

THB US Micro Cap Fund

Quarterly Report – March 2020

Market commentary

The Russell Microcap® Index (Index) returned -21.9% (AUD) in Q1 2020.

Utilities (-7.3%) was the best performing sector in Q1 followed by Health Care (-20.8%) and Consumer Staples (-22.0%). Energy (-48.1%) was the worst performing sector, followed by Consumer Discretionary (-47.7%) and Financials (-37.1%).

The drawdown in global equities during March 2020 as a result of the COVID-19 pandemic was widespread with few stocks, sectors or asset classes offering refuge from the selling pressure. The selling was indiscriminate, and correlations increased as participants sought liquidity above all else. Broad global equity indices were down 25-35%. Within the S&P 500, 62% of companies were down more than 20% and 30% down more than 35%. Smaller capitalisation equities (Russell Small Cap/Microcap) showed similar negative breadth with 75% of companies down more than 20% and 49% down more than 35%. As well, oil prices plunged as lockdowns across the globe weakened the outlook for demand along with disagreement between OPEC and non-OPEC countries to reach an agreement for supply.

While COVID-19 is different from past macroeconomic shocks and market drawdowns, the market reaction, behavioural tendencies, and news flow have tended to follow similar patterns. Each calamity or crisis follows a similar path as the crisis in question seems insurmountable, a brighter future appears difficult to envision, the media popularises the most extreme voices and the markets quickly price in extreme scenarios as leveraged participants and weak hands are sold out of the market.

In reaction to the forced shutdown of large parts of the US economy, there have been numerous fiscal and monetary programs announced to offset the lost economic output. Lessons learned from the GFC have seen the Federal Reserve act quickly and decisively. Enormous amounts of liquidity have been injected into various conduits within markets, with measures including the Fed cutting interest rates twice in March (for the first time since the GFC) and introducing unlimited quantitative easing. On the fiscal policy front, the US government announced an unprecedented US\$2 trillion stimulus packages to reduce the impact of lockdowns.

The US Consumer entered this year as one of the pillars of the economy, registering multi-decade levels of high confidence and sound financial footing with all time low levels of household debt. These low levels of debt combined with significant support from the government should allow the US Consumer to quickly recover from this current economic shock.

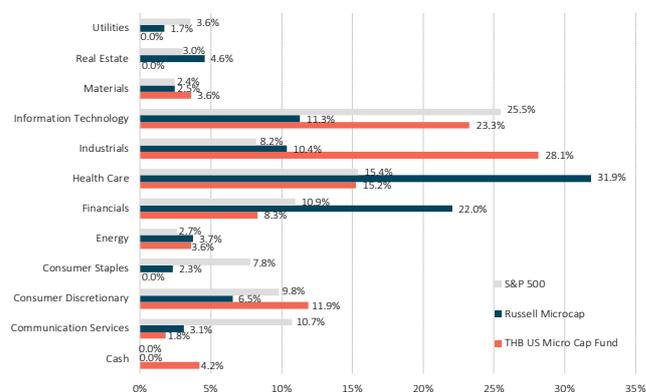
Fund details	
Benchmark	Russell Microcap® Index ³
Inception date	5 September 2014
Fund size	A\$171 million

Performance ¹ – 31 March 2020			
	Fund ²	Russell Microcap®	Difference
1 month	(21.1%)	(19.3%)	(1.8%)
3 months	(25.5%)	(21.9%)	(3.6%)
1 year	(21.4%)	(14.6%)	(6.8%)
2 years p.a.	(8.7%)	(5.1%)	(3.6%)
3 years p.a.	(2.1%)	(0.6%)	(2.7%)
Since inception p.a. ²	5.6%	7.5%	(1.9%)

1. Performance figures are presented in AUD on a net, pre-tax basis and assume the reinvestment of distributions. Past performance is not an indicator of future performance.

