

# Yarra Australian Equities Fund

## Gross returns as at 30 April 2023

	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	2.52	3.45	9.24	17.65	7.94	8.13	10.63
S&P/ASX 200 Accumulation Index†	1.85	-0.80	2.83	13.99	8.26	7.89	9.19
Excess return (before fees)‡	0.67	4.25	6.41	3.66	-0.31	0.24	1.44

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 gross of all fees, meaning they do not reflect the deduction of any investment management fees which would reduce returns and assume reinvestment of all distributions. Investment in the fund is not available on a fee free basis and this should be factored into any analysis of past performance.

## Net returns as at 30 April 2023

	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	2.45	3.22	8.26	16.60	6.96	7.13	9.63
S&P/ASX 200 Accumulation Index†	1.85	-0.80	2.83	13.99	8.26	7.89	9.19
Excess return (after fees)‡	0.60	4.02	5.44	2.61	-1.29	-0.76	0.44

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.

\* Inception date Yarra Australian Equities Fund: July 1996

† The benchmark for the Yarra Australian Equities Fund has been amended since the Fund's inception. Effective 28 February 2008 the benchmark is the S&P/ASX 200 Accumulation Index, replacing the S&P/ASX 200 ex Property Accumulation Index Monthly. Further information on changes to the Fund's benchmark is available upon request.

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

### Market review

Australian equities market performance improved in April after the weak performance of the prior two months, with almost every sector delivering positive returns. The 10-year bond rate held relatively steady at 3.3%.

The S&P/ASX 200 Accumulation Index returned +1.8% for the month, taking its 12-month return to +2.8%. The broader S&P/ASX 300 Accumulation Index followed suit (+1.8%) for the month and globally, the MSCI World Index also climbed +1.8%.

Real Estate (+5.2%) was the top performer during the period driven by Mirvac (MGR, +15.9%), Stockland (SGP, +11.8%) and Vicinity Centre (VCX, +8.0%). The sector was supported during the month following the RBA's decision to keep interest rates on hold.

Just behind was Information Technology (+4.5%), with NextDC (NXT, +9.7%) rallying after announcing a 36 megawatt increase in contract utilisation, Wisetech (WTC, +5.2%) gaining post announcement of \$600mn acquisition of Blume Global, while Megaport's (MP1, +36.6%) share price rose following the company's positive third-quarter report.

Conversely, the weakest performing sector was Metals & Mining (-2.6%), with Rio Tinto (RIO, -6.6%) and Fortescue (FMG, -6.9%) underperforming as the benchmark 62% FE iron ore

index fell 15% to close at US\$106/t as construction and infrastructure activity data in China came in below expectations.

### Portfolio review

#### Key Contributors

**Reliance Worldwide (RWC, overweight)** – the manufacturer and distributor of plumbing and heating parts outperformed following the release of its March-quarter trading update. The trading update was broadly positive, demonstrating the resilience of its repair-focussed end markets (total sales growth of +14.2% for the nine months ending March-23) and a robust margin outlook supported by cost-out plans and easing raw material cost pressure. We view RWC as a compelling opportunity, with the market pricing for a significant decline in earnings (P/E of only 14.9 times vs 17.0 times mid cycle) whereas we remain constructive on the demand environment given the defensive nature of RWC's revenue base, the majority of which relates to repair and remodelling sales.

**Rio Tinto (RIO, underweight)** – the diversified miner was a contributor during April as the stock underperformed on falling iron ore prices. During April the benchmark 62% Fe iron ore index fell 15% to close at USAssu\$106/t as construction and infrastructure activity in China fell below expectations. RIO is

highly leveraged to iron ore, which we continue to view as expensive above US\$100/t, well above cost curve support. As a result, we are happy to remain underweight RIO. BHP is our preferred diversified mining exposure given stronger cost control, exposure to copper, and fewer social licence challenges that remain a material headwind for RIO.

**Fortescue Metals (FMG, underweight)** – our underweight position in the iron ore producer was a contributor during the period as the stock underperformed on falling iron ore prices. During April the benchmark 62% Fe iron ore index fell 15% to close at US\$106/t as construction and infrastructure activity data in China came in below expectations. As a high-cost iron ore producer, Fortescue is very levered to movements in spot iron ore prices, and we remain happily underweight FMG. BHP is our preferred exposure to iron ore given its higher grades, lower operating costs and diversified commodity base.

### Key Detractors

**United Malt (UMG, overweight)** – the global commercial malt processor and distributor underperformed during the period. UMG received a takeover bid from peer Malteries Soufflet priced at \$5.00/share (+45% premium to prior closing price) in the prior month and retraced modestly from its highs close to the deal terms. Malteries Soufflet is currently undertaking due diligence and we believe that the likelihood of a deal proceeding is high.

