

# Yarra Australian Equities Fund

## Gross returns as at 31 July 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	0.55	5.78	33.25	7.33	8.72	9.79	10.84
S&P/ASX 200 Accumulation Index†	1.10	5.80	28.56	9.47	10.04	9.82	9.56
Excess return (before fees)‡	-0.55	-0.02	4.69	-2.15	-1.32	-0.03	1.28

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 July 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	0.48	5.54	32.06	6.35	7.72	8.77	9.84
S&P/ASX 200 Accumulation Index†	1.10	5.80	28.56	9.47	10.04	9.82	9.56
Excess return (after fees)‡	-0.62	-0.26	3.50	-3.13	-2.33	-1.05	0.28

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 shares rose modestly in July despite ongoing lockdowns across the east coast of the country.

The S&P/ASX 200 Accumulation Index returned 1.1% for the month, taking its 12-month return to 28.6%. However, the market lagged overseas indices, with the S&P500 returning 2.4% during the month amid an upbeat US corporate earnings season.

Metals & Mining ex-Gold (+9.1%) was the top contributor to the index, supported in the most part by BHP Group (BHP, +10.1%), Rio Tinto (RIO, +5.4%) and Fortescue Metals Group (FMG, +6.7%) as stronger-than-expected production results more than offset the lower Fe price (-15%). Other contributors were miners leveraged to the electric vehicle theme, including Mineral Resources (MIN, +17.3%), Lynas Rare Earths (LYC, +28.5%), IGO Limited (IGO, +22.0%) and Pilbara Minerals (PLS, +22.1%).

Corporate activity increased during the period, with Sydney Airport (SYD, +34.9%) and Spark Infrastructure (SKI, +23.8%) receiving takeover bids during the period. The SYD board rejected the bid on the grounds that it was opportunistic and not in the best interest of shareholders. SKI granted due diligence after receiving a third takeover bid – at \$2.95 per

share up from \$2.80 per share previously – from a consortium comprising KKR and OTPP.

Conversely, sectors leveraged to the re-opening theme underperformed during the period. Underperformers included Consumer Services (-4.1%), Media & Entertainment (-4.5%) and the Banks (-1.6%). At a stock level, Crown Resorts (CWN, -27.7%) was among the worst performers over concern it would be stripped of its gaming licenses in Victoria and Star Entertainment (SGR, -7.3%) withdrawing its merger offer.

### Portfolio review

#### Key Contributors

**IGO Limited (IGO, overweight)** – the diversified miner outperformed after announcing the completion of its Greenbushes lithium acquisition late in the prior period and, secondly, a strong June quarter production report. While no guidance was outlined for Greenbushes, production and costs at Nova were well ahead of consensus estimates and FY22 guidance was broadly in line with forecasts. Our positive view is premised on the recent Greenbushes lithium acquisition, which gives IGO exposure to a high-quality, long-dated asset (>20 years mine life) and completes its suite of battery commodities, with the company already producing nickel, copper and cobalt. We also believe the purchase price was

reasonable, with Greenbushes likely to be NPV and EPS accretive by FY23. We also hold a positive view of IGO's Nova asset, a world-class reserve which supports an increasing production profile.

**Afterpay (APT, underweight)** – the buy-now, pay-later (BNPL) provider underperformed as competitive pressure increased during the period. PayPal said it would never charge late fees if customers decide to use its "Pay in 4" option, while Apple was reportedly launching its own BNPL service as part of Apple Pay. However, APT rallied sharply following month-end as it received a takeover offer from US digital payments company Square. The offer equated to \$126 per share in an all-stock deal, representing a 31% premium to APT's last traded 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.

**BHP Group (BHP, overweight)** – the miner outperformed after delivering an impressive June quarter result. Production and realized iron ore prices were better than expected across its divisions, while FY22 guidance matched analyst forecasts with Pilbara shipments of Fe expected to be between 278-288Mt. There was also speculation during the period that BHP is looking to exit its petroleum assets which, if it does occur, would accelerate its exit from fossil fuels and improve its ESG profile. We continue to see the company's valuation as attractive in the context of ongoing supply issues for iron ore and strong demand from China. BHP trades on a 12-month forward P/E of 9.1 times, an EV/EBITDA multiple of 4.3 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.

### Key Detractors

**Sydney Airport (SYD, underweight)** – the airport operator outperformed after receiving a takeover proposal from an IFM-backed consortium. The bid, which was priced at \$8.25 per share, implying a valuation of 21 times FY24 EV/EBITDA which is in-line with other major historic airport transaction multiples (e.g. Gatwick and Copenhagen, which were priced 20-21 times EV/EBITDA). The SYD board rejected the bid on the grounds that it was opportunistic and not in the best interest of shareholders. We remain underweight on the grounds that, absent a higher takeover price, the recovery of international travel will be protracted and there are 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 not extended, may result in adverse pricing outcomes for the airport operator.

