MARKET MATTERS
INVEST

MONTHLY REPORT | FEBRUARY 2023 | EMERGING COMPANIES

PORTFOLIO DETAILS

Portfolio Name	Emerging Companies
Structure	Separately Managed Account
Benchmark	S&P/ASX Small Ords Index
Management Fee	0.85% incl GST
Platform	OpenInvest
Included Assets	Equities
Portfolio Managers	James Gerrish & Harrison Watt
Annual Performance	5.02%*

**Inception Date 31.01.2020*

OBJECTIVE

The objective of the Market Matters Emerging Companies Portfolio is to provide an active exposure to Australian emerging companies defined as all listed stocks outside the S&P/ASX 100. Returns will primarily be achieved through capital appreciation rather than income with an overall objective of outperformance of the S&P/ASX Small Ordinaries Index over 5 years.

MARKETS & PERFORMANCE

The Market Matters Emerging Companies Portfolio declined -4.24% in February, slightly underperforming a weak S&P/ASX Small Ordinaries Accumulation Index which was down -3.70%. The portfolio has returned -5.08% for the rolling 12 months & 7.23% per annum over 3 years.

PERIOD	1 MONTH	3 MONTH	6 MONTH	1 YEAR	3 YEAR PA	INCEPTION
PORTFOLIO %	-4.24	-0.61	-1.6	-5.08	7.23	5.02
BENCHMARK %	-3.7	-1.21	-2.01	-7.97	4.24	1.29
RELATIVE %	-0.54	0.6	0.41	2.89	2.99	3.73

Benchmark: S&P/ASX Small Ords Accum Index

February was a weak month for equities, as company results illustrated waning earnings momentum. The S&P/ASX 200 was down (-2.4%), as the RBAs 25bps rate hike to 3.35% placed pressure on the already decelerating economy. Australian 10-year bond yields moved in reaction to tightening monetary policy, selling off 30bps to 3.86%. US yields also sold off 39bps to 3.92%, in reaction to stronger-than-expected economic data.

Elsewhere, the MSCI Developed Markets Index fell (-1.5%), and the S&P 500 also lost momentum (-2.4%) in local currency terms. Commodity prices fell across the board. Brent Oil lost US$2.04 to US$82.45/bbl fuelled by a stronger USD. Iron Ore prices also declined US$3.00 to US$126/Mt on flat demand and a soft Chinese property market. Gold prices were hit hard, down by US$105.25 to US$1,819, hindered by the strength of the Greenback.

Locally, the Utility sector was the top performer up (+3.4%), while IT (+2.7%), Industrials (+1.5%), Consumer Staples & Property (+1.1%) all made gains.

The Materials sector was the hardest hit ending down (-6.6%) while Financials (-3.1%) and Energy (-0.8%) also fell.

When the two most influential sectors on the ASX (Financials & Materials) fall an average of 4.85%, it's always going to be a tough month at the index level.

PORTFOLIO STOCKS

The portfolio held 19 positions at the end of January, finishing the month with a cash balance of ~14%. We took a profit on **Pinnacle Investment Management (PNI)** early in the month to reduce the overall leverage to the market given the weaker backdrop and risk that FUM flows would be soft, a call that was proven correct at the company's HY result soon after.

Reporting season was the main focus for markets in February, with the standout report within the portfolio being audio-visual company **Audinate (AD8)**. The company hit record revenues and EBITDA in the half and with a large backlog of orders still in the pipeline supporting the outlook, they have good visibility of a strong 2H. The only letdown was softer margins as their video product starts to ramp up, though we expect this to improve alongside increased take-up of their software offering.

Another great result came from the independent investment platform **Praemium (PPS)** which saw margins improve and costs come down. Revenue margins jumped 9bps thanks to higher rates earning the company a better take on Funds Under Administration (FUA) held as cash. Praemium remains cheap vs peers Hub24 (HUB) and Netwealth (NWL), and the company has turned a corner after selling its international businesses. The company flagged that a dividend policy will be provided later this year, an opportunity for further returns for shareholders as their cash balance grows.

The most disappointing holding of the reporting period was gold miner **St Barbara (SBM)** which wrote down asset values and reduced guidance. The company is looking to demerge their international assets Atlantic and Simberi, from which they wrote off around $500m. The demerger would then pace the way to join forces with Genesis (GMD), combining their assets in the Leonora gold region of WA. A number of hurdles remain to this deal and St Barbara has made it harder for themselves after pushing production guidance to the low end of the range while increasing cost guidance to the upper end.