**CSL (CSL, underweight)** – our underweight to the globally focused biotechnology company detracted from performance in the month, which included several minor but supportive data points for the outlook for its blood plasma business, Behring (approximately 65% of group earnings). Our research has led us to conclude that we are seeing the start of moderation in donor collection fees in the United States, an important (positive) data point for the outlook for plasma economics and operating margins. Secondly, we saw CSL receive FDA approval for a self-infused subcutaneous immune globulin (Hizentra), supporting the outlook for positive product mix shift within the overall Behring business. Notwithstanding these data points, we continue to see overall earnings growth from Behring to be more difficult moving forward due to elevated and sticky overall cost pressures, increased competition, relative product growth rates and product substitution risk in the longer run.

**National Australia Bank (NAB, underweight)** – the Australian bank outperformed during the period as the banking sector reversed some of the selloff in banks globally following the failure of Silicon Valley Bank, Signature Bank and Credit Suisse. We view Australian banks as having very strong liquidity, high levels of capital and conservative balance sheet structures, so hold no concerns from a failure perspective. We do, however, believe the resultant increase in funding costs will pressure future earnings further, and happily remain underweight the company.

### Key Purchases

**Tabcorp (TAH)** – we initiated a position in the wagering operator, reflecting our view that TAH will be a net beneficiary of the upcoming Victorian wagering license tender and

regulatory alignment between retail and digital operators. In our view, TAH also remains well positioned to benefit from its refreshed TAB25 strategy and gradual consolidation in the sector, which we expect will assist in delivering on the company's medium-term 10% ROIC target.

**Sims Metals (SGM)** – we increased our position in the scrap and metals recycling company during the period. The company's US business (SA Recycling) is performing strongly, and we see further upside from bolt-on acquisitions in what remains a highly fragmented market. Scrap margins are improving following a period of significant moderation from historical highs and, in our view, are positioned to strengthen further. Sims is trading below our estimates of mid-cycle earnings, and we believe it represents attractive value at these levels. A skew towards improving environmental performance on increased capital spend in this area should position the business strongly relative to peers as environmental regulations tighten.

**Iluka Resources (ILU)** – we increased our position in the mineral-sands producer during the period, reflecting solid structural support for key mineral sands commodities zircon and titanium dioxide as demand improves and existing mine supplies decline. ILU is the world's largest zircon producer and the fifth largest producer of titanium feedstocks. Additionally, the company is moving into rare earths production with the Eneabba refinery currently under development in Western Australia. Rare earths are a by-product of mineral sands mining, and a key component of permanent magnets that are critical to electric motors, including those in electric vehicles and wind turbines. With 90% of the world's rare earths currently produced in China, we see significant strategic value in ILU's rare earths business.

### Key Sales

**Aristocrat Leisure (ALL)** – we exited our position in the gaming content developer as the stock continued to re-rate higher, with evidence of a normalisation in Digital momentum after a period of elevated trading through COVID. We retain a positive view given ALL's position in Land-Based gaming and expect that Digital revenues will likely continue to stabilise in coming months, but remain wary that expectations for the business remain elevated (consensus EPS growth +14%/+8% in FY23/24) and P/E multiples are approaching long-run averages (19 times vs 21 times 10-year avg.). As a result, we believe better opportunities can be found elsewhere at this time.

**Qantas (QAN)** – the portfolio's position in the national airline carrier was reduced during the month. QAN has experienced a period of unprecedented profitability with high demand and limited capacity coming out of COVID. Whilst we believe some of the improvements in market structure that QAN is enjoying will persist, profitability will reduce from current peak levels, warranting a smaller position.

**Carsales.com (CAR)** – we reduced our position in Carsales during the month, bringing it back to a target level following participation in the rights issue that supported the purchase of a 40% stake in leading Brazilian online auto classifieds business Webmotors, taking CAR's ownership to 70%.

## Key Active Overweights

**Reliance Worldwide (RWC)** – the market is showing concern for a weaker demand environment for the manufacturer and distributor of plumbing and heating parts, with RWC's FY23 earnings estimates having been lowered after recent market updates. We view RWC as a compelling opportunity, with the market pricing for a significant decline in earnings (P/E of only 14.9 times vs 17.0 times mid cycle) whereas we remain constructive on the demand environment given the defensive nature of RWC's revenue base, the majority of which relates to repair and remodelling sales.

**QBE Insurance (QBE)** – the general insurer remains our preferred insurance exposure, which we expect will deliver strong earnings growth in 2023 and beyond driven by the delivery of strong volume growth, sustained premium rate growth and the beneficial impact of higher interest rates on investment earnings. QBE has substantially improved its underwriting discipline and product focus over the last five years, and we believe its 9.9 times FY23 earnings multiple excessively discounts the risks inherent in its business model.

