

# Yarra Australian Equities Fund

## Gross returns as at 28 February 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	2.75	3.39	3.70	4.85	9.04	7.48	10.49
S&P/ASX 200 Accumulation Index <sup>†</sup>	1.45	3.00	6.48	7.38	10.73	7.76	9.22
Excess return (before fees) <sup>‡</sup>	1.30	0.39	-2.78	-2.53	-1.69	-0.28	1.27

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 28 February 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	2.68	3.16	2.78	3.88	8.03	6.47	9.48
S&P/ASX 200 Accumulation Index <sup>†</sup>	1.45	3.00	6.48	7.38	10.73	7.76	9.22
Excess return (after fees) <sup>‡</sup>	1.23	0.16	-3.70	-3.50	-2.70	-1.28	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

<sup>†</sup> 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.

<sup>‡</sup> Excess return: The difference between the portfolio's return and the benchmark return.

### Market review

Australian equities rose modestly in February as rising bond yields globally offset a stronger-than-expected reporting season.

The S&P/ASX 200 Accumulation Index increased 1.5% for the month, taking its 12-month return to 6.5%. The local market lagged overseas indices, with the MSCI World Index and S&P500 returning 2.7% and 2.8% respectively. Returns had been stronger as companies delivered one of the best reporting seasons on record, with 3.2 times more beats than misses<sup>1</sup>. However, equities de-rated in the second half of the month as the Australian 10-year bond yield rose 79 bps to 1.88%.

The banking sector (+5.6%) was the standout as direct beneficiaries of higher bond yields and, moreover, as results highlighted lower impairments and more resilient revenue than anticipated. Westpac Bank (WBC, +12.7%) and ANZ Bank (ANZ, +10.4%) were the top performers as the banks announced \$510mn and \$150mn write-backs respectively and higher margins as deposits were repriced.

Elsewhere, Resources stocks rallied as the global recovery continued to take shape. Iron ore miners BHP Group (BHP, +12.8%), Rio Tinto (RIO, +15.3%) and Fortescue Metals Group (FMG, +10.7%) increased in value alongside the iron ore price (+11% to US\$176 per tonne) and after announcing higher than anticipated dividends at their results. Within Energy (+2.4%), Santos (STO, 12.0%) and Oil Search (OSH, +9.3%) were the top performers as Brent Crude increased 19.2% to US\$66 per barrel.

Conversely, the worst performing sectors were Health Care (-2.9%) and Information Technology (-8.9%). CSL (CSL, -3.4%) declined despite a strong 1H21 result, with investors instead focused on the sales outlook following COVID-related supply disruption at collection centres. Losses were widespread across the tech sector (given the impact of higher bond yields on their long-dated cash flows). The worst performers included Afterpay (APT, -11.5%), Xero (XRO, -8.8%), Wisetech Global (WTC, -12.8%), Altium (ALU, -14.6%) and Appen (APX, -25.3%).

<sup>1</sup> Source: Morgan Stanley, March 2021.

## Portfolio review

### Key Contributors

**Vocus (VOC, overweight)** – the telco outperformed during the period after receiving a takeover bid and delivering a better-than-expected 1H21 result. A consortium comprising Macquarie Infrastructure and Real Asset Holdings (MIRA) and Aware Super made a non-binding, indicative offer of \$5.50 per share. Subsequent to month-end the consortium finalised the bid after four weeks of due diligence. Meanwhile, the result highlighted positive momentum in the Networks division, with VOC taking share from competitors following a large number of deals in 1H21 and management talking to a strong pipeline for the full year. The result and takeover bid supported our investment thesis on the stock; namely that the combination of good management, improving fundamentals and quality of the asset base will result in significant upside. We remain overweight on the grounds VOC trades at a discount to the takeover offer and, given the appeal of its assets, a competitor bid could emerge.

**BHP Group (BHP, overweight)** – the miner outperformed as the iron ore price increased by 11% to \$US176 per tonne and after announcing a dividend of \$US1.01 per share at its 1H21 result – well ahead of consensus for US84 cents – which equated to an 85% payout ratio and nearly 100% of free cash flow. We continue to believe the company's valuation is attractive in the context of firm iron ore prices and China returning to production following COVID-19. BHP still trades on a 12-month forward P/E of 13.5 times, an EV/EBITDA of 6.1 times, and generates a FCF yield of >10%. Its balance sheet is robust (gearing ~15%), with management carrying out a well-defined capital allocation strategy. More broadly, we view BHP as a relatively defensive Metals & Mining exposure, with a diversified portfolio and clear strategy of capital allocation.

