

UBS Microcap Fund

January 2023

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 Ltd	Technology One
Ridley Corporation	NIB Holdings Ltd
Supply Network	Seven Group Holdings
Lycopodium	Chorus
GR Engineering Services Ltd	New Hope Corporation

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

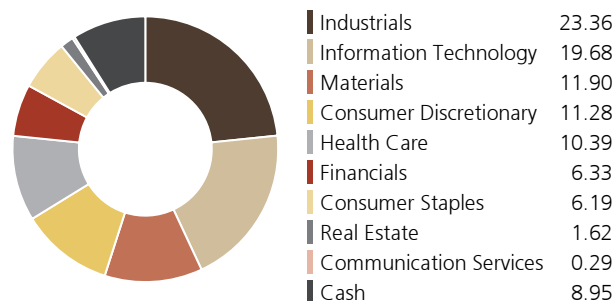
Fund information[^]

Inception date	12 August 2014
Fund size	\$ 59.2m
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	1.92	2.81	(13.39)	5.77	9.61	12.47
Benchmark**	6.56	7.64	(4.44)	2.41	4.35	6.67
Added Value	(4.64)	(4.83)	(8.95)	3.36	5.26	5.80

* 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 increased by 1.92% during the month, underperforming its benchmark by 464 bps.

The largest positive contributors were Smartpay, Codan and New Hope (Not Held). SmartPay provided an impressive trading update, confirming that total consolidated revenue had increased by 60% (y/y), with total transactions processed up 76%. Codan rallied on the back of a trading update which highlighted expectations of revenue hitting the top end of guidance, with NPAT likely to beat guidance at \$31m for 1H23. New Hope traded lower on the back of a weaker underlying coal price, which fell to recent lows of ~US\$260/t during the month.

The largest negative contributors were RPM Global, Ridley Corporation and Praemium. RPM Global traded lower on no new company specific news. Similarly, Ridley Corporation was modestly sold off after hitting all-time highs in recent months. Lastly, Praemium provided their 1H23 update confirming net flows of \$1,016m which was 53% below the prior corresponding period, highlighting challenging market conditions and putting them on course to be well below FY23 guidance (~\$2.9bn).

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.

Client Services

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

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