

# Yarra Australian Equities Fund

## Gross returns as at 31 December 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	2.69	1.20	19.49	12.66	8.66	10.61	10.77
S&P/ASX 200 Accumulation Index†	2.75	2.09	17.23	13.61	9.76	10.79	9.51
Excess return (before fees)‡	-0.06	-0.89	2.26	-0.95	-1.10	-0.18	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 December 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	2.61	0.98	18.43	11.64	7.66	9.58	9.76
S&P/ASX 200 Accumulation Index†	2.75	2.09	17.23	13.61	9.76	10.79	9.51
Excess return (after fees)‡	-0.14	-1.12	1.20	-1.97	-2.10	-1.21	0.25

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 rose modestly in the December 2021 quarter as strong performances from the miners and defensive sectors offset weakness elsewhere.

The ASX 200 Accumulation Index increased by 2.1% during the quarter, taking its 2021 return to +17.2%. The local index underperformed global indices, with the MSCI World Index returning 8.2% during the quarter even as a new COVID variant, labelled Omicron, drove uncertainty around the growth outlook. Further, persistent inflation in the US continued to stoke concerns about faster tapering and US interest rate rises.

At a sector level, Metals & Mining (+13.9%) provided the most support to the benchmark, led by a rally in iron ore miners Fortescue Metals Group (FMG, +28.4%) and BHP Group (BHP, +10.3%). Elsewhere, battery material producers Mineral Resources (MIN, +25.0%) and Lynas Rare Earths (LYC, +51.6%) also delivered strong returns.

Other positive sectors were Communication Services (+4.9%) and Real Estate (+9.3%). Defensive names such as Telstra (TLS, +6.4%) and Goodman Group (GMG, +22.9%) were the top performing stocks in their sectors.

Conversely, Energy (-8.8%) and Financials (-2.2%) were the worst performers. The former was weighed down by the oil

price which declined late in the period. In the latter, Westpac Bank (WBC, -15.7%) was largely responsible after delivering a disappointing FY21 result.

### Portfolio review

#### Key Contributors

**Link Administration (LNK, overweight)** – the share registry company outperformed after receiving several takeover offers during the period and giving a positive trading update. The highest offer came from Canadian-based group Dye & Durham at \$5.50 per share, representing a 28% premium to its closing price prior to an earlier offer from Carlyle Group. The LNK board has recommended shareholders vote in favour of the scheme in the absence of a superior proposal. LNK also gave a trading update during the period, reaffirming full-year guidance and commenting that year-to-date trading has been ahead of expectations. We remain overweight as the corporate activity supported our view of the latent value in the business. We hold a positive view of PEXA premised on the infrastructure-like characteristics of the property settlement exchange upon maturity, supplemented by numerous growth opportunities in immediate adjacencies. Further, LNK is positively leveraged to higher US interest rates, which we see as a meaningful tailwind over the medium term.

**Afterpay (APT, underweight)** – the payment solutions provider underperformed during the period without any material news. We remain underweight following US-based Square's proposed takeover of the company, 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.

**IGO Limited (IGO, overweight)** – the battery materials producer outperformed alongside the lithium price. We remain overweight the company. Our positive thesis is premised on its US\$1.4bn Greenbushes acquisition and its existing portfolio of high-quality assets. We support the acquisition for several reasons. Not only does it give IGO exposure to a high-quality, long-dated asset (>20 years mine life), but it also completes IGO's suite of battery commodities with the company already producing nickel, copper and cobalt. We also think the purchase price was reasonable, with Greenbushes likely to be NPV and EPS accretive earlier than FY23. We also hold a positive view of IGO's Nova asset – a world-class reserve which supports an increasing production profile.

**Pexa Group (PXA, overweight)** – the property exchange network company outperformed after reaffirming prospectus FY22 forecasts at an AGM update, with risks to the upside due to stronger-than-expected volumes (up 40% y/y to 1.36mn billable transactions). Our investment thesis is premised on infrastructure like characteristics of the property settlement exchange upon maturity, supplemented by numerous growth opportunities in immediate adjacencies (data and new markets). We see significant earnings upside as cost reductions are realised in the transition from the business's growth phase towards more of a utility phase, supporting higher sustainable EBITDA margins going forward.

