Yarra Emerging Leaders Fund

Gross returns as at 31 May 2022

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception* % p.a.
Yarra Emerging Leaders Fund	-6.26	-1.57	4.48	10.36	10.66	12.35	11.29
Emerging Leaders Combined Benchmark†	-5.21	-0.89	0.11	8.88	9.66	9.68	7.30
Excess return (before fees)‡	-1.05	-0.68	4.36	1.47	1.01	2.67	3.98

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 management costs, meaning they do not reflect the deduction of any investment management fees and expenses 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 May 2022

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception* % p.a.
Yarra Emerging Leaders Fund	-6.36	-1.87	3.19	9.00	9.30	10.97	9.98
Emerging Leaders Combined Benchmark†	-5.21	-0.89	0.11	8.88	9.66	9.68	7.30
Excess return (after fees)‡	-1.15	-0.99	3.07	0.11	-0.36	1.28	2.68

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 Emerging Leaders Fund: September 1997

† Comprising 50% S&P/ASX Midcap 50 Accumulation Index and 50% S&P/ASX Small Ordinaries Accumulation Index

‡ Excess return: The difference between the Fund's return and the benchmark return.

Market review

Australian small and mid caps declined during May as Australia's first interest rate hike since 2010 pressured valuations, with only Energy and Utilities recording positive returns.

The Emerging Leaders Benchmark returned -5.2% for the month, taking its 12-month return to +0.5%. In comparison, the broader ASX300 declined 2.8% for the month while global indices were flat (MSCI World Index -0.2%). The benchmark's forward P/E declined from 14.8 times to 13.7 times as the RBA lifted the official cash rate by 25 bps to 0.35%.

Within Energy (+0.4%), coal producers continued to rise in value amid the global energy crisis. While hard coking coal retreated 15% during the month to US$442/t, thermal coal rose another 31% to US$427/t. Whitehaven Coal (WHC) – now the largest constituent in the index – climbed +7.3% and New Hope Corporation (NHC) lifted +5.7%. Within Utilities (+0.9%), sole constituent AGL Energy (AGL, +0.9%) benefited from higher wholesale electricity prices.

Conversely, the worst performing sectors included Consumer Discretionary (-11.0%), Media (-16.2%) and Information Technology (-6.1%). Notably, travel services companies Corporate Travel Management (CTD, -15.5%) and Flight Centre (FLT, -9.3%) underperformed as updates suggested ongoing lower margins for international travel.

Elsewhere, Real Estate (-7.0%) also experienced widespread declines given its negative correlation to higher rates, led by Centuria Capital Group (CNI, -20.7%), Centuria Industrial REIT (CIP, -14.0%) and Home Consortium (HMC, -17.2%).

Portfolio review

Key Contributors

Worley (WOR, overweight) – the engineering services firm outperformed due to expectations the global energy crisis will stimulate capex for both oil & gas and energy transition projects. We remain overweight the company. Following the Jacobs ECR acquisition, the business is diversified across different markets and, in our view, is well positioned to capture higher structural demand from energy transition work to low carbon solutions in addition to its traditional work for the oil & gas industry. 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.

Tabcorp (TAH, overweight) – the company contributed to excess returns as it demerged its lottery and wagering divisions during the month. The outcome supported our investment thesis that the spin-off will crystalise value for the lotteries division. We see Lotteries (70% of FY21 EBITDA) 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%). 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.

Atlas Arteria (ALX, overweight) – the toll road operator outperformed without any materially positive news during the period. We maintain an overweight position based on ALX's strong liquidity and balance sheet position, discounted valuation and exposure to traffic recovery in Europe and the US. ALX on less than 11.0 times normalised EV/EBITDA which, in our view, more than captures the disruption from COVID-19 as travel restrictions and lockdowns reduce traffic volumes in the short term. Beyond traffic normalisation, we see a path towards value creation for ALX through concession extensions at APRR achieved as a means of funding expansion projects and settling the Dulles Greenway tolling regime.

Key Detractors

AUB Group (AUB, overweight) – the insurance broker underperformed after announcing the acquisition of London-based Tysers, a wholesale insurance broker, for up to $1,056mn. The deal is funded from a $350mn equity raising, a new $675mn debt facility and a $176mn placement to the vendor (with deferred consideration). We support the acquisition, which is highly EPS accretive (30% on a pro-forma basis for CY22) and offers new growth through global commercial insurance lines. More broadly we are overweight AUB on the grounds that its earnings are resilient in the current environment (mid-single digit premium rate rises) as the core business sees higher earnings growth via improved product and capacity offerings. As a result, we view the company's valuation as attractive (18.4 times forward earnings), well below peer Steadfast (SDF) (22.5 times) but with stronger growth options.

