

# Yarra Australian Equities Fund

## Gross returns as at 31 October 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	-0.27	1.22	31.13	9.95	9.96	9.96	10.78
S&P/ASX 200 Accumulation Index†	-0.10	0.51	27.96	11.91	10.87	10.01	9.48
Excess return (before fees)‡	-0.17	0.71	3.17	-1.96	-0.91	-0.06	1.30

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 October 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	-0.35	0.99	29.96	8.96	8.95	8.93	9.78
S&P/ASX 200 Accumulation Index†	-0.10	0.51	27.96	11.91	10.87	10.01	9.48
Excess return (after fees)‡	-0.25	0.48	2.00	-2.95	-1.92	-1.08	0.29

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 were flat in October, underperforming global equities as Australian bond yields rose sharply in response to higher inflation expectations.

The ASX 200 Accumulation Index declined 0.1% during the month, taking its 12-month return to 28.0%. The local index underperformed global indices – with the MSCI World Index returning 5.5% – as Australian 10-year bond yields lifted 59 bps to 2.08% during the period on expectations the RBA would hike rates earlier amid inflation pressure.

Gold (+9.1%) was the top performer during the period, with the sector seen as a beneficiary of stronger inflation. Within the sector, Newcrest (NCM, +9.9%), Northern Star (NST, +8.7%), Silver Lake Resources (SLR, +26.5%) and West African Resources (WAF, +34.0%) contributed most to the benchmark's return.

Information Technology (+2.1%) also delivered a solid return, with the sector likely supported by lower real yields in the US. The best performing stocks included Xero (XRO, +7.6%), Appen (APX, +20.0%) and Nearnmap (NEA, +16.6%).

Conversely, Transportation Infrastructure (-3.6%) and Consumer Staples (-2.3%) underperformed. In the former, the shift in bond yields weighed on Transurban (TCL, -5.1%) and

Atlas Arteria (ALX, -4.5%). In the latter, Treasury Wine Estates (TWE, -7.2%) gave a worse-than-expected update at its AGM due to supply chain challenges and slower re-opening across key markets.

### Portfolio review

#### Key Contributors

**Rio Tinto (RIO, underweight)** – the miner declined alongside the iron ore price (-10% to \$US107/t) and as it cut Pilbara production guidance in CY21 to 320-325mt (from 325mt). The company also increased its decarbonization capex from \$US1.5bn over the next three years to \$US7.5bn from CY22 to CY30 as part of its new target to reduce emissions by 50% by 2030. Notwithstanding RIO's position as a high-quality iron ore 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.

**Northern Star (NST, overweight)** – the gold miner outperformed during the period alongside the gold price (+2% to \$US1,784) and as the gold sector was seen as a beneficiary of higher inflation. The macro-environment outweighed NST's slightly softer-than-expected 1Q21 result. Production came in at 373,000 ounces, 6% below consensus forecasts, while

costs were 5% above at \$1,594 per ounce. 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 Super Pit Mine in February this year. We see the company's valuation as attractive at 5.8 times forward EV/EBITDA, which is only marginally above the wider Gold sector's 5.4 times despite a superior growth outlook. More broadly, we have a neutral 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).

**JB Hi-Fi (JBH, overweight)** – the electronics retailer outperformed during the period after releasing a better-than-expected 1Q22 sales result. Sales fell just 6-8% y/y despite 60% of its stores being closed in NSW and Victoria due to lockdowns. We remain overweight the company. We continue to believe the market underestimates JBH's ability to grow across different trading conditions, which is not reflected in its valuation at 14.8 times 12-month forward earnings. In regards to The Good Guys, execution has improved significantly and management is now focused on maintaining the strong increase in customers as homewares benefits from the COVID-19 pandemic, which could add significant upside.

### Key Detractors

**Star Entertainment (SGR, overweight)** – the casino operator underperformed in response to media allegations that it had enabled suspected money laundering, fraud and foreign interference. Following the allegations, the company announced that the Liquor and Gaming Authority's regular review of The Star Sydney would now also incorporate public hearings. We reduced our position in the company following the media allegations. We had taken some comfort from SGR having undergone several recent reviews without any major issues identified, in stark contrast to Crown Resorts (CWN). However, the allegations raise the risk profile of the stock, introduces the possibility there may be sanctions against the company, and may remove potential upside opportunities (extra gaming licences, concessions). We are engaging extensively with management and are undertaking further independent validation in relation to the allegations, which the company has labelled as misleading.

**Macquarie Group (MQG, overweight)** – the investment bank outperformed after announcing a strong 1H21 result, in which NPAT came in 6% ahead of consensus forecasts \$2,043mn largely due to its Commodities and Global Markets division. We remain overweight 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 20.0 times consensus forward earnings as unattractive.

**National Australia Bank (NAB, underweight)** – the bank outperformed as it led solid system credit growth alongside Commonwealth Bank (CBA), growing its loan book by 8% annualised over the six months to September-end. 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 14.6 times forward earnings, above peer ANZ (at 13.0 times forward earnings) where we see a superior outlook.

