

Yarra Australian Equities Fund

Total returns as at 31 October 2017

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception* % p.a.
Yarra Australian Equities Fund	5.27	4.62	17.17	6.25	10.41	4.56	10.31
S&P/ASX 200 Accumulation Index†	4.01	4.73	16.13	6.94	10.30	3.34	9.46
Excess return after fees‡	1.25	-0.12	1.04	-0.69	0.11	1.22	0.85

Past performance is not a reliable indicator of future performance. Taxes payable by investors have not been taken into account. The figures shown have been provided for illustrative purposes – they are unaudited and subject to change. The total returns shown are prepared on an exit to exit basis – they include all ongoing fees and expenses and assume reinvestment of all distributions.

Due to differences in business dates for the September month-end period, Fund performance returns include 29 September 2017. The monthly performance return has been impacted.

* Inception date Yarra Australian Equities Fund: July 1996

† Effective 1 April 2008, the benchmark for the Yarra Australian Equities Funds is the S&P/ASX 200 Accumulation Index.

‡ Excess return: The difference between the portfolio's return and the benchmark return.

Market review

Australian shares rose sharply in October as euphoria around global economic growth and political initiatives drove the asset class higher.

The S&P/ASX 200 Accumulation Index rose 4.0% in October – its best month in 2017. After lagging in recent months, the index finally outperformed overseas indices with the MSCI World Index returning 2.6% and the S&P500 returning 2.3%.

However, much of the excitement was overseas. Economic conditions continued to improve in Europe despite political tension in Spain, the US quarterly reporting season was better than expected and confidence grew that President Trump can enact his tax cut initiatives.

Domestically the environment was mixed: labour force data was strong with total employment rising by 3.1% year-on-year in September (its strongest rate since 2008) but retail sales for August were weaker than anticipated, rising 2.1% year-on-year.

Nevertheless, all sectors made positive returns in the month. Information Technology (+8.7%) delivered the highest returns with strong performances from Computershare (CPU, +7.7%) and NextDC (NXT, +18.3%). In contrast, Real Estate was the worst performer (+1.3%) as soft retail conditions continued to weigh on the retail sub-sector (+0.9%).

The banks (+2.8%) underperformed the market as a modestly disappointing FY17 result from ANZ Bank (ANZ, +1.1%) weighed on the sector, though Commonwealth Bank (CBA), Westpac (WBC) and National Australia Bank (NAB) all rose more than 3%.

Elsewhere, Metals & Mining returned 3.9% with BHP Billiton (BHP, +2.9%) and Rio Tinto (RIO, +4.4%) rising despite the iron ore price falling \$US3 per tonne to \$58.50. Gold miners (+6.8%) also outperformed despite the gold price falling 1% to \$US1,270 per ounce during the month.

Portfolio review

Key contributors

Seek (SEK, overweight) – the online employment company outperformed after releasing data showing its Australian job ads were up 13% in the first quarter of FY18 compared to 9% in FY17 (around two-thirds of SEK's revenue growth comes from volumes). We continue to see upside in the stock, with new product developments delivering material new revenue opportunities and strengthening the existing businesses, both domestically and internationally. The structural growth of earlier stage markets should also support international growth, in our view, with synergies from recent acquisitions adding to earnings growth. SEK has a strong balance sheet position (FY17 net debt to EBITDA 0.8 times) which will support further accretive acquisitions, including increases to existing investments (at a lower risk).

ResMed (RMD, overweight) – the sleep apnea device maker outperformed following a better-than-expected first quarter FY18 result. Revenue grew 13% in the period on strong mask and ongoing solid device sales, with RMD finally benefiting from the launch of its new AirFit 20-series masks after being hampered by production issues in prior quarters. The company remains a high conviction overweight in the portfolio, consistent with our view that RMD's current market valuation does not sufficiently capture its appealing growth characteristics. We believe earnings growth rates will accelerate over the next one to two years as benefits accrue from a positive product cycle in the flow generator segment.

Vocus Group (VOC, overweight) – shares in the telecommunications company lifted sharply in the month after VOC released its first-quarter FY18 trading update, in which it outlined plans to divest its New Zealand business and data centres in order to strengthen the balance sheet. Notwithstanding VOC's short-term challenges, we continue to believe the longer term revenue and margin opportunities remain and that the share price (at 13 times forward earnings)

currently capitalises only limited future growth. Management remains focused on integrating and simplifying the various acquired businesses, unifying the VOC product offering and increasing customer product penetration.

