UBS Asset Management
For Professional / Qualified / Institutional Investors only
All data as at 31 January 2023

UBS Australian Small Companies Fund

January 2023

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
Pinnacle Investment Mgmt. Group	Technology One
Nanosonics	NIB Holdings Ltd
Auckland International Airport	Seven Group Holdings
BWP Trust	Chorus
AUB Group	Pro Medicus

Active industry positions

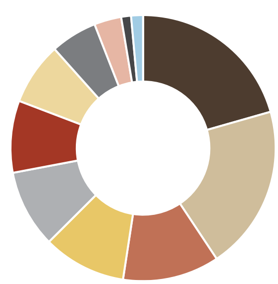
Overweight	Underweight
Transportation	Materials
Health Care Equipment & Services	Energy
Diversified Financials	Retailing
Insurance	Real Estate
Media & Entertainment	Pharmaceuticals Biotechnology & Life Sciences

Fund information^

Inception date	31 March 2004
Fund size	$ 120.1m
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 (%)



Financials	20.59
Materials	20.04
Industrials	11.79
Health Care	10.14
Consumer Discretionary	9.46
Real Estate	8.75
Communication Services	7.59
Information Technology	5.67
Consumer Staples	3.31
Energy	1.20
Cash	1.45

Top 5 stocks

Name	Portfolio Weight (%)
Pinnacle Investment Management Group	4.65
Nanosonics	4.20
AUB Group	4.16
Auckland International Airport	4.13
BWP Trust	4.04

Investment performance

Fund	1 month %	3 months %	1 year %	3 years % pa	5 years % pa	Since inception* % pa
Total return	5.50	7.89	(4.96)	6.67	8.48	11.81
Benchmark**	6.56	7.64	(4.44)	2.41	4.35	5.67
Added Value	**(1.06)**	**0.25**	**(0.52)**	**4.26**	**4.13**	**6.14**

* 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 performance

After fees and expenses, the Portfolio increased by 5.50% during the month, underperforming its benchmark by 106 bps.

The largest positive contributors were Pinnacle Investments (PNI), Sims (SGM) and Sandfire Resources (SFR). Pinnacle Investments outperformed during the period despite no material company news, although higher equity markets (supporting higher funds under management) were supportive to earnings during the period. Our position in scrap and metals recycling company Sims contributed positively during the period. Scrap steel margins are improving following a period of significant moderation from historical highs and are positioned to strengthen further, in our view. Sandfire Resources was a positive contributor, with copper prices increasing ~10% over the month to close at US$4.17/lb on expectations that the re-opening of China post COVID-zero would support copper demand.

The largest negative contributors were Infomedia (IFM), Megaport (MP1) and Gold Road (GOR). Infomedia underperformed during the period despite no material company news, although this is a part reversal of outperformance during December. Megaport underperformed after a weaker than expected December quarterly result across key volume metrics such as new customer numbers. We believe these volume trends will improve going forward as execution improves, new distribution channels mature and macroeconomic headwinds moderate. Our position in Gold Road was a negative contributor during January, despite the gold price rising 3% to US$1,928/oz at month end. The company reported weak production for the December quarter, however the driver was an extended shutdown at its Gruyere mill and in our view is not symptomatic of longer-term issues.

Market review

The S&P/ASX Small Ordinaries Index returned +6.6% for the month, taking its 12-month return to -4.4%. The broader ASX300 also produced positive gains of +6.5% for the month, as did global indices (MSCI World Index +7.0%).

All sectors delivered positive returns for the month, with Consumer Discretionary (+11.2%) the best performing sector, led by Kogan (KGN, +28.6%), Collins Food (CKF, +11.6%) and Corporate Travel Management (CTD, 24.6%), with consumer spending patterns remaining resilient during the holiday season.

Health Care (+8.4%) was also a strong performer during the month, with the sector buoyed by Nanosonics (NAN, +12.6%), Pro Medicus (PNE, +21.0%) and Polynovo (PNV, +24.3%).

Conversely, Industrials (+3.1%) delivered a mixed bag performance during the period, with the shipbuilder Austal (ASB, -20.2%) sliding after halving its earning guidance for the year. Transportation, conversely, made a strong comeback, supported by Auckland International Airport (AIA, +4.9%) and Dalrymple Bay Infrastructure (DBI, +2.1%).

Outlook

Financial market enthusiasm at the commencement of 2023 has been stoked by three key forces; signs globally that the period of excess inflation is starting to recede, an acceleration in the trend decline in the US$ which is helping to ease the contraction in global credit, and the expected impetus from "China's reopening" post is movement away from COVID zero. Each of these factors helps to diminish the risk of a harder landing for global growth and marginally increase the probability that a formal global recession may be avoided.

Importantly, the long-awaited pivot from major central banks appears to have been delayed until labour markets show more convincing signs of easing and the inflation down trend more assured. On balance, we still believe the US and Europe will enter a modest recession in 1H23 and inflation dynamics will change sufficiently for policy makers to conclude that the monetary policy is sufficiently restrictive to halt the tightening cycle in coming months.

We continue to argue that Australia presents as a safe haven from both the perspective of more robust growth relative to the G7 peer group and as having good leverage to signs of a trough in the economic cycle in China. Although both the RBA and we expect economic activity to slow significantly in 2023 to average just 1.5%, we believe Australia should be able to avoid a technical recession due to four 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 and even though commodity prices are now off their peaks they remain very elevated from a historical perspective. The consequence has been strong national income growth, profits growth and an improving underlying fiscal position. Indeed, the Commonwealth Budget will likely be close to surplus for the 2023 financial year.

2) The household sector continues to hold a significant buffer of over $270bn 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) 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 10x by 2030 and Australia has the world's 2nd largest copper resource. LNG is an

important energy transition fuel, and currently accounting for 23% of global electricity generation. Australia just happens to be the world's equal largest exporter of LNG. Iron ore obviously remains Australia's biggest export and China the dominant customer. However, we expect the global energy transition to be steel intensive, opening up new customers.

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 appears likely in coming months, ensuring that Australia's population growth will be close to 2% in 2023.

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. Following the February rate hike of 25 bps, we believe financial conditions are now in the restrictive zone and the RBA is now close to the finish of the tightening cycle.

Nevertheless, following the February hike its clear the RBA is retaining the option of delivering two or more further rate hikes. 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. Interest rate hikes in Australia will remain a month-to-month proposition for the next six months, however, our bias is that just one further 25 bps hike is likely to be delivered this cycle.

The A$/US$ has finally started to appreciate, after a long period of relative weakness. 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 aggressive hiking strategy, we expect the A$/US$ will appreciate to the mid-70s by mid-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

Telephone: (03) 9046 4041 Freecall: 1800 572 018 Email: ubs@unitregistry.com.au www.ubs.com/am-australia

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