

THB US Micro Cap Fund

Quarterly Report – Q3 2024

Market commentary

The Russell Microcap® Index (the “Index”) returned 4.2% in AUD in Q3 2024. Real Estate (+13.98%) was the best performing sector, followed by Financials (13.97%) and Health Care (+9.68%). Energy (-1.28%) performed the worst, followed by Materials (+3.51%) and Consumer Discretionary (+3.84%).

Equities delivered solid performance during the quarter as investors gained more confidence that the U.S. economy would experience a ‘soft’ or ‘no landing’ scenario. Moderating, but still strong labor markets, cooling inflation, solid economic growth, and lower interest rates supported the notion that a hard economic landing was a low probability event.

The Russell 2000®, Russell Midcap® and Russell Microcap indices led the markets delivering returns of 9.3%, 9.2% and 8.29% respectively while the S&P 500® posted a 5.9% gain.

The shift to accommodative monetary policy began in September with the Federal Reserve cutting interest rates by fifty basis points. The current federal funds rate was held for over a year at current levels before this pivot began. This policy shift follows a period of eleven rate hikes aimed at combating the post pandemic inflation surge.

Fund details	
Benchmark	Russell Microcap® Index ³
Inception date	5 September 2014
Fund size	A\$85 million

Fund performance ¹			
	Fund ²	Russell Microcap®	Difference
1 month	(2.1%)	(2.7%)	0.6%
3 months	4.7%	4.2%	0.4%
1 year	10.6%	15.9%	(5.3%)
2 years p.a.	12.5%	6.7%	5.8%
3 years p.a.	1.0%	(2.4%)	3.4%
5 years p.a.	9.0%	7.8%	1.1%
Since inception p.a. ²	10.4%	9.8%	0.6%

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. 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. Returns greater than 1 year are annualised.

Composite performance ³			
	Composite (Net)	Russell Microcap ⁴	S&P500
1 month	0.2%	(0.5%)	2.1%
3 months	10.3%	8.3%	5.9%
1 year	20.5%	24.6%	36.7%
3 years p.a.	0.5%	(3.7%)	11.9%
5 years p.a.	10.6%	8.4%	16.0%
10 years p.a.	8.4%	7.3%	13.4%
Inception p.a.	11.8%	6.5%	8.5%

3. Returns in USD; the THB Micro Cap Composite contains fully discretionary micro cap equity accounts. THB claims compliance with the Global Investment Performance Standards (GIPS). The minimum account size for this composite is US\$1 million. Performance is shown net of 1.25% p.a. management fees and assumes the reinvestment of income. 4. Since inception return is the Russell 2000 Index from June 1998 to December 2006, and Russell Microcap Index thereafter. 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. Returns greater than 1 year are annualised. Past performance is no indication of future performance.

Portfolio commentary

The THB US Micro Cap Fund returned 4.7% in AUD (net of fees) in Q3 2024. The portfolio saw positive contribution from stock selection in Health Care (+1.11%), Consumer Discretionary (+1.07%) and Financials (+0.63%). Negative contribution came mainly from underallocation to Financials (-0.85%) and Health Care (-0.72%) as well as overallocation to Industrials (-0.64%).

The portfolio's top five performing stocks (from a contribution standpoint) were Hawkins, Inc. (Materials, +0.88%); Climb Global Solutions, Inc. (Information Technology, +0.77%); ePlus, Inc. (Information Technology, +0.73%); UFP Technologies, Inc. (Health Care, +0.62%); and Green Brick Partners, Inc. (Consumer Discretionary, +0.49%).

The bottom five performing stocks (from a contribution standpoint) were Expro Group Holdings, N.V. (Energy, -0.39%); Allient, Inc. (Industrials, -0.26%); Bowman Consulting Group, Ltd. (Industrials, -0.24%); MYR Group, Inc. (Industrials, -0.24%); and Ultra Clean Holdings, Inc. (Information Technology, -0.17%).

During the quarter, the THB portfolio companies announced 22 acquisitions and 4 stock repurchase authorisations.

One portfolio holding to highlight this quarter is Ribbon Communications, Inc. (Ribbon). Ribbon is a leading supplier of IP based real-time communications solutions (both equipment and software) for service provider carriers and enterprise customers.

The company was created by the merger of Sonus and GENBAND in 2017 and later it entered the optical networking industry through ECI Telecom acquisition in 2020.

Ribbon is currently benefiting from new customer wins like Tier 1 service providers Verizon and Lumen helping them in network transformation. Ribbon is also offering the industry's latest 5nm and 3nm optical engine technology in its new DCI product offerings where it has a pipeline of 20 customers, mainly second tier of data center operators and telcos deploying its solutions to connect data centers over fiber.

