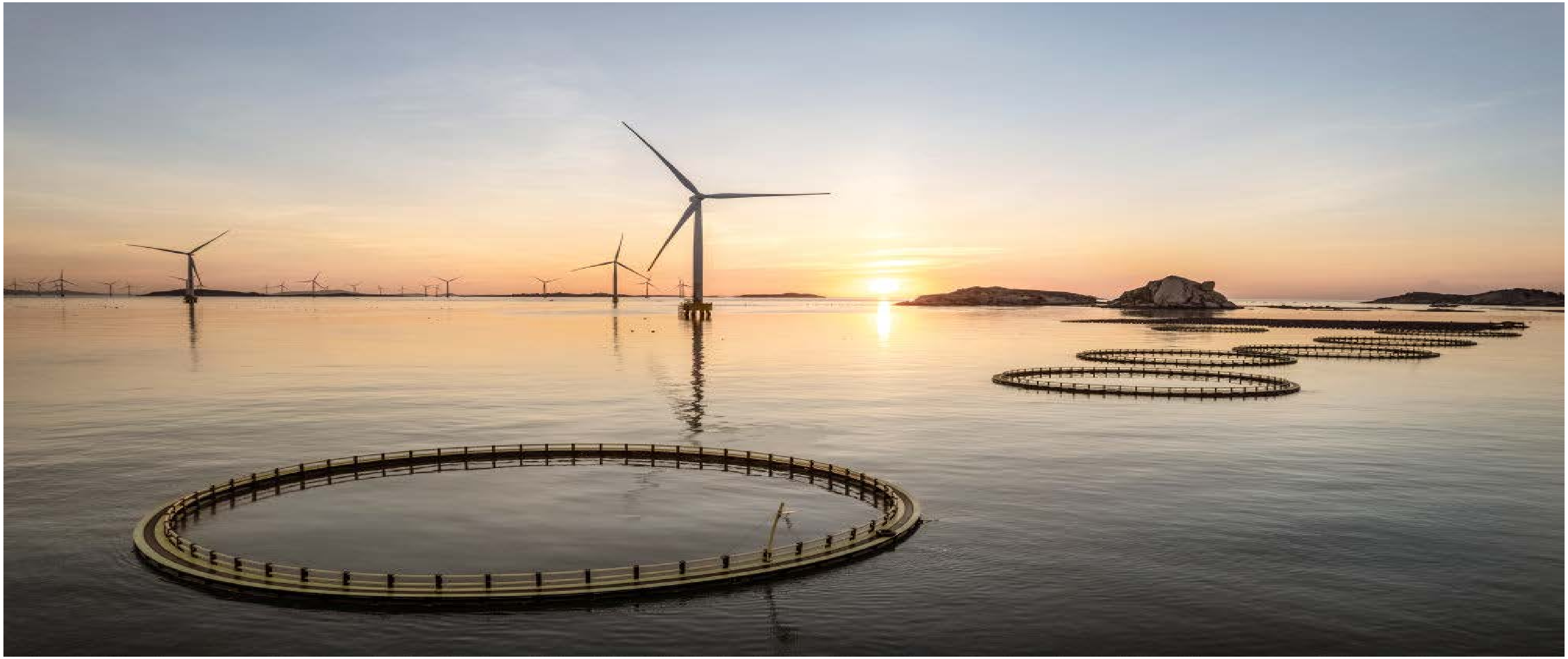
Portfolio report

UBS Australian Small Companies Fund
Australia Equity Small Cap
Client report from 01.09.2024 to 30.09.2024



Performance comments

After fees and expenses, the Portfolio increased by 5.23% during the quarter, underperforming its benchmark by 130bps.

The largest positive contributors were Pinnacle Investment Management, Centuria Capital and Australian Clinical Labs. Pinnacle Investment Management outperformed during the period following the release of its FY24 results which included an increase in profit and revenue. Similarly, Centuria Capital outperformed during the period following a solid FY24 update and supportive FY25 outlook while Australian Clinical Labs positively contributed following FY24 results as the stock was supported by increased confidence around the ability for the business to deliver improved margins.

The largest detractors during the period were Megaport, Kelsian and Lifestyle Communities. Megaport detracted following the release of its FY24 results with its FY25 revenue and earnings guidance below consensus expectations while Kelsian also detracted following its result with F25 guidance below expectations. Lifestyle Communities underperformed during the period driven by a trading update in which the company withdrew its forward-looking guidance due to the difficulty in quantifying the impact of uncertainty caused by recent media coverage.

% Return (Net)	Fund[1]	Benchmark*	Difference
3 months	5.23	6.53	(1.30)
1 years	13.54	18.79	(5.25)
3 years	0.65	(0.57)	1.22
5 years	7.69	4.38	3.31
Calendar Year to Date	7.19	9.47	(2.28)
Since inception (03/04)	11.53	5.72	5.81

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

* S&P/ASX Small Ordinaries 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
Pinnacle Investment Management	29.24	0.65	OW
Centuria Capital	26.67	0.58	OW
Australian Clinical Labs	50.18	0.47	OW
Sandfire Resources	4.24	0.46	OW
Neuren Pharmaceuticals	(28.82)	0.40	UW
Total of top 5 Contributors		**2.56**	
Zip	88.36	(0.55)	UW
Bellevue Gold	(26.05)	(0.57)	OW
Lifestyle Communities	(31.72)	(0.63)	OW
Kelsian	(17.94)	(0.66)	OW
Megaport	(34.76)	(0.76)	OW
Total of top 5 detractors		**(3.17)**	

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	
Health Care Equipment & Services	7.55	Consumer Discretionary Distribution & Retail	(6.76)
Transportation	5.91	Materials	(4.93)
Financial Services	3.43	Energy	(3.62)
Banks	2.59	Telecommunication Services	(3.33)
Media & Entertainment	2.45	Pharmaceuticals, Biotechnology & Life Sciences	(3.02)

Active Positions by Stock (%)

Top 5 Overweights		Top 5 Underweights	
Centuria Capital	3.46	Life360	(1.57)
Auckland International Airport	3.21	Ventia Services Group Pty	(1.45)
Sandfire Resources	3.18	Alcoa	(1.45)
Netwealth	3.04	ARB	(1.37)
Imdex	3.03	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

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

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