YARRA CAPITAL MANAGEMENT

Investment Commentary
Month to 28 February 2022

Yarra Australian Equities Fund

Gross returns as at 28 February 2022

	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	1.91	0.08	13.07	8.01	7.80	9.48	10.59
S&P/ASX 200 Accumulation Index†	2.14	-1.72	10.19	8.42	8.48	9.55	9.26
Excess return (before fees)‡	-0.23	1.80	2.88	-0.41	-0.67	-0.07	1.33

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 2022

	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	1.84	-0.14	12.06	7.03	6.81	8.47	9.58
S&P/ASX 200 Accumulation Index†	2.14	-1.72	10.19	8.42	8.48	9.55	9.26
Excess return (after fees)‡	-0.30	1.58	1.87	-1.39	-1.66	-1.08	0.33

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 defied a fall in global markets during February, rising on a better-than-expected earnings season even as uncertainty spiked over Russia invading Ukraine and resulting sanctions.

The S&P/ASX 200 Accumulation Index increased by 2.1% during the month, taking its 12-month return to 10.2%. While global indices fell (S&P500 -3.0%), a solid set of 1H22 earnings held up the domestic market. Around 36% of companies received consensus upgrades for the full year (two times the long-run average)[1] as strong top line growth more than offset rising input costs.

At a sector level, Energy (+8.6%) and Consumer Staples (+5.6%) were the top performers. In the former, Woodside Petroleum (WPL, +19.8%) and Whitehaven Coal (WHC, +22.8%) rose alongside higher oil & gas and coal prices respectively. Staples saw strong results from Endeavour Group (EDV, +14.0%) and Graincorp (GNC, +15.4%).

Conversely, Information Technology (-6.6%) declined the most in value. Losses were widespread in the tech sector as the prospect of higher interest rates compressed valuations, with notable declines including Xero (XRO -17.0%), Life360 (360, -37%), Novonix (NVX, -32.9%) and Tyro Payments (-31.5%). Consumer Discretionary (-5.0%) also underperformed amid higher cost pressures and as COVID beneficiaries cycled strong earnings, led by Wesfarmers (WES, -7.1%), Temple & Webster (TPW, -19.5%) and PointsBet (PBH, -27.0%).

Portfolio review

Key Contributors

Northern Star (NST, overweight) – the gold miner outperformed as the commodity increased by 6% to $US1,910 per ounce in response to growing uncertainty around the Ukraine-Russia conflict. The company also delivered its 1H22 result, with cash NPAT of $430mn between guidance for $425-440mn. For the full year, FY22 guidance was unchanged at 1.55-1.65mn ounces at an all-in sustaining cost of $1,475-1575/oz. We remain overweight NST. We believe the company will benefit from higher-than-expected production and reserves/resources after taking full ownership of the KCGM SuperPit Mine last year. We see the company's valuation as attractive at 6.4 times forward EV/EBITDA, which is only marginally above the wider Gold sector despite a superior

[1] Source: Goldman Sachs Investment Research.

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growth outlook. More broadly, we have a selective exposure to the commodity, balancing the prospect of higher inflation with an uncertain rate hike path in the US (which is generally a headwind to the gold price).

Wesfarmers (WES, underweight) – the conglomerate delivered a disappointing 1H22 result in which store closures, staff payments and lockdowns weighed on earnings, with growth in online sales impacting margins for its retail businesses. 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 23.6 times forward earnings.

Westpac Bank (WBC, overweight) – the bank outperformed after its quarterly result, with 1Q22 cash profit coming in at $1.58bn – 8% above consensus forecasts – primarily driven by higher Markets income. Management also reiterated its $8bn cost target by FY24 as costs were well down on the quarter versus the first half of the year. We remain overweight the company based on our view that revenue pressures will continue to moderate going forward with asset growth restarted and NIMs now re-based. 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 13.7 times (a ~10% discount to the sector) and 5.5% dividend yield as attractive.

