

# K2 Australian Small Cap Fund (Hedge Fund)

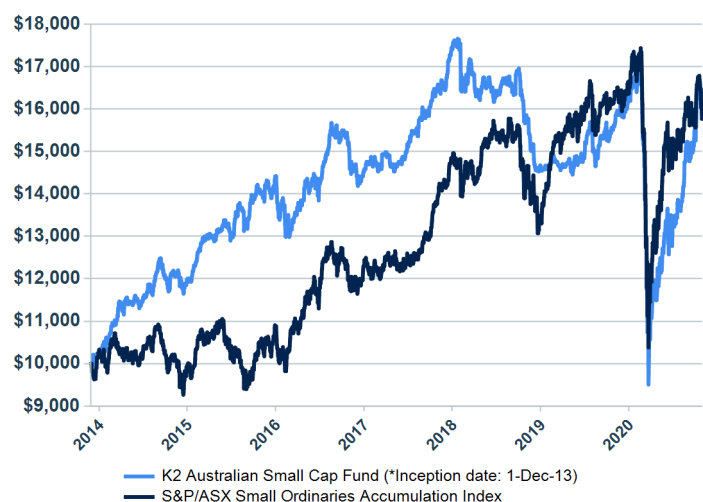
## 31 October 2020



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 | Inception (%pa) | Inception Date |
|---------------------------|---------|-----------------|----------------|
| Performance (Net of Fees) | 3.2%    | 7.0%            | 1-Dec-2013     |
| Average Net Exposure      | 95.6%   | 75.4%           |                |

### Growth of \$10,000



| Top 5 Stock Holdings         | Current | Monthly Move |
|------------------------------|---------|--------------|
| Summerset Group Holdings Ltd | 8.1%    | +0.9%        |
| Pendal Group Ltd             | 7.2%    | +0.8%        |
| People Infrastructure Ltd    | 7.0%    | +0.2%        |
| Moelis Australia Ltd         | 5.0%    | -0.2%        |
| Corporate Travel Management  | 5.0%    | -1.6%        |

| Month End Exposures    | Current | Monthly Move |
|------------------------|---------|--------------|
| Consumer               | 11.9%   | +2.2%        |
| Financials             | 23.7%   | -4.9%        |
| Health Care            | 14.1%   | +1.3%        |
| Industrials            | 23.2%   | +1.1%        |
| Information Technology | 2.9%    | -0.3%        |
| Materials              | 1.1%    | -1.0%        |
| Real Estate            | 17.3%   | -0.5%        |
| Number of Positions    | 40      | +1           |
| Gross Equity Exposure  | 94.2%   | -2.0%        |
| Cash Weighting         | 5.8%    | +2.0%        |
| Net Equity Exposure    | 94.2%   | -2.0%        |

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### Commentary

The K2 Australian SmallCap Fund returned +3.2% for the month of October and has now returned +22% this financial year. Since the March lows the fund is up a very strong +68% outperforming the benchmark by +15.8%. The combination of good stock selection and investing cash early in the recovery have contributed to the strong performance vs benchmark since the March correction.

During the month, the Australian Treasurer delivered the 2020/21 Budget. For the year ahead the underlying deficit is expected to be \$213 billion (11% of GDP) and gross debt is estimated to reach \$872 billion (45% of GDP). The Budget included nearly \$100 billion of support in response to the COVID pandemic. Personal income tax relief, business investment incentives, a targeted modern manufacturing strategy and new and accelerated infrastructure projects have all been designed to rebuild the economy. The RBA Governor also delivered a speech that suggested that interest rates could be lower for longer; potentially for up to 3 years. Then late in the month it was announced that Victoria would move out of COVID lockdown and gradually progress towards reopening. As a result of all these measures we believe that Australian listed market EPS growth projections will start to accelerate; greater activity will drive profit growth which will no longer be diluted by overly cautious equity raisings.

The best performing holdings for the Fund were Pendal Group (PDL), Summerset Group Holdings (SUM NZ) and Netwealth (NWL) which rose 18%, 15% and 18% respectively. PDL is a recent addition to the portfolio. We believe that PDL is well positioned to benefit from a continuation of equity market gains. The asset management operations of JO Hambro are PDL's most profitable business. JO Hambro was acquired in 2011 and has subsequently generated more than \$340 million in performance fees. JO Hambro's performance fees are determined on a December year end basis and could exceed \$50 million this year. SUM delivered strong sales of occupancy rights in the 3Q; +36% on last year. NWL announced a 34% and 81% lift in 3Q FUA and FUM respectively. We sold out of NWL during the month as it reached our target price 2 years earlier than expected. The main detractors to performance were Austal Limited (ASB), Kina Securities (KSL) and Corporate Travel Management (CTD).

