

Ironbark Karara Australian Small Companies Fund

BENCHMARK

S&P/ASX Small Ordinaries Accumulation Index

OBJECTIVE

To outperform the benchmark (before fees) over rolling 4-year periods.

APIR

PAT0002AU

ARSN

114 291 486

INCEPTION DATE

30 June 2005

MANAGER APPOINTED

1 May 2010

MANAGEMENT FEE

1.1275% p.a.

FUND SIZE

\$216.7m

BUY / SELL SPREAD

+0.20% / -0.20%

EXIT PRICE

\$2.2601

Net performance (%)

	1 month	3 months	1 year	3 years p.a.	5 years p.a.	10 years p.a.	Since inception p.a. ¹
Fund	-13.75	-21.29	-23.80	-3.18	2.19	6.63	9.87
Benchmark	-13.09	-20.39	-19.52	0.38	5.07	5.37	3.91
Active	-0.66	-0.90	-4.28	-3.56	-2.88	1.26	5.96

Top 3 monthly contributors and detractors

Contributing stocks	Active position	Detracting stocks	Active position
Uniti Group	Overweight	G.U.D. Holdings	Overweight
SKYCITY Entertainment Group	Overweight	Ramelius Resources	Overweight
Steadfast Group	Overweight	Stanmore Resources	Overweight

Top 3 quarterly contributors and detractors

Contributing stocks	Active position	Detracting stocks	Active position
Uniti Group	Overweight	Silver Lake Resources	Overweight
Mineral Resources	Overweight	Whitehaven Coal	Underweight
Steadfast Group	Overweight	G.U.D. Holdings	Overweight

Top 5 holdings (In alphabetical order)

Stocks	Sector
EBOS Group	Health Care
Elders	Consumer Staples
Seven Group Holdings	Industrials
Steadfast Group	Financial ex-Property Trusts
Uniti Group	Communication Services

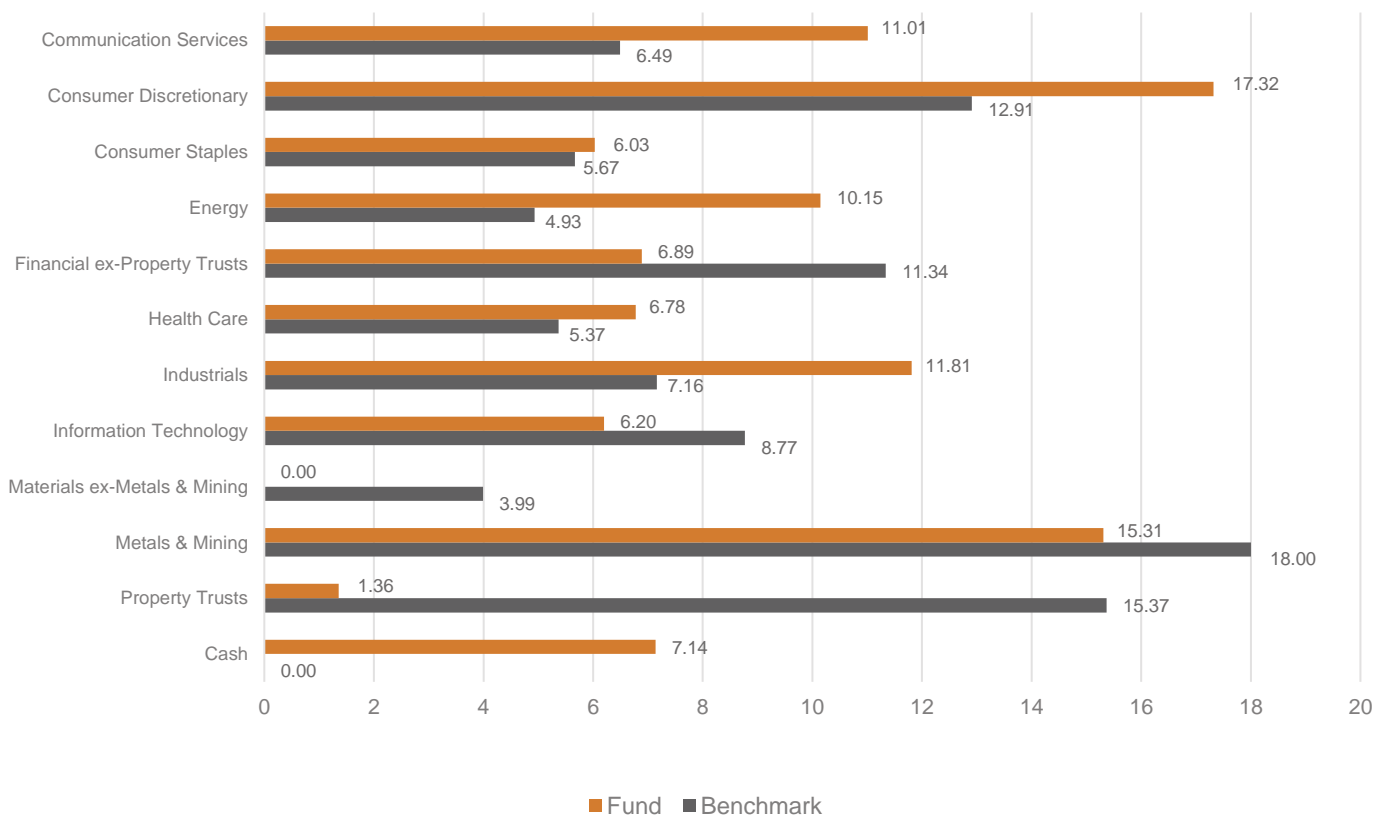
Past performance is not indicative of future performance. Net performance figures are calculated using exit prices, net of fees and reflect the annual reinvestment of distribution. Returns are rounded to two decimal places. Slight variations to actual calculations may occur.