**Incitec Pivot (IPL, overweight)** – the company outperformed after delivering a better-than-expected FY21 result and as ammonia prices moved to record highs. Management reported underlying NPAT of \$359mn, well above consensus for \$297mn, with strong performances from both the fertiliser and explosives divisions. Meanwhile, the December Tampa ammonia price increased by 20% to US\$990/t, with margins increasing as US gas prices remained relatively low. We remain overweight the company. While we are likely near the top of the cycle for fertiliser prices, we believe this is mostly reflected in consensus expectations. However, persisting spot prices would result in significant earnings upgrades and potential capital management initiatives, particularly if IPL can maintain its improved plant performance (running at nameplate capacity).

### Key Detractors

**TPG Telecom (TPG, overweight)** – the telecommunication services company partially retraced outperformance from prior months as its founder sold a block of shares during the period. Our positive view is premised on the improving outlook for the mobiles market, recovery in volumes post COVID and the recently completed Vodafone merger, which in our view will unlock significant synergies. The combined entity is well placed to harness its infrastructure, scale and balance sheet to

disrupt incumbents Telstra (TLS) and Optus through its lower-cost structure, as well as new products such as Fixed Wireless.

**Westpac Bank (WBC, overweight)** – the bank underperformed following a disappointing FY21 result. Pre-provision profit for the second half came in 17% below consensus forecasts, driven by lower margins and higher costs. Revenue pressures in the half were extreme and we expect to moderate going forward with asset growth restarted and NIM now rebased. Further, whilst we do not expect WBC to meet its \$8bn FY24 cost target, progress on cost out should go a long way towards stabilising pre provision earnings and restoring confidence in what is otherwise a strong, consumer-oriented franchise. In this context we view WBC's forward earnings multiple of 13.2 times (a ~10% discount to the sector) and 5% dividend yield as attractive.

**Star Entertainment (SGR, overweight)** – the casino operator underperformed in response to media allegations that it had enabled suspected money laundering, fraud and foreign interference. Following the allegations, the company announced that the Liquor and Gaming Authority's regular review of The Star Sydney would now also incorporate public hearings. We exited our position following extensive engagement with management and after undertaking independent validation in relation to media allegations that the company enabled suspected money laundering, fraud and foreign interference. We had taken some comfort from SGR having undergone several recent reviews without any major issues identified, in stark contrast to Crown Resorts (CWN). However, the allegations raise the risk profile of the stock, introduces the possibility there may be sanctions against the company, and may remove potential upside opportunities (extra gaming licences, concessions).

**Macquarie Group (MQG, underweight)** – the investment bank outperformed after announcing a strong 1H21 result, in which NPAT came in 6% ahead of consensus forecasts \$2,043mn largely due to its Commodities and Global Markets division. 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 see as unsustainable into the medium term. We see significant downside risk to consensus forecasts from FY22, which currently reflects a strong contribution from lumpy items including gains on sale, performance fees and low loan-loss provisions. Meanwhile, we do not expect growth in the more stable business to be able to offset this. As a result, we regard MQG's headline forecast P/E multiple of 21.6 times consensus forward earnings as unattractive.

**Goodman Group (GMG, underweight)** – the industrial REIT outperformed after upgrading FY22 earnings guidance during the period. Management now expects more than 15% operating EPS growth for the financial year (up from its previous guidance of 10%) and announced development WIP at an all-time high of \$12.7bn. The fundamentals for the business across key global markets are strong, supported by tailwinds of e-commerce growth, supply-chain optimisation and a rebound in global industrial growth following Covid disruptions. Nevertheless, we believe the positive outlook is

fully reflected in GMG's valuation, trading at 31.8 times forward earnings and an EV/EBITDA of 30.0 times.

