

# UBS Microcap Fund

March 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                 | Liontown Resources Limited   |
| Alliance Aviation Services Limited   | Seven Group Holdings Limited |
| Lycopodium Limited                   | Chorus Limited               |
| Generation Development Group Limited | Perseus Mining Limited       |
| XRF Scientific Limited               | Pro Medicus Limited          |

## Active industry positions

| Overweight                       | Underweight                                  |
|----------------------------------|----------------------------------------------|
| Capital Goods                    | Materials                                    |
| Software & Services              | Equity Real Estate Investment Trusts (REITs) |
| Retailing                        | Financial Services                           |
| Health Care Equipment & Services | Consumer Discretionary Distribution & Retail |
| Insurance                        | Energy                                       |

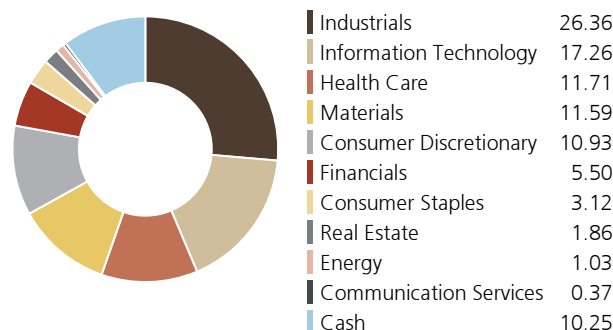
## Fund information<sup>^</sup>

|                              |                |
|------------------------------|----------------|
| Inception date               | 12 August 2014 |
| Fund size                    | \$ 45.8m       |
| Management fee               | 1.20% pa       |
| Performance fee <sup>*</sup> | Yes            |
| Minimum initial investment   | \$ 50,000      |
| Typical number of holdings   | 35 to 65       |
| Distributions                | Semi-annually  |
| Buy/sell spread              | +/- 0.50%      |
| APIR code                    | UBS0057AU      |

<sup>^</sup> The UBS Yarra Microcap Fund has been renamed the UBS Microcap Fund, effective as at 9 November 2022.

<sup>\*</sup> 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<br>%  | 3 months<br>% | 1 year<br>%   | 3 years<br>% pa | 5 years<br>% pa | Since inception*<br>% pa |
|--------------------|---------------|---------------|---------------|-----------------|-----------------|--------------------------|
| Total return       | (2.25)        | 0.39          | (14.51)       | 21.06           | 9.66            | 12.02                    |
| Benchmark**        | (0.72)        | 1.88          | (13.19)       | 13.15           | 3.89            | 5.99                     |
| <b>Added Value</b> | <b>(1.53)</b> | <b>(1.49)</b> | <b>(1.32)</b> | <b>7.91</b>     | <b>5.77</b>     | <b>6.03</b>              |

\* 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 2.25% during the month, underperforming its benchmark by 153 bps.

The largest positive contributors were Monash IVF, NextEd Group and Mincor Resources. Reproductive and fertility services group Monash IVF traded higher on no stock specific news. Education business NextEd Group reached all-time highs as the market digested their stella 1H23 result, with record revenues of \$43.6m (up 239% on pcp) and EBITDA of \$6.6m (up 403% on pcp). Mincor Resources was subject to an on-market takeover bid from Andrew Forrest's Wyloo Metals at \$1.40/share representing a 35% premium to the last closing price of \$1.04.

The largest negative contributors were Liontown Resources (not held), Janison Education and GR Engineering Services. Liontown Resources (not held) received a non-binding indicative proposal from Albemarle Corporation at \$2.50/share. Janison Education was removed from the All-Ordinaries index which saw selling by passive index funds, further weighing on the share price. GR Engineering Services traded lower after paying a \$0.09 dividend for the half year.

## Market review

Australian equities returned -0.2% during March. The Australian 10-year bond yield decreased by 56bps, whilst the AUD/USD depreciated by -0.7%.

The S&P/ASX Small Ordinaries Accumulation Index returned -0.7% for the month, taking its 12-month return to -13.2%. In comparison, the broader ASX300 declined -0.2% for the month and, globally, the MSCI World Index gained by +3.2%.

Health Care (+7.0%) was the top performing sector during the period with Healius (HLS, +15.0%) rising following a proposed merger with Australian Clinical Labs (ACL). Neuren Pharmaceuticals (NEU, +84.2%) surged to a \$1bn valuation post approval of its drug by the FDA.

The Metals and Mining sector (+6.4%) was a positive contributor during the month, with gold producers benefiting from a surge in the gold price due to uncertainty over financial conditions, led by Northern Star Resources (NST, +20.0%) and Evolution (EVN, +14.7%). Liontown (LTR, +89.7%) was subject to a takeover offer from US-listed lithium producer Albermarle Corporation.

Conversely, the weakest performing sector was Financials (-7.9%), with majority of the asset management companies negatively correlated with market performance. Notable movers were Insignia Financials (IFL, -13.6%) and Pinnacle Investments (PNI, -13.4%).

## Outlook

The June quarter 2023 will mark the top of the interest cycle for most of the developed world. With ongoing evidence of inflation moderating, tightening in lending availability and downgrades accumulating for economic growth, including the Federal Reserve staff formally forecasting a modest recession in the US, the appetite for policy makers to persist with the tightening cycle is rapidly evaporating. Although the Fed may choose to hike in May, the decline in headline inflation has returned real interest rates to zero and our nowcasting for US economic growth continues to suggest the US has been contracting modestly since late 2022. We believe the US labour market is set to post more modest employment gains in 2Q23 which in concert with improving labour supply will continue to moderate wage growth and help underwrite the commencement of a gradual easing cycle in the US from September 2023.

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 1H22, 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. Albeit we remain particularly cautious on discretionary retail spending, given most of the excess savings can be traced to older and wealthier households.
- 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 10 times by 2030 and Australia has the world's 2nd largest copper resource. LNG is an

important energy transition fuel, and currently accounts 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 will 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 Reserve Bank of Australia (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 and March rate hikes 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. Importantly, it is clear the RBA is now openly considering pausing the hiking cycle. 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 the last hike has likely been delivered this cycle. It is unlikely that policy easing will be delivered in 2023, however, we do expect that the RBA will commence an easing modest easing cycle in 1H24.

The A\$/US\$ has been under downward pressure as markets grappled with a seemingly more hawkish Fed and a relatively more dovish RBA. Nevertheless, both central banks are in the concluding phases of the tightening cycle. 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 to an easing cycle in 2023, we expect the A\$/US\$ will appreciate to the mid-70s through 2H CY23.

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

## Client Services

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