2. Fund inception date was 5 September 2014 however inception performance is calculated from 1 October 2014.

Sector allocation⁴



3. The Russell Microcap Index is a capitalisation weighted index of 2,000 stocks that captures the smallest 1,000 companies in the Russell 2000 and 1,000 smaller US based listed stocks.

4. Portfolio holdings and allocations are subject to change and should not be considered as investment recommendations to trade individual securities. The securities identified and described do not represent all of the securities purchased, sold or recommended for client accounts. The reader should not assume that an investment in the securities identified were or will be profitable. There is no assurance that any securities discussed herein will remain in the portfolio at the time you receive this report, or that securities sold have not been repurchased. There can be no assurance that investment objectives will be achieved. A full list showing every holding's contribution to the overall account's performance during the measurement period and calculation methodology is available upon request.

Portfolio commentary

The THB US Micro Cap Fund returned -25.5% in AUD (net of fees) in Q1 underperforming the Index by 3.6%. A large component (2.5%) of the underperformance is attributable to Biotechnology companies which THB does not own in the strategy. These companies accounted for 60% of the top 25 positive movers within the benchmark during the quarter.

The portfolio saw positive contribution from Stock selection to Industrials (+1.3%), Consumer Discretionary (+1.2%), and underallocation to Financials (+0.8%). Negative contribution came mainly from selection in Information Technology (-1.8%), underallocation to Health Care (-1.4%), and overallocation to Consumer Discretionary (-1.0%).

THB's top five performing stocks (from a contribution standpoint) were Vicor Corporation (Industrials, +0.3%), Ambarella, Inc. (Information Technology, +0.2%), Jack in the Box, Inc. (Consumer Discretionary, +0.3%), Advanced Energy Industries, Inc. (Information Technology, +0.2%) and Diodes, Inc. (Information Technology, +0.2%).

The bottom five performing stocks (from a contribution standpoint) were PAR Technology Corporation (Information Technology, -1.8%), Koppers Holdings, Inc. (Materials, -1.4%), Century Communities, Inc. (Consumer Discretionary, -1.3%), Old Second Bancorp, Inc. (Financials, -1.1%) and Heritage-Crystal Clean, Inc. (Industrials, -0.9%).

A positive outlook or good news story is not easy to find in this current environment so THB will endeavour to provide some thoughts on the opportunities which may be getting lost in the cacophony of this crisis. THB's 35+ year investing history enables it to take advantage of the current situation, having successfully invested through trying times before. During times like this, there is often a disconnect between the stock price and the intrinsic value of the corporations and their cash flow streams. The decoupling can last longer and be more violent than originally anticipated. Such periods are trying, but provide the seeds for longer-term outperformance. THB's experience managing through periods like this and its philosophical focus on high quality, well capitalised companies allows it to capture the abundant opportunities present in its universe.

The swift drawdown and indiscriminate selling have created outsized return opportunities within THB's universe. THB's opportunity set has greatly expanded, and THB is analysing each of its holdings to process new information, confirm assumptions and associated risks, with risk-adjusted returns being the primary decision driver. THB is finding great opportunities across all sectors, with the Consumer and Technology sectors being particularly compelling with the highest percentage of companies entering THB's portfolio and on the THB watchlist.

Valuations for smaller cap equities continue to be attractive on both an absolute and relative basis. Current valuations are at all-time low levels except for the GFC. The attractive valuations create a very positive skew for forward returns.

Markets may be exhibiting the first phase of a bottoming process. Signals of selling exhaustion are apparent in the markets and that typically marks the first phase of a bottoming process. Similar to past drawdowns, the broader market indices may retest prior low levels, but a high percentage of individual stocks may likely have already put lows in, which begins the healing process of the markets.

The COVID-19 related drawdown and its effect on the economy and markets have created challenges, opportunities and will usher in changes. THB believes that the era of globalisation was already peaking before the COVID-19 pandemic and that it may serve to accelerate those trends. Nationalism was rising in many countries and tariffs and other disputes highlight the trend towards de-globalisation. Smaller capitalisation equities, whose revenues tend

to be primarily domestic (US Micro Cap 90%, International Micro Cap 65%) should benefit as companies rework long, complex global supply chains. Smaller capitalisation domestic companies should be prime beneficiaries as countries and companies look to shift offshore production back within their borders.

