grade. Calidus resources announced a 50/50 joint venture in new Pilbara Lithium exploration company Pirra Lithium, providing optionality and potentially additional value to shareholders. This will have no bearing on their core asset at Warrawoona, which has its first gold pour scheduled for this quarter. PTB Group provided its preliminary half-year results, highlighting strong trading conditions in the USA and Asia pacific regions resulting in a 44% increase in revenue (y/y).

The largest negative contributors were Brainchip (not held), RightCrowd and Champion Iron (not held). Brainchip jumped higher after announcing full commercialistion of a new AI processor. RightCrowd released their FY22 Q2 quarterly results, generating $4.2m of revenue which was 5% below the prior corresponding period. Nonetheless, ARR has achieved 50% growth on the prior year. Champion Iron was stronger on the backdrop of improving iron ore prices following continued strong demand from China which is using monetary policy tools to spur the economy, brightening the outlook for iron ore and raw materials more broadly.

Market Review

Australian equities declined sharply in January as high inflation spurred Federal Banks to accelerate quantitative tapering and signal earlier rate rises.

The S&P/ASX Small Ordinaries Accumulation Index declined 9.0% during the month, underperforming the broader ASX300's -6.5% return and taking its 12-month return to 6.7%. Globally, the S&P500 and MSCI World Index returned -5.2% and -4.9% respectively as US real yields rose, with the US 10-year Treasury Inflation-Protected Securities (TIPS) climbing 38 bps to -0.69% as the US Fed said it would likely start to increase interest rates in March.

At a sector level, high-PE cohorts within Health Care (-17.5%), Financials (-12.3%) and Information Technology (-11.2%) recorded the most significant declines, led by companies with long-dated cash flows like Pro Medicus (PME, -27.8%), ZIP Co. (Z1P, -27.0%) and Megaport (MP1, -27.8%). Gold (-13.7%) also declined significantly given its negative correlation with real interest rates.

Conversely, Energy (-0.1%) was the strongest performer as Brent Crude lifted by 20% to US$92/bbl. Oil & Gas producers Beach Energy (BPT, +17.5%), Karoon Energy (+13.7%) and Cooper Energy (+7.1%) were among the top performers.

Outlook

The pattern of quarterly economic growth in Australia remains volatile, having declined 1.7% (q/q) in 3Q under the impact of the Delta strain of COVID. Nevertheless, record fiscal stimulus and easy financial conditions have helped underpin solid real economic growth of 3.9% (y/y) and a 4Q recovery from the Delta variant disruption is expected to see real economic growth in calendar 2021 to average 4.0%.

Recovering underlying household income growth, $200bn in 'excess saving', strong corporate profit growth, low inventory levels and robust capex expectations – in concert with a still solid global growth backdrop – suggests Australian economic growth into 2022 will be above 'potential'. In both CY2022 and CY2023 we expect the Australian economy to expand at an above 'potential' rate of 3%.

The strength of the economic recovery has been particularly evident via the strength in employment. After peaking at 7.5% in July 2020, the unemployment rate has declined sharply to 4.2% in December 2021. In essence the unemployment rate is now in line with the RBA estimate of non-accelerating inflation rate of unemployment (NAIRU) and the combination of excess demand relative to available supply has seen 2H21 produce sufficient broad based inflation pressures to prompt an abrupt reassessment of the RBA's monetary stance. We expect the RBA will commence increasing interest rates in 4Q2022 with a 35 bps hike, with a further four 25 bps rate hikes in 2023.

Although we remain constructive on global economic growth, we believe the industrial cycle peaked in mid-2022 and that a relatively controlled slowing in economic activity is currently taking place. Nevertheless, there are some areas that are cause for concern. For over 18 months we have warned about rising US inflation pressures and rising inflation expectations, and while these threats have been realised, supply chain constraints and energy shortages in the Northern Hemisphere risk inflation pressures becoming more widespread and more entrenched. With the peak in global business surveys having passed, cost inflation continuing to escalate and the Federal Reserve announcing its decision to taper bond purchases, we expect bond yields will move higher, providing some ongoing challenges for risk assets.

The A$/US$ has recently been buffeted by concerns of a peak in global industrial growth indicators, slowing China economic momentum and volatility in commodity 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 the RBA joining other central banks in tightening interest rates this year. We expect the A$ will finish CY 2022 at around 76 cents.
Our investment process seeks to look through short-term noise and focus on small businesses capable of growing outside of broader macro uncertainties. With a large investable universe, we remain confident that significant opportunities exist to find undervalued small companies that can become substantially larger businesses over time. Those businesses supported by structural tailwinds in a rapidly changing environment should deliver our investors attractive investment returns over the medium term.

Client Services

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