Key detractors

Super Retail Group (SUL, overweight) – the retailer underperformed after delivering a mixed trading update at its 2017 Annual General Meeting (AGM) and in response to slightly-weaker-than-expected retail sales data for August, with sales rising 2.1% year-on-year. At the AGM SUL indicated a subdued consumer environment had dampened sales for the first 16 weeks of FY18, but that supply chain and sourcing efficiencies and cost control have supported margins. We continue to believe SUL provides a diversified discretionary retail exposure (across Auto, Sport and Leisure) which should support medium to long term mid to high single-digit earnings growth from both sales and margin opportunities. The stock now trades at 10.2 times earnings on a 12-month forward basis – a record discount to the broader Industrials sector – which is in line with GFC levels.

ANZ Bank (ANZ, overweight) – the bank underperformed after announcing an FY17 result below consensus expectations. While cash profit was in line with market forecasts at a headline level, it was aided by very low bad and doubtful debt (BDD) charges. Before provisions the bank missed consensus by 3%, largely as a result of volatility in the markets income segment, which declined 27% in the second half. However, the core Australian division performed strongly and asset quality was benign, boding well for the rest of the sector. ANZ remains a high-conviction overweight in the portfolio based on the bank's strong Australian and New Zealand franchises which will support growth through the rationalisation of the low returning institutional exposures. We view the company's discount to peers as attractive at a P/E multiple of 12.7 times and a price to book multiple of 1.4 times.

Iluka Resources (ILU, overweight) – the mineral sands producer underperformed the market during the month, partially retracing its strong rise in prior months, despite releasing a solid September quarter update. In the year-to-date, revenue for zircon was at \$US905 per tonne and \$US772 per tonne for rutile. We expect to see a solid demand environment for zircon, exceeding current production levels and implying tightness to the market given the low inventory levels of producers. We continue to think ILU will generate material earnings growth from its high quality assets and dominant position in zircon and titanium dioxide feedstock markets. We believe that mineral sands prices will continue to revert to sustainably higher levels now that destocking has largely run its course.

Key purchases

Super Retail Group (SUL) – we increased our position in the retailer in the month. We believe the share price fall in recent months, largely due to concerns over consumer spending and Amazon's impending arrival, are overdone. We believe SUL provides a diversified discretionary retail exposure (across Auto, Sport and Leisure) which should support medium to long

term mid to high single-digit earnings growth from both sales and margin opportunities. The stock now trades at 10.2 times earnings on a 12-month forward basis – a record discount to the broader Industrials sector – which is in line with GFC levels.

James Hardie (JHX) – we increased our position in the month based on our positive view of JHX's US business (70% of group earnings) given its ongoing pricing and market share initiatives. While the Hurricane activity in the quarter will cause a short-term and minor impact to earnings (affected areas comprise 15% of the group's US sales), it doesn't alter our strong medium-term stock view. We anticipate US market share growth to return as supply issues are resolved and earnings before interest and tax (EBIT) margins to improve due to falling per unit operating costs.

Santos (STO) – we increased our position in the oil producer in the month. We believe STO can turn its business around following several operational improvements that have reduced operating and development costs. STO is significantly cash flow positive at current oil price levels of around \$US50 per barrel and an all-in sustaining cost per barrel at around \$US33, generating a free cash flow yield of 7-8% and enabling STO to repair its balance sheet. Management has targeted debt to fall to \$US2bn and a gearing ratio of 20% by the end of 2019. STO can then resume growth, with a number of options available.

Key sales

APA Group (APA) – we exited the position in the gas pipeline company in the month. We believe that APA's new negotiation framework creates a large uncertainty regarding the repricing outcomes from contracts, given they are subject to most favoured nation clauses. Furthermore, we prefer Transurban (TCL) in the infrastructure & utilities sectors, as we believe it has more options for earnings growth – with a number of new projects and expansion plans – and is less sensitive to higher interest rates given TCL's revenue growth is largely linked to CPI.

Star Entertainment (SGR) – we reduced our position during the period for portfolio construction purposes but remain positive towards the stock. We believe the market underestimates SGR's ability to enhance asset performance through operational improvements and capex programs. The company's brownfield developments – the expansion in Sydney, the redevelopment in Gold Coast and the Queen's Wharf in Brisbane – provide meaningful opportunities for upside in the medium to longer term.

