

UBS Australian Small Companies SIV Fund

March 2024

Fund description

The Fund is an actively managed fund investing in a portfolio of 30–90 Australian small company equity securities across a range of industry sectors, designed with the objective of meeting the Australian Department of Immigration and Border Protection's Significant Investor Visa ('SIV') requirements as a 'managed investment fund' investing in 'emerging companies investments'.

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 30–90 stocks in companies with a market capitalisation of generally less than \$500m (at the time of initial purchase), which are selected for inclusion in the portfolio after a rigorous investment process.

Investment objective

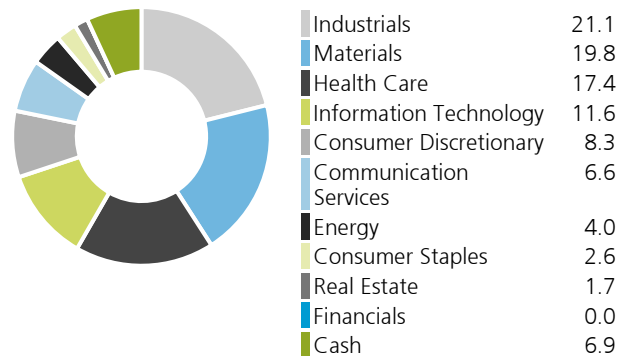
The Fund aims to outperform (after management costs) the S&P/ASX Small Ordinaries Accumulation Index over rolling five year periods.

Fund information

Inception date	28 August 2015
Fund size	\$ 68.3m
Management fee	0.85% pa
Performance fee*	Yes
Minimum initial investment	\$ 500,000
Typical number of holdings	30 to 90
Distributions	Quarterly
Buy/sell spread	+/- 0.45%

* The performance fee equals 20% of the amount by which the Fund outperforms the S&P/ASX Small Ordinaries Accumulation Index.

Sector allocation (%)



Top 5 stocks

Name	Portfolio Weight (%)
Metals X Limited	4.35
Lycopodium Limited	4.26
RPMGlobal Holdings Ltd	4.25
Superloop Ltd.	4.15
Coventry Group Limited	3.94

Active security positions

Overweight	Underweight
Metals X Limited	CSR Limited
Lycopodium Limited	Paladin Energy Ltd
RPMGlobal Holdings Ltd	Sandfire Resources Ltd
Superloop Ltd.	Viva Energy Group Ltd.
Coventry Group Limited	Telix Pharmaceuticals Ltd.

Active industry positions

Overweight	Underweight
Capital Goods	Financial Services
Health Care Equipment & Services	Equity Real Estate Investment Trusts (REITs)
Software & Services	Consumer Discretionary Distribution & Retail
Pharmaceuticals Biotechnology & Life Sciences	Materials
Retailing	Real Estate

Investment performance

Fund	1 month %	3 months %	1 year %	2 years % pa	3 years % pa	5 years % pa	Since inception* % pa
Total return	5.79	5.20	12.80	(6.64)	2.23	10.08	7.89
Benchmark**	4.79	7.55	13.83	(0.60)	2.71	5.42	8.46
Added Value	1.00	(2.35)	(1.03)	(6.04)	(0.48)	4.66	(0.57)

* Inception date: 28 August 2015.

** 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 5.79% during the month, outperforming its benchmark by 100 bps.

The largest positive contributors were Superloop, Metals X and Botanix Pharmaceuticals. Telecommunications services provider Superloop traded higher after announcing a landmark agreement with Origin Energy to provide wholesale internet services to its subscriber base, expected to add \$19m in annualised EBITDA. Botanix Pharmaceuticals traded higher as FDA approval for their novel drug Sofdra neared, with commercial activities accelerating for launch. Tin producer Metals X announced the undertaking of an on-market share buyback to acquire up to 10% of the company's issued capital.

The largest negative contributors were Clover Corporation, Empire Energy and Life360 (not held). Clover Corporation released a disappointing 1H Fy24 result experiencing continued challenges in the infant formula market with revenue down 39% to \$27.3m resulting in a net loss of \$0.6m. Empire Energy traded lower with the underlying commodity price with Natural gas falling from highs of US\$2.1/MMBtu to a low of US\$1.7/MMBtu during the month. Life360 (not held) rallied after a substantial CY23 EBITDA beat, coming in 29% above top end of guidance in conjunction with the announcement to monetise non-paying active users.

Market review

The Australian small caps market was positive for the month of March.

The S&P/ASX Small Ordinaries Index returned +4.8% return for the month, taking its 12-month return to +13.8%. As a comparison, the broader S&P/ASX 300 Accumulation Index generated a +3.3% return, and globally, the MSCI World Index jumped by 3.0%.

Materials (+6.7%) was the best performing sector, with Sandfire resources (SFR, +17.1%) leading the gains. The copper producer was a positive contributor with the copper price increasing by ~4.5% during the month. Other positive contributors were Perseus Mining (PRU, +23.3%) and Alumina (AWC, +16.4%).

Real Estate (+6.6%) was also a significant contributor to March performance as the RBA have signaled that interest rates have peaked. The outperformance was across the sector, with Arena REIT (ARF, +17.1%), National Storage REIT (NSR, +6.2%) and Region Group (RGN, +7.2%) leading the gains.

In contrast, Communication Services (-2.8%) was the worst performing sector. Aussie Broadband (ABB, -21.3%) declined as it announced their agreement to provide telecommunication services to Origin Energy customers was terminated. Other detractors to the benchmark included Chorus (CNU, -3.7%) and Spark New Zealand (SPK, -4.4%).

