

UBS Australian Share Fund

May 2023

Fund description

The Fund is an actively managed fund investing in a portfolio of 30–70 listed Australian equity securities listed on the Australian Securities exchange.

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 objective

The Fund aims to outperform (after management costs) the S&P/ASX 300 Accumulation Index over rolling five-year periods.

Active security positions

Overweight	Underweight
Reliance Worldwide Corp. Ltd.	CSL Limited
Worley Limited	National Australia Bank Limited
QBE Insurance Group Limited	Macquarie Group, Ltd.
Origin Energy Limited	Wesfarmers Limited
United Malt Group Ltd.	Woolworths Group Ltd

Active industry positions

Overweight	Underweight
Software & Services	Banks
Capital Goods	Pharmaceuticals Biotechnology & Life Sciences
Media & Entertainment	Consumer Staples Distribution & Retail
Telecommunication Services	Financial Services
Insurance	Equity Real Estate Investment Trusts (REITs)

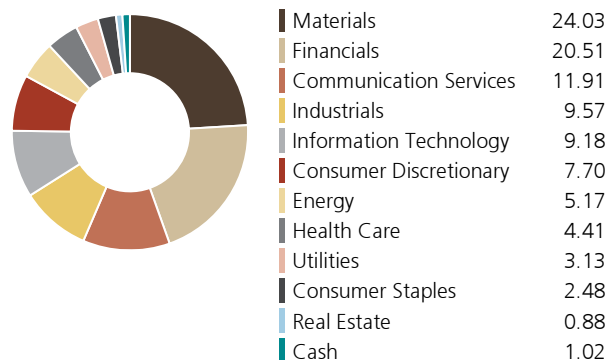
Fund information[^]

Inception date	15 July 1992
Fund size	\$ 236.2m
Management fee*	0.80% pa
Minimum initial investment	\$ 50,000
Typical number of holdings	30 to 70
Distributions	Semi-annually
Buy/sell spread	+/- 0.25%
APIR code	SBC0817AU

[^] The UBS Yarra Australian Share Fund has been renamed the UBS Australian Share Fund, effective as at 9 November 2022.

* The management fees and costs for the fund have been reduced from 0.90% p.a. to 0.80% p.a effective as at 9 November 2022.

Fund positioning (%)



Investment performance

Fund	1 month %	3 months %	1 year %	3 years % pa	5 years % pa	Since inception* % pa
Total return	(1.57)	3.16	9.83	14.59	6.86	9.62
Benchmark**	(2.53)	(0.96)	2.37	11.33	7.42	9.18
Added Value	0.96	4.12	7.46	3.26	(0.56)	0.44

* The UBS Asset Management price/value equities process was adopted on 1 April 1996.

** S&P/ASX 300 Accumulation Index. All Ordinaries Accumulation Index prior to June 2000.

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.

Performance/attribution comments

After fees and expenses, the Portfolio declined by -1.57% during the month, outperforming its benchmark by 96 bps.

The largest positive contributors were Xero (XRO), NextDC (NXT) and Worley (WOR). The online accounting software provider Xero outperformed following the announcement of a strong result, with subscribers and revenues in line with expectations and EBITDA ahead of estimates. Following the previous month's largest ever individual contract announcement, data centre provider NEXTDC continued to outperform with the market's conviction in Artificial Intelligence (AI) applications as a driver of demand grew. Worley also rallied in the month, with leading indicators (Factored Sales Pipeline +36%, Rolling 12 Month Bookings +28%, Backlog +8%) and structural drivers pointing to strong top-line growth.

The largest negative contributors were CSL (CSL), Tyro Payments (TYR) and Sandfire Resources (SFR). Globally focused biotechnology company CSL was a detractor as it outperformed, despite the challenging outlook for blood plasma economics which include elevated non-donor fee cost inflation, increased competition, adverse relative product growth rates and product substitution risk in the longer run. Domestic payments provider Tyro underperformed after prolonged takeover negotiations came to an end. Sandfire Resources was a negative contributor, despite achieving an important milestone through the first concentrate production at the Motheo project in Namibia, as copper prices declined by about 5% to close out the month at US\$3.68/lb.

Market review

Australian equities market performance fell in May, with nearly every sector delivering negative returns, while the 10-year bond rate rose to 3.6% on the resumption of cash rate hikes.

The S&P/ASX 300 Accumulation Index generated -2.5% for the month, taking its 12-month performance to +2.4% and mirroring the S&P/ASX 200 Accumulation index, which also returned -2.5%. On the global scale, the MSCI World Index returned -0.9%.

Information Technology (+9.7%) was the top performing sector during the month, which was led by Xero (XRO, +17.8%). Other notable stocks within the IT services space were NEXTDC (NXT, +11.8%) and Megaport (MP1, +21.1%).

Utilities (+1.1%) was another sector that delivered a positive return for the period. The return was driven by AGL (AGL, +13.1%) with the market becoming increasingly comfortable with the electricity generator and energy retailer's near-term earnings outlook, supported by higher wholesale electricity costs.

By contrast, Consumer Discretionary (-6.1%) was the worst performer with many retailers impacted due to increasing interest rates curtailing discretionary spending. One of the primary contributors to the sector's negative return was Wesfarmers (WES, -8.3%) following the CEO's announcement that he anticipates tougher months ahead as household costs continue to rise.

Consumer Staples (-4.6%) and Materials (-4.4%) also detracted from the index performance. The main contributors to negative returns in Consumer Staples were Woolworths (WOW, -3.3%) and Treasury Wine Estates (TWE, -16.6%). Within Materials sector, which saw a decline in pricing of Brent oil, iron ore, copper and gold during the period (the Bloomberg Commodity Index was down by 6.1%), BHP (BHP, -5.36%), Newcrest Mining (NCM, -11.2%), and Fortescue Metals (FMG, -8.2%) were among the largest detractors.

