

# THB US Micro Cap Fund

## Quarterly Report – December 2020

### Market commentary

The Russell Microcap® Index (Index) returned 22.0% (AUD) in Q4 2020.

Consumer Staples (+47.9%) was the best performing sector in Q4 followed by Energy (+41.5%) and Information Technology (+41.4%). Utilities (+12.5%) was the worst performing sector, followed by Health Care (+18.6%) and Real Estate (+25.0%).

The combination of continued strong economic data and positive Covid-19 vaccine trials propelled US Equities broadly higher in Q4. Worst case fears about a prolonged recovery and impairment of large swaths of the economy were misplaced. During the quarter small capitalisation equities led the market with the Russell 2000 and Russell Microcap delivering 31.3% respectively while the S&P 500 was up 12.1%.

This year will undoubtedly be remembered for the global pandemic, suffering, sorrow, and economic and market shocks. Historical perspective may enable us to see 2020 from a different perspective, with some positive elements of change occurring that were accelerated by the onset of the virus and cooperation between the public and private sectors. Additionally, post virus optimism and changes in behaviours may spur societal advancement and economic growth.

As we enter the post Covid-19 period, some of the drivers of market performance, asset allocations and expectations appear to be changing. Style (Growth vs. Value) rotation was topical this quarter as investors questioned the long run of outperformance of growth over value. Large/Mega cap leadership and valuations were also spotlighted as investors took note of the strong relative and absolute performance of small capitalisation stocks. The Russell 2000 Index return of 18.4% in November was the highest on record and breadth has been historic. Such occurrences have historically been an indicator of strong forward returns. Predicting regime changes within the markets can be incredibly difficult, but there are signals that the return drivers of the past decade may be shifting.

A cornerstone of the US economy, the consumer entered the pandemic in very good financial shape and has remained so despite the lockdowns and corresponding economic impact. Lower interest rates, government stimulus and a faster than expected economic recovery have left the consumer with higher cash balances and lower interest payments. Household debt service burdens have hit the lowest level in 30 years. Low debt service is likely to allow consumers to continue to spend even if virus lockdowns continue to dampen economic output. The higher consumer cash balances will likely fuel better than anticipated GDP readings in the coming quarters as pent-up demand and spending flow through the economy.

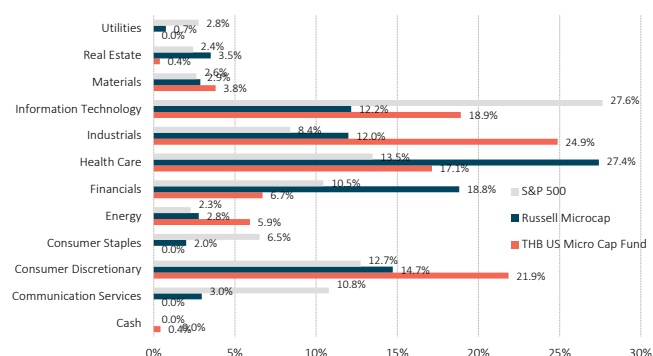
Fund details	
Benchmark	Russell Microcap® Index <sup>3</sup>
Inception date	5 September 2014
Fund size	A\$76 million

Performance <sup>1</sup> – 31 December 2020			
	Fund <sup>2</sup>	Russell Microcap®	Difference
1 month	3.9%	2.8%	1.0%
3 months	23.8%	22.0%	1.7%
1 year	15.5%	10.2%	5.3%
2 years p.a.	13.7%	16.2%	(2.5%)
3 years p.a.	10.2%	9.3%	1.0%
5 years p.a.	12.8%	10.6%	2.2%
Since inception p.a. <sup>2</sup>	12.5%	12.6%	(0.0%)

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 allocation<sup>4</sup>



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 here 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 23.8% in AUD (net of fees) in Q4, outperforming the Index by 1.7%.

The portfolio saw positive contribution from underallocation to Health Care (+1.4%), overallocation to Industrials (+1.1%), and stock selection in Health Care (+0.7%). Negative contribution came mainly from selection in Information Technology (-1.6%), Industrials (-0.3%), and underallocation to Financials (-0.5%).

THB's top five performing stocks (from a contribution standpoint) were Guess? Inc. (Consumer Discretionary, +1.7%), TPI Composites, Inc. (Industrials, +1.7%), PAR Technology Corporation (Information Technology, +1.0%), Sleep Number Corporation (Consumer Discretionary, +1.1%), and Boot Barn Holdings, Inc. (Consumer Discretionary, +1.0%).

The bottom five performing stocks (from a contribution standpoint) were Ping Identity Holding Corp (Information Technology, -0.3%), US Xpress Enterprises, Inc. (Industrials, -0.2%), M/I Homes, Inc. (Consumer Discretionary, -0.1%), Coherus BioSciences, Inc. (Health Care, 0.0%) and Churchill Capital Corp. (Financials, 0.0%).

This year witnessed an incredible amount of medical and scientific progress, a geopolitical pivot away from China, peak globalisation, increased awareness of and progress towards decarbonisation, geographic worker mobility and rapid corporate innovation. It is impossible to predict the exact impact from these events and developments, but they will affect markets and the economy for years to come. The status quo will shift creating both risks and opportunities. THB believes such an environment is ideal for smaller capitalisation equities and active management.

