

UBS Microcap Fund

December 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 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	NIB Holdings
Ridley Corporation	Technology One
Supply Network	Chorus
Lycopodium	New Hope Corporation
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

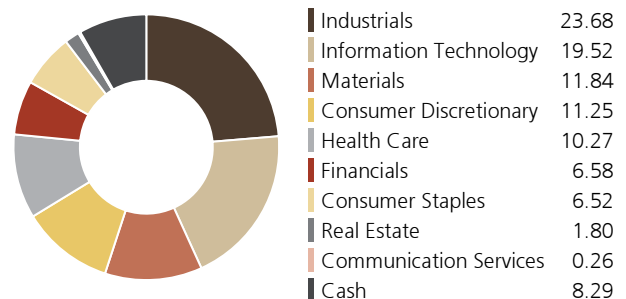
Fund information[^]

Inception date	12 August 2014
Fund size	\$ 57.5m
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. 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	(1.51)	1.12	(20.02)	5.90	8.87	12.35
Benchmark**	(3.73)	7.54	(18.38)	1.38	2.92	5.94
Added Value	2.22	(6.42)	(1.64)	4.52	5.95	6.41

* 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 performance

After fees and expenses, the Portfolio declined by 1.51% during the month, outperforming its benchmark by 222 bps.

The largest positive contributors were Liontown Resources (not held) fell on the back of a softer underlying lithium price following new concerns around the longer-term demand outlook, with weaker than expected electric vehicle sales in China. XRF Scientific traded higher despite no new company specific news post their positive Investor update in August. Lunnon Metals provided impressive drilling results at their Warren site, hitting their best intercept yet of 7.48m @ 4.46% Ni. The discovery was significant given it opens up a new exploration region that was not historically considered prospective.

The largest negative contributors were Calidus Resources, Champion Iron (not Held) and Chalice Mining (not held). Calidus Resources was sold off following after suboptimal blasting and mining practices caused lower mill throughput and temporary water shortages. Champion Iron rallied on the back of a stronger underlying iron ore price. Chalice Mining rose after announcing a delay to its scoping study until they had released an updated mineral resource estimate following new metallurgical testing relating to the Julimar deposit.

Market review

Australian equities returned -3.2% during December, with all sectors ending the month in the red.

The S&P/ASX Small Ordinaries Accumulation Index returned -3.7% for the month, taking its 12-month return to -18.4%. In comparison, the broader ASX300 declined 3.3% for the month and, globally, the MSCI World Index fell by 4.2%.

The worst performing sectors were Information Technology (-5.5%) and Consumer Discretionary (-5.4%). Notable stocks within the sectors are Life360 (360, -22.2%), Tyro Payments (TYR, -19.4%), City Chic Collective (CCX, -40.2%) and Eagers Automotive (APE, -11.5%).

Elsewhere, Health Care (-4.8%) declined during the month despite no major news. Some notable declines were Australian Clinical Labs (ACL, -12.1%), Nanosonics (NAN, -9.5%) and Pro Medicus (PME, -7.0%).

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 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 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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