

# Yarra Australian Equities Fund

## Gross returns as at 31 March 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	5.55	2.88	14.75	10.40	8.12	9.87	10.78
S&P/ASX 200 Accumulation Index†	6.89	2.24	14.97	10.58	9.21	10.15	9.51
Excess return (before fees)‡	-1.33	0.64	-0.22	-0.18	-1.09	-0.27	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 31 March 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	5.47	2.65	13.73	9.40	7.13	8.85	9.78
S&P/ASX 200 Accumulation Index†	6.89	2.24	14.97	10.58	9.21	10.15	9.51
Excess return (after fees)‡	-1.41	0.41	-1.24	-1.18	-2.08	-1.29	0.27

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 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 2.2% during the quarter, taking its 12-month return to 15.0%. While global indices fell (S&P500 -4.6%), 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) as strong top line growth offset rising input costs.

At a sector level, Energy (+28.6%), Utilities (+14.1%) and Metals & Mining (+19.0%) were the top performers. Higher commodity prices supported the sectors, in particular oil (Brent Crude +46%) as the energy crisis in Europe escalated following the Russia-Ukraine conflict. Top performers included Woodside Petroleum (WPL, +54.0%), Worley (WOR, +24.0%), Santos (STO, +21.5%), AGL Energy (AGL, +28.4%), Origin Energy (ORG, +21.6%), BHP Group (BHP, +30.5%), Rio Tinto (RIO, +26.1%) and South32 (S32, +28.3%).

Conversely, Health Care (-10.1%) and Information Technology (-13.7%) declined the most in value. Losses were widespread

across both sectors as the prospect of higher interest rates compressed valuations, with notable declines including CSL (CSL, -7.3%), ResMed (RMD, -8.2%), Fisher & Paykel Healthcare (FPH, -26.5%), Xero (XRO, -27.4%) and Altium (ALU, -24.0%).

### Portfolio review

#### Key Contributors

**BHP Group (BHP, overweight)** – the miner outperformed amid higher iron ore prices (up 32% to US\$158/t), as it completed the unification of its dual-listed structure and, lastly, after announcing a solid 2QFY22 result with strong iron ore production offsetting lower-than-expected volumes from copper, met coal and oil. Following its unification and benchmark adjustment, we are modestly overweight the iron ore miner. We continue to hold BHP on the grounds of its attractive valuation (3.1 times forward EV/EBITDA), strong free cash flow (FCF yield >10%) and robust balance sheet, with management carrying out a well-defined capital allocation strategy. However, more broadly we are negative towards the outlook for iron ore on the grounds China's property sector faces significant challenges (and hence steel), with our underweight reflected in underweights Rio Tinto (RIO) and Fortescue Metals (FMG).

**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.

**CSL (CSL, underweight)** – the biotechnology company underperformed as its valuation compressed during the period amid the outlook for higher real rates, more than offsetting a better-than-expected 1H22 result in which net profits were +18% ahead of consensus. We remain underweight CSL based on its forward valuation (35.1 times P/E and 24.1 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.

**Worley (WOR, overweight)** – the engineering services company outperformed following its 1H22 result, in which leading indicators and management's commentary are pointing towards an improving sales environment. After two years of minimal investment, growth is resuming across the oil & gas and the chemicals side of the business. We remain overweight. We believe the company is in a strong position to benefit from the recovery in its traditional work and, increasingly, new sustainability projects. Following the Jacobs ECR acquisition, the business is diversified across different markets and is well positioned to capture higher structural demand from energy transition work to low carbon solutions. We believe WOR's valuation provides significant support at current levels, with the stock trading on 18.9 times forward earnings, a sharp discount to the Industrials ex-Financials at 25.5 times.

