

THB US Micro Cap Fund

Quarterly Report – Q3 2023

Market commentary

The Russell Microcap® Index (the “Index”) returned -5.0% in AUD in Q3 2023.

Energy (+18.28%) was the best performing sector, followed by Financials (-1.06%) and Consumer Discretionary (-3.39%). Information Technology (-18.08%) performed the worst, followed by Health Care (-17.37%) and Real Estate (-10.37%).

U.S. Equities closed the third quarter on a negative note posting consecutive monthly price declines which drove all major indices negative during the quarter. Broad based declines were likely a give back from the strong and unanticipated returns leading into the quarter, plus a confluence of events and issues which weighed on economic expectations.

The optimism of the preceding quarter quickly gave way as pre-existing concerns about the economy were amplified by rolling strikes at the big three automakers, a potential U.S. government shutdown, higher interest rates, and rising crude oil prices. Realisation that interest rates may stay higher for longer came during what is historically the weakest seasonal period for stocks.

Large Cap stocks outperformed Small and Mid-Cap stocks as the S&P 500 was -3.27% compared to -5.13% for the Russell 2000 and -4.68% for the Russell Mid Cap.

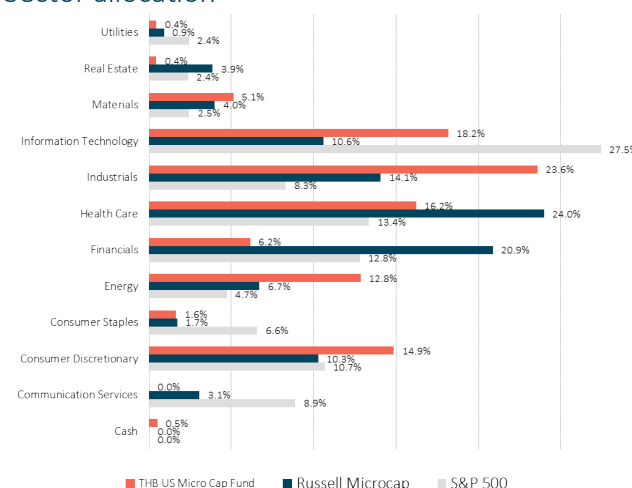
| Fund details | |
|----------------|--------------------------------------|
| Benchmark | Russell Microcap® Index ³ |
| Inception date | 5 September 2014 |
| Fund size | A\$82 million |

| Performance ¹ – 30 September 2023 | | | |
|--|-------------------|-------------------|------------|
| | Fund ² | Russell Microcap® | Difference |
| 1 month | (5.5%) | (6.1%) | 0.6% |
| 3 months | (2.8%) | (5.0%) | 2.2% |
| 1 year | 14.5% | (1.7%) | 16.2% |
| 2 years p.a. | (3.5%) | (10.5%) | 7.0% |
| 3 years p.a. | 12.9% | 8.6% | 4.3% |
| 5 years p.a. | 5.1% | 2.5% | 2.6% |
| Since inception p.a. ² | 10.4% | 9.2% | 1.2% |

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 allocation³



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.

3. 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 -2.8% in AUD (net of fees) in Q3 2023.

The portfolio saw positive contribution from over allocation to Energy (+2.11%) and Industrials (+0.80%) as well as stock selection in Energy (+0.78%). Negative contribution came mainly from under allocation to Financials (-1.11%) as well as stock selection in Consumer Discretionary (-1.05%) and Health Care (-0.61%).

The top five performing stocks from a contribution standpoint were Tetra Technologies, Inc. (Energy, +1.85%); RPC, Inc. (Energy, +0.51%); Limbach Holdings, Inc. (Industrials, +0.39%); Expro Group Holdings, N.V. (Energy, +0.36%), and Holley, Inc. (Consumer Discretionary, +0.35%).

The bottom five performing stocks from a contribution standpoint were Overstock.com, Inc. (Consumer Discretionary, -0.99%); Luna Innovations, Inc. (Information Technology, -0.64%); Biolife Solutions, Inc. (Health Care, -0.52%); UFP Technologies, Inc. (Health Care, -0.48%); and LeMaitre Vascular, Inc. (Health Care, -0.46%).

During the quarter, THB's portfolio companies announced 16 acquisitions and 14 new share repurchase authorisations.

One portfolio holding to highlight this quarter is Atmus Filtration Technologies Inc (Atmus).

Atmus is a leading manufacturer of premium filtration products for highway and off-highway commercial vehicles. Atmus is a spinoff from Cummins and is currently trading at a discount to direct filtration peers providing an attractive entry point. As an independent entity, the company is well-positioned to accelerate its growth through expansion in new market and distribution channels. It was a strong brand recognition protected by over 1,300 patents worldwide and deep expertise in filtration equipment made for first-fit or aftermarket for OEMs. Their products are primarily sold in the aftermarket as it comprises 84% of revenues, which reduces its truck market cyclical exposure.