Nine Entertainment (NEC, overweight) – the media company underperformed despite delivering a solid trading update during the period. Management expects FY22 EBITDA to be up 22% y/y, unchanged versus its previous guidance, supported by slightly stronger underlying metrics. Our positive view remains premised on a supportive valuation, its high-quality digital assets (Stan, 9Now and Domain), and a number of cost saving initiatives in the short term. We believe the ad market's recovery is only partially factored into NEC's valuation, with the stock trading at 10.8 times forward earnings. At these levels, we also do not believe sufficient value is attributed to its subsidiaries when considering their long-term growth profile, with double-digit earnings growth expected in the next 12 months.

Eclipx (ECX, overweight) – the fleet management company underperformed despite beating expectations in its 1H22 result. NPATA for the period came in at $60.4mn, well ahead of consensus of $46.2mn, primarily driven by end-of-lease income. We remain overweight. We believe its core business (largely fleet management) will be a strong beneficiary of Australia's post-COVID recovery, and that the valuation provides ample support (at around 10 times forward earnings excluding end-of-lease income). We believe ECX can take market share in the longer term (with high single-digit volume growth and stable pricing).

Key Purchases

Reliance (RWC) – we increased our 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 pricing power (in-house R&D). As a result, we see its valuation (at a 12.9 times forward P/E) as attractive.

AUB Group (AUB) – we participated in the capital raising during the period to fund the acquisition of London-based Tysers. We support the acquisition, which is highly EPS accretive (30% on a pro-forma basis for CY22) and offers new growth through global commercial insurance lines. More broadly we are overweight AUB on the grounds that its earnings are resilient in the current environment (mid-single digit premium rate rises) as the core business sees higher earnings growth via improved product and capacity offerings. As a result, we view the company's valuation as attractive (18.4 times forward earnings), well below peer Steadfast (SDF) (22.5 times) but with stronger growth options.

Pinnacle Investment Management (PNI) – we increased our position in the investment manager during the period, taking advantage of recent underperformance. We continue to see PNI as a high-quality company with further upside potential on a three-year view. The asset manager now trades at a 12-month forward P/E of 18.7 times which, in our view, doesn't factor in its superior growth versus the wider sector and the high level of growth investment captured in earnings. In the long term we continue to expect new strategies and managers, as well as underlying growth in existing managers, to drive double digit earnings growth.

Key Sales

Centuria Capital Group (CNI) – we exited our position as concerns around higher real yields resulted in lower capacity to maintain FUM growth at elevated levels. The company trades at 14.3 times forecast P/E, which we no longer see as justified given its risk to long-term growth and premium to peer Charter Hall Group (CHC, at 13.8 times). That being said, CNI manages a diversified portfolio by property asset type and capital source, underpinned by listed investment vehicles (CIP and COF).

Northern Star (NST) – we reduced our position to reflect the risks to gold from a faster-than-expected rate hike path in the US (which is generally a headwind to the gold price). That being said, we remain overweight the gold miner. We believe the company will benefit from higher-than-expected production and reserves/resources at its flagship KCGM SuperPit Mine, and we see the company's valuation as attractive at 5.0 times forward EV/EBITDA, which is only marginally above the wider Gold sector despite a superior growth outlook. More broadly, we have a selective 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).

Key Active Overweights

IGO Limited (IGO) – our positive thesis is premised on the miner's US$1.4bn Greenbushes and $A1.25bn Western Areas (WSA) acquisitions, and its existing portfolio of high-quality assets. We support the acquisitions for several reasons. Greenbushes gives IGO exposure to a high-quality, long-dated asset (>20 years mine life) and completes IGO's suite of battery commodities with the company already producing nickel, copper and cobalt. We support the WSA acquisition on the grounds it diversifies production (rebalancing commodity exposure to 70% Li, 30% Ni) and extends the mine life for nickel production (which is currently through its world-class Nova asset).

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, in our view, 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 19.8 times forward earnings, a sharp discount to the Industrials ex-Financials at 24.7 times.

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, in our view, LNK is positively leveraged to higher US interest rates, which we see as a meaningful tailwind over the medium term. Lastly, LNK trades at 20.3 times forward earnings, a discount to the Industrials ex-Financials at 24.7 times.

Key Active Underweights

Mineral Resources (MIN) – we remain underweight based on the view the positive outlook is fully priced in at current levels. And while MIN's Wodgina lithium project is well positioned to benefit from higher lithium prices as the EV thematic accelerates, its iron ore business is exposed to downside risk based on unsustainably high iron ore prices into the medium term.

Lynas Rare Earths (LYC) – we remain underweight. Notwithstanding the positive outlook for the commodity basket, particularly given its leverage to the EV thematic, we see risks due to regulatory uncertainty of its operating licence in Malaysia and its valuation, at a 12-month forward EV/EBITDA of 10.0 times. Our preferred EV exposure is IGO Limited (IGO), which trades at a more attractive 6.1 times despite superior diversification and lower geopolitical risk.

