

UBS Microcap Fund

November 2022

Fund description

The Fund is an actively managed fund investing in a portfolio of 35 to 65 predominantly Australian Microcap equity securities across a range on 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 Microcap shares that are believed to be undervalued by the market, based on an assessment of the companies' future cash flows. Normally the Fund will hold between 35–65 stocks in companies with a market capitalisation of generally less than \$250m at the time of initial purchase. The Portfolio Manager searches for businesses that have exposure to growing markets or are benefiting from changes in market structure and are in a rapid growth phase of their life cycle.

Investment return 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
Monash IVF Group	Technology One
Ridley Corporation	Liontown Resources
Supply Network	NIB Holdings
Lycopodium	Chorus
RPMGlobal Holdings	Seven Group Holdings

Active industry positions

Overweight	Underweight
Capital Goods	Materials
Software & Services	Real Estate
Health Care Equipment & Services	Energy
Food Beverage & Tobacco	Diversified Financials
Transportation	Telecommunication Services

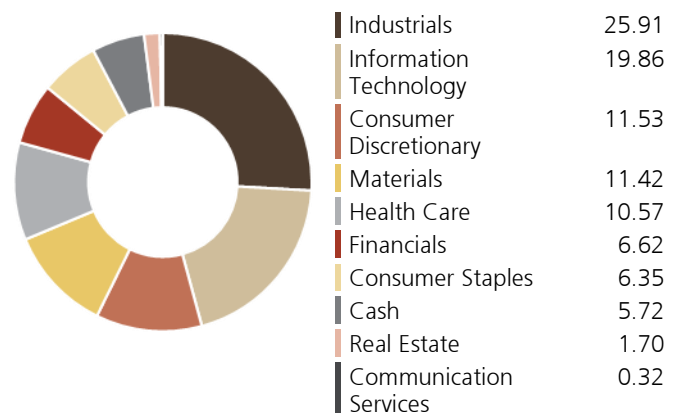
Fund information[^]

Inception date	12 August 2014
Fund size	\$ 59.1m
Management fee	1.20% pa
Performance fee*	Yes
Minimum initial investment	\$ 50,000
Typical number of holdings	35 to 65
Distributions	Semi-annually
Buy/sell spread	+/- 0.50%
APIR code	UBS0057AU

[^]The UBS Yarra Microcap Fund has been renamed the UBS Microcap 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 (%)



Investment performance

Fund	1 month %	3 months %	1 year %	3 years % pa	5 years % pa	Since inception* % pa
Total return	2.42	(4.67)	(17.31)	6.69	10.20	12.69
Benchmark**	4.92	(0.81)	(14.03)	2.57	4.36	6.49
Added Value	(2.50)	(3.86)	(3.28)	4.12	5.84	6.20

* Inception date: 12 August 2014.

** 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 2.42% during the month, underperforming its benchmark by 251 bps.

The largest positive contributors were Supply Network, SmartPay and Janison Education. Supply Network rallied on the back of a trading update highlighting 1H23 revenue guidance of \$116-\$118m and NPAT of \$12-\$12.5m. SmartPay provided an impressive update confirming that over the prior six months, terminal market share had grown 1.1% from 3.9% to 5.0%. Janison Education continued to trade higher on the back of media speculation regarding possible corporate activity, appointing E&P Corporate Advisory to assist with evaluating approaches from third parties.

The largest negative contributors were Ridley Corporation, GR Engineering and RPM Global. Ridley Corporation was sold off despite the company reaffirming its outlook, with 1H23 EBITDA expected to improve on the prior corresponding period. GR Engineering disappointed the market, providing a revenue forecast of \$500-\$530m for FY23, a significant reduction on FY22 revenue of \$652m. Finally, RPM Global traded lower after rallying on reaffirmed guidance in the prior month.

Market review

Australian equities delivered another month of strong performance, gaining a further 6.6% in November following the 6.0% recovery in October.

The S&P/ASX Small Ordinaries Index returned +4.9% for the month, taking its 12-month return to -14.0%. The broader ASX300 also produced positive gains of 6.5% for the month, as did global indices (MSCI World Index +7.0%).

Materials (+16.3%) was the strongest performing sector in November, with notable returns reflected across the Metals and Mining constituents namely Bellevue Gold (BGL, +48.7%), Sandfire Resources Limited (SFR, +45.2%) and Champion Iron (CIA, +39.0%) being some of the key highlights for the month.

Within Financials (+5.1%), Insurance provided positive returns through the likes of AUB Group (AUB, +11.6%) and NIB Holdings (NHF, +9.5%), as did the small-to-medium enterprise lender Judo Capital Holding (JDO, +18.4%) which reflected superior returns in contrast to the performance of the Big Four banks for the month.

The worst performing sector was Consumer Staples (-1.3%) with Costa Group Holdings (CGC, +3.9%) being largely outweighed by Elders (ELD, -18.4%) and Select Harvests (SHV, -17.3%), resulting in agricultural products being the largest contributor to negative sector performance.

Outlook

Financial markets have now embraced the risk of recession in the US and Europe over the past quarter, and the gap between our more pessimistic forecasts for the global economy and the consensus has narrowed. Indeed, with markets anticipating the end of the Fed tightening cycle may be at hand, financial conditions have eased considerably in the US as credit spreads narrowed, the equity market rallied strongly in October and November and the US\$ declined.

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 in the first three quarters of 2022, 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 \$260bn 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.

In 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. Following the December rate hike of 25bps we believe the RBA is now very close to the finish of the tightening cycle. Officially we expect a final 15bps hike in February. Indeed, we believe the RBA inflation forecasts will likely be downgraded slightly in February 2023 which will be used to put a full stop to the current rate tightening 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 be more robust than its peers 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 mid-2023.

Client Services

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