**Origin Energy (ORG, overweight)** – the energy company outperformed as oil prices increased (with Brent Crude rising 46% to US\$113/bbl), the outlook for higher electricity prices domestically and in response to a strong 2QFY22 result. LNG prices were ahead of expectations, averaging US\$11.80/mmbtu during the period, while production was solid due to planned maintenance completing ahead of schedule. We remain overweight the company. At current valuation levels (14.9 times forward earnings), the market factors in ORG's energy transition risks but largely ignores potential upside as the company improves its emissions profile. Following the accelerated closure of Eraring (from 2032 to 2025), ORG's emissions intensity will be half that of

the national electricity market, with no coal exposure and a credible pathway to decarbonise further through increased renewables penetration.

### 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 21.6 times forward earnings when considering the Industrials Ex-Financials trades at 25.5 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 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 reflected in TYR's valuation, with the stock trading at 3.8 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 defensible position versus peers such as the banks which rely on a clunky intermediary.

**National Australia Bank (NAB, underweight)** – the bank outperformed after delivering a better-than-expected 1Q22 result. Cash NPAT grew +9% y/y to \$1.8bn and ex-Markets revenue growth increased +5%, driven by market share gains in key products. We remain underweight the bank, 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.

**Rio Tinto (RIO, underweight)** – the miner outperformed as the iron ore price increased by 32% to US\$158/t, which outweighed a worse-than-expected 4Q21 result with production coming in at the lower end of 2021 guidance for most commodities. Following a record year of earnings (NPAT US\$21.4bn), management announced a special dividend of US\$2.47 per share, however guided to elevated costs in 2022 and higher capex in CY23 and CY24. Notwithstanding RIO's position as a high-quality operator, our preferred exposure remains BHP Group (BHP), which has a diversified portfolio (with latent value in its other commodity exposures) and a

clear strategy of capital allocation. More broadly we are negative towards the outlook for iron ore on the grounds China's property sector faces significant challenges (and hence steel), with our underweight also reflected through Fortescue Metals Group (FMG).

**Carsales.com (CAR, overweight)** – the online automotive classifieds company underperformed despite delivering a solid 1H22 result, with FY22 guidance retained for "strong" growth in adjusted net income. However, its valuation compressed alongside the wider sector amid the outlook for higher interest rates. 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 product initiatives to drive long-term growth (such as transitioning from a leads-based model to a transaction-based model) and undervalued international businesses.

### Key Purchases

**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 has rebuffed – the lotteries business trades at 15 times EBITDA, well below peers including reseller Jumbo Interactive (JIN) at 30 times.

**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 US\$5bn in new energy opportunities by 2030, as well as its ambitious decarbonisation targets and the use of an US\$80/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 9.6 times forward earnings and an EV/EBITDA of 4.6 times.

**Reliance (RWC)** – we established a position in the plumbing fittings group during the period. In our view RWC is a quality industrial company which has been over-sold based on short term earnings headwinds (the roll-off of the COVID benefit, higher raw material costs), which we expect to ease over our longer-term investment horizon. Further, we are more positive on the US Repair & Remodel (R&R) market than consensus, which comprises 38% of RWC's EBITDA and is more resilient to macro factors than new housing. In terms of quality attributes, we note RWC's brand power through products such

as SharkBite, loyal customers in both Lowes, and Home Depot and end customers, excellent supply chain management in normal times (98% OTIF in the Americas retail channel), and strong process power (in-house R&D). As a result, we see its valuation (at a 14 times FY24 P/E) as attractive.

### Key Sales

**Transurban (TCL)** – we exited our position in the toll road operator during the period. While we continue to believe TCL has a strong growth outlook (with a number of new projects 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.

**Mirvac Group (MGR)** – we exited our position due to increased uncertainty on the sustainability of development profits. We are cautious towards the housing outlook as approvals retreat from elevated levels, which will impact MGR's residential division. Further, we see risk to development profits on the non-commercial side with the prospect cap rates rise. Lastly, we see ongoing long-term headwinds from MGR's Retail and Office assets following COVID-19, which has accelerated the shift to online shopping and embeds more flexible working practices.

