SGH SG HISCOCK & COMPANY

SGH Australian Small Companies Fund

29 February 2024

Performance	Total Net Return (after MER)	Income Return	Growth Return	S&P/ASX Small Ords Accum. Index	**Total Net Return vs. Benchmark**
1 month (%)	-0.02	0.00	-0.02	1.72	**-1.74**
3 months (%)	6.41	0.98	5.43	10.05	**-3.64**
6 months (%)	2.92	0.95	1.97	6.88	**-3.96**
1 year (%)	7.39	2.15	5.24	7.84	**-0.45**
3 years (% pa)	0.95	3.98	-3.03	1.39	**-0.44**
5 years (% pa)	5.45	5.06	0.39	4.42	**1.03**
7 years (% pa)	5.53	4.34	1.19	6.48	**-0.95**
10 years (% pa)	7.73	3.98	3.75	6.07	**1.66**
Inception (% pa)	10.06	4.82	5.24	6.10	**3.96**

Past performance is not a reliable indicator of future performance.

- For the month, the portfolio returned -0.02%, underperforming the Small Ordinaries Accumulation Index by 1.74% (net of fees).
- The February reporting season produced corporate earnings that in aggregate, were ahead of expectations. There was however wide dispersion in performance across sectors. Consumer discretionary was a strong outperformer as resilient sales momentum and clean inventory positions during the period meant that a discounting cycle was avoided and retailers were able to extract better margins as freight costs and other inflationary pressures eased. Outlook statements however, were generally muted and much is dependent on how the ongoing economic slowdown will impact consumer spending over the coming months.
- Another observation during the month was the significant volatility in share price reactions through reporting season. A number of small cap stocks that delivered outsized outperformance were not a result of large earnings upgrades, and were in fact more driven by multiple re-rating, which in some cases remain unjustified.
- The portfolio retains a strong quality bias and continues to offer reliable downside protection in what has proven to be a volatile and uneven market dynamic.

Key Facts

Investment manager	SG Hiscock & Company Ltd.
Launch date	23 Mar 2001
Benchmark	S&P/ASX Small Ordinaries Accumulation Index
Management fees	1.26%
Performance fee	Nil
Fund size	$201.4M
Number of holdings	40
Dividends payable	Semiannual
Buy/sell spread	+0.30/ -0.30%
Minimum initial investment	$20,000
Base currency	AUD
APIR	CSA0131AU
mFund code	SFZ20
Domicile	Australia
	Unit price
Application	$3.2464
Net Asset Value	$3.2367
Withdrawal	$3.2270
	Distribution cpu
31-Dec-21	1.0821
30-Jun-22	2.8996
31-Dec-22	2.5300
30-Jun-23	3.3416
31-Dec-23	2.9748

Fund Strategy

Our focus is on identifying quality small cap businesses with sustainable growth that are mispriced. Our process seeks to identify companies which are growing free cash flow and returns at a margin of safety, are well-positioned in attractive end markets, and led by proven management teams.

Investment Objective

To outperform the benchmark, the S&P/ASX Small Ordinaries Accumulation Index, after fees, over rolling three-year periods, by investing mainly in Australian (primarily outside the S&P/ASX 100 Accumulation Index) and New Zealand securities.

Investment Held

This Fund is generally fully invested in Australian and New Zealand equity securities in a mix of asset classes as follows:

75 – 100% Australian equity securities

0 – 15% New Zealand equity securities

0-10% cash.

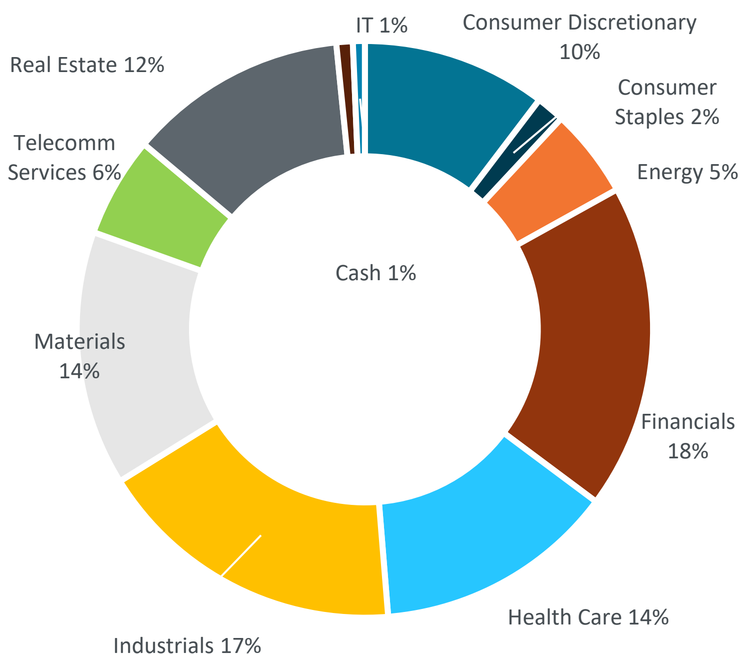
Top 5 Holdings (in alphabetical order)
Beach Energy Limited
Brickworks Limited
Centuria Industrial REIT
HUB24 Limited
Pro Medicus Limited

