THB Asset Management
A VICTORY CAPITAL® INVESTMENT FRANCHISE

# THB International (ex-USA) Micro Cap Fund – Class W

## Quarterly Report – Q1 2022

## Market commentary

The MSCI World ex USA Small Cap® Index returned -10.2% (AUD) in Q1 2022.

Energy (+24.7%) was the best performing sector, followed by Materials (+1.9%) and Utilities (+1.0%). Health Care (-17.9%) was the worst performing sector, followed by Consumer Discretionary (-14.8%) and Information Technology (-14.6%).

Canada (+6.5%) was the best performing country, followed by Singapore (+3.0%) and Ireland (+0.5%). Finland (-19.9%), Sweden (-18.2%), and United Kingdom (-14.3%) were the worst performing countries in the Index.

Global equities delivered mixed performance this quarter as participants digested persistent levels of higher inflation, tighter monetary policy, as well as simmering geopolitical tensions that culminated with Russia's invasion of Ukraine on February 24. The invasion of Ukraine had been weighing on the markets throughout February, and most indices have recovered to levels above the invasion day lows. Western countries reacted swiftly to the invasion and unleashed a host of sanctions against Russia and also effectively unplugged Russia from the world banking system by disallowing transactions via the SWIFT system. In addition to mandatory governmental sanctions, a significant number of major brands and corporations have voluntarily decided to exit or cease operations in Russia. These sanctions and actions have served to amplify preexisting inflationary drivers such as energy prices and supply chain disruptions.

The Federal Reserve raised interest rates and struck a more hawkish tone, intending to bring inflation under control. Large-cap companies outperformed this quarter, with the MSCI World ex USA Index returning-4.8% versus the MSCI World ex USA Small Cap Index return of-7.2%.

## Portfolio commentary

The THB International (ex-USA) Micro Cap Fund returned-16.3% (net of fees) in Q1 2022.

Contributors to the portfolio's performance were positive stock selection in Canada, underallocation to Singapore, and underallocation to Israel. Detractors from performance included underallocation to Canada as well as stock selection in the United Kingdom and Japan.

From a sector perspective, primary contributors to performance mainly came from underallocation to Financials, stock selection in Real Estate, and underallocation to Consumer Discretionary. Stock selection in Financials and Industrials as well as overallocation to Health Care were primary detractors to performance this quarter.

THB's top five performing stocks (from a contribution standpoint) were Karora Resources, Inc. (Australia, Materials, +0.3%), u-blox Holding AG (Switzerland, Information Technology, +0.3%), Wesdome Goldmines Ltd. (Canada, Materials, +0.3%), VERBIO Vereinigte BioEnergie AG (Germany, Energy, +0.2%), and 2G Energy AG (Germany, Industrials, +0.2%).

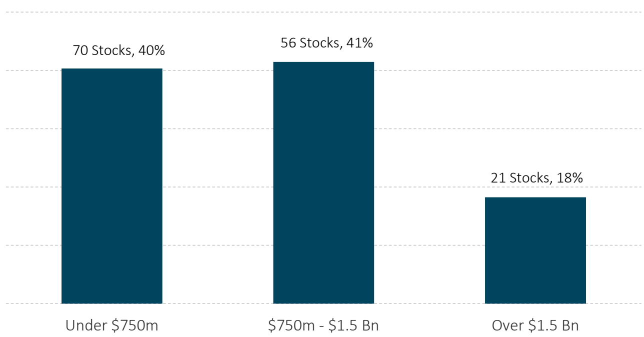
| Fund details | |
|---|---|
| Benchmark | MSCI World ex USA Small Cap Total Return Index (AUD)[2] |
| Inception date | 23 August 2018 |
| Fund size | A$95 million |

**Net performance – 31 March 2022**

| | Fund[1] | MSCI World ex USA Small Cap®[2] | MSCI World ex USA Micro Cap®[3] |
|---|---|---|---|
| 1 month | (2.2%) | (2.9%) | (1.4%) |
| 3 months | (16.3%) | (10.2%) | (9.3%) |
| 1 year | (0.8%) | (0.3%) | 0.1% |
| 2 years p.a. | 17.0% | 15.1% | 21.4% |
| 3 years p.a. | 9.5% | 7.5% | 10.4% |
| Since inception | 4.8% | 5.0% | 6.6% |

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. Fund inception date was 23 August 2018 however inception performance for this class is calculated from 7 September 2018.

