

# UBS Australian Share Fund

July 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.

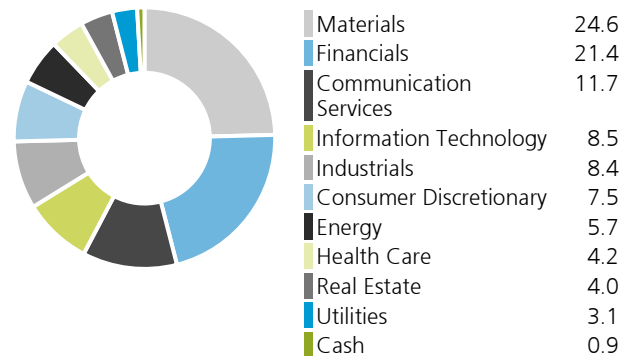
## Fund information<sup>^</sup>

Inception date	15 July 1992
Fund size	\$ 237.4m
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

<sup>^</sup> 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.

## Sector allocation (%)



## Active security positions

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

## Active industry positions

Overweight	Underweight
Software & Services	Banks
Capital Goods	Pharmaceuticals Biotechnology & Life Sciences
Media & Entertainment	Financial Services
Telecommunication Services	Consumer Staples Distribution & Retail
Insurance	Commercial & Professional Services

## Investment performance

Fund	1 month %	3 months %	1 year %	2 years % pa	3 years % pa	5 years % pa	Since inception* % pa
Total return	2.95	2.46	18.25	7.28	15.01	6.88	9.71
Benchmark**	2.89	2.03	11.09	4.18	11.91	7.45	9.29
<b>Added Value</b>	<b>0.06</b>	<b>0.43</b>	<b>7.16</b>	<b>3.10</b>	<b>3.10</b>	<b>(0.57)</b>	<b>0.42</b>

\* 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.

## Portfolio performance

After fees and expenses, the Portfolio increased by 2.95% during the month, outperforming its benchmark by 6 bps.

The largest positive contributors were CSL, United Malt and Sandfire Resources. Biotechnology company CSL outperformed in July following the pre-release of earnings guidance in June which fell below market expectation (around 10% lower than consensus for group FY24 NPATA). United Malt outperformed during the month after European bidder Malteries Soufflet signed a binding deal to buy United Malt at \$5.00 per share (a +45% premium to the undisturbed priced) following an extensive period of due diligence. Copper producer Sandfire Resources outperformed after posting a 13% quarterly production increase at its MATSA copper operations in Spain to achieve a total annual production of 99kt.

The largest negative contributors were Iluka Resources, National Australia Bank and Tabcorp. Iluka Resources underperformed after confirming it expects softer demand in 2H23 despite a robust June quarterly production report. The weaker outlook was also highlighted by competitor Tronox, further fueling market concerns. Our underweight to National Australia Bank was a detractor for the month as NAB benefitted from the market pricing in a higher probability of a soft landing and interest rates remaining higher for longer. Northern Star underperformed following a mixed June quarterly report; the gold producer had a strong quarter but FY24 production guidance was 8% below market expectations.

## Market review

Australian equities rose in the month of July with almost every sector delivering positive returns. The RBA held the cash rate at 4.1% given inflation figures had eased for the second quarter.

The S&P/ASX 300 Accumulation Index returned 2.9% for the month, taking its 12-month performance to +11.1%. Similarly, the S&P/ASX 200 Accumulation index generated a return of +2.9% for the month. Globally, the MSCI World Index rose by 3.4%.

Energy (+8.4%) sector was the strongest sector for the month, Woodside Energy (WDS, +10.3%) was a key contributor to the sector return. Despite a weak Q2 2023 update, Woodside shares still gained as the Brent crude oil price rose by ~14% (closed at US\$85/barrel). Another notable stock that also benefitted from the commodity's gain was Santos (STO, +5.9%).

July month also saw the Financials (+4.9%) sector continuing its upwards movement from the prior month. Within the sector, Commonwealth Bank (CBA, +5.4%), NAB (NAB, +7.8%), ANZ (ANZ, +8.6%) and Westpac (WBC, +4.7%) were among the top contributors. The bank subsector performed well during the month as the market began to place a higher probability on a soft landing and interest rates to remain higher for a longer period.

Conversely, Health Care (-1.5%) was one of the only 2 sectors that closed in the red for the month. The lagging sector return can be mainly attributed to CSL (CSL, -3.2%) as the stock underperformed following the pre-release of lower-than-expected earnings guidance in June (~10% lower than consensus for group FY24 NPATA).

## Outlook

With the major central banks declaring that further interest rates are now data dependent and as evidence continues to accumulate that inflation continues to moderate, our long-held view that mid-2023 would mark the top of the interest rate cycle appears to be broadly on track. Crucially, both labour markets and core services inflation have eased in recent months and forward indicators suggest further progress should be made through the rest of 2023.

As a consequence, interest rate futures have been quick to price 125 bps of easing in the US through 2024, albeit interest rate futures in most other major economies have merely removed multiple rate hike expectations and adopted a flatter profile through 2024 around current levels rather than actively embedding interest rate reductions.

Moreover, the pessimistic tone of the economic activity data in the US that threatened a technical recession has given way to slightly more update data in recent weeks encouraging the belief that the US will escape a technical recession in 2023. Indeed, some leading indicators are suggesting that a broader turn in the global industrial cycle is at hand, which should encourage a rotation from a narrow mega-cap tech led equity market rally to broader participation in 2023.

While negative EPS revisions are likely to persist for several more months, a levelling out in economic momentum and an end to the interest rate tightening cycle will likely provide a shift from bearish equity positioning. Rising bond yields continue to provide the more significant challenge to equity market valuations, albeit the lift in bond yields into mid-2023 can mostly be attributed to a significant lift in the supply of US bonds as the US budget deficit continues to increase sharply, thereby providing a counter cyclical boost to economic growth.

Economic growth has also slowed in Australia, recording just 0.3% q/q growth in the March quarter, with much of this growth able to be traced merely 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 fall 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, government demand growth is waning even faster than private demand growth.

Nevertheless, the good news is that after a pause in the tightening cycle in July, The Reserve Bank of Australia (RBA) remained on hold in August and flagged that future monetary policy adjustments will be data dependent. To be clear, the RBA retains a tightening bias, however an update of their inflation forecasts now has inflation returning to inside the target band in 2025, providing a signal that absent any unexpected inflation shocks the RBA's rate tightening cycle is complete. The RBA also revised down economic growth modestly to just 1.0% in 2023, acknowledging that local economic growth had faltered.

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 six 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 domestically 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 second largest copper resource. LNG is an important energy transition fuel – it currently accounts for 23% of global electricity generation – and 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. 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. 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 early 2024, we expect the A\$/US\$ will appreciate to the mid-70s towards mid-2024.

We are most overweight stocks within the Communication Services, Information Technology and Utilities sectors and are underweight Financials, Health Care, and Consumer Staples.

## Client Services

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