Top 5 holdings represent 22% of the total Fund.

Top Contributors	**Top Detractors**
ARB Corporation	Ridley Corporation
Maas Group	Lifestyle Communities
GWA Group	Johns Lyng Group
Integral Diagnostics Limited	IPH Limited
Centuria Industrial REIT	Deterra Royalties

Asset Allocation: The Fund

Sector	Fund (%)
Consumer Discretionary	10.35
Consumer Staples	1.59
Energy	5.00
Financials	18.25
Health Care	13.52
Industrials	17.46
Materials	14.30
Telecommunication Services	5.63
Real Estate	12.31
Utilities	---
Information Technology	0.92
Cash	0.67
Total	**100**



Monthly Observations

The ASX 300 Accumulation Index provided a modest return of 1.0% underperforming global peers, with the US S&P500 the standout market up 5.3%, while Japanese equities were up 4.9%.

Technology continued to provide a major driver both here and abroad with NVIDIA rising 29%, adding to its 225% annual gain. The performance of the "magnificent seven' US tech stocks has become more nuanced based on their perceived leverage to the AI theme. Apple (-2%) and Alphabet's (-1.4%) performance was more subdued. Domestically, technology (+19.7%) and consumer discretionary (+9.7%) were the best performers while materials (-4.8%) and energy (-5.9%) lagged.

For markets hoping to see a continued easing in inflation pressures leading to a near term US central bank rate cut, the latest Consumer Price Index (CPI) report in the US was disappointing. [1]

For January, the report showed the monthly pace of inflation accelerated from prior months on both a "headline" and "core" (excluding food and energy) basis. While January data can sometimes produce aberrant results (often caused by volatility in weather conditions), it caused bond markets to wind back their expectations of US interest rate cuts starting in March.

However, equity markets appear to be continuing to favour the 'goldilocks' scenario where growth slows but not too much, corporate earnings remain resilient, and inflation continues to cool allowing central backs to cut rates. This "soft-landing" scenario has increasingly become the prevailing consensus view. If this was to change or the data no longer supported this narrative there is a growing risk of a market pullback given the strength of the recent run.

In Australia, the latest inflation report was more supportive of markets with the Australian Bureau of Statistics (ABS) reporting the Australian CPI rose 3.4% in the 12 months to January 2024, steady with the rate recorded in December, and at the lowest annual rate since November 2021.

In contrast the RBA's preferred wage measure – the Wage Price Index - rose by 0.9% in the December quarter taking the annual rate of wage growth to 4.2%, the highest increase since March 2009.

Because much of the inflation pressures present in Australia are "home-grown" and emanating from the services sector, for which wages are a very significant proportion of overall costs, the RBA is acutely focussed on trends in wage rates. In isolation it is hard to see how the latest report gives the RBA any reason to bring forward their rate cutting cycle.

The key risk for investors who have been hoping for central bank rate cuts sooner rather than later is that the persistence of inflationary pressures is pushing out the prospects of interest rate relief, with monetary officials assessing that the risks from cutting too early are less than the risks of cutting too late.

The domestic reporting season delivered its usual degree of volatility with some patchy performances late in the month offsetting early strength in domestic cyclicals. Overall:

- Top line growth again proved resilient as did margins helped with companies still looking to pass on costs, and where this is becoming more challenging there was greater evidence on cost control.

[1] US Bureau of Labor Statistics

- Consumer discretionary and industrial cyclicals surprised versus expectations as did many technology stocks as the market gave the greenlight on those companies achieving cashflow breakeven and increasing confidence they will be self-funding and won't need to come back to the capital well for more.
    - Caution around slower growth also played second fiddle to the hope of lower rates and tax cuts with share prices outpacing earnings upgrades in many instances.
    - The metal and mining sector, particularly within the larger caps, underperformed as higher capex, write-downs and lower commodity prices weighed on earnings and share prices.
    - There was evidence borrowing costs are still rising as interest rates reset, but the number of companies missing versus consensus was lower than in August.