Key Detractors

Aristocrat Leisure (ALL, overweight) – the gaming company underperformed after its proposed acquisition of US-based Playtech fell through. While we view the outcome as disappointing, ALL still has significant opportunities to enter Real Money Gaming – a market which has compelling growth prospects – through other potential acquisitions. More broadly, 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. We see ALL's valuation as undervalued at 22.0 times forward earnings when considering the Industrials Ex-Financials trades at 24.5 times and ALL's superior long-term growth potential.

Tyro Payments (TYR, overweight) – the payment solutions company underperformed after delivering a worse-than-expected 1H22 result. Gross profit was ahead of forecasts, but this was more than offset by wage inflation and increased investment spending. While the result was still disappointing, we believe the stock was oversold and remain overweight. Short-term headwinds are more than reflected in TYR's valuation, with the stock trading at 2.2 times forward sales – a significant discount to technology peers. As the lead provider of software that allows payment terminals to be integrated into point-of-sale (POS) systems, TYR remains in a defendable position versus peers such as the banks which rely on a clunky intermediary.

South32 (S32, underweight) – the base metals miner outperformed alongside higher commodity prices and after delivering a better-than-expected 1H22 result. The company announced EBITDA of $US1.87bn, roughly 10% ahead of consensus, mostly driven by higher metallurgical coal and aluminium prices. At spot commodity prices, S32 is set to generate 140% higher earnings in FY23 with a free cash flow yield in excess of 30%. Nevertheless, we maintain a negative medium to longer-term view towards the company: in our view S32's key commodity prices are unsustainable, with the prices of manganese and coking coal – around 50% of S32's earnings – skewed to the downside, based on supply and demand fundamentals. S32 appears devoid of growth opportunities, with short mine lives, no active exploration, increased capital intensity and material geopolitical risk from its South African operations.

Key Purchases

Woodside Petroleum (WPL) – we established a position in the oil & gas producer during the period. While we have been underweight due to concerns around execution risk of future projects and potential stranded asset risk as the world decarbonises, we are positive towards WPL's new strategy to invest $US5bn in new energy opportunities by 2030, as well as its ambitious decarbonisation targets and the use of an $US80/t carbon price in hurdle rate calculations for new projects. Further, as energy security is prioritized, we see demand strengthening for WPL's production as a top 10 oil & gas producer (post the BHP merger) that resides in relatively safe geopolitical locations. As a result, we see its valuation as supportive at 9.0 times forward earnings and an EV/EBITDA of 4.3 times.

Tabcorp (TAH) – we established a position in the wagering & lotteries company during the period. Our positive investment thesis is premised on its Lotteries business (70% of FY21 EBITDA), which we see as having a defensive revenue stream, significant pricing power and growth opportunities driven by online penetration (which currently sits at 32%, below the global average of 50%). We expect the planned spin-off, announced in July, will crystallise value for the division. While we are more negative towards TAH's wagering & media business (30% of FY21 EBITDA), recent takeover bids have placed a floor under the division's valuation. Assuming the division is valued at $3.5bn – the highest bid that TAH rebuffed – the lotteries business trades at 15 times EBITDA, well below peers including reseller Jumbo Interactive (JIN) at 30 times.

SEEK (SEK) – we increased our position in the online recruitment company during the period. We believe SEK, as the market leader, is well positioned to benefit from the ongoing recovery in the global hiring cycle. Furthermore, we believe product developments will drive new revenue opportunities and strengthen the existing businesses, both domestically and internationally, in the long term. The structural growth of SEK's earlier stage markets should also support international growth.

Key Sales

Transurban (TCL) – we exited our position in the toll road operator, moving from overweight to underweight. While we continue to believe TCL has a strong growth outlook (with a number of new project and expansion plans), we no longer see its risk-adjusted total return potential as attractive in the current macro environment. Our preferred toll road exposure is Atlas Arteria (ALX), where we see greater valuation support particularly through concession extensions at APRR and settling the Dulles Greenway tolling regime.