## Companies by market capitalisation




Source: THB Asset Management

2. The MSCI World ex-USA Small Cap Total Return Index (AUD) captures small cap representation across 22 of 23 Developed Markets (DM) countries (excluding the United States). With ~2,496 constituents, the Index covers approximately 14% of the free float-adjusted market capitalisation in each country. Source: MSCI

3. The MSCI World ex USA Micro Cap Index captures micro cap representation across 22 of 23 Developed Markets (DM) countries (excluding the United States). With ~4,735 constituents, the index covers approximately 1% of the free float-adjusted market capitalisation in each country.

## Portfolio commentary (continued)

The bottom five performing stocks (from a contribution standpoint) were Esker SA (France, Information Technology,-0.6%), Kainos Group PLC (United Kingdom, Information Technology,-0.5%), Basler AG (Germany, Information Technology,-0.5%), Eckert & Ziegler Strahlen- und Medizintechnik AG (Germany, Health Care,-0.5%), and Kardex Holding AG (Switzerland, Industrials,-0.4%).

We may look back on the invasion of Ukraine as a time marker when a new geopolitical and economic era began. In the short span of a few weeks, seismic geopolitical changes have taken place which will have a sizable impact on global economies, industries, and markets for years to come.

***Globalisation as we knew it ends***

Years of Western countries' appeasement and ignorance regarding the issues surrounding questionable trading partners and practices likely peaked with the invasion of Ukraine. The revanchist tendencies of Mr. Putin set in motion changes that were hard to imagine a month prior. With a single action, he has united NATO and the EU, ended decades of Swiss neutrality, doubled the German defense budget, severely damaged and isolated the Russian economy for years to come, united the US Democrats and Republicans in their common support for Ukraine, and managed to possibly damage his "no limits" friendship with China.

The next era of globalisation will likely encompass trading blocs and regions versus full global integration. Countries will value self-sufficiency above other considerations and trade primarily with countries with shared values and politics. Looking inward (versus outward to low-cost manufacturing locations) will likely be a long-term positive shift for domestic workers and industries.

***Inflation will not be homogenous***

Inflation will not be homogenous across all goods, services, and wages. Unexpected winners and losers will emerge as secondary effects ripple through the economy and difficult-to-predict adaptations occur. Inflation is a point-to-point metric capturing shorter term (12-month to 18-month) directional changes. This is of course important, but sometimes misses the longer-term backdrop. Certain prices and wage groups have experienced a decade-plus of flat to declining movement. The recent "spikes" may be partially caused by current events but are also reflective of the secular declines witnessed during the prior periods. As the new era in geopolitics is ushered in, previous inflation trends may change and not reverse so quickly.

Globalisation was a key deflationary factor in the global economy, creating its own set of countries, industries, and companies which experienced significant benefits as globalisation roared ahead. One group that did not win during the globalisation was domestic factory workers in many developed markets. As jobs were lost to low-cost countries, workers lost any expectation of wage increases. Jobs were scarce and workers were plentiful, allowing corporations to keep wages consistently flat during a fairly strong economic period.

As peak globalisation occurs, many companies are aiming to shore up complex supply chains and move production back onshore. Such simultaneous actions by varying groups of industries are increasing the demand for this cohort of workers in an already tight labor market. Due to the secular nature of changes taking place, the recent increase in wages may not recede as quickly as anticipated.

Inflationary effects on certain goods will surely recede. The laws of supply and demand still hold true, and producers will move to take advantage of sharply higher prices with increased supply. Additionally, the rate of price change for certain goods will moderate slowing overall inflation. This relationship breaks down when multiple forces inhibit the anticipated supply response, as we are currently experiencing with the global energy markets.

***En-flation***

Hydrocarbons impact many aspects of our economy, and rising oil and gas prices will make controlling inflation even more difficult. The breadth of energy's impact on our economy makes taming overall inflation very challenging. Factories run on energy, and hydrocarbons are a key raw material in many products we use each day. Additionally, labour-intensive industries such as farming use vast amounts of energy to plant and harvest the foods we eat. Rising energy prices will be passed along in the form of higher prices for food and services, impacting large parts of our economy.

Fossil fuels have generally experienced boom-and-bust cycles largely anchored to the cyclical elements of supply and demand. Societal, governmental, and investment changes, such as ESG considerations and decarbonisation, have altered the typical supply response. Investors and banks are reducing exposure to the industry, and the companies themselves are diverting cash flows from exploration (supply growth) to dividends and share repurchases.