**Wesfarmers (WES, underweight)** – the conglomerate underperformed during the period despite delivering a strong 1H21 result, partially retracing prior outperformance from prior months. Normalised EBIT increased by 25% y/y to \$2,163mn, 13% ahead of consensus forecasts, underpinned by its Bunnings (+34% growth) and Kmart (+40% growth). Notwithstanding the result, 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 24.1 times forward earnings.

### Key Detractors

**Atlas Arteria (ALX, overweight)** – the toll road operator underperformed during the period amid rising bond yields globally and as its FY20 result showed COVID-19 related restrictions continued to impact traffic volumes for its key assets. ALX reported that traffic for APRR remained 25% lower y/y in the beginning of CY21, while Dulles Greenway was down

50% y/y. That being said, ALX's actual FY20 result was solid, with proportional EBITDA of \$881mn above consensus of \$837mn and dividend guidance for 2H21 was raised to 13 cents per share. We remain overweight based on its strong liquidity and balance sheet position, which leaves it well placed to weather any further COVID-19 related downturn, and a positive long-term view. ALX holds attractive, long-duration assets and trades at a discounted valuation (11 times normalised EV/EBITDA), which more than captures the disruption from COVID-19 but doesn't reflect the outlook for a recovery as vaccines roll out. We continue to believe the intrinsic value of ALX's assets will eventually be realised following the simplification of its ownership structure in the past two years, resulting in significant upside.

**Rio Tinto (RIO, underweight)** – Rio Tinto outperformed as the iron ore price increased by 11% to \$US176 per tonne and delivered a better-than-expected FY20 result, with underlying EBITDA rising +13% to \$US23.9bn and a final dividend of US3.09 per share and a special dividend of \$US93 cents per share. Notwithstanding the current supportive environment for RIO and its position as a high-quality iron ore operator, we remain underweight the stock. Our preferred exposure remains BHP Group (BHP), which has a diversified portfolio (with latent value in its metallurgical coal and oil businesses) and a clear strategy of capital allocation.

**TPG Telecom (TPG, overweight)** – the telco underperformed during the period after missing expectations with its FY20 result. Pro-forma EBITDA declined 10% to the year to \$1,789mn, 2% below consensus forecasts. Further, FY21 forecasts saw similar downgrades as the Mobile division faces continued COVID-19 related disruption, particularly given its relatively high exposure to tourism and migrants. Notwithstanding these short-term headwinds, we remain overweight the stock. Our positive view remains premised on 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 Purchases

**Telstra (TLS)** – we established a position in the telco during the period. Our investment thesis is premised on several factors. Firstly, we believe management's guidance for Mobile growth in 2H21 and FY22 is achievable. Average revenue per user (ARPU) is set to benefit from the \$5 increase across the company's back-book in November and December, its front book is seeing \$3 rises from new plans and headwinds to the business relating to COVID-19, out-of-bundle plans and accounting changes are fading. Secondly, the company's cost reduction initiatives are proving to be real and flowing through to earnings, with management announcing a further \$200mn to its \$2bn productivity program by FY22 and reiterating "hundreds of millions" beyond that. Thirdly, TLS is committed to maintaining the current dividend (as evidenced by paying 125% of underlying earnings in 1H21), which was justified given its strong cash flow (the dividend was only 60% of FCF) and outlook for earnings growth. Lastly, we expect the sale

mobile tower business, TowerCo, will result in a significant portion of its capital (at a \$4-5bn valuation) to be returned to shareholders. We do not believe these positive factors are reflected in TLS's valuation, with the stock trading at 21.4 times 12-month forward earnings and offering a 5.3% dividend yield.

**Metcash (MTS)** – we increased our position during the period due to strong momentum across all three divisions (Food, Hardware & Liquor), with our positive view predominantly based on the wholesale distributor's Food Division (56% of EBIT). In the short term, we expect the division to continue benefiting from the shift to local shopping amid the COVID-19 pandemic. Further, MTS is taking market share and should benefit from stronger operating leverage as elevated costs associated with COVID-19 abate. In the longer term, we see the Food division as more sustainable following recent management changes to the franchisor / franchisee model, which now prioritises retailer revenue growth (rather than MTS profit), which has in turn led to suppliers being willing to invest to reduce prices. Within Hardware (31% of divisional EBIT), we see MTS as a key beneficiary of Australia's improving housing environment, with the majority of its business in the trade segment (where it has exposure to small and medium-dwelling builders as opposed to high-rise builders). We do not believe this is factored into consensus expectations, with MTS trading at 14.6 times (versus COL at 19.7 times and WOW at 24.1 times).

