

THB US Micro Cap Fund

Quarterly Report – Q4 2023

Market commentary

The Russell Microcap® Index (the “Index”) returned 9.8% in AUD in Q4 2023.

Financials (+22.84%) was the best performing sector, followed by Utilities (+22.34%) and Health Care (+21.21%). Energy (-2.96%) performed the worst, followed by Materials (+7.91%) and Communication Services (+8.66%).

U.S. Equities were broadly higher during the quarter as investors began to price in an end to the Federal Reserve’s rate tightening cycle, in which the widely anticipated recession did not occur, and attractive valuations spurred buying.

The quarter began with continued selling pressure that quickly reversed in late October as most indices bottomed. Economic releases (GDP, Inflation, Employment) supported the narrative of strong underlying economic growth, moderating inflation, and a normalizing labor market. The equity rally began around November 1st, when the U.S. Treasury triggered a powerful upward price move in the 10 and 30-year bonds by focusing new debt sales on the shorter-term notes instead of the longer-term maturities.

In December, Fed Chair Jerome Powell comforted investors as he stated that the fight against inflation might soon be ending. Small Cap stocks lead the markets this quarter as the Russell Microcap Index® delivered a 16.06% return compared to 11.69% for the S&P 500® Index and 12.56% for the Magnificent Seven (USD).

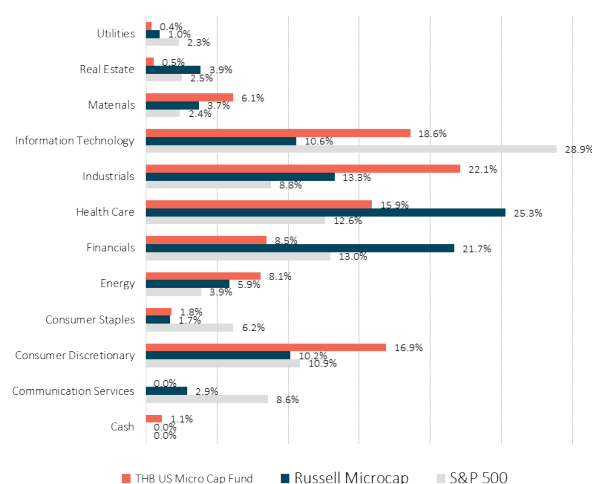
Fund details	
Benchmark	Russell Microcap® Index ³
Inception date	5 September 2014
Fund size	A\$83 million

Performance ¹ – 31 December 2023			
	Fund ²	Russell Microcap®	Difference
1 month	9.0%	11.0%	(2.1%)
3 months	3.4%	9.8%	(6.4%)
1 year	15.6%	8.7%	7.0%
2 years p.a.	(1.0%)	(4.7%)	3.6%
3 years p.a.	6.3%	4.8%	1.5%
5 years p.a.	9.2%	9.3%	0.0%
Since inception p.a. ²	10.5%	10.0%	0.5%

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 3.4% in AUD (net of fees) in Q4 2023.

Two of the larger detractors from our relative performance this quarter stemmed from our underweight position to Biotechnology and Banks. Biotechnology is one of the larger weights in the Russell Microcap® Index (13.80%) and comprised largely of unprofitable companies which we will not own in the strategy. The Biotechnology Industry group was +25.70% for the quarter, and the underweight position cost us approximately 150 basis points during the period. We remain underweight banks due to the volatile interest rate movements, heightened regulatory environment, and increased competition from private credit. The underweight position in banks cost us approximately 160 basis points.

The portfolio saw positive contribution from stock selection in Consumer Discretionary (+1.12%), Materials (+0.70%), and Real Estate (+0.57%). Negative contribution came mainly from stock selection in Health Care (-2.42%), overallocation to Energy (-1.72%), and stock selection in Energy (-1.50%).

The top five performing stocks (from a contribution standpoint) were M/I Homes, Inc. (Consumer Discretionary, +1.05%); Universal Technical Institute, Inc. (Consumer Discretionary, +0.91%); Beyond, Inc. (Consumer Discretionary, +0.82%); Limbach Holdings, Inc. (Industrials, +0.72%), and Century Aluminum Company (Materials, +0.65%).

The bottom five performing stocks (from a contribution standpoint) were Tetra Technologies, Inc. (Energy, -1.30%); Expro Group Holdings N.V. (Energy, -0.70%); RPC, Inc. (Energy, -0.61%); Preformed Line Products Company (Industrials, -0.47%); and Beauty Health Company (Consumer Staples, -0.35%).

