MAPLE-BROWN ABBOTT
INVESTMENT MANAGERS SINCE 1984

Maple-Brown Abbott Australian Small Companies Fund

Monthly Commentary – 30 April 2024

Fund performance (%) [1]

	1 month	3 months	1 year	Since inception p.a. 24 Jun 2022
Fund [2]	-2.8	3.8	11.8	18.9
Benchmark [3]	-3.1	3.3	7.4	9.7

Market commentary

The Australian small caps market declined 3.1% in April due to the realisation that central bank easing may not come through as quickly as previously thought, with forecasts in Australia now shifting to no interest rate cuts over calendar 2024. Mixed economic data served to elevate volatility, with US GDP coming in at 1.6% (below market expectations), global PMIs ratcheting up and various indicators showing a stabilisation / upswing in the previously downward inflation trend. Notable among these inflation measures was the US Core PCE spiking to 3.7%, which was well above market expectations. The fading likelihood of rate cuts resulted in the Australian 10-year government bond yield moving up 0.46% over the month to 4.42% and US yields increasing by 0.48% to 4.68%. This contributed to downward pressure on equity valuations and interest rate sensitive stocks. Small resources stocks returned +2.0%, as measured by the S&P/ASX Small Resources Index, driven by commodities performing well with copper and gold prices continuing their upward trajectory.

Many of the key winners from the February reporting season that were supported by the expectation of interest rate cuts, rather than earnings delivery, pulled back over the month. The month continued to see elevated mergers and acquisitions (M&A) activity at the smaller end of the market, including Austal, Pacific Smiles Group and Naomi Cotton.

Portfolio commentary

The Fund returned -2.8% over the month, outperforming the benchmark by +0.3%. The Fund continues to generate strong returns since inception (24 June 2022), returning 18.9% and outperforming the benchmark by +9.2% on an annualised basis.

Over the month, performance contributors included Pro Medicus (PME) and NexGen Energy (NXG). Pro Medicus outperformed on no new news during the month. The company is the clear market leader in cloud-native Picture Archiving and Communication Systems (PACS) in radiology via its flagship Visage 7 solution which continues to build contract award momentum and provide significant pricing power to drive strong medium-term earnings. The market is only starting to comprehend the significant opportunity in artificial intelligence to deliver improved accuracy and client outcomes. In addition, the company is expanding outside of radiology via cardiology with the market having lower volumes although offset by higher pricing. NexGen Energy continues to be a beneficiary of nuclear power which is enjoying a renaissance by governments which are realising that renewables alone will not solve decarbonisation targets. The market expects the company to receive federal regulator approval for the Rook 1 Project in Saskatchewan, Canada following the Federal Environmental process in the near term which will be a major catalyst for the development of this world-leading uranium mining deposit to commence.

Over the month, performance detractors included GUD Holdings (GUD) and Light & Wonder (LNW). GUD Holdings underperformed given patchy new vehicle supply recovery from certain car manufacturer brands, notably Toyota, which is expected to dampen the earnings recovery for the APG division. In addition, there are signs of slowing growth in the traditional automotive after-market parts division due to vehicle servicing being deferred given cost-of-living pressures. This is typically a defensive market segment which is expected to recover given car maintenance servicing can only be delayed for so long before major vehicle repairs are required. Light & Wonder pulled back during the month following a stellar 12-month period which has seen investment in organic opportunities across content and people driving new product development, notably Dragon Train. This is seeing strong market share penetration in the Australian slots market which is typically a test case for the rest of the world. The market is eagerly anticipating the successful roll-out of Dragon Train in the US slots market which is a significant market opportunity.

Please see next page for Outlook

Notes:

1 Past performance is not a reliable indicator of future performance. Source: Maple-Brown Abbott Ltd, S&P as at 30 April 2024.

2 The Fund's performance is based on the movement in net asset value per unit plus distributions and is before tax and after all fees and charges. Imputation credits are not included in the performance figures.

3 S&P/ASX Small Ordinaries Total Return Index (Benchmark).

Want to find out more?

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Signatory of:
PRI Principles for Responsible Investment

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Outlook

The current macroeconomic landscape is one of the most challenging we have seen for a long time. Many of the key economic inter-relationships that have historically worked are starting to show signs of breaking. A great example is the continuing upward trajectory in the gold price when both nominal and real yields are increasing. Gold has also shrugged off relative USD strength, which is a typical for the commodity. You can read more about our views on the gold price and gold stock opportunities at the smaller end of the market here.

The big question facing investors at the moment is the extent of the re-emergence of inflation at a time when global government debt levels are at record highs. As markets again walk an inflation expectation tightrope, what are the implications for asset class returns and how should investors be positioned going forward?

We don't proclaim to have the answers to the above, although do believe the current market environment will be more volatile and create opportunities for astute investors. In this kind of environment, we believe we can better exercise our competitive advantage of managing idiosyncratic exposures to select Australian small companies which are undiscovered and/or mispriced by the market. We believe this is a more reliable source of alpha generation rather than forecasting macro-economic themes.

Despite the current variability in global lead indicators, we continue to remain positive for Australian small caps given the domestic economy remains resilient with valuation metrics looking attractive with forecast earnings upside relative to Australian large caps.

Key themes underpinning portfolio allocations include:

- **Structural growth**: We focus on structural growth stories that can grow irrespective of the macro-economic environment with niche product offerings e.g. Life360.
- **Wage inflation**: the delayed flow-through of wage inflation will have a material down-stream impact on the profitability of select sectors, including retail and select healthcare stocks. We continue to focus on companies with pricing power, notably in the IT sector.
- **Gold sector re-emergence**: sector valuations continue to be based on gold prices below spot with a focus on companies which continue to deliver production growth, meet cost guidance and build cash reserves.
- **Rising energy demand**: Rising power demand from electrification of vehicle fleet, artificial intelligence and data centres, with a focus on reliable baseload power required e.g. uranium.

As we enter the traditional May 'confession season' we expect to see share price volatility increase as many companies update the market on their earnings guidance provided during the February 2024 reporting season. Company visits by the team through March and April reinforced our expectations that Fund holdings will deliver more resilient earnings relative to the broader market.

The Fund remains well positioned with regards to its core pillars of earnings delivery and sustainability. Going forward we see solid earnings potential, better than benchmark sustainability characteristics and a superior risk profile for the stocks held in the Fund.

For latest Fund factsheet click here.

Want to find out more?
Contact our Client Service team by:
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