The M&A theme continued to gain traction with $21billion in takeovers announced in February, comprising 7 deals. Interestingly, 4 were offshore buyers, suggesting perhaps in a relative sense Australian companies continue to look attractive from a valuation and geopolitical perspective given the uncertainty that prevails globally. [2]

Portfolio positioning & performance

For the month of January 2024, the portfolio returned -0.02% net of fees, underperforming the benchmark by 1.74%.

Global 4x4 accessories maker, **ARB Corporation (ASX: ARB, +22.2%)** was a strong contributor to performance this month. The company reported a strong 1H24 result that was ahead of market expectations driven largely by improved gross profit margins as freight costs and other inflationary pressures eased. Importantly, the company indicated confidence in maintaining these improved margins over the coming periods and highlighted that constraints with availability of fitment labour have also improved over the past few months. Positively, the company is making good progress with its large supply contracts with both Ford and Toyota for the launch of upcoming north American vehicles models.

Regional materials and construction business, **Maas Group (ASX: MGH, +19.0%)** performed strongly in February 2024. The company announced results that were slightly ahead of market expectations and continued to showcase strong growth across its key building materials division, which is exposed to buoyant regional infrastructure and renewables activity. One of the highlights of the result was the extremely strong cash conversion achieved in the half, and this was further supplemented by the successful sale of commercial property assets. These sales have been highly anticipated by the market as it proves up the development profit achieved by the company and allows for capital recycling into new strategic acquisitions.

Leading bathroom and tapware supplier, **GWA Group (ASX: GWA, +17.5%)** contributed positively to performance this month. The company announced stronger than expected 1H24 results which was driven by both resilient topline performance and stronger margins. While the domestic home improvement market remains soggy, GWA were able to strategically take share through new product development and a number of strategic sales initiatives that have been put in place over the past few periods. Strong margin performance was another theme observed across the building materials

[2] Australian Financial Review

sector, with GWA benefiting from lower cost of freight as well as lower factory floor prices, supplemented by material cost out program that was put in place from the middle of 2023.

Animal feed producer, **Ridley corporation (ASX: RIC, -14.3%)** gave up some of strong gains it achieved in 2023. While the company's 1H24 results were largely in line with market's expectations, there were concerns of rising headwinds emerging in the 2H24 period leading to some profit taking in the shares. One key headwind is lower commodity prices for tallow that the company produces and exports. One of the medium to long term demand drivers for tallow is in the emerging bio diesel sector. Delays to construction of large bio diesel plants in the US has resulted in softer near-term demand and correspondingly, commodity pricing. The company expects the market to return to a more favourable position once these plants are commission in the later part of 2024. Forecasts for drier weather in 2H24 will likely also benefit Ridley as this typically increases supplementary feeding and animal feed demand.

Retirement living operator, **Lifestyle Communities (ASX: LIC, -14.0%)** suffered a soft month of performance. The company announced results that missed expectations largely driven by delayed settlements across its retirement villages in Victoria. These delays appear to be due to the extension in the time to sell a property, as well as an increasing consumer aversion to purchasing uncompleted homes in the aftermath of widespread builder collapses recently observed in Victoria. In addition to this softer than expected update, the market also reacted negatively to the company announcing a surprise equity capital raise, where funds will be predominantly used to purchase new land parcels in order to accelerate the future growth of the business and take advantage of some distressed opportunities currently available in the market. Our conclusion is that LIC's underlying capital recycling model remains sound and therefore whilst we acknowledge this was indeed a set of disappointing results, the accompanying capital raise now resets the company's balance sheet to more manageable levels and sets the company up well to continually create value for shareholders over the long run.

Finally, our position in insurance restoration provider, **Johns Lyng Group (ASX: JLG, -7.0%)** contributed negatively to performance this month. While underlying 1H24 results were largely in line with market consensus, there were larger than expected non-recurring losses from the to be discontinued commercial construction business, which led to some market disappointment. Furthermore, growth in the US business appears to have stalled as a result of significant hurricane damage in Fort Myer, Florida, one of the company's key operating areas. Such events tend to lead to ongoing work for homeowner associations being put on hold in the short term, although the medium term implications are more positive, with the scope and volume of work to be caught up likely to increase over time as a result of the damage endured. The company also upgraded 2H24 underlying earnings guidance as a result of higher contracted catastrophe activity on the eastern seaboard of Australia (and related restoration work) that have been secured.

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