Outlook

We have been of the view that the June quarter 2023 will mark the top of the interest cycle for most of the developed world, however, global central banks are seemingly prepared to continue hiking interest rates despite evidence inflation is moderating, lending availability tightened and economic growth is faltering. With respect to the latter, we have received confirmation that the Euro Area entered recession and the Federal Reserve staff have retained their forecast that a modest recession in the US is likely. Nevertheless, it seems the appetite for policy makers to persist with the tightening cycle into Q3 has remained, with central bankers seemingly perplexed at why services inflation has yet to ease and why the labour market has yet to ease appreciably. It is possible that a pause in the hiking cycle in June by the Fed will set the scene for a pause across most of the developed world, however, the risk of overtightening and even weaker economic activity is now a real prospect. We believe the US labour market is set to post more modest employment gains from mid-23 which in concert with improving labour supply will continue to moderate wage growth and help underwrite the commencement of a gradual easing cycle in the US by the end of 2023. However, we have to acknowledge that the message from most central banks is that further hikes may be required and an interest rate easing cycle is not in prospect.

This weak economic growth narrative in concert with enthusiasm over the potential impacts from AI has seen large cap 'growth' stocks drive a narrow but strong equity market rally. This has largely hidden from view an ongoing negative earnings revision cycle which in concert with rising bond yields is leaving aggregate markets valuations looking more challenging.

Economic growth has also slowed in Australia, recording just 0.3%qoq growth in the March quarter and much of this growth can merely be traced to strong population growth and ongoing engineering construction projects. It is clear the prior tightening of monetary policy is having a material impact on the interest rate sensitive parts of the economy. Nominal retail sales have slowed to 0% six-month annualised, following on from declining volumes in recent quarters. Building approvals continue to decline and are likely to decline further in coming months as declining housing affordability outweighs the impact of an under supplied housing market. Moreover, it is also clear that despite the Federal Budget forecast to return to surplus, that government demand growth is waning even faster than private demand growth.

Nevertheless, after describing the May decision to increase interest rates as finally balanced, the Reserve Bank of Australia (RBA) followed up with a further hike in June and has flagged that further tightening may be required. The RBA has clearly shifted its focus to worrying about weak productivity growth and high unit labour costs as the main reason for fearing inflation may be higher than it forecasts. We think this ignores the fact that average compensation per hour has not risen sharply, and the main reason for high unit labour costs is a surge in hours worked and employment as the influx in immigration is absorbed into a slowing economy. This shift in the RBA's focus risks a further hike in July or August, however, in our view the RBA would have been better served to pause after the May rate hike, rather than risking a harder economic landing.

Australia should still be able to avoid a technical recession due to four key reasons:

- 1) Australia has been a net beneficiary of global commodity shortages and the prior surge in commodity prices. Commodity prices are now off their peaks, and although they remain very elevated from a historical perspective, the impact of moving through the peak will be for nominal GDP growth will slow quickly over the next 6 months, removing some of the cushion that has protected corporate profits, tax receipts and wage growth.
- 2) The household sector continues to hold a significant buffer of excess savings which can be used to smooth consumption growth amid acute cost of living pressures. Nevertheless, our analysis suggests that the residual of the savings buffer skews to older households, leaving younger and more indebted households exposed. As such we remain particularly cautious on discretionary retail spending.
- 3) Australia remains incredibly well placed to benefit from the global energy transition. Lithium is already a A\$10bn export industry for Australia and Australia is the world's dominant producer. Electric Vehicle sales are forecast to increase 10 times by 2030 and Australia has the world's 2nd largest copper resource. LNG is an important energy transition fuel, and currently accounts for 23% of global electricity generation. Australia just happens to be the world's equal largest exporter of LNG. The limiting factor nearer term is that escalating costs and project delays risk pushing out the economic benefits.
- 4) Net migration into Australia contracted in 2021 for the first time since 1945. However, a very strong recovery was recorded through 2022 and a record level of net migration has occurred in recent months, ensuring that Australia's population growth will exceed 2% in 2023. This will be the primary mechanism keeping Australia out of recession, yet it comes with the complication of exacerbating the rental shortage evident across all capital cities.

While the RBA has been later than most other developed nations we believe financial conditions are now firmly in the restrictive zone. From our perspective, the RBA's focus on global growth, trends in household spending and the outlook for inflation and labour markets in informing their future decisions suggest that multiple additional hikes are unlikely to be required. Surprisingly, the RBA cited the A\$ and house prices as a catalyst for the May rate hike, neither of which had risen materially. While interest rate hikes in Australia will remain a month-to-month proposition for the next six months, our bias is that the RBA should have concluded its hiking cycle yet an ever-shifting RBA framework suggest they may hike again in July or August. It is unlikely that policy easing will be delivered in 2023, however, we do expect that the RBA will commence a modest easing cycle in 1H24.

The A\$/US\$ had been under downward pressure as markets grappled with a seemingly more hawkish Fed and a relatively more dovish RBA. However, the RBA has recently sounded more hawkish than the Fed the A\$ has started to appreciate. With Australia's external accounts remaining in excellent health, our expectation that Australia's economic growth will prove more robust, and the prospect the US\$ down trend will persist as the Fed pivots from its hiking strategy to an easing cycle in 2023, we expect the A\$/US\$ will appreciate to the mid-70s towards the end of 2023.

We are most overweight stocks within the Communication Services, Information Technology and Industrials sectors and are underweight Financials, Health Care and Real Estate.

Client Services

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