Weakness across the board in EV-related commodities weighed on our exposure in **Global Lithium (GL1)** and **Lynas Rare Earths (LYC)**.

Lithium came under pressure as battery makers reduced demand on weaker expected EV sales, a concern that also weighed on rare earth markets. Lynas is building a processing plant in Kalgoorlie WA as they look to replace their Malaysian operations following some licence changes that come into effect on 1 July.

While there may be some downtime between the changeover, we believe Lynas has managed its inventory well and we are backing the company given its strong track record of managing production issues in the past. We expect demand in the space to pick back up and support both companies which have significant opportunities moving forward.

PORTFOLIO STOCKS	
NO. OF HOLDINGS	19
ESTIMATED YIELD (%)	1.72
TOP 5 POSITIONS (% OF AUM)	36.15
TOP 10 POSITIONS (% OF AUM)	57.66

STOCK	CONTRIBUTION (%)
BAPCOR (BAP)	0.67
AUDINATE (AD8)	0.61
CALIS (CXL)	0.25
PRAEMIUM (PPS)	0.25
AUSSIE BROADBAND (ABB)	0.24

STOCK	DETRACTION (%)
PALADIN (PDN)	-1.23
GLOBAL LITHIUM (GL1)	-1.01
ST BARBARA (SBM)	-0.79
REGAL PARTNERS (RPL)	-0.67
LYNAS RARE EARTHS (LYC)	-0.51

	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	YTD
FY23	14.48	3.07	-9.21	0.87	5.76	-6.42	8.36	-4.24					**12.67**
FY22	2.97	1.17	5.91	1.13	2.19	-2.47	-10.29	-5.93	6.68	-5.19	-7.80	-15.25	**-26.88**
FY21	10.92	17.19	-10.89	0.63	0.58	0.57	-0.86	5.91	-7.10	4.38	-3.81	2.37	**19.89**
FY20								-16.09	-27.07	37.98	21.26	5.66	**21.74**
CUMULATIVE													**27.42**

REPORTING

As always, there are a lot of moving parts when it comes to reporting and these interim results were no different. Overall, it seems likely earnings have peaked and we're now in for a tougher period, however, it's not all bad news. It fits with our thinking that the RBA is too positive in their assumptions around the health of the Australian economy and as a result, far too hawkish on interest rates. While earnings may have peaked overall, pockets of the market are still performing while rates in our view will not reach the height that markets are currently pricing in, so the headwind on valuations from sharply higher yields may ease.

- More companies missed expectations than beat, but it wasn't by a lot. While the companies that missed saw ongoing underperformance i.e., the strong became more highly valued than the weak.
- Ahead of reporting, analysts were expecting earnings growth year on year of +7.3%. As we exit reporting, that number sits at +6.6%, a reduction of 0.7% – down but not a disaster.
- Resources companies battling with higher costs were the main drag here, and while it's a negative, we can't help but think these pressures will improve as tightness in the labour market ultimately eases.
- We saw some pockets of consumer strength, so instead of all retailers struggling, there was a greater divergence of outcomes. Big ticket items, lounges, white goods etc are a tougher ask, but smaller items, or retailers that give options to trade down, did well.
- Extrapolating CBA's results across the banks, they are in very good shape, although there were signs that intense competition was eroding the benefit of higher rates on margins.
- More broadly, there was clear caution on what comes next and an acknowledgment that the next six months will be tougher, although it wasn't the case across the board implying more of a 'patchy' slowdown than a deep and wide recession.
- Labour shortages were the No 1 issue in FY22 results six months ago, but for the most part, this has improved, though wage pressure is still bubbling away, more so in some sectors like mining.
- Inflation is there for all to see, but many companies are having success passing on price rises to protect margins, although that is a blanket comment, and some companies would disagree.
- The housing market is weak, and that's flowing into weakness more broadly, but some areas have remained immune, like travel.
- Companies are still planning to spend, with capex intentions remaining robust.

In summary, a patchy period rather than a universally weak one, the 2H will be very important and we need to be on our toes, but it would be a mistake to think a hard economic landing is a fait accompli.

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