### Key Purchases

**Insurance Australia Group (IAG)** – we established a position in the insurer during the period for several reasons. We took advantage of recent underperformance, which reflected IAG enduring an unusually high level of mid-sized events FYTD (at ~8 times normal losses). As a result, the stock was trading at a 20% discount to the ASX 200 on FY23 earnings, well below its long-run average of -2%. While we acknowledge the structural pressure on catastrophe allowances and that IAG will need to increase its loss estimates going forward, we believe this is mostly captured by consensus. Further, IAG has \$1.15bn of business interruption reserves, most of which we believe will not be required – putting the company in a strong capital position. With \$12.5bn in policyholder and shareholder funds, IAG also has significant positive interest rate leverage: every 10 bp increase in base rates translates to a 1% increase in NPAT.

**Amcor (AMC)** – we established a position in the packaging company late in the quarter. We view AMC as a defensive stock with a strong dividend yield (+4.2%) that should generate strong EPS growth in FY22 (+13%), before returning to more normal levels from FY23 onwards (mid-single digit). While AMC's Flexibles division faces volume headwinds as customers turn away from non-recyclable plastics, we believe the company is moving in the right direction from the point of view of producing more recycled product, and using more post-consume resin. Further, shifts to higher margin customers (pharmaceutical and medical) and cost-out initiatives will provide an offset. Lastly, we view AMC's valuation as attractive at 13.8 times forward P/E, below its 15.4 times long-term average.

**Link Administration (LNK)** – we increased our position in the company during the period, prior to the company agreeing to a takeover offer from Canadian-based Dye & Durham. We see compelling value in its base share registry business and electronic conveyancing business PEXA, which has been supported by recent corporate interest. We hold a positive view of PEXA premised on its infrastructure-like characteristics of the property settlement exchange upon maturity, supplemented by numerous growth opportunities in immediate adjacencies. Further, LNK is positively leveraged to higher US interest rates, which we see as a meaningful tailwind over the medium term. Lastly, LNK trades at 24.2 times forward earnings, a discount to peer Computershare (CPU) at 24.9 times.

### Key Sales

**Star Entertainment (SGR)** – we exited our position following extensive engagement with management and after undertaking independent validation in relation to media allegations that the company enabled suspected money laundering, fraud and foreign interference. We had taken some comfort from SGR having undergone several recent reviews without any major issues identified, in stark contrast to Crown Resorts (CWN). However, the allegations raise the risk profile

of the stock, introduces the possibility there may be sanctions against the company, and may remove potential upside opportunities (extra gaming licences, concessions).

**Iluka Resources (ILU)** – we exited our position during the period. We are cautious about the company's operating outlook as developments in China's real estate industry slows from elevated levels, which we believe is not fully reflected despite its headline valuation multiple (forward EV/EBITDA of 4.7 times). We regard the industry structure as attractive (consolidated supply), with less pricing volatility compared to previous cycles. Our preferred mining exposures at this time include BHP Group (BHP), IGO Limited (IGO) and Alumina (AWC).

**Lendlease (LLC)** – we exited our position in the property group during the period in response to greater uncertainty over the outlook and to fund more compelling, near-term opportunities elsewhere. LLC's strategy targets have been pushed out to FY24 (from FY23/24 previously) as COVID continues to impact LLC's real estate markets, particularly its UK developments, and the new chief executive reset earnings expectations with a more conservative approach to profit recognition.

### Key Active Overweights

**Link Administration (LNK)** – we are positive on the company because we see compelling value in its base share registry business and electronic conveyancing business PEXA, which has been supported by recent corporate interest with the board agreeing to a \$5.50 per share near period-end by Canadian-based Dye & Durham. We hold a positive view of PEXA premised on its infrastructure-like characteristics of the property settlement exchange upon maturity, supplemented by numerous growth opportunities in immediate adjacencies. Further, LNK is positively leveraged to higher US interest rates, which we see as a meaningful tailwind over the medium term. Lastly, LNK trades at 24.2 times forward earnings, a discount to peer Computershare (CPU) at 24.9 times.