Outlook

The equity markets have recently experienced significant shifts driven by expectations of a Fed policy pivot, easing inflationary pressures and mixed economic data. With the unemployment rate moderating and other indicators suggesting some economic softness, there has been increased speculation about future potential rate cuts (both size and timing). Jerome Powell, the chair of the Federal Reserve, in recent statements has telegraphed that they would move aggressively if any further weakening of the labor markets emerged.

Despite some uncertainty, THB remains optimistic about future economic activity and the prospect of lower interest rates. One of THB's biggest concerns was a policy mistake (overly restrictive rates) by the Fed. As we now enter an easing cycle, THB believe that threat has largely passed.

Financial conditions (as measured by the Chicago Fed National Financial Conditions Index) have continued to trend more accommodative (lower number) throughout the year and now sit at the lowest level in two years. These levels indicate credit is readily available (albeit at a higher rate than five years ago) and there is no systemic stress in the banking system.

The Bureau of Economic Analysis (BEA) released several sizable positive revisions to real Gross Domestic Product (GDP), real Gross Domestic Income (GDI) and personal income. These data releases have effectively negated the economic 'hard landing' scenario and also highlight rising levels of economic productivity.

Increases in productivity can provide a powerful tailwind to an already strong U.S. economy. It serves to increase overall economic output, dampen rising labour costs and foster durable economic growth.

Automation, AI, and trickle down (to small businesses) effect of existing technologies is driving U.S. output per worker to record high levels. The recent pick up in productivity is a welcome change versus the stagnation experienced during the last ten years.

The last time the U.S. experienced solid increases in productivity was the 1990s. During that time, computers hit an inflection point (in both price and power) enabling sizable productivity gains across most industries in the U.S. economy. Secular economic improvements such as productivity can serve as a powerful catalyst for both earnings and multiples of Small and Mid-size stocks.

Portfolio statistics⁵

	Fund	Russell Microcap®
Weighted avg market cap	US\$1,400m	US\$683m
Price/sales	1.1x	1.2x
Price/book	1.9x	1.7x
Dividend yield	0.8%	1.5%
Number of securities	97	1,443
Standard deviation	21.8%	21.9%
Sharpe ratio	0.4	0.3
Beta	1.0	
Tracking error	6.4	
Information ratio	0.3	

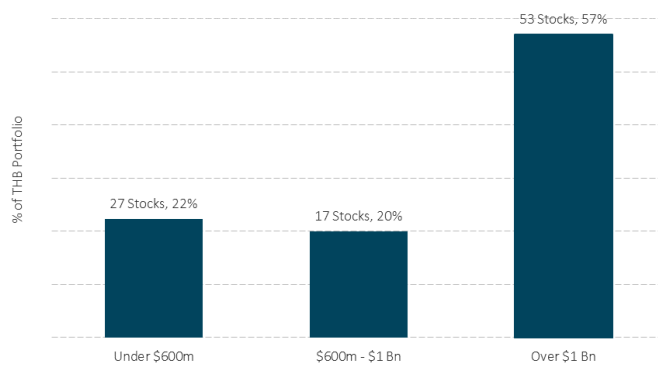
5. Portfolio statistics are reported in USD. Source: THB Asset Management

Top 10 holdings

Stock	Sector	Portfolio weight
Hawkins, Inc.	Materials	2.4%
Latham Group Inc.	Consumer Disc	2.3%
Transcat, Inc.	Industrials	2.3%
ePlus inc.	Technology	2.2%
MarineMax, Inc.	Consumer Disc	2.1%
BrightSphere Investment	Financials	2.1%
Climb Global Solutions, Inc.	Technology	2.0%
UFP Technologies, Inc.	Health Care	1.9%
Immersion Corporation	Technology	1.9%
Century Communities, Inc.	Consumer Disc	1.8%

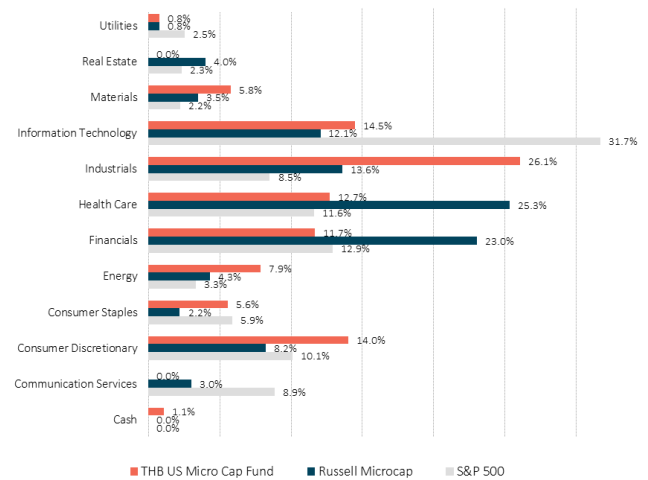
Source: THB Asset Management

Companies by market capitalisation



Source: THB Asset Management

Sector allocation⁶



6. 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. 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 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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