

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

\$472.0m

BUY / SELL SPREAD

+0.20% / -0.20%

EXIT PRICE

\$3.6240

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	2.03	8.31	10.18	6.47	8.72	7.90	12.31
Benchmark	2.76	13.83	9.21	6.57	10.46	3.77	5.07
Active	-0.73	-5.52	0.97	-0.10	-1.74	4.13	7.24

Top 5 monthly contributors and detractors

Contributing stocks	Active position	Detracting stocks	Active position
Mineral Resources	Overweight	IGO	Underweight
City Chic Collective	Overweight	Reece	Underweight
Meridian Energy	Overweight	Bellevue Gold	Overweight
Mercury NZ	Overweight	SeaLink Travel Group	Overweight
Nuix	Overweight	Elders	Overweight

Top 5 quarterly contributors and detractors

Contributing stocks	Active position	Detracting stocks	Active position
Mineral Resources	Overweight	Saracen Mineral Holdings	Overweight
Meridian Energy	Overweight	Silver Lake Resources	Overweight
Regis Resources	Underweight	Austal	Overweight
Mercury NZ	Overweight	Mcperson's	Overweight
EML Payments	Overweight	Elders	Overweight

Top 5 holdings (In alphabetical order)

Stocks	Sector
Mineral Resources	Metals & Mining
Saracen Mineral Holdings	Metals & Mining
Seven Group Holdings	Industrials
Uniti Group	Communication Services
Vocus Group	Communication Services

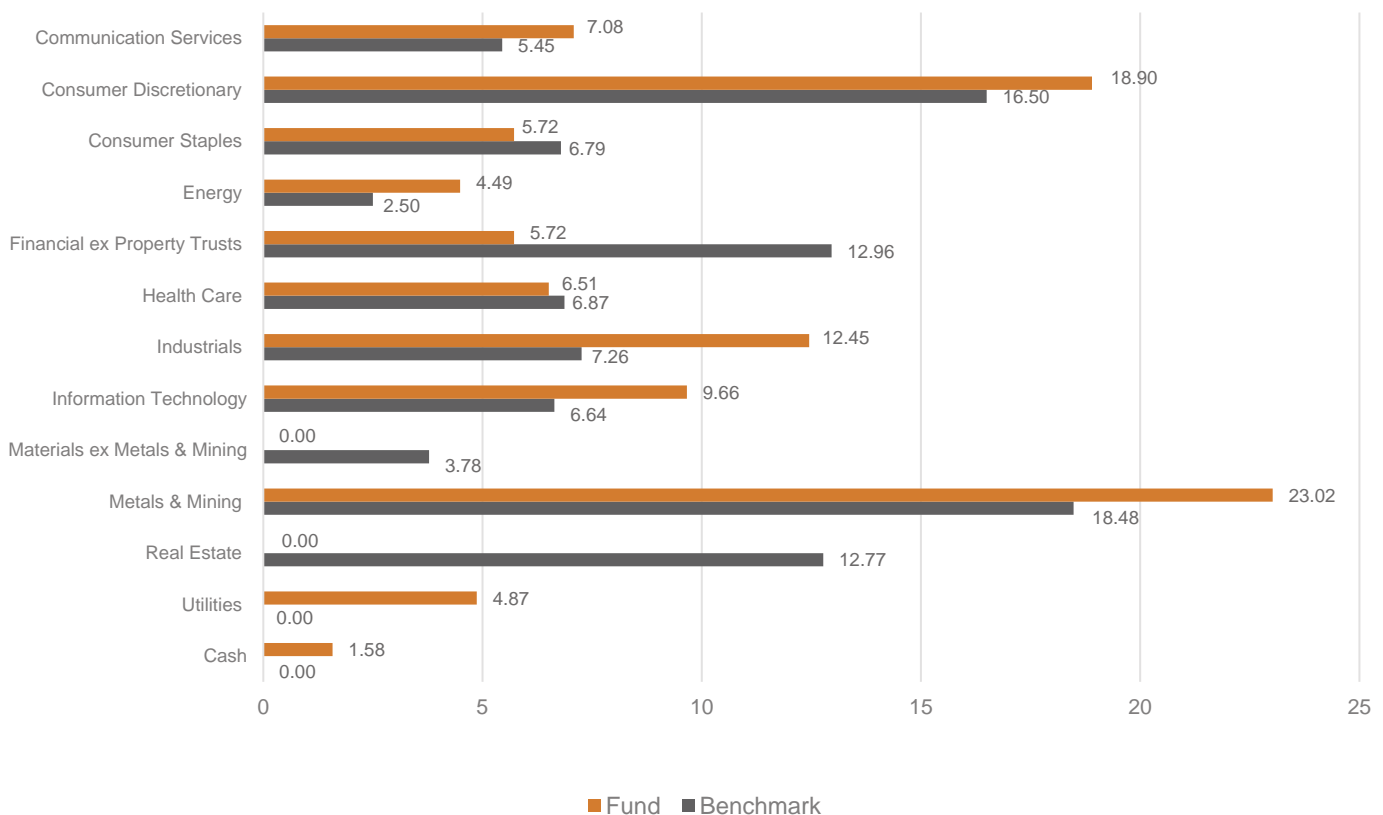
Past performance is not indicative of future performance. Net performance figures are calculated using exit prices, net of fees and reflect the annual reinvestment of distribution. Returns are rounded to two decimal places. Slight variations to actual calculations may occur.

