

# Yarra Australian Equities Fund

## Gross returns as at 31 July 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	5.45	-5.87	-2.03	3.98	6.65	9.38	10.31
S&P/ASX 200 Accumulation Index†	5.75	-6.04	-2.17	4.27	8.02	9.44	9.08
Excess return (before fees)‡	-0.30	0.16	0.13	-0.28	-1.37	-0.06	1.23

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 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	5.37	-6.09	-2.91	3.05	5.68	8.36	9.32
S&P/ASX 200 Accumulation Index†	5.75	-6.04	-2.17	4.27	8.02	9.44	9.08
Excess return (after fees)‡	-0.38	-0.05	-0.74	-1.21	-2.35	-1.07	0.23

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 rallied sharply during July, following the 9% decline in June, as market expectations increased that interest rate expectations have peaked.

The S&P/ASX 200 returned +5.7% for the month, taking its 12-month return to -2.2%. In comparison, the broader ASX300 gained 5.9% for the month and global indices were positive (MSCI World Index +7.9%)

Information Technology was the best performing sector in the period. Within Information Technology (+15.2%), Megaport (MP1, +77.8%), Life360 (360, +58.8%), BrainChip (BRN, +35.6%) and Wisetech (WTC, +32.3%) were all strong performers.

Elsewhere, Real Estate (+12.10%) outperformed, led by Charter Hall Group (CHC, +17.6%) and Lifestyle Communities (LIC, +24.1%).

Conversely, the worst performing sector was Materials (-0.7%). In particular, Cornordo (CRN, -14.8%), Champion Iron (CIA, -10.9%) and Newcrest Mining (NCM, -7.6%) all delivered disappointing FY22 results on the back of falling prices in key commodities such as iron ore, copper and alumina and rising cost pressures which are now becoming evident.

### Portfolio review

#### Key Contributors

**Link Administration (LNK, overweight)** – the company outperformed following the announcement of a revised offer by Dye and Durham priced at \$4.81 that was agreed to by LNK's Board. The revised offer includes structural undertakings on Dye and Durham's behalf to divest its Australian conveyancing software assets, which should see it placate concerns previously raised by the ACCC.

**Rio Tinto (RIO, underweight)** – our underweight position in Rio Tinto was a positive contributor to July performance. Falling prices in RIO's key commodities iron ore (-5% to US\$114/t), copper (-4% to US\$3.60/lb) and alumina (-10% to US\$330/t) all contributed to the company's underperformance. The company's June quarterly report included updated cost guidance, underlining the challenging cost environment for mining companies as power, diesel and labour costs all rose. Additionally downgrades to alumina and aluminium production guidance weighed on the company's share price performance. We remain negative towards the outlook for iron ore on the grounds China's property sector faces significant challenges, impacting demand for both steel and iron ore.

**Latitude Group (LFS, overweight)** – the company outperformed during the period having been sharply sold off in the prior month due to concerns around consumer credit quality and following the announcement of the termination of its acquisition of Humm. Whilst we do expect to see some deterioration in the company's credit quality metrics over the coming 12 months, the company enters a period of economic slowdown at a strong starting point on the quality of loans written, low delinquency rates and higher than normal provisions for loan losses. Even factoring in the potential for a large step up in bad debts, LFS trades on 8 times forward earnings which we view as inexpensive.

### Key Detractors

**National Australia Bank (NAB, underweight)** – NAB outperformed during the month as the market's concerns around the potential for a coming bad debt cycle recede, which had seen the entire sector sell off sharply in the prior month. The major banks have been very slow to pass on interest rate rises to depositors, which will benefit net interest margins (NIM) and earnings in the short-term, however we do not expect this to be sustained into the medium term. We remain underweight the banking sector with a view that, despite improving NIM trends, earnings per share has peaked as asset growth slows, cost growth continues and bad debt expense normalises from historically low levels.

**Atlas Arteria (ALX, overweight)** – the toll road operator underperformed during the month after IFM, which had built an approximate 15% stake in the company at above market levels the prior month, announced they were not in a position to make a bid at this time. We maintain an overweight position as we see a path towards significant value creation for ALX through concession extensions at APRR, achieved as a means of funding expansion projects, and settling the Dulles Greenway tolling regime. With IFM having put ALX into play, we do currently believe a privatisation transaction of some form remains a likely outcome.

**QBE Insurance (QBE, overweight)** – the insurer underperformed during the month on limited news flow outside of the announcement of a \$75m charge relating to the mispricing of historic policies, which we do not view as overly material. We have a favourable view on the insurance industry and QBE is performing well with strong premium rate increases and volume growth driving a strong top line, and declining attrition claim ratios and higher investment yields improving the underlying combined operating ratio. The portfolio has expressed its positive industry view through positions in QBE and IAG.

