

# Yarra Australian Equities Fund

## Gross returns as at 31 October 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	7.17	2.32	-0.97	4.22	6.13	8.76	10.31
S&P/ASX 200 Accumulation Index†	6.04	0.67	-2.01	4.82	7.17	8.72	9.02
Excess return (before fees)‡	1.13	1.65	1.04	-0.59	-1.04	0.03	1.29

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 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 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	7.09	2.09	-1.85	3.29	5.16	7.75	9.31
S&P/ASX 200 Accumulation Index†	6.04	0.67	-2.01	4.82	7.17	8.72	9.02
Excess return (after fees)‡	1.05	1.42	0.16	-1.52	-2.01	-0.97	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 rallied sharply during October, following a 6.2% decline in September.

The S&P/ASX 200 Accumulation Index returned +6.0% for the month, taking its 12-month return to -2%. The broader S&P/ASX 300 Accumulation Index also added +6.0% for the month, while global indices notched up strong gains in October (MSCI World Index, +7.2%).

Within Financials (+12.2%), the sector performed strongly over the month as the market factored in higher expectations around the pace of net interest margin expansion led by Westpac Bank (WBC, +16.8%), Commonwealth Bank (CBA, +15.4%) and National Australian Bank (NAB, +12.5%).

Real Estate was a strong performer (+9.3%) as investors start to revisit the sector following material underperformance and with the sector trading well below asset backing, performance was led by Arena REIT (ARF, +18.0%), National Storage REIT (NSR, +17.0%) and Centuria Industrial REIT (CIP, +17.0%).

Conversely, the worst performing sector was Materials (-0.1%), St. Barbara (SBM, -31.1%), Fortescue Metals (FMG, -12.6%) and Sandfire Resources (SFR, -6.7%), as the mining sector struggled to keep pace with the market rebound.

### Portfolio review

#### Key Contributors

**CSL (CSL, underweight)** – our underweight position contributed to portfolio returns following the company hosting an investor day for its newly acquired Vifor business. Vifor is a leading iron-deficiency and kidney-related treatments (new treatments for CSL) and now contributes 15% to group sales and earnings. While informative around the medium to longer term opportunities for the business, the update saw modest negative earnings revisions as a result of less earnings accretion from the deal. Overall, at this early stage, we view the Vifor business as being lower quality to Behring (around 70% group earnings) given generic substitution risks over coming years, and elevated expectations on new product commercialisation. Within the healthcare space we favour ResMed and continue to see better stock opportunities elsewhere; CSL continues to command a P/E multiple in excess of 30 times for a growth profile that is exposed to ongoing cost and competition pressures.

**Link Group (LNK, overweight)** – the company's share price recovered somewhat during the month following sharp underperformance in the prior month following termination of the agreed deal with Dye & Durham to buy the company. We

still see considerable value in LNK and a pathway to crystalizing this value and regard the announced demerger of its stake in PEXA as an appropriate first step. LNK received a substantial bid from Dye & Durham for its Corporate Markets and Banking & Credit Markets businesses during the month which further highlights the value in the constituent parts of LNK.

**Fortescue Metals (FMG, underweight)** – the iron ore producer was a key contributor during the period as the stock underperformed on falling iron ore prices. The benchmark 62% Fe index fell 17% during the month to close at \$79.50/t, driving a 12.4% decline in FMG's share price. As a high-cost iron ore producer, the company is highly levered to movements in spot iron ore prices. We continue to view iron ore prices as unsustainably high in light of weak steel demand in China as a result of slowing industrial production and housing starts. As a result, we are happy to remain underweight FMG, retaining BHP as our preferred exposure to iron ore given its lower operating costs and diversified commodity base.

### Key Detractors

**National Australia Bank (NAB, underweight)** – the banking sector performed strongly over the month as the market factored in higher expectations around the pace of net interest margin expansion, with the banks being near term beneficiaries from a higher interest rate environment. We expect the benefit to bank earnings from higher net interest margins will be transitory in nature as deposit pricing catches up and front book mortgage competition remains intense.

