Investment Commentary
Month to 31 August 2021

Yarra Australian Equities Fund

Gross returns as at 31 August 2021

	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	2.14	5.43	30.69	7.16	9.13	10.34	10.89
S&P/ASX 200 Accumulation Index†	2.50	5.97	28.15	9.86	10.93	10.30	9.63
Excess return (before fees)‡	-0.36	-0.54	2.54	-2.70	-1.80	0.04	1.26

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 31 August 2021

	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	2.06	5.20	29.53	6.18	8.13	9.31	9.89
S&P/ASX 200 Accumulation Index†	2.50	5.97	28.15	9.86	10.93	10.30	9.63
Excess return (after fees)‡	-0.44	-0.78	1.38	-3.68	-2.81	-0.99	0.26

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 delivered their best monthly return since April 2021 during reporting season, overcoming uncertainty relating to protracted lockdowns in NSW and VIC and negative earnings revisions across the market.

The S&P/ASX 300 Accumulation Index lifted by 2.5% in August, taking its 12-month return to +28.1%. In comparison, the MSCI Global Index returned 2.7%. However, FY21 reporting season saw more misses than beats despite recording +28% growth y/y, and FY22 forecasts were revised down at -1.2% for the ASX200 and -1.5% for the Small Ords[1].

Nevertheless, equity valuations rose globally amid lower bond yields, with the US 10-year bond yield declining 21 bps to 1.23% in response to dovish commentary from the US Fed and the Australian 10-year bond yield remaining flat at 1.16%.

Information Technology (+17.0%) was the top performer, supported by Afterpay (APT, +39.2%) as the buy-now pay-later (BNPL) company received a takeover bid from US digital payments company Square in an all-scrip bid equating to a 30% premium to APT's last traded share price. Wisetech Global (WTC, +57.0%) and Xero (XRO, +8.2%) also outperformed following better-than-expected results.

Health Care (+6.8%) was another strong contributor to the benchmark. CSL (CSL, +8.0%) outperformed as a re-opening beneficiary, while ResMed's (RMD, +11.4%) 4Q21 result beat expectations and as a key competitor was forced to issue a product recall.

Conversely, the falling iron ore price (-15%) weighed on mining majors Fortescue Metals Group (FMG, -15.7%), BHP Group (BHP, -14.7%) and Rio Tinto (RIO, -10.7%) even as they delivered better-than-expected dividends and announced major climate change initiatives, with BHP exiting Petroleum in a proposed merger of the division with Woodside (WPL, -9.2%) and Fortescue Metals Group (FMG, -15.7%) announcing 10% of future NPAT would go towards renewable energy projects.

Portfolio review

Key Contributors

Fortescue Metals Group (FMG, underweight) – the iron ore miner underperformed as the commodity price declined 15% to US$154 per tonne in response to China clamping down on

[1] Source: GS Investment Research.

steel output to lessen pollution. The fall overshadowed a strong FY21 result in which FMG delivered record earnings and dividends, with NPAT more than doubling to US$10.3bn (in line with consensus). However, much of the attention was focused on Fortescue Future Industries (FFI), a subsidiary which will receive 10% of FMG's future NPAT to invest in renewable energy projects. We remain underweight FMG based on its stretched valuation metrics and our view that current iron ore prices are unsustainable. We prefer exposure to iron ore through BHP Group (BHP), which has a diversified portfolio (with latent value in its other commodity exposures) and a clear strategy of capital allocation.

Rio Tinto (RIO, underweight) – the miner underperformed as the iron ore price declined 15% to US$154 per tonne in response to China clamping down on steel output to lessen pollution. Notwithstanding the current supportive environment for RIO and its position as a high-quality iron ore operator, our preferred exposure remains BHP Group (BHP), which has a diversified portfolio (with latent value in its other commodity exposures) and a clear strategy of capital allocation.