Stocks in focus

The below two companies, Jack in the Box and Ambarella are examples of the widespread mispricing of securities within THB's universe. An overview of each follows.

Jack in the Box, Inc. (JACK)

Jack in the Box opened its first restaurant in 1951 and has since become one of the nation's largest hamburger chains. Today, the company system includes 2,244 restaurants in 21 states of which 2,107 were franchise-operated (~94% of total). The stock sold off more than 70% since February along with peers as restaurants across the country were ordered to close dining rooms and operate only off-premise. THB believes JACK was overly punished as almost all of its restaurants are operating in an off-premise capacity, close to 90% of the company's business. As a result, the impact of dining room closures would be smaller relative to casual dining peers. Additionally, the individual franchisees are eligible to participate in the recently announced U.S. government stimulus package which includes a \$350 billion Paycheck Protection Program aimed at businesses with 500 or fewer employees. JACK is well-positioned to weather the current downturn and achieve its \$4 billion system sales target.

Ambarella, Inc. (AMBA)

Ambarella's products are used in a wide variety of human and computer vision applications, including video security, advanced driver assistance systems, electronic mirror, autonomous driving, and robotic applications. Over the past few years, AMBA has invested more than \$350 million in AI and focused on diversifying its end-markets away from consumer discretionary to automotive, security camera and robotic applications. Its technology integrates AI and a video processor to enable a complete computer vision solution used in lane departure warning, forward collision warning, face recognition or gun detection. It has a large global installed base of over 750 million security cameras and is in design at nine of the ten leading security camera companies. AMBA is also benefitting from the growth in home automation. Their product is the embedded technology in Google's Nest and Amazon's Ring products. The company has successfully reinvented itself and is positioned for continued growth supported by improving profitability and a strong balance sheet with \$405 million in cash and no debt.

Portfolio statistics¹

As at 31 March 2020		
	Fund	Russell Microcap®
Weighted avg market cap	US\$632m	US\$555m
Price/sales	0.6x	0.5x
Price/book	1.3x	1.1x
Dividend yield	0.8%	1.8%
Number of securities	100	1,454
Standard deviation	19.1%	19.6%
Sharpe ratio	0.0	0.1
Beta	0.9	
Tracking error	5.5	
Information ratio	-0.2	

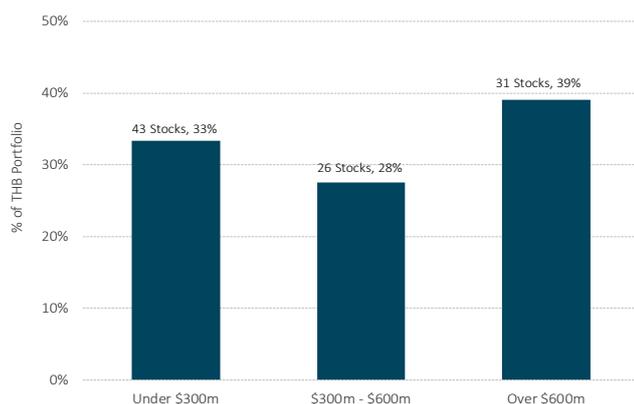
1. Portfolio statistics are reported in USD. Source: THB Asset Management

Top 10 holdings

Stock	Sector	Weight
Renewable Energy Group	Energy	2.6%
Johnson Outdoors	Consumer Disc.	2.4%
Hyster-Yale Materials	Industrials	2.3%
Miller Industries	Industrials	1.9%
PAR Technology	Technology	1.9%
Old Second Bancorp	Financials	1.9%
Graham Corporation	Industrials	1.9%
LeMaitre Vascular	Health Care	1.9%
ePlus	Technology	1.9%
Cardlytics	Communication	1.8%

