Macquarie Australian Small Companies

Quarterly Investment Option Update

30 September 2021

Aim and Strategy

The option aims to outperform the S&P/ASX Small Ordinaries Accumulation Index over the medium to long term (before fees). It aims to provide capital growth and some income. The option provides exposure to an actively managed and diversified portfolio of Australian small cap equities through securities listed, or expected to be listed, on the Australian Securities Exchange. The option may also provide exposure to equity issued by Australian entities on offshore exchanges, derivatives (including options, future, warrants and forwards) and cash.

The investment manager aims to build a portfolio of equities that are exposed to a wide range of factors driving share market performance. The process seeks to identify companies which rank highly on the investment manager's quantitative screens and which may exceed market expectations over the long term.

Asset Allocation	Benchmark (%)	Actual (%)
Australian Shares	n/a	99.00
Cash	n/a	1.00

Sector Allocation	%
Energy	7.00
Materials	17.62
Industrials	12.56
Consumer Discretionary	10.08
Consumer Staples	6.21
Health Care	7.17
Financials	14.55
Real Estate	8.75
Information Technology	6.05
Communication Services	8.98

Investment Option Performance

To view the latest investment performances for each product please visit amp.com.au/performance

Investment Option Overview

Investment Category	Australian Shares
Suggested Investment timeframe	5+ years
Relative risk rating	7/ Very High
Investment style	Quantitative
Manager style	Single Manager

Top Holdings	%
IGO Ltd	2.27
Uniti Group Ltd	1.94
Virgin Money UK CDI	1.88
Charter Hall Group	1.88
Spark New Zealand Ltd	1.86
Oz Minerals Limited	1.83
Ardent Leisure Group Limited	1.67
Aventus Retail Property Fund	1.50
Healius Ltd	1.50
Elders Limited	1.50

Portfolio Summary
The fund outperformed the benchmark over the quarter.

Investment Option Commentary

The biggest contributors to relative performance for the quarter included overweight positions in Ardent Leisure Group (ALG), IGO Ltd (IGO), and Johns Lyng Group (JLG).

Lithium and metals miner IGO Limited (IGO) outperformed at the start of the quarter. Many of IGO's key production assets are benefitting from strong price growth due to the shift to clean energy, such as lithium, cobalt and nickel. On 30 June 2021 IGO finalised its joint venture deal with Chinese Lithium giant Tianqi Lithium Corporation, which will see IGO take 25% ownership of Tianqi's Greenbushes lithium mine in WA and 49% of the nearby Kwinana processing plant.

The main detractors from relative performance included underweight positions in Pilbara Minerals (PLS) and Flight Centre (FLT), and an overweight position in Evolution Mining (EVN).

WA based lithium producer Pilbara Minerals (PLS) outperformed in July after announcing strong results in its quarterly activity report for Q2 2021. In the update, management announced record sales and shipments for the quarter, citing continued strength in global lithium demand.

As at 30 September 2021, the largest overweight positions in the Fund were IGO Ltd (IGO), Uniti Group (UWL), and Virgin Money UK (VUK).

Market Commentary

The Australian market continued its strong run, with the S&P/ASX Small Ordinaries Accumulation Index ending the quarter up 3.44%. Small caps materially outperformed the broad based market index, with the S&P/ASX 300 Accumulation Index up a more modest 1.79%. This takes the 12 month returns for the S&P/ASX Small Ordinaries Accumulation index to 30.41%.

It was a strong start to the quarter, with both July and August posting positive returns, driven by the continued relative success of the global vaccine roll-out. A general reopening theme was observed in much of the developed world, while lockdowns were extended across the Australian eastern seaboard. September saw a pullback across markets globally, driven by concerns about Chinese property giant Evergrande's debt crisis, and a more hawkish tone from the US Federal Reserve which lifted bond yields. Iron ore had a weak quarter, falling materially after hitting multi-year highs earlier this year. Inflation remains front of mind for investors. Supply chain constraints are being felt across the global economy and it remains to be seen if the recent uptick in prices observed is indeed 'transitory.'

Reporting season was the focus for many domestic investors in August. Across the market, only 31% of companies missed expectations, with consensus FY22 earnings downgraded by a modest 1.5%, largely due to downgrades in COVID 'losers'. Globally exposed companies were the standout, performing strongly as re-opening activity continued offshore. Capital management was another highlight of reporting season, with many dividend 'beats' across the board. This suggests many companies believe their balance sheets are in good health and are instead choosing to return excess cash to shareholders in the form of dividends and buybacks. While companies are taking COVID impacts into consideration when providing guidance, it seems they have more certainty around the extent of disruption of COVID on their specific operations.

In sector news, Energy (+28.6%) and Communication Services (+11.0%) were the top performers. The outperformance of Energy was driven by large increases in oil and gas prices, which in turn were driven by observed shortages in multiple regional markets. Information Technology (-1.9%) and Materials (-1.8%) lagged.

The focus on the commodities front was iron ore. The price of iron ore fell a staggering 49% as regulatory tightening and a decarbonisation push in China softens steel demand.

Bond yields drifted throughout the quarter although finished broadly flat. The US 10 year government bond yield increased 7 basis points to 1.52%, while the Australian 10 year government bond yield fell by a modest 3 basis points to 1.49%. US Fed Chair Powell's comments at the annual Jackson Hole Conference in August suggested a taper announcement is likely to occur soon, while more recent commentary in September has also had a hawkish tone.

The AUD was depreciated against the USD, ending 2.7c weaker, at US$0.723. In the domestic economy, the RBA maintained the cash rate at 0.15%.

Outlook

With New South Wales and Victoria edging towards reopening in October, the focus will be on how the national economy reacts given the level of pent-up demand in the two largest states. Previous re-openings have seen a strong and immediate snap-back in activity. The uncertainty this time is whether higher levels of COVID circulating through the community, albeit offset by high vaccination rates, will affect the strength of the recovery.

The local market is entering 'AGM season' and initial earnings updates have generally been positive, following a broadly positive reporting season in August. Solid earnings growth, accompanied by accommodative monetary and fiscal policy is likely to remain supportive for equities.

Availability

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