

UBS Australian Small Companies Fund

October 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
BWP Trust	Chorus
Nanosonics	Technology One
Auckland International Airport	NIB Holdings
AUB Group	Seven Group Holdings
Pinnacle Investment Management Group	Charter Hall Long WALE REIT

Active industry positions

Overweight	Underweight
Transportation	Materials
Health Care Equipment & Services	Retailing
Insurance	Energy
Diversified Financials	Real Estate
Media & Entertainment	Pharmaceuticals Biotechnology & Life Sciences

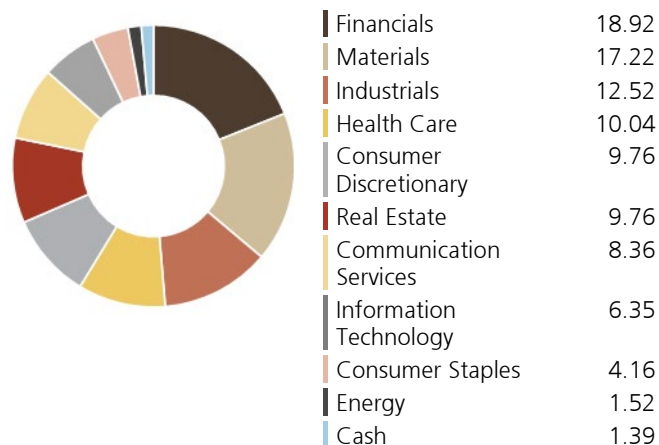
Fund information[^]

Inception date	31 March 2004
Fund size	\$ 107.5 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%
APIR code	UBS0004AU

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

* The performance fee equals 20% of the amount by which the Fund outperforms the S&P/ASX Small Ordinaries Accumulation Index.

Fund positioning (%)



Top 5 stocks (%)

BWP Trust	4.56
AUB Group	4.19
Auckland International Airport	4.02
Nanosonics	3.87
Pinnacle Investment Management Group	3.84

Investment performance

Fund	1 month %	3 months %	1 year % pa	3 years % pa	5 years % pa	Since inception* % pa
Total return	2.52	(5.75)	(17.50)	4.85	8.38	11.52
Benchmark**	6.46	(4.91)	(18.31)	1.46	4.16	5.33
Added Value	(3.94)	(0.84)	0.81	3.39	4.22	6.19

*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 2.52% during the month, underperforming its benchmark by 394 bps.

The largest positive contributors were Nanosonics, NIB Holdings (not held) and Flight Centre. Nanosonics outperformed during the period as the business continues to perform well with consumables sales growth resuming, increasing penetration and strong double digit revenue growth. The NIB Holdings stock price came under pressure following its \$315mn equity raising (at 8% discount to close price) to fund its entry into the Australia National Disability Insurance Scheme as a plan manager. Flight Centre outperformed as its Leisure division (40% of pre-COVID EBIT) continues to benefit from pent-up travel demand, with improved margins after a material reduction in the cost base.

The largest negative contributors were Megaport, 29Metals and Cooper Energy. Megaport underperformed after a weaker than expected September quarterly result across customer volume metrics and higher than expected capex. 29Metals also underperformed after announcing a softer than expected September quarter production report. Cooper Energy declined following its recent equity raising to fund the acquisition of the Orbost gas plant from APA Group.

Market review

Australian equities rallied sharply during October, following the 6.2% decline in September.

The S&P/ASX Small Ordinaries Index returned 6.5% for the month, taking its 12-month return to -18.%. In comparison, the broader ASX300 gained 6% for the month and global indices notched up strong gains in October (MSCI World Index, +7.2%).

Within Health Care (+12.3%), the Australian Health Care sector was the largest contributor led by Polynovo (PNV, 53.8%), Telix Pharmaceuticals (TLX, +46.5%) and Mesoblast (MSB, +18.6%).

Real Estate was a strong performer (+11.6%) as investors were attracted to the sector trading materially below asset backing following recent underperformance, led by National Storage REIT (NSR, 17.0%), Arena REIT (ARF, 18.0%) Unibail-Rodamco-Westfield CDI (URW, 19.9%).

Conversely, the weakest performing sector was Financials (+2.8%), with investors remaining pessimistic on the industry across a range of issues, indicating they anticipate long term growth rates will be lower than they have historically. Notable positive contributions from HUB24 (HUB, +21.5%), Omni Bridgeway (OBL, +19.6%) were partially offset by negative performance from Eclixp Group (ECX, -16.4%).

Outlook

Financial markets have now embraced the risk of recession in the US and Europe, and the gap between our more pessimistic forecasts for the global economy and the consensus has narrowed. Indeed, with the Fed signalling that financial conditions are close to neutral, we are edging closer to the point where the pace of monetary tightening will slow, providing some scope for risk markets to recover some lost ground.

The period of excess inflation is starting to recede, with prior surges in commodity prices retreating, an easing in supply constraints, and signs of slowing demand likely to compress elevated sales margins. As central banks continue to await firmer signs that inflation expectations have stabilised and for labour demand to ease, financial markets are faced with the positive news of less restrictive monetary policy and the negative news of likely weaker company earnings.

In a world of heightened concerns of recession in major developed economies, subdued economic activity in China and ongoing conflict between Russia and the Ukraine which has contributed to commodity shortages, high inflation and rising interest rates, the Australian economy presents as a relative safe haven.

Australia's economic data has remained robust in 1H2022, although we do expect economic activity to slow significantly in 2023 to average just 1.5%. While a local recession is possible in 2023, we believe Australia should be able to avoid a technical recession due to three key reasons:

1. Australia has been a net beneficiary of global commodity shortages. This surge in commodity prices saw Australia's export prices in A\$ terms move to their highest levels since the 1880s in 1H2022. The consequence has been strong national income growth, profits growth and an improving underlying fiscal position.
2. The household sector continues to hold a significant buffer of over \$160bn of excess savings relative to pre-COVID levels. Although we expect the impact of higher interest rates and higher living expenses will curtail consumer spending, we do expect the combination of rising wage growth and a run down in the level of savings to continue to support consumption spending.
3. Low levels of spare productive capacity, strong profit and low corporate debt have contributed to robust capital investment intentions.

Over the medium term we believe a recovery in net immigration levels into Australia and Australia's exposure to key commodities crucial to the global energy transition will provide a solid underpin for future economic growth.

While the RBA has been later than most other developed nations in tightening policy, tighter financial conditions in 2022 have come via both significantly higher cash rates, higher government bond yields and wider corporate bond spreads. We expect that the RBA cash rate will finish the year at 3.10%, which we expect will mark the peak for the RBA, well below market expectations of a 4.0% peak in 2H23. The A\$/US\$ has been particularly weak in recent weeks, albeit on a TWI basis the A\$ has been broadly stable. With Australia's external accounts are in their best position since the early 1970s and the prospect the US\$ uptrend will peak as the Fed pivots from its aggressive hiking strategy we expect the A\$/US\$ will appreciate to the mid-70s by end-2023.

We are most overweight stocks within the Financials, Industrials and Health Care sectors and are most underweight Materials, Consumer Discretionary and Energy.

Client Services

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