The supply problem is further complicated by where reserves are located. As Russian oil went under sanctions, the countries with slack capacity (such as Iran, Venezuela, and Saudi Arabia) were talked about as areas from which to source increased supply. Iran and Venezuela already occupy spots on the list of top five most sanctioned countries in the world, and Saudi Arabia's production facilities were recently attacked by Yemen rebels (Houthi). It should be clear that global slack energy capacity is not located in ideal or stable areas, and as certain European countries are quickly learning, this should not be viewed as a long-term supply solution.

Fossil fuels, as the world has suddenly witnessed, have not been relegated to the dustbin of history just yet. As expected, the journey to a greener, lower carbon future will require hydrocarbons and not be as linear as some would hope.

***Wars are inflationary***

History has shown that wars are generally inflationary, and we are currently experiencing three "wars" across different fronts; war in Ukraine, the war against climate change, and the very recent battle against Covid-19. Wars typically require large amounts of "stuff" in a short time frame. Depending on the actual war, food, machinery, ammunition, clothing, fuel, technological solutions, and vehicles are some examples of what is needed. Governments have historically printed money to finance wars, and the same is happening today. Governments across the world are increasing their budgets to fight these three wars.

***Why small companies perform well during inflationary periods***

Smaller cap stocks have historically performed well during inflationary periods. This relative outperformance is likely due to a host of factors. The structure of the underlying businesses, industry representation of the benchmarks, and labour force composition are some of the reasons which contribute to their ability to prosper during higher levels of inflation. Additionally, smaller companies typically have sizable market shares of lower total addressable market sizes. Put simply, smaller companies sell mission-critical, niche parts or services that go into much larger products or projects. This structure generally affords them a large degree of pricing power.

## Portfolio commentary (continued)

***Inflationary opportunities in today's markets***

Every market cycle, even with similar drivers such as inflation, will have differing sets of companies that prosper. THB's investment process seeks out companies with traits such as low levels of debt, pricing power, high operating margins, and high returns on capital. Many of these traits are also shared by businesses which should prosper during inflationary periods.

Considering today's economic structure and inflation backdrop, THB sees a host of attractive opportunities. Some are textbook inflation hedges, and others are more tangential and situational to today's environment. These opportunities include:

- Commodity producers: energy, metals, chemicals, wood products, fertilisers, aggregates, and food producers
- Commodity producer ecosystem: companies that sell to or that service commodity producers will benefit from the higher volumes and increased revenue from their customers. These include oil service companies and machinery producers
- Distributors: companies that distribute various goods (machinery, food, technology, chemicals) stand to benefit from inflation, assuming they are able to hold margins. They will experience higher gross margin revenue over some element of fixed costs
- People businesses/services: In the current very tight labour market, having an intact team that can provide various services will be in high demand. Customers may not have the ability to find and retain personnel needed to perform certain services. Companies which can provide them in a timely, efficient manner should do well
- Technology companies: broad wage and goods inflation will spur capital investment into projects which increase efficiency and productivity. Software, services, and hardware will all be needed.

## Stocks in focus

THB's portfolio companies continue to deploy capital with the goal of increasing shareholder value. They announced 22 share repurchase authorisations and 28 acquisitions in the first quarter.

During the quarter, THB added two new holdings to the strategy which it believes stand to benefit from the transition to electric vehicles (EVs). A significant amount of metals such as nickel, lithium and cobalt will be required to increase the production of these cars and their batteries.

**Imdex Ltd (Australia)**

Imdex is a global mining technology company that develops drilling optimisation products and cloud-connected sensors. Its solutions provide real-time rock knowledge and data that enables fast, successful and cost-effective operations to drilling contractors and resource companies. Imdex IoG sensors enable creation of a virtual rock model for critical analysis and precision mining, which helps their customers reduce GHG emissions from mining operations.

Imdex has a global presence in all key mining regions of the world and a comprehensive distribution network. It is well positioned to benefit from increasing capital spending due to demand for critical metals used in clean energy such as electric vehicles and batteries. For the world to achieve its net-zero goals, the aluminum, copper and nickel industries need to double in size by the late 2020s, while lithium and cobalt mining would need to increase fivefold.

**Karora Resources (Canada)**

Karora is a Canada-listed company with two gold mining operations in Western Australia: Beta Hunt Mine and Higginsville Gold Operations. The company is investing in more exploration projects in the nearby area to leverage their milling process in a hub-and-spoke model. They are also exploring the option to mine nearby nickel.

The company has an attractive ESG profile, reaching carbon neutrality in 2021 through both direct GHG reduction initiatives and offset projects in renewables and Australian reforestation under the Australian government's Climate Active Program.

New CEO Paul Huet, who joined the company in 2019, brought 30 years of industry experience in the mining industry and a strong operational track record.