### Key Purchases

**Link Group (LNK)** – we increased our position in the company during the period. We continue to see compelling value in its base share registry business and electronic conveyancing business PEXA. Notwithstanding the PEP/Carlyle consortium walking away from its takeover proposal, we continue to see value in PEXA (with the company retaining its 45% stake in the IPO). Our positive view of PEXA is premised on infrastructure like characteristics of the property settlement exchange upon maturity supplemented by numerous growth opportunities in immediate adjacencies. Excluding PEXA, LNK trades at a forward P/E of less than 10-11 times, a substantial discount to peer Computershare (CPU) at 25.2 times.

**Kathmandu (KMD)** – we increased our position in the outdoor adventure retailer during the period. The company is well placed to benefit from easing travel restrictions, both domestically and internationally. Further, we see upside from its two acquisitions, Rip Curl and OBOZ, its attractive category exposure as well as market share and margin expansion opportunities. We continue to see the stock as undervalued at 14.0 times forward earnings, a sharp discount to its Specialty Retail peers at 16.1 times.

**Latitude Group Holdings (LFS)** – we modestly increased our position in the consumer finance company during the period. Our positive view is based on several factors. Firstly, we see its valuation as attractive at 9.1 times 12-month forward earnings, which we believe more than compensates for its small adjusted free float (28%) and selling overhang, and attractive versus peers on an average multiple of 11 times. Secondly, we see LFS as positively leveraged to the strengthening Australian consumer, both through sales and credit expenses. Lastly, we see LFS as a beneficiary of COVID-affected categories including travel services, which we don't believe is captured in market expectations.

### Key Sales

**Star Entertainment (SGR)** – we reduced our position in the company following the media allegations that the company had enabled suspected money laundering, fraud and foreign interference. We had taken some comfort from SGR having undergone several recent reviews without any major issues identified, in stark contrast to Crown Resorts (CWN). However, the allegations raise the risk profile of the stock, introduces the

possibility there may be sanctions against the company, and may remove potential upside opportunities (extra gaming licences, concessions). We are engaging extensively with management and are undertaking further independent validation in relation to the allegations, which the company has labelled as misleading.

**Iluka Resources (ILU)** – we reduced our position following recent outperformance, but remain overweight the mineral sands producer. We are overweight ILU based on our view that zircon and rutile markets are improving, with the current pace of the recovery exceeding our expectations amid the global economic recovery. We regard the industry structure as attractive (consolidated supply), with less pricing volatility compared to previous cycles. As a result, we see ILU's valuation as attractive (at 5.3 times EV/EBITDA). While the outlook for rare earths appears promising in the context of a strong demand profile (as a component for electric vehicles) and potential government support, we ascribe limited value given it is long-dated opportunity with significant execution risks. We ascribe zero to ILU's valuation from Sierra Rutile after the company suspended operations due to ongoing poor financial performance.

**Incitec Pivot (IPL)** – we trimmed our position following recent outperformance but remain overweight the fertiliser and explosives maker. We believe the risk is skewed to the upside at current levels (at 12.5 times forward earnings), particularly as operational issues are resolved. The company's key end markets – fertilisers and coal volumes – are benefiting from an emerging energy crisis globally, which we believe will result in upgrades to consensus forecasts. As an ammonia producer in the US, IPL is benefiting from a widening spread between Ammonia prices (where the marginal producer is in Europe) and the US natural gas price.

### 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 as the vaccine roll-out hits key targets and lockdown restrictions ease. 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 13.0 times forward earnings, particularly relative to NAB and CBA (at 14.6 and 19.9 times respectively).

**Aristocrat Leisure (ALL)** – our investment thesis is based on our positive view of its recent acquisition, London-based Playtech. By acquiring Playtech, ALL gains access to Real Money Gaming (RMG) – a market which has a strong growth outlook, particularly in the US as the country legalizes the practice state by state. Moreover, RMG is an obvious extension for ALL: it provides an additional channel to sell its best-in-market slot content in the US and leverages its strong

relationships with casinos. Outside of the acquisition, 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. Lastly, the stock screens as undervalued at 28.4 times forward earnings when considering the Industrials Ex-Financials trades at 29.8 times and ALL's superior long-term growth potential.

**Westpac Bank (WBC)** – while we see WBC's recently announced cost base target as challenging (given embedded inflation), we expect that achieving even half of it will be a reasonable outcome. More broadly, our overweight position remains premised on a better-than-expected earnings and dividend recovery post-COVID. We expect bad debt expenses to be close to zero over the next 18 months net of provision releases, driving double-digit earnings upside and capital management initiatives from FY22. WBC trades at 14.3 times forward earnings with a 4.9% dividend yield, well below peer Commonwealth Bank (CBA) at 19.9 times.

### Key Active Underweights

**CSL (CSL)** – we remain underweight CSL based on its forward valuation (42.9 times P/E and 29.6 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 14.6 times forward earnings, above peer ANZ (at 13.0 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 28.2 times forward earnings.