¹The return since inception represents the annualised performance from the first full month of operation.

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Sector asset allocation (%)



Market review

Global markets fell across the board in the June quarter as investors braced for higher interest rates, the Russian invasion of Ukraine continued, and China intensified its COVID-19 zero policy, deepening the supply chain crisis. Data in the US showed inflation running at the highest rate in 40 years, prompting interest rate increases from the US Federal Reserve, as well as central banks in Switzerland, England, New Zealand and Australia. In Australia the broad-based S&P/ASX 300 Index ended the quarter down 12.2% while the Small Ordinaries Index fell 20.4%.

In Australia, the Reserve Bank blindsided many economists in June when it increased the cash rate from 0.35% to 0.85%, the largest single increase in 22 years, and forecast inflation to peak above 7% later this year.

The policy shift came after annual CPI spiked to 5.1% in the March quarter. Core inflation rose to 3.7%, exceeding the RBA's 2% to 3% target band for the first time in more than a decade. Bond yields rallied in response, mirroring global peers. The Australian three-year rate climbed to 3.04% for the first time since April 2014. The Australian 10-year bond rate shot up to 3.41%, a level last recorded in November 2014.

Domestic GDP overcame flooding, COVID-19 and supply chain disruptions to grow 0.8% over the first quarter of 2022 and 3.3% annually. The result was ahead of market expectations for 0.7% largely due to surging commodity prices, and despite a drop in export volumes. Nominal GDP grew 3.7% over the quarter and 10.2% over the year.

Commodity prices were mixed. Oil prices fell 3% and iron ore lost 14% on renewed global growth concerns. Base metals extended recent declines: copper fell 7% to its lowest level since mid-December.

Nickel dropped 13%, aluminium was down 15% from previously elevated levels and zinc lost 5%. Gold dropped 1% in USD terms yet rose in value against most other currencies reflecting the relative strength of the USD this year to date against most fiat currencies, other than the Russian ruble.

Performance review

The Fund fell -21.29% (net) during the June quarter. This constituted -0.90% of underperformance when compared with the benchmark S&P/ASX Small Ordinaries Accumulation Index return of -20.39% for the quarter.

The strongest contributors to the Fund's performance at a sector level were overweight positions in communication services and metals and mining as well as underweight positions in financials ex-property trusts and information technology. An overweight position in consumer discretionary detracted from relative performance.

At a stock level, positive contributors to quarterly performance included overweight positions in Uniti Group, Mineral Resources, Steadfast and SkyCity Entertainment.

- Mineral Resources shares fell 4%, outperforming a negative market on the back of little specific news but positive sentiment regarding the re-opening of China lockdowns and the four pillars of the Mineral Resources business. The mining service division remains characterised by ongoing volume growth and margin expansion with an order book relatively less impacted by the commodity cycle. The company's iron-ore business is transitioning to higher volumes and lower costs, with first production from Ashburton expected in late 2023. The MARBL Lithium joint venture announced plans to accelerate the restart of Wodgina train 2 in early April, with first spodumene production expected imminently. Lastly, further well testing and data analysis of the company's on-shore WA Lockyer Deeps gas discovery confirmed the significant scale and quality of the gas resource.
- Uniti shares were up 4%, supported by the \$5 per share bid from the Morrison/Brookfield consortium.
- Steadfast shares rose 5% on little new news, however the company re-iterated financial year 2022 earnings guidance during several broker presentations.
- SkyCity shares gained 2% with the stock offering exposure to relatively stable cash flows and the company benefitting from New Zealand's relatively successful management of COVID-19 outbreaks with more limited closures/restrictions on operations recently. The investment manager expects the company to remain comfortably within financial covenants, allowing the payment of future dividends. With the Adelaide development now largely complete and NZICC costs to be funded by insurance, the company is entering a period of lower capex and balance sheet deleveraging.