Carsales.com (CAR, overweight) – the online automotive company outperformed as its FY21 result came in at the top end of guidance issued in May, with revenue and NPAT growing 4% and 11% respectively (y/y). While prolonged lockdowns in NSW and VIC cloud the outlook, CAR still expects 'solid growth' in underlying NPAT for FY22. A new product launch called "carsales Select" – a digital offering allowing consumers to purchased used cars directly off dealers – also impressed investors. We remain overweight the automotive online classifieds company. Our positive view is premised on the belief CAR should benefit from attractive earnings growth, conservative accounting (with low capitalisation of R&D investment), product initiatives to drive long-term growth (such as transitioning from a leads-based model to a transaction-based model) and undervalued international businesses.

Key Detractors

BHP Group (BHP, overweight) – the miner underperformed during the period over uncertainty relating to several major initiatives and the iron ore price falling 15%, which overshadowed its strongest earnings result since FY12. Underlying EBITDA came in at US$37.4bn, in line with expectations, and the final dividend was a record US$2.00 per share, with BHP returning US$15bn to shareholders during FY21. Management announced it intends to collapse its dual-company structure and transfer all investors to its ASX-listed entity, Moreover, the company plans to exit Petroleum by merging the division with Woodside Petroleum (WPL) under a deal in which BHP shareholders receive WPL scrip. We support the moves and BHP's pivot into Potash, which was done for a good price and strengthens its position as the world's energy transition accelerates. We continue to see the company's valuation as attractive in the context of strong free-cash-flow generation at spot commodity prices. BHP trades on a 12-month forward P/E of 8.3 times, an EV/EBITDA of 3.0 times, and generates a FCF yield of >10%. Its balance sheet is robust (gearing ~7%), with management carrying out a well-defined capital allocation strategy.

Afterpay (APT, underweight) – the buy-now, pay-later company outperformed after receiving a takeover bid from US digital payments company Square in an all-scrip bid equating to a 30% premium to APT's last traded share price. With APT's board recommending shareholders accept the offer, we remain underweight as we see better opportunities elsewhere. Our original underweight thesis was based on the prospect of heightened regulation (e.g. expense verification), increased competition and the sustainability of the company's attractive margins.

Link Group (LNK, overweight) – the share registry company underperformed in response to a disappointing FY21 result. While operating NPATA of $113.2mn was only 2% below consensus, management guided to broadly flat operating EBIT in FY22 – well below consensus for 15% growth. The market was anticipating an earnings recovery in FY22, but this appears to have been pushed out to FY23 due to further investment in operations and higher costs. We remain overweight the company because we continue to see compelling value in its base share registry business and electronic conveyancing business PEXA. Notwithstanding the PEP/Carlyle consortium walking away from its takeover proposal, we continue to see value in PEXA (with the company retaining its 45% stake in the IPO subsequent to month-end). Our positive view of PEXA is premised on infrastructure like characteristics of the property settlement exchange upon maturity supplemented by numerous growth opportunities in immediate adjacencies. Excluding PEXA, LNK trades at a forward P/E of less than 10-11 times, a substantial discount to peer Computershare (CPU) at 22.3 times.

Key Purchases

Northern Star (NST) – we increased our overweight to the gold miner during the period. While NST's valuation – at a 12-month forward EV/EBITDA of 6.5 times – limits our exposure, we believe the company will benefit from higher-than-expected production and reserves/resources after taking full ownership of the KCGM SuperPit Mine in February this year.

Qantas (QAN) – we increased our position in the airline during the period. Notwithstanding short-term disruption from border restrictions, our positive view is predicated on QAN emerging from COVID with a significantly improved industry structure and more competitive cost base in both its domestic and international businesses. We are particularly optimistic on the domestic side of the business, where we expect the improved industry structure, operating leverage and cost out initiatives (up to $300mn) to drive significant earnings upside versus consensus forecasts. We expect relative multiples to retrace to historic averages as confidence in the recovery builds (trading at or above pre-COVID multiples on normalised earnings).