### Market outlook

After completing 1H2021 with strong momentum, renewed COVID-related lockdowns in Melbourne and Sydney will see the Australian economy contract in 3Q21, albeit it has been

notable how well both business surveys and employment indicators have held up in Q3, suggesting a modest contraction than might have been expected several months ago. Real-time data suggests Q4 economic growth will rebound solidly, led by the service-based industries.

We continue to believe the interruption to economic growth from renewed lockdowns will be an aberration within an improving trend. 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 \$185bn in excess household saving, in concert with strong asset price gains, leaves the consumer uniquely positioned to underpin economic growth in 2021-2022. Dwelling investment is set to provide solid support for economic growth over the next 6 months as previously approved housing moves through the construction phase, 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% and the Australian economy to expand 4.5% in 2021. We expect another strong year of economic growth in 2022 of 4.0%.

Nevertheless, there are some areas that are cause for concern. For over 12 months we have warned about rising US inflation pressures and rising inflation expectations. However, supply chain constraints and energy shortages in the Northern Hemisphere risk inflation pressures becoming more widespread and more entrenched. With the peak in global business surveys having passed, cost inflation continuing to escalate and the Federal Reserve announcing its decision to taper its bond purchases, we expect bond yields will move higher through the remainder of 2021. We expect US 10-year yields to approach 1.80% by the end of 2021, providing some ongoing challenges for risk assets in Q4.

The A\$/US\$ has recently been buffeted by concerns of a 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, we believe the A\$/US\$ should remain supported by global reflationary forces through 2021-22. We expect the A\$/US\$ to finish the year in the 76-78c range, and remain around that level through 1H22.

We see significant value in certain sectors but believe others to be overvalued based on our earnings and cash flow expectations. We are most overweight stocks within the Communication Services, Materials and Information Technology sectors, and underweight Real Estate, Health Care and Consumer Staples.

## Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	13.24	4.25	8.98
Consumer Discretionary	8.95	8.39	0.56
Consumer Staples	1.29	5.07	-3.79
Energy	2.03	3.15	-1.12
Financials	26.97	31.19	-4.22
Health Care	6.63	10.46	-3.84
Industrials	6.73	7.04	-0.31
Information Technology	6.88	4.66	2.22
Materials	20.63	17.20	3.43
Real Estate	1.97	7.03	-5.06
Utilities	2.28	1.54	0.75

## Top 5 holdings

	Portfolio %	Benchmark %	Active %
Commonwealth Bank of Australia	7.75	8.65	-0.90
ANZ Banking	7.26	3.88	3.38
Westpac Banking	7.25	4.56	2.69
BHP	6.88	5.22	1.66
Aristocrat Leisure	4.87	1.51	3.36

## Key active positions

Overweights	Portfolio %	Benchmark %	Active %
ANZ Banking	7.26	3.88	3.38
Aristocrat Leisure	4.87	1.51	3.36
Link Administration	3.12	0.11	3.01
Underweights			
CSL	1.85	6.62	-4.77
National Australia Bank	0.00	4.58	-4.58
Macquarie Group	0.00	3.32	-3.32

Portfolio holdings may not be representative of current or future investments. The securities discussed may not represent all of the portfolio's holdings and may represent only a small percentage of the strategy's portfolio holdings. Future portfolio holdings may not be profitable.

## Income and growth

	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.
Growth return	8.21	-7.35	-2.85	-0.14
Distribution return	21.75	16.30	11.80	9.07

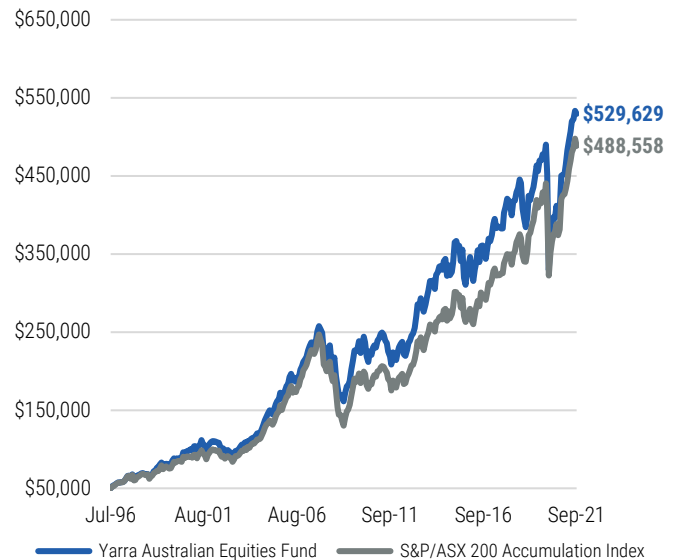
The Growth Return is measured by the movement in the Fund's unit price (inclusive of fees), ex-distribution, and can be positive or negative as the unit price can fluctuate with changes in the underlying market value of the Fund's assets. The Distribution Return is the amount that is paid to unitholders 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\$100.5 mn as at 31 October 2021	
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 October 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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