**Worley (WOR)** – we remain overweight the leading global provider of engineering services. WOR's earnings recovery is in its early stages following COVID impacts across FY20-22. Revenue is expected to grow 13-15% in FY23, with leading indicators (Factored Sales Pipeline +16%, Rolling 12 Month Bookings +23%, Backlog +7%) and structural drivers (capital investment required to decarbonise) pointing to strong top-line growth ahead. Margins are also set to accelerate over the coming years as WOR benefits from a more consolidated industry structure, operating leverage, and active mix management.

## Key Active Underweights

**CSL (CSL)** – we retain an underweight to the globally focused biotechnology company. Underpinning this position is our view that earnings growth from the core blood plasma division (approximately 65% of group earnings) will be more difficult moving forward due to elevated and sticky cost pressures, increased competition, relative product growth rates and product substitution risk over the longer-term. While the more recently acquired business, Vifor (now approximately 15% of group earnings) does provide differentiation, we view the business as lower quality than the core plasma franchise. Considering this operating outlook, we do not believe the current valuation looks overly attractive (30.4 times forward P/E, 21.1 times EV/EBITDA) and maintain a preference for global sleep-apnoea device supplier ResMed in the large-cap Healthcare space.

**National Australia Bank (NAB)** – we remain underweight the Australian bank reflecting our negative sector view. The favourable dynamics around expanding net interest margins (NIM) due to higher interest rates are now well understood, and we do not expect gains to be sustained into the medium term. Furthermore, the banks are facing material earnings offsets through elevated expense growth and a normalization in bad debt expenses, meaning sector EPS is likely to be at peak levels.

**Macquarie Group (MQG)** – we remain underweight the stock based on the view the recent earnings uplift is driven by its lower quality and highly cyclical businesses, which we view as unsustainable into the medium term. We see significant downside risk to consensus forecasts beyond FY23, which currently reflects a strong contribution from lumpy items including trading revenue in its commodities business, gains on sale, performance fees and low loan-loss provisions. We do not expect growth in its more stable businesses to be able to offset this. As a result, we regard MQG's headline forecast P/E multiple of 15.0 times consensus forward earnings as unattractive at this time.

## Market outlook

The June quarter 2023 will mark the top of the interest cycle for most of the developed world. With ongoing evidence of inflation moderating, tightening in lending availability and downgrades accumulating for economic growth, including the Federal Reserve staff formally forecasting a modest recession in the US, the appetite for policy makers to persist with the tightening cycle is rapidly evaporating. Although the Fed did choose to hike in May, the decline in headline inflation has returned real interest rates to zero and our nowcasting for US economic growth continues to suggest the US has been contracting modestly since late 2022. We believe the US labour market is set to post more modest employment gains from mid-23 which in concert with improving labour supply will continue to moderate wage growth and help underwrite the commencement of a gradual easing cycle in the US from September 2023.

We continue to argue that Australia presents as a safe haven from both the perspective of more robust growth relative to the G7 peer group and as having good leverage to signs of a trough in the economic cycle in China. Although both the RBA and we expect economic activity to slow significantly in 2023 to average just 1.5%, we believe Australia should be able to avoid a technical recession due to four key reasons:

Australia has been a net beneficiary of global commodity shortages. This surge in commodity prices saw Australia's export prices in A\$ terms move to their highest levels since the 1880s in 1H22, and even though commodity prices are now off their peaks they remain very elevated from a historical perspective. The consequence has been strong national income growth, profits growth and an improving underlying fiscal position. Indeed, the Commonwealth Budget will likely be close to surplus for the 2023 financial year.

The household sector continues to hold a significant buffer of over \$270bn of excess savings relative to pre-COVID levels. Although we expect the impact of higher interest rates and higher living expenses will curtail consumer spending, we do expect the combination of rising wage growth and a run down in the level of savings to continue to support consumption spending. Albeit we remain particularly cautious on discretionary retail spending, given most of the excess savings can be traced to older and wealthier households.

Australia remains incredibly well placed to benefit from the global energy transition. Lithium is already a A\$10bn export

industry for Australia and Australia is the world's dominant producer. Electric Vehicle sales are forecast to increase 10 times by 2030 and Australia has the world's 2nd largest copper resource. LNG is an important energy transition fuel, and currently accounts for 23% of global electricity generation. Australia just happens to be the world's equal largest exporter of LNG. Iron ore obviously remains Australia's biggest export and China the dominant customer. However, we expect the global energy transition will be steel intensive, opening up new customers.

Net migration into Australia contracted in 2021 for the first time since 1945. However, a very strong recovery was recorded through 2022 and a record level of net migration appears likely in coming months, ensuring that Australia's population growth will exceed 2% in 2023.