NEXTDC (NXT) – we believe NXT is structurally set to benefit from increasing adoption of cloud technology, and is accelerating its expansion to meet client demands by building new data centres which will support significant medium to longer term earnings growth. Though the stock appears expensive at a headline 39.0 times 12-months forward EV/EBITDA multiple, we see it supported by a strong balance sheet (net cash) and annuity-style revenue growth (+20% p.a.).

Key Sales

Santos (STO) – we exited our small position in the oil & gas company during the period as its valuation appeal has subsided. We remain positive towards the company on a fundamental basis, premised on its resilient low-cost base business (break-even <$US25/bbl); a diversified asset base across multiple basins, customers and products (with 60% oil exposure); latent value in its midstream infrastructure and a defined pathway to net zero emissions. However, we note emissions cuts rely heavily on scaling carbon capture and storage (CCS) and hydrogen – two unproven technologies at scale – without committing significant capital to shifting the business to a low carbon world. We view the proposed merger with Oil Search (OSH) as logical from a financial perspective, however at this stage it is unclear how the merger affects the group's climate change strategy.

Healius (HLS) – we exited our position in the company during the period. We hold a positive view of its pathology and diagnostic imaging divisions, while the sale of the medical centre business last year enables management to focus on and invest in the pathology, day surgery and diagnostic imaging businesses, which are return on invested capital (ROIC) accretive and have significant margin opportunities. That being said, we believe this is more fully reflected in its valuation.

Bluescope Steel (BSL) – we exited our position in the steel producer during the period following recent outperformance. In our view the current favourable conditions are unsustainable in the medium term, with steel prices likely to revert and housing volumes likely to normalise. As a result, its headline forward P/E of 5.6 times is misleading. That being said, we continue to view BSL as a high-quality cyclical company with attractive assets (both domestically and internationally) and a strong balance sheet.

Key Active Overweights

ANZ Bank (ANZ) – we are overweight ANZ on the grounds that the bank is positioned strongly for an earnings and dividend recovery as the vaccine roll-out hits key targets and lockdown restrictions ease. We believe the most recent lockdowns have delayed (and not aborted) the recovery, with capital management initiatives still likely as bad debts turn out to be more benign than feared. While there are challenges to its outlook – including persistent top-line pressures from lower interest rates – the bank is able to offset these pressures by cutting costs at a superior rate to peers, and management remains committed to its $8bn expense target (requiring a $600mn cost reduction ex-investment). We see ANZ's valuation as attractive at 12.9 times forward earnings, particularly relative to NAB and CBA (at 14.3 and 19.0 times respectively).

Aristocrat Leisure (ALL) – our investment thesis is premised on ALL's strong growth profile following the resolution of the COVID-19 crisis. ALL has a dominant position in land-based games (45% of EBIT post-COVID) and is set to benefit from significant opportunities from Digital (55% of EBIT post-COVID), which offers a wide range of outcomes. Lastly, the stock screens as undervalued at 28.6 times forward earnings when considering the Industrials Ex-Financials trades at 31.0 times and ALL's superior long-term growth potential.

ResMed (RMD) – our overweight position is based on RMD's strong market position in both the short and long term. In the short term, key competitor Phillips has been forced to recall a range of respiratory devices on safety issues, which we believe will allow RMD to take significant market share. More broadly, RMD's core sleep apnea division will rebound strongly on the grounds that demand for its products has been deferred, not lost. Our long-term investment thesis remains intact, with benefits accruing from a positive product cycle in the flow generator and mask segments, with the Airsense 11 launching formally in December this year. New software and integration with the customer is supporting device sales versus competitors. While RMD trades at a headline 46.3 times forward earnings, in reality we see it as much lower given meaningfully better-than-expected NPAT outcomes to come in the medium term.

