Portfolio report

UBS Microcap Fund
Australia Equity Micro Cap
Client report from 01.04.2024 to 30.06.2024

Performance Comments

After fees and expenses, the Portfolio increased by 7.63% during the quarter, outperforming its benchmark by 1209 bps.

The largest positive contributors were Southern Cross Electrical Engineering, Generation Development Group and RPM Global. Southern Cross Electrical Engineering was awarded a $160m contract for the Collie battery energy storage system in Western Australia and subsequently upgraded guidance to achieve at least $48m in EBITDA over FY25. Generation Development rallied after acquiring the remaining 61.9% stake in fund research and rating provider Lonsec, raising $155.4m in new equity. RPM Global continued to rally after the announcement to extend their on-market share buy-back for an additional 5% of shares on issue over the 12 month period from 14th June 2024.

The largest negative contributors were Telix Pharmaceuticals (not held), PeopleIn and Life 360 (not held). Radiopharmaceutical company Telix (not held) outperformed due to strong growth in their core product, Illuccix taking market share against its main competitor, Lantheus' Pylarify. Human resourcing firm PeopleIn continued to trade lower given expectations that unemployment will increase near term, creating a difficult operating environment. Life360 (not held) rallied after reporting a strong March quarter result boasting a 31% increase in monthly average users to 66.4m whilst maintaining their calendar revenue year guidance of $365-$375m.

% Return (Net)	Fund	Benchmark*	Difference
3 months	7.63	(4.46)	12.09
1 years	13.35	9.34	4.01
3 years	2.52	(1.54)	4.06
5 years	12.52	3.70	8.82
Calendar Year to Date	12.20	2.75	9.45
Since inception (08/14)	12.38	6.11	6.27

* 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.

Source: UBS Asset Management. These figures refer to the past. Past performance is not a reliable indicator of future results.

Stock Contributors & Detractors (%)

Company name	Return	Contribution	Over / underweight
Southern Cross Electrical Engineering	67.96	1.88	OW
Generation Development	27.22	1.38	OW
RPMGlobal	29.86	1.34	OW
Botanix Pharmaceuticals	53.33	1.18	OW
Pantoro	52.38	0.84	OW
Total of top 5 contributors		**6.62**	
MaxiPARTS	(17.99)	(0.30)	OW
Alumina	19.37	(0.31)	UW
Life360	25.06	(0.32)	UW
Peoplein	(26.36)	(0.35)	OW
Telix Pharmaceuticals	44.69	(0.72)	UW
Total of top 5 detractors		**(2.00)**	

Note: Position at quarter-end, which may be different to the position during the quarter.

Portfolio Positioning

Active Positions by Industry Group (%)

Top 5 Overweights		Top 5 Underweights	
Capital Goods	12.11	Equity Real Estate Investment Trusts (Reits)	(10.59)
Software & Services	7.04	Financial Services	(6.82)
Insurance	4.19	Materials	(5.77)
Health Care Equipment & Services	3.98	Consumer Services	(4.60)
Transportation	1.83	Consumer Discretionary Distribution & Retail	(3.65)

Active Positions by Stock (%)

Top 5 Overweights		Top 5 Underweights	
Generation Development	5.47	Telix Pharmaceuticals	(2.14)
RPMGlobal Holdings	4.47	Sandfire Resources	(1.61)
Southern Cross Electrical Engineering	4.32	Alumina	(1.61)
Lycopodium	3.64	Webjet	(1.41)
Pantoro	3.43	Life360	(1.38)

Note: Position at quarter-end, which may be different to the position during the quarter.

Market review

The Australian small caps market weakened during the second quarter of 2024.

The S&P/ASX Small Ordinaries Index returned -4.5% return for the quarter, taking its 12-month return to +9.3%. As a comparison, the broader S&P/ASX 300 Accumulation Index generated a -1.2% return, and globally, the MSCI World Index jumped by 2.2%.

Healthcare (+11.3%) was the main sector contributor with Telix Pharmaceuticals (TLX, +44.7%) the primary driver of outperformance. The biotech company rallied during the quarter on the back of positive drug trials for prostate cancer treatment. Other positive contributors included Mesoblast (MSB, +78.4%) and Polynovo (PNV, +11.9%).

In contrast, Consumer Discretionary (-11.7%) was the worst performing sector during the quarter with underperformance stemming from across the sector. Cettire (CTT, -71.1%) was a notable detractor following a trading update in June which was significantly below market expectations while Eagers Automotive (APE, -25.7%) saw their share price fall during the period following weak 1H results. Other detractors included Corporate Travel Management (CTD, -22.0%) and Super Retail Group (SUL, -13.4%).