Sirtex Medical (SRX) – we decreased our small overweight position in the month. SRX announced global dose sales were flat for the first quarter of FY18, highlighting that FY17 headwinds to the business have persisted. While we have lower conviction towards SRX given short-term concerns, we continue to see the stock as being undervalued (at nine times EV/EBITDA), given the company's longer term revenue growth potential (market share and new countries), margin expansion from a restructured cost base and fixed cost leverage, which should lead to double-digit NPAT growth over the medium term.

Key active overweights

Westpac Bank (WBC) – we remain overweight WBC because we believe its favourable business mix, namely an overweight to retail banking, offers an attractive medium-term risk adjusted growth profile. Bad debt levels have declined to benign levels after rising in prior periods due to large single name exposures, further strengthening our conviction in the stock. We believe WBC offers an attractive total return, trading on a forward 5.8% fully franked dividend yield with mid-single digit earnings growth.

Commonwealth Bank (CBA) – we believe CBA, as a high quality banking franchise with a strong track record of delivery, is well placed to take advantage of the prevailing stable banking fundamentals of flat net interest margins, mid-single digit credit growth and ongoing cost reductions. Furthermore, we think the valuation – at 13.1 times earnings per share with a 5.7% fully franked dividend yield – remains attractive. Finally, in regards to the AUSTRAC case we believe CBA's board has acted swiftly, establishing clear accountability by announcing that the management team will not receive any short-term performance incentives and setting in motion the replacement of the CEO. While compliance costs will be higher in FY18, we believe positive trends for net interest margins, markets income and credit quality will more than offset this headwind.

Origin Energy (ORG) – our overweight position is premised on the positive outlook for ORG's Energy Markets business and, in our view, underappreciated latent value. The simplification of the business through asset sales will substantially reduce leverage and focus attention on ORG's key asset – the Energy Markets business. The implied valuation of both the Energy Markets business and APLNG appears overly conservative, with an eventual demerger of both businesses looming as the critical next step in crystallising this value.

Key active underweights

National Australia Bank (NAB) – the stock remains our least preferred bank exposure. NAB's domestic business is a clear underperformer relative to peers with pre-provision earnings stagnant over a number of years and significant catch-up investment required, particularly in its business bank, which was flagged in their FY17 result. Against this backdrop we don't view NAB's valuation as compelling at 13.4 times forward earnings and 1.7 times book value.

CSL (CSL) – we remain underweight CSL based on its forward valuation (29.0 times P/E and 20.4 times EV/EBITDA), which we believe more than captures the earnings growth outlook. Growth rates may also be more challenging to achieve in the longer term given new product growth across the industry will largely come from the more competitive recombinant portfolio sector, where CSL's plasma product economics and relative competitive advantage are less relevant.

BHP Billiton (BHP) – our underweight position in the mining company is premised on our cautious view towards its commodity exposures, particularly iron ore and coal. We believe fundamentals point to lower prices as new supply comes on to the market and China's demand wanes from strong, stimulus-induced levels.

Market outlook

Consensus expects Industrials to support modest market earnings growth in FY18, with Financials at low single digit levels and Resources modestly negative. Aside from Financials, we regard forecasts as being too optimistic in aggregate, making stock selection crucial.

Australian equities are priced above long-term averages based on forward earnings estimates, though their valuations remain attractive relative to alternatives such as fixed income. The S&P/ASX 200 Index yields 4.4% on a 12-month forward basis versus 2.7% from the Australian 10-year government bond yield.

We believe fundamentals are mixed for Australia, with economic growth improving albeit slowly (illustrated through employment data, GDP and rising business expenditure) and despite known headwinds such as consumer debt.

At a global level, excitement about political change is driving valuations to elevated levels despite the headwinds to implementing pro-growth policies. Meanwhile, economic and geopolitical risks are real (interest rates surging, geopolitical risks and China's real growth).

We see significant value in certain sectors but believe others to be overvalued based on earnings and cash flow expectations. We remain overweight the Information Technology, Banking and Industrials sectors, but are underweight Real Estate, Metals & Mining and Consumer Staples.