Key Active Underweights

CSL (CSL) – we remain underweight CSL based on its forward valuation (44.7 times P/E and 30.6 times EV/EBITDA on a 12-month forward basis), which we believe appropriately captures the earnings outlook at this time. While CSL is a key beneficiary of the post-COVID re-opening theme, we believe this is already reflected in consensus forecasts. However, in our view the prospect of higher costs going forward is underappreciated by the market, with donor fees likely to be higher for longer. We continue to prefer ResMed (RMD) within the Health Care sector, where we see better growth prospects and a strong competitive position versus peers.

National Australia Bank (NAB) – we remain underweight the bank. While NAB has strengthened its capital position through a highly dilutive, discounted $3.5bn capital raising and has increased collective provisioning, the bank is yet to take an AUSTRAC provision unlike its peers. Notwithstanding the improving trends for the bank (albeit delayed by Australia's most recent lockdowns), we see less scope for surplus capital compared to Westpac Bank (WBC) and ANZ Bank (ANZ). Further, NAB trades at 14.3 times forward earnings, above peer ANZ (at 12.9 times forward earnings) where we see a superior outlook.

Wesfarmers (WES) – our underweight position remains premised on the view its divisions, outside Bunnings (62% of operating income), face significant earnings headwinds. Officeworks (5% of operating income) and the department store industry (including discount department stores Target and Kmart, 25% of EBIT) face increasing competition and excess physical store capacity. Furthermore, the company's Industrials segment (9% of EBIT) comprises cyclical, lower quality businesses. As such, we don't find the valuation attractive at 20.3 times forward earnings.

Market outlook

The Australia economy completed 1H2021 with strong momentum, prompting the RBA and consensus to upgrade expectations for both 2021 and 2022 calendar year growth. Both the size of the economy and the number of people employed comfortably exceed pre-pandemic levels. Clear highlights were the unemployment rate declining from a peak of 7.5% in July 2020 to just 4.6% in July 2021 and June quarter GDP rising 0.7%, well ahead of expectations. Nevertheless, renewed COVID-related lockdowns in Melbourne and Sydney will sharply impact the data in 3Q21 and materially alter our growth forecasts for the remainder of 2021 and 2022.

We believe the interruption to economic growth from renewed lockdowns will be an aberration within an improving trend, rather than a view altering event. Indeed, the fundamentals that will drive the economic recovery remain in place. The recovery in labour market income has been sufficient to offset the gradual withdrawal of temporary fiscal support. Moreover, the accumulation of an estimated $171bn in excess household saving, in concert with strong asset price gains, leaves the consumer uniquely positioned to underpin economic growth in 2021-22. Dwelling investment is set to provide solid support for economic growth over the next 12 months following a surge in demand for new housing construction, and a broader-based lift in business investment expectations is an important step in ensuring a sustained economic recovery. We expect the global economy to expand 6.5% and the Australian economy to expand 4.75% in 2021, a downward revision from our pre-lockdown forecast of 6%. We expect another strong year of economic growth in 2022 of 4.0%.

While we continue to expect US inflation to surprise on the upside over the remainder of 2021, the biggest inflation surprises are now behind us and our expectation that global business surveys would likely peak around mid-2021 appears to have been realised. The peak in global business surveys, in concert with slower bond issuance relative to central bank buying, helped push real bond yields to record lows over recent weeks. As the Federal Reserve signals increased willingness to taper its purchases and global economic and inflation indicators remain elevated, we expect bond yields will again start to move higher through the remainder of 2021. We expect US 10 year yields to approach 1.80% by the end of 2021.

The A$/US$ has recently been buffeted by concerns of a peak in global industrial growth indicators, slowing China economic momentum and recent declines in iron ore prices. Nevertheless, Australia's external accounts are in their best position since the early 1970s, and despite some moderation in commodity prices the A$/US$ should remain supported by global reflationary forces through 2021-22. Reflecting the factors above, we have lowered our expectations for the A$/US$ somewhat over the remainder of 2021, and now expect the A$/US$ to finish the year in the 76-78c range, down from a forecast 81-83c range previously.