During the quarter, our portfolio companies announced 27 acquisitions and 14 new share repurchase authorizations.

A portfolio holding to highlight this quarter is Atmus Filtration. Atmus Filtration Technologies is a leading manufacturer of premium filtration products for highway and off-highway commercial vehicles. Atmus is a spin-off 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 has strong brand recognition protected by over 1,300 patents worldwide and deep expertise in filtration equipment made for first-fit or aftermarket for OEMs. The company's products are primarily sold in the aftermarket, as it comprises 84% of revenues, which reduces its truck market cyclicality 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. Atmus continues to innovate, and the company has started to offer zero-emission vehicle (ZEV) filters to adapt to the higher number of electric vehicles on the market.

Outlook

We maintain our positive outlook regarding the overall health of the economy and U.S. Consumers. However, our cautious stance about potential negative feedback loops that could arise from an excessively tight monetary policy is moderating. We initially doubted Fed Chair Jerome Powell and other Federal Reserve academics ability to remedy the inflation they initially created and then labeled "transitory". Nonetheless, it appears evident that interest rates might have peaked for this cycle without causing a significant economic crisis. This transition allows for a thorough damage assessment and the identification of potential problem areas, aiding us in their analysis and avoidance. This increased certainty is also very positive for the equity markets.

We are cautiously optimistic that exiting the zero-interest rate era will create a more normalized investment environment. One where wealth is created through investing in prudent corporations instead of financial engineering. For the past decade, The Fed, various Quantitative Easing (QE) programs and experimental monetary policies had an outsized impact on price action in the equity markets and likely led to widespread misallocations of capital. Investors sought returns in risky places and began to perceive levered private assets as less risky than liquid public equities.

Although the highly anticipated recession has not yet materialized, we of course recognize that future economic growth may witness downturns. Attempting to precisely predict recessions, although noble, remains a challenging pursuit. This year particularly emphasized the unpredictability, with many top financial minds predicting a recession that never happened. Our focus remains on understanding the potential duration, severity, and impact of any impending recession on our invested companies. Considering the robust labor and housing markets, we anticipate that any recession will likely be brief and shallow. Additionally, the resilient and high-quality business models we invest in afford protection and can possibly leverage economic disruptions to their advantage.

Portfolio statistics⁵

As at 31 December 2023		
	Fund	Russell Microcap®
Weighted avg market cap	US\$1,056m	US\$856m
Price/sales	1.1x	1.2x
Price/book	1.9x	1.6x
Dividend yield	0.7%	1.4%
Number of securities	99	1,495
Standard deviation	21.8%	22.1%
Sharpe ratio	0.4	0.3
Beta	0.9	
Tracking error	6.6	
Information ratio	0.2	

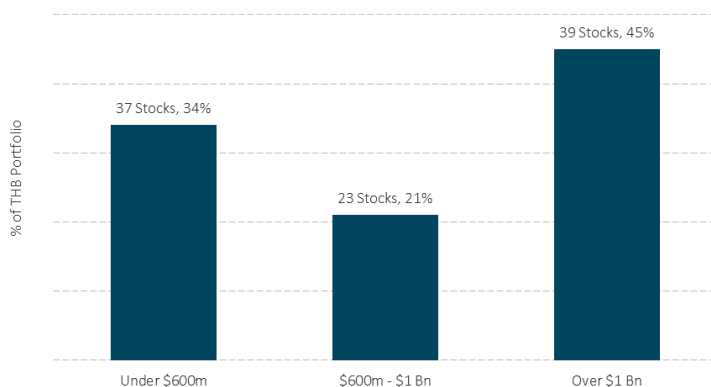
5. Portfolio statistics are reported in USD. Source: THB Asset Management

Top 10 holdings

Stock	Sector	Portfolio weight
ePlus inc.	Technology	2.5%
Transcat, Inc.	Industrials	2.3%
UFP Technologies, Inc.	Health Care	2.3%
LeMaitre Vascular, Inc.	Health Care	2.1%
M/I Homes, Inc.	Consumer Disc	2.1%
RPC, Inc.	Energy	2.0%
TETRA Technologies, Inc.	Energy	1.9%
First Busey Corporation	Financials	1.8%
Universal Technical Institute	Consumer Disc	1.8%
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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