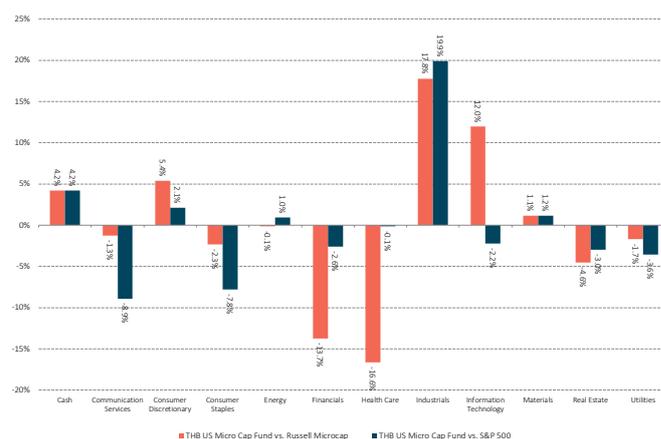
Source: THB Asset Management

Companies by market capitalisation



Source: THB Asset Management

Active sector positioning



Source: THB Asset Management

Investment strategy

THB Asset Management (THB) is an employee-owned boutique investment management firm based in Connecticut specialising in smaller company strategies. THB's US Micro Cap strategy is based on the belief that there are inefficiencies in the micro cap segment of the market due to lack of analyst coverage, difficulty in identifying value and the impact that management skill has on the direction of smaller companies. THB utilises a disciplined, fundamental bottom-up approach that blends both qualitative and quantitative methods to construct a well-diversified portfolio of companies that possess attractive operating metrics, yet with comparable valuation to the Russell Microcap® Index.

BROOKVINE

THB
Asset Management

For more information contact:
Natalie Hall on +61 2 9328 6445 or
nataliehall@brookvine.com.au

This document has been prepared and issued by Thomson Horstmann & Bryant Inc. (THB) and is intended for the general information of 'wholesale clients' (as defined in the Corporations Act 2001) only. THB is exempt from holding an Australian Financial Services Licence pursuant to ASIC Class Order 03/1100 'Relief for US SEC regulated financial service providers' in respect of the financial services it provides to Wholesale Clients, and is not licensed to provide financial services to retail clients, in Australia. THB is regulated by the Securities and Exchange Commission of the United States of America under US laws, which differ from Australian laws. Equity Trustees Limited (Equity Trustees) (ABN 46 004 031 298, AFSL 240975) is a subsidiary of EQT Holdings Limited (ABN 22607 797 615), a publicly listed company on the Australian Securities Exchange (ASX:EQT). Equity Trustees is the Responsible Entity of the THB US Micro Cap Fund (ARSN 600 158 450). This document is neither an offer to sell or a solicitation of any offer to acquire interests in any investment. The information contained in this document is of a general nature only. Accordingly, reliance should not be placed on this information as the basis for making an investment, financial or other decision. In preparing this document, THB has not taken into account the investment objectives, financial situation and needs of any particular person. Before making any investment decision, you should consider whether the investment is appropriate in light of those matters. Whilst every effort is taken to ensure the information in this document is accurate, THB and Equity Trustees provides no warranty as to the accuracy, reliability and completeness of the information in this document and you rely on this information at your own risk. To the extent permitted by law, THB and Equity Trustees disclaims all liability to any person relying on the information contained in this document in respect of any loss or damage (including consequential loss or damage) however caused, which may be suffered or arise directly or indirectly in respect of such information. Past performance is not a reliable indicator of future performance. The return of capital or any particular rate of return from the Fund is not guaranteed. You should obtain and consider the Fund's Product Disclosure Statement (PDS) before deciding whether to acquire, or continue to hold, an interest in the Fund. Applications can only be accepted on an application form attached to a current Product Disclosure Statement. Neither THB, Equity Trustees nor any of its related parties, their employees or directors, provide and warranty of accuracy or reliability in relation to such information or accepts any liability to any person who relies on it.