***Outlook***

Many of the challenges and opportunities witnessed and discussed over the past year remain in place. Like Covid-19, the war in Ukraine appears to be another accelerant for preexisting trends. In the short term, higher levels of volatility may be experienced as recalibration to a new geopolitical and inflationary environment takes place. Longer term, THB believes there are many positive developments and conditions which will increase the opportunity set for smaller company investors.

## Portfolio statistics[4]

| As at 31 March 2022 | | |
|---|---|---|
| | Fund | Benchmark |
| Weighted avg market cap | US$976m | US$2,993m |
| Price/sales | 1.7x | 1.2x |
| Price/Book | 3.0x | 1.5x |
| Dividend yield | 1.5% | 2.4% |
| Number of securities | 147 | 2,578 |
| Standard deviation | 18.5% | 16.1% |
| Sharpe ratio | 0.8 | |
| Beta | 1.1 | |
| Tracking error | 6.4 | |
| Information ratio | 1.1 | |

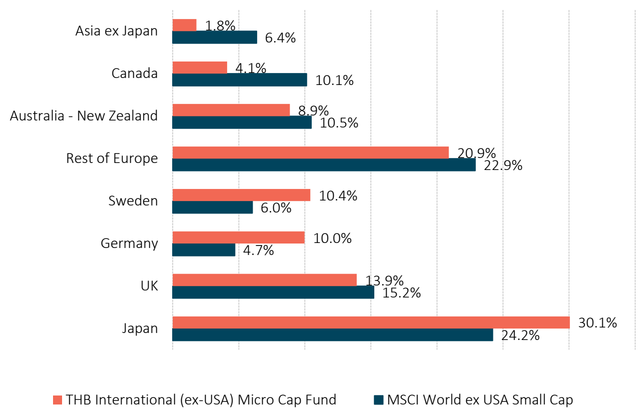
Source: THB Asset Management

## Top 10 holdings[5]

| Stock | Sector/Country | Weight |
|---|---|---|
| Johns Lyng Group Ltd | Industrials/Australia | 1.5% |
| El.En. S.p.A. | Health Care/Italy | 1.4% |
| Treatt plc | Materials/UK | 1.4% |
| Judges Scientific plc | Industrials/UK | 1.4% |
| secunet Security Networks | Technology/Germany | 1.3% |
| u-blox Holding AG | Technology/Switzerland | 1.2% |
| Focusrite PLC | Consumer Disc/UK | 1.2% |
| Biotage AB | Health Care/Sweden | 1.2% |
| PWR Holdings Ltd | Consumer Disc/Australia | 1.2% |
| Kainos Group PLC | Technology/UK | 1.1% |

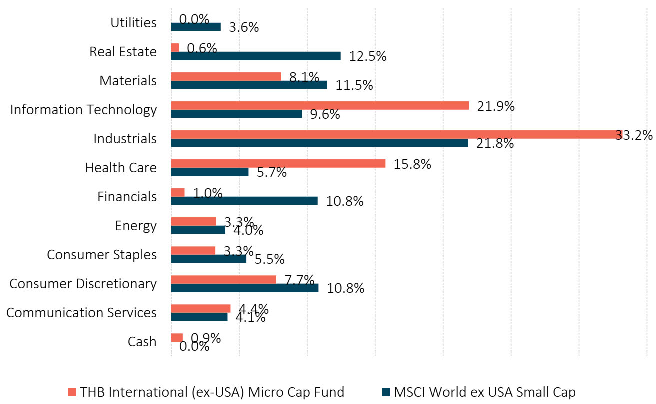
Source: THB Asset Management

## Country allocation[5]




Source: THB Asset Management

## Sector allocation[5]




Source: THB Asset Management

4.Portfolio statistics are reported in USD.

5. 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.

## Investment strategy

THB Asset Management (THB), an investment franchise of Victory Capital Management Inc., is a dedicated micro and small cap specialist investment franchise based in Connecticut, USA. Founded in 1982, THB Asset Management has 39 years' experience investing in micro and small cap companies. THB's International Opportunities strategy is based on the belief that there are inefficiencies in the micro cap segment of the market due to lack of analyst coverage, limited investable options, resource constraints and difficulty in identifying value. THB utilises a disciplined, fundamental approach that blends both qualitative and quantitative methods to construct a well-diversified, low-risk portfolio of companies that possess attractive operating metrics, yet with comparable valuation to the MSCI World ex USA Small Cap® Index.

For more information, contact Brookvine Client Service on +61 2 9328 6445 or clientservice@brookvine.com.au