**Ansell (ANN, overweight)** – the protective equipment manufacturer underperformed without any material news during the period. We remain overweight the company. In the short term, we continue to believe the 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 15.8 times, a large discount to the wider Industrials ex-Financials at 29.2 times.

**Kathmandu (KMD, overweight)** – the outdoor adventure retailer underperformed as lockdowns across the east coast of Australia forced the closure of a number of its stores. Notwithstanding the short-term challenges, we remain overweight KMD. Following the resolution of the COVID crisis, the company is well placed following its two acquisitions, Rip Curl and OBOZ, and its attractive category exposure as well as market share and margin expansion opportunities. We continue to see the stock as undervalued at 11.7 times forward earnings, a sharp discount to its Specialty Retail peers at 16.3 times.

### Key Purchases

**Transurban (TCL)** – we increased our position in the toll road operator. Once the COVID disruption has passed, TCL has a strong growth outlook (with a number of new project and expansion plans) and attractive risk-adjusted total return. TCL has the ability to maintain strong (5%-plus) dividend growth by releasing equity over time from its large projects – given their conservative initial funding – such as WestConnex and the West Gate Tunnel, which we believe is underappreciated by the market.

**QBE insurance (QBE)** – we increased our position in the general insurer during the period. We continue to see upside to its relative valuation, with the stock trading on 13.2 times forward earnings and offering a 4.5% dividend yield, with strong underlying fundamentals remaining intact (global commercial hardening cycle). We expect premium rate rises to be well ahead of underlying claims inflation and above consensus forecasts, notwithstanding the prospect of higher COVID provisions (with QBE guiding to another US\$130mn) and catastrophes exceeding allowances.

**Qantas (QAN)** – we established a small underweight position in the airline during the period. Notwithstanding short-term disruption from border restrictions, our more 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) will 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).

## Key Sales

**APA Group (APA)** – we exited our position in the gas pipeline operator during the period. We believe management is appropriately shifting its business model towards renewables and transmission as Australia's energy mix decarbonises. However, potential upside from the shift is dwarfed by the discount increasingly applied to its gas pipeline business, particularly as planned government policies accelerate the shift to zero emissions sources. As a result, we no longer regard its valuation (at a 12-month EV/EBITDA of 12.0 times) as sufficiently compelling when compared to large cap infrastructure alternatives. We used the proceeds to increase our position size in Transurban (TCL), which has a strong growth outlook (with a number of new project and expansion plans), a high degree of inflation-linked revenues and a valuation not penalised with an ESG discount.

**Healius (HLS)** – we reduced 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.

**Carsales.com (CAR)** – we modestly reduced our position size following recent outperformance, but 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 research and development investment) and undervalued international businesses.

## 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. 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 12.8 times forward earnings, particularly relative to NAB and CBA (at 13.5 and 19.1 times respectively).

**Aristocrat Leisure (ALL)** – our investment thesis is premised on ALL's strong growth profile following the resolution of the COVID-19 crisis, particularly in North America where the economy is reopening quickly. 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 26.5 times forward

earnings when considering the Industrials Ex-Financials trades at 29.2 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, we expect 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 44.0 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 (41.5 times P/E and 27.9 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 13.5 times forward earnings, above peer ANZ (at 13.1 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 29.1 times forward earnings.

## Market outlook

The Australian 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 people employed comfortably exceed pre-pandemic levels. The unemployment rate declining from a peak of 7.5% in July 2020 to just 4.9% in June 2021 is the clear highlight. Nevertheless, renewed COVID-related lockdowns in Melbourne, Sydney and South East Queensland 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 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 are most overweight stocks within the Communication Services, Information Technology and Consumer Discretionary sectors, and are underweight Real Estate, Consumer Staples and Financials.

## Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	12.75	4.07	8.68
Consumer Discretionary	9.20	8.05	1.14
Consumer Staples	1.49	5.19	-3.70
Energy	2.94	2.91	0.03
Financials	26.05	29.26	-3.21
Health Care	7.93	10.15	-2.22
Industrials	5.21	6.78	-1.57
Information Technology	5.75	3.85	1.90
Materials	21.58	21.52	0.06
Real Estate	2.66	6.72	-4.06
Utilities	1.89	1.50	0.39

## Top 5 holdings

	Portfolio %	Benchmark %	Active %
BHP	10.51	7.59	2.92
Commonwealth Bank of Australia	7.49	8.52	-1.03
ANZ Banking	7.25	3.80	3.45
Westpac Banking	7.03	4.34	2.70
Telstra	4.60	2.17	2.44

## Key active positions

Overweights	Portfolio %	Benchmark %	Active %
ANZ Banking	7.25	3.80	3.45
Aristocrat Leisure	4.33	1.28	3.05
ResMed	3.65	0.61	3.04
Underweights			
CSL	1.80	6.34	-4.53
National Australia Bank	0.00	4.12	-4.12
Wesfarmers	0.00	3.34	-3.34

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	9.95	-9.56	-3.95	-0.29
Distribution return	22.11	15.91	11.67	9.06

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\$108.6 mn as at 31 July 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 July 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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