

K2 Australian Small Cap Fund (Hedge Fund)

31 July 2022

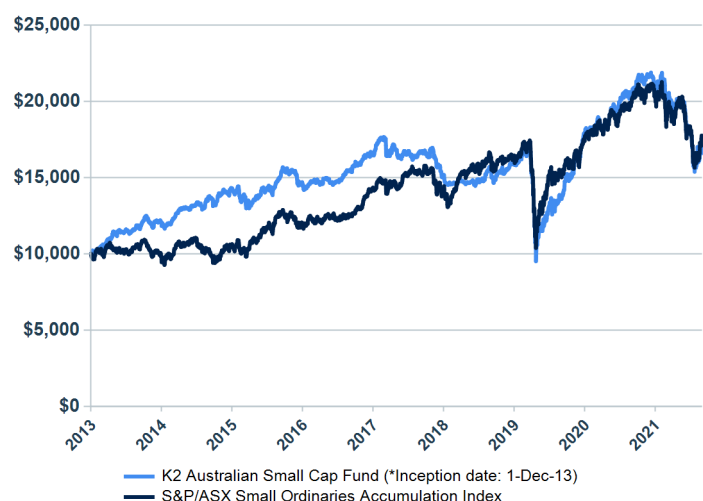


The K2 Australian Small Cap Fund is an Absolute Return equities fund. The fund is index-unaware, aiming to produce positive absolute returns over the long term with a capital preservation mindset. The Fund's mandate allows it to actively manage its net market exposure – utilising both cash and shorts to help protect clients' capital.

	1 Month	Unit Price	Inception (%pa)
Performance (Net of Fees)	9.20%	2.40	6.37%

Refer below detailed performance data matrix

Growth of \$10,000



Top 5 Stock Holdings	Current	Monthly Move
Summerset Group Holdings Ltd	6.9%	-1.6%
Seven Group Holdings Ltd	6.3%	+0.0%
PeopleIn Ltd	5.7%	+0.6%
Maas Group Holdings Ltd	5.0%	-1.4%
Judo Capital Holdings Ltd	5.0%	+0.2%

Market Capitalisation Coverage	Current	Monthly Move
Large Caps >= AUD\$7.5b	0.0%	0.0%
Mid Caps >= AUD\$2b < AUD\$7.5b	31.4%	+0.2%
Small Caps < AUD\$2b	49.9%	-8.4%

Month End Exposures	Current	Monthly Move
Communication Services	2.4%	+2.4%
Consumer	8.6%	-3.8%
Energy	3.3%	-0.1%
Financials	20.5%	+1.7%
Health Care	11.6%	-1.3%
Industrials/Real Estate	31.3%	-8.3%
Information Technology	3.2%	+3.2%
Materials	0.4%	-2.0%
SHORTS	-0.3%	-0.3%
Number of Positions	29	-4
Gross Equity Exposure	81.7%	-7.9%
Cash Weighting	18.9%	+8.5%
Net Equity Exposure	81.1%	-8.5%

Commentary

The K2 Australian Small Cap Fund returned 9.20% for the month.

The Reserve Bank of Australia (RBA) continues to tighten monetary policy. The cash rate now stands at 1.85% and this has driven a 2.25% lift in the average standard variable home loan rate over the past 12 months. This annual elevation in mortgage servicing costs is one of the most aggressive moves in more than forty years. The most obvious casualty will be the residential property market. The RBA hiked interest rates quickly in 1982, 1985, 1989 and 1994. During these cycles the subsequent average move in the median house price was down 4%. Clearly house price valuations are more than double what they were forty years ago, but mortgage serviceability metrics are 30% lower than the long run average. Hence, we expect the weakness in house prices to continue but we are not anticipating double digit declines.