The main detractors to relative performance were overweight positions in Silverlake Resources, GUD Holdings and Johns Lyng.

- Silverlake Resources shares fell 44%. The company was the first WA gold miner to put the spotlight on the impact of labour shortages and increasing diesel and consumable costs during the March quarter reporting season and consequently withdrew its financial year 2022 guidance. With the company tracking to the bottom end of the prior guidance range, \$287 million in cash and no debt, Silverlake remains in a very robust position to navigate current challenges and announced an on-market share buyback.
- GUD fell 31% after the company provided a trading update that downgraded financial year 2022 EBITDA by 7% vs the mid-point of the prior guidance range. Management pointed to delays in new vehicle deliveries pushing out sales, despite strong underlying consumer demand. The investment manager continues to view the demand profile as robust, with much of the earnings downgrade a matter of timing of vehicle deliveries.
- Johns Lyng fell 34%, a victim of the market rotation away from companies with higher relative trading multiples. Johns Lyng operates a capital light business with a strong pipeline of insurance rectification work as well as growing a growing insurance catastrophe (CAT) exposure, both in Australia and the US. The company re-upgraded its financial year 2022 guidance during June, and is yet to fully quantifying the positive financial impact of the recent QLD and NSW floods, estimated to be the costliest on record.

Market outlook

The outlook for global markets remains highly uncertain. Persistently high global inflation remains the key issue – both demand and supply factors e.g., Chinese COVID lockdowns, are impacting, often in unpredictable ways and with lagged effects. The global shift to clean (and often intermittent) energy sources and a resultant, structural lack of investment in maintaining current levels of oil and gas supply, plus geo-political issues/Ukraine War are exacerbating the imbalances.

With inflation expectations more entrenched, Global Central Bank credibility is increasingly being called into question. Short term interest rates are still a long way below prevailing inflation levels in most major economies and emergency/zero interest rate policies (and QE i.e., excessive liquidity) have been in place for much of the last 10-12 years, even during periods of no emergency. The unwind of the resultant distorted capital allocation decisions will take some time to play-out.

Despite Central Banks' increasingly hawkish rhetoric (in a relative sense), in light of weakening economic conditions and increasing likelihood of recession, the question remains as to whether they will actually follow-through and "fight the inflation fight" by meaningfully raising short-term interest rates. While backward-looking unemployment data remains solid, in the US, announced employment layoffs are on the rise and any significant deterioration in actual employment levels could trigger a more dovish re-think, especially with US voters heading to mid-term elections in November this year.

Often over-looked, the "elephant in the room" of high indebtedness, also effectively constrains the ability of Central Banks to substantially raise interest rates from current levels – the "Gordian Knot" the investment manager has previously referred to. A salient case in point being Japan's current Yield Curve Control ("YCC") policy, where the 10-year government bond yield is being "capped" at 0.25% p.a. notwithstanding inflation running at levels 10x higher at 2.50% p.a. Japanese Government debt now approximates a record +260% of GDP and the Japanese Yen has been under significant pressure in FX markets, particularly versus the USD.

In the short to medium term, Government Bond markets will be key to observe – the current consensus is that inflation will not be a long-term problem (e.g., the US Treasury Yield curve is essentially flat from 2 years through to 30 years). Will that view change if Central Banks pause or "pivot" in their inflation battle if confronted with a materially weakening economic outlook? "Peak inflation" is now the prevailing narrative - while decreases in inflation rates are quite likely from their current 40-year highs, the risk of a more embedded, secular inflation component (including "stickier" services related inflation) remains, which may keep annual inflation rates well above the still-paltry nominal interest rates in many countries. The last period of serious stagflation was the 1970's – many of today's market participants (bond and equity investors alike) were not around then.

With the recent pull-back in domestic equity markets, and the associated de-rating in higher P/E stocks, there has been a material convergence in trading multiples between "value" stocks and a number of quality "growth" names in the small cap universe. While this may still have further to play-out given earnings expectations are falling and exogenous disturbances to many companies' operating environments seem to be occurring with greater frequency, the investment manager is actively building their target "buy" list of stocks and have begun selectively adding to positions. Some particularly attractive opportunities are starting to emerge in areas where supply chain issues have caused a "deferment of demand fulfillment" rather than a permanent loss of sales, with a skittish market extrapolating the particular short-term negative disruption excessively into the future.

In an uncertain macro environment and with short to medium term inflation and supply chain concerns still elevated, the investment manager's focus remains on identifying companies that can generate reasonable earnings growth against a challenging economic backdrop, particularly those that have at least some degree of pricing power (and/or ability to reduce costs) as well as strong balance sheets.

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