Genworth Mortgage Insurance (GMA) – we reduced our position size following recent outperformance but remain overweight. We continue to view GMA as an attractive exposure to Australia's robust housing market through lower claims expense and higher new business volumes along with being the most positively exposed insurer to rising interest rates.

Metcash (MTS) – we trimmed our position during the period but remain overweight. MTS trades at 14.8 times, a discount to peers WOW and COL, with the market treating MTS as if it is a majority Food business in structural decline. This however is no longer the case, with MTS' largest division is now Hardware (41% of Group EBIT). Hardware is set to benefit from a strong store rollout and refurbishment strategy as well as more corporate stores (from current 30% to ~50%), which will support margins. In regard to Food (41% of Group EBIT), significant work has been done over recent time to gain supplier support to reduce prices, which has finally come to fruition over the last 6-12 months as C-19 provided a surge in foot traffic. Continued strength in states where minimal C-19 restrictions have been in place for an extended period highlights the improvement in the IGA offer and builds confidence for the NSW/VIC outlook in the short to medium term. Finally, inflation is anticipated in the coming 12 months which will benefit MTS by assisting them cycle strong comps whilst also being margin accretive as existing stock in their shed (which they generally try buy as much as possible before the price rise) can be on sold at higher prices.

Key Active Overweights

Link Group (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. 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 21.6 times forward earnings, a discount to the Industrials ex-Financials at 24.5 times.

Aristocrat Leisure (ALL) – 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. We see ALL as undervalued at 22.0 times forward earnings when considering the Industrials Ex-Financials trades at 24.5 times and ALL's superior long-term growth potential. While ALL's setback in acquiring Playtech is disappointing, ALL still has significant opportunities to enter Real Money Gaming – a market which has compelling growth prospects – through other potential acquisitions.

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 12.3 times forward earnings and offering a 3.9% dividend yield.

Key Active Underweights

National Australia Bank (NAB) – we remain underweight the bank on the grounds due to our negative sector view following recent outperformance. Favourable dynamics of excess provisions and capital are now well understood, while low bad debts and significant buybacks have seen the sector re-rate to trade at peak multiples versus pre-provision earnings. We believe consensus estimates for pre-provision forecasts are too high in the absence of revenue growth – with earnings quality deteriorating in recent years as abnormal items take up a larger proportion – and an inability for the industry to meaningfully take costs out. We hold small overweight positions in Westpac Bank (WBC) and ANZ Bank (ANZ), where the valuations are more supportive at current levels.

CSL (CSL) – we remain underweight CSL based on its forward valuation (33.3 times P/E and 23.1 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.

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 17.0 times consensus forward earnings as unattractive.

Market outlook

Geopolitical events and surging commodity prices have taken centre stage this month, shaking risk sentiment and challenging consensus' optimistic forecast for global growth in 2022. From our perspective, although for the past six months our forecasts for global growth in 2022 have been below consensus, we believe a series of downgrades will soon be evident for global growth and earnings growth in most major markets. Surging commodity prices and ongoing supply shortages have resulted in further upside to the inflation outlook and risks forcing the hand of central banks in coming months in an attempt to contain rising inflation expectations. The reality for 2022 is that a world of higher inflation, slower growth and higher financing costs awaits.

Australia does have some key natural advantages in such a climate. The most notable is that Australia's export dominance of iron ore, coal, LNG, gold, wheat, and base metals contribute close to 80% of Australia's exports, and each of these commodities have seen strong price rises in early 2022 which will translate into a large positive national income boost, even if spot prices retreat in coming weeks. Indeed, Australia presents as a safe haven market which is far from the conflict in Europe, an exporter of in demand raw materials and given its own undershooting of its inflation target since 2015, it has ample room to adjust policy setting at a more gradual pace.