### Key Purchases

**OZ Minerals (OZL)** – we increased our position in the copper producer during the period. Our positive view remains premised on OZL's two high quality, long life, 100% owned copper mines in South Australia - Prominent Hill and Carrapateena. We expect the company's copper production to double to >200ktpa by 2030, as Carrapateena moves to a block caving operation, and the company develops the greenfield West Musgrave copper/nickel deposit in Western Australia. Notwithstanding the recent pull-back in copper

prices, we believe OZL can fund its growth ambitions through the net cash balance sheet, strong cash flow generation, and flexibility to divest assets such as the Centro Gold deposit in Brazil. We also support OZL's plan to achieve net zero scope 1 and 2 emissions by 2030.

**Carsales.com (CAR)** – we participated pro-rata in CAR's equity raising during the period to acquire the remaining 51% of Trader interactive, CAR's US based classifieds business. There is strong potential for growth from various drivers across the trader Interactive business, including: an uplift in dealer penetration, moving from a subscription based to a leads-based and higher yielding model, and an improvement in inventories on the site.

### Key Sales

**BHP Group (BHP)** – we reduced our position in the miner during the period. We continue to view BHP more favourably than peers Rio Tinto (RIO) and Fortescue Metals (FMG), but valuation support has narrowed. A robust balance sheet, coupled with a well-defined capital allocation strategy, is attractive. However, we are increasingly negative towards the outlook for iron ore on the grounds that China's property sector faces significant challenges, impacting demand for steel and hence iron ore. The recent fall in iron ore prices will likely continue into FY23, with prices in our view still well above cost curve support. We expect BHP's high correlation to iron ore prices will be a headwind in the near term as a result. Cost inflation for key inputs including power, diesel and labour will likely further weigh on near-term margins.

**Amcor (AMC)** – we added Amcor to the portfolio in mid-December 2021 to provide a defensive exposure, given the company's key businesses operate in non-discretionary end markets. Following a period of recent outperformance, we exited AMC to fund better opportunities post the recent sell-off.

**Woodside Energy Group (WDS)** – we reduced our position in the oil & gas producer during the period. We believe oil prices have now peaked, and we expect price weakness in the near term as challenges to the global economy weigh on oil demand. Demand for natural gas – particularly in Europe – is likely to remain robust, however we struggle to see spot LNG prices as sustainable at current prices (>US\$40/mmbtu). We continue to prefer Woodside for its greater exposure to spot LNG than peers Santos (STO) and Origin Energy (ORG) and now hold a smaller position to better reflect the balance of risks in global energy markets.

### 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 the infrastructure-like characteristics of its property settlement exchange upon maturity, supplemented by numerous growth opportunities in immediate adjacencies.

**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 the disruption from its exposure to Ukraine as temporary. Around 1,000 (40%) of its employees within the Digital business work in Ukraine, most of whom have now moved to safer regions of the country or to Poland. We see ALL's valuation as undervalued at 19.2 times forward earnings (below the Industrials Ex-Financials multiple) and ALL's superior long-term growth potential.

**Worley (WOR)** – following years of underinvestment in oil & gas projects, and with the more recent supply disruptions stemming from the war in Ukraine, expectations for project spend across WOR's traditional customer base has increased to 27% growth (YoY). There is also a strong pipeline of margin accretive capital spend required to decarbonise energy production and provide more sustainable solutions for chemical and resources customers. We also believe incremental margins could be higher going forward after the company's \$375mn cost-out program during COVID.

### Key Active Underweights

**CSL (CSL)** – we remain underweight CSL based on the challenge the business faces returning to pre-COVID profitability, coupled with its forward valuation (35.6 times P/E and 25.8 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 from a plasma collection perspective, we believe this is already appropriately reflected in consensus forecasts. In our view the prospect of higher costs going forward remains underappreciated by the market, with donor fees and other collection center costs 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, due to our negative sector view. Favourable dynamics of excess provisions and capital are now well understood, while low bad debts and significant buybacks have seen the sector trade around peak multiples versus pre-provision earnings. We believe consensus estimates for pre-provision forecasts are too high and see material earnings pressure emerging as bad debt expenses normalise. We hold small overweight positions in Westpac Bank (WBC) and ANZ Bank (ANZ), where the valuations are more supportive at current levels.

**Macquarie Group (MQG)** – we remain underweight the stock based on the view that the recent earnings uplift is driven by its lower quality and highly cyclical businesses, which we regard as unsustainable into the medium term. We see significant downside risk to consensus forecasts beyond FY23, which currently reflects a strong contribution from lumpy items including gains on sale, performance fees and low loan-loss provisions. 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 15.3 times consensus forward earnings as unattractive.

## Market outlook

Financial markets have now embraced the risk of recession in the US and Europe over the past quarter and the gap between our more pessimistic forecasts for the global economy and the consensus has narrowed. Indeed, with the Fed signalling that financial conditions are close to neutral, we are edging closer to the point where the pace of monetary tightening will slow, providing some scope for risk markets to recover some lost ground.

Indeed, the period of excess inflation is starting to recede with prior surges in commodity prices retreating, an easing in supply constraints, and signs of slowing demand likely to compress elevated sales margins. As central banks continue to await firmer signs that inflation expectations have stabilised and for labour demand to ease, financial markets are faced with the positive news of less restrictive monetary policy and the negative news of likely weaker company earnings.