Allkem (AKE) – we are underweight the lithium miner based on its stretched valuation metrics, with IGO Limited our preferred exposure to the commodity. Our positive view of IGO is premised on the miner's recent $US1.4bn Greenbushes acquisition, its existing portfolio of high-quality assets and its relatively undemanding valuation at a forward EV/EBITDA of 6.1 times. While AKE trades at 4.9 times EV/EBITDA, its asset value is concenctrated in higher risk jurisdictions (Argentina) with greater development risk. Following the merger with Galaxy Resources (GXY), we believe significant value lies in the undeveloped and capital intensive Sal de Vida brine project.

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 awaits.

Australia does have some key natural advantages in such a climate. One of 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 1H 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 CY2022 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.

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. 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 is providing an incentive for the A$/US$ to commence an appreciation cycle, together with the attractive carry on offer. 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 Health Care, Communication Services and Information Technology sectors, and are underweight Real Estate, Materials and Energy.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	11.93	5.79	6.14
Consumer Discretionary	10.54	11.61	-1.07
Consumer Staples	4.87	4.04	0.83
Energy	4.92	6.94	-2.02
Financials	8.49	10.49	-2.00
Health Care	9.98	3.69	6.30
Industrials	11.38	11.58	-0.20
Information Technology	8.31	7.01	1.30
Materials	23.86	27.99	-4.13
Real Estate	3.05	9.79	-6.75
Utilities	0.00	1.07	-1.07

Top 5 holdings

	Portfolio %	Benchmark %	Active %
IGO	6.00	1.58	4.41
Worley	4.92	1.02	3.90
OZ Minerals	4.29	1.50	2.79
Atlas Arteria	4.26	1.28	2.98
Link Administration	3.96	0.45	3.51

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
IGO	6.00	1.58	4.41
Worley	4.92	1.02	3.90
Link Administration	3.96	0.45	3.51
Underweights			
Mineral Resources	0.00	1.97	-1.97
Lynas Rare Earths	0.00	1.65	-1.65
Allkem	0.00	1.51	-1.51

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	1.94	7.48	7.54	8.77
Distribution return	1.24	1.51	1.76	2.20

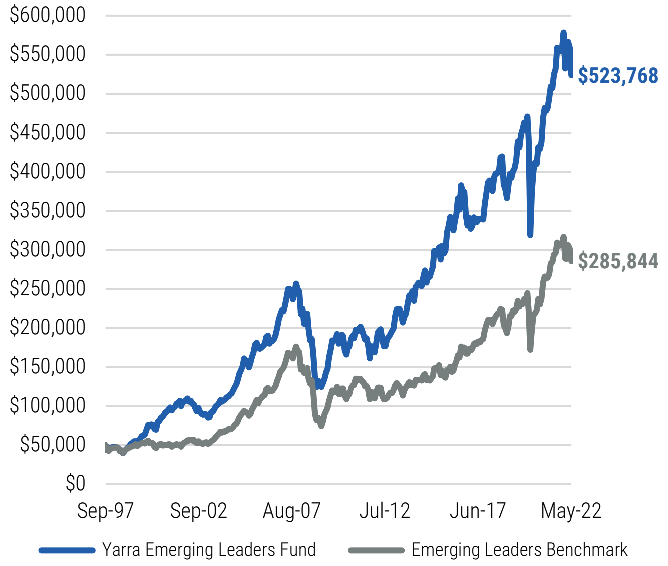
The Growth Return is measured by the movement in the Fund's unit price (inclusive of fees), ex-distribution, and can be positive or negative as the unit price can fluctuate with changes in the underlying market value of the Fund's assets. The Distribution Return is the amount that is paid to unitholders 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 small and medium sized Australian companies that are considered to possess strong capital growth potential. In doing so, the aim is to outperform the benchmark over rolling 3-year periods.	
Recommended investment time frame	5 - 7 + years	
Fund inception	September 1997	
Fund size	A$71.4 mn as at 31 May 2022	
APIR codes	JBW0010AU	
Estimated management cost	1.25% p.a.	
Buy/sell spread	+/- 0.20%	
Platform availability	Asgard Ausmaq BT Panorama BT SuperWrap Financial Index	Hub24 Macquarie Wrap Mason Stevens MLC Wrap OneVue

Investment performance comparison of $50,000

After fees, since inception of the Yarra Emerging Leaders Fund, September 1997 to May 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 benchmark (comprising 50% S&P/ASX Midcap 50 Accumulation Index and 50% S&P/ASX Small Ordinaries 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.

Applications and contacts

Investment into the Yarra Emerging Leaders Fund can be made by Australian resident investors only.

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