**Ansell (ANN)** – we increased our position in the stock during the period. In the short term, we continue to believe ANN's Health Care division (55% of EBIT) will support earnings as it provides crucial equipment to combat the COVID-19 virus, more than offsetting likely short-term disruption from its Industrial division (45% of group EBIT). More broadly, we continue to view the business favourably as it undergoes internal programs to increase operational efficiency and improve margins from new distributor agreements, and shifts towards higher-value products. We do not believe this is captured by consensus; the stock trades at 17.2 times 12-month forward earnings, a large discount to the wider Industrials ex-Financials at 26.5 times.

### Key Sales

**Sydney Airport (SYD)** – we exited our position in the airport operator due to the outlook for a more protracted recovery in international travel, underappreciated risks arising from airline and tenant agreements and the prospect of higher interest rates in the long term. Most airline agreements are scheduled for renewal in July 2021 which, if they are not extended, may result in adverse pricing outcomes for the airport operator. While we continue to view SYD's assets as high-quality with strong barriers to entry, we see the stock as fully valued at a CY22 EV/EBITDA of 20.2 times earnings when considering these risks.

**Saracen Minerals (SAR)** – we exited our position in the gold miner during the period ahead of its merger with Northern Star (NST). We are underweight NST based on its stretched valuation metrics, at 6.3 times forward EV/EBITDA, and negative long-term view of the gold price. While we are positive

towards the company's operations and its proposed merger with Saracen Minerals (SAR), we see significant downside risk to the commodity – at elevated levels of \$US1,800oz – amid an outlook for higher real interest rates (which are generally a headwind to the gold price).

**Atlas Arteria (ALX)** – we reduced our position during the period to fund other compelling opportunities, but remain overweight the toll road operator. ALX maintains a strong liquidity and balance sheet position, which leaves it well placed to weather any further COVID-19 related downturn. The company holds attractive, long-duration assets and trades at a discounted valuation (11 times normalised EV/EBITDA), which more than captures the disruption from COVID-19 but doesn't reflect the outlook for a recovery as vaccines roll out. We continue to believe the intrinsic value of ALX's assets will eventually be realised following the simplification of its ownership structure in the past two years, resulting in significant upside.

### 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 post-COVID, with capital management initiatives likely as 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 13.1 times forward earnings, particularly relative to NAB and CBA (at 14.5 and 17.7 times respectively).

**BHP Group (BHP)** – we believe the company's valuation is attractive in the context of firm iron ore prices and China returning to production following COVID-19. BHP still trades on a 12-month forward P/E of 13.5 times, an EV/EBITDA of 6.1 times, and generates a FCF yield of >10%. Its balance sheet is robust (gearing ~15%), with management carrying out a well-defined capital allocation strategy. More broadly, we view BHP as a relatively defensive Metals & Mining exposure, with a diversified portfolio and clear strategy of capital allocation.

**Westpac Bank (WBC)** – we are overweight WBC on the grounds that on the grounds that the bank is positioned strongly for an earnings and dividend recovery post-COVID, with capital management initiatives likely as debts turn out to be more benign than feared. Consensus for bad debts remain at 14 bps for FY21 and 17 bps for FY22, which we view as overly conservative. Further, challenges to its outlook – including higher costs relating to risk compliance and mortgage processing – are more than reflected into its valuation (at 14.3 times forward earnings). Lastly, the bank trades at a discount to CBA at 17.7 times and National Australia Bank (NAB) at 14.5 times.

### Key Active Underweights

**CSL (CSL)** – we remain underweight CSL based on its forward valuation (39.3 times P/E and 26.4 times EV/EBITDA on a 12-month forward basis), which we believe appropriately captures the earnings outlook at this time. The growth outlook for CSL's

key plasma products remains robust, with the company continuing to strengthen its relative market position through long-term investment in capacity, product innovation and collection centres.

**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. As a result, we see less scope for surplus capital compared to Westpac Bank (WBC) and ANZ Bank (ANZ), both of which trade at more appealing valuations (at up to 10% discounts to NAB based on forward earnings) and are our preferred banking exposures at this time.

**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 24.1 times forward earnings.

## Market outlook

The Australian economy finished 2020 with strong momentum and incoming data suggests this momentum has spilled over into 2021. A trend decline in new COVID-19 infections in developed countries and the successful commencement of vaccine programs in concert with exceptionally loose financial and fiscal setting has helped underpin confidence in the global economic recovery. We expect global economic growth will accelerate to average 5.5% in CY21, compared to the average global growth rate from 1980 to 2019 of 3.5%. Although this is strong global growth by historical comparison, we believe the Australian economy will more than keep pace. Indeed, our estimates of real time economic activity suggest Australia is currently expanding faster than any G7 country and we expect Australian economic growth will average 6% in 2021.