**Reliance Worldwide (RWC, overweight)** – the plumbing supplies company underperformed during the period following the release of its 1Q23 result which showed volumes are softening modestly across the business (-1.9% in 1Q) and expectations that volumes will be down mid-single digits in the Americas division over FY23. Margins were also weak at 21.4% (ex EZ Flo), with the price recovery for cost inflation insufficient to cover cost inflation in the quarter. Over the full year, raw material costs should deflate, which should mean that margins improve over the full year. Whilst the quarterly result was weak, we regard the sell-off as over-done and retain our conviction in the longer-term investment thesis.

**OZ Minerals (OZL, overweight)** – the copper miner was a negative contributor in October despite no incremental news, with BHP's takeover offer for the company weighing on share price performance. With the OZL board rejecting the initial offer, we recognize the potential for BHP to return with a higher bid and regard the potential for a counterbidder to emerge as limited, given BHP's significant available regional synergies. We retain our fundamental positive view on OZL due to its 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.

### Key Purchases

**Sandfire (SFR)** – we increased our exposure to the copper producer during the period, reflecting our conviction in the commodity given its leverage to electrification as a key material in batteries and electric motors. While we recognise risks of an oversupplied market in the near term, we believe recent falls in copper prices are now largely complete given cost curve support. While Sandfire faces near-term challenges including gearing levels, power costs at the MATSA project in southern Spain, and construction risk at the Motheo project in Namibia, we believe these risks have been significantly over-priced and see upside value at current share price levels.

**Evolution Mining (EVN)** – we added the gold producer to the portfolio during the period. The stock has significantly underperformed listed gold peers in recent months due to disappointing production levels and guidance downgrades. While gearing approaching 30% means EVN is more highly geared than peers, we believe the company represents compelling value, with risks of an unexpected capital raising to support the balance sheet considerably over-played in our view. AUD denominated gold prices remain robust, and we continue to see price support for gold in the near to medium term.

### Key Sales

**Northern Star (NST)** – we trimmed our position in Northern Star following a period of outperformance relative to peers Newcrest (NCM) and Evolution Mining (EVN) but remain overweight the gold producer. Northern Star has demonstrated strong cost control, with FY23 cost guidance implied inflation pressures expected to remain lower than peers (+6% at the mid-point). We believe the company's ownership of power assets in Kalgoorlie, coupled with a lack of exposure to Australia's east coast power market – in contrast to NCM and EVN – remain key differentiators for NST.

**Insurance Australia Group (IAG)** – we trimmed our position during the month following a period of outperformance but remain overweight the general insurer. The company received further positive court rulings on COVID-19 related business interruption test cases during the month, which saw it release \$360m of related provisions and announce a \$350m buyback. IAG retains a further \$615m of COVID-19 related provisions, hence we expect further provision releases and buybacks as greater clarity emerges.

**QANTAS Group (QAN)** – we trimmed the portfolio's position in the Australian airline during the month following strong outperformance post its market update, which highlighted strong expected earnings for the current half. QAN expects to earn \$1.2b to \$1.3b profit before tax in 1H23, which is 25% ahead of full year FY23 consensus earnings. This earnings strength has come through improved market share, high load factors and very strong pricing given the supportive demand backdrop for both domestic and international travel.

## Key Active Overweights

**Aristocrat Leisure (ALL)** – our positive investment view remains premised on the gaming company's dominant position in land-based Games and the significant opportunities from Digital, which offers a wide range of outcomes. We regard 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 view ALL's valuation as being undervalued at 19.2 times forward earnings (below the Industrials Ex-Financials multiple) given the company's superior long-term growth potential.

**Link Group (LNK)** – despite the uncertainty created by the failed takeover bid from Dye & Durham and UK regulatory action on its Fund Solutions business, we still see considerable value in LNK's constituent parts and a pathway to crystallizing this value. In the interim LNK's two main operating businesses are performing well, with two upgrades to guidance provided in the last six months.