Australia's rate of inflation is still elevated, and the next reading is not until mid-October. So, given the brisk decline in global commodity prices of late, inflation pressures may already be easing. In addition, the supply side of the labour market continues to remain tight. This is a global phenomenon so central bankers around the world are creating tighter financial conditions in an effort to curtail the demand side of the labour market. To our mind this is working. We would expect indicators like job advertisements and job vacancies to start turning down soon. As a result, long bond yields should drift towards official cash rates. Ultimately this would be supportive for equity markets. Valuation metrics would gravitate higher particularly if sustainable earnings growth is evident. The median company in the Small Ordinaries is attractively priced at 15x forward earnings, which is 3 PE points lower than last year.

The best performing holdings for the Fund this month were MA Financial Group (MAF), Summerset Group (SUM) and PeopleIn (PPE) which rose 37%, 11% and 17% respectively. Both MAF and PPE more than recovered the declines from June and their forthcoming half year results should exhibit continued growth. SUM delivered its 2nd strongest half yearly sales result in history and said that demand remains firm.

The median holding for the Fund has a market capitalisation of \$1.5 billion and is attractively priced on a PE that is 10% lower than the Small Ordinaries Index whilst generating an ROE that is 50% more productive.

Fund Characteristics

Portfolio Managers	Campbell Neal, David Poppenbeek and Bill Laister
Strategy	Australian and New Zealand Small Cap Equities
Objectives	To deliver consistent returns over the investment cycle with a focus on capital protection during periods of market declines
Return Target	S&P/ASX Small Ordinaries Accumulation Index + 3%pa
Number of Stocks	40 to 60
Cash	Up to 100% of portfolio
Distributions	Annually
Management Fee	1.31%
Buy/Sell	Bought and Sold on the ASX market (ASX: KSM)
Performance Fee	15.38% pa of the amount by which the NAV per unit exceeds the High Water Mark once the fund achieves its hurdle
Investment Horizon	5 Years
Style Bias	Growth At a Reasonable Price
Market Capitalisation Bias	>\$1billion

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K2 Australian Small Cap Fund Net Monthly Returns in AUD

Year	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Fin YTD	Fin YTD Index (1)	Average Cash	Average Short	
2013/14						2.86	3.19	3.06	4.44	0.36	1.15	-1.26	14.52	1.12	41.95%	0.00%	
2014/15	3.64	2.57	-0.68	0.50	-1.04	-0.37	2.60	4.48	1.37	-0.22	2.23	-2.11	13.51	0.44	22.50%	0.00%	
2015/16	5.71	-2.77	3.61	1.57	1.31	1.20	-3.95	-5.76	4.80	3.33	1.21	-0.40	9.58	14.40	12.48%	-0.20%	
2016/17	4.80	3.05	0.00	-1.48	-3.76	-0.39	1.57	-1.54	3.14	-2.28	0.78	2.80	6.50	7.01	15.90%	-0.54%	
2017/18	2.08	3.58	0.05	2.86	-0.23	5.91	-0.28	-3.36	0.04	-2.06	1.65	-1.87	8.29	24.25	21.35%	-2.04%	
2018/19	1.82	-0.96	2.06	-6.33	-4.24	-3.25	-0.36	1.48	-1.08	1.04	0.31	-0.08	-9.53	1.92	44.79%	-3.92%	
2019/20	5.21	-3.19	3.27	-0.11	2.71	1.01	2.56	-8.00	-28.03	11.37	6.81	-0.18	-12.11	-5.67	26.59%	-1.28%	
2020/21	4.81	11.25	1.40	3.21	12.13	1.58	0.80	-1.11	2.75	6.18	1.08	3.57	58.25	33.23	5.99%	-0.23%	
2021/22	-1.03	4.78	0.19	0.75	-2.02	2.31	-8.61	-1.08	2.50	-0.86	-9.08	-13.71	-24.36	-19.52	8.02%	-0.01%	
2022/23	9.20												9.20	11.43	16.74%	-0.03%	
													Incept.	70.74	77.47		
													Incept.	6.37%pa	6.84%pa	21.63%	-0.82%

(1) S&P/ASX Small Ordinaries Accumulation Index

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