¹This figure represents the annualised performance of the Fund since inception.

CONTACT DETAILS

T.1800 034 402 | E. Client.Services@ironbarkam.com | W. www.ironbarkam.com

Sector asset allocation (%)



Market review

Global markets were boosted by a pro-cyclical rotation during the December quarter that was inspired by the US election and positive vaccine developments. Domestically, an interest rate cut, the implementation of yield curve control, and a \$100 billion quantitative easing program also laid the groundwork for an impressive 13.79% return for the broad-based S&P/ASX 300 Index. The Small Ordinaries gained a similar 13.83%.

Steadily easing restrictions allowed the domestic economy to bounce out of recession after GDP rose 3.3% in the September quarter, the strongest quarterly growth rate since March 1976. The quarterly rebound steered the year-on-year contraction to 3.8%, up from negative 6.4% in the June quarter.

Reserve Bank of Australia governor Philip Lowe told a Parliamentary committee that fiscal stimulus had played a “critical role” in supporting the economy through the pandemic and he now expected unemployment to peak between 7% and 8% with employment levels during the quarter running only 1.7% below pre-pandemic levels. Even so, the Reserve Bank of Australia cut interest rates from 0.25% to 0.1% at its November meeting and launched a \$100 billion bond-buying program in response to “high unemployment and subdued inflation for an extended period”. The Board noted that the cash rate would not be lifted until inflation is “sustainably” back within the bank’s 2-3% target range.

Commodity price movements during the quarter were overwhelmingly positive and skewed to re-opening sentiment. Iron ore (up 34%) rose to levels last seen in 2014 following robust China demand and Vale lowering output forecasts for the third time in 2020. Oil (WTI up 25%, Brent up 27%) gained on expectations of a demand recovery and OPEC-led supply restrictions. Industrial metals were all stronger for the quarter with copper (up 18%), nickel (up 14%), aluminium (up 12%), zinc (up 13%) all appreciating. The gold price was flat in US dollar terms and down 7% on a rising Australian dollar.

Performance review

The Ironbark Karara Australian Small Companies Fund returned 8.31% (net) for the quarter, an underperformance of 5.52% when compared to the S&P/ASX Small Ordinaries Accumulation Index return of 13.83% for the quarter.

Performance review (continued)

The strongest contributors to Fund performance at a sector level were overweight positions in utilities, information technology and consumer discretionary. An underweight position in real estate also benefitted. An overweight position in metals & mining and an underweight position in financials ex property trusts were the largest detractors from relative performance.

At a stock level, positive contributors to quarterly performance included overweight positions in Mineral Resources, Meridan Energy, Mercury NZ and EML Payments. Not holding Regis Resources also contributed to relative performance.

Mineral Resources shares gained 50%, outpacing the 34% rise in the iron ore price and a flattening in the lithium price. The company outlined plans to grow its iron-ore business significantly over the next three to five years at its annual meeting. The current operations at Koolyanobbing (13 million tonnes per annum) and Iron Valley (8 million tonnes per annum) will continue to provide base production load, while new hubs at Ashburton (25 million tonnes per annum) and the Southwest Creek (40 million tonnes per annum) both set to be developed. Recent issues with iron ore supply out of Brazil have supported the strong iron ore price in recent months, after Vale was forced to cut iron ore production for the third time in 2020 due to heavy rains and licence delays.

Meridan shares gained 55% and Mercury NZ added 33% due in part to the New Zealand Labour Party's push to delay the closure of Rio Tinto's Tiwai Point aluminium smelter by three to five years. In the case of Meridan, the strong share price performance was also most likely driven by strong ETF buying with the iShares Global Clean Energy ETF holding adding 19 million Metgasco shares during the quarter.

EML Payments shares rose 47% as a beneficiary of the recovery trade on COVID 19 vaccine news and expectations that gift, and incentive volumes would recover over the Christmas period in-line with shopping mall foot traffic.

The largest detractors from monthly performance included overweight positions in Saracen Minerals, Silverlake Resources and Austal. The US dollar gold price was flat over the quarter despite a combination of momentum-selling and ETF liquidation in response to vaccine developments, sending Saracen shares down 8% and Silverlake shares down 22%. While gold ETF holdings appear to be down 3.5 million ounces from their 111 million ounces high two months ago.

Austal shares fell 19% after the company's annual meeting provided 2021 financial year earnings before interest and tax guidance of \$125 million, a little below consensus, impacted by reduced throughput and a stronger Australian dollar. Austal has typically been conservative in setting guidance and the investment manager recalls FY20 guidance was upgraded to greater than \$110m in February this year before being upgraded again to greater than \$125m in June before coming in at \$130m.

