

# UBS Yarra Australian Small Companies Fund

January 2022

## 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
AUB	Iluka
Kelsian Group	ARB Corporation
oOh Media	Seven Group Holdings Limited
Auckland International Airport	Shopping Centres Australasia Property Group
TPG Telecom	TPG Telecom

## Active industry positions

Overweight	Underweight
Transportation	Real Estate
Health Care Equipment & Services	Retailing
Insurance	Energy
Media & Entertainment	Materials
Food Beverage & Tobacco	Commercial & Professional Services

## Investment performance

Fund	1 month %	3 months %	1 year %	3 years % pa	5 years % pa	Since inception* % pa
Total return	(9.27)	(6.35)	12.68	17.79	14.84	12.83
Benchmark**	(9.00)	(7.99)	6.65	10.12	9.63	6.27
<b>Added Value</b>	<b>(0.27)</b>	<b>1.64</b>	<b>6.03</b>	<b>7.67</b>	<b>5.21</b>	<b>6.56</b>

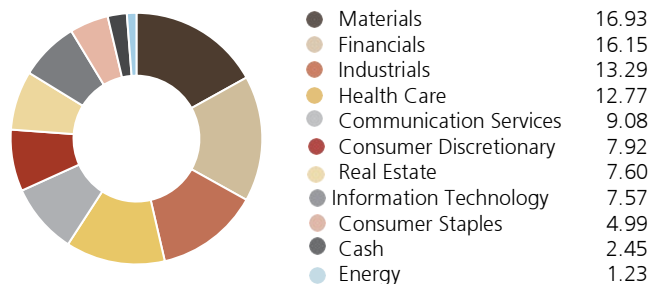
\*Inception date: 31 March 2004. \*\*S&P/ASX Small Ordinaries Accumulation Index. Performance figures are net of ongoing fees and expenses. The performance figures quoted are historical, calculated using end of month redemption prices, and do not allow for the effects of income tax or inflation. Total 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	\$ 139.2 m
Management fee	0.85% pa
Performance fee*	Yes
Minimum initial investment	\$50,000
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 (%)

AUB	4.62
TPG Telecom	3.78
Kelsian Group	3.55
BWP Trust	3.54
Auckland International Airport	3.54

## Portfolio review

After fees and expenses, the Portfolio declined by 9.27% during the month, underperforming its benchmark by 28 bps.

The largest positive contributors were Virtus Health, Pilbara Minerals and TPG Telecom. Virtus Health outperformed after receiving a second takeover offer for the business from new suitor CapVest. The new bid was at \$7.60 per share, 7% above BGH's offer last month. Pilbara Minerals outperformed alongside the lithium price, with spodumene rising 6% to US\$2,710/t. TPG Telecom maintained value during the period without any material news, outperforming the declining market.

The largest negative contributors were Megaport, Pinnacle Investment Management and Redbubble. Megaport gave a 2Q22 update which revealed higher costs as the business adjusts its operating model to focus on its indirect sales channel. While Pinnacle didn't announce any material news, the investment manager declined alongside equity markets. Redbubble released a disappointing 2Q22 trading update with lower-than-expected margins due to higher customer acquisition costs, higher shipping costs and Apple's IOS 14 changes to privacy settings.

## 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.

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

## Client Services

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