UBS Yarra Australian Small Companies Fund

March 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	Whitehaven Coal Limited
BWP Trust	AVZ Minerals Ltd.
Auckland International Airport Limited	Liontown Resources Limited
Kelsian Group Limited	Seven Group Holdings Limited
oOh media Ltd	Shopping Centres Australasia Property Group RE Ltd.

Active industry positions

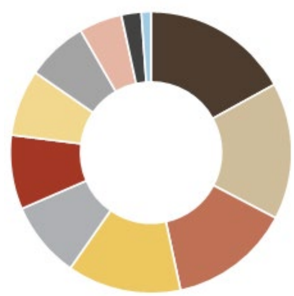
Overweight	Underweight
Health Care Equipment & Services	Materials
Transportation	Real Estate
Insurance	Retailing
Media & Entertainment	Energy
Diversified Financials	Commercial & Professional Services

Fund information

Inception date	31 March 2004
Fund size	$ 144.3 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	16.98
Materials	15.70
Industrials	13.94
Health Care	13.08
Communication Services	8.78
Consumer Discretionary	8.51
Information Technology	7.63
Real Estate	7.04
Consumer Staples	4.95
Cash	2.28
Energy	1.09

Top 5 stocks (%)

AUB Group Limited	4.02
BWP Trust	3.94
TPG Telecom Limited	3.70
Auckland International Airport Limited	3.66
Flight Centre Travel Group Limited	3.62

Investment performance

Fund	1 month %	3 months %	1 year % pa	3 years % pa	5 years % pa	Since inception* % pa
Total return	3.11	(6.92)	11.78	16.31	14.68	12.87
Benchmark**	5.26	(4.21)	9.68	9.63	9.89	6.51
Added Value	**(2.15)**	**(2.71)**	**2.10**	**6.68**	**4.79**	**6.36**

*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 increased by 3.11% during the month, underperforming its benchmark by 215 bps.

The largest contributors were Pilbara Minerals, Nickel Mines (not held) and Zip Co (not held). Pilbara Minerals outperformed amid higher lithium prices, with spodumene rising 4% to $US2,710/t. Nickel Mines declined over uncertainty about the ability of its largest shareholder, Tsingshan Holding Group, to cover a significant nickel short position following a price spike in the commodity. Zip announced an acquisition of peer Sezzle (SZL) at the end of the prior month, funded by scrip, and a capital raising to support growth of the combined business.

The largest negative contributors were Uniti (not held), AVZ Minerals (not held) and Sandfire Resources. Uniti outperformed as two suitors, Macquarie Infrastructure and Real Assets (MIRA) and a joint venture comprising Morrison and Brookfield announced competing takeover offers for the business. AVZ Minerals outperformed amid higher lithium prices, with spodumene rising 4% to $US2,710/t. Sandfire Resources declined following its 1H22 result at the end of the prior month in which management gave disappointing cost guidance for the newly acquired MATSA project, in part due to higher energy prices in Spain.

Market review

Australian equities small caps rallied in March as surging commodity prices supported the resources sectors.

The S&P/ASX Small Ordinaries Accumulation Index increased by 5.3% during the month, taking its 12-month return to +9.7%. In comparison, the MSCI World Index and the S&P500 returned +3.2% and 3.7% respectively. The domestic market benefited from a much larger weighting to Resources: Metals & Mining and Energy comprise 26% of the benchmark versus the S&P500 at 4%.

At a sector level, Metals & Mining (+12.6%) saw strong gains across Steel (+19.8%) and Diversifieds (+17.8%). At a stock level, lithium producers AVZ Minerals (AVZ, +35.0%) and Liontown Resources (LTR, +31.0%) and scrap metal recycler Sims (SGM, +20.9%) were the top performers. Within Energy (+12.2%), coal producers Whitehaven Coal (WHC, +29.3%) and New Hope Corporation (NHC, +33.9%) continued to strengthen amid the global energy crisis.

Elsewhere, Information Technology (+6.3%) rallied following weakness in January and February. Top benchmark contributors included Technology One (TNE, +16.3%), Novonix (NVX, +23.3%) and Iress (IRE, +15.3%).

While all sectors rose during the period, the worst performers were Financials (+0.8%) and Consumer Discretionary (+1.4%). In the former, Zip Co. (Z1P, -32.8%) weighed on the benchmark after announcing a merger with Sezzle and an associated capital raising. In the latter, higher online advertising costs and/or supply chain disruptions weighed on companies including Redbubble (RBL, -14.8%), City Chic Collective (CCX, -13.0%) and Accent Group (AX1, -7.7%).

Outlook

Geopolitical events and surging commodity prices have taken centre stage in 2022, shaking risk sentiment and challenging consensus' optimistic forecast for global growth. 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 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 to try to contain rising inflation expectations. The reality for 2022 is likely a world of higher inflation, slower growth and higher financing costs.

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 likely 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 settings at a 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 and 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) and further wage pressure will 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 35 bps hike. We expect a further four 25 bps rate hikes in 2023 and we believe the consumer is well placed to absorb the 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 are providing an incentive for the A$/US$ to commence an appreciation cycle well before the RBA joins alongside 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 most overweight stocks within the Health Care, Financials and Industrials sectors, and are underweight Materials, Real Estate and Consumer Discretionary.

Client Services

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