We see significant value in certain sectors but believe others to be overvalued based on our earnings and cash flow expectations. We are most overweight stocks within the Communication Services, Information Technology and Materials sectors, and underweight Real Estate, Consumer Staples and Health Care.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	13.19	4.15	9.04
Consumer Discretionary	9.50	8.17	1.33
Consumer Staples	1.48	5.43	-3.95
Energy	1.95	2.71	-0.76
Financials	26.41	29.88	-3.47
Health Care	7.24	10.65	-3.41
Industrials	6.28	6.82	-0.54
Information Technology	6.36	4.41	1.94
Materials	20.72	19.33	1.39
Real Estate	2.19	6.95	-4.76
Utilities	1.99	1.48	0.51

Top 5 holdings

	Portfolio %	Benchmark %	Active %
BHP	8.49	6.36	2.13
Commonwealth Bank of Australia	7.34	8.41	-1.07
Westpac Banking	7.23	4.48	2.74
ANZ Banking	7.11	3.75	3.36
Aristocrat Leisure	4.63	1.38	3.25

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
ANZ Banking	7.11	3.75	3.36
Aristocrat Leisure	4.63	1.38	3.25
ResMed	3.51	0.67	2.84
Underweights			
CSL	1.90	6.72	-4.82
National Australia Bank	0.00	4.33	-4.33
Wesfarmers	0.00	3.22	-3.22

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	7.85	-9.70	-3.59	0.21
Distribution return	21.68	15.89	11.71	9.10

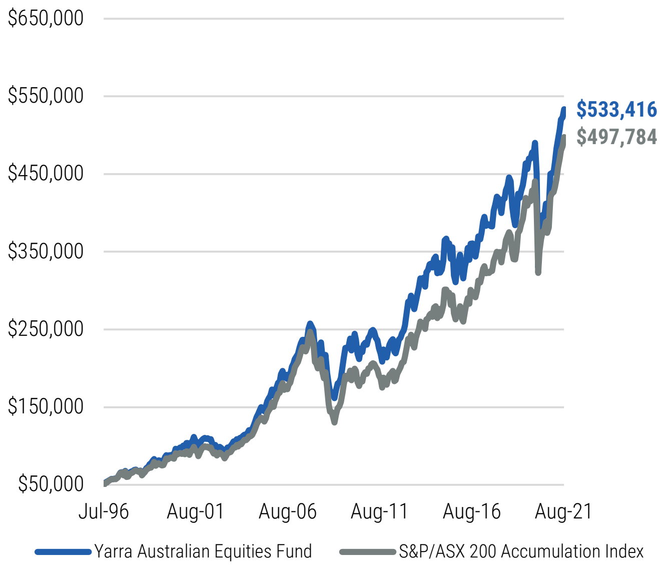
The Growth Return is measured by the movement in the Fund's unit price (inclusive of fees), ex-distribution, and can be positive or negative as the unit price can fluctuate with changes in the underlying market value of the Fund's assets. The Distribution Return is the amount that is paid to unitholders 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$111.2 mn as at 31 August 2021
APIR codes	JBW0009AU
Estimated management cost	0.90% p.a.
Buy/sell spread	+/- 0.15%
Platform availability	AMP Flexible Lifetime AMP PortfolioCare AMP Wealthview ANZ Grow Wrap Asgard BT Panorama BT Wrap Colonial FirstWrap Freedom of Choice Hub24 IOOF Pursuit Select Macquarie Wrap Accumulator Macquarie Wrap Consolidator Netwealth North Oasis OnePath PortfolioOne PowerWrap SmartWrap Wealthtrac

Investment performance comparison of $50,000

After fees, since inception of the Yarra Australian Equities Fund, July 1996 to August 2021.



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.

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

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