**Aristocrat Leisure (ALL)** – our investment thesis is based on our positive view of, amongst other factors, its recent acquisition, London-based Playtech. By acquiring Playtech, ALL gains access to Real Money Gaming (RMG) – a market which has a strong growth outlook, particularly in the US as the country legalizes the practice state by state. Moreover, RMG is an obvious extension for ALL: it provides an additional channel to sell its best-in-market slot content in the US and leverages its strong relationships with casinos. Outside of the acquisition, our positive investment view remains premised on ALL's dominant position in Land-Based Games and significant opportunities from Digital, which offers a wide range of outcomes. Lastly, the stock screens as undervalued at 26.7 times forward earnings when considering the Industrials Ex-Financials trades at 28.6 times and ALL's superior long-term growth potential.

**Telstra (TLS)** – our investment thesis is premised on several factors. Firstly, we believe continued Mobile growth over the medium term is possible as average revenue per user (ARPU) rises due to a rational market which has seen all players raise prices, in addition to tailwinds from international borders

reopening through international roaming charges and migration. Secondly, the company's cost reduction initiatives are proving to be real and flowing through to earnings, with management announcing a further \$500mn reduction between FY23-25 following on from the \$2.3bn productivity program ending in FY22. Thirdly, with revenues now growing, the NBN headwind largely behind the business and costs coming down, the outlook for the dividend has significantly improved – turning from concerns around a cut to likely increases over the medium term. Lastly, the sale of 49% of its stake in mobile tower business, TowerCo, for \$2.8bn, highlights the value of TLS' infrastructure which will continue to rise as the business further highlights its earnings potential.

**QBE Insurance (QBE)** – our positive view towards the general insurer is premised on the company benefiting from an ongoing global hardening cycle in commercial insurance along with a return to unit growth after several years of volume declines as the company exited sub economic exposures. QBE's recent result demonstrated that the company has sufficiently strengthened reserves against problematic North American long tail insurance lines, which was previously viewed as a key risk. We continue to see upside to its relative valuation, with the stock trading on 11.5 times forward earnings and offering a 4.9% dividend yield.

**TPG Telecom (TPG)** – our thesis is premised on the improving outlook for the mobiles market, recovery in volumes post COVID and the recently completed Vodafone merger, which in our view will unlock significant synergies. The combined entity is well placed to harness its infrastructure, scale and balance sheet to disrupt incumbents Telstra (TLS) and Optus through its lower-cost structure, as well as new products such as Fixed Wireless.

### Key Active Underweights

**CSL (CSL)** – we remain underweight CSL based on its forward valuation (38.8 times P/E and 27.1 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 for several reasons. We see less scope for surplus capital compared to Westpac Bank (WBC) and ANZ Bank (ANZ). Further, NAB trades at 14.8 times forward earnings, above peer ANZ (at 12.7 times forward earnings) and Westpac Bank (WBC) at 13.2 times. More broadly, we are underweight the Banking sector, having switched our preference to Insurance where we see more attractive valuations, a more favourable outlook and a better industry structure.

**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 see as

unsustainable into the medium term. We see significant downside risk to consensus forecasts from FY22, which currently reflects a strong contribution from lumpy items including gains on sale, performance fees and low loan-loss provisions. Meanwhile, we do not expect growth in the more stable business to be able to offset this. As a result, we regard MQG's headline forecast P/E multiple of 21.6 times consensus forward earnings as unattractive.

**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 28.2 times forward earnings.

**Woolworths (WOW)** – our underweight position reflects concerns at the stock's stretched valuation at 29.7 times forward earnings, which is well above Coles (COL) at 23.0 times and does not reflect emerging challenges in its supermarket business (85% of group earnings) as COVID-related supply chain and labour disruptions raise costs in the short term. Furthermore, the outlook for discount department store Big W remains challenged, particularly considering the threat of online and the need to rationalise excess store capacity.

### Market outlook

We expect the Australian economy to continue to rebound in the short-term, following a better-than-expected contraction in 1Q21 amid COVID-related lockdowns in Melbourne and Sydney.

Notwithstanding the ongoing risk from new variants such as Omicron, we believe any interruption to economic growth from renewed lockdowns will be an aberration within an improving trend. 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 \$185bn in excess household saving, in concert with strong asset price gains, leaves the consumer uniquely positioned to underpin economic growth in 2021-2022. Dwelling investment is set to provide solid support for economic growth over the next six months as previously approved housing moves through the construction phase, 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 have expanded 6% in 2021 and the Australian economy 4.5%. We expect another strong year of economic growth in 2022 of 4.0%.

