Portfolio report

UBS Australian Share Fund
Asia Pacific Equity Indexed
Client report from 01.01.2024 to 31.03.2024

Performance Comments

After fees and expenses, the Portfolio increased by 5.83% during the quarter, outperforming its benchmark by 40 bps.

The largest positive contributors were Reliance Worldwide, NEXTDC and QBE Insurance. Reliance Worldwide outperformed with an encouraging 1H24 result ahead of consensus driven by the core Americas division while NEXTDC contributed positively following a solid 1H24 result with contracted capacity of 149MW. Similarly, Resmed outperformed during the period following its second quarter result, reporting an increase of revenue by 12% which was ahead of consensus.

The largest detractors during the period were Goodman Group, Sims and Wesfarmers. Our underweight in Goodman was a negative contributor as the industrial property giant performed strongly following the release of half year results. Sims underperformed during the period following a weak 1H24 result driven by lower metal trading margins and inflationary pressures. Our underweight in Wesfarmers was a detractor during the period as the diversified conglomerate outperformed following strong results underpinned by Kmart which came in ahead of market expectations.

% Return (Net)	Fund[1]	Benchmark*	Difference
3 months	5.83	5.43	0.40
1 year	11.06	14.40	(3.34)
3 years	9.63	9.43	0.20
5 years	8.75	9.14	(0.39)
Calendar Year to Date	5.83	5.43	0.40
Since inception (07/92)	9.69	9.41	0.28

[1] Performance figures are net of ongoing fees and expenses.

* S&P/ASX 300 Accumulation Index

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
Reliance Worldwide	30.60	0.66	OW
Nextdc	29.57	0.47	OW
QBE Insurance Group	25.90	0.43	OW
ResMed Inc.	18.81	0.42	OW
JB Hi-Fi	24.23	0.34	OW
Total of top 5 contributors		**2.32**	
National Australia Bank	12.83	(0.30)	UW
Nine Entertainment	(13.29)	(0.33)	OW
Wesfarmers	21.65	(0.45)	UW
Sims Ltd.	(18.25)	(0.52)	OW
Goodman Group	33.64	(0.53)	UW
Total of top 5 detractors		**(2.13)**	

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	4.68	Banks	(6.41)
Utilities	4.24	Pharmaceuticals, Biotechnology & Life Sciences	(4.60)
Media & Entertainment	4.15	Financial Services	(4.30)
Software & Services	3.03	Equity Real Estate Investment Trusts (Reits)	(4.03)
Materials	2.32	Consumer Staples Distribution & Retail	(3.12)

Active Positions by Stock (%)

Top 5 Overweights		Top 5 Underweights	
ResMed	3.46	National Australia Bank	(4.39)
Reliance Worldwide	3.21	CSL	(4.24)
PEXA	2.52	Wesfarmers	(3.16)
CAR	2.49	Macquarie	(2.91)
Worley	2.48	Goodman	(2.38)

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

Market Review

The Australian equities market performed strongly during the first quarter of 2024.

The S&P/ASX 300 Accumulation Index returned +5.4% for the quarter, taking its 12-month return to +14.4%. The S&P/ASX200 gained +5.3% for the quarter. Whilst globally, the MSCI World Index rallied strongly returning +8.5% for the quarter.

Financials (+12.1%) was the best performing sector, with the major banks, Westpac (WBC, +14.0%), ANZ (ANZ, +13.4%), National Australia Bank (NAB, +12.8%) and Commonwealth Bank (CBA, +9.7%) all performing strongly during the period following positive quarter results. Consumer Discretionary (+13.4%) was also a strong performing sector, with Wesfarmers (+21.7%) the main driver of performance following a positive H1 earnings update which beat market expectations.

Real Estate (+28.2%) was another strong performing sector, with Goodman Group (GMG, +33.6%) primarily contributing to the outperformance following a positive H1 earnings update.

By contrast, Materials (-6.3%) was the weakest performing sector. The largest detractor during the period was BHP Group (-10.0%), as the multinational mining and metals company revealed its half-yearly profit had dropped by 86%.

Outlook & Strategy

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 addition 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 in large caps and 15% in small caps. We are overweight the Utilities, Information Technology and Industrials sectors, and are underweight Financials, Health Care and Consumer Staples..

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