While the Reserve Bank of Australia (RBA) has been later than most other developed nations in tightening policy, tighter financial conditions in 2022 have come via significantly higher cash rates, higher government bond yields and wider corporate bond spreads. Following the February, March and May rate hikes of 25 bps, we believe financial conditions are now in the restrictive zone and the RBA has now likely finished this tightening cycle. From our perspective, the RBA's focus on global growth, trends in household spending and the outlook for inflation and labour markets in informing their future decisions suggest that multiple additional hikes are unlikely to be required. Surprisingly, the RBA cited modest rises in the A\$ and house prices as a catalyst for the May rate hike, neither of which had risen materially. While interest rate hikes in Australia will remain a month-to-month proposition for the next six months, our bias is that the last hike has likely been delivered this cycle. It is unlikely that policy easing will be delivered in 2023, however, we do expect that the RBA will commence a modest easing cycle in 1H24.

The A\$/US\$ has been under downward pressure as markets grappled with a seemingly more hawkish Fed and a relatively more dovish RBA. Nevertheless, both central banks are in the concluding phases of the tightening cycle. With Australia's external accounts remaining in excellent health, our expectation that Australia's economic growth will prove more robust, and the prospect the US\$ down trend will persist as the Fed pivots from its aggressive hiking strategy to an easing cycle in 2023, we expect the A\$/US\$ will appreciate to the mid-70s through 2H 2023.

We are most overweight stocks within the Communication Services, Information Technology and Industrials sectors, and are underweight Financials, Real Estate and Health Care.

## Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	11.07	4.10	6.97
Consumer Discretionary	6.75	6.66	0.09
Consumer Staples	2.37	4.98	-2.60
Energy	5.04	5.51	-0.47
Financials	20.70	27.64	-6.94
Health Care	4.44	10.26	-5.82
Industrials	9.87	6.97	2.90
Information Technology	8.61	2.14	6.47
Materials	26.38	24.19	2.19
Real Estate	0.00	6.10	-6.10
Utilities	3.02	1.46	1.56

## Top 5 holdings

	Portfolio %	Benchmark %	Active %
BHP	10.52	10.42	0.10
Commonwealth Bank of Australia	5.80	7.77	-1.98
Woodside Energy	5.04	2.96	2.08
Westpac Banking	4.81	3.65	1.16
Telstra	4.28	2.34	1.94

## Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Reliance Worldwide	3.26	0.15	3.11
QBE Insurance	3.81	1.05	2.76
Worley	2.86	0.26	2.60
Underweights			
CSL	1.64	6.71	-5.07
National Australia Bank	0.00	4.20	-4.20
Macquarie Group	0.00	3.07	-3.07

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	-2.92	1.48	-5.89	-2.63
Distribution return	11.19	15.11	12.85	9.76

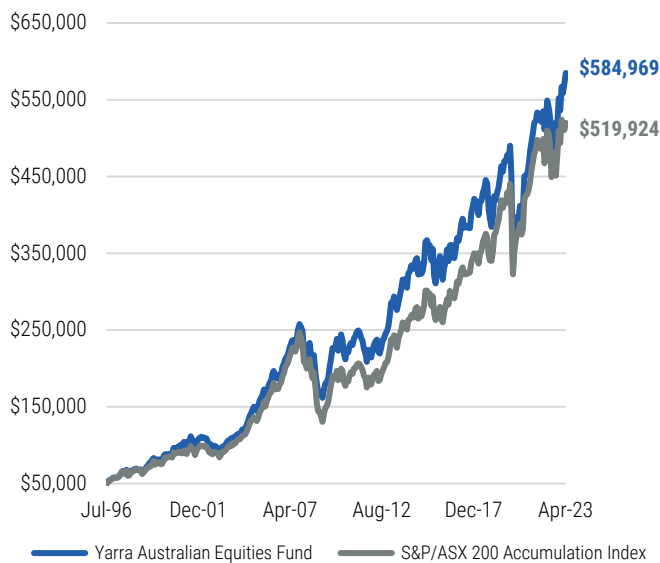
The Growth Return is measured by the movement in the Fund's unit price (inclusive of fees), ex-distribution, and can be positive or negative as the unit price can fluctuate with changes in the underlying market value of the Fund's assets. The Distribution Return is the amount that is paid to unitholders 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	A\$103.7 mn as at 30 April 2023	
APIR codes	JBW0009AU	
Estimated management cost	0.90% p.a.	
Buy/sell spread	+/- 0.15%	
Platform availability	Asgard Ausmaq BT Panorama BT Super Wrap FirstWrap GrowWrap	Hub24 IOOF Pursuit Macquarie Wrap Netwealth Oasis Powerwrap

## Investment performance comparison of \$50,000

After fees, since inception of the Yarra Australian Equities Fund, July 1996 to April 2023.



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. Note that the minimum initial investment amount for the Yarra Australian Equities Fund is \$10,000.

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## Applications and contacts

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

**Website** [www.yarracm.com](http://www.yarracm.com)

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