Nevertheless, there are some areas that are cause for concern. For over 12 months we have warned about rising US inflation pressures and rising inflation expectations. However, supply chain constraints and energy shortages in the Northern

Hemisphere risk inflation pressures becoming more widespread and more entrenched. With the peak in global business surveys having passed, cost inflation continuing to escalate and the Federal Reserve announcing its decision to taper its bond purchases, we expect bond yields will move higher, providing some ongoing challenges for risk assets.

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 we expect the A\$/US\$ to remain supported by global reflationary forces through 2022.

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, Materials and Industrials sectors, and underweight Real Estate, Consumer Staples and Health Care.

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## Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	13.21	4.47	8.73
Consumer Discretionary	8.62	8.01	0.61
Consumer Staples	1.38	5.04	-3.66
Energy	1.94	3.16	-1.22
Financials	24.90	29.20	-4.31
Health Care	6.37	10.56	-4.18
Industrials	7.75	7.10	0.64
Information Technology	8.18	4.36	3.82
Materials	23.02	19.23	3.79
Real Estate	1.55	7.45	-5.91
Utilities	2.31	1.42	0.89

## Top 5 holdings

	Portfolio %	Benchmark %	Active %
BHP	7.59	5.78	1.82
Commonwealth Bank of Australia	6.97	8.13	-1.16
Westpac Banking	5.48	3.70	1.78
Aristocrat Leisure	4.91	1.38	3.53
Telstra	4.75	2.35	2.41

## Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Link Administration	3.83	0.13	3.69
Aristocrat Leisure	4.91	1.38	3.53
Telstra	4.75	2.35	2.41
Underweights			
CSL	1.84	6.57	-4.73
National Australia Bank	0.00	4.47	-4.47
Macquarie Group	0.00	3.43	-3.43

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	-1.90	-4.95	-3.93	0.41
Distribution return	20.33	16.58	11.59	9.17

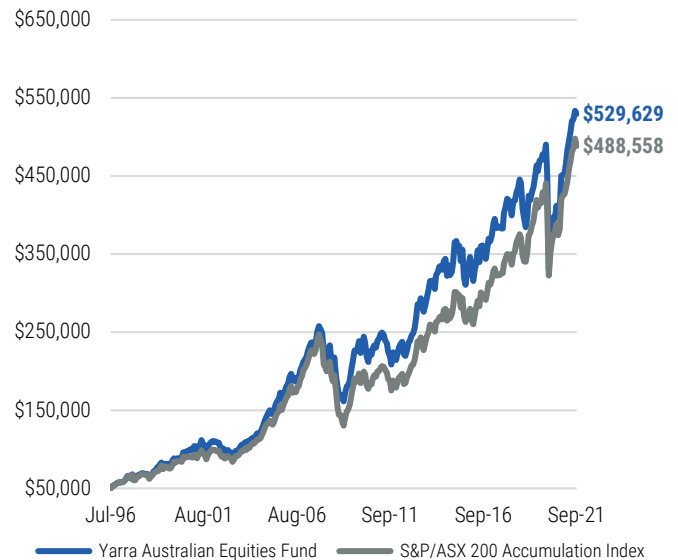
The Growth Return is measured by the movement in the Fund's unit price (inclusive of fees), ex-distribution, and can be positive or negative as the unit price can fluctuate with changes in the underlying market value of the Fund's assets. The Distribution Return is the amount that is paid to unitholders 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\$103.5 mn as at 31 December 2021	
APIR codes	JBW0009AU	
Estimated management cost	0.90% p.a.	
Buy/sell spread	+/- 0.15%	
Platform availability	AMG Freedom of Choice AMP North Asgard BT Panorama Colonial FirstWrap Grow Wrap	Hub24 IOOF Pursuit Macquarie Wrap Netwealth Oasis Praemium

## Investment performance comparison of \$50,000

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

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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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