The Fund's net exposure for the month averaged 95.6%. The median holding for the Fund has favourable characteristics when compared to the Small Ordinaries Index; using consensus forecasts for the year ahead the PE is 12% lower, ROE is 40% stronger, and the dividend yield is 35% higher. The market capitalisation of the median holding for the Fund is \$675 million.

### Fund Characteristics

|                    |   |
|--------------------|---|
| FUM                | AUD \$9m  |
| Portfolio Managers | Campbell Neal, David Popenbeek and Josh Kitchen   |
| Strategy           | Australian and New Zealand Small Cap Equities   |
| Objectives         | To deliver consistent absolute returns over the investment cycle with a focus on capital protection during periods of market declines |
| Return Target      | +10% pa over the long term  |
| Number of Stocks   | Up to 100   |
| 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                       |

## 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 |     |      |      |      |      | 2.9  | 3.2  | 3.1  | 4.4   | 0.4  | 1.2 | -1.3   | 14.5    | 1.1               | 41.9%        | 0.0%          |
| 2014/15 | 3.6 | 2.6  | -0.7 | 0.5  | -1.0 | -0.4 | 2.6  | 4.5  | 1.4   | -0.2 | 2.2 | -2.1   | 13.5    | 0.4               | 22.5%        | 0.0%          |
| 2015/16 | 5.7 | -2.8 | 3.6  | 1.6  | 1.3  | 1.2  | -4.0 | -5.8 | 4.8   | 3.3  | 1.2 | -0.4   | 9.6     | 14.4              | 12.5%        | -0.2%         |
| 2016/17 | 4.8 | 3.1  | 0.0  | -1.5 | -3.8 | -0.4 | 1.6  | -1.5 | 3.1   | -2.3 | 0.8 | 2.8    | 6.5     | 7.0               | 15.9%        | -0.5%         |
| 2017/18 | 2.1 | 3.6  | 0.1  | 2.9  | -0.2 | 5.9  | -0.3 | -3.4 | 0.0   | -2.1 | 1.7 | -1.9   | 8.3     | 24.2              | 21.3%        | -2.0%         |
| 2018/19 | 1.8 | -1.0 | 2.1  | -6.3 | -4.2 | -3.3 | -0.4 | 1.5  | -1.1  | 1.0  | 0.3 | -0.1   | -9.5    | 1.9               | 44.8%        | -3.9%         |
| 2019/20 | 5.2 | -3.2 | 3.3  | -0.1 | 2.7  | 1.0  | 2.6  | -8.0 | -28.0 | 11.4 | 6.8 | -0.2   | -12.1   | -5.7              | 26.6%        | -1.3%         |
| 2020/21 | 4.8 | 11.3 | 1.4  | 3.2  |      |      |      |      |       |      |     |        | 22.0    | 6.2               | 7.4%         | -0.5%         |
|         |     |      |      |      |      |      |      |      |       |      |     | Incept | 59.4    | 57.7              |              |               |
|         |     |      |      |      |      |      |      |      |       |      |     | Incept | 7.0%pa  | 6.8%pa            | 24.1%        | -1.1%         |

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

DISCLAIMER: Returns are shown after fees (including performance fees) and expenses have been deducted and assume the reinvestment of income distributions. Please note that past performance is not a reliable indicator of future performance. The information contained in this document is produced by K2 Asset Management Ltd ("K2") in good faith, but does not constitute any representation or offer by K2. It is subject to change without notice, and is intended as general information only and is not complete or definitive. K2 does not accept any responsibility, and disclaims any liability whatsoever for loss caused to any party by reliance on the information in this document. A product disclosure statement for general information on any Fund referred to in this document can be obtained at [www.k2am.com.au](http://www.k2am.com.au) or by contacting K2. You should read the product disclosure statement and consider whether the product is appropriate for you before making a decision to acquire or continue to hold an interest in a Fund. Fees referred to in this document are inclusive of GST and RITC and do not include expense recoveries.