**Reliance Worldwide (RWC)** – we remain positive on the compelling opportunities within the plumbing supplies company. While the market pricing for a significant decline in earnings (as reflected in the forward P/E of only 11.0 times), we remain constructive on the demand environment – both in the trough and longer term – given the defensive nature of the majority of RWC's repair and remodelling sales. Approximately 80% of RWC's sales are repair and remodel, which is not tightly correlated with the housing sector, while 60% of US sales are for repairs which are more defensive in nature.

## Key Active Underweights

**National Australia Bank (NAB)** – we remain underweight the big four bank, reflecting our negative sector view. The favorable dynamics around expanding net interest margins (NIM) due to higher interest rates are now well understood, and we do not expect the gains to be sustained into the medium term. Further, the banks are facing material earnings offsets through elevated expense growth and a normalization in bad debt expenses which will mean sector EPS is likely to be approaching peak levels. 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 the challenges the business faces returning to pre-COVID profitability, coupled with its forward valuation (30.9 times P/E and 18.0 times EV/EBITDA on a 12-month forward basis), which we believe appropriately captures the current earnings outlook. While CSL is a key beneficiary of the post-COVID re-opening theme from a plasma collection perspective, 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 and other collection centre costs likely to be higher for longer. We retain our preference for 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 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 view MQG's headline forecast P/E multiple of 15.4 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. The process clearly started in October with equities recovering most of the large declines recorded in September.

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, although we do expect economic activity to slow significantly in 2023 to average just 1.5%. While a local recession is possible in 2023, we believe Australia should be able to avoid a technical recession 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 \$260bn of excess savings relative to pre-COVID levels. Although we expect the impact of higher interest rates and higher living expenses will 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.

- Low levels of spare productive capacity, strong profit and low corporate debt have contributed to robust capital investment intentions.

In the medium term we believe a recovery in net immigration levels into Australia and Australia's exposure to key commodities crucial to the global energy transition 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 have come via both significantly higher cash rates, higher government bond yields and wider corporate bond spreads. We expect that the RBA cash rate will finish the year at 3.10%, which might well mark the peak for the RBA, well below market expectations of a 4.0% peak in 2H23. The A\$/US\$ has been particularly weak in recent months, albeit on a TWI basis the A\$ has been broadly stable. With Australia's external accounts are in their best position since the early 1970s and the prospect the US\$ uptrend will peak as the Fed pivots from its aggressive hiking strategy we expect the A\$/US\$ will appreciate to the mid-70s by end-2023.

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

## Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	11.98	3.92	8.07
Consumer Discretionary	9.67	6.53	3.14
Consumer Staples	1.42	4.77	-3.35
Energy	6.73	6.50	0.23
Financials	21.86	30.14	-8.28
Health Care	4.49	9.97	-5.48
Industrials	7.76	5.81	1.95
Information Technology	8.62	2.80	5.82
Materials	22.42	22.08	0.33
Real Estate	0.00	6.20	-6.20
Utilities	1.95	1.28	0.67

## Top 5 holdings

	Portfolio %	Benchmark %	Active %
BHP	8.08	9.30	-1.22
Commonwealth Bank of Australia	6.90	8.79	-1.88
Westpac Banking	5.84	4.15	1.69
Aristocrat Leisure	4.08	1.21	2.87
Woodside Energy	4.02	3.36	0.66

## Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Aristocrat Leisure	4.08	1.21	2.87
Link Administration	2.95	0.09	2.86
Reliance Worldwide	2.85	0.12	2.73
Underweights			
National Australia Bank	0.00	5.06	-5.06
CSL	1.73	6.65	-4.91
Macquarie Group	0.00	3.03	-3.03

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	-11.77	-10.02	-7.47	-1.98
Distribution return	9.91	13.31	12.63	9.73

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\$100.2 mn as at 31 October 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 October 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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