Market outlook

The Australian equity market returned a very solid 3.3% in March, completing a 5.3% gain for the March quarter – the strongest March quarter since 2019. In concert with the rally of late 2023 the ASX200 has delivered a six-month annualised return of 14%. Despite the strong performance in large caps, small capitalisation stocks outperformed, returning 4.8% in March and 7.5% for the quarter. The standouts in the month were REITS which have returned 9.2% in March and 16.6% CYTD and gold which returned 9.1% in March and 8.1% CYTD. The laggards in March were alternative assets and the Australian dollar.

Optimism continues to be driven by financial markets becoming increasingly convinced that central banks are now preparing to ease interest rates from mid-2024.

Good news on inflation has also been met with signs of economic resilience. Although Europe continues to toy with a technical recession, the strength of the recovery in Emerging Market industrial production bodes well for a recovery in European demand in 2024, and indeed survey evidence suggests a recovery in European demand has commenced. This strength in Emerging Market growth has largely been in spite of China rather than because of China. Nevertheless, the bout disinflation in China has largely run its course and economic data has become more mixed/positive rather than universally poor. We continue to expect China to deliver on a more meaningful infrastructure package in 2024 and further encourage credit expansion to the real economy which should underpin economic growth around 5% in 2024 – a target that the Chinese government also adopted in recent weeks. As such we expect China to begin to provide a more meaningful support to global economic growth as we move through 2024.

Turning to Australia's prospects despite a weak finish for economic growth in 2023 – expanding just 0.2%qoq and 1.5%yoy - we continue to suggest that not only will Australia avoid a recession it will likely accelerate sequentially through 2024 with the improving global backdrop acting as a tailwind. No one should be disputing that 2023 likely felt like a recession for many Australians.

A per capita recession and a negative income shock for those with high debt and young families has cascaded into weak discretionary spending as high interest rates coalesced with surging insurance, utilities, rates, education and food prices. Nevertheless, economic growth was held up by several unusual features this economic cycle vis-à-vis prior cycles;

1. **Commodities.** Prior commodity price strength continued to underwrite double digit nominal economic growth and profitability.
2. **Backlogs.** Much has been made of the backlog of work in housing construction that has nullified the typical cyclical shock that is transmitted via the housing construction sector during rate hiking cycles. Approvals and affordability are at very poor levels yet the level of home building has barely declined at all. The backlog in work yet to be done is now peaking at a very high level suggesting we shouldn't be looking at the housing sector as a source of new economic growth, but equally we shouldn't be expecting a precipitous collapse in 2024. That may come in 2025 if interest rates remain at current levels, but that is not our expectation. But less has been made of the backlogs in non-residential building (led by offices, warehouses, health and transport) which equates to 7% of GDP and the backlog of engineering construction (led by roads, railways, electricity and mining which equates to 16% of GDP. This enormous backlog of work has kept upward pressure on the labour market and on input prices at a time when typically a global slow down would have seen investment tumble between 10-15%.
3. **Buffers and Asset prices.** Newly indebted households without other forms of income producing assets feel the full force of rate hikes. However, the economy wide impact of interest rates is diluted the more that growth in income producing assets outstrip the growth in debt. The rising trend in net household assets as a share of income over time means that income from term deposits, financial assets and investment property ownership have all risen over time and all produce an income stream which even after 13 rate hikes this cycle is still in excess of the rise in interest payments on the outstanding debt. This explains the bifurcated nature of spending growth. Older asset rich households are largely impervious to the rate hikes and as such luxury spending categories remain strong whereas younger indebted households cashflow has turned negative and spending is being seriously challenged. In aggregate a rate hike pack less of punch compared to prior cycles but the young and indebted are taking a disproportioned beating.

4. **Population pump priming.** Net immigration has surged well through government projections taking population growth close to 2.5%yoy growth in 2H23. Quite simply, it is very hard to record a recession with that type of population growth at your back. We do expect net migration to slow in 2024 as the government seeks to tighten up some education programs and entitlements, yet the risk remains that the flood of people entering Australia surprises on the upside until a more material rise in the unemployment rate is realised.

In 2024 some additional factors are worth noting that support a more positive outlook into 2024 and beyond.

1. **Commodity prices are rising again.** A falling USD and stronger global demand has seen commodity prices rising in Q4 which will provide a fillip for profits, tax revenue and nominal economic growth.
2. **Fiscal support and tax cuts.** Despite a change to the details of the Stage 3 income tax cuts, the package is equivalent to 1.0% of disposable income. In conjunction with the Federal Budget in surplus, the RBA rate cycle likely complete and an election looming in 2025 it is likely that additional fiscal support will be announced in 1H24 to support lower and middle income households.
3. **Inflation moderation to drive rate cuts.** We expect inflation to move into the top of the RBA target band before the end of 2024, setting up the prospect of the RBA easing in August and again in November 2024. While we are expecting a shallow rate easing cycle it will likely come earlier than most expect and importantly the RBA has renewed firepower to drive a more powerful economic recovery should inflation surprise on the downside.
4. **Capex intentions have lifted.** We were pleasantly surprised to see that the ABS measure of investment intentions rose through 2H23 and now suggests business investment will rise 10% in 2023-24 – well above the RBA's 1-2% forecast. Indeed, not only has business investment been robust, there are signs it is accelerating.

As a consequence, we are relatively optimistic on the outlook for the Australian economy and constructive on the equity market outlook for 2024. We expect economic growth to average 2.25% v a consensus forecast of 1.5%, bond yields to finish the year at 4.0%, the \$A/\$US to reach 74c, and Australian equities to return 10% in large caps and 15% in small caps. We are most overweight stocks in the Financials, Industrials and Information Technology sectors, and are underweight Consumer Discretionary, Energy and Materials.

Client Services

www.ubs.com/am-australia

Telephone: (03) 9046 4041

Freecall: 1800 572 018

Email: ubs@unitregistry.com.au

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