**James Hardie (JHX)** – we reduced our holdings to reflect the increased uncertainty and capture earlier outperformance. We continue to believe JHX can sustain growth ahead of the market and sell higher value products, which will more than compensate for risks around growth rates normalising and higher borrowing costs. We are confident in the company's market share outlook due to its high-quality and reliable products, improved sales strategies (positioning the product as superior versus alternatives) and the resolution of US supply and manufacturing issues.

### 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 21.6 times forward earnings when considering the Industrials Ex-Financials trades at 25.5 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.

**Worley (WOR)** – we believe the company is in a strong position to benefit from the recovery in its traditional work and, increasingly, new sustainability projects. Following the Jacobs ECR acquisition, the business is diversified across different markets and is well positioned to capture higher structural demand from energy transition work to low carbon solutions. We believe WOR's valuation provides significant support at current levels, with the stock trading on 18.9 times forward earnings, a sharp discount to the Industrials ex-Financials at 25.5 times.

**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.

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

### Key Active Underweights

**National Australia Bank (NAB)** – we remain underweight the bank, 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 (35.1 times P/E and 24.1 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 19.1 times consensus forward earnings as unattractive.

**Wesfarmers (WES)** – our underweight position remains premised on the view its divisions, outside Bunnings (62% of operating income), face significant earnings headwinds. Officeworks (5% of operating income) and the department store industry (including discount department stores Target and Kmart, 25% of EBIT) face increasing competition and excess physical store capacity. Furthermore, the company's Industrials segment (9% of EBIT) comprises cyclical, lower quality businesses. As such, we don't find the valuation attractive at 24.0 times forward earnings.

**Woolworths (WOW)** – our underweight position reflects concerns at the stock's stretched valuation at 27.2 times forward earnings, which is well above Coles (COL) at 22.3 times and does not reflect emerging challenges in its supermarket business (85% of group earnings) as COVID-related supply chain and labour disruptions raise costs in the short term. Furthermore, the outlook for discount department store Big W remains challenged, particularly considering the threat of online and the need to rationalise excess store capacity.

### Market outlook

Geopolitical events and surging commodity prices have taken centre stage in 2022, shaking risk sentiment and challenging consensus' optimistic forecast for global growth. 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 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 to try to contain rising inflation expectations. The reality for 2022 is likely a world of higher inflation, slower growth and higher financing costs.

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 likely 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 settings at a 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 and 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) and further wage pressure will 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 35 bps hike. We expect a further four 25 bps rate hikes in 2023 and we believe the consumer is well placed to absorb the 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 are providing an incentive for the A\$/US\$ to commence an appreciation cycle well before the RBA joins alongside 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.

We are most overweight stocks within the Communication Services, Consumer Discretionary and Materials sectors, and are underweight Real Estate, Consumer Staples and Financials.

## Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	12.25	3.93	8.32
Consumer Discretionary	9.62	6.86	2.76
Consumer Staples	1.22	4.76	-3.54
Energy	5.28	3.78	1.50
Financials	23.49	28.79	-5.30
Health Care	5.57	9.07	-3.50
Industrials	5.20	5.46	-0.27
Information Technology	7.22	3.60	3.62
Materials	26.41	25.75	0.66
Real Estate	0.00	6.72	-6.72
Utilities	2.31	1.29	1.02

## Top 5 holdings

	Portfolio %	Benchmark %	Active %
BHP	11.52	11.83	-0.31
Commonwealth Bank of Australia	6.94	8.15	-1.21
Westpac Banking	5.71	3.83	1.88
Aristocrat Leisure	3.93	1.11	2.82
Telstra	3.91	2.10	1.81

## Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Link Administration	3.60	0.12	3.48
Aristocrat Leisure	3.93	1.11	2.82
Worley	2.76	0.22	2.54
Underweights			
National Australia Bank	0.00	4.74	-4.74
CSL	1.61	5.80	-4.19
Macquarie Group	0.00	3.31	-3.31

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	-5.79	-6.85	-4.41	-0.26
Distribution return	19.52	16.25	11.54	9.11

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\$109.6 mn as at 31 March 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 March 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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### Disclaimers

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