The driving force of the recovery into 2021 will be consumption growth. The combination of the highest household saving ratio since the mid-1970s in concert with rising asset prices, declining unemployment, rising hours worked and improving consumer confidence is expected to underpin a 7.0% rise in consumption growth in 2021. Although concerns have persisted over fiscal fade via lapsing fiscal stimulus measures, our analysis has long suggested that the extension of some fiscal programs, the pull forward of income tax cuts and the recovery in labour income as furloughed workers return to work is sufficient to avoid a bout of fiscal fade weighing on household income growth. From our perspective, the fundamentals for household consumption growth in 2021 are as strong as any period in the past 30 years.

A secondary force assisting the recovery is the upswing in new housing approvals, housing finance approvals and house prices. Despite a sharp drop in net migration and earlier

concerns over house price declines, sentiment regarding housing has been buoyed by record low interest rates, a shift in responsible lending onus back to the borrower, large government incentives for construction and the strong guidance by the RBA that interest rates will remain at current levels for the next 3 years has seen detached housing approvals surge to a record high which will support construction activity throughout 2021.

Our expectation is that additional fiscal stimulus in the US and additional QE in major offshore markets in concert with the extension of the QE program in Australia, will leave a pro-growth fiscal and monetary environment for both economic growth and earnings growth in Australia.

The RBA's explicit aim of QE is to lower Australian longer term bond rates and lower the A\$. We expect the RBA to be partially successful in moderating the appreciation of the A\$, however, upward pressure on the A\$ will likely remain as the global economic recovery continues. We continue to expect the A\$ to finish 2021 at 80c.

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 Telecommunication Services, Media & Entertainment and Energy sectors, and underweight Financials, Real Estate and Consumer Staples.

## Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	12.74	3.97	8.76
Consumer Discretionary	8.97	7.51	1.46
Consumer Staples	2.43	5.67	-3.23
Energy	6.17	3.80	2.37
Financials	23.90	29.29	-5.39
Health Care	7.31	10.01	-2.71
Industrials	5.34	6.83	-1.50
Information Technology	4.62	4.01	0.61
Materials	21.48	21.21	0.27
Real Estate	2.78	6.44	-3.66
Utilities	2.85	1.25	1.60

## Top 5 holdings

	Portfolio %	Benchmark %	Active %
BHP	11.25	7.76	3.49
ANZ Banking	7.71	3.99	3.72
Westpac Banking	7.67	4.61	3.05
Commonwealth Bank of Australia	6.39	7.76	-1.37
Aristocrat Leisure	4.04	1.04	3.00

## Key active positions

Overweights	Portfolio %	Benchmark %	Active %
ANZ Banking	7.71	3.99	3.72
BHP	11.25	7.76	3.49
Westpac Banking	7.67	4.61	3.05
Underweights			
CSL	1.91	6.41	-4.50
National Australia Bank	0.00	4.35	-4.35
Wesfarmers	0.00	2.99	-2.99

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	-8.76	-7.33	-0.56	-1.84
Distribution return	11.54	11.22	8.59	8.32

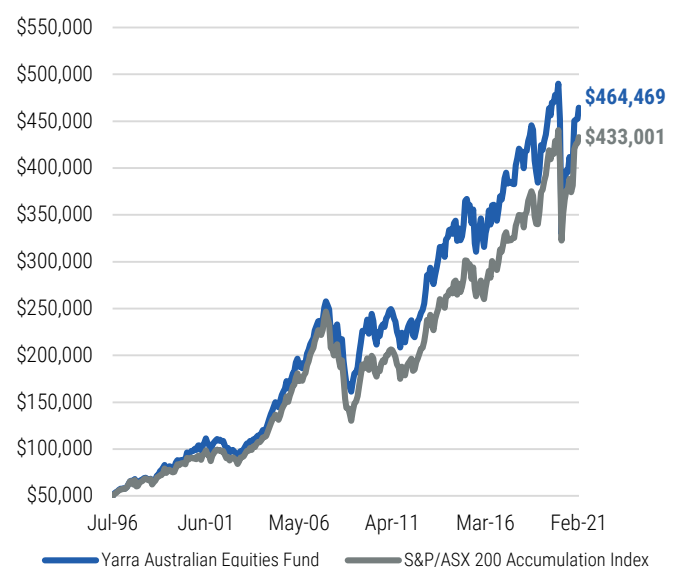
The Growth Return is measured by the movement in the Fund's unit price (inclusive of fees), ex-distribution, and can be positive or negative as the unit price can fluctuate with changes in the underlying market value of the Fund's assets. The Distribution Return is the amount that is paid to unitholders 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\$118.59 mn as at 28 February 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 Wealthrac

## Investment performance comparison of \$50,000

After fees, since inception of the Yarra Australian Equities Fund, July 1996 to February 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)

**Investor Services Team** 1800 034 494 (Australia) +61 3 9002 1980 (Overseas) [IST@yarracm.com](mailto:IST@yarracm.com)

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