Efforts towards decarbonisation accelerated in this difficult year as corporations around the world made various pledges to lower their carbon footprint and governments gave monetary support necessary to achieve these goals. A confluence of events including a continued fall in production costs, governmental support/mandates, consumer awareness and corporate initiatives have served to accelerate green technologies and their utilisation. Many countries, regions and corporations have pledged to have substantially lower or zero carbon emissions in the next 15 to 30 years. Solar, wind, hydrogen, and clean/biofuels will all be necessary to achieve carbon targets. Many of the innovative companies within this universe are within the smaller capitalisation range. Electric vehicles and related industries receive the bulk of media coverage, however to achieve lower carbon targets, a host of technologies and fuels will need to be utilised. Smaller capitalisation companies offer exposure to these secular growth industries, but at reasonable valuations. THB's US strategy currently owns nine companies which provide meaningful exposure to efforts to lower global carbon levels.

During the quarter, seven holdings announced new stock repurchase authorisations totaling \$253M and 15 holdings announced acquisitions.

## Stocks in focus<sup>5</sup>

### Clean Energy (CLNE)

Clean Energy Fuel Corp's principal business is supplying renewable natural gas (RNG), compressed natural gas (CNG) and liquefied natural gas (LNG) for medium and heavy-duty vehicles and providing operation and maintenance services for public and private vehicle fleet customer stations. The company has the largest CNG, LNG and RNG refueling network in the United States with 550 stations, three times the size of the next competitor. Efforts to reduce carbon emissions and consume power from renewable resources provides a meaningful tailwind for CLNE and their business is at an inflection point given its infrastructure has been built out (~\$1B spend during the last 5 years), significantly reducing capital spending needs going forward. The company has supply agreements with blue chip customers such as Waste Management, Home Depot, FedEx, Costco, Anheuser Busch and United Parcel Service (UPS). Total SE (European energy company) has partnered with CLNE to provide financing for CLNE's "Zero Now Truck Financing Program" which allows transportation companies to switch in RNG powered trucks from diesel.

### Luna Innovations (LUNA)

Luna Innovations is a manufacturer of proprietary fiber optic testing equipment, fiber optic-based sensors, temperature, and strain sensors. Their business is being driven by two secular growth opportunities. Optical technology is gaining increased share of computing and data transmission markets. Light travels over one hundred times faster than electricity and optical components are displacing copper. Efforts by traditional automotive companies to reduce vehicle weights and thus fuel consumption is the other area of strong growth for the company. End market drivers for Luna products are 5G, IOT, smart infrastructure, light weighting and process control.

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## Portfolio statistics<sup>5</sup>

As at 31 December 2020		
	Fund	Russell Microcap®
Weighted avg market cap	US\$1,089m	US\$837m
Price/sales	1.0x	0.8x
Price/book	2.3x	1.8x
Dividend yield	0.5%	1.0%
Number of securities	101	1,321
Standard deviation	21.6%	21.5%
Sharpe ratio	0.5	0.5
Beta	1.0	
Tracking error	5.8	
Information ratio	0.2	

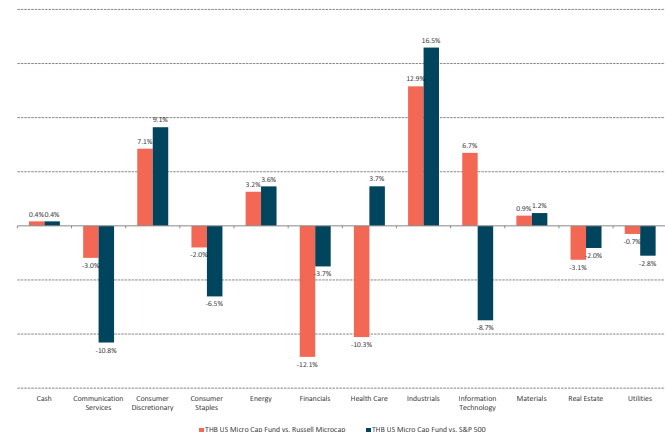
Portfolio statistics are reported in USD. Source: THB Asset Management

## Top 10 holdings<sup>5</sup>

Stock	Sector	Weight
Guess Inc.	Consumer Disc	2.9%
TPI Composites	Industrials	2.7%
PAR Technology	Technology	2.5%
First Busey Corporation	Financials	2.4%
Hyster-Yale Materials	Industrials	2.2%
Perficient	Technology	2.1%
BJ's Restaurants	Consumer Disc	2.1%
BioLife Solutions	Healthcare	2.0%
Renewable Energy Group	Energy	2.0%
Joint Corp	Healthcare	1.9%

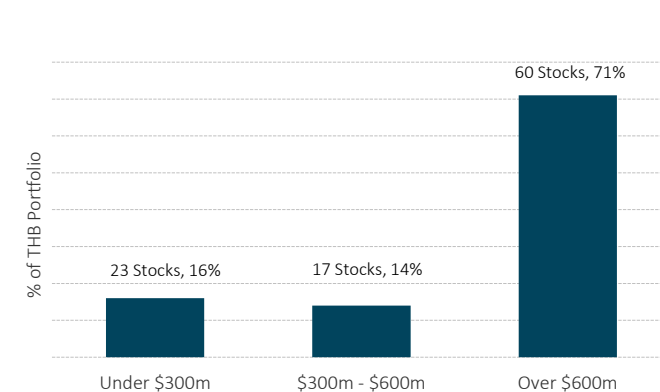
Source: THB Asset Management

## Active sector positioning



Source: THB Asset Management

## Companies by market capitalisation



Source: THB Asset Management

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## 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.

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Asset Management

For more information contact: +61 2 9328 6445 or  
clientservice@brookvine.com.au

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