

K2 Australian Small Cap Fund (Hedge Fund)

31 August 2024



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)	-2.59%	2.29	4.70%

Refer below detailed performance data matrix

Top 5 Stock Holdings	Current	Monthly Move
Seven Group Holdings Ltd	8.0%	+0.5%
Summerset Group Holdings Ltd	5.6%	+0.3%
GQG Partners Inc-Cdi	5.4%	+1.7%
NIB Holdings Ltd	4.4%	-0.8%
National Storage REIT	4.2%	+0.0%

Market Capitalisation Coverage	Current	Monthly Move
Large Caps>=AUD\$7.5b	18.4%	+3.7%
Mid Caps>=AUD\$2b<AUD\$7.5b	38.6%	-0.8%
Small Caps<AUD\$2b	37.9%	+1.8%

Month End Exposures	Current	Monthly Move
Consumer	12.5%	+2.6%
Energy	3.2%	+1.2%
Financials/Real Estate	39.5%	+0.2%
Health Care	7.3%	+0.5%
Industrials	20.0%	-1.5%
Information Technology	3.2%	-0.2%
Materials	9.5%	+2.0%
Number of Positions	31	-4
Gross Equity Exposure	95.3%	+3.2%
Cash Weighting	4.7%	-6.1%
Net Equity Exposure	95.3%	+6.1%

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	+10% pa over the long term
Number of Stocks	25 to 50
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

Commentary

The K2 Small Cap Fund returned -2.59% for the month.

During the month, the Governor of the Reserve Bank of Australian (RBA) made some interesting comments. Firstly, at the media conference for the Monetary Policy Decision the Governor succinctly said, "when demand is above supply, that's inflation - prices go up". This is why the RBA adjusts monetary policy; to help realign demand with supply thus enabling the inflation rate to trend into its 2-3% target band. Unfortunately, COVID upended the demand/supply dynamics and throughout 2022 and 2023 Australia's annual headline inflation rate averaged over 6%. However, over the past seven months the rate of inflation has faded and is now 3.5%. Given that inflation is still above the RBA's target range, the Governor stated that "a near-term reduction in the cash rate doesn't align with the Board's current thinking". But, what if the supply side of the economy finally starts to expand? Let's use supermarkets as a simple case study.

Between 2022 and 2023 Coles (COL) stated that its supermarkets delivered an average inflation rate of 5%pa. At its peak during the last quarter of 2022, the annual inflation rate of COL's supermarkets hit 7.7%. The supply chain was struggling with shortages of workers, pallets and raw materials. Floods in New South Wales and Queensland added to the complex task of delivering goods to customers. Today, most of the bottlenecks in the supply chain have been decongested and hence, COL's supermarkets are now showing an annual inflation rate of just 1.5%. This partly reflects a greater availability of produce in a more timely manner, but also demonstrates a greater level of competitive pricing behaviour. Elevated mortgage expenses and household running costs has forced consumers to become more value-oriented. As a result, we think that the COL supermarket observation can be rolled out across a number of other industries. All up, we can't help but feel that the supply side of the Australian economy has the potential to drive inflation into the RBA's target range sooner than expected.

The June half reporting season for the members of the Small Ordinaries Index was unremarkable; half of the companies had earnings forecasts upgraded but the median move in EPS projections for the year ahead was unchanged during the month. What was remarkable was the share price movements. Nearly a quarter of the companies in the Small Ordinaries Index had a plus or minus 10% share price move on the day of the result announcement. The companies that downgraded expectations saw an abundance of sellers and very few contrarian buyers. Directional trading algorithms that look for intra-day demand and supply imbalances then went on to amplify the downward share price impact. Interestingly, the companies that exhibited strong upward share price movements did not necessarily deliver profit upgrades. Existing shareholders continued to show faith that conditions will improve, and this simply removed the selling pressure that would otherwise have triggered the directional algorithms. We sense that investor sentiment towards Small Caps is becoming more constructive.

The best performing holdings for the Fund this month were MA Financial Group (MAF) and Judo Capital (JDO). MAF has invested heavily in strategic growth initiatives that are on the cusp of contributing to meaningful earnings in coming years. JDO continues to advance towards its ambitious at-scale metrics. Nib Holdings (NHF) and Johns Lyng Group (JLG) were performance detractors.

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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	1.14	-9.78	2.28	3.94	-4.45	8.43	-2.17	-4.84	2.21	-3.10	-3.33	-2.16	8.45	7.44%	-0.20%	
2023/24	5.12	-2.13	-1.49	-4.25	3.80	5.92	1.15	0.18	3.34	-3.49	-0.63	-1.88	5.13	9.35	7.51%	-0.11%	
2024/25	4.56	-2.59											1.85	1.40	9.68%	-0.78%	
													Incept.	63.81	91.50		
													Incept.	4.70%pa	6.23%pa	18.68%	-0.78%

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

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