In a world of heightened concerns of recession in major developed economies, subdued economic activity in China and ongoing conflict between Russia and the Ukraine which has contributed to commodity shortages, high inflation and rising interest rates, the Australian economy presents as a relative safe haven.

Australia's economic data has remained robust in 1H2022, and although we do expect economic activity to slow in FY23 we do not expect a recession in Australia due to three key reasons:

1. Australia has been a net beneficiary of global commodity shortages. This surge in commodity prices saw Australia's export prices in A\$ terms move to their highest levels since the 1880s in 1H2022. The consequence has been strong national income growth, profits growth and an improving underlying fiscal position.
2. The household sector continues to hold a significant buffer of over \$150bn of excess savings (approximately 7% of GDP) relative to pre-COVID levels. Although we expect the impact of higher interest rates and higher living expenses to curtail consumer spending, we do expect the combination of rising wage growth and a run down in the level of savings to continue to support consumption spending.
3. Low levels of spare productive capacity, strong profit and low corporate debt have contributed to robust capital investment intentions.

Over the medium term we believe a recovery in net immigration levels into Australia and Australia's exposure to the key commodities crucial to the global energy transition – including copper, lithium and iron ore – will provide a solid underpin for future economic growth.

While the RBA has been later than most other developed nations in tightening policy, tighter financial conditions in 2022 are likely to come via both significantly higher cash rates and a stronger currency. While we expect that the RBA Cash Rate will finish the year at less than 2.5%, below market

expectations of 3.0%, the A\$ risk continues to skew to the upside. Australia's external accounts are in their best position since the early 1970s, providing an incentive for the A\$/US\$ to commence an appreciation cycle, together with the attractive carry on offer, improving China economic data and the prospect the US\$ uptrend will peak as the Fed pivots from its aggressive hiking strategy. We expect the A\$ will finish 2022 at around 76 cents.

We are most overweight stocks within the Communication Services, Information Technology and Consumer Discretionary sectors, and are underweight Financials, Real Estate and Health Care.

## Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	13.08	3.86	9.22
Consumer Discretionary	10.00	6.54	3.46
Consumer Staples	0.00	5.18	-5.18
Energy	6.88	5.70	1.18
Financials	22.18	29.03	-6.85
Health Care	4.77	10.35	-5.59
Industrials	7.32	5.87	1.46
Information Technology	9.30	2.98	6.32
Materials	22.14	22.32	-0.18
Real Estate	0.00	6.71	-6.71
Utilities	2.18	1.46	0.72

## Top 5 holdings

	Portfolio %	Benchmark %	Active %
BHP	8.75	9.55	-0.80
Commonwealth Bank of Australia	6.95	8.39	-1.44
Westpac Banking	5.45	3.67	1.77
Telstra	4.12	2.20	1.92
Aristocrat Leisure	4.06	1.15	2.91

## Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Link Administration	3.28	0.11	3.17
Aristocrat Leisure	4.06	1.15	2.91
Worley	3.14	0.26	2.88
Underweights			
CSL	1.87	6.81	-4.94
National Australia Bank	0.00	4.80	-4.80
Macquarie Group	0.00	3.19	-3.19

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	-12.72	-10.23	-7.01	-1.42
Distribution return	9.81	13.28	12.69	9.79

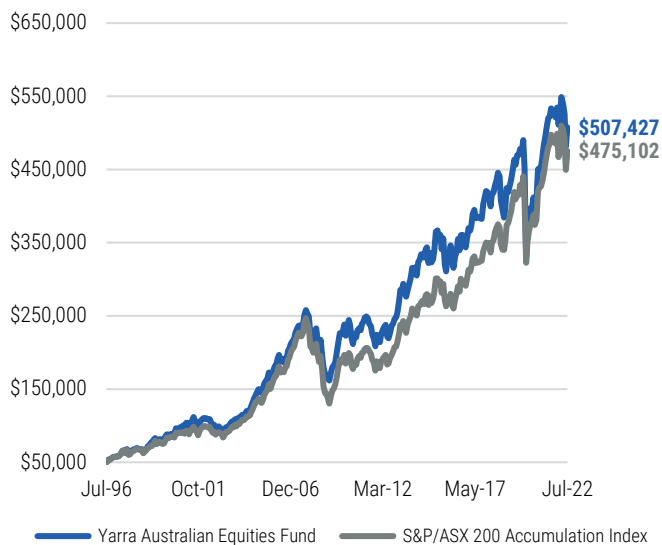
The Growth Return is measured by the movement in the Fund's unit price (inclusive of fees), ex-distribution, and can be positive or negative as the unit price can fluctuate with changes in the underlying market value of the Fund's assets. The Distribution Return is the amount that is paid to unitholders 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\$96.4 mn as at 31 July 2022	
APIR codes	JBW0009AU	
Estimated management cost	0.90% p.a.	
Buy/sell spread	+/- 0.15%	
Platform availability	Asgard Ausmaq BT Panorama BT Super Wrap FirstWrap GrowWrap	Hub24 IOOF Pursuit Macquarie Wrap Netwealth Oasis Powerwrap

## Investment performance comparison of \$50,000

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

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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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