The replacement and repair opportunities for Atmus are rising as global emissions standards become more stringent and phase-ins require lower emissions per vehicle which can be addressed through newer filters and more filter components per vehicle. They continue to innovate as the company has started to offer Zero Emission Vehicle (ZEV) filters to adapt to the higher number of electric vehicles on the market.

Outlook

Rising interest rates increase THB's existing concerns about excessive debt levels built up during the period of zero interest rates. As debt financing was readily available and low cost, it spread through the economy and was utilised to increase returns and sometimes be a foundational element of business models. It would be foolish to assume that exiting the ultra-low interest rate era will not produce debt induced problems somewhere in the economy. Where this will manifest itself has yet to materialise. Commercial Real Estate (CRE), especially offices, has been quickly identified as a potential problem. It makes rational sense and is written about regularly in the press. For those very reasons, CRE will likely not be where sizable problems arise. It is a rare occurrence when such issues are so well telegraphed and known. THB remains vigilant in monitoring for any developments.

The broad market remains highly concentrated in a handful of stocks which can create multiple risks. The FAANG stocks

(Facebook, Amazon, Apple, Netflix, Google) have now morphed into Magnificent Seven (Tesla, Meta, Alphabet, Microsoft, Apple, Nvidia, Amazon). Some names changed, but still a small grouping of stocks having an outsized impact on Large Cap index returns. Prior instances of such concentrations (Nifty Fifty '70-73, Tech Bubble '99) all ended. Post those concentrated periods, less concentrated (both by sector and industries) asset classes performed best. Periods of extreme market concentrations can potentially diminish forward returns for Large Cap.

During the post COVID period, models and forecasts have shown their failings in the economy amongst other areas. Despite these glaring shortcomings, we still yearn for someone or entity to accurately predict the future for us. Unfortunately, this will likely not happen. Still, many wait anxiously for Chair Powell to give us his thoughts on the interest rates and the economy or a star portfolio manager to explain his or her holdings which will define the new economy.

Interest rates and the Fed actions or non-actions will likely saturate the press in the coming months. Jerome Powell maintains that patience is needed for their work to bear fruit in slowing the economy and reducing inflation. This is also the same Federal reserve which could not stimulate economic activity with seven years of zero rates and three rounds of quantitative easing (QE) and recently called the first signs on inflation transitory.

THB prefers to focus on the current and not gaze too far into future nor rely on the past as a perfect predictor. There are many current positives for high quality small and mid-cap equities which THB believes can deliver above average returns in the coming periods. Waiting for perfect clarity is one the more expensive investment propositions.

Portfolio statistics⁵

| As at 30 September 2023 | | |
|-------------------------|----------|-------------------|
| | Fund | Russell Microcap® |
| Weighted avg market cap | US\$904m | US\$633m |
| Price/sales | 1x | 1x |
| Price/book | 1.8x | 1.4x |
| Dividend yield | 0.7% | 1.6% |
| Number of securities | 97 | 1,525 |
| Standard deviation | 21.3% | 21.6% |
| Sharpe ratio | 0.4 | 0.3 |
| Beta | 0.9 | |
| Tracking error | 6.5 | |
| Information ratio | 0.4 | |

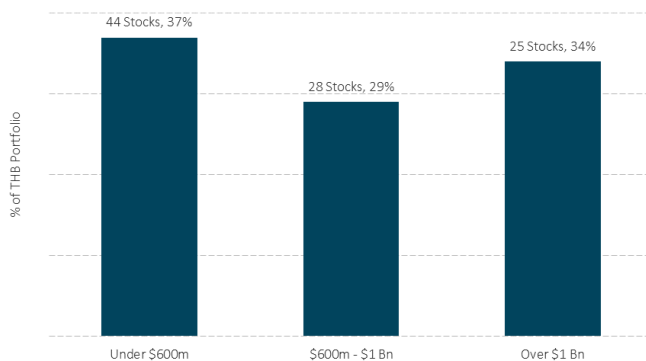
5. Portfolio statistics are reported in USD. Source: THB Asset Management

Top 10 holdings

| Stock | Sector | Portfolio weight |
|-------------------------------|---------------|------------------|
| TETRA Technologies, Inc. | Energy | 3.6% |
| Transcat, Inc. | Industrials | 2.8% |
| UFP Technologies, Inc. | Health Care | 2.7% |
| RPC, Inc. | Energy | 2.6% |
| ePlus inc. | Technology | 2.6% |
| LeMaitre Vascular, Inc. | Health Care | 2.2% |
| Preformed Line Products | Industrials | 2.1% |
| Ichor Holdings, Ltd. | Technology | 2.0% |
| Johnson Outdoors Inc. Class A | Consumer Disc | 1.9% |
| Immersion Corporation | Technology | 1.8% |

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 40 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.

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For more information, contact Brookvine Client Service on clientservice@brookvine.com.au

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