Australia also has the benefit of recovering underlying household income growth, $230bn in 'excess saving', strong corporate profit growth, robust capex expectations in concert with improving government finances which suggests Australian economic growth in 2022 will remain more robust than its developed economy peer group. In both CY2022 and CY2023 we expect the Australian economy to expand at an above 'potential' rate of 3%. While this is slower than the 4% pace recorded in 2021, it is still sufficient to see further employment growth gains and we expect the unemployment rate will soon fall below 4% and below the RBA's estimate of non-accelerating inflation rate of unemployment (NAIRU), with further wage pressure to become evident into mid-2022. We expect the RBA will still take its time to assess the outlook for inflation and most likely will commence increasing interest rates in 4Q2022 with a 35bp hike. We expect a further four 25bp rate hikes in 2023, with the consumer well placed to absorb initial interest rate rises.

While the RBA may well prove to be later than most other developed nations in tightening policy, tighter financial conditions in 2022 are likely to come via a stronger currency. The A$/US$ has in recent months been buffeted by concerns of a peak in global industrial growth indicators and slowing China economic momentum. Nevertheless, Australia's external accounts are in their best position since the early 1970s and surging commodity prices in early 2022 is providing an incentive for the A$/US$ to commence an appreciation cycle well before the RBA joins other central banks in tightening interest rates later this year. We expect the A$ will finish 2022 at around 76 cents, albeit the risk to this forecast is on the upside.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	12.39	4.11	8.29
Consumer Discretionary	9.51	7.02	2.48
Consumer Staples	1.17	4.91	-3.74
Energy	4.54	3.68	0.86
Financials	24.52	28.35	-3.83
Health Care	5.92	9.52	-3.60
Industrials	4.57	5.61	-1.04
Information Technology	7.26	3.38	3.88
Materials	25.81	25.11	0.70
Real Estate	0.00	7.04	-7.04
Utilities	2.52	1.29	1.23

Top 5 holdings

	Portfolio %	Benchmark %	Active %
BHP	10.99	11.37	-0.39
Commonwealth Bank of Australia	6.49	7.68	-1.19
Westpac Banking	5.69	3.84	1.84
ANZ Banking	4.37	3.53	0.83
Aristocrat Leisure	4.22	1.20	3.02

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Link Administration	3.65	0.13	3.52
Aristocrat Leisure	4.22	1.20	3.02
QBE Insurance	3.46	0.82	2.64
Underweights			
National Australia Bank	0.00	4.57	-4.57
CSL	1.65	5.99	-4.34
Macquarie Group	0.00	3.08	-3.08

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	-7.18	-8.87	-4.69	-0.61
Distribution return	19.24	15.90	11.50	9.08

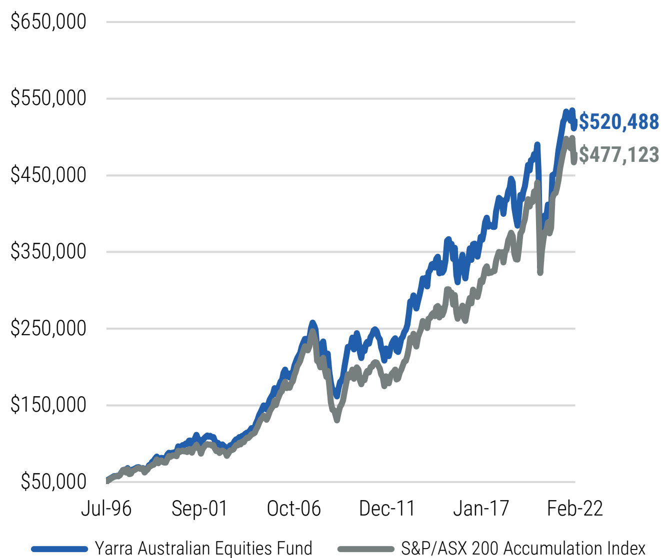
The Growth Return is measured by the movement in the Fund's unit price (inclusive of fees), ex-distribution, and can be positive or negative as the unit price can fluctuate with changes in the underlying market value of the Fund's assets. The Distribution Return is the amount that is paid to unitholders 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$99.4 mn as at 28 February 2022
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 February 2022.



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

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

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