The Real Estate (-5.6%) sector also fell as the prospect of a rate hike in August increased following higher than anticipated CPI results in June. Charter Hall Long WALE REIT (CLW, -13.2%), Centuria Industrial REIT (CIP, -13.9%) and Region Group (RGN, -9.2%) all detracted during the quarter.

Outlook & strategy

The 2023-24 financial year is now complete and concludes what we have broadly labelled the "hope" phase for financial markets – an environment where equities rally via PE expansion rather than via earnings growth. It's now time for the individual stocks to deliver on those growth expectations, which typically is a bumpier experience for markets. In broad terms, it was a good financial year for markets. A 20% return for global equity markets, regardless of whether you bothered to hedge or not, was only just eclipsed by a 21% return from gold, thanks in part to central bank buying. REITs returned a solid 17%, commodities rose a respectable 15%, and although it was a weaker finish to the financial year the AS200 returned an above average 12% - the same return generated by alternative assets. In contrast, Australian fixed interest returned 3.7% and global bonds a paltry 0.9%.

We adopted a top-down pro-risk stance heading into Q4 2023, in part because we expected consensus to lift their economic growth forecasts, lower their inflation forecasts and for interest rates to commence declining across the major economies from mid-2024. Interest rate reductions in Sweden, Switzerland, Canada and the Euro Area are likely to be met with the Bank of England likely easing in August and we believe the Fed will commence its easing cycle in September. All of this is good news, however, there is now less of a gap between our long held more optimist views on global growth and the consensus. There are also signs that the positive momentum for global economic growth is starting to falter. Broadly, we think most of the good news we have been flagging is now largely imbedded in market pricing and we are somewhat uncomfortable with the narrow nature of the equity rally and what promises to be a drawn out and we think ultimately demoralising US election campaign. In short, we are expecting that transitioning from the more thematic driven "hope" phase of the cycle to the more stock specific mid-cycle phase for financial markets will not come without some growing pains in Q3 2024.

Turning to Australia, a recession has been avoided, yet Australia continues to operate near stall speed. GDP increased just 0.1%qoq taking the annual rate to 1.1%yoy. Excluding COVID this is the slowest annual rate of growth in 32 years. GDP per capita declined 0.4%qoq – the 4th consecutive decline - taking the annual rate to negative 1.3%yoy. This is the worst contraction since December quarter 1991 excluding the COVID period, and this measure has only expanded once in the past 7 quarters. No one should be disputing that the past 12 months likely felt like a recession for many Australians.

The Reserve Bank of Australia (RBA) is caught between a relatively weak economy and persistent wage growth and consumer inflation, nevertheless, the RBA should be buoyed by signs that the decline in productivity appears to have passed and wage pressures appear to have peaked. With respect to the latter, the 3.75% increase in awards, compared to the 5.75% in 2023, will help expedite an easing in wage pressures through 2H2024.

Australia, like many of its developed nation peers, also printed above consensus inflation in 1Q and the volatile monthly CPI measure points to high and persistent inflation in 2Q. However, we believe the upside surprise in Australia's CPI overstates the real-time price pressures. Much of the upside came via government administered prices, which tend to reflect where inflation was in the prior year rather than current cost pressures, and the prevalence of residual seasonality in inflation pressures at the start of the calendar year. Traded goods prices are trending lower and once administered prices are removed, private sector services prices are expanding at an inflation target consistent pace. While we can't rule out the RBA choosing to hike again in August, we remain of the view that inflation will finish 2024 inside the RBA's target band of 2-3% and the RBA will commence a modest easing cycle for interest rates in 4Q 2024.

Against this moderation in inflationary pressure we expect economic growth to accelerate sequentially through 2024, albeit remaining well below 'potential' growth. We expect the upswing in global industrial production to provide a tailwind for Australian economic growth. Rising capex intentions in concert with investment backlogs should support business investment growth and the consumer outlook should be supported by a recovery in real household income growth driven by ongoing wage growth, income tax cuts, cost of living support delivered in the Budget and the commencement of the rate easing cycle later in 2024.

As a consequence, we are relatively constructive on the outlook for the Australian economy and the equity market outlook for 2024-25, even if there are some nearer term headwinds. We expect economic growth to average 1.75% v a consensus forecast of 1.3% in 2024, bond yields to finish the year at 4.5%, the $A/$US to reach 72c, and Australian equities to return 10%.

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