Sector allocation

	Portfolio %	Benchmark %	Active %
Consumer Discretionary	9.29	4.91	4.38
Consumer Staples	2.04	7.27	-5.23
Energy	5.34	4.58	0.76
Financials	37.35	37.16	0.20
Health Care	6.06	7.20	-1.13
Industrials	13.38	7.27	6.12
Information Technology	6.39	1.46	4.93
Materials	15.16	16.95	-1.79
Real Estate	0.00	7.97	-7.97
Telecommunication Services	3.82	3.06	0.77
Utilities	0.00	2.18	-2.18

Top 5 holdings

	Portfolio %	Benchmark %	Active %
Commonwealth Bank of Australia	12.04	8.69	3.35
Westpac Banking	10.91	7.15	3.77
ANZ Banking	8.32	5.61	2.71
Origin Energy	4.05	0.88	3.17
Transurban	3.63	1.59	2.04

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Westpac Banking	10.91	7.15	3.77
Commonwealth Bank of Australia	12.04	8.69	3.35
Origin Energy	4.05	0.88	3.17
Underweights			
National Australia Bank	0.45	5.60	-5.15
CSL	0.00	4.01	-4.01
BHP Billiton	2.17	5.44	-3.27

Portfolio holdings may not be representative of current or future investments. The securities discussed may not represent all of the portfolio's holdings and may represent only a small percentage of the strategy's portfolio holdings. Future portfolio holdings may not be profitable.

Income and growth

	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.
Growth return	12.55	1.10	3.83	-3.94
Distribution return	4.62	5.15	6.58	8.50

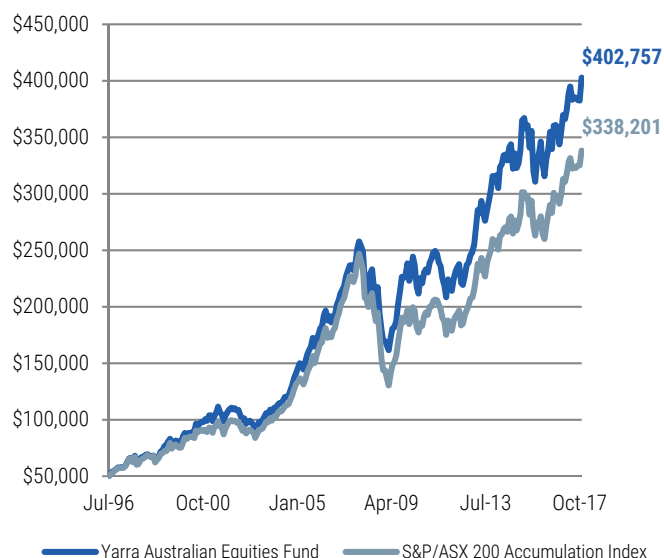
The Growth Return is measured by the movement in the Fund's units price, ex-distribution, and can be positive or negative as the unit price can fluctuate with changes in the underlying market value of the Fund's assets. The Distribution Return is the amount that is paid to unitholders by way of income distribution in a 12-month period. It does not include capital distributions.

Features

Investment objective	To achieve medium-to-long term capital growth through exposure to companies listed on the Australian Securities Exchange. In doing so, the aim is to outperform the S&P/ASX 200 Accumulation Index over rolling 3-year periods.	
Recommended investment time frame	5 - 7 + years	
Fund inception	July 1996	
Fund size	Pooled Fund A\$550.03 mn as at 31 October 2017	
APIR codes	JBW0009AU	
Estimated management cost	0.95% p.a.	
Buy/sell spread	+/- 0.15%	
Platform availability (Fund only)	AMP PortfolioCare AMP Wealthview AMP Flexible Lifetime North Asgard BT Wrap BT Panorama Colonial FirstWrap IOOF Pursuit Select Macquarie Wrap Consolidator	Macquarie Wrap Accumulator OnePath PortfolioOne Oasis ANZ Grow Wrap Netwealth SimpleWrap PowerWrap SmartWrap Hub24

Investment performance comparison of \$50,000

After fees, since inception of the Yarra Australian Equities Fund, July 1996 to October 2017.



For illustrative purposes only. Past performance does not guarantee future results, which may vary. The total net fund returns shown are prepared on an exit to exit basis (i.e. they include all ongoing fees and expenses and assume reinvestment of all distributions). They do not take personal taxation into account. The comparison with the S&P/ASX 200 Accumulation Index is for comparative purposes only. Index returns do not allow for transactional, management, operational or tax costs. An index is not managed and investors cannot invest directly in an index.

Applications and contacts

Investment into the Yarra Australian Equities Fund can be made by Australian and New Zealand resident investors only.

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Disclaimers

The Yarra Australian Equities Fund is substantially invested in the Yarra Australian Equities Pooled Fund ('Pooled Fund'). References in this document to the underlying assets or investments of the Fund generally relate to the assets held in the Pooled Fund.

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