Portfolio report

UBS Microcap Fund
Australia Equity Micro Cap
Client report from 01.07.2024 to 30.09.2024

Performance Comments

After fees and expenses, the Portfolio increased by 6.79% during the quarter, outperforming its benchmark by 26bps.

The largest positive contributors were Santana Minerals, Supply Network and XRF Scientific. New Zealand gold explorer Santana Minerals trended higher as the read out for the fast-track bill for permitting approval neared. After market commercial vehicle parts supplier Supply Network reported a strong annual result with record revenue of $302.6m up 20% and NPAT of $33m up 20.5%. Scientific instrument manufacturer XRF Scientific traded higher on a strong annual result achieving record revenues of $60.1m and NPAT of $8.9m.

The largest negative contributors were SmartPay, Zip (Not Held) and Prophecy international. SmartPay continued to trade lower as the market waits on an update regarding their new payment processing solution in New Zealand. Digital payment service provider Zip (Not Held) traded higher on a strong Fy24 result achieving top end of their cash EBTDA guidance. Software provider Prophecy International fell given a significant increase in software hosting costs despite achieving record annual recurring revenue of $28.4m.

% Return (Net)	Fund	Benchmark*	Difference
3 months	6.79	6.53	0.26
1 years	21.46	18.79	2.67
3 years	2.88	(0.57)	3.45
5 years	9.63	4.38	5.25
Calendar Year to Date	19.82	9.47	10.35
Since inception (08/14)	12.79	6.62	6.17

* 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
Santana Minerals	117.56	1.15	OW
Supply Network	37.68	0.91	OW
XRF Scientific	28.22	0.60	OW
Codan	35.06	0.55	OW
Pantoro	19.79	0.44	OW
Total of top 5 contributors		**3.65**	
Dimerix	(26.47)	(0.40)	OW
Aurelia Metals	(7.89)	(0.41)	OW
Prophecy International	(25.29)	(0.47)	OW
Zip	88.36	(0.55)	UW
SmartPay	(23.98)	(0.57)	OW
Total of top 5 detractors		**(2.40)**	

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	11.32	Equity Real Estate Investment Trusts (Reits)	(10.96)
Software & Services	3.62	Materials	(6.01)
Insurance	3.28	Financial Services	(5.97)
Technology Hardware & Equipment	3.02	Consumer Services	(4.36)
Health Care Equipment & Services	3.00	Telecommunication Services	(3.33)

Active Positions by Stock (%)

Top 5 Overweights		Top 5 Underweights	
Generation Development	4.51	Life360	(1.57)
RPMGlobal Holdings	3.90	Ventia Services Group Pty	(1.45)
Southern Cross Electrical Engineering	3.84	Alcoa	(1.45)
Pantoro	3.65	ARB	(1.37)
Supply Network	3.63	Perseus Mining	(1.34)

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

Market review

The Australian small caps market strengthened during the third quarter of 2024.

The S&P/ASX Small Ordinaries Index returned +6.5% for the quarter, taking its 12-month return to +18.8%. 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%.

Financials (+15.9%) was the best performing sector during the period, with Zip Co (ZIP, +88.4%) and HUB24 (HUB, +23.0%) the largest contributors following strong FY24 results which included an increase in revenue and profit figures. Other outperformers during the period included Pinnacle Investment Management (PNI, +29.2%) and Netwealth (NWL, +12.8%).

Materials (+6.8%) was also a strong performing sector during the quarter. Mining companies were the main source of outperformance as commodity prices rose in September following news of a Chinese stimulus package, with De Grey Mining (DEG, +21.9%), Resolute Mining (RSG, +42.3%) and Alcoa Corporation (AAI, +13.5%) all contributing strongly to performance.

In contrast, Energy (-6.2%) was the worst performing sector during the period as global oil prices fell during the quarter. Beach Energy (BPT, -17.1%), Boss Energy (BOE, -20.3%) and Karoon Energy (KAR, -12.2%) were all detractors during the period.

Outlook & strategy

Last month we reiterated our non-consensus view that the US Federal Reserve would commence an easing cycle with a 50bps reduction and that a 100bps of easing before year end was likely. In the end the 50bps reduction carried out by the Federal Reserve in September was greeted with enthusiasm by risk markets as they quickly embedded an expectation of successive 50bps hikes. The federal Reserve Chairman Powell has since attempted to dampen that expectation and a strong labour market report for September has clearly challenged the need for aggressive near-term easing. Nevertheless, the case for two successive 25bp rate cuts over the remainder of 2024 remains both justified and is our base case.

The additional catalyst for the month of October has been renewed efforts by Chinese authorities to bolster the Chinese housing market via a combination of mortgage rate reductions, lower downpayment requirements and liquidity facilities. Equity markets have interpreted this package very favourably, however, we caution that the prospect of a material reacceleration in Chinese housing turnover, house prices and new housing construction is likely to be closer to 18 months away. While Chinese equities and related assets may continue to rally on the expectation that Chinese policy makers will continue to ease policy, our view is that Chinese authorities have little intention to rapidly reflate the housing market. The objective is to stabilise and reflate in a controlled manner. As such, we caution against expecting meaningful shifts in demand for Chinese construction activity growth for at least 12 months.

Elsewhere, moderate inflation and easing activity data in Europe suggest the easing cycle in the Euro Area will continue, and together with New Zealand and Canada, the risk is skewing to greater easing in the near term. In short, our central thesis of moderating inflation and easing policy sufficient to generate a reflationary environment remains well in place.

Locally, Australia continues to operate with economic growth at near stall speed. GDP increased just 0.2% qoq and 1.0% yoy in 2Q24 the weakest annual rate of economic growth in 32 years, excluding COVID. The Reserve Bank of Australia ('RBA') remains of the view that inflation is too high and economic growth had been too strong for the supply side of the economy to respond. It is particularly uncertain over the outlook for the household saving rate as the tax cuts are delivered and the risk that prior strong wealth gains translate to strong consumption growth. From our perspective it's pretty clear that when the saving rate is already near zero, the banks are not facilitating mass access to liquidity for households to consume prior wealth gains, the superannuation system remains in a state of net inflow and the recent rapid rise in the SG levy in addition to a further rise in 2025 essentially guarantees the saving rate will rise rather than fall in the period ahead.

In concert with the observations that the buffer of liquid excess savings from the post-COVID period has now been completely depleted and a clear trend rise in the unemployment rate, it is likely that a bout of precautionary saving ensues in the months ahead. In the absence of easing along with the decision to rapidly slow population growth from 1 Jan 2025 via cutting student numbers, the risks to economic growth projections are skewed to the downside. We believe, the RBA will recognise that wage and inflation pressures have eased sufficiently by the end of 2024 and that they will commence a modest easing cycle at the December meeting.

Against this moderation in inflationary pressures we still expect economic growth to accelerate sequentially through 2H2024, albeit remaining well below 'potential' growth. The growth outlook should be supported by ongoing business investment and 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.

We expect economic growth to average 1.5% versus a consensus forecast of 1.2% in 2024, bond yields to finish the year at 4.0%, the $A/$US to reach 72c, and Australian equities to return 10-12%.

We are most overweight stocks in the Financials, Health Care and Industrials sectors, and are underweight Consumer Discretionary, Materials and Energy.

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