UBS Yarra Australian Small Companies Fund

February 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.

Target market

The Target Market Determination (TMD) for the Fund sets out the class of consumers for whom the product, including its key attributes, would likely be consistent with their likely objectives, financial situation and needs. To access to the TMD and other Fund documentation visit our website.

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 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 Group Limited	Seven Group Holdings Limited
BWP Trust	Shopping Centres Australasia Property Group RE Ltd.
Kelsian Group Limited	Charter Hall Long WALE REIT
oOh media Ltd	Whitehaven Coal Limited
Auckland International Airport Limited	Chorus Limited

Active industry positions

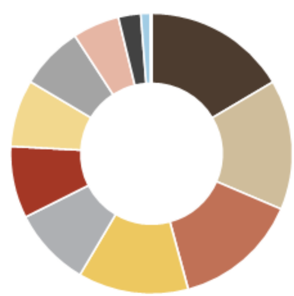
Overweight	Underweight
Transportation	Real Estate
Health Care Equipment & Services	Materials
Media & Entertainment	Retailing
Insurance	Energy
Food Beverage & Tobacco	Commercial & Professional Services

Fund information

Inception date	31 March 2004
Fund size	$ 138.0 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%

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

Fund positioning (%)



Financials	16.50
Materials	14.98
Industrials	14.38
Health Care	12.68
Communication Services	9.09
Consumer Discretionary	8.29
Information Technology	7.73
Real Estate	7.29
Consumer Staples	5.38
Cash	2.57
Energy	1.10

Top 5 stocks

AUB Group Limited	4.31%
BWP Trust	4.14%
Kelsian Group Limited	3.64%
Megaport Ltd.	3.59%
TPG Telecom Limited	3.57%

Investment performance

Fund	1 month %	3 months %	1 year % pa	3 years % pa	5 years % pa	Since inception* % pa
Total return	(0.50)	(5.56)	9.49	15.54	14.40	12.74
Benchmark**	(0.01)	(7.71)	5.02	7.74	9.35	6.24
Added Value	**(0.49)**	**2.15**	**4.47**	**7.80**	**5.05**	**6.50**

*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..

Portfolio review

After fees and expenses, the Portfolio declined by 0.50% during the month, underperforming its benchmark by 49 bps. The largest positive contributors were Monadelphous, NRW Holdings and Gold Road Resources. Monadelphous exceeded low expectations with its 1H21 result as strong revenue growth (+12.3% y/y) more than offset cost pressures from the tight labour market in Western Australia. NRW met forecasts for 1H22 and upgraded full-year EBIT guidance from $145-50mn to $150-155mn, with the group set to benefit from its leverage to iron ore and infrastructure capex. Gold Road Resources outperformed alongside the gold price (+6% to US$1,910/oz), which more than offset a slightly weaker-than-expected 4Q21 result.

The largest negative contributors were Nanosonics, Pilbara Minerals and Sims Ltd (not held). Nanosonics underperformed as the market focused on risks associated with its post-COVID recovery, specifically as the company shifts the sale of its consumables from its partner, GE, to its own direct channel. Pilbara Minerals partially retraced prior outperformance following a disappointing 1H22 result (with production guidance lowered ~10% to 75-90kwmt) and the surprise resignation of its chief executive. Sims beat expectations with its 1H22 result on higher revenues (+8% versus consensus), with EBIT of $362mn above its guidance range despite inflationary pressures.

Market review

Australian equities defied a fall in global markets during February, rising on a better-than-expected earnings season even as uncertainty spiked over Russia invading Ukraine and resulting sanctions.

The S&P/ASX Small Ordinaries Accumulation Index was flat during the month, taking its 12-month return to 5.0%. While global indices fell (S&P500 -3.0%), a solid set of 1H22 earnings held up the domestic market. Around 36% of companies received consensus upgrades for the full year (two times the long-run average) as strong top line growth more than offset rising input costs.

At a sector level, Energy (+10.2%) and Materials (+7.1%) were the top performers. In the former, coal producers Whitehaven Coal (WHC, +22.8%) and New Hope Corporation (NHC, +11.9%) continued to surge alongside higher thermal and coking coal prices. In the latter, chemicals producer Nufarm (NUF, +23.2%) announced a strong 1Q22 update as well as aspirational long-term growth targets, while the Gold sector (+12.2%) rose in value alongside the commodity (+6% to US$1,910/oz).

Conversely, Information Technology (-12.8%) declined the most in value. Losses were widespread in the tech sector as the prospect of higher interest rates compressed valuations, with notable declines including Life360 (360, -37%), Novonix (NVX, -32.9%) and Tyro Payments (TYR, -31.5%). Health Care (-10.0%) also weighed on the index, weighed down by Telix Pharmaceuticals (TLC, -27.2%), Imugene (IMU, -24.2%) and Polynovo (PMV, -23.7%) and Nanosonics (NAN, -17.5%).

Outlook

Geopolitical events and surging commodity prices have taken centre stage this month, shaking risk sentiment and challenging consensus' optimistic forecast for global growth in 2022. From our perspective, although for the past six months our forecasts for global growth in 2022 have been below consensus, we believe a series of downgrades will soon be evident for global growth and earnings growth in most major markets. Surging commodity prices and ongoing supply shortages have resulted in further upside to the inflation outlook and risks forcing the hand of central banks in coming months in an attempt to contain rising inflation expectations. The reality for 2022 is that a world of higher inflation, slower growth and higher financing costs awaits.

Australia does have some key natural advantages in such a climate. The most notable is that Australia's export dominance of iron ore, coal, LNG, gold, wheat, and base metals contribute close to 80% of Australia's exports, and each of these commodities have seen strong price rises in early 2022 which will translate into a large positive national income boost, even if spot prices retreat in coming weeks. Indeed, Australia presents as a safe haven market which is far from the conflict in Europe, an exporter of in demand raw materials and given its own undershooting of its inflation target since 2015, it has ample room to adjust policy setting at a more gradual pace.

Australia also has the benefit of recovering underlying household income growth, $230bn in 'excess saving', strong corporate profit growth, robust capex expectations in concert with improving government finances which suggests Australian economic growth in 2022 will remain more robust than its developed economy peer group. In both CY2022 and CY2023 we expect the Australian economy to expand at an above 'potential' rate of 3%. While this is slower than the 4% pace recorded in 2021, it is still sufficient to see further employment growth gains and we expect the unemployment rate will soon fall below 4% and below the RBA's estimate of non-accelerating inflation rate of unemployment (NAIRU), with further wage pressure to become evident into mid-2022.

We expect the RBA will still take its time to assess the outlook for inflation and most likely will commence increasing interest rates in 4Q2022 with a 35bp hike.

We expect a further four 25bp rate hikes in 2023, with the consumer well placed to absorb initial interest rate rises.

While the RBA may well prove to be later than most other developed nations in tightening policy, tighter financial conditions in 2022 are likely to come via a stronger currency. The A$/US$ has in recent months been buffeted by concerns of a peak in global industrial growth indicators and slowing China economic momentum.

Nevertheless, Australia's external accounts are in their best position since the early 1970s and surging commodity prices in early 2022 is providing an incentive for the A$/US$ to commence an appreciation cycle well before the RBA joins other central banks in tightening interest rates later this year. We expect the A$ will finish 2022 at around 76 cents, albeit the risk to this forecast is on the upside.

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

Client Services

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