Market outlook

The approval of multiple vaccines foreshadows the resolution of the health crisis should allow a sustainable economic reopening in most of the developed world by mid-2021. Despite inevitable logistical hiccups in their rollout, as the growth sapping and distortive lockdown measures are unwound the global economic recovery should gain pace in 2021. As vaccination programs accelerate this should help markets to work through the near-term resurgence of the COVID 19 virus and its impact on short term economic activity.

COVID 19 has rewritten the rules of public policy with fiscal and monetary policies now effectively co-joined. This will have consequences that will endure beyond the pandemic. Interest rates will remain suppressed by central banks while governments (and voters) no longer seem fussed by government budget constraints. The investment manager expects policy support will continue to underwrite economic activity, but this will come with implications for inflation and economic growth.

The investment manager is seeing evidence of upward price pressure in several industries (and commodities) already, driven by precautionary inventory building, rebounding demand which are outstripping the ability to supply. This is still beyond the market's horizon with price pressures well within central bank's higher tolerances and while large quantities of fresh liquidity continuing to be added. This continues to bode well for hard assets relative to financials with strong growth in the monetary base and low interest rates impacting on financial margins.

The US Federal Reserve has rejected yield curve control, and so it is hard to imagine nominal interest rates staying as low as the market currently expects. The investment manager believes forward rates may eventually adjust higher once the cyclical upturn broadens, the output gap narrows and the level of incremental liquidity injected is pared back. As economies recover the reflation trade should build and shorter duration assets (value) should do better relative to longer ones (growth) supported by a rebound in corporate profits, especially in industries where demand has been suppressed.

While the backdrop is supportive of equities, particularly relative to bonds, the sharp recovery in equity markets is feeding increased and broadening speculation. In the investment manager's assessment, this has resulted in prices that are far beyond any likely improvement in fundamentals for most of the current market favourites. Further, aggregate industrial company valuations are at heights that have been seen very rarely, and from which extended bear markets have always followed.

For many companies that have far surpassed pre-COVID 19 highs, global markets anticipate the step-change in digital migration will be sustained and extended. In some instances, this may turn out to be warranted. But locally there are few plays that have the sustainable competitive advantage that has enabled the FAANG (Facebook, Amazon, Apple, Netflix, Google) phenomenon seen in the US.

Market outlook (continued)

Just as in 1999, there a wide and dangerous consensus has built that valuations in some areas are impossible to square with fundamentals, but also that it has further to run. This is drawing in fresh investors in search of quick returns but also a valuation dispersion of historically epic proportions.

The emergence of some corporate activity among the value sector in the December quarter, the investment manager thinks, is a broader manifestation of investor impatience with lower growth companies in a difficult operating environment. An arbitrage has opened in earnings yields versus the cost of money for corporates, activist investors, or financial sponsors. Although the Fund has seen some small benefit from this so far, the investment manager sees this as a matter of time if management are not able to aggressively address under valuation directly.

Despite the re-emergence of hotspots in December, Australia is better positioned than most developed countries in the medium term. Unemployment has not reached the peaks expected, stimulus is fuelling a recovery and house prices are recovering strongly. The outlook is underpinned by relatively low levels of public debt, strength of its commodity income base, and inbound migration, which will likely return in due course as the fundamental attraction to live here has likely only been strengthened as a result of its handling of the pandemic.

The Fund remains positioned for normalisation of activity globally and holds a range of companies that have yet to price a proper recovery despite strong performance through the shutdowns, lowered costs and stronger balance sheets. Included in this category are a range of COVID 19 impacted stocks that provide a levered play on value. The impact of COVID 19 and associated policy responses has accelerated structural change in a number of industries and this in turn, has led to a number of new and exciting companies seeking to IPO, further broadening the investment manager's opportunity universe.

Despite the market rebound and risks noted above, the investment manager still sees opportunities arising to build positions in quality companies at attractive prices. As seen after the GFC, substantial returns are on offer when companies can transition from fears of declining growth or short-term earnings risk, back to a profile that the market is prepared to construe as sustainable steady growth.

Issued by Ironbark Asset Management (Fund Services) Limited ABN 63 116 232 154 AFSL 298626 ('Ironbark'). Ironbark is the responsible entity for the Fund(s) referred to in this document. The relevant offer document is available from www.ironbarkam.com/our-funds/ or by calling Ironbark on 1800 034 402. You should consider the offer document before making an investment decision to acquire or to continue to hold units in the Fund. Ironbark and its representatives believe that the information in this document is correct at the time of compilation, but no warranty of accuracy or reliability is given and no responsibility arising in any other way for errors or omissions (including responsibility to any person due to negligence) is accepted by Ironbark. This document contains general information only and is not intended to represent specific investment or professional advice. The information does not take into account an individual's financial circumstances. Past performance is not indicative of future performance. All currency references are shown in Australian dollars unless stated otherwise. All indices are copyrighted by and proprietary to the issuer of the index.

CONTACT DETAILS

T.1800 034 402 | E. Client.Services@ironbarkam.com | W. www.ironbarkam.com