

THB US Micro Cap Fund

Quarterly Report – Q2 2022

Market commentary

The Russell Microcap® Index returned -11.5% in Q2. Utilities (+2.7%) was the best performing sector, followed by Consumer Staples (-7.8%) and Financials (-11.3%). Communication Services (-27.4%) performed the worst, followed by Materials (-25.9%) and Consumer Discretionary (-23.9%).

US Equities were broadly lower this quarter and delivered fluctuating monthly performance. Following an April sell-off, May witnessed stabilisation driven by improved optimism around economic normalisation. However, the market sentiment deteriorated again in June among escalating concerns about the odds for a recession. The Fed pivoted to a more aggressive stance in regard to combating inflation. On June 15th the Fed announced a 75 bps rate hike and made it clear to the market that they may increase the tempo and scope of future rate hikes. The Fed's more aggressive posture combined with stubbornly high inflation weighed on sentiment as a recession might need to be induced in order to tame inflation. The specter on higher interest rates continued to pressure high multiple equities and growth underperformed across all capitalisation ranges.

High inflation, a driving force behind the economic and market uncertainty, may be showing early signs of moderation. There is evidence that may indicate that inflation has peaked and could experience lower readings in the coming months, these being high inventory levels/markdowns, commodity price moderation and job cuts across certain industries.

An unintended consequence of the pandemic driven supply chain bottlenecks is stocking excess inventories. The strategy made sense at a time when demand came back strong during the re-opening while goods were hard to secure. Large retailers such as Walmart and Target are now dealing with the downside of markdowns or inventory write-offs. With too much stock in certain categories, Target has decided to reduce prices on such items. While Target and Walmart are feeling the pain, the consumer may reap the benefit. If others follow Target's lead, inflation in the retail sector could begin to moderate.

Commodity prices have begun to moderate from peak levels as supply catches up with demand surge experienced across the various complexes. Falling prices are likely a result of the confluence of normalising demand patterns, less urgent restocking, and improving supply chains. Broad based declines in commodities will work through the various inflation readings in the coming quarters.

A host of companies have recently announced hiring freezes and/or job cuts. These actions currently remain largely confined to the technology sector and high growth companies. The majority of these job cuts are likely driven more by the operating models these businesses employ and not a perfect reflection of economic conditions. Certain companies favoured growth over profits and are quickly recalibrating to the recent drawdown in their valuation multiples. Any easing of wage inflation and tight labour market conditions may serve to ease inflation.

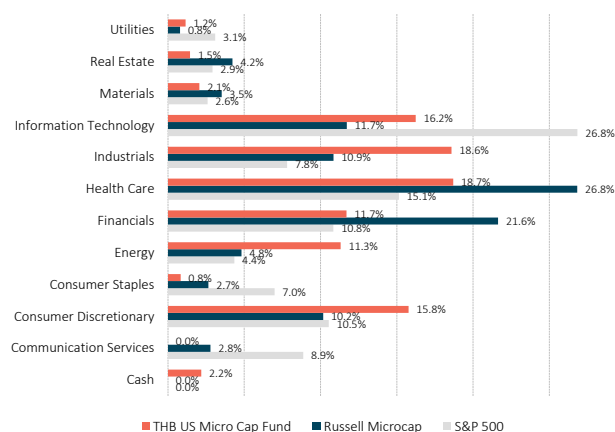
| Fund details | |
|----------------|--------------------------------------|
| Benchmark | Russell Microcap® Index ³ |
| Inception date | 5 September 2014 |
| Fund size | A\$68.3 million |

| Performance ¹ – 30 June 2022 | | | |
|---|-------------------|-------------------|------------|
| | Fund ² | Russell Microcap® | Difference |
| 1 month | (5.2%) | (5.3%) | 0.1% |
| 3 months | (9.9%) | (11.5%) | 1.6% |
| 1 year | (21.8%) | (24.4%) | 2.6% |
| 2 years p.a. | 15.2% | 10.4% | 4.8% |
| 3 years p.a. | 5.8% | 5.8% | 0.0% |
| 5 years p.a. | 6.9% | 6.9% | 0.1% |
| Since inception p.a. ² | 9.9% | 10.1% | (0.2%) |

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. Figures in the table may not sum correctly due to rounding.

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 -9.9% in AUD (net of fees) in Q2.

The portfolio saw positive contribution from stock selection in Health Care (+2.2%), stock selection in Information Technology (+0.9%), and underallocation to Communication Services (+0.8%). Negative contribution came mainly from underallocation to Financials (-1.2%), stock selection in Communication Services (-0.9%), and stock selection in Real Estate (-0.6%).

The top five performing stocks (from a contribution standpoint) were Grid Dynamics Holdings, Inc. Class A (Information Technology, +0.3%); UFP Technologies, Inc. (Health Care, +0.2%); Lantheus Holdings, Inc. (Health Care, +0.2%); Bassett Furniture Industries, Inc. (Consumer Discretionary, +0.2%); and CryoPort, Inc. (Health Care, +0.2%).

The bottom five performing stocks (from a contribution standpoint) were RPC, Inc. (Energy, -1.2%); Transcat, Inc. (Industrials, -1.0%); Greenbrier Companies Inc. (Industrials, -0.7%); Clean Energy Fuels Corp. (Energy, -0.7%); and EverQuote, Inc. Class A. (Communication Services, -0.55%)

During the quarter, THB's portfolio companies announced 16 acquisitions and six stock repurchase authorisations.

A new holding added to the strategy in the quarter is **OptimizeRx**. They provide a digital health messaging platform via the electronic health records (EHR) platforms. This serves as a direct channel for pharmaceutical companies to communicate with healthcare providers and market their products digitally. Its platform allows pharmaceutical manufacturers to reach patients and increase clinical awareness, treatment initiations and care management support through its vast network of physicians. OPRX serves 95% of the large pharma manufacturers, offering superior marketing return on investment through its platform. The company is seeing significant growth acceleration fueled by the pandemic when pharma companies shifted marketing spend from in-person to digital channels. This trend is expected to continue leading to a projected 50% increase in digital spend over the next three years. OPRX has gained critical mass to drive operating leverage and continues to invest in new technology supported by its debt free balance sheet.

The uncertainty which took hold in the market and economy this quarter can cause volatility, but also presents predictable patterns and opportunities. As fear spreads, worst case scenarios morph into the base case and irrational behaviour ensues. This has happened numerous times in the past and will continue to happen in the future. THB believes these periods provide a wealth of alpha opportunities as the number of level of mispricing within the universe increases.

THB believes valuations for Micro Cap stocks are attractive on a relative and absolute basis. The current drawdown is historically rare and has typically been a good entry point. As the market recalibrates to a changing economic, monetary and geopolitical regime, dislocation is taking place that should provide great long term investment opportunities.

Portfolio statistics⁵

| As at 30 June 2022 | | |
|-------------------------|----------|-------------------|
| | Fund | Russell Microcap® |
| Weighted avg market cap | US\$838m | US\$546m |
| Price/sales | 1.1x | 1.2x |
| Price/book | 1.7x | 1.5x |
| Dividend yield | 0.9% | 1.2% |
| Number of securities | 97 | 1,798 |
| Standard deviation | 21.0% | 21.4% |
| Sharpe ratio | 0.4 | 0.3 |
| Beta | 0.9 | |
| Tracking error | 6.2 | |
| Information ratio | 0.1 | |

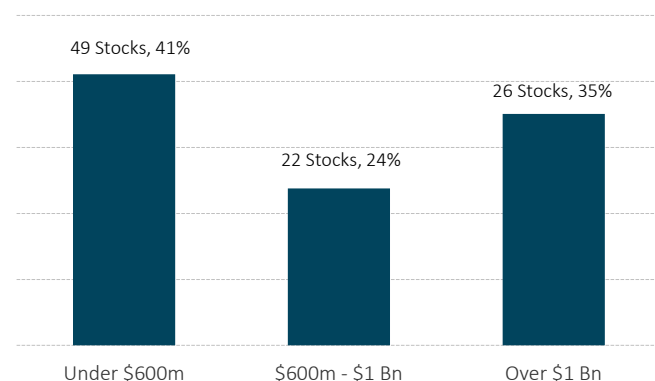
5. Portfolio statistics are reported in USD. Source: THB Asset Management

Top 10 holdings

| Stock | Sector | Portfolio weight |
|--------------------------------|---------------|------------------|
| First Busey Corporation | Financials | 3.4% |
| ePlus Inc | Technology | 2.9% |
| TETRA Technologies Inc | Energy | 2.9% |
| Transcat Inc | Industrials | 2.7% |
| RPC Inc | Energy | 2.5% |
| Movado Group Inc | Consumer Disc | 2.4% |
| Grid Dynamics Holdings Inc | Technology | 2.3% |
| Old Second Bancorp Inc | Financials | 2.3% |
| Heritage Financial Corporation | Financials | 2.2% |
| LeMaitre Vascular Inc | Health Care | 2.2% |

Source: THB Asset Management

Companies by market capitalisation



Source: THB Asset Management

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 